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BBNN: Shocks
Shocks

• Shocks to the controls
  – Especially aggregate demand.
    • Consumer confidence and Fear
    • Investors confidence

• Shocks to the BB schedule
  – Productivity and growth
    • New technologies, Education, Health, Managerial Improvements
  – Prices
    • Change in the price of our exports or imports
  – External Shocks
    • Natural Disasters
    • Drop of international demand for our products

• Shocks to the NN schedule
  – Labor market reforms
  – Immigration
BBNN: Negative Demand Shock

Unemployment increases
Improvements in CA

Increase in fear.
Drop in consumer confidence.
Drop in investors confidence.
BBNN: Increases in productivity

Technological improvements increase the productivity of workers.

The economy remains in the same place but now it has a surplus.

At the same salaries and demand, the country is able to produce more! So, we were before in equilibrium but now we have a surplus in the CA.

Domestic Demand = C+I+G
BBNN: Increases in productivity

Through time, along the equilibrium path, the economy ends up with higher wages and demand. This is the natural adjustment mechanism.

\[ \text{Domestic Demand} = C + I + G \]
**BBNN**: Increases in price of exports

Increases in the price of our exports, increases their value. So, our exports rise as in the case of growth, but for a different reason.

At the same salaries and demand, the country is able to produce more! So, we were before in equilibrium but now we have a surplus in the CA.

The economy remains in the same place but now it has a surplus.

*Domestic Demand = C+I+G*
BBNN: Increases in price of exports

Through time, along the equilibrium path, the economy ends up with higher wages and demand. This is the natural adjustment mechanism.

But this salaries increase because the exports are wanted by foreigners, not because our workers are better.

This is the Dutch Disease

Domestic Demand = C+I+G
BBNN: Natural Disaster

Assume that we have a natural disaster that destroys capital but has no impact on lives. Because the country has less capital, production falls. For the same demand, the country will need to import goods, and is able to export less.

CA turns into deficit. During the adjustment unemployment will increase, and salaries need to fall (or currency needs to depreciate).
BBNN: Immigration of workers

When the immigrants arrive, they become part of the unemployed pool.

In the end, the wages in dollars need to decline. Either nominal wages fall, or there is a depreciation.

At the same demand and the same wage in dollars we have a situation of unemployment.

Domestic Demand = C+I+G
Sustainability

• Social and political sustainability
  – The probability of social unrest, or political tensions, is associated with the standard of living.
  – Higher wages in dollars in general produce higher standards of living.

• Environmental sustainability
  – The idea of this restriction is to highlight that higher consumption in general tends to increase its negative environmental impact
Domestic Demand = C+I+G
Social and political tensions increase

Domestic Demand = C+I+G

Social and political peace

Social and political peace increase

BBNN Sustainability

BBNN

e/w

NN

BB

SP

Social and political tensions increase
Sustainability

Domestic Demand = C+I+G
What happens in each of the equilibria?

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BBNN: Sustainability

Domestic Demand = C+I+G
BBNN: Sustainability

Domestic Demand = C+I+G
How to solve the conflicts?

• What do I like about this model?
  – In a very simple framework we highlight how social, political, environmental, and economic equilibriums might not agree with each other.
  – What are the solutions?
Moving the social peace

• In general the social peace shifts upward for two reasons
  – Getting used to Misery
    • If the individuals are subject to misery during a prolong period of time, they will tend to accept it as “normal”
  – Coordinating Device
    • “What is the reason why would you be willing to sacrifice something that is yours for the good of the country”.

Argentina’s BBNN

Annotations from case HBS9702001
1816-1930

• Tremendous economic performance
  – Significant Growth
  – Low inflation
  – Massive immigration

• Significantly “good” standards of living
  – 6\textsuperscript{th} economy in the world
  – One of the best education systems

• 1919-1929
  – Growth accelerated (6+)
  – Improvements in political representation
1816-1930

TB>0
High Standards of Living
Crisis: 1930

• External shocks
  – Great Depression: drop in US demand.
  – Protectionism: increase in tariffs.
1930-1943

Promise of Prosperity

Need to move!
TB<0
Wage increases

Protection: Tariffs

Promise of Prosperity
1943-1946

• Political and social turmoil was unattended
• What were the problems? (according to them)
  – Excessive dependence on exports
  – Excessive dependence on Agriculture
  – Need to solve the Latin Triangle problem
• What was decided?
  – Import Substitution
  – Tax Agriculture, and subsidize Manufacturing
  – Protection by raising tariffs
  – Significant increase in wages
1943-1946

Need to move!
TB<0
Wage increases

Promise of Productivity
Import Substitution
Peron 1946-1955

• Most important development
  – Creation of the first “Mini-me” (4.2.2)

• Political Capital
  – Peron provided the wage/labor concessions (4.4.x)

• Economic Policy
  – Expansion of expenditures (16.e7.3)
  – Large fiscal deficits (18.e9)
  – TB deficits (14.e5.1)
  – Real wages increase (16.e7.1)
Peron 1946-1955

Promise of Prosperity
Import Substitution
Peron 1946-1955

- Wages outpaced productivity increases (6.6.1)
- Large expenditure expansion produced overheating and inflation (6.6.3, 17.e8.1)
- Trade Balance Deficit were large (14.e5.2)
- Control of inflation
  - Adjustment of fiscal expenditures
Crisis: 1954-1955
Ghost of Peron: 1955-1973

• Full Latin Triangle Dynamics
  – Adjustment: devaluation and cut demand
    • Real wages drop by 26% (7.5.1)
  – Political pressures
    • Strikes
    • Political turnover
    • Conspiracies and coups
  – Control of the demand and Wage concessions (7.6.x)
  – Populism before elections
Ghost of Peron: 1955-1973
Peron II: 1973-1983

• Social Peace: Peron is Back
  – Popular support for Peron
  – Peron’s “Social Pact”

• Economic Policies
  – “Conservative Measures” (8.5.1)
  – Devaluations

• Military Government
  – Social Peace: “Malvinas’ war”
  – Demand increase (9.1.1)
  – Appreciation of real exchange rate
Peron II: 1973-1983

Malvinas’ war

Peron is Back

Peron dies
Austral: 1983-1989

• Policy Actions (9.5.x)
  – Structural Reforms
    • Privatization
  – Economic Liberalization
    • Reduction of protectionism
  – Debt Renegotiation

• What is missing?
  – Coordinating Device (the SP line)
Austral: 1983-1989

The increase in wages happens because there are inflation expectations that affect wages, but the exchange rate is fixed!
Convertibility 1991-2001

• Structural Reforms
  – Privatizations
  – Deregulation
  – Trade reform
  – Pension fund reforms
  – Labor reforms
  – Tax reform (VAT)
  – Administrative reform

• Debt Restructuring

• Currency Reform
  – Currency Board
    • Credibility in currency
    • Change of inflation expectations

• Coordinating device
  – Social Pact
Convertibility 1991-2001

• Outcomes
  – Inflation slow down significantly (10.e1.1)
  – Growth Reappeared (10.e1.1)
  – Negative CA and TB (11.e3)
  – Unemployment increased significantly
  – Fiscal deficit remained high
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<td>• Social &amp; Personal needs</td>
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