

Comments on Sánchez,  
Fernández, and Armenta  
Una Historia Monetaria de  
Colombia

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# An Important Advance

**The authors have written a monetary history based, first, on series of monetary aggregates that they have put together since the founding of the Banco de la República in 1923, and second on the policy statements of the Banco de la República.**

**They are to be commended for their detailed research.**

# Main Findings

- **The principal determinant of the money supply is the foreign sector.**
- **The government used monetary tools to carry out counter-cyclical policies.**
- **The Banco de la República became increasingly interventionist.**
  - **It funded deficits by money creation.**
  - **It fought inflation by increasing reserve rates (encaje).**
  - **It fought inflation by regulating deposit and loan interest rates.**
  - **It engaged in directed lending, rediscounting loans to particular sectors for purposes of economic development.**

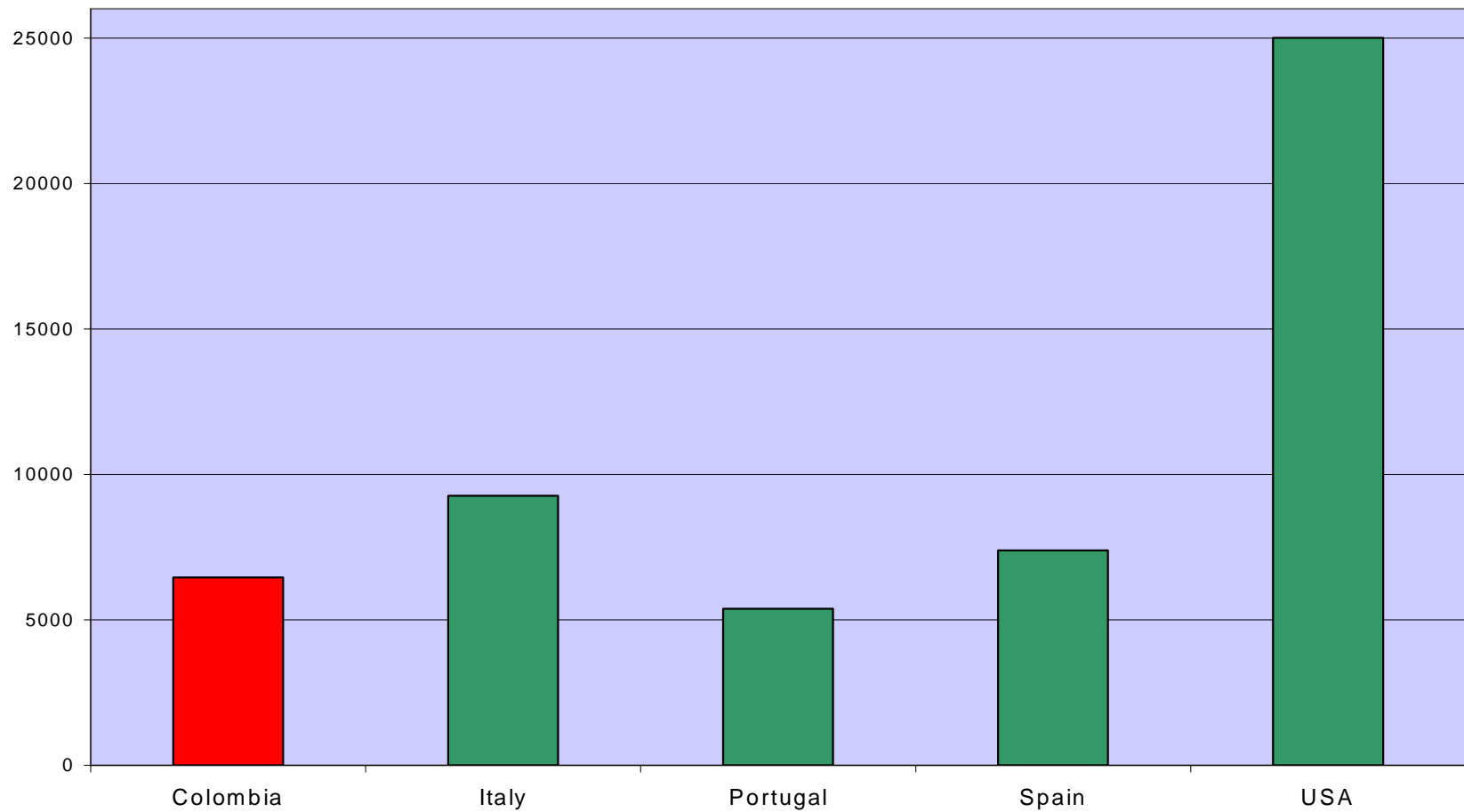
# Overall Results

**This is a well done book that will be an important addition to our stock of knowledge on the evolution of the Colombian economy in the 20th century.**

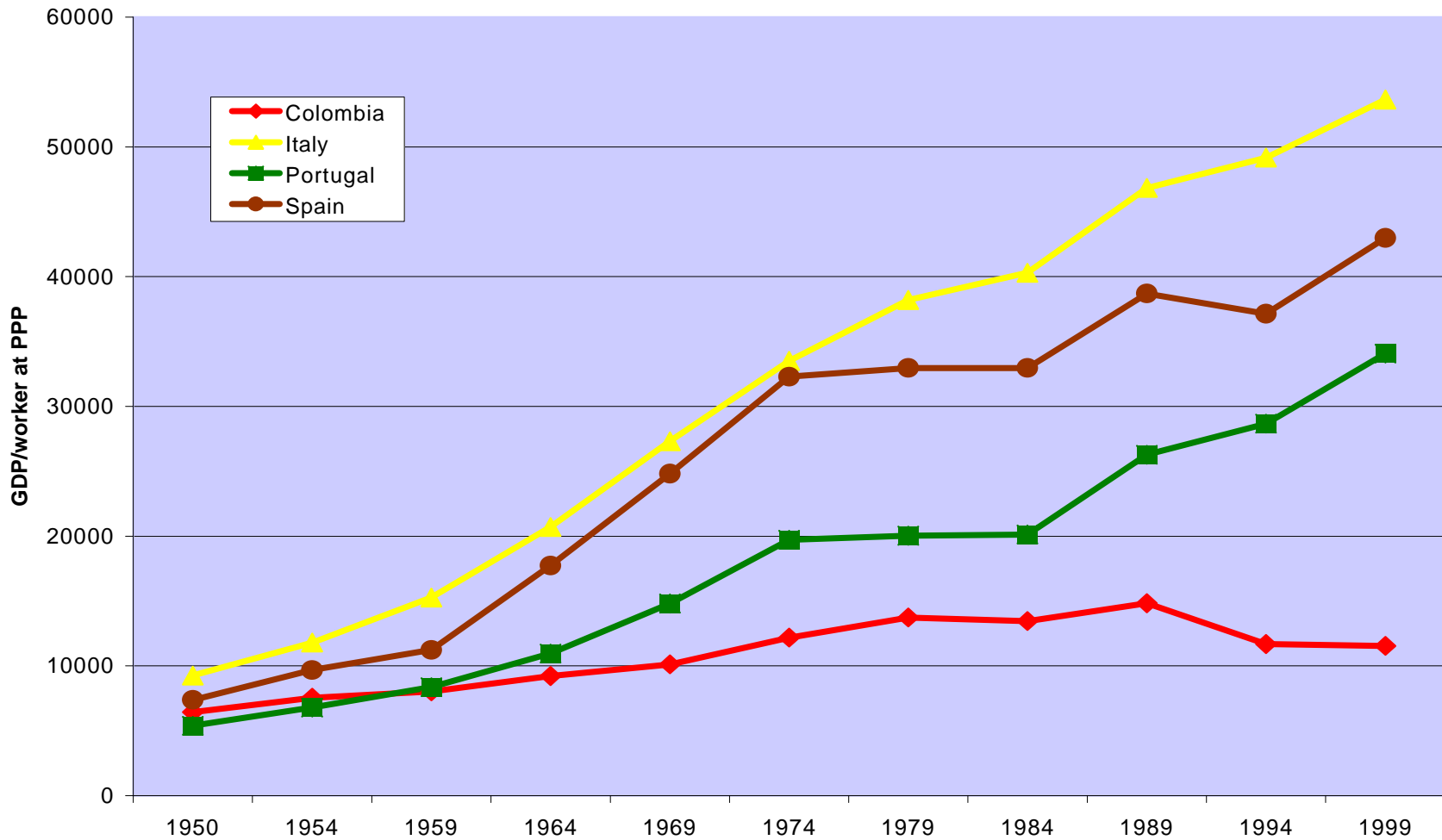
# Suggestions for Revision

- **Permit me to pay the authors the largest compliment I can think of in academia.**
- **Their results are even more important than they suspect.**
- **They should push their results harder, and integrate them into a larger framework for understanding what, in my view, is a crucial puzzle in the economic history of Colombia.**

# Real GDP/Worker 1950



# Real GDP/Worker, 1950-2000

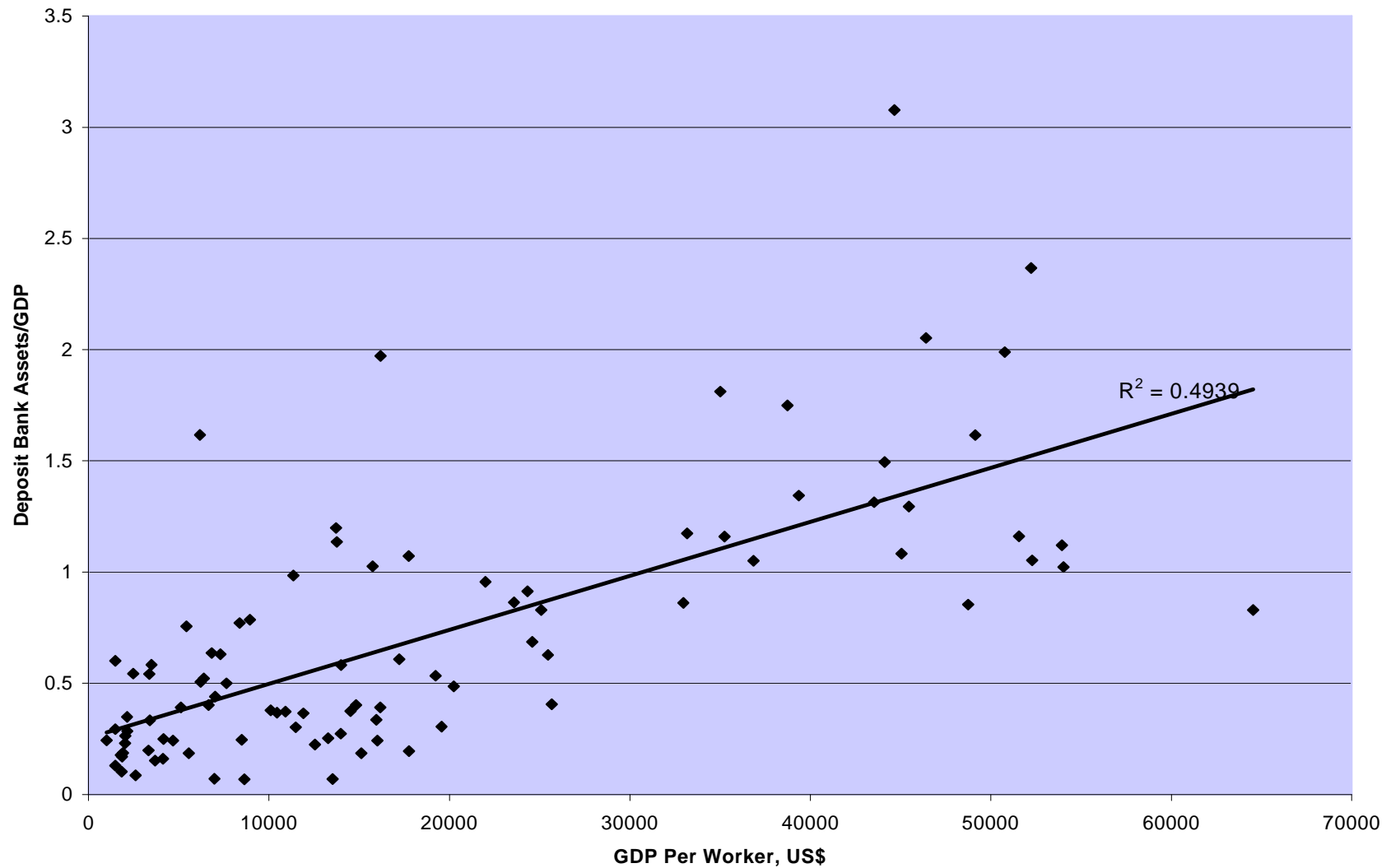


- What do the Facts in Sánchez, Fernández and Armenta have to do with this puzzle?

# There is a Crucial Link between the Financial System and Growth.

- Rajan and Zingales. 1998. “Financial Dependence and Growth.” AER
- Levine 1997. “Financial Development and Economic Growth: Views and Agenda.” JEL.
- Demirgüç-Kunt and Levine. 2001. Financial Structure and Economic Growth.

# The Data Make it Clear As Well



# Monetary System and Policy Play a Crucial Role in Financial System

- Financial Systems are Composed of Five Inter-Linked Components:
  - 1. Private Banks.
  - 2. Securities Markets
  - 3. System of Public Finance
  - 4. A system of Money.
  - 5. A Central Bank.

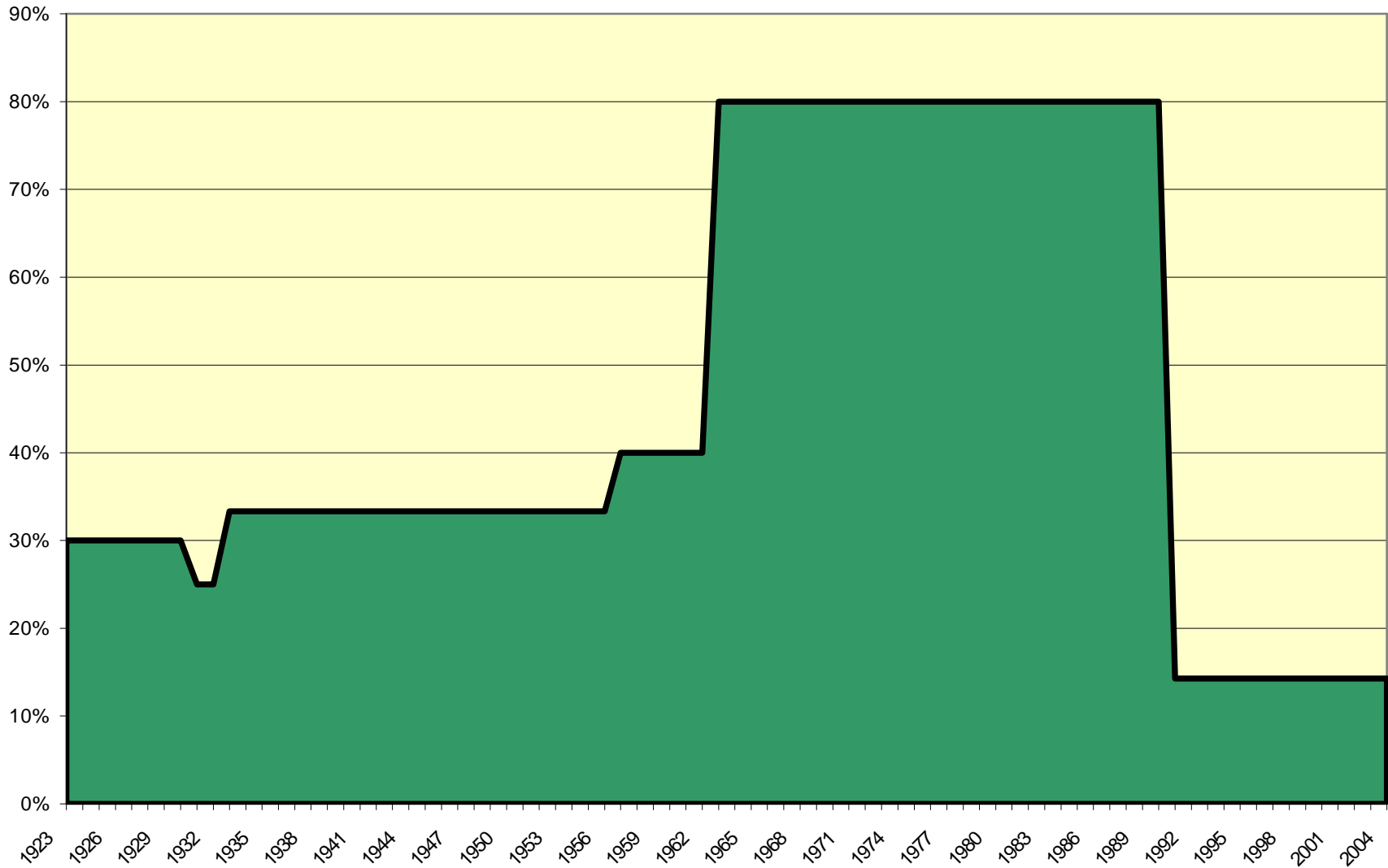
# The Government's Conflict of Interest

- The government regulates the securities markets and the private banks, and at the same time, it needs the markets and the banks to finance its own operations.
- It can use its control of the Central Bank to behave opportunistically.

# The Importance of Political Institutions

- Thus, the political institutions that limit the discretion of the government in controlling the Central Bank are a key to the development of the financial system.
- What does the evidence from Sánchez, Fernández, and Armenta look like regarding government discretion in the control of the Banco de la República?

# % of BR Directors From Government



# The graph understates the degree of government control

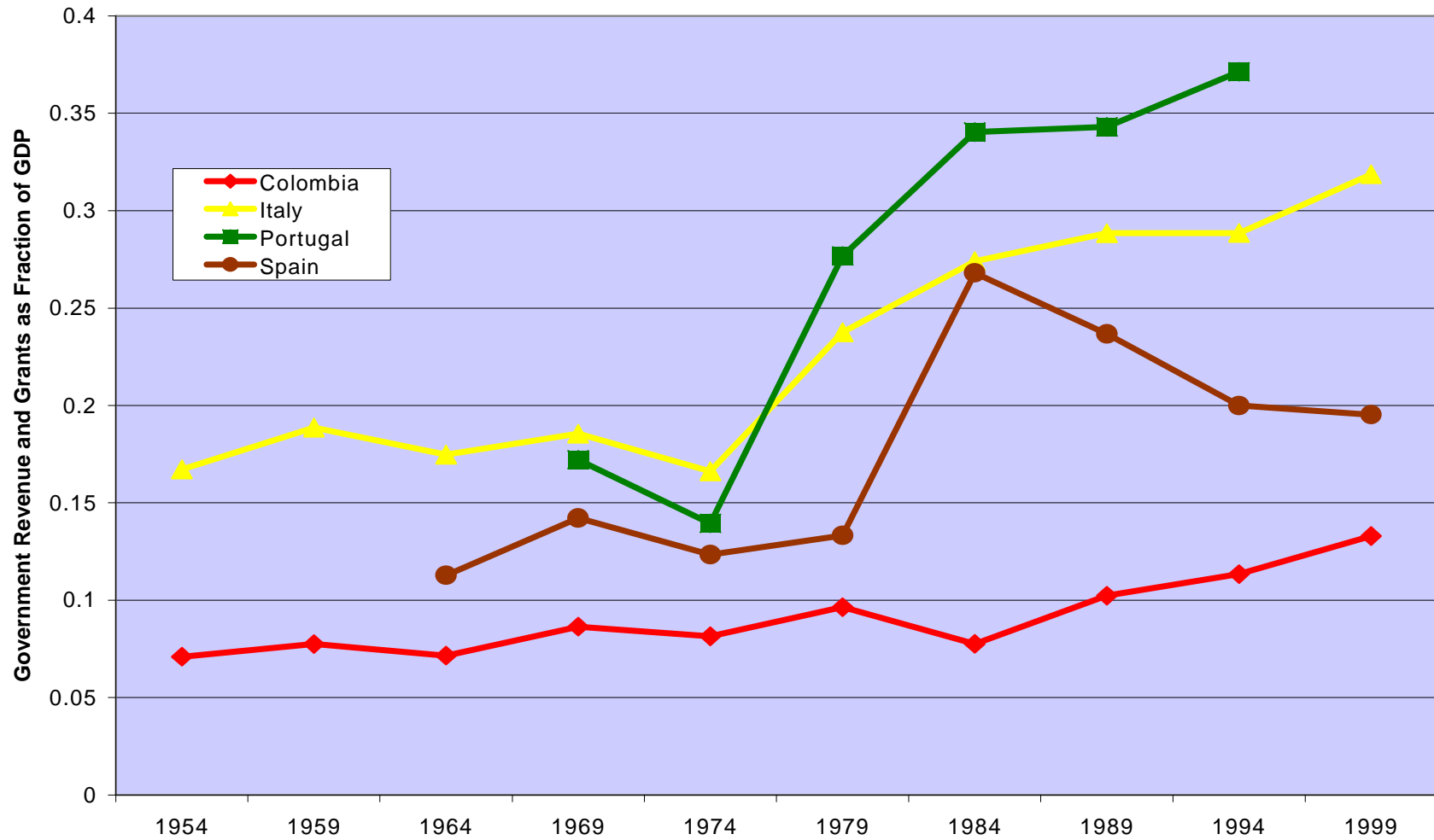
After 1951 the government got to choose the private sector representatives.

From 1963 to 1991 the only non-government member was the Director of the Bank.

# What difference did this make?

- In the Context of a Weak System of Public Finance, it appears to have produced financial repression and reduced private lending.

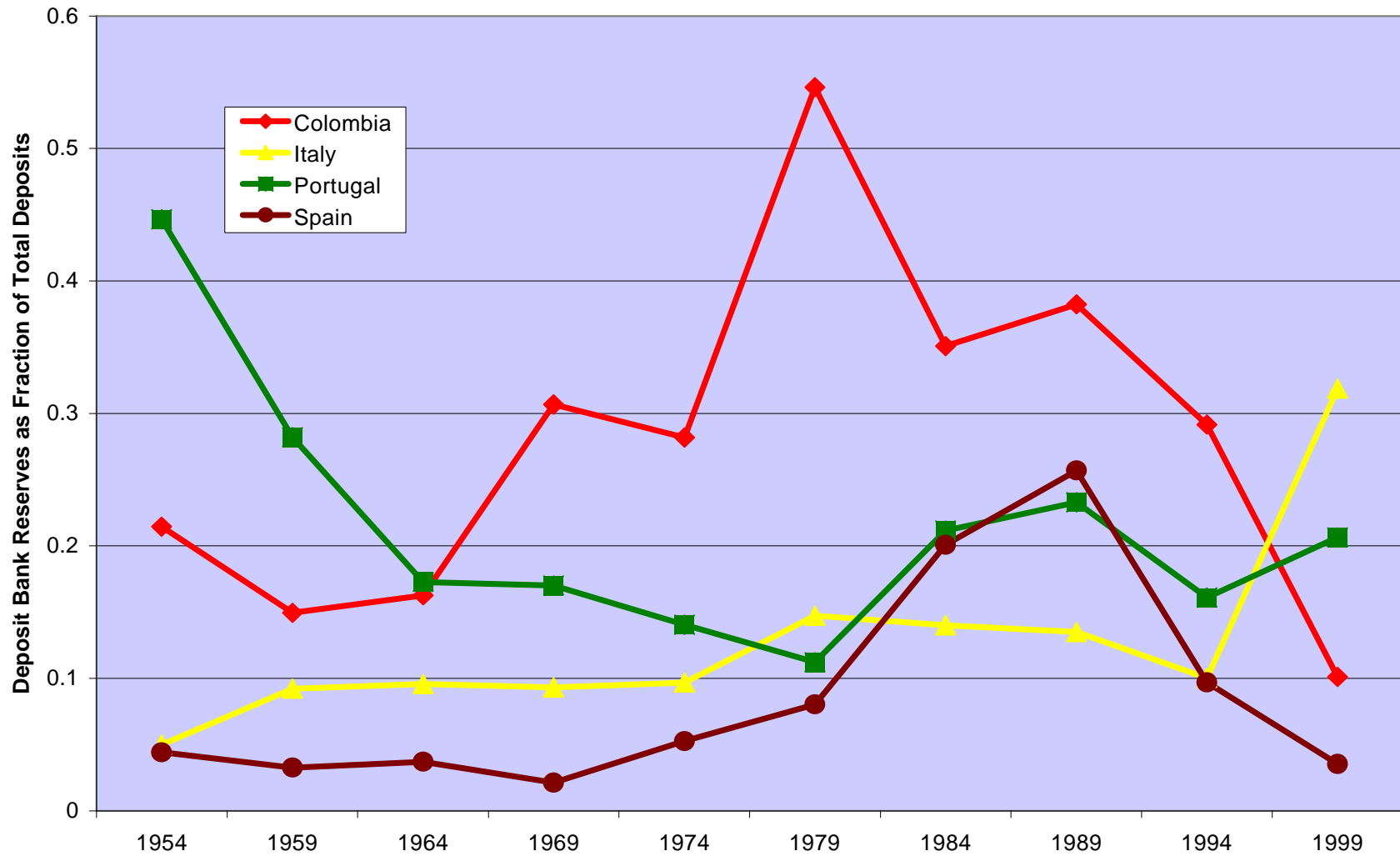
# Government Revenues as % GDP



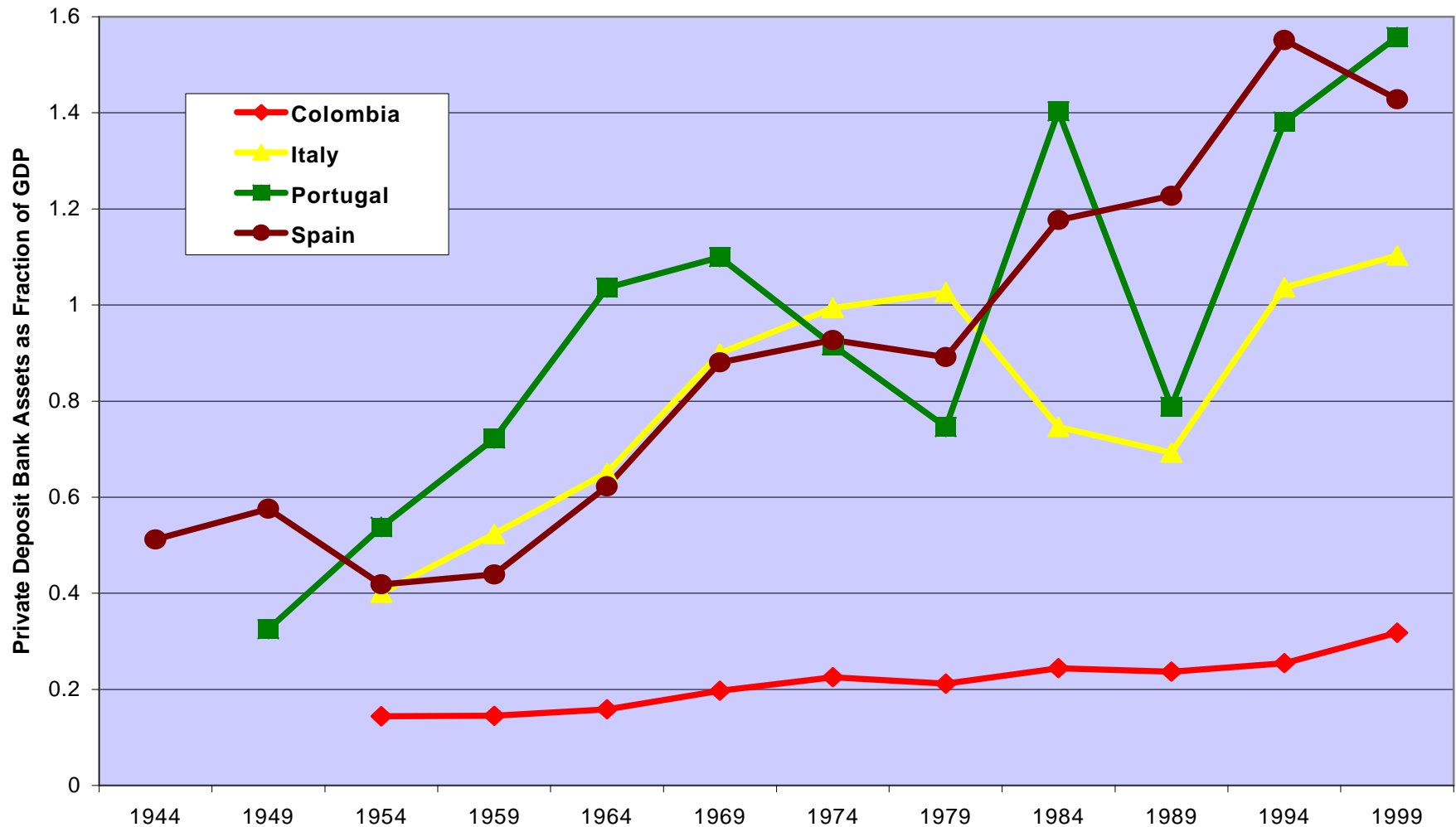
# Government Response to Low Revenues

- Beginning in the 1950s the government ran large fiscal deficits: from 2 to 8 percent of GDP. (Sánchez et. al, Graph II.6).
- Deficits financed by expanding the monetary base: 10 to 25 percent per year. (Graph II.7).
- Money creation set off inflation, which accelerated over time. (Graph II.4)
- The government fought inflation by financial system repression.

# Reserves/Deposits



# The Impact of Repression on the Banking System

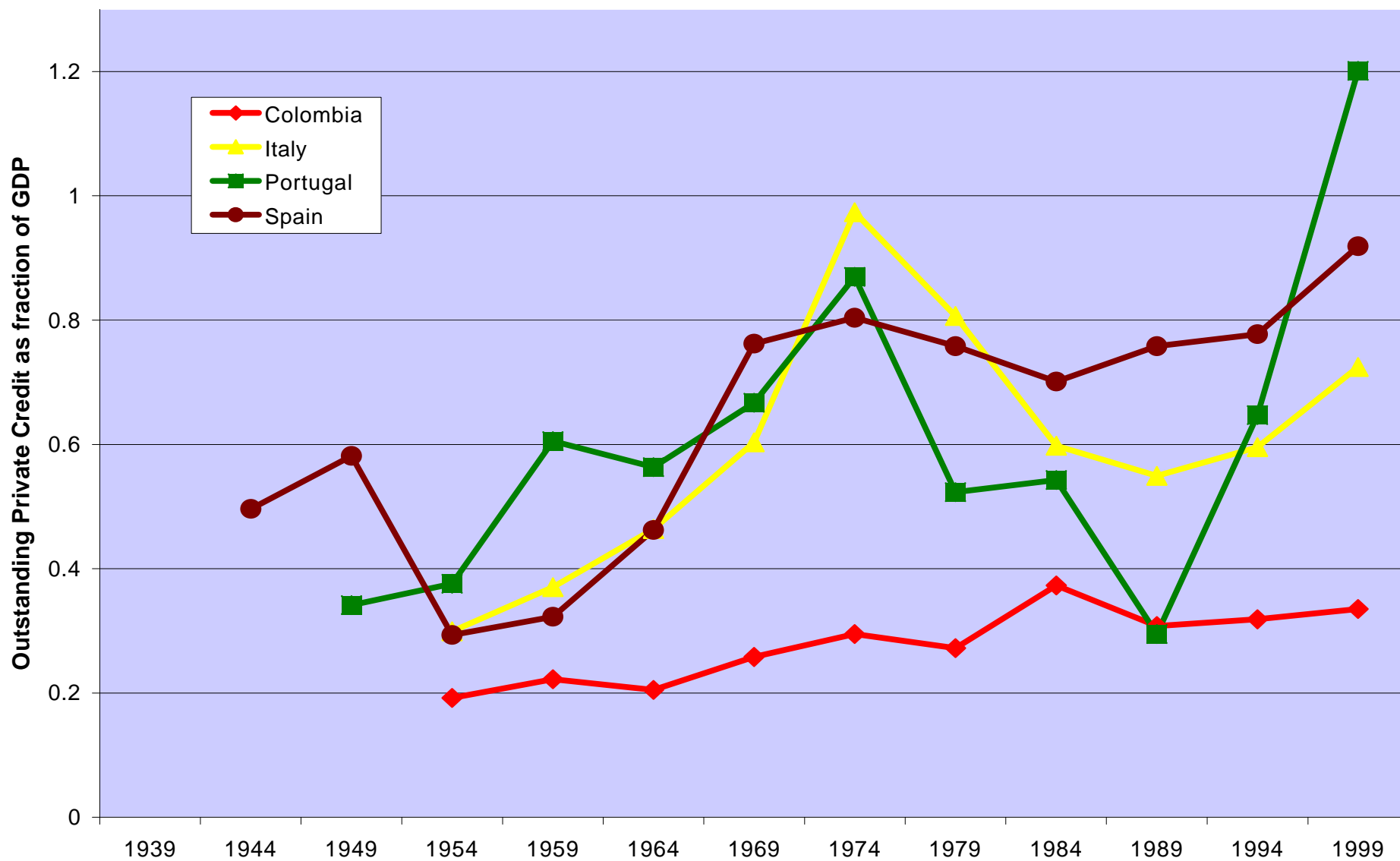


- One might argue that the government's policy of using the Banco de la República to engage in directed credit mitigated the small size of the private banks.

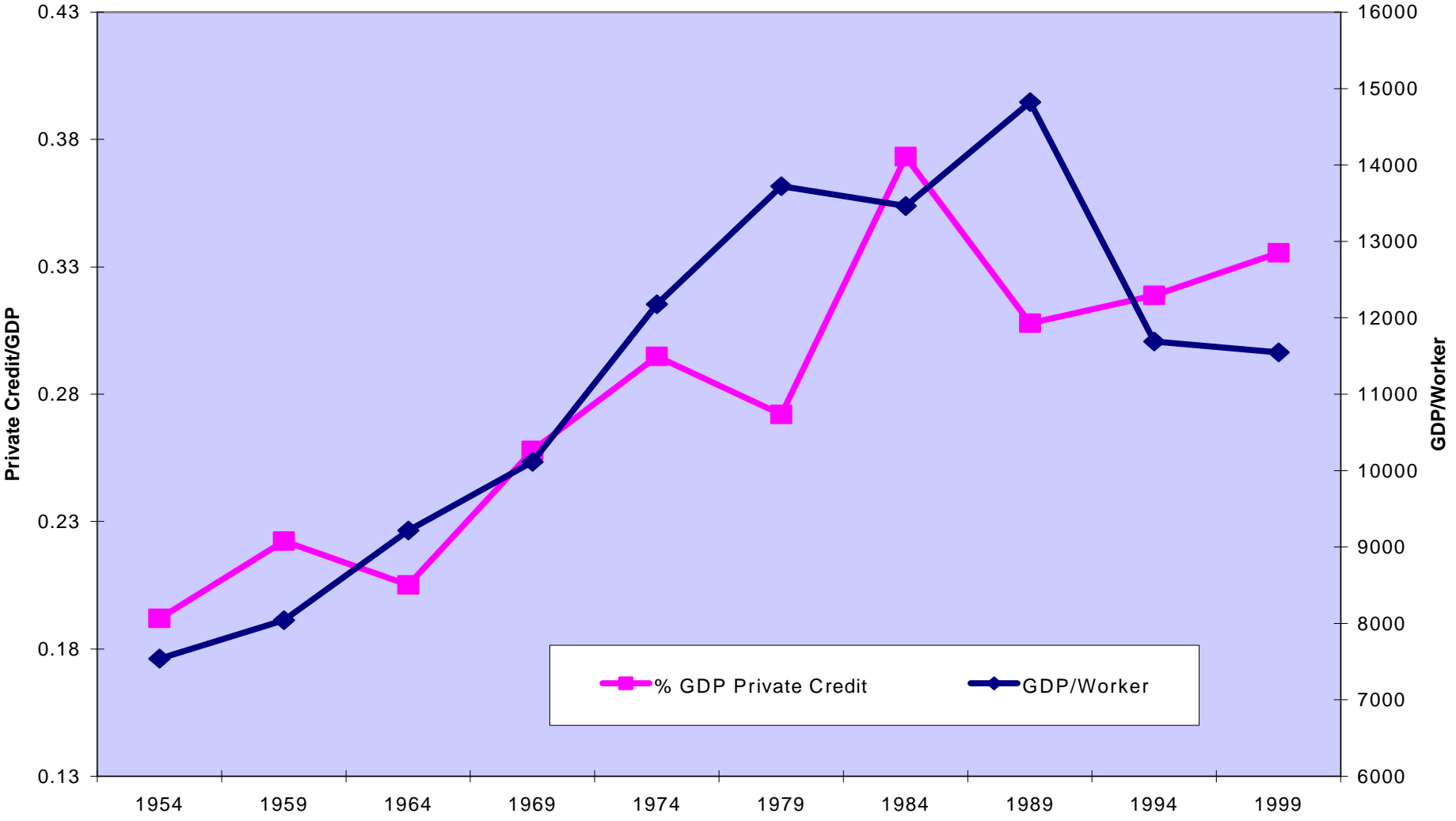
# Two Problems with this View

- You have to believe that the government was more efficient at choosing which firms should receive credit than the market.
- The view is not consistent with the evidence about private lending.

# Total Credit to Private Sector/GDP



# The Nexus Between Finance and Growth



# Conclusion:

## A metaphor from baseball.

- Sánchez, Fernández, and Armenta have stepped up to the plate, taken a difficult pitch, and hit a home run.
- But, if they embed what they have done into a larger story about the political economy of the financial system, they'll have the bases loaded, and will hit a grand slam.