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Economic Crisis in Argentina and no way out?

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Economic Crisis in Argentina and No Way Out?

by

Bernhard Fischer, Ulrich Hiemenz
and Peter Trapp

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Economic Crisis in Argentina and No Way Out?

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ECONOMIC CRISIS IN ARGENTINA AND NO WAY OUT?*

I. Introduction

1. Argentina has made the headlines of international media not only for its successful return to democratic political rules in December 1983 but also for its renewed slump into economic crisis. The country is no longer able to meet the debt servicing requirements and to repay loans due this year while auspices for rescheduling and extending foreign debt are bleak. As a corollary to external problems, there are high public sector deficits, inflation is accelerating at a galopping pace, and net private investment has turned negative. Up to now, the new democratic government has not lived up to expectations since it did not present a reform package designed to overcome the severe economic problems of the country. Rather, the government has relied on some ad-hoc emergency measures in an attempt to prevent the crisis from turning into catastrophy. Such "muddling through" approaches to economic policy making have frequently been applied in

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* The analysis presented in this paper is based on a research project carried out on behalf of the Friedrich-Naumann-Stiftung. The larger part of the project was undertaken in Buenos Aires between June 15 and August 24, 1984. The research team included the authors and Juergen B. Donges, who prepared a summary of the main findings in Spanish [Donges, 1984]. An in-depth analysis of fiscal and monetary policies is provided in Fischer and Trapp [1984a, 1984b]. The authors are grateful to a large number of economists both in the government and the private sector for helpful suggestions concerning the analysis and comments on the policy recommendations. In Buenos Aires, Jorge Galmes provided invaluable assistance in organizing the research work and establishing important contacts. The analysis was concluded on August 24, 1984.

Argentina and have frequently failed to achieve the stated objectives. Instead, a deteriorating performance of the economy used to increase social tension and finally forced the government out of office. To prevent a repetition of this dreadful experience, the present government has no other choice but to thoroughly review its economic policies and to implement policy changes which take into account the underlying causes of repeated economic crises in Argentina rather than only the symptoms of these crises as was done in the past.

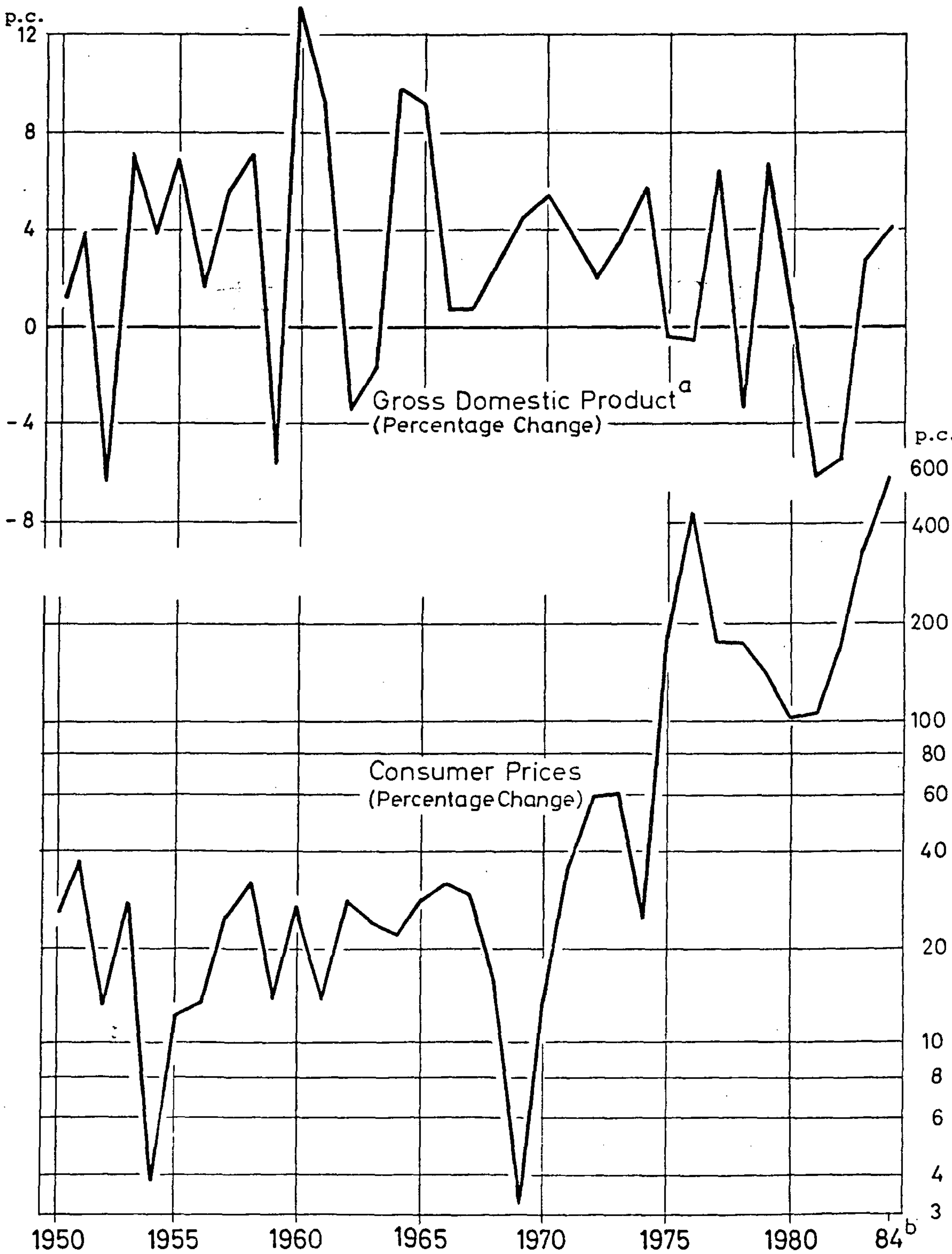
2. The subsequent analysis of economic performance and policy making in Argentina over the last 15 years isolates major obstacles to achieving a period of sustained economic growth and stability in the country and shows why government intervention as well as successive liberalization attempts have failed to produce the desired results (Chapters II and III). Against this background, stabilization policies applied by the present government are reviewed (Chapter IV) and confronted with a stabilization cum restructuring program which could be successful in overcoming the basic deficiencies of the Argentine economy (Chapter V).

II. Economic Policies and Economic Performance in the 1970-1983 Period

3. The more recent economic history of Argentina has to be viewed against the country's earlier successes[1]. In the pre-World War I period Argentina enjoyed about 70 years of rapid and almost uninterrupted growth which put the country in the ranks of industrialized nations. Argentina benefitted from its vast natural resources and swiftly expanded its exports of agricultural products. At the beginning of this century, real per capita income was higher than in Italy and Austria and about as high as in France. The development in the inter-war period was strongly influenced by the Great Depression which led to a sharp reduction of Argentine exports. All in all, however, the country did not fare worse than many other economies at that time, and during World War II, Argentina recovered notably. Although external conditions for economic growth as measured by the expansion of markets and the availability of funds and know-how were favourable after the War, the increase in aggregate output was much weaker and more unstable and inflation was much higher in Argentina than in most other countries in that period. What is even worse, the post-war period was characterized by a sequence of economic crises and a persistent deterioration of the performance of the Argentine economy (Figure 1).

[1] For an analysis of the economic history of Argentina, see Díaz-Alejandro [1970 and 1982] and Mallon and Sourrouille [1975].

Figure 1 - Economic Growth and Inflation in Argentina, 1950-1984



[a]At 1970 prices. - [b]Estimate. Source: BCRA.

4. An analysis of economic policies over the last 10-15 years provides some clues as to why economic management was successful, if at all, only in the very short term. A synopsis of major changes in economic policies introduced by the successive governments is given in Table 1. This synopsis and the macroeconomic data presented in Table 2 demonstrate that the present crisis is by no means as extraordinary as it might appear at first glance. It is rather the last link in a chain of economic crises which, notwithstanding their respective characteristics, seem to stem from similar underlying causes.

5. The year 1969 marks the end of the Krieger Vasena stabilization plan. Under this plan, the rate of inflation had been brought down from more than 20 p.c. per annum to less than 10 p.c., the government deficit declined to about 1 p.c. of GDP, and foreign exchange reserves were replenished. A major recession had been avoided by allowing monetary expansion to accelerate again, following a temporary credit tightening at the beginning of the plan. The plan was geared to real income targets and to a fixed exchange rate which was expected to keep the rate of inflation at a low level. However, both targets became untenable when a construction boom stimulated by low interest rates gained momentum in 1969. Wage and price increases picked up again and led to a revaluation of the real rate of exchange which contributed to a decline in agricultural prices thus starting yet another cattle cycle [Mallon and Sourrouille, 1975:32].

Table 1 - Synopsis of Governments and Major Changes in Economic Policy, Argentina 1970-1984

In Office Since	President	Minister of Economics[a]	Main Economic Policies Pursued
June 1970 March 1971	General Levingston General Lanusse	Moyano Llerena Ferrer Licciardo Wehbe	Devaluations of the $ a to solve the balance of payment problem. Expansive monetary and fiscal policies to stimulate economic activity.
May 1973[b] July 1974	J.D. Perón M.E.M. Perón	Gelbard Gómez Morales Cafiero	Massive increase of real wages to stimulate domestic demand. Fixed exchange rate and price controls in order to reduce inflation. Expansive monetary and fiscal policy.
April 1976	General Videla	Martínez de Hoz	Emergency program: strong devaluations, ceilings on nominal wages, ease of price controls, steps to reduce the fiscal deficit. 1977 attempt to establish a free market economy (lift of price controls, liberalization of interest rates) and opening up of the economy to international competition (partial elimination of export taxes, exchange rate guarantees). 1979 a pre-announced crawling peg system (tablita) was introduced. After an initial tightening of monetary and fiscal policy the policy stance was reversed in the course of the period.
March 1981	General Viola	Sigaut	Abolition of the crawling peg in favour of ad hoc devaluations. Split of the exchange market into a controlled commercial market and a financial market with free floating exchange rates. Financing of the increasing public deficit by bond sales to the private sector. Monetary policy designed to the financing needs of the public sector deficit and ensuring liquidity of the private sector.
Dec. 1981	General Galtieri	Alemann	Free floating and re-unified exchange rates. Restrictive monetary and fiscal policy to reduce inflation.
June 1982	General Bignone	Dagnino Pastore Wehbe	Renewed introduction of a crawling peg system. Refinancing of private debt through long-term loans at a highly negative real rate of interest in order to prevent a breakdown of major parts of the industry and the banking sector.
Dec. 1983	R. Alfonsín	Grinspun	Active income policy (increase of real minimum wages and granting cost of living adjustment to higher wage brackets) combined with efforts for a socio-economic pact. Devaluations according to the expected rate of inflation. Price controls for industrial products and ceilings on wage increases in private companies. Severe import controls. Persistently high public sector deficits.

[a]List does not include Ministers who served less than 6 months. - [b]During an interim period after the election the government was led by Campora and Lasteri.

Table 2 - Basic Economic Indicators, Argentina 1970-1983

Year	Per-Capita Income[a] (Percentage change)	Public Sector Deficit[b] (P.c.of GDP)	Bank Credit to the Private Sector in Real Terms (Percentage change)	Money Supply[c] M1 (Percentage change)	Rate of Inflation[d]	Real Wages (Percentage change)	Exchange Rate[e] (Percentage change) (1) Commercial	(2) Financial[f]	Current Account[g] (Millions of US-$)	Change in Foreign Reserves[h] (Millions of US-$)
1970	4.3	- 0.9	6.5	12.9	13.6	3.7	14		- 163	- 259
1971	2.1	- 3.5	-25.2	24.4	34.7	1.5	37	106	- 390	420
1972	0.4	- 5.2	-16.3	39.1	58.5	- 5.2	57	19	- 227	110
1973	1.8	- 7.3	26.6	74.7	60.3	4.9	9	0	711	- 864
1974	4.1	- 9.4	15.0	70.8	24.2	10.5	-2	0	118	45
1975	-1.9	-15.1	-43.9	96.3	182.8	- 3.6	432	471	-1,287	1,107
1976	-2.0	-11.7	-13.8	303.1	441.1	-28.1	407	377	651	35
1977	4.7	- 5.1	46.2	155.7	176.0	- 7.5	122		1,126	-2,214
1978	-4.9	- 6.8	14.9	135.6	175.5	- 2.2	96		1,856	-3,246
1979	5.0	- 6.3	43.5	155.8	139.7	13.3	66		- 513	-4,442
1980	-0.7	- 7.6	32.4	120.7	100.7	12.7	40		-4,774	2,737
1981	-7.5	-15.6	- 5.0	53.2	104.4	- 8.7	140	211	-4,712	3,807
1982	-6.6	-16.5	-24.7	165.2	164.7	-10.6	389	491	-2,477	651
1983	1.6	-15.8	-52.2	312.0	343.8	+14.0	388	324	-2,000[i]	n.a.

[a]At 1970 constant prices; [b]Non-financial public sector; [c]Currency in circulation and demand deposits; [d]Consumer prices of Greater Buenos Aires, annual average; [e]$ a per US-$; [f]Since 1982 parallel market; [g]Includes net current transfers; [h](-) increase in reserves; [i]Estimate.

Source: BCRA, FIEL, IFS.

6. As devaluation expectations emerged and the current account moved into deficit the emphasis in exchange rate policy shifted from fighting inflation to solving the balance of payments problem. From 1970 to 1972, the Peso was allowed to devalue by some 60 p.c. Since the authorities did not want the unemployment rate to rise, monetary and fiscal policy became increasingly expansionary. In 1972, the fiscal deficit in terms of GDP was 5 times higher than in 1970 and the increase in the money stock amounted to roughly 40 p.c. (Table 2). As a result of this policy, inflation accelerated to nearly 60 p.c. per annum in 1972. However, the balance of payments improved because of the devaluation and in 1973, when the Peronist government was elected, the current account was comfortably in surplus and there was an increase in foreign reserves.

7. The main objective of the new government under Juan Péron (Table 1) was to increase real wages and to achieve a high level of economic activity. To reduce the rate of inflation, price controls were introduced and the exchange rate was fixed again in 1973. The fiscal deficit rose to about 7 1/2 p.c. of GDP and the rate of growth of the money supply almost doubled to some 75 p.c. While real wages increased sharply, price controls kept the rate of inflation at 24 p.c. in 1974 (Table 2). The result was that there were black markets for almost all kinds of goods [Cavallo and Petrei, 1983: 157]. In 1975, the government was no longer able to repress inflation. The index of consumer prices (CPI) rose dramatically and, in the first quarter of 1976, the annual rate of inflation amounted

to 900 p.c. The government deficit was twice as high as in 1973 and the current account registered a deficit of 1.3 bill. US-$. Real output declined in 1975 and 1976 for the first time since 1963 (Figure 1).

8. In spring 1976, a military government under General Videla took office and tried to stabilize the economy by applying some emergency measures (Table 1). The Peso was devalued by about 80 p.c., a ceiling on nominal wages was introduced, price controls were eased, and steps were taken to reduce the government deficit. Real wages fell by about one third. Lower wage costs, the devaluation of the currency and the elimination of export taxes led to a marked expansion of exports. For the year as a whole the current account was in surplus again and the decline in foreign reserves was reversed.

Whereas the 1975 drop in aggregate output was mainly due to lower exports, it was the decline in domestic demand that led to the 1976 reduction of real GDP (Table A1). Monetary expansion remained nonetheless high because the Central Bank had to monetize huge losses from subsidized sales of US-$ in the futures market undertaken by the previous government. For the year 1976 as a whole, the increase of the CPI amounted to 441 p.c., however, with a declining trend during the year. The budget deficit as well as the increase in the money stock had been considerably reduced in the second half of 1976, but at the end of the year both variables were still high and in excess of the levels prevailing from 1970 to 1974 (Table 2).

9. In 1977, the Martínez de Hoz plan was implemented, which was based on the idea of fighting inflation be reestablishing the conditions of a free market economy and by opening up the economy to international competition[1]. While price controls were lifted after a transitional period, wages remained under strict government control.

After the correction of monetary and fiscal trends in 1976, policies were again relaxed somewhat in 1977. There was a noticeable recovery of economic activity with both domestic expenditure and exports expanding at a rapid pace. The current account continued to improve and the rate of inflation declined, but by far not as much as the government had envisaged. Therefore, monetary policy was tightened again in 1978. Since the government's credit requirements remained high in view of the large budget deficit, real interest rates increased steeply. This produced another recession of domestic demand in 1978. The share of domestic absorption in aggregate supply (GDP plus imports) decreased by 5 percentage points compared to 1975 (Table A1).

10. Since the rate of inflation remained high, the government introduced a pre-announced crawling peg (tablita) in 1979 which was designed in such a way as to keep price increases of traded goods more in line with international inflation. The tablita was expected to break inflationary expectations in the domestic market. However, the government did not adjust the

[1] This liberalization attempt has been widely described in the literature, see e.g. McKinnon [1982], Sjaastad [1983], Wogart [1983], and Barletta et al. [1984].

stance of monetary and fiscal policies which were inconsistent with the planned reduction of the inflation rate. In addition, real wages were raised substantially in 1979. The result was a consumption-induced recovery in 1979 with domestic expenditure increasing at a rate of about 12 p.c. Since the higher domestic wage costs were not compensated for by the crawling peg, the international competitiveness of the domestic industry was sharply reduced and exports declined while imports of goods and services (in real terms) surged by about 50 p.c. in 1980 (Table A2). The competitive position of the traded goods sector deteriorated further because the government stuck to the pre-announced crawling peg which implied a further appreciation of the currency in real terms (Table A3). Therefore, manufacturing output continued to decline in 1980 while agricultural output was adversely affected by low export prices and bad weather conditions. Nevertheless, total GDP more or less stagnated in 1980 because domestic expenditures on consumption and investment continued to increase at a rate of about 6 p.c.

11. From December 1977 to December 1980, the Peso appreciated by about 40 p.c. in real terms. In view of the persistently high increases of domestic prices, devaluation expectations became stronger in the course of 1980. Although the government encouraged foreign lending by reducing both the risk (by providing an exchange rate guarantee) and the Peso cost of foreign borrowing (by maintaining an overvalued exchange rate), there were massive capital outflows in the last quarter of

1980 and in 1981 (Table A5). In February 1981, the Peso was devalued by 10 per cent and a new exchange rate schedule was announced which covered the subsequent seven months. This time, credit policy was tightened severely in order to support the exchange rate policy. However, these policy changes were never fully applied since the Videla administration was replaced by a new military government under General Viola in March 1981 (Table 1).

12. The new government abolished the crawling peg, and after devaluing the Peso twice by 23 p.c., the exchange market was split into a commercial market with a crawling peg on a daily basis and a financial market with a freely floating exchange rate in June 1981. On average, the real exchange rate rose somewhat, but at the end of the year it was still some 25 p.c. lower than in December 1977 (Table A3). Monetary expansion remained moderate, but the fiscal deficit rose to about 16 p.c. of GDP, mainly because of the foreign exchange guarantees granted to private borrowers. Deviating from earlier policies, a sizable share of the public deficit was financed by bond sales to the private sector. Higher interest rates and crowding out paved the way to another downward slide of the domestic economy. Imports fell by 36 p.c. from the 4th quarter of 1980 to the 4th quarter of 1981 (Table A4), and the rate of inflation remained at about 100 p.c. per annum.

13. Economic recession, high inflation and capital flight brought a new administration under General Galtieri into

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office in December 1981 (Table 1). The foreign exchange market was reunified and the exchange rate was allowed to float freely. After a strong devaluation, capital outflows came temporarily to a halt. The hike in import prices prevented the rate of inflation from showing any abatement. Therefore, the decline of real domestic expenditure continued at an accelerated pace. In the second quarter of 1982, domestic expenditures on consumption and investment were 17.5 p.c. lower than a year ago.

At the outbreak of the Malvinas conflict in mid-1982, economic policies were totally reversed once again. The exchange rate regime changed several times, but, on balance, there was an accelerated (real) devaluation of the Peso. The severe recession, the lack of competitiveness, and the foreign exchange burden contributed to a drastic deterioration of the financial situation of the private sector. In order to save borrowers and banks from default, the government entered into large-scale refinancing of private debt through long-term loans (6 years) at a highly negative real rate of interest in mid-1982. The cost of bailing out private enterprises further enlarged the public sector deficit which had already been increased by previous rescue operations and by the military conflict. The Central Bank refrained from any active role in financial policy; monetary expansion was merely geared at financing the public sector deficit and ensuring the liquidity of the private sector. The foreign debt continued to increase and reached US-$ 39.8 billion at the end of 1982 (Table 3),

Table 3 - External Debt, Argentina 1978 - 1983

(Billions of US$)

Year[a]	Public	Private	Total
1978	8.4	4.1	12.5
1979	10.0	9.1	19.1
1980	14.5	12.7	27.2
1981	20.0	15.6	35.6
1982	24.8	15.0	39.8[b]
1983	43.6[c]	-	43.6[c]

[a]December. - [b]Includes public and private sector arrears amounting to US$ 2,104 and 656 million, respectively. - [c]Estimated (without interest payments).

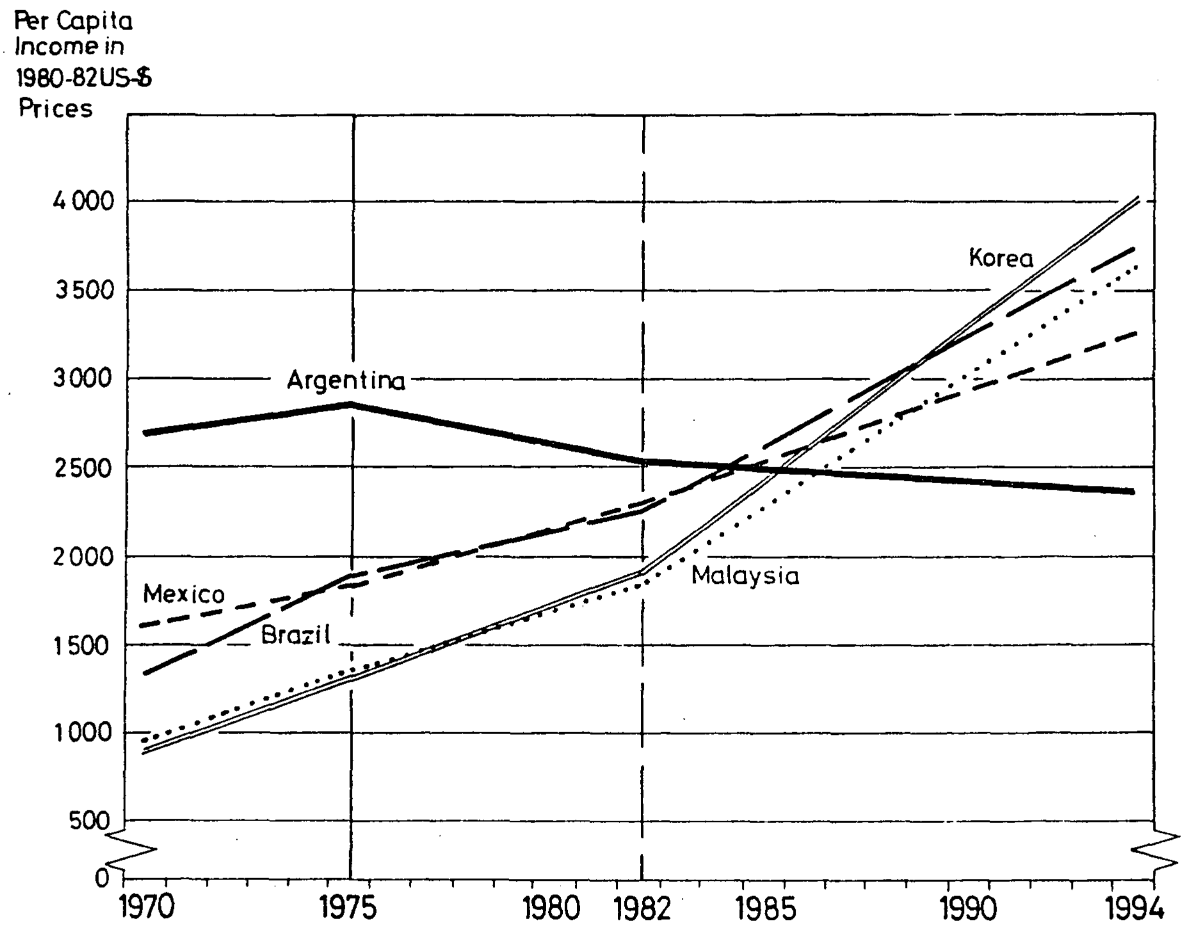
Source: BCRA

causing unsustainable debt service obligations. A stand-by arrangement with the IMF, which wassupposed to provide relief, was interrupted after only 9 months in autumn 1983, as the government could not meet the conditions on which the arrangement rested (mainly reduction of the budget deficit and removal of trade restrictions as well as capital controls). Inevitably, foreign commercial banks, which were prepared to reschedule Argentina's debt parallel to IMF assistance, stopped providing the required new finance.

III. Economic and Social Costs of Development Policies Applied in Argentina

14. Despite the unperturbed outer appearance of a relatively rich country, Argentina's growth record over the last 15 years has been rather similar to that of an African country than to economic development in other Latin American countries, not to speak of Asian countries. Since 1975, real per capita income has been declining more or less steadily at an annual average rate of 1.3 p.c. Measured in prices of 1970, 1983 per capita income was 4.5 p.c. lower than per capita income in 1970. Had it not been for the wealth the country accumulated in the last and at the beginning of this century, a loss of real income of this magnitude would undoubtedly have caused much more concern as it apparently did in Argentina up to now. Figure 2 shows the deterioration in the relative income position of the country vis-à-vis other Latin American and Asian countries in a

Figure 2 - Actual[a] and Projected[b] Growth of Per Capita Income in Selected Developing Countries, 1970-1994



[a]Until 1982. - [b]Projections for the 1982-1994 period are based on average annual growth rates of the 1970-1982 period. -

Sources: World Bank (1984: 110-111); UN (1984: Special Table 1; Table 1).

period of only 12 years. Starting from an income level almost twice as high as that of Brazil and Mexico in 1970, Argentina has managed to draw roughly even with these countries in the early 1980s and will fall far behind in another 12 year period if past trends persist. Under this assumption, even such countries as Malaysia and Korea which compared to Argentina were at a rather early stage of economic development in 1970 are likely to have overtaken this country in terms of real per capita income by 1994.

15. Many other countries have experienced a deterioration of economic performance since the mid-70s, however, by far not as pronounced as Argentina. In view of the relatively small share of foreign trade in GDP and Argentina's endowment with natural resources such as land and crude oil, it is hardly conceivable that changes in foreign demand and supply or the oil price hikes are responsible for the shock waves which repeatedly went through the economy. The crises that struck Argentina again and again were rather the result of structural deficiencies of the economy induced by the basic thrust of the development strategy applied in the country and by misguided short-term policy responses to market disequilibria. Concerning the fundamentals of economic decision making, two major elements can be singled out which have contributed to the reoccurence of economic crises: the inward-orientation of economic policies and the high degree of government interventions into virtually all markets.

16. The strategy of import substitution already adopted after the Great Depression has promoted the development of a highly diversified industrial sector, but the lack of external and partly also internal competition contributed to a wasteful use of both capital and labour [Canitrot, 1974]. Argentina shares this experience with many other countries which heavily relied on import substitution to promote industrial expansion [Krüger, 1983]. Industrial profits rather depended on access to subsidized credit and public sector contracts than on international competitiveness. The export promotion scheme introduced in the late 1960s and the subsequent reduction of the overall level of import protection achieved little with respect to changing the basic structure of incentives[1]. While traditional labour- and skill-intensive industries showed some positive responses in the early 1970s, the anti-export and anti-agriculture bias of commercial and exchange rate policies largely remained untouched. Furthermore, many measures introduced to promote exports failed to yield the expected results since trade policies implemented for short-term balance-of-payments considerations were frequently offset by exchange rate policies geared at lowering the rate of

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[1] According to Berlinski and Schydlowski [1982], the average rate of effective protection on domestic sales for manufacturing was reduced from 111 p.c. in 1969 to 39 p.c. in 1977. The main problem in the latter year was the dispersion of protection among industries which ranged from negative rates of effective protection for some traditional industries (tractors and agricultural equipment; tanning material; durable household consumer goods) to very high effective protection for some industrial and agricultural intermediates as well as office machinery, communication equipment, and motorcycles and bicycles. For the structure of effective protection see also Nogués [1983] and FIEL [1982]. The latter study shows that the high dispersion of effective protection among industrial subsectors was maintained in the 1980s.

inflation. In such an economic environment, foreign direct investment hardly contributed to the maturation of the Argentine industry. Subsidiaries of foreign firms rather adjusted to local technological standards and concentrated their efforts on domestic sales.

17. For these reasons, the inward orientation of industrial policies became a permanent source of balance-of-payments problems. Many industrial enterprises considered exports more or less as a residual arising from an excess of production over domestic sales and, hence, every increase in domestic absorption or slowdown of foreign demand was bound to create wide fluctuations in industrial exports. Therefore, the Argentine economy continued to rely heavily on revenues derived from agricultural exports for the payment of its import needs which had become increasingly complementary to domestic production. Since international demand and prices for agricultural goods also fluctuated considerably over time, sharp swings in export revenues repeatedly interrupted the supply of necessary imported inputs. Furthermore, the policy-induced discrimination against agriculture combined with the emergence of extremely protectionistic agricultural policies in other countries particularly in Europe prevented an agricultural export expansion in line with the import requirements of the country.

18. The insufficient and uncertain supply of intermediate inputs as well as the lack of competitive pressure reduced the

need for continuous product innovations and the introduction of new production techniques. The limited size of domestic markets for manufactured goods prevented the realisation of economies of scale and favoured the emergence of monopolistic and oligopolistic market structures. Productivity of industrial enterprises suffers from widespread X-inefficiency and low rates of capacity utilization. Industrial productivity did hardly increase in the 1980-83 period (Table A6). In agriculture, the introduction of new technologies based on the use of chemical fertilizers is only in its early stages because of an almost prohibitive tariff on fertilizer imports while such technologies have been implemented in other countries since long. Hectare productivity in wheat production, for example, which used to be similar to productivity of US farmers at the beginning of this century, now ranges about 30 p.c. below US productivity [US Department of Agriculture, 1984].

19. The distortion of relative prices introduced by trade and exchange rate policies was reinforced by direct government intervention into financial, labour and goods markets such as the gradual transfer of all major functions of the financial sector to the Central Bank, administrative wage fixing and restrictive labour regulations as well as quantitative restrictions concerning imports and local production of certain goods. These interventions were of an ad-hoc nature and induced unpredictable fluctuations of relative prices [Machinea, 1983]. High information costs resulting from the necessity to live with or circumvent controls and a high

degree of uncertainty about the next turn of government policies created disincentives to private investment. Gross domestic investment has declined by 45 p.c. since 1981 (Table A4) and there are indications that private investment has been reduced even more. Taking into account depreciation, private net investment may have been negative since quite some time suggesting that the country is eating up its capital stock. To prevent a breakdown of the financial sector the government stepped in several times to rescue a considerable number of private enterprises and banks that were at the brink of bankruptcy when real appreciations of the Peso destroyed the competitiveness of domestic suppliers and threatened to lead to a desintegration of the financial sector. It is estimated that 200 of the 350 private and state banks as well as a sizable share of industrial enterprises are bankrupt when judged by standard accounting procedures. Under these circumstances, it is not surprising that grey markets, in particular a parallel market for US-$, are developing rapidly. However, profits earned in these markets are classified as illegal and will hardly be returning to the official economy thus adding to the scarcity of investible funds. The same applies to surpluses generated in the underground economy which is estimated to amount to at least 30 p.c. of official GDP.

20. The permanent instability in the basic orientation of macro-economic policies can be traced by assessing the reversals in major macro-economic policy instruments such as the

public sector deficit, the rate of growth of money supply (M1), and real wages. The data presented in Table 2 show a clear policy cycle. From the beginning of the 1970s to the mid-1970s all policy variables tend to rise. This expansionary phase is followed by a period of 4 to 5 years in which policy variables are corrected downwards substantially. Finally, at the end of the 1970s, policies again become increasingly expansionary. The existence of a policy cycle does not distinguish Argentina from other countries. However, in Argentina the fluctuations are extremely strong since instability was reinforced by the extensive and unpredictable use of regulations and controls in all areas of the economy. This by itself is sufficient to explain the fluctuations of overall output and the successive waves of inflation (Figure 1). The basic mechanism can be demonstrated with respect to public deficits in relation to GDP growth.

21. Supporters of government policies may argue that public deficits tended to increase at times of recession (e.g. 1975 and 1980-83) and helped to smooth output fluctuations caused by other influences. However, large public sector deficits went along with high deficits in the current account and an increase in the rate of inflation, i.e. fiscal deficits were normally increasing when demand pressures were already extremely high. The coincidence of a high budget deficit and recession (in terms of production) resulted from the failure of using the exchange rate in a proper way [Sjaastad, 1983]. By maintaining an overvalued exchange rate Argentina has

repeatedly reduced the profitability and the level of activity in its traded goods sector. Overvaluation of the currency was then combined with expansionary policies designed to stimulate production. This policy mix made the situation even worse. It resulted in strong wage pressure and accelerating inflation, while the budget deficit widened because of price freezes for public goods and rescue operations for private companies in distress. And each time the crisis culminated, when the balance-of-payments constraint finally forced the government - often a new one - to devalue and to reduce demand pressures by monetary and fiscal restriction. Given this policy cycle, fiscal policy can hardly be considered as a stabilizing element. The inconsistency of fiscal, exchange rate and wage policies has been the major cause for the failures of successive liberalization attempts in Argentina which have burdened the debate on economic policies today with so many deep-rooted prejudices.

22. Inconsistency and instability of policy making in Argentina is a result of the preoccupation of successive governments to favour one sector or segment of the economy over the others instead of appealing to a broader social consensus for its economic management[1]. In the past 15 years, military governments used to favour business, whereas populist governments favoured labour. Later on, the respective govern-

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[1] This is clearly stated in Wynia [1978:247]: "The continual failure of Argentine leaders to secure the cooperation of private interests in the implementation of their economic programs was not due to their excessive reliance on competitive pluralism or corporatism, but their failure to develop either, or any other system that linked policy makers with their constituents."

ments regularly had to reverse their policy either because the pressure of trade unions for higher wages threatened to lead to a major strike and political unrest or because the balance-of-payments constraint forced the government to reorientate policies. Since the government decides - at least nominally - over prices and wages, it is exposed to strong pressures from organized labour and specific interest groups which all do not assume any political responsibility for the course of action urged upon the government.

23. The incomes policies applied by various civilian and military governments provide a good example on how good intentions may have adverse effects under such circumstances. Incomes policies were usually geared at improving the distribution of income by raising the standard of living of the work force. Data presented in Table A6 show that organized labour has so far been sheltered from suffering real income losses since real wages have been maintained at 1977 peak levels. The relative income position of the organized sector has been preserved by a reduction of formal employment (Table A7) and by large-scale subsidy programs granted to industrial and banking activities. The emergence of widespread unemployment has been prevented by a rapid expansion of self-employment in the service sector and, more recently, of public employment.

24. The economic costs of these policies had to be borne by those members of the society who are hit hardest by the

inflation tax the government is levying on currency holdings and demand deposits as well as on time deposits at negative real rates of interest to finance the public sector deficit. As the chance to protect oneself from negative effects of inflation by investing in grey markets is open to a large segment of the population and not just to the "happy few", it is very difficult to trace the incidence of impoverishment to one particular group. For this reason, there is so little opposition voiced against the present economic system; many can even gain from "speculative" investment opportunities offered by high inflation while those carrying the burden are scattered through many social groups and usually comprise the weakest members of the society in terms of disposable income and/or access to grey markets. People primarily concerned are workers outside the organized labour market, i.e. so-called self-employed workers particularly in the artificially inflated service sector and agricultural labourers, as well as owners and family helpers of smaller farms and small-scale industries. Contrary to announced intentions, government policies have not contributed to improving the distribution of income but rather bolstered the income position of capital owners and members at the labour force that could effectively organize in pressure groups. It is not surprising that these policies have a regional dimension as well. In poorer regions of the country such as the Northern Provinces income losses and unemployment rates have increased overproportionally compared to Greater Buenos Aires [FIEL, 1984].

25. The lessons to be drawn from this experience is twofold. If more stability in economic policies is to be achieved, economic planning has to be based on improving the productive potential of the economy as a whole rather than the well-being of certain groups. Such a strategy will eventually benefit all members of the society and not just those groups protected by the respective government. To gain the freedom to implement such a strategy, the government has to reduce its almost total control (and responsibility) over the economy. It cannot fix wages, prices, and the exchange rate independently of each other and at the same time please all parties concerned. Instead, central parameters of economic development should be determined autonomously either by market forces or by groups directly involved such as trade unions and employers.

IV. Argentina 1984: On the Road to Hyperinflation?

26. The economic situation the Alfonsín government inherited from its predecessor could have hardly been worse. Foreign debt had accumulated to some 45 billion US-$ and interest payments alone amounted to about 7 p.c. of GDP or 60 p.c. of export revenues. If amortization and repayment of short-term debt is included debt service required about 250 p.c. of export revenues in 1983. The total public sector deficit is estimated to have amounted to more than 20 p.c. of GDP at the end of 1983 and was totally financed by the Central Bank. Consumer prices rose at a monthly rate of 17.7 p.c. in

December 1983 and were 433.7 p.c. higher than a year ago (Table A8). Real wages had been pushed up to a new peak in December 1983, thus fuelling - together with an acceleration of monetary expansion and the growing uncertainty with respect to economic prospects - a consumption boom. Real GDP and industrial production rose by 3 and 9 p.c. respectively in 1983; investment, however, continued to decline by almost 8 p.c. (Table A4). At the end of 1983, total gross investment was about 45 p.c. lower than three years ago and hardly sufficient to cover replacement needs.

27. Financial markets had suffered greatly from the acceleration of inflation. Due to the high opportunity costs of holding money (notes and coins plus demand deposits) and due to negative real rates of interest on time deposits (Table A9), the volume of financial markets had been shrinking. Measured in real terms, the holdings of financial assets were some 50 p.c. lower in 1983 than in 1980 and the ratio of M2 to GDP had dropped from 25.4 to 12.4 p.c. (Table A10). As in other countries during inflationary processes, the average maturity of time deposits had shortened dramatically as a result of rising inflationary expectations. More than 90 p.c. of all time deposits carried a maturity of less than 30 days. Any medium- or long-term capital market had disappeared. In order to safeguard the purchasing power of their savings, households turned increasingly to more inflation-proof assets like real estate, gold or "greenbacks". US-Dollar balances within the country were estimated to amount to 3-5 bill. US-$.

Because of the massive increase in the monetary base (Table A11) resulting from financing the huge public deficit by money creation, bank credit had already been restricted severely in 1982 by reserve requirements of 100 p.c. and narrow rediscount facilities. Thus, the banking system was prevented from performing its original task of channelling funds into the economy and was mainly used as an instrument to collect the inflation tax[1].

28. Foreign trade was totally dominated by the lack of foreign exchange. In view of the inability to service external debt, there was no access to additional funds from abroad at the end of 1983. Severe restrictions had already been imposed on imports and import permits were only granted for intermediate inputs not available in the domestic market. Despite of the recovery of domestic expenditure there continued to be a surplus in the trade balance in 1983 (Table A12). However, this was mainly due to enforced import restrictions, which caused the volume of imports to decline faster than exports. On the whole, the economy was virtually closed at the end of 1983.

29. Faced with the disastrous consequences of past policies, the new government did very little to reverse economic trends. It refrained from any decisive move towards fighting inflation

[1] For a detailed description and analysis of the financial market in Argentina see Fischer, Trapp [1984a]. The effects of the inflation tax on the financial sector, economic growth and income distribution are discussed in Fischer, Trapp [1984b].

and rather attempted to stick to its election promise of raising real wages by 4 to 6 p.c. over and above the December-1983 level. In order to make real wage increases bearable to private enterprises, the government tried to reduce capital cost by further lowering already negative real rates of interest in January and February 1984. However, it became soon obvious that this policy was not sustainable. It resulted in enforced financial disintermediation, widespread misuse of funds borrowed at the controlled rate, and an expansion of grey capital markets. Therefore, priority has recently been shifted from raising the level of real wages in general to a policy of increasing real minimum wages and granting cost-of-living adjustments to higher wage brackets, thus aiming at a reduction of wage differentials.

30. The only attempt of the government to reduce inflation concerned the introduction of price controls for industrial products immediately after the election[1]. In spite of these price controls the rate of inflation rose to an annual rate of 1076 p.c. in August, which clearly demonstrates the ineffectiveness of the price controls. Their major effects have been additional distortions of the price structure and disincentives to industrial production. Presently, the government is trying to establish some kind of concerted action (concertación) to achieve a broader concensus in wage

[1] A set of prices in each company is directly controlled and price increases due to higher production costs have to be negotiated with the government. For another set of prices there is more flexibility, but any individual price increase must not exceed the average rate of inflation (as measured by the CPI).

and price policies. Given the populistic policy stance of the government, this so-called socio-economic pact will hardly be meant as a substitute for wage and price controls, but rather provide a new instrument to facilitate the implementation of additional regulations.

31. Concerning the foreign exchange market, the multiple exchange rate system[1] has been maintained and the Peso has been devalued gradually over the last months. The rate of devaluation was oriented at the expected rate of inflation. However, since inflation was underestimated considerably, the real exchange rate appreciated by about 12 p.c. between December 1983 and May 1984 (Table A3). The relative decline of export prices added to the disincentives to output expansion and investment introduced by domestic price controls. In order to return to the real exchange-rate level of December 1983, the devaluation of the Peso has been accelerated since April 1984. Up to now, however, exchange rate adjustments are badly lagging behind the increase of the inflation rate. Due to declining exports the government was forced to cut down imports sharply. There has been no indication of any discernible trade policy or of considerations in that direction over the last months.

32. According to official estimates, the budget deficit has

[1] This system includes a commercial rate for industrial exports and special rates for agricultural exports which are kept by 15 to 25 p.c. below the commercial rate.

been reduced from more than 20 p.c. of GDP in the last quarter of 1983 to about 8 p.c. in the second quarter of 1984. Adjusted for delayed payments, however, the deficit is likely to be much higher. In addition, a substantial deficit is run by the public financial sector, which is not included in the official estimate. On the whole, there are no clear-cut indications of any sustained reduction of the deficit. On the expenditure side, there have been some cuts of military expenditures and of investment projects while wage and salary payments which account for about one third of total public outlays have been boosted substantially because public employment and public real wages have been raised by a significant margin after the election. On the revenue side, relief was expected from the increase of relative prices for public services and higher taxes on gasoline consumption. The latter, however, has - at least in the short run - failed to improve revenues since gasoline consumption was reduced significantly. Higher revenues were also expected from a resumption of normal tax payments which had dropped off steeply at the end of 1983 because of an expected tax amnesty after the election. Instead, tax evasion increased and tax payments were delayed to gain from accelerating inflation. The percentage share of gain revenues in GDP declined from 33.6 p.c. in 1983 to 30.3 p.c. in the first half of 1984. For these reasons, it is not very likely that there has been a major reduction of the public sector deficit. The more or less unabated expansion of Central Bank credit to the government leads to the same conclusion. Currency in circulation which is a good proxy for the money creation has more than tripled since December 1983.

33. On the whole, the economic policy of the new government can only be described as a zick-zack course. A medium-term economic program has been announced several times but has not been presented yet. Likewise, the government did not come to terms with the IMF over the conditions for a stand-by agreement. Conflicting statements of members of the government concerning medium-term directions of economic policies have increased uncertainty and further dampened the propensity of the private sector to invest. Obviously, economic policy is geared at maintaining some kind of status quo. It appears that the government is hoping to outlive the crisis by a strategy of "muddling through" until a more favourable international environment, i.e. lower real interest rates in the US and a devaluation of the US-$, would help to overcome the present problems.

34. The fundamental misconceptions of this approach are the belief that the economic crisis in Argentina is not home-made but imported, and the disregard for the economic and social costs of present economic policies. If the government continues on its present course, an economic collapse is inevitable. The time for a strategy of "muddling through" has run out because of the disastrous economic situation inherited from previous governments. The high and persistent public deficit is threatening to push the country into hyperinfla-

tion. The inflation tax, which is equivalent to the rate of inflation for non-interest-bearing money and to the negative real rate of interest on time deposits, has already been exploited excessively. Currency substitution and investment in indexed and real assets have increasingly eroded the base on which the inflation tax is levied. The ratio of M1 to GDP declined from more than 12 p.c. at the beginning of the 70s to 7.7 p.c. in 1980 and less than 4 p.c. in the first half of 1984 (Table A10). Since the public sector deficit was not reduced substantially, inflation had to accelerate over the last months.

35. The decline of real money balances and the acceleration of inflation have reached dimensions in Argentina comparable to those observed in other countries at the beginning of hyperinflationary processes [Sargent, 1982; Cagan, 1956]. The Argentine economy is approaching a point where a sustained high public deficit will push the rate of inflation to a level at which yields from the inflation tax are no longer sufficient to finance the deficit[1]. At this point galopping inflation turns into hyperinflation as the government will print money at an accelerated pace in a futile attempt to satisfy the budgetary needs. Hyperinflation means that

[1] According to estimates by Fernández and Rodríguez [1984] the inflation tax in terms of GDP will fall when inflation exceeds a monthly rate of 30.8 p.c. However, this seems to be a rather optimistic estimate; with accelerating currency substitution, hyperinflation may already start at a lower rate of inflation.

- the monetary system breaks down, because everybody will refuse to accept domestic money;
- goods disappear from all markets and will be kept in hoardings;
- trade will only be possible on a barter basis;
- regular production activities will cease to exist because wages cannot be paid any longer and people will chase after any chance to provide themselves with a minimum of goods and services; and
- the public sector will fall apart because it has no means to finance its needs.

36. Any further attempt to maintain the status quo will inevitably drive Argentina into an economic catastrophy which threatens to destroy the political system and the social fabric of the society as well. Both the general public and the political leaders have to acknowledge these grim perspectives. To secure its own survival and the survival of the democratic system as such, the Alfonsín government has no choice but to reverse its economic policies.

V. A Stabilization Cum Restructuring Program[1]

a) The Basic Approach

37. More than just a few ad-hoc stabilization measures are required to save Argentina from economic collapse and to reestablish the international creditworthiness of the country. Policy reform has to be geared towards achieving a number of goals simultaneously and as fast as possible to avoid hyperinflation and to stop the process of impoverishment. These goals are:

- Restoration of confidence in government policies and their continuity to reduce uncertainty in economic decision making;
- A substantial relaxation of inflationary pressure without which no other policy can be implemented successfully;
- A revival of foreign trade to facilitate debt servicing; and
- An elimination of price distortions to open up new investment opportunities and to improve productivity growth.

38. In pursuing these goals, the severe imbalances in the Argentine economy have to be taken into account which require a high degree of complementarity and a careful timing of policy changes. Conventional stabilization policies frequently applied in the past and now again recommended by the IMF are

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1 For a more policy-oriented outline of the reform package, see Donges [1984].

insufficient to solve the economic problems of Argentina and may even have unwarranted side-effects. The IMF mainly suggests a cut of the public deficit, a "managed" devaluation of the currency and a complete deregulation of interest rates. The economic history of the country shows that exchange-rate policies geared towards devaluation of the Peso succeeded at best in the very short run and have rather contributed to wild fluctuations of the real exchange rate (Table A3). Concerning interest rates, there is a well founded fear that an immediate full deregulation would lead to a collapse of the financial market with disastrous consequences for the banking sector and many industrial enterprises which entirely rely on subsidized credit from the government. And most importantly, IMF recommendations lack a structural component which would reduce the severe distortions in the economy introduced by direct government intervention.

39. The emergency package presented in this paper aims at a combination of economic stabilization with structural adjustment. In view of existing institutional and political constraints, it is suggested to proceed in two steps: a) a short-term stabilization program which includes some initial measures to encourage a reallocation of resources and b) a medium-term structural adjustment program to be applied when some degree of stabilization has been achieved. This paper focuses on the short-term program which would have to include a sudden and drastic reduction of the public sector deficit, a freely floating exchange rate, a strengthening of the free capital

market, elimination of price controls, and some degree of import liberalization to support export expansion. Other important measures needed for Argentina's return to sustained economic growth (para 56) have to be postponed until the government has regained the freedom to implement adjustment policies which is lost in the present state of the economy.

b) Reduction of Public Sector Deficits

40. The piecemeal approach to expenditure cuts applied by the present government has to be replaced by a sweeping immediate cut of public expenditures to reduce inflation and inflationary expectations. Fighting inflation is the key to any economic improvement in the country since only drastically lower rates of inflation would enable the government to loosen its almost total control of the economy. The restoration of a sound government budget calls for expenditure cuts, a ceiling on the expansion of subsidy programs largely channeled through the Central Bank, and a reduction of direct government participation in economic activities. Equally important are improvements of tax collection to prevent a further decline of the share of tax revenues in GDP. However, higher taxes are no alternative to a review of expenditures since they are likely to increase price distortions and, hence, hardly produce higher revenues. The government should, nevertheless, consider certain changes of the tax structure which will have a positive effect on revenues at least in the medium term.

41. Prime candidates for budget cuts are[1]

(1) public investment in projects with doubtful economic returns (such as most energy and infrastructure projects);

(2) subsidy programs which at present ensure the survival of many industrial enterprises or banks (without preventing the decline of the respective sectors as a whole; Table A13). Many of these programs are granted through financial institutions and increase in volume almost automatically;

(3) public enterprises producing large deficits as a result of conflicting targets imposed on these enterprises. With given price and wage policies, they will continue to be a heavy drain on public resources. Therefore, they should be established as independent production units with clearly defined responsibilites and the freedom to charge cost-covering prices;

(4) military expenditure which includes a number of activities not directly related to the defense of the country such as large parts of "Fabricaciones Militares". These activities could be turned into independent public enterprises or transferred to the private sector;

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1 For a more detailed discussion of some of the subsequent suggestions, see Petrei [1983].

(5) public employment which was again augmented heavily under the new government (Table A7);

(6) public wages and salaries which have frequently been spearheading wage increases in other economic sectors. There is no rationale for a wage leadership of the public sector.

42. On the revenue side, steps should be taken by the government

(1) to improve the effectiveness of the tax collection system in order to reduce widespread delays in tax payments and tax evasion;

(2) to abstain from any fiscal amnesty (blanqueo) because it punishes honest tax payers and erodes tax moral;

(3) to review the numerous tax exemptions now distorting the tax structure;

(4) to change the tax structure by lowering the value added tax and eliminating the tax on agricultural exports (para 44) in exchange for a broader coverage of the income tax and a newly introduced land tax.

43. A reduction of the public deficit will immediately ease inflationary pressure which is a prerequisite to restoring

financial markets. Ceilings on subsidies and privatization of at least some public or military enterprises would provide a potential for the expansion of viable private enterprises and create new investment opportunities. Recessionary effects of expenditure cuts are considered to be mild if budgetary policies are accompanied by incentives for output expansion and for investment through an adjustment of relative prices.

c) Elimination of Price Distortions

44. In 1984, Argentina is a virtually closed economy, where all major goods and factor prices are fixed independently of each other by government intervention. The domestic currency is grossly overvalued heavily discriminating against exports in general and agricultural exports in particular, while erratic adjustments of domestic prices cause uncertainty, lower the propensity to invest, and inflate the size of the (non-traded) service sector. If confidence in the country's economic performance is to be restored and exports are to be increased to facilitate debt servicing, major price distortions have to be removed. The first and most important step in this direction would be to abolish the present system of multiple fixed exchange rates and to allow the exchange rate to be determined by market forces. The subsequent devaluation will not only encourage exports and reduce capacity underutilization in manufacturing, higher export revenues will also speed up the introduction of improved technologies in agri-

culture (including the use of chemical fertilizers). Modernization in agriculture and agricultural export expansion should be further supported by the substitution of a land tax for the present export tax on agricultural products[1]. This tax would provide an incentive for land holders to make productive use of the available land and punish those holding land simply for speculative reasons.

45. If exports are to expand significantly some degree of import liberalization will be inevitable. The present ban on all imports for which domestic substitutes are available and the highly selective nature of interventions in import markets prevent any substantial increase of industrial production since the necessary supply of intermediate inputs and capital goods is not assured. A reform of import restrictions should be based on a more positive attitude of the government towards foreign competition and include initially:

- a substitution of tariffs for quantitative import restrictions (as was done successfully in Turkey; [Gönensay, 1984]) and

- a reduction of the (effective) discrimination against exports by either lowering import tariffs or establishing a refund or draw-back scheme commensurate with artificially increased import prices.

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[1] On August 12, 1984 the President has announced in a public speech the intention of his government to abolish the export tax on meat by October of this year.

46. The reform of the price structure which is to create new investment opportunities and more productive jobs than hitherto provided in the service sector also has to include the elimination of the present system of ex-factory price controls. This system has proven to be unable to contain inflation. Furthermore, selective control of some product prices distorts the structure of production and - with a monthly rate of inflation of more than 20 p.c. - creates windfall profits for the trade sector. Price negotiations are highly arbitrary and consume a substantial amount of public and private resources. Abolishing price controls will most certainly result in higher ex-factory prices which is desirable to encourage capacity utilization and production growth as well as to compensate private companies for the phasing out of government subsidies. Higher ex-factory prices do, however, not mean a new wave of inflation. Most of these price increases will go at the expense of excessive trade margins and hardly affect retail prices.

d) Financial Sector Reform

47. With reserve requirements of almost 100 p.c. on deposits, the banking sector had to abandon its role in collecting and reallocating financial resources. The banks have become subsidiaries of the Central Bank which guarantees deposits at fixed maximum interest rates and offers preferential credit - almost the only source of credit in the country by now. The Cuenta de Regulación Monetaria, the vehicle for steering

financial markets and collecting the inflation tax, can, however, not be abolished until the public deficit and inflation have been substantially reduced and the banking sector has been revived. A relaxation of reserve requirements does not provide a policy option for the time being since the resulting additional money supply would fuel inflation and offset the effects of a declining public deficit on money supply. But even if the restoration of a truly independent banking sector rather constitutes a long-term option, some immediate policy changes are required to increase the supply of voluntary savings to the financial sector and to improve the allocation of financial resources.

48. At subsidized interest rates demand for credit overshoots supply and results in credit rationing. The arbitrary element inherent in such decisions greatly reduces the economic efficiency of credit allocation. As an approximation to the long-term goal of liberalizing interest rates it is suggested to strengthen the existing parallel markets and to freeze or better reduce the size of the officially controlled market for preferential credit. A number of measures can be implemented to this end while anti-inflationary budget policies are pursued:

(1) interest rate policies on the official market that support a positive real rate of interest for all <u>new</u> credit arrangements;

(2) an increase in the volume of indexed deposits private banks are allowed to offer combined with a gradual reduction of the guarantee against losses by bank default the Central Bank now grants to all such deposits. This policy would increase voluntary savings as well as the amount of credit banks can offer at free interest rates while banks are forced to compete for deposits;

(3) The same purpose is served by an increase in the volume of bank acceptances which is now severely restricted.

49. Such measures would impose a more active role on the banking sector in the allocation of credit, and thus increase competition among those demanding credit and among the banks themselves. The latter aspect is very important to return to sound banking practices and to reverse the current trend to financial disintermediation. It is recognized that some special arrangements may be needed with respect to outstanding debt at highly preferential interest rates. This debt will have to be phased out gradually without burdening the banking sector with a default risk.

50. An alternative to this rather moderate reform of the financial sector is a currency reform which is under consideration among some economists in Argentina. It has to be stressed that such a drastic monetary reform cannot substitute the above recommendations with respect to public deficits, foreign trade and relative prices. The experience with currency reform in countries such as Austria, Germany, Hungary and Poland proves that the success of those reforms depended in particular on a simultaneous return to sound budgetary policies [Lutz, 1949; Wallich, 1955]. The policy changes applied in those countries were much more painful than anything suggested in this paper. Another important aspect of currency reform concerns the required institutional changes. To be successful, the reform has to include among other things the establishment of an independent Central Bank which issues the new currency[1]. If such an institutional innovation is deemed feasible, the introduction of a parallel currency may be preferred to the substitution of the old for a new currency in order to minimize the problems arising in the transition period. It has to be left open at this stage whether enough political will could be mobilized in Argentina to support such a far-reaching policy initiative.

e) Macro-Economic Effects of Policy Reform

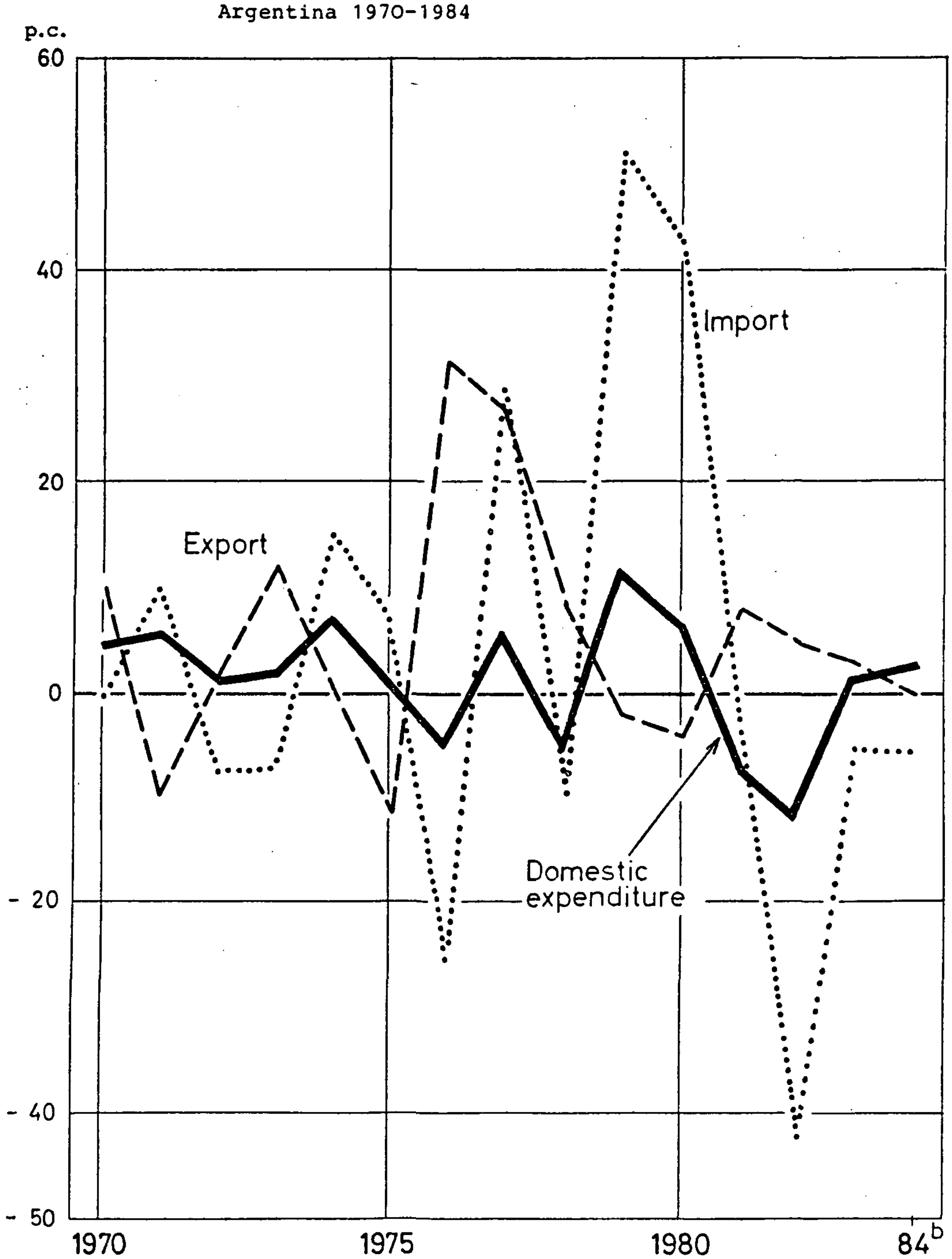
51. The effects of any policy reform in Argentina have to be

[1] An example is the introduction of the German "Rentenmark" in 1923. See Netzband, Widmaier [1964].

judged against the costs of continuing present policies (para 35). There is no policy option benefitting all segments of the economy simultaneously. Yet, the above proposed emergency package paves the way toward achieving high and stable rates of economic growth which will also allow increases of real wages without detrimental effects on price stability and output growth. Argentina is extremely well endowed for a quick economic revival (better than other heavily indebted Latin American countries) since the country is rich in natural resources (oil, land); has a well educated labour force; could mobilize a hidden reserve of financial capital (3-5 billion US-$ hoarded at home and 20-30 billion US-$ invested abroad); and - most importantly - has shown a high degree of responsiveness to changes of economic incentives even in the very short term, particulary in agriculture. This is demonstrated in Figure 3 with respect to the export performance. Export volumes increased rapidly at times when the discrimination against exports by over-valued exchange rates was absolished, e.g. in 1976 and 1981. This experience suggests that economic adjustment can be achieved in Argentina at much lower economic costs than in other countries.

52. A reduction of the public deficit together with policies promoting foreign trade (a free exchange rate, lower import protection and eliminating the agricultural export tax) will effect both the level and the structure of supply, demand, and prices. On the demand side, the recessionary impact of expenditure cuts is countered by an increase in external

Figure 3 - Domestic Expenditure, Import and Export[a], Argentina 1970-1984



[a]At 1970 prices, percentage changes. - [b]Estimate.

Source: BCRA.

demand. More importantly, however, there are supply side effects associated with a reduction of existing price distortions. A clear-cut policy change with respect to public expenditures, export discrimination and import protection will break inflationary and rent seeking mentalities and favourably influence a better use of installed capacity and the propensity to invest. It is expected that efficiency of industrial production can be raised substantially if bottlenecks due to the lack of imported intermediate goods and capital goods can be removed. Taking these factors together, the recessionary impact of the proposed measures is supposed to be mild and shortlived.

53. The devaluation of the currency and the elimination of the export taxes induce a once-for-all increase of prices of tradables partly offsetting the disinflationary effects of expenditure cuts in the first round. The budgetary policies will nonetheless arrest the rate of continuous price increases and eventually stabilize the price level. Simultaneously, the structure of relative prices is going to shift in favour of traded goods in general and exports in particular. These shifts ecourage a reallocation of resources from the tertiary sector to industrial and agricultural activities and induce the urgently needed reduction of the share of total consumption in GDP.

54. First round effects on real wages are twofold: the initial price increases resulting from exchange rate and trade

policies tend to reduce real wages while decreasing rates of inflation lower the inflation tax and, hence, positively effect real disposable income in particular of low income groups. But even if a temporary decline of real wages during the adjustment process seems to be unavoidable, it should be kept in mind that real wages in the organized sector were maintained at high levels (paras 23, 24) although per capita GDP declined since 1975 and the burden of servicing foreign debt has increased substantially. Furthermore, suggested policy changes do not place the burden of adjustment costs solely on organized labour as has been the case with previous stabilization attempts. Lower government subsidies to industry and banking and diminished chances to reep speculation gains from high rates of inflation is going to stop the transfer of net wealth from the public sector (i.e. tax payers) to the non-agricultural private sector which is taking place under the present system. And finally, structural adjustment does not only create new investment opportunities, but also productive jobs which ultimately allow higher wage increases than achievable under the present structure of relative prices.

55. Economic recovery is expected to be led by increases in agricultural output and a higher capacity utilization in the industrial sector. Private net investment in fixed capital assets which is now negative in real terms will gradually pick up fuelled by a decline in hoarding and an eventual repatriation of financial funds invested abroad. The prerequisite to attracting financial capital is a positive real rate of

interest as suggested above (para 48). Interest rate induced capital inflows put a downward pressure on the real exchange rate which could erode the competitive position of export activities and, thus, reverse the inflow of financial capital. However, if the government abstains from interventions into the foreign exchange markets (i.e. does not buy foreign exchange to prevent a revaluation of the Peso) such a detrimental outcome is unlikely. A steady course of the Central Bank with respect to monetary policies can prevent an inflationary increase of domestic money supply while higher imports made possible by some degree of import liberalization will mitigate the revaluationary pressure of capital inflows. The government should be prepared to accept a temporary deficit in the current account to accelerate productive investment based on imported capital goods and to limit the inflow of speculative capital. Once new investments go into operation and export growth is accelerating, the current account deficit will automatically be eliminated.

56. The stabilization cum restructuring program paves the way to a fundamental recovery of the Argentine economy which could be accomplished in a year's time. Concerning structural change, incentives are given to reduce the propensity to consume, to expand the private sector of the economy, to produce for international rather than domestic markets, and to re-establish a sound financial sector. In the medium term the proposed measures will, however, not be sufficient to bring about those changes of the structure of production which are

necessary to ensure a stable and healthy economic performance of the country in the longer term. The degree of government intervention into many markets will still be high and a substantial share of the industrial and the banking sector will remain inefficient by international standards. Necessary medium-term adjustment policies concern

- import protection which should be gradually lowered disproportionately so as to reduce dispersion of effective protection among subsectors;
- financial markets which should be fully liberalized by abolishing the regulation of interest rates, the deposit guarantee scheme, and the Cuenta de Regulación Monetaria; the latter should be replaced by a fractional reserve system;
- labour markets where wage determination should be left to trade unions and employers.

Such policy reforms, which by no means will be painless, can, however, be implemented with greater ease once the present downward spiralling trend of economic development in Argentina has been reversed.

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Abbreviations

BCRA	Banco Central de la República Argentina
FIEL	Fundación de Investigaciones Económicas Latinoamericanas
IFS	International Financial Statistics
IMF	International Monetary Fund
IEERAL	Instituto de Estudios Económicos sobre la Realidad Argentina y Latinoamericana
INDEC	Instituto Nacional de Estadística y Censos
$a	Argentine Peso

Statistical Appendix

List of Tables

Table A1 - Aggregate Supply, Gross Domestic Product, and Domestic Expenditure, Argentina 1971-1984/I

(At market prices, in $a of 1970)

Year	Aggregate Supply	GDP	Domestic Expenditure	Domestic Demand (In p.c. of aggregate supply)	Consumption	Investment
	(Percentage changes)				(In p.c. of GDP)	
1970	5.6	5.4	4.6	87.8	78.6	21.2
1971	4.2	3.7	5.5	92.7	78.9	22.6
1972	1.1	1.9	1.1	92.6	78.3	22.3
1973	2.6	3.4	1.5	92.0	78.5	20.6
1974	6.4	5.7	6.9	92.4	80.4	20.4
1975	0.2	-0.4	1.1	93.3	81.5	20.2
1976	- 2.5	-0.5	- 5.0	91.0	75.5	21.6
1977	7.8	6.4	5.9	89.4	72.4	24.3
1978	- 3.8	-3.4	- 5.2	88.1	73.5	21.3
1979	9.8	6.7	11.6	89.4	77.5	21.5
1980	4.8	0.7	5.9	90.3	81.2	22.9
1981	- 5.9	-6.2	- 7.4	88.9	84.0	18.8
1982	-10.3	-5.6	-12.4	86.8	79.3	15.9
1983	2.1	2.8	1.3	86.8	80.2	14.3
1984[a]	2.3	3.3	2.6	86.8	85.0	8.2

[a] 1st quarter 1984 over 1st quarter 1983.

Source: BCRA.

Table A2 - Export and Import Volumes, Argentina 1970-1984/I

(In p.c. of real GDP)

Year	Exports	Imports
1970	9.22	8.94
1971	8.01	9.47
1972	7.89	8.59
1973	8.64	7.69
1974	8.19	8.37
1975	7.29	8.97
1976	9.64	6.70
1977	11.47	8.11
1978	12.79	7.58
1979	11.73	10.74
1980	11.17	15.23
1981	12.86	15.62
1982	14.26	9.52
1983	14.41	8.79
1984[a]	14.13	7.37

[a] 1st quarter 1984.

Source: BCRA.

Table A3 - Rate of Inflation and Real Exchange Rate, Argentina Dec. 1976 - Aug. 1984

	Monthly Percentage Change of CPI	Corresponding Yearly Percentage Change	Real Exchange Rate[a] (Dec.1969=100)	(Dec.1976=100)
1976				
December	14.3	397.2	110.8	
1977				
December	7.3	132.9	106.1	
1978				
December	9.1	184.4	91.6	
1979				
December	4.5	69.6	75.3	
1980				
December	3.8	56.4	63.1	36.6
1981				
December	8.8	175.1	79.7	63.5
1982				
December	10.6	235.0	111.5	119.6
1983				
December	17.7	606.8		100.2
1984				
January	12.5	311.0		102.7
February	17.0	558.0		99.7
March	20.3	818.7		93.9
April	18.5	666.7		89.9[b]
May	17.1	562.8		88.5[b]
June	17.9	621.4		n.a.
July	18.3	651.3		n.a.
August	22.8	1075.9		n.a.

[a]Based on a currency basket. - [b]Preliminary.

Source: FIEL, IEERAL and unpublished IMF estimates.

Table A4 - Gross Domestic Product by Expenditure[a], Argentina 1979-1984/I

(Yearly percentage changes)

Year	GDP (At market prices)	Consumption	Gross Domestic Investment	Exports	Imports
1979					
I	8.6	14.9	3.0	- 4.1	36.3
II	8.2	14.3	0.0	4.6	36.4
III	5.0	13.1	6.3	-10.3	54.2
IV	5.1	8.0	20.8	2.5	76.6
1980					
I	1.6	4.7	13.6	7.8	55.4
II	- 3.5	2.9	7.9	-23.7	44.0
III	1.8	5.2	9.3	- 3.1	33.9
IV	3.2	9.1	0.4	11.5	40.4
1981					
I	0.0	10.4	-18.2	-11.2	23.4
II	0.4	4.6	-17.6	30.7	20.5
III	-11.1	-10.8	-30.4	21.7	-13.6
IV	-13.5	-15.1	-24.9	-11.4	-36.0
1982					
I	- 7.6	-15.1	-25.9	17.4	-47.1
II	-10.1	-16.6	-21.6	- 2.1	-49.7
III	- 3.1	- 7.3	- 3.7	-15.5	-41.3
IV	0.2	- 3.0	-10.3	16.8	-24.3
1983					
I	1.2	- 1.0	-17.8	15.4	-21.3
II	4.4	6.8	- 4.0	1.1	2.5
III	4.9	8.1	-10.0	6.8	8.2
IV	0.3	3.6	-18.1	8.2	-7.1
1984					
I	3.3	6.2	-24.3	0.1	-9.9

[a]At 1970 prices.

Source: BCRA.

Table A5 - Long-Term and Short-Term Net Capital Flows[a], Argentina 1979 - 1983/II

(Millions of US$)

Period	Direct Investment[b]	Other Long-Term Capital	Short-Term Capital[c]
1979			
I	45	500	393
II	148	457	460
III	135	698	297
IV	159	1,012	368
1980			
I	206	1,014	-73
II	254	596	-1,569
III	214	671	586
IV	304	1,270	-1,388
1981			
I	637	1,823	-3,243
II	524	1,756	-994
III	395	2,245	-2,457
IV	513	2,675	-1,833
1982			
I	201	458	-112
II	624	-219	-2,483
III	1,088	484	-437
IV	1,284	-231	-1,842
1983			
I	137	1,436	-555
II	410	-316	-263

[a]Minus sign indicates outflow. - [b]Portfolio investment included. - [c]Net errors and omissions included.

Source: IFS.

Table A6 - Selected Indicators for the Performance of the Industrial Sector, Argentina 1980-1984/I

Period	Industrial Production[a]	Employment[a] Occupied Workers	Employment[a] Working Hours	Productivity[b]	Real Monthly Salary[c]	Real Exchange Rate[d]
1980						
I	109.7	94.0	87.1	126.0	118.7	48.1
II	88.0	90.5	98.2	89.6	112.0	44.4
III	125.0	85.4	97.1	128.7	111.1	41.9
IV	120.9	83.9	90.1	134.2	113.4	37.3
1981						
I	107.4	81.9	76.8	139.8	111.2	36.7
II	102.0	77.7	83.9	121.6	109.9	46.5
III	90.3	74.9	77.9	115.9	98.2	51.6
IV	99.1	74.0	75.1	132.0	92.7	59.1
1982						
I	90.6	76.2	70.6	128.3	88.9	70.1
II	85.1	72.0	75.4	112.9	91.3	81.4
III	99.5	71.0	77.5	128.4	95.3	97.5
IV	105.2	72.9	78.2	134.5	92.0	111.1
1983						
I	98.5	76.7	73.1	134.7	88.2	113.7
II	102.7	75.7	82.2	124.9	99.6	109.1
III	106.0	73.6	82.3	128.8	115.6	98.9
IV	107.3	75.5	79.9	134.3	114.2	98.4
1984						
I	100.0	77.8	73.8	135.5	n.a.	98.8

[a] 1970 = 100. - [b] Output per working hour. - [c] Seasonal adjusted, 1976 = 100. - [d] Currency basket, December 1976 = 100.

Source: INDEC, FIEL, El Cronista Comercial (1984); Own calculations.

Table A7 - Employment Indicators, Argentina 1970-1984/I

Year	Employment in Industry		Public Sector Civilian Employment	Unemployment Rate[a]
	Employment	Working Hours		
	(1978 = 100)			
1970	102.4	99.0	86.6	.
1971	105.4	102.5	86.1	.
1972	107.8	104.8	88.2	6.6
1973	111.2	107.8	90.8	5.4
1974	116.5	112.9	95.8	3.3
1975	122.0	114.4	101.1	3.6
1976	118.0	112.3	104.3	4.5
1977	110.7	111.7	104.9	2.8
1978	100.0	100.0	100.0	2.8
1979	97.9	101.3	99.2	2.0
1980	90.2	92.4	97.8	2.3
1981	78.9	77.6	97.0	4.5
1982	74.7	74.7	98.2	4.7
1983	77.2	78.6	97.6	4.0
1984[b]	79.7	73.1	103.5	n.a.

[a] Greater Buenos Aires; in p.c. of the labor force; annual averages; Figures do not include "underemployed persons".
[b] 1st quarter 1984.

Source: FIEL, INDEC, Ministry of Economics.

Table A8 - Quarterly Rate of Change of Consumer and Wholesale Prices on an Annual Basis, Argentina 1979 - 1984/II

Year	Consumer Prices	Wholesale Prices
1979		
I	167.3	170.7
II	160.9	182.5
III	172.2	179.1
IV	139.7	135.9
1980		
I	119.4	76.5
II	107.6	71.4
III	84.0	40.9
IV	87.6	59.6
1981		
I	81.9	79.6
II	94.3	94.8
III	119.1	157.4
IV	131.3	254.3
1982		
I	146.4	212.3
II	125.0	119.4
III	175.5	288.3
IV	209.7	311.3
1983		
I	268.0	369.9
II	340.2	373.9
III	351.3	338.1
IV	433.7	411.3
1984		
I	446.6	418.1
II	559.1	546.0

Source: INDEC.

Table A9 - Selected Interest Rates, Argentina 1978-1984/II
(Up to 30 days, per month, p.c.)

Period		Nominal				Real			
		Credits		Deposits		Credits[a]		Deposits[c]	
		Controlled Rate	Free Rate	Controlled Rate	Free Rate	Controlled Rate	Free Rate	Controlled Rate	Free Rate
1978			8.8		7.2		1.7		- 1.3
1979			7.3		6.4		- 0.4		- 0.9
1980			5.9		5.0		1.0		- 0.4
1981			9.8		8.1		1.9		0.8
1982	I		8.4		7.1		1.5		- 0.3
	II		8.7		7.1		1.2		2.0
	III	6.7	-	5.7	-	- 9.1	-	- 8.9	-
	IV	8.7	13.9	8.0	10.2	- 3.3	1.4	- 3.1	- 1.2
1983	I	11.2	15.0	10.2	11.2	- 2.0	1.3	- 2.9	- 1.9
	II	10.6	15.9	9.6	11.0	- 0.7	4.0	- 1.8	- 0.6
	III	13.2	20.6	12.2		- 3.8	2.5	- 4.1	
	IV	15.5	23.3[b]	14.5		- 2.1	4.5	- 2.9	
1984	I	11.5	13.0[b]	10.5		- 2.4	- 1.0	- 5.2	
	II	14.0	18.0[b]	13.0		- 4.5	- 0.9	- 4.1	

[a]Deflated by the CARTECO price index. - [b]Interest rates on bank acceptances. - [c]Deflated by the CPI.

Source: El Cronista Comercial (1984); Own calculations.

Table A10 - Liquidity Coefficients[a], Argentina 1970-1984

Year	Monetary base/GDP	M1/GDP	M2/GDP
1970	10.5	14.7	25.1
1971	8.4	12.6	21.9
1972	6.3	9.7	17.1
1973	8.0	11.0	19.0
1974	12.3	14.8	26.3
1975	8.3	10.0	14.8
1976	7.3	6.7	9.6
1977	9.3	6.5	13.6
1978	10.6	6.4	17.9
1979	7.7	6.2	19.5
1980	7.1	7.7	25.4
1981	7.1	6.0	22.9
1982	11.9	4.7	15.6
1983	12.8	4.1	12.4
1984[b]	11.8	3.9	11.0

[a]Monetary aggregates deflated by the index of wholesale prices (1970 = 100) divided by real GDP at market prices. - [b] 1st half of 1984.

Source: BCRA, FIEL.

Table A11 - Monetary Aggregates[a], Argentina 1970-1984
(Percentage changes)

Year	Monetary base[b]	M1[c]	M2[d]
1970	9.2	12.9	16.6
1971	16.0	24.4	26.4
1972	35.5	39.1	40.7
1973	95.5	74.7	72.8
1974	95.9	70.8	75.2
1975	97.3	96.3	64.7
1976	421.8	303.1	285.9
1977	235.8	155.7	275.8
1978	174.1	135.6	213.9
1979	91.9	155.8	188.4
1980	63.1	120.7	130.4
1981	97.5	53.2	77.2
1982	463.3	165.2	129.1
1983	410.5	312.0	277.2
1984[e]	449.3	492.2	456.7

[a]Annual averages. - [b]Not adjusted for changes in reserve ratios. - [c]Currency in circulation plus demand deposits. - [d]M1 plus interest bearing deposits. - [e]1st half of 1984 over 1st half of 1983.

Source: BCRA.

Table A12 - Current Account, Argentina 1970-1983
(Millions of US-$)

Year	Exports	Imports	Trade balance	Services balance	Transfer payments	Current account	Memorandum items: Change in reserves
1970	1773	1499	274	-434	-3	-131	-135
1971	1740	1653	87	-474	-3	-390	390
1972	1941	1685	256	-479	-4	-227	14
1973	3266	1978	1289	-589	11	711	-814
1974	3930	3216	714	-597	-	118	-127
1975	2961	3510	-549	-743	5	-1287	1071
1976	3918	2765	1153	-520	18	651	-921
1977	5651	3799	1852	-757	31	1126	-1828
1978	6401	3488	2913	-1125	68	1856	-2297
1979	7810	6028	1782	-2352	57	-513	-4381
1980	8021	9394	-1373	-3424	23	-4774	2794
1981	9143	8431	712	-5402	-22	-4712	3437
1982	7599	4873	2726	-5234	31	-2477	758
1983[a]	4001	1907	2094	-3009	7	-908	546

[a] 1st half of 1983

Source: IFS.

Table A13 - Gross Domestic Product[a] by Sector of Origin, Argentina 1971-1984/I

- Average annual rates of growth, p.c. -

	1971-1974[b]	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984[b]
GDP at Factor Cost	3.8	-0.8	-0.5	6.4	-3.4	7.1	0.7	-6.2	-5.3	2.8	3.3
Agriculture	5.3	-3.8	4.6	2.7	1.4	4.1	-6.4	2.4	6.4	0.8	7.6
Mining	2.6	-1.5	2.4	8.5	1.9	6.3	3.8	0.6	-0.7	2.2	4.1
Manufacturing	5.0	-2.6	-3.0	7.8	-10.5	10.2	-3.8	-16.0	-4.7	9.9	2.9
Construction	0.4	4.6	12.5	13.5	-0.6	2.7	6.4	-13.8	-19.8	-6.8	-10.1
Electricity, Gas and Water	8.2	6.1	3.7	4.6	3.3	10.7	7.8	-1.1	3.1	8.0	7.9
Commerce, Restaurants and Hotels	3.0	0.7	-5.2	7.3	-7.6	10.3	2.7	-6.8	-18.3	3.6	4.6
Transport and Communication	3.3	-3.2	-0.9	5.9	-3.6	8.4	0.6	-3.7	-3.0	2.8	4.6
Banking	4.1	-8.4	-4.2	13.8	6.7	8.0	12.0	-5.3	-11.9	-8.0	-1.9
Government and Other Services	3.3	6.4	0.3	0.8	0.9	2.0	2.2	2.0	0.8	1.9	2.0

- Percentage shares of GDP at factor cost -

	1970-1974	1975-1979	1980-1982	1983
Agriculture	13.3	13.5	13.8	15.2
Mining	2.3	2.3	2.6	2.8
Manufacturing	27.9	26.7	23.2	24.1
Construction	6.1	6.8	6.3	4.7
Electricity, Gas and Water	2.5	3.1	3.8	4.3
Commerce, Restaurants and Hotels	14.8	14.2	13.9	12.9
Transport and Communication	11.2	13.1	11.0	11.3
Banking	7.4	7.5	8.9	7.6
Government and Other Services	14.5	15.0	15.9	17.0

[a]At 1970 prices; [b]1st quarter 1984 over 1st quarter 1983.

Source: BCRA; Own calculations.