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7 Progress Report on Argentina

Rudiger Dornbusch

7.1 Introduction

Argentina, it used to be said, has problems: the money is outside and the unions are inside; the unions are British and the taxpayers Italian. Half a year ago one might have believed that all this was changing. The money had been coming back at a rapid pace, the unions had moved off the stage, and the tax system was showing a rapid improvement in yield. On courageous reform, Argentina was moving far ahead of Italy. Unfortunately, today Argentina is once again under the shadow of financial instability, though decidedly not on the ropes. Acute overvaluation, melting of confidence, questions about the sustainability of reforms are all back. Today the questions are how much of the recent progress can be carried forward and how best to defuse the currency crisis.

The economic reforms are less than two years old, started in April 1991 in the aftermath of the most recent hyperinflation. From hyperinflation, the rate of price increase has been brought down to a modest 15–20% per year. Pervasive reform in the economy, ranging from deregulation and privatization to trade opening, has raised productivity and helped reduce budget deficits. A radical and broad-based attack on poor fiscal performance is gradually showing results in increased tax collection and containment of spending. All of that is only a beginning, and the effort will have to continue for years. For a moment the payoff was phenomenal: growth returned at an astounding pace and with it confidence that Argentina can make it. The return of confidence is the most gratifying reward: Argentines have traditionally been highly contemptuous of their country's economy and cynical beyond belief. Today they keep their heads high even though they once again are worrying about their currency.

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Argentina has not yet escaped from its most traditional problem, already described a century ago in 1899 in the *Banker's Magazine* (quoted by Cardoso 1987): "They are always in trouble about their currency. Either it is too good for home use, or as frequently happens, it is too bad for foreign exchange. Generally, they have too much of it, but their own idea is that they never have enough. . . . The Argentineans alter their currency almost as frequently as they change presidents. . . . No people in the world take a keener interest in currency experiments than the Argentineans."

Only a year ago, there was the prospect that a century of instability would be put behind and a golden age would open up for Argentina.[1] Not implausible, but it will take persistent, hard work, and at this time the prospects are unclear.

7.2 Looking Back

At the beginning of the century, Argentina was among the most prosperous countries in the world. It is not true that Argentina had an income level *equal* to that of the United States or the leading country, Britain—in fact, as table 7.1 shows, Argentine per capita income was more nearly half the U.S. level. Argentina is often compared to Australia—both are resource rich and were among the ten most prosperous regions at the beginning of the century. Again, Australia already had almost twice the level of per capita income that Argentina showed. Interestingly, Italy closely matched Argentina at the outset of the century and in 1950.

Even so, Argentina was one of the very rich countries in the world and deserved a weekly report in the *Economist.* The country had made it when the invention of the Libby process made it possible to conserve meat and thus bring Argentine beef to the world market. The end of the past century, including the move to the gold standard in the 1890s which stabilized the currency, marked the dramatic ascent of Argentina to world-class performance.

What did Argentina look like then? Here is a contemporary description by Hyndman in 1892.

> Buenos Aires surpassed every other city in its luxury, extravagance, and wholesale squandering of wealth. There was literally no limit to the excesses of the wealthier classes. While money, luxuries, and material poured in on the one hand, crowds of immiserization from Italy and other countries flocked in to perpetuate the prosperity of the new Eldorado of the South. Railways, docks, tramways, waterworks, gas-works, public building, mansions, all were being carried on at once in hot haste. (89)

Over the past eighty years much if not most of that status has been lost. Argentine per capita growth has been dismal, lower even than that of Britain.

1. Cavallo (1984) enunciated a new growth paradigm for Argentina already in the 1980s.

Table 7.1 Per Capita GDP (U.S. 1913 = 100)

	1913	1950	1987	Growth, 1900–87
Argentina	47	62	88	1.1
Brazil	14	28	91	2.4
Australia	90	116	253	1.4
United Kingdom	81	106	243	1.4
United States	100	178	359	1.8
Italy	47	62	239	2.2
Japan	21	30	259	3.1

Source: Maddison (1982).

What went wrong in this century? First, in the interwar period, the Depression hit Argentina extra hard. Having built a fortune on a very open economy oriented toward exports of agricultural commodities—wheat and beef—protection in industrial countries and the collapse of world trade and of prices had a devastating impact. Even so, the country maintained its international credit by steadfast adherence to debt service and internationalism.

Protection of manufacturing and the building up of a sheltered industrial sector was the common response of Latin America to the 1930s crisis in world trade. The strategy worked at the outset to create employment and dampen the Depression. Moreover, World War II filled the coffers with reserves and allowed the strategy to be carried forward for a while. But Peron was too much—a nationalist-populist policy of protection, regulation, and macroeconomic instability increasingly brought down growth and prosperity and ultimately destroyed macroeconomic stability. Inflation became endemic, deficits became structural, and the country fell into cycles of populism and stabilization.

The 1960s were the last cycle of expansion, and since then there has been only bad news: dictatorships and a "dirty war" on domestic dissent and guerrillas, a mad war on Britain over the Malvinas, massive capital flight, and a few hyperinflations. Raped over and over again, Argentina ultimately fell into full and complete disillusionment. By 1991 the economy was almost completely dollarized, and a massive part of wealth had moved abroad.

In the 1980s the debt crisis was particularly severe. Having financed massive capital flight in 1978–82 by borrowing abroad, the country had no way of facing the large debt service burdens that emerged with the end of voluntary lending, world recession, and record high dollar interest rates in the early 1980s.

Net investment has been negative for almost a decade, and real income has been falling (see fig. 7.1). A once great country had been run down to the point where millions of people in Buenos Aires were fed at soup kitchens. Real GDP per capita was back to the level of the early 1960s.

Table 7.2 **Long-Term Performance (%)**

	1960–80	1980–90
Growth per capita	1.8	−2.3
Investment/GNP	22.0	13.6
Inflation	71.7	440.0

Table 7.3 **Current Indicators**

	1989	1990	1991	1992[a]
Inflation	5,386	800	56	15
Public debt[b]	79,377	74,832	75,048	
External	50,532	48,300	49,007	
Trade balance[b]	5,376	8,189	4,406	−1,000
Budget[b]	−1,883	−333	−1,107	
Revenue	7,073	10,345	15,334	
Expenditure	8,956	10,679	16,441	
Real wage[c]	68	66	73	76
Real exchange rate[d]	170	122	75	65
Industrial production[e]	90	86	96	120

[a]April 1992.
[b]Million US$.
[c]1986 = 100.
[d]1976 = 100.
[e]1988 = 100.

7.3 The Menem-Cavallo Miracle[2]

In March 1991, following yet another burst of extreme inflation (see fig. 7.2), the country moved to a radical stabilization. The program was centered on the "convertibility plan." Under this plan the government guaranteed the convertibility of pesos at a fixed exchange rate into U.S. dollars *and* undertook not to print any money except in the course of buying dollars in the foreign exchange market. Since foreign exchange reserves in the central bank exceeded the dollar value of the domestic money supply, the program was "credible" provided the government stuck to the constitutional commitment not to print money to finance the budget.

So far, for more than a year, the promises have been kept. The currency has become strong in the sense that there has been a major rebuilding of monetary assets in the form of peso currency holdings and bank deposits. Moreover, the government has initiated sweeping economic reforms.

Privatization is proceeding at breakneck speed. Without much regard for

2. See de Pablo (1992); Cline (1992); table 7.3 in this chapter.

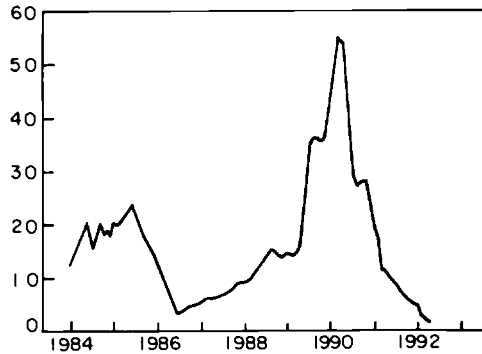

Fig. 7.1 Argentine per capita GDP (index 1980 = 100)

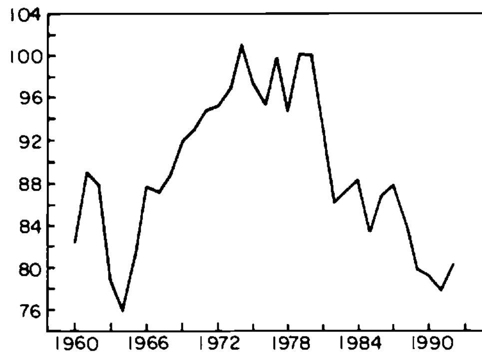

Fig. 7.2 Twelve-month inflation rate (percentage per month)

getting "good" or "fair" prices, the government is selling enterprises from oil to steel, from airlines to military production facilities (see Petrecolla, Porto, and Gerchunoff 1992). The key recognition is that the public sector enterprises make up much of the deficit; the sooner they pass out of public hands, the sooner there is a chance to balance the budget.

Deregulation is pervasive. A while back, restrictions on economic activity abounded. Hours for shops, licensing, permits, prohibitions wherever one looked. In one sweeping piece of legislation the government cleaned out an entire range of impediments to productivity.

Trade liberalization has been pushed aggressively and is seen as a key building block in more rational and productive use of the national resources. Access to cheaper and better intermediate goods has started lowering production costs and raising international competitiveness. More broadly, in manufacturing, international competition that comes with trade opening has started to exert price discipline.

Beyond unilateral trade liberalization, the ongoing effort to construct a MERCOSUR free trade area complements the trade strategy.[3]

Fiscal reform is equally ambitious, although progress is inevitably only gradual. The enforcement of tax laws has been stepped up dramatically, taxation has been simplified, and the tax yield is up. Between 1989 and 1991 the real (in U.S. dollars) revenue from taxation doubled!

Institutional reform is being implemented in the social security system, with a major impact on the budget, national saving, and the labor market.

Inflation has been brought down dramatically and possibly on a lasting basis.

Discarding entirely a leftish, nationalist perspective, the country has been thrown open to *foreign investment* in the asset markets and in the area of direct investment.

The country has *normalized relations* with the rest of the world. Politically, an understanding has been reached with Britain. In the Gulf War, Argentina was among the first to commit troops. In the economic area a quiet and responsible Brady debt relief plan secured access to International Monetary Fund (IMF) and World Bank funding.

Most important, *democracy* is firmly established, and the possibility of putsches or other adventures is just not part of the scene.

All of this is splendid. If kept up and pushed further, year after year, the reform program cannot fail to give Argentina the same stability that Chile or Mexico have secured from a decade of adjustment. For the time being, the willingness to do more is strong, and the program and the government command wide support.

The external environment has been immensely favorable in supporting the reforms with capital inflows and hence support for what otherwise might have been a fledging currency. The external support derived in part from the decline in alternative yields in developed economies.[4] But in large measure, restored access to the world capital market derived from the receptivenss of the world capital market to "reform economies"—Chile and Mexico had paved the way. There is certainly something to the view that either a developing country gets too much capital from abroad or too little, but rarely the middle ground. Taussig (1928, 130) long ago remarked on this fact: "The loans from creditor countries . . . begin with a modest amount, then increase and proceed crescendo. They are likely to be made in exceptionally large amounts toward the culminating stage of a period of activity and speculative upswing, and during that stage become larger from month to month so long as the upswing continues. With the advent of crisis, they are at once drawn down sharply, even cease entirely."

3. The recent imposition of import duties, prompted by Brazil's "excess competitiveness," clearly represents a setback in progress toward regional liberalization.

4. On this argument see Calvo, Leiderman, and Reinhardt (1992). Hanson (1992) reviews the problems of a capital account opening.

Of course, there are areas of vulnerability. The picture would not be complete without talking of three acute problems.

Fiscal correction notwithstanding, the budget continues to be in deficit. Over time there will be further improvement, but for now the deficit is lowered by privatization income, which will not be permanent. The financing by external credit helps financial stability, but ultimately is not sustainable. Hence, a first clear message: far more must be done with the budget to secure a very comfortable position of equilibrium without extraordinary revenues or special financing. That point is widely understood and may happen.

Competitiveness is a serious issue. Over the past year, on a fixed exchange rate but with inflation of 20%, competitiveness has been eroded. Wholesale prices in dollars are very high relative to levels of the mid-1980s. Some real appreciation is warranted by the fact that Argentina is now a stabilizing or even almost stable country, but too much real appreciation threatens stability because it suggests that the convertibility plan might fail.

External debt remains an issue. The public debt amounts to $61 billion, including a sizable portion of arrears. The financing of debt service either requires foreign private capital flows or else a large trade surplus. Both are in question. The resource transfer problem therefore remains acute.[5]

All is well while growth proceeds at a fast pace. But does Argentina's political and economic miracle have the stamina to go through a few hard years? A look at the reforms will give a better basis to judge that question.

7.4 Fiscal Reform

Correcting the budget deficit is a critical step in establishing financial stability. Any deficit financed by money creation is bound to be inflationary. The fact that the economy is substantially demonetized translates even quite small deficits into extremely large inflation rates (see Rodriquez 1992).

Only a few years ago, Argentines would have thought that paying taxes was a serious mistake. There were no sanctions; the government was in disgrace. The public did not get "their money's worth." Public finance is on the way to major improvement. Efficiency in government is derived by layoffs, privatization, and accountability. The budget is being nudged toward balance. Macroeconomic performance as a result is better and certainly more stable, and the chances for growth are enhanced.

Part of the fiscal improvement can be attributed to privatization. In 1990–92 the government derived $4 billion in cash revenue and achieved debt reduction by conversion in the amount of $7,343 (Salomon Brothers 1992). Of course, the benefit of privatization is not measured exclusively by these numbers. There is typically an accompanying deficit reduction because the public sector is a major source of deficits. Moreover, privatization brings a chance of invest-

5. See United Nations, *CEPAL* (1992) on the historical pattern of these transfers.

Table 7.4 **Public Finance**

	1985	1986	1987	1988	1989	1990	1991[a]	1992[b]
Overall balance	−7.9	−4.1	−6.5	−7.0	−21.8	−3.3	−1.8	−0.4
Tax revenue	18.6	18.5	17.8	16.8	16.3	16.6	19.1	20.9
Nonfinancial Public Sector								
Primary balance	0.7	1.8	−0.9	−1.0	−0.4	2.2	2.4	2.2
Interest	5.9	4.3	4.7	5.4	15.6	4.5	3.7	2.2
Central Bank quasi-Fiscal								
Deficit	−2.8	−1.6	−0.9	−0.7	−5.9	−1.0	−0.6	
Central government								
Revenues	11.3	11.8	10.9	9.2	9.8	9.6	14.2	
Primary balance	3.2	3.2	2.2	0.8	1.5	2.6	3.7	

[a]Preliminary.
[b]International Monetary Fund program.

ment by a party that faces less financial constraint than the government. This ought to translate into a reduction of bottlenecks, improved technology, and ultimately a better supply response.

Beyond privatization, reform of the social security system is a key priority of reform. The number of recipients exceeds the number of sixty-year-olds; the ratio of recipients to the supporting labor force is extravagant. Reforms are now passing the Congress and are likely to improve both the budget and the real income of qualified recipients. In the process Argentina will move to a more realistic retirement age—sixty-five years, instead of the present sixty.

Another critical area of fiscal reform involves revenue sharing and sharing of spending responsibilities between the federal and provincial governments. The early attempt at fiscal federalism invariably involves a major transfer of revenues of the provinces without an equivalent transfer of burdens. In the correction phase now under way the center recovers revenues and increasingly shifts responsibilities to the provinces.

7.5 Trade Opening

In the 1930s Argentina became a highly protected economy. An extreme example of the impact of such protection is that the Ford Falcon, produced with 1960s U.S. secondhand machinery, kept being produced in Argentina right up to 1990. But that is not the only example. Throughout manufacturing costs were high, quality was poor, models were obsolete, and all this was maintained by a tight regime of protection. Tariffs and quotas were the rule. And when, as often happened, the exchange rate was overvalued, the impact on imports was not extreme because protection was so fierce.

Over the past two decades, but notably in the last few years, Argentina has moved sharply in the direction of trade liberalization. Quotas have been largely

Table 7.5 Average Tariff Rates (%)

1976	1980	1989	1991
55.9	27.8	23.8	9.4

Source: GATT (1992).

Table 7.6 Protective Duties by Category

	Mean	Standard Deviation	Minimum	Maximum
Total	12.2	7.3	5	35
Raw materials	6.5	3.1	5	22
Semimanufactures	10.3	5.8	5	22
Finished goods	14.1	7.7	5	35

Source: GATT (1992).

Table 7.7 Effective Tariff Rate, 1991

	Tariff Only	Tariff & Tariff-Type Measures
Mean	12.4	28.2
Standard deviation	4.1	8.1
Minimum	−1.7	0
Maximum	32.3	52.0

Source: GATT (1992).

Table 7.8 Balance of Payments

	1988	1989	1990	1991	1992[a]
Trade balance	3,813	5,379	8,274	3,879	−402
Exports	9,135	9,579	12,353	11,972	7,518
Imports	5,322	4,200	4,079	8,093	8,275
Current account	−1,572	−1,305	1,903	−2,500	

Source: Banco Central Republica Argentina; International Monetary Fund: International Financial Statistics.

[a]January to July, *not* annualized.

eliminated, and tariff rates have come down both in level and, perhaps even more important, in their dispersion.

Trade opening, the boom of 1991–92, and the overvaluation (discussed below) combined to worsen sharply the external balance. Argentina had a tradition of trade surpluses. In the past thirty years, with the exception of 1975, there was never a deficit. This time the deficit will be large—$1 billion or more. Moreover, the shift in the trade balance is nothing short of huge. Aware-

ness of this growing trade problem and the accompanying question of how this might be financed if foreign capital inflows taper off is the basis for the confidence crisis that is now emerging.

It might be thought that the trade deficit is benign in that it reflects a high component of capital goods imports—a reflection of modernization and no risk since ultimately the expanded capacity pays its own dividends. In fact, however, capital goods imports doubled since 1989. But consumer goods increased more than fourfold and intermediates also doubled. It is clear that protection held back imports and that now the liberalization, the boom, and the exchange rate all combine to yield a 1979-Chile-style blowup of the external balance.

7.6 Overvaluation

A simple model helps formulate the problem of currency appreciation.[6] Let P, W, and E be the log level of prices, wages, and the exchange rate. Lowercase letters stand for their rates of change with π, the rate of inflation. The unemployment rate (or the GDP gap) is represented by y.

$$\pi = (1 - \alpha)(w - \pi) + \alpha(e - \pi) \tag{1}$$

$$w = \pi - \sigma y \tag{2}$$

$$y = \theta(i^* + e + \Delta - \pi) - \lambda(E - P) + f \tag{3}$$

$$CA = \mu(E - P) + \nu(i^* + \Delta + e - \pi) + \rho f \tag{4}$$

i^* and i are foreign and home interest rates and Δ denotes the political risk premium. Fiscal restraint is denoted by f, and the current account surplus is denoted by CA.

Equation (1) represents a standard accelerationist pricing equation: inflation has inertia.[7] Deceleration is possible only if wage inflation or the rate currency depreciation can be brought down below the prevailing rate of inflation. Equation (2) describes wage inflation. The rate of increase of wages, because of explicit or implicit indexation, is equal to the rate of inflation but with an adjustment for cyclical conditions. In the third equation the unemployment rate is determined by real interest rates and by the level of competitiveness.

Figure 7.3 shows the phase diagram of this model, using equation (3) and the combination of (1) and (2):

$$\pi = \gamma(e - \pi) + (1 - \alpha)\lambda(E - P) - (1 - \alpha)\theta(i^* + \Delta); \quad \gamma = [\alpha - (1 - \alpha)\theta]. \tag{5}$$

6. See also Dornbusch (1979); Rodriguez (1982); Dornbusch and de Pablo (1990); Edwards (1989).

7. On the disinflation problem see Calvo (1983); Chadha, Masson, and Meredith (1992); Dornbusch and Fischer (1992); Edwards and Montiel (1989); Végh (1992).

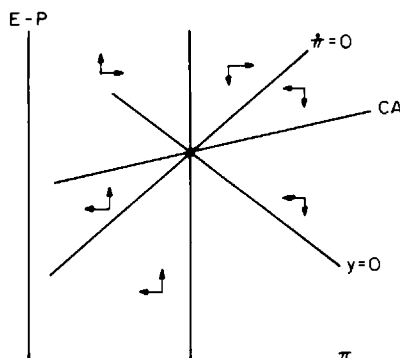

Fig. 7.3 Phase diagram of the currency model

The diagram is drawn for a given rate of depreciation e_0, and it is assumed that the term γ is positive.

Consider now a program of disinflation. Starting in a steady state at point A, the government reduces the rate of depreciation to zero and sustains the now fixed exchange rate. The new long-run equilibrium is at point B, where inflation has come down to zero.

The immediate impact of the rate fixing is to cut nominal interest rates and hence the real interest rate so that demand increases (see fig. 7.4). Higher demand and the elimination next lead to real appreciation. The instant rise in the level of demand, output, and employment gradually wears off. Ultimately the loss in competitiveness returns the economy to normal levels of output and then creates a recession. The economy will return to full equilibrium, with reduced inflation, only after deflation has restored the initial level of competitiveness. Protracted unemployment is the rule. Moreover, in the early phases of the adjustment program, the current account turns toward deficit.

The model is oversimplified in a number of respects. First, there are no large movements in the adjustment of demand and the current account to changes in the real exchange rate. In addition, the adjustment to real exchange rate changes assumes an immediate dominance of substitution effects, contrary to the Diaz-Alejandro hypothesis. Second, the monetary mechanism operates entirely through interest rates, and there is no special role for credit or confidence. Third, wealth effects and asset process play no role. But even though these aspects of the adjustment process are absent, the highly stylized model captures the patterns of the adjustment process. It highlights in particular that, on the way to full disinflation, high unemployment and large deficits constitute major confidence blocks to the continuation of the program. And if confidence does break down, so does the financing of external imbalances. Interest rates will soar, output will fall faster, and ultimately the program will be abandoned.

Argentina today is in a situation of currency overvaluation. Table 7.9 shows the extreme increase of the Argentine CPI measured in U.S. dollars. The ques-

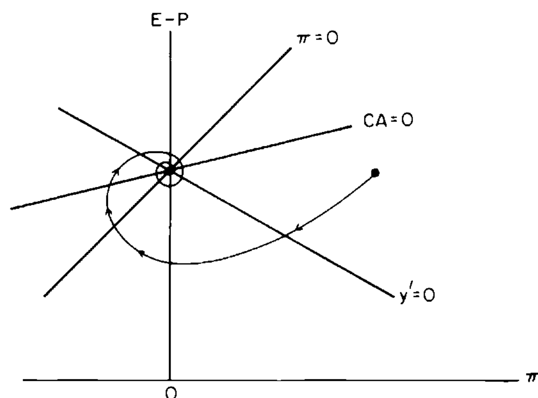

Fig. 7.4 The impact of rate fixing

Table 7.9 Argentina: Relative Prices and Real Wages (1986 = 100)

	Goods	Services[a]	Real Wage[b]
1987	96.2	119.7	91.7
1988	99.7	103.1	90.9
1989	107.5	91.9	82.9
1990	94.9	129.7	78.7
1991	85.0	158.8	74.7
1992[c]	81.0	173.8	75.4

Source: Banco Central Republica Argentina.
[a]Private.
[b]Manufacturing.
[c]July.

tion is whether high *domestic* prices will now start affecting wages and from there the competitiveness of the international sector.

Interestingly, the strong inflation impetus is entirely concentrated in the service sector (see fig. 7.5). The boom of 1991–92—28.9% growth in industrial production between midyear 1990 and 1992—in an economy that had not invested in capacity for many years must be the chief reason. What remains puzzling, however, is the combination of (measured) declining real wages with an expanding economy. The ability to repatriate assets from abroad is an essential ingredient in sustaining that process.

But the idea that competitiveness has not suffered because inflation has occurred predominantly in services is not right. Measures of the effective real exchange rate have been prepared by the Banco Central Republica Argentina (BCRA) and are shown in table 7.10. These data show a drastic loss in competitiveness over the past few years. Moreover, detailed data reveal that there are no significant differences across sectors. Thus it is no surprise that the trade balance should have shifted so massively toward deficit.

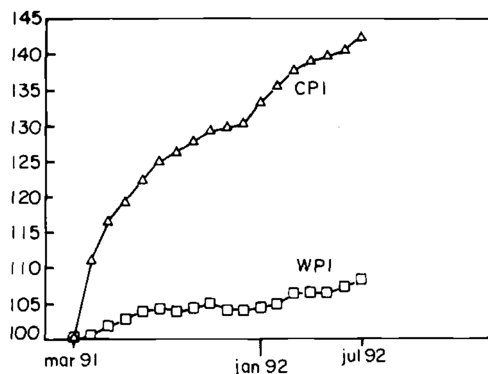

Fig. 7.5 Argentine CPI and WPI

Table 7.10 Real Effective Exchange Rates (1986 = 100, trade weighted)

	Imports	Exports
1987	101.6	108.2
1988	101.4	104.9
1989	120.5	118.9
1990	74.8	85.3
1991	52.1	65.0
1992[a]	54.6	58.9

Source: Banco Central Republica Argentina.
[a]September.

What next? If high consumer prices make their way into wages and costs, the overvaluation is bound to spread to a sharp loss of competitiveness, a trade crisis, and a currency crisis. The beginning of that process is already visible. If so, another payments problem and with it expectations of devaluation and instability will emerge. For the time being, reflow of Argentine money and investment in Argentina's assets by the rest of the world easily finance the trade deficit. But, of course, hot money can also go the other way.

There are five ways of coping with the process under way. The first is to just let it run its course. Hang on to the convertibility law both in respect to the level of the peso and the money supply rule and fully play the gold standard. If a loss in confidence occurs, this will mean capital flight, a tightening of credit, and a recession—the rules of the game.

Second, the government could hasten a recession by a sharp tightening of fiscal policy. That would crush demand and hence service sector inflation. This strategy has the advantage of keeping interest rates low, thus avoiding a new wave of balance sheet problems. Under both these options the government would follow an uncharted, unprecedented path of maintaining the integrity of

exchange rate commitments. That would be new in a country where most years, around December, confidence in the currency vanishes, and the lack of confidence soon becomes self-fulfilling.

A third possibility is to abrogate the convertibility law (how can this be done expeditiously?), devalue, and declare that this is the very last time. Nobody would be fooled, and the loss of confidence not only in the exchange rate but in the entire promise of reform and modernization might be vehement and destructive.

A fourth possibility is to depart marginally from the convertibility law in that one maintains the monetary rule but moves to a crawling peg without initial devaluation. This strategy would do little to reduce the initial overvaluation, and there would also be no mechanism to stabilize inflation. If money is endogenous and the exchange rate is indexed to inflation, with a minimal lag, the rate of increase of inflation might be sluggish, but inflation itself could reach any level in time.

Of these four options, following the rules, reinforced by a sharp fiscal tightening, is the strategy most likely to avoid destabilizing inflation. In another country one would add an appeal for a social pact. In Argentina that might be asking for the impossible. The basic fact is that the popularity of the Menem-Cavallo strategy derived from the image and the supergrowth. The bad news is that the country now will go into far more disappointing performance as it gradually builds up stability, institutions, and supply capacity just as Chile and Mexico have done.

Another devaluation would break the confidence that has been built and risk an outbreak of another inflation wave. A sharp tightening of the budget and a slowdown of the premature boom in demand will maintain confidence and result in better performance in the long run.

A fifth and final option goes even further than mere adherence to the convertibility law. In this option the government elimintates *all* domestic money and proceeds to complete dollarization. The proposal does nothing to solve the problem of an accumulated lack of competitiveness, but it works forcefully on the credibility front.[8] The usual arguments about the loss of seigniorgage apply only in a mitigated fashion, since the country is de facto dollarized. The only issue is whether to proceed from 95% to 100% dollarization.

7.7 Concluding Remarks

Today Argentina needs to save and invest, not to spend and spend. Politically that message is unpopular. But Argentina is like Germany or Austria in 1920 or in 1947—destroyed economically and in need of reconstruction; saving and productivity growth are essential, running down assets to finance a consumption boom is dead wrong.

8. See Dornbusch, Sturzenegger, and Wolf (1990) for such a proposal.

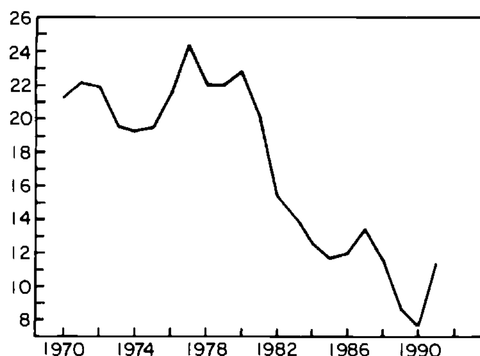

Fig. 7.6 Investment/GDP ratio (%)

Argentines have become far too optimistic in regard to the ease of modernizing and recovering their lost position. The benchmark is not to return to 1980 but rather to put the country in place to compete with Asia. For over a decade investment performance has been minimal (see fig. 7.6). In an economy where net investment has been negative, real wages cannot plausibly be the same as they were ten years ago. If Argentina succeeds, and it may well because the disillusionment accompanying the last inflation was extreme, it will take a decade or more to stabilize and put in place a firm basis for sustained growth. Chile, which has made the turn to sustained high growth, took fifteen years to get there. Mexico, which has not made it yet, has been at work for nearly a decade. Argentina is just starting, and already impatience is shining through. One hundred years ago, Argentina was stabilized and set off into a period of striking growth. The agenda today is the same, but the task is harder because agricultural endowments count for less and in industry Italian talent and flair just are no longer enough.

Argentina now has come around to the view that inflation is deadly and that an inefficient state represents a weight that will ultimately crush prosperity. On the inflation front the country is wrestling with adjustments and mechanisms to put in place lasting stability. On the modernization front the country is grappling with cleaning out the state and establishing efficient arrangements between the federal government and the provinces. Argentina clearly has come around to the view that technocrats do better than populists. It has at the helm an immensely competent, pragmatic technocrat. Continuity and perseverance can put the country back in the race. As these efforts bear fruit, the need will emerge to open a discussion on a new role of the state in areas such as education and social welfare, which is now all but dismissed.

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