

This PDF is a selection from an out-of-print volume from the National Bureau of Economic Research

Volume Title: The Macroeconomics of Populism in Latin America

Volume Author/Editor: Rudiger Dornbusch and Sebastian Edwards, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-15843-8

Volume URL: <http://www.nber.org/books/dorn91-1>

Conference Date: May 18-19, 1990

Publication Date: January 1991

Chapter Title: Description of a Populist Experience: Argentina, 1973-1976

Chapter Author: Federico A. Sturzenegger

Chapter URL: <http://www.nber.org/chapters/c8298>

Chapter pages in book: (p. 77 - 120)

4 Description of a Populist Experience: Argentina, 1973–1976

Federico A. Sturzenegger

4.1 Introduction

In a recent paper, Dornbusch and Edwards (1989) established a stylized outline of the macroeconomics of populism. They showed that the experiences of Chile under Allende and Peru under Alán García are very similar and consistent with features they consider characteristic of populist governments and policies. The purpose of my contribution is to reconsider that description to see if it also applies to the Argentine experience between 1973 and 1976 and to evaluate and understand both the possible motivations for such policies and their long-run implications.

During those years Argentina underwent an important economic policy experiment. At the same time the country was in the midst of strong political violence and social conflict. Violence had began around 1968 and had originated as the consequence of guerrilla activities. Among the guerrilla groups, the most prominent were the Montoneros, which initially worked from within the Peronist party, and the ERP (Ejército Revolucionario del Pueblo).¹ In the

Federico A. Sturzenegger is at the Department of Economics, Massachusetts Institute of Technology.

The author wants to especially thank Rudiger Dornbusch for encouragement and support. The author is also indebted to German Coloma for efficient research assistantship and to José De Gregorio, Guido Di Tella, Afonso Pastore, and Adolfo Sturzenegger for useful comments. The author claims responsibility for any remaining errors.

1. The sociology of the guerrilla movement is extremely complex. Montoneros belonged initially to intellectual groups educated in a violent nationalistic tradition. Afterward it combined a wide spectrum of ideological lines among which right-and left-wing nationalism, Marxism, Trotskyism, certain versions of Peronism, and the ideology embedded in the theory of dependency and liberation theology were all components. Montoneros had a strategy of selective attacks, murders, and kidnappings. It was predominantly an urban movement. The ERP, founded in 1971, had initially a Trotskyist and later a Guevarist orientation. They tried to carry on an open war against the government for which they made themselves strong in the north of the country. They were both an urban and rural movement (see, e.g., Floria and García Belsunce 1988; David Rock 1987).

early seventies, political violence escalated as extreme right-wing groups resorted to explicit violence as well. Among these, the most well known was the Triple A (AAA or Alianza Anticomunista Argentina), which was also later proved to have been commanded by chief Peronist party members. As violence gained the streets, the citizenry began to perceive the struggle not only as an ideological war but also as an internal struggle for power among the leaders of the ruling party. This, among other things, undermined the confidence in the democratic system and helped substantially in generating a consensus for the military coup of 1976.

Four different Presidents—Héctor Cámpora, Raúl Lastiri, Juan Domingo Perón, and Isabel Perón—held office between 1973 and 1976. The first, who came from the most left-wing groups of the party, had the support of guerrilla organizations and left-wing intellectuals. The second, Raúl Lastiri, belonged to the right-wing factions of the Peronist party. Perón supported a more ambiguous middle-of-the-road position, trying to maintain good relations with all the groups that constituted his movement. His strong personality and historical authority allowed him to control internal struggles or at least to keep them in a silent and hidden second place. Finally, Isabel Perón favored the right-wing factions, but her weak personality generated, while president, an open explosion of internal struggles of which she quickly lost control.

Surprisingly, especially considering the diversity of personalities that held the presidency between 1973 and 1976, the initial economic policy was maintained unchanged through all of them. Only during the government of Isabel Perón did the situation deteriorate to the point that corrections could not be avoided. The initial stability of the economic policies was due to the strong backstage influence of Perón, who imposed on Cámpora a minister of finance of his own choosing. During this period, José Ber Gelbard held office without interruption throughout the presidencies of Cámpora, Lastiri, Perón, and Isabel Perón.

But before reviewing the political events of the period and studying in more detail the implementation and evolution of economic policies, it is useful to briefly describe the main facts regarding populist policies and experiences as summarized in Dornbusch and Edwards (1989).

According to Dornbusch and Edwards (1989), the populist program arises as a reaction to a period of slow growth or recession, which has usually occurred under the patronage of the International Monetary Fund (IMF) and/or conservative governments at home.

The populist paradigm explicitly rejects conservative thought by dismissing the idea of resource constraints. Unemployed labor and idle capital capacity is seen as proof of lack of demand and the need of expansionary policies. Existing reserves provide room for a loosening of foreign restrictions, overvaluation of the exchange rate, and therefore for an increase in real wages. Demand expansion is not considered to be inflationary. Increasing returns to scale, declining average costs, and profit squeezing provide room for expan-

sion with price stability. Higher real wages feed back by expanding demand and therefore generating efficiency gains, which allow reductions in prices, increased competitiveness, and efficiency. This improves the balance of payments, increases investment and output, which in turn initiates another round of the virtuous cycle.

Dornbusch and Edwards consider, then, that the policy prescription of populist programs is very simple: "reactivation with redistribution," which is to be achieved by wage increases, price controls, increased spending, overvaluation of the exchange rate, and the restructuring of production to generate higher savings and higher growth.

The macroeconomics of populism can be separated into two main topics. The first relates to the properties of the real equilibrium of the economy. In this respect it is assumed that the economy can do much better. The rhetoric has old-fashioned Keynesian tones and calls for strong expansion of government spending. Loose monetary policy is advocated on credit-rationing arguments. Even though these arguments may be outdated, the theoretical issue of multiple real equilibria remains an important one in the macro literature. Search models (Diamond 1982) and increasing-returns-to-scale models (Murphy, Vishny, and Shleifer 1989) support a similar view. The old price-rigidity arguments can be replaced by those of multiple equilibria, coordination failure, or thin and thick externalities, to give a neoclassical theoretical support to the possible long-run success of expansionary policies. It is necessary to note, nevertheless, that populist regimes were all but neoclassical. As will be shown below in the analysis of the Three Year Plan of the Peronist party it was accepted and believed that market forces should be strongly modified and reoriented in order to achieve improved social outcomes.

The second topic is that of macroeconomic adjustment. Here populist policies call for strongly heterodox programs: price and exchange controls with a freezing of wages and of public tariffs. Inflation is not viewed as a monetary phenomenon but as a consequence of income struggle. As noted previously, demand expansion is not considered inflationary, so that the basic strategy should concentrate on arranging an agreement between main economic interest groups so that income struggle stops. Theoretical work on this topic has been less developed.²

As will be seen below, the Argentine experience shows that heterodox stabilization policies, while by themselves insufficient to reduce inflation in the long run, may be extremely useful initially in the transition to a lower inflation rate. On the other hand, no support is given to the idea of multiple equilibria. The attempt to expand output was unsuccessful in the end.

According to Dornbusch and Edwards (1989), populist programs evolve in four phases. First, an initially successful stabilization is accompanied by

2. See Dornbusch and Simonsen (1987) for a review, or Bruno et al. (1988) for a review of recent experiences.

strong output expansion. In the second phase, problems begin to emerge as a result of the overheating of the economy and increased pressure on bottleneck sectors. Lack of foreign exchange begins to be a complication for the Central Bank. The third phase presents an acute worsening of problems, explosion of inflation, crisis in the balance of payments, capital flight, and an increase in the budget deficit. The government then tries to stabilize and adjust the economy, devalues the currency, reduces subsidies, and increases public tariffs. Real wages begin to fall. The end comes with an orthodox stabilization program, with wages falling below the initial level due to capital flight, a higher real exchange rate, and a shift of political power against labor unions and lower income classes.

As a brief summary it can be said that, for the Argentine experience between 1973 and 1976, it is not true that initial conditions featured a recession previous to the implementation of the program. In the postwar period and until the early eighties, Argentina's historic growth rate was of about 4% a year (Brodersohn 1973). The military had been in power since 1966 with GNP increasing by 0.6% in 1966, 2.7% in 1967, 4.3% in 1968, 8.5% in 1969, and 5.4% in 1970. In 1971 and 1972 growth of total GNP was 4.6% and 3.1%, respectively. The first half of 1973 was strongly expansionary with a growth rate of 6.1% in the first quarter and of 6.3% in the second.

The initial phase, implemented through the *Acta de Concertación* (Concertation Act) by Minister of Finance Ber Gelbard was extremely successful in achieving even higher growth, complete price stabilization, progressive redistribution of income, and an increase in the reserves held by the Central Bank. After a year, the results of the program had been so spectacular that even those most strongly opposed to the government had to give credit to the economic policy being implemented. Among these, Roberto Alemann, a well-known conservative said:³

The economic policy implemented last May has in its favor the fact that it tries to stop inflation suddenly. In order to do that, it attacked simultaneously several factors: it froze and reduced prices, raised taxes, [and] fixed wages, markups, and other related measures. The immediate result was a halt in the increase of the cost of living. Annual inflation of 70% stopped, the stock market bounded upward, the black market exchange rate dropped, and tax collection increased. The country watches surprised [at] these results that nobody would have imagined before the twenty-fifth of May, maybe not even the authors of the policy. (*Clarín*, 12 August 1973)

After a year and a half problems began to emerge. The price freeze caught many producers with low real prices, and shortages appeared in different sectors. On the other hand, monetary and fiscal policies continued to be very permissive. The terms of trade began to move against the country, quickly worsening the external-sector situation. This eventually led to a shift in the

3. All of the following newspaper quotations were obtained from Di Tella (1977).

cabinet, which placed Gómez Morales, considered a more orthodox economist, as minister of finance. During his administration, problems went on accumulating, and even though some flexibility was introduced in the control of prices and wages, serious corrections of the economy's imbalances were avoided.

Following Dornbusch and Edwards (1989), the third phase arrives when problems become so intense that the government decides to make an adjustment of the economy. In June 1975, an acute crisis in the balance of payments precipitated that readjustment. It was carried on by the new minister of finance: Celestino Rodrigo, member of the right-wing faction of the Perónist party, which was now in control of the government. (Isabel Perón was already president and José López Rega, minister of social welfare and chief of AAA, had accumulated considerable power.) Real wages fell, inflation exploded, and a recession ensued. This led to a quick discreditation of the right-wing group, which was therefore neutralized from the government.

After the Rodrigo experiment, center-left members of the party temporarily gained some power, and even occupied the office of the presidency for a short period. Isabel Perón, claiming medical reasons, asked for a temporary leave. Italo Luder, head of the senate and member of the center-left coalition, was provisionally sworn in as president. Antonio Cafiero, who had the confidence of the unions and the moderate groups of the Peronist party, became minister of finance. He implemented a gradualist strategy for reducing rampant inflation and maintained expansionary demand policies to avoid increasing unemployment.

In January 1976, President Isabel Perón engineered a comeback, displacing the more moderate groups and imposing tougher adjustment measures. By then though, the end of the regime was in clear sight. Phase 4 in Dornbusch and Edwards's characterization finally took place after March 1976 with a military coup and the implementation of strict orthodox policies.

After this brief summary it is clear that Dornbusch and Edwards's description of the evolution of populist programs fits reasonably well the Argentine experience between 1973 and 1976. If any differences should be distinguished, it would be that the adjustment phase appears to have been extremely long, alternating back and forth between shock and gradualist policies. The end was characterized by social unrest, political violence carried to its height, a fall in real wages, an increase in inflation, and a discreditation of the political parties and the democratic system in general.

As Guido Di Tella (1983) has put it: "The military coup met no opposition, and with it ended the two and a half years of Argentina's second populist experience. It had indeed been an unhappy one" (p. 83).

4.2 The Political Environment

The Peronist party came to existence and consolidation with the advent of Teniente Coronel Juan Domingo Perón's rise to power in 1946. In 1943 Perón

had participated in a nationalist coup d'état, holding the office of Secretary of National Labor where he came to popularity and gained the love of Argentina's working class. Perón was elected president in 1946. His first six years in power were characterized by aggressive demand policies, industrial protection, import substitution, a hostile attitude toward foreign capital, progressive labor legislation, and a substantial increase in state intervention in the economy. After a constitutional reform, which enabled him to run for office for a second consecutive term, he was reelected by a landslide victory in 1952. That year the country experienced a balance of payment crisis, which forced a switch to an adjustment program that was sustained until the fall of Perón in 1955. Political totalitarianism, curtailment of the free press, open conflict with the church and with some sectors of the military created a wide coalition that eventually supported the coup of 1955, which ousted Perón and sent him to exile. From then until 1973 the Peronist party was forbidden to participate in any electoral contest.

The military called for elections in 1957, which led in 1958 to the election of President Frondizi, who, though not belonging to the Peronist party had the explicit support from exile of Perón. Frondizi implemented strong populist measures (basically granting substantial wage increases) during his first year of government, afterward switching to a different strategy (*El Desarrollismo*) which gave paramount importance to free enterprise, saving, and capital accumulation (see Mallon and Sourrouille 1975).

Another coup, in 1962, ousted Frondizi and new elections were called for in 1963. The election took a radical, Arturo Illia, to the office of the presidency. Illia won with 25% of the votes. Blank votes (which obviously corresponded to the proscribed Peronist party) totaled 19%. Three years later, in 1966, the military once again stepped in. The new president, General Onganía, declared then that "the system of pluralist democracy has been given its chance in Argentina and therefore something new should be tried now" (Ferns 1971).

This new military regime was completely discredited by 1972 and free elections were called. For the first time Peronism would not be banned, though Perón himself was. Elections were held 11 March 1973. Hector Cámpora, the Peronist presidential candidate, obtained 49.6% of all of votes. Cámpora had promised to give a kickoff to the Peronist program before resigning and calling for new elections in which Perón himself would be allowed to run for office. It is not surprising then that one of the campaign slogans was, "Cámpora to government, Perón to power."

Cámpora was sworn in as president 25 May 1973 and resigned 12 July 1973. The presidency was handed to Raúl Lastiri (head of the Chamber of Representatives). This designation was intended to prevent the head of the Senate, who was the legal successor but associated to the Cámpora ideology, from being sworn in.

New elections were to be held in September, and finally took place the

twenty-third of that month. Perón was a candidate, with his wife Isabel running as vice president. The election resulted in a landslide victory for Perón. He obtained 57.3% of all votes followed by 26.3% for the formula of the Unión Cívica Radical (UCR).

Perón was sworn in 12 October 1973 and held office until his death on 1 July 1974. He represented the traditional constituency and policies of the Peronist movement, which were strongly based on labor unions and gave priority to state intervention, import substitution, and the redistribution of income. He always supported a moderate position, avoiding the extremes (both left and right) which had slowly, after so many years of proscription, made their way into the party. This orientation was the one he had already imposed on both Cámpora and Lastiri.

Isabel Perón, on the other hand, favored the right-wing groups (under the strong influence of her minister of social welfare, José López Rega). The right-wing program had five main goals: (a) moving toward market-oriented policies; (b) curtailing union power; (c) eliminating subversion and guerrilla activity; (d) gaining the support of the military; and, finally, (e) eliminating left-wing intellectuals from the University (Di Tella 1983).

The administration of Isabel Perón was therefore characterized by deep and violent struggle between the different groups and members of the Peronist party. Ideological differences, which had remained silent while Juan Perón was alive, became open and explicit during Isabel Perón's presidency. At the same time, economic problems appeared with a strength never before seen in Argentina, which, added to the open political fight, doomed from the start the possibilities of the vice president. Nevertheless it was still almost two years before the conflicts became so intense that the fall of the government finally took place, on 24 March 1976. Describing the economic evolution during this period is the purpose of the following pages.

4.3 The Three Year Plan

The Three Year Plan (Poder Ejecutivo 1973) was an extensive document intended to summarize objectives, instruments, and policies of the administration that took office in 1973. It is considered to represent the main lines of thought regarding economic policy held by the government or the people in the Peronist party at that moment. It is worth remembering that in 1973 there was a universal trend toward more state intervention in the economy. This trend was not unique to Latin America even though it was particularly forceful there, and it is clearly reflected in the Three Year Plan.

Among the objectives considered in the plan was that of social justice, which was defined as a fair distribution of income with special concern for eliminating extreme levels of poverty and unemployment. The plan endorsed (1) strong reactivation of the economy by means of developing specific industrial activities; (2) national unity, that is, correcting the economic and cultural

differences between regions; (3) reorganization of the state, in order to fully realize its new activities as a guide for the economy as a whole, as a mechanism for income redistribution, and as a producer of goods and services; (4) economic independence, to be achieved by a strict control of capital flows, foreign investment, and international trade; and finally, (5) integration with Latin America.

The Three Year Plan considered that output growth would be led by basic industries (oil refineries, iron and steel) and state enterprises. Popular consumption would be the basis for massive production and therefore of an increase in efficiency. Prioritized among economic groups were state and local entrepreneurs (a reduction in the importance of foreign capital was also expected). Three basic conditions justified the feasibility of achieving higher growth rates. First, that the possibilities of growth had been jeopardized in the past by the action of special interest groups. Second, that political instability had also undermined the achievable levels of growth. And finally, that the present conditions in domestic and international markets were extremely favorable for the acceleration of the growth rate. The authors of the plan assumed that the strength of the new government would overcome the two first problems and that external and internal situations would continue to look good at least in the medium term. The quantitative goals were a 7.5% annual increase in GNP and a 12% annual increase of investment. Furthermore, it predicted a doubling of exports between 1973 and 1976.

Possible constraints were also taken into account. Among these the three considered most important were financial, energy, and external restrictions. These were to be overcome in the following way: the first through an increase in savings and tax collection, the second through a program of hydroelectric development, and the third through an aggressive program of export promotion. Nevertheless the main solution would be made through "an important effort in the organization and mobilization of resources which was going to be possible due to the political will to use them in favor of the popular majorities" (Poder Ejecutivo 1973).

The plan's backbone consisted of three instruments. The first was to obtain a compromise between the main economic interest groups and the state. The second was to pass a legislative package with laws oriented to changing the structure of the economy, and the third was to use direct economic policy measures. Among the latter, for example, a nationalization of deposits (i.e., a 100% of reserve requirement), an improvement in the quality of planning, and a tax reform. The plan previewed a strong increase in wage and price controls. Public enterprises would expand progressively, occupying those sectors in which the market had *already proven its failure* and redistributing income by charging higher rates to big consumers. A special law of industrial promotion would aim to develop small and medium-size firms.

For those measures concerning the external sector it is worthwhile to quote directly from the plan:

Regarding the external sector, the control of the state over commercial transactions will be increased and indirect mechanisms for obtaining equilibrium in the balance of payments will be avoided. Bilateral negotiations will be encouraged (especially with Latin America and Third World and Socialist countries). Traditional exports will be regulated by the Juntas Nacionales de Carnes y de Granos in order to maximize benefits for the country and to protect them from foreign interests. Industrial exports will receive fiscal incentives, easy credit and foreign exchange insurance. Imports will be planned regarding their level and characteristics meanwhile tariffs will protect national production, promote commerce and improve the allocation of resources.

In addition to the general policies the plan considered complementary instruments of economic regulation. I quote here again from the plan:

Such instruments would be principally the use of control enterprises [those in which the state is a producer in order to regulate a particular market] . . . production quotas for durables and semidurables [whose purpose is to achieve a quicker accommodation of supply to the changes in aggregate demand that will be produced as a consequence of income redistribution] . . . tariffs with a social and regional purpose [as an instrument of income redistribution] . . . subsidies in different categories [promotion of certain regions or sectors, modification of relative prices as compensation toward social necessary but inefficient firms] . . . import and export quotas [in order to rationalize the use of foreign exchange and to distribute the production of certain goods between internal demand and the international market].

The plan also contained a detailed description of all components of the national accounts, with predictions for all of them in the future.⁴ It also contained a wide variety of different statements. It explained, for example, the need and advantages of increasing the consumption of fish, as well as arguing why the unemployment rate should be reduced from 6% to 2.5%.

The state was conceived as the moving force of development:

The state is conceived as a mechanism oriented by the political power who, in interpreting the needs and objectives of national popular majorities, has to establish the basic rules and orientations of its own behavior. Several are the tasks which the state will have under the spirit of the Trienal Plan. First, it will have to regulate the economy; this will take place by means of an open agreement with the main political, labor and business organizations, and will not have any technocratic or elitist connotations but will derive from a clear understanding of the interests of the people. Second it will take

4. For example, exports were expected to increase by 92% between 1972 and 1977. Agricultural exports were supposed to grow by 81%, cattle sector exports by 50%, and industrial exports by 381%. The service account was to improve by 30% due to an increase in insurance and freight made by Argentine ships and airline tickets sales. It is difficult to assess where these predictions came from.

over the production of goods and services, not only those related to social needs and traditional economic infrastructure but also those important in the process of development and which are characterized by having a big multiplier effect over all the economy and by being oriented by the concepts of sovereignty, national reconstruction and territorial integration. Third and final, the state will work on the important function of income redistribution, which will take place through social spending, wage increases and tax and credit policies to be implemented.

In order to achieve all these goals, the plan proposed, in addition to the basic agreement, several other instruments. Among these was the State Compromise Act, in which the national and provincial governments would agree to make public administration more efficient. Also included were the National Institute of Public Administration, an institution with the objective of teaching people how to run the state more efficiently, and the creation of the Corporation of National Enterprises, which would coordinate the functioning of state-owned enterprises.

As can be seen from the previous exposition, the plan was mainly voluntaristic, with changes to be achieved by means of agreements between the parties to improve things. It is difficult to determine whether the predictions it contained were anything more than numbers made up in order to fit consistently in the national accounts framework and to justify some of the basic objectives of the authors of the program. It is also hard to assess the final influence of the program on government policies. The National Pact was a key factor in the stabilization program, but the Corporation of National Enterprises, for example, never achieved anything of importance.

The Three Year Plan was a medium- and long-run program that was basically concerned with structural reforms. Many of these died out in Congress, and many of those that passed were never implemented. The program was in line with a common trend at that time—not only in Latin America but in the whole world—of increased intervention of the state in the economy, but it also fell short of socializing completely the economy. It therefore gained many critics from both the left and the right, and it eventually was only supported by the moderate group surrounding Perón. Later on it could be read, “With Perón in the Pink House the probability that this development plan will be implemented is high. This signals the strength of the plan but also shows its dependency on a particular source of constant and solid political power, such as the one that can be provided by the President” (*La Opinión*, 26 December 1973).

4.4 Initial Conditions

By June 1973 external and internal conditions for the Argentine economy guaranteed an optimistic forecast for the evolution of the economy in the near

future. On the one hand, the economy was experiencing a period of high growth of GNP with growth rates in the two first quarters of 1973 of 6.1% and 6.3%.⁵ The agricultural sector, which had done badly in 1972 (it finished with a drop of 7.9%), was experiencing a strong recovery due to high international prices and good weather conditions. (Agricultural output growth was 12.2% in the first quarter and 21.8% in the second.) The sector finished the year with a growth rate of 13.5%, which was not only important in itself but had a considerable positive impact on the availability of foreign exchange for the economy. The industrial sector had experienced a growth rate of 6% during 1972, increasing to 7.4% and 6.6% for the first two quarters of 1973. Investment at 21.6% of GNP in 1972 was slightly above historic levels, rising to 22.6% and 22.4% of GNP in the first two quarters of 1973. As much as investment is an intertemporal decision, these figures indicate that the expectations on the future evolution of the economy were optimistic.

Unemployment was considered to be at its natural rate. In April 1973 it had been 6.1% in greater Buenos Aires. Inflation was the biggest problem and was extremely high if compared with that experienced in the postwar period. The Consumer Price Index (CPI) in 1972 showed an increase of 64.2%, which almost doubled that experienced in any previous year of Argentine history (except for the strong inflationary peak of 1958). The importance of this number can be appreciated by repeating what was said at the moment the 1972 inflation rate was made public:

The dramatic signification of the numbers reveals with absolute clarity that inflation is here a process apparently out of control. In the first place, it is by now proved that a reduction in the means of payment has been useless in the containment of inflation. That means that even though an increase in monetary circulation can be one of the factors which feed the inflationary process, this is a phenomenon which evolves through other channels. . . . Argentine inflation recognizes other causes. . . . They must be contained in the structural deficiencies of our economy. . . . The vicious circle of inflation threatens to become the image of frustration. (*Clarín*, 5 January 1973)

The Wholesale Price Index (WPI) had also had strong increases in the first three months of 1973. This was in part the consequence of the anticipation of the price freeze. If firms forecast a freeze but know that no restrictions will be applied to any possible rebates they may charge, then it is optimal for them to increase their price to the level expected to prevail at the end of the freeze while offering at the same time compensatory rebates. While nominal prices are fixed they can permanently adjust their real prices by changing the amount of the rebate. As firms were anticipating a freeze with the new government,

5. Growth rates considered in this paper arise from a comparison with the corresponding period of the previous year.

early in 1973 they tried to increase their relative price prior to its implementation. (See table 4.1 and fig. 4.1. Data provided in the statistical appendix of Di Tella 1983 was used.)

The fiscal deficit was high but not excessively so. Data from the Fundación Mediterránea shows a deficit of 3.7% of GNP in 1972. (Previous values had been 3.1% in 1971, 1.8% in 1970, and 0.9% in 1969.) It is true that the fiscal deficit was higher than that of the immediate previous years, but it was perfectly in line with the values observed in the 1950s and 1960s. Data from the Central Bank (which considers the central government's Treasury operations)

Table 4.1 Monthly Inflation Rates: The CPI and WPI

	CPI	WPI		CPI	WPI
1972:			1974:		
January	10.9	6.3	July	2.4	2.8
February	3.9	6.3	August	3.0	2.8
March	4.5	3.8	September	3.4	3.5
April	5.4	5.2	October	2.7	3.6
May	2.5	3.4	November	3.3	4.3
June	5.6	6.6	December	5.2	2.9
July	5.1	4.0	1975:		
August	1.0	2.3	January	2.9	5.7
September	2.6	4.7	February	4.6	12.5
October	3.8	3.2	March	8.1	5.6
November	4.0	1.8	April	9.7	3.5
December	1.6	3.3	May	3.9	5.2
1973:			June	21.3	42.5
January	10.3	4.9	July	34.9	32.2
February	7.9	6.9	August	23.8	15.3
March	2.9	6.5	September	10.9	13.1
April	5.0	.4	October	12.6	9.2
May	4.4	.6	November	8.1	9.7
June	-2.8	-1.4	December	11.5	9.5
July	.1	-.6	1976:		
August	1.9	1.2	January	14.8	19.5
September	.6	.4	February	19.3	28.6
October	.5	.1	March	38.0	54.1
November	.0	1.1	April	34.6	26.3
December	.9	1.3	May	13.1	4.8
1974:			June	28.0	4.7
January	-.6	.4	July	4.3	6.1
February	1.9	.4	August	6.7	8.0
March	1.5	.4	September	10.7	8.8
April	3.4	2.5	October	7.4	4.4
May	4.3	4.2	November	7.1	6.9
June	3.9	3.7	December	6.7	6.4

Source: Instituto Nacional de Estadísticas y Censos (INDEC).

Note: CPI = Consumer Price Index, seasonal; WPI = Wholesale Price Index.

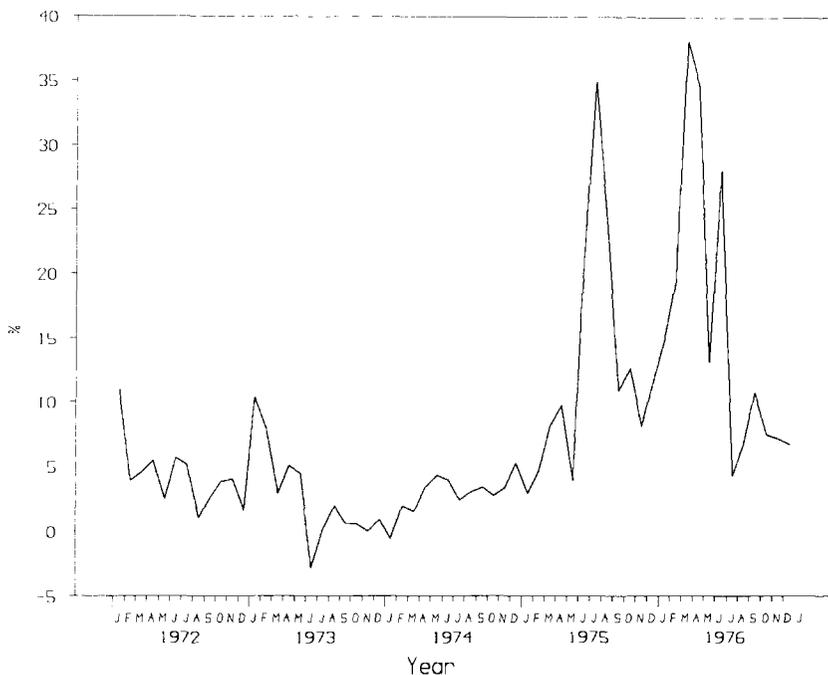


Fig. 4.1 Monthly CPI increases, 1972–76

shows in the first quarter of 1973 a positive but not very large increase in the deficit (see table 4.2). Money creation was not only positive but was increasingly so. In 1972, M1 had increased by 44%.

In conclusion, on the internal side the economy was experiencing a period of overheating induced by expansionary demand policies. At the moment the same impression was supported as one could read, "There are indications that the first quarter of 1973, which is half way through, keeps and even surpasses the evolution which the economy exhibited at the end of 1972. . . . In summary it is possible to forecast for this first quarter of 1973 a rising level of economic activity. This could vary substantially in the second quarter but not enough to avoid making 1973 the tenth consecutive year of continued growth" (*La Nación*, 18 February 1973).

On the external front, multiple exchange rates were in place. There was an exchange rate for traditional exports, one for promoted exports, another for imports, and one for financial transactions. All of these had been strongly overvalued during the year, previous to May 1973. There was also a free parallel market. In May, trading in the parallel market was being done with a 32% premium over the financial rate. (Part of this increase had been built up in the weeks before the change in government.)

Export prices increased substantially in the period immediately before the

Table 4.2 Public-Sector Deficit

Year and Quarter	BCRA	Fundación Mediterránea
1972	2.43	3.70
I	2.10	
II	1.65	
III	2.56	
IV	3.12	
1973	5.43	7.60
I	3.86	
II	5.01	
III	5.58	
IV	6.93	
1974	6.54	8.10
I	5.43	
II	5.34	
III	6.35	
IV	8.24	
1975	11.71	16.10
I	7.12	
II	6.92	
III	9.75	
IV	16.38	
1976	8.01	13.60
I	12.94	
II	7.02	
III	7.79	
IV	7.18	

Note: BCRA (Banco Central de la República Argentina): Central government's treasury operations (as % of GNP); Fundación Mediterránea: Change in total public-sector indebtedness (as % of GNP).

beginning of the populist experience. This was the main cause in a substantial improvement of the terms of trade for Argentina. The export price index, which had a value of 100 in both 1970 and 1971, jumped to 121 in 1972 and 180 in 1973. The terms of trade, which had been around 100 in 1970 and 1971, jumped to 117 in 1972 and remained at that level until the third quarter of 1973. In 1974 they dropped to around 70 and stabilized there (see table 4.3). During the first half of 1973 the noninterest current account experienced a surplus of \$400 million. Foreign exchange reserves increased from \$300 million in the first quarter of 1972 to \$900 million in the second quarter of 1973.

In summary, the situation in the external front in May 1973 was excellent: high international prices for Argentine exports plus abundant international reserves in the Central Bank.

4.5 Initial Phase of the Stabilization Program

On 25 May 1973, after being sworn as President, Hector Cámpora appointed José Ber Gelbard as minister of finance. Gelbard was a businessman and director of one of the main business lobbying groups, the Confederación General Económica (CGE), which basically represented national capital. The extreme left-wing groups that surrounded President Cámpora accepted this designation because it had been an imposition of General Perón.

Gelbard first attacked the most compelling problem of the economy, the extreme rate of inflation. The stabilization package consisted, as stated in the Three Year Plan, of an agreement among interest groups which was formalized in the Acta de Compromiso Nacional (National Compromise Act). This was in line with the inter-class cooperation approach usually put forward by the Peronist party but basically corresponded to the view that the inflationary process was a consequence of an income struggle which the Act intended to

Table 4.3 Terms of Trade

Year and Quarter	Terms of Trade	Export Prices	Import Prices
1972	117.4	121.5	103.5
I	105.0	106.0	104.0
II	114.0	117.0	102.0
III	120.0	126.0	105.0
IV	129.0	138.0	107.0
1973	108.9	180.3	165.5
I	112.0	151.0	121.0
II	120.0	168.0	140.0
III	114.0	205.0	181.0
IV	89.0	197.0	220.0
1974	71.9	195.7	272.3
I	83.0	214.0	258.0
II	65.0	113.0	283.0
III	69.0	196.0	239.0
IV	71.0	188.0	265.0
1975	71.2	170.2	239.0
I	66.0	166.0	265.0
II	71.0	171.0	240.0
III	76.0	175.0	230.0
IV	72.0	168.0	235.0
1976	69.3	179.0	256.0
I	72.0	179.0	248.0
II	73.0	187.0	260.0
III	69.0	177.0	264.0
IV	64.0	164.0	257.0

Source: Fundación de investigaciones económicas latinoamericanas (FIEL).

Note: 1970 = 100.

stop. The explicit target was an inflation rate of zero, an objective too ambitious and which was afterwards to be sustained for too long.

Public tariffs were adjusted and prices of all goods were frozen until 1 June 1975.⁶ The freeze involved the reduction in nominal terms of some prices. Medicine, clothes, and shoes prices, for example, were decreased by 15%. The price of meat was reduced 13.5% compared to that prior to the freeze. Regarding this measure it could be read on 3 June 1973 (*La Nación*), that “the most spectacular measure was the fixing of a maximum price for meat. This was a measure previously imposed by other governments and always generating wide resistance. Everything indicates in this case that there is a generalized will of cooperation among producers . . . In fact, these maximum prices generated a fall of approximately 15% in the price of cattle and even of 27% in some other minor categories.”

Wages were raised by a fixed amount of \$200. This had the double effect of increasing the real wage and of flattening the wage pyramid. Family subsidies were augmented by 40% and the minimum wage was raised to \$1,000. After this, wages were to remain fixed until 1 June 1975, with an adjustment for productivity 1 June 1974. (This two-year freeze was a policy copied from Perón’s 1952 stabilization program.) The increase in real wages had the double purpose of improving income distribution and of raising consumption demand, therefore reactivating the economy.

The exchange rates were fixed at the levels recorded 25 May, and nominal interest rates were reduced. Easy credit was issued, especially to finance the increase in wages. A 13% yearly nominal interest rate was set for these credits, in what was at most a suspicious policy that was to become almost a continuous practice in the subsequent years.⁷ This expansion in money supply was of no concern to the authorities, which regarded inflation not as a monetary phenomenon but as related to structural characteristics of the economy such as income distribution and income struggle, which eventually generated a wage/price spiral. Concerning monetary policy it was stated that “the instrument of the fight against inflation in this popular government is not and cannot be exclusively monetary, said a top aide of the economic team. . . . We begin by accepting that the inflationary process in Argentina is related to a regressive income distribution, and it is that regressivity that we are committed to eliminate, and for that we will use stability as an instrument and not as an end in itself” (*La Opinión*, 15 August 1973).

Several important laws were also sent to and approved by Congress. Among these were a law regulating agricultural exports, the “Buy Argentine Act” (which forced public firms to have Argentine suppliers), and a foreign investment law, to restrict the remission of profits and the nationalization of

6. Petrol prices increased by 70%, natural gas by 30%, etc.

7. Recall that the CPI inflation rate had been 5% in April alone. It is true, nevertheless, that inflationary expectations are forward looking and, ex ante, the expected real interest rate may have been positive.

bank deposits. A tax reform, which included a moratorium on formerly undeclared taxes, introduced profit, capital, wealth, and value-added taxes. The National Corporation of State Enterprises was created. The state was given power to fix maximum prices. Professional work was regulated through the *Ley de Asociaciones Profesionales*.

These reforms did not bear directly on the stabilization program but were part of the government's policy that was not only oriented to stabilize the economy but designed to change it in a permanent and distinguishable way. Regarding income distribution, the final objective was an equal distribution between labor and capital.

The announcement of this stabilization program and the structural reforms just mentioned made clear that the government was implementing middle-of-the-road policies, which corresponded to the traditional thought of General Perón.

The program further alienated the extreme left, which considered it a sell-out to interest groups and consequently increased its level of violence. The businessmen, on the other hand, felt relief as they were expecting a much more radical program. The conflict among left-wing intellectuals appears clearly reflected in the following comment by M. Diamand, a strong supporter of the government:

The economic measures contained in the social pact . . . constitute an important step toward the peaceful revolution announced by President Cárpora. It is probable that many may be disappointed: a smaller than expected wage increase, followed by a rise in public sector tariffs and taxes and also accompanied by a suspension in wage negotiations which brings unpleasant memories. Nevertheless the price freeze, the structure of tax reforms, the allocation of public investment to social ends and an expansive monetary policy give to this package a completely different content, making it a powerful agent of income redistribution and increase in the level of activity. (*La Opinión*, 12 June 1973)

The results of the program were impressive. The inflation rate was negative in June, with a decrease of 2.85% in the CPI and of 1.4% in the WPI. Inflation remained extremely low afterward for almost a year. During the first 12 months of the plan, inflation was just 0.6% per month, and during the 17 months in which José Ber Gelbard was Minister of Finance it averaged only 1.4% per month (see table 4.1 and fig. 4.1).

Real wages increased, especially in July when they rose by 20.5% (see fig. 4.2 and table 4.4). Unemployment decreased from 6.1% in April of 1973 to 5.5% in July and 4.5% in October (De Pablo 1980a) (see fig. 4.3 and table 4.5).⁸

8. This trend continued in 1974 with unemployment rates of 4.2%, 3.4%, and 2.5% in April, July, and October, respectively. De Pablo (1980a) considers that half the unemployment reduction was due to an increase in public employees.

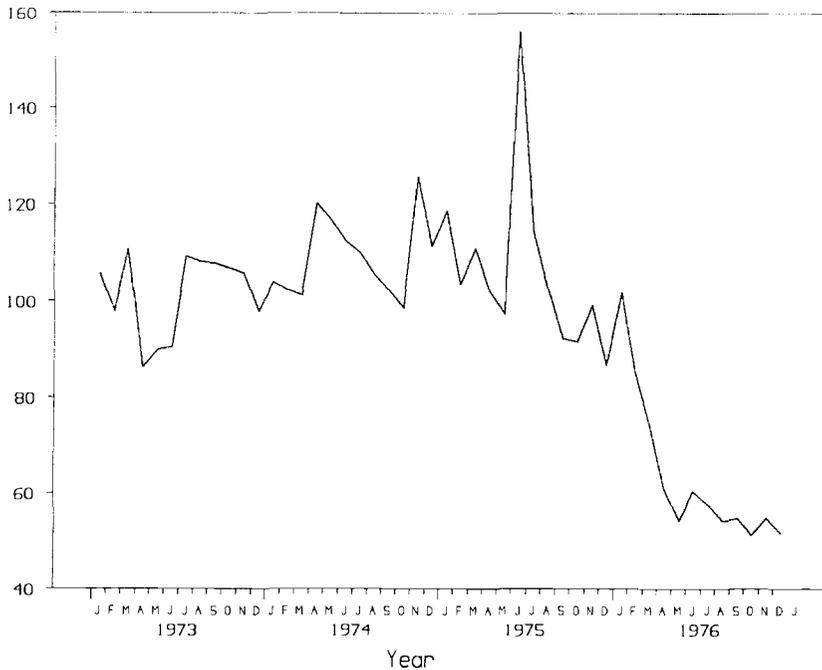


Fig. 4.2 Real wages, 1973 = 100

Output growth remained high: 5.8% in 1973 and 6.5% in 1974. The agricultural sector experienced the strongest increase, with a growth rate in 1973 of 13.5%, which fell but nevertheless remained high during 1974, at 6.2%. The industrial sector showed a more stable pattern, with growth rates of 6.4% in 1973 and 6.1% in 1974 (see table 4.6). Consumption also began to boom. As De Pablo (1980a) points out, it increased 7% in the last half of 1973, 7.3% in the last quarter of 1973 and 11% in the first three months of 1974. Most strikingly, the percentage of income accruing to wage earners increased by 4.2% of GNP in 1973 and stabilized at this new level in 1974. The wage increase implemented by the government had successfully achieved both an increase in consumption and a progressive redistribution of income. Already in September 1973, one could read: "Now almost at the end of the third quarter, the industrial sector shows consistent indications of a strong recovery. . . . The majority of firms considers, now, that the notorious deceleration of prices produced by the stabilization program will keep the change in inflationary expectations generating such a shift in increased productive behavior" (*La Opinión*, 13 September 1973).

Nominal money continued to expand. During 1973 the increase in the monetary aggregates doubled that of 1972. Nominal interest rates decreased and real interest rates became negative. Disinflation was at the same time quickly

Table 4.4 Real Wage* Index

Year and Month	Wages	Year and Month	Wages
1973	100.0	1975	105.6
January	105.7	January	118.6
February	97.8	February	103.4
March	110.7	March	111.0
April	86.3	April	101.7
May	89.9	May	97.2
June	90.6	June	155.9
July	109.2	July	114.3
August	108.0	August	102.1
September	107.7	September	92.2
October	106.7	October	91.6
November	105.7	November	99.1
December	97.8	December	86.6
1974	109.2	1976	63.3
January	103.8	January	101.8
February	102.1	February	85.3
March	101.1	March	74.1
April	120.2	April	60.9
May	116.6	May	54.0
June	112.3	June	60.3
July	110.0	July	57.6
August	105.4	August	54.0
September	102.1	September	54.7
October	98.5	October	51.1
November	125.5	November	54.7
December	111.3	December	51.4

Source: International Bank for Reconstruction and Development (IBRD).

*Unskilled married worker, 1973 = 100.

monetizing the economy. And M1 as a percentage of GNP was 9.2% during the first half of 1973, rising to 12.2% in the last quarter and to 14.4% in the first quarter of 1974. This represented for the government a revenue of 5.2% of GNP as seignorage in just nine months (see table 4.7). In those nine months, M2 increased by 9.5% of GNP.

The external sector was also improving substantially. Reserves began to increase, from \$700 million in the first quarter of 1973, to \$1,400 in the fourth and to its peak of \$2,000 in the second quarter of 1974 (see fig. 4.4, and table 4.8 below). The free market exchange rate appreciated and fell to par. The noninterest current account experienced a surplus of \$700 million in 1973, a sizable improvement compared to a deficit of \$218 million in 1972. Exports increased 68% to \$3,266 million. Imports being rationed increased by just 17%.

The economic team supported the idea that exports, and especially traditional exports, were not strongly responsive to prices. Therefore, a devalua-



Fig. 4.3 Unemployment, April–October, 1972–76

Table 4.5 Unemployment Rate*

Period	Percentage
1972:	
April	7.4
October	5.8
1973:	
April	6.1
October	4.5
1974:	
April	4.2
October	2.5
1975:	
April	2.3
October	2.7
1976:	
April	4.8
October	4.2

Source: INDEC.

*Greater Buenos Aires.

Table 4.6 Growth Rates of Output* (%)

Year and Quarter	GNP	Agriculture	Industry	Construction	Investment
1972	3.1	-7.9	6.0	4.9	5.2
I	4.7	-4.3	8.9	12.9	-.4
II	1.3	-13.2	7.6	8.0	-3.0
III	1.5	-3.7	5.2	1.6	-2.3
IV	3.3	4.0	2.9	-2.4	37.3
1973	5.8	13.5	6.4	-5.1	-1.3
I	6.1	12.2	7.4	-3.5	.7
II	6.3	21.8	6.6	-12.7	.5
III	4.1	12.1	4.6	-10.2	-14.8
IV	6.6	7.3	7.0	6.8	9.8
1974	6.5	6.2	6.1	12.2	3.9
I	4.3	8.8	3.2	6.9	-4.6
II	7.5	8.6	7.3	11.0	2.8
III	7.3	6.9	6.5	15.3	7.5
IV	6.8	-.6	7.0	15.8	9.5
1975	-1.3	-3.5	-2.8	-9.6	-7.2
I	3.3	-5.7	2.9	8.2	4.3
II	1.4	-5.9	1.4	-6.7	-2.2
III	-3.2	-3.6	-5.6	-11.3	-8.1
IV	-6.3	2.8	-8.9	-26.3	-20.2
1976	-2.9	3.5	-4.5	-14.1	-6.2
I	-4.4	7.9	-6.7	-26.7	-16.9
II	-5.2	-.1	-6.3	-15.0	-12.6
III	-1.7	.8	-2.9	-10.7	.5
IV	-.2	5.9	-2.0	-.3	5.4

Source: Banco Central de la República Argentina (BCRA).

*Growth from same quarter of previous year.

Table 4.7 Liquidity Coefficients

Year and Quarter	M1/Y	Year and Quarter	M1/Y
1973	.1025	1975	.0902
I	.0933	I	.1416
II	.0910	II	.1119
III	.1078	III	.0791
IV	.1219	IV	.0875
1974	.1377	1976	.0621
I	.1440	I	.0793
II	.1339	II	.0551
III	.1416	III	.0666
IV	.1377	IV	.0674

Source: BCRA, (CEMYB).

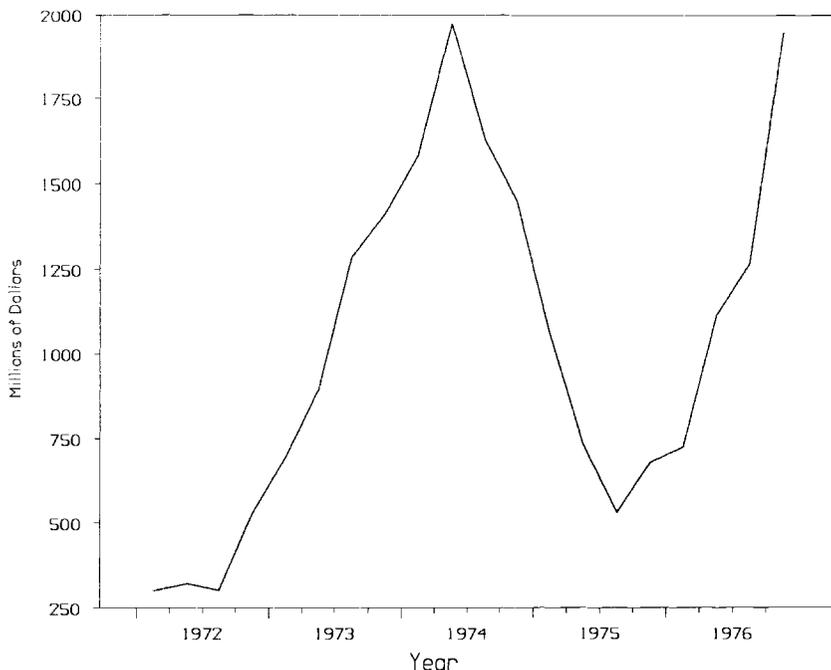


Fig. 4.4 Reserves in BCRA

tion of the currency was not considered a useful way of improving the trade balance.⁹

It is surprising that without a devaluation and in spite of strong growth in money supply and an expansion in domestic spending, both generated by an increase in the public-sector deficit and a strong increase in private consumption, the Central Bank was able to accumulate reserves for over a year. Several factors helped in achieving such a success. Among them the most important was the strong increase in the terms of trade during both 1972 and 1973. In the fourth quarter of 1973 the terms of trade began falling, but imports remained strictly controlled. This positive external shock gave open room for a loosening of the foreign restriction (see table 4.3 above).

4.6 Problems Begin to Appear

By the end of 1973 the stabilization effort was haunted by different circumstances: "The rigorous anti-inflationary policy of the government faces at the

9. The idea that traditional exports were unresponsive to prices was complemented with ideas about the contractionary effects of the devaluation that worked through the induced fall in real wages. Early work on this field had been done by Diaz Alejandro (1966) and Krugman and Taylor (1978).

beginning of 1974 three main threats. The first comes from the rest of the world and is expressed in the dramatic increase in prices of all the imported inputs needed by the country. The second enemy of stabilization policy is the wage increases pursued by some unions. . . . The stabilization faces a third problem, which is the lack of confidence by wide sectors about the sustainability of stability" (*La Opinión*, 25 January 1974).

Indeed, by December 1973 the program had been so successful that internal inflation was below international levels and pressure for revaluation of the currency began to arise. This pressure was generated by firms with fixed prices that were facing an ever higher price for their imported inputs. Two basic positions in the government were set forward, one supporting price flexibility and the other defending a revaluation of the currency. After approving an increase in the prices for those firms it considered were suffering from this problem, the government reversed its decision and revalued the currency for imports. This generated substantial losses (quasi-fiscal deficit) to the Central Bank, as it was paying exporters a higher exchange rate than the one it was charging to importers.

During the first quarter of 1974, inflation remained low and was about 3% during the whole quarter for the CPI and about 1.2% for the WPI. Finally the government gave in to union pressures and decided to adjust wages before the scheduled date in June 1974. As can be seen in figure 4.2, wages had slowly deteriorated since June 1973. A new National Compromise Act was signed 27 March 1974. It included an increase in wages of 13% from the first of April (but only if that increment was not less than \$240, in which case it would equal \$240). The minimum wage was raised by 30%. Easy credit at subsidized rates was issued to pay for these increases, and, in addition, nominal interests rates were reduced by 4 percentage points.

Tariffs were adjusted once again with the general index increasing by 53.4%, but with considerable dispersion between enterprises. At the beginning of April some 121 firms were allowed to change their prices from those they had had the previous year. (Special attention was given to the cases of negative profits.)

The decision to modify the adjustment scheme would prove a major cause in the subsequent collapse of the program. The agents realized that rules were really not that strict and that eventually the government was willing to give in. Unions intensified their pressures, firms became more aggressive, and confidence in the program immediately disappeared. The government gave up in this way one of its most valuable assets, which was its commitment to its own rules. Monetary and fiscal policies were also incompatible with complete nominal price rigidity. The combination of these with a fall in confidence and therefore demonetization made the situation explosive in the short run.

During the second quarter of 1974 signs of problems began to appear more clearly. Among these, illegal price increases and black markets began to proliferate. This had already been recognized by Ber Gelbard. When signing the

new National Compromise Act, he said, "The CGT [Confederación General del Trabajo] has announced its decision of constituting sectorial commissions in order to control the adherence to the price and supply policy and therefore contribute to avoiding speculation and abuse, but this should not end with the work of the CGT. Each and every one of the Argentines must be an agent that should look after that policy, because the State, by itself or with its institutions, can't take care of the pockets of 25 million fools that don't do [this]" (*La Nación*, 28 March 1974.)

Other sources were also taking stock of the problem. M. Diamand had argued before the signing of the new act that:

From the result of the negotiations underway between the CGE [Confederación General Económica] and the CGT over price and wage policies [hangs] the solution to the most difficult obstacle to the economic policy of the government, I refer to the shortages seen in the industrial sector, which every day are more serious.

Every day we can hear of dozens of stories. Shortages of paper bags doesn't allow the provision of lime, sugar, etc. A TV factory stops due to lack of paint, . . .

The complete freeze was very successful in the achievement of very difficult objectives. . . . Nevertheless, industrial firms in many cases could not compensate even variable costs. . . . In the present situation it is necessary to change from an income policy based on absolute stability to a policy based on price and wage flexibility. (*La Opinión*, 15 March 1974)

Gelbard later had to defend his own policy in this particular respect. In a conference given at the CGT on 22 May, he said: "We do not fool anybody in this or any other respect: there are shortages, there is a certain black market and a certain amount of speculation. But we hurry to say that, as we get notice of those responsible for these distortions we will fall on them with all the strength of law. . . . We think that these saboteurs of the process are the agents of counterrevolution" (*La Opinión*, 27 May 1974).

By 12 June, after knowing that the inflation of May was above 4% (both for CPI and WPI), the president himself decided to defend the economic policy of the government. In a message to the country, President Perón said, "Only months after the acceptance of that key agreement for the country [an allusion to the new National Compromise Act], it seems that some of those that signed it are decided in not obeying the agreement and want to make everybody believe the same way. . . . Those of us who have been for years in this job, know perfectly that about 80% or 90% of the things being said are invented by the professionals of the psychological action" (De Pablo 1980, pp. 87–88).

But Perón himself was not making things easy. Five days later he announced the payment of a whole extra salary at the end of June.¹⁰ Of course

10. Argentine labor legislation provides for the payment of an extra monthly wage each year, paid half at the end of June and half at the end of December.

this was to come from money creation, directly used by the government to pay the extra wages, or through easy credit to the private sector.

On the first of July a most dramatic event left the country shocked and stunned. At 1:15 P.M., President Juan Domingo Perón suddenly died. His wife, Maria Estela Martinez de Perón, was sworn in as president. With this, political expectations moved further against the government. The situation that Isabel Perón received was just about to become unmanageable.

The external sector was deteriorating very quickly. Terms of trade had fallen from 120 in the second quarter of 1973 to 65 in the second of 1974. The official exchange rates had become increasingly overvalued and furthermore, fiscal and monetary policies had continued to be strongly expansionary. Between July and October 1974, the Central Bank lost almost 25% of its reserves, and the noninterest current account surplus, which had been \$704 million dollars in 1973, dropped to \$127 million in 1974. But this number hides the real deterioration that the external sector was experiencing. Indeed, the economy had a surplus of \$395 million in the first half of 1974 and a deficit of \$268 million in the second.

Real interest rates, which had been about -10% in the first half dropped to around -20% in the second half of 1974, owing to the increase in the inflation rate.

It was by now clear that the price freeze would be removed any moment: "The reorientation of the process, to make it once again compatible with the social agreement, looks toward the implementation of a more flexible scheme. . . . The most difficult problem is that of eliminating the machinery of black markets and reduce to the legal level those prices which increased above [those limits]" (*La Opinión*, 22 June 1974). "Laws of this nature [the law on supply to markets], saturated with fines and terrific corporal punishments, is another negative result of an economic policy which has proven its failure" (*La Prensa*, 26 June 1974).

This became an open conflict within the government after Gómez Morales (president of the Central Bank) publicly declared that the whole price policy was in crisis. The president was already also suggesting that something had to be done; on 18 September, she declared: "Only a very significant change in the conditions that made Gral. Perón implement this economic policy would eventually suggest the need to implement changes in the road pursued" (*La Opinión*, 18 September 1974).

One month later it seemed that those significant changes in the conditions had arrived. On 21 October, as the situation worsened, the president reached a compromise with other sectors of the party and appointed Alfredo Gómez Morales, a respected traditional economist from Perón's first government, minister of finance.¹¹ The economic team of José Ber Gelbard had slowly

11. Gómez Morales had been president of the Central Bank since the presidency of Cámpora. Differences with Ber Gelbard resulted in his resignation shortly before Ber Gelbard left the office of minister of finance (De Pablo 1980b).

wasted away. "The difficulties of the economic team in the present reality must have taken it to this epilogue, in which it decides to retire. It must not [have] been prepared to assume the responsibility of the necessary fundamental rectifying measures" (Antonio Troccoli in *La Opinión*, 22 October 1974). "The economic program had arrived, under Minister Gelbard, at a situation of being completely worn out. Inflation was threatening to come back. . . . The previous team promoted the increase in public employees, reduced firms' profits and left the state 'to be'" (Mariano Grondona in *La Opinión*, 25 October 1974).

Gómez Morales was expected to bring more flexibility to the economic system and to make some adjustment in the increasingly disordered fiscal situation. For the president this postponed a full implementation of the right-wing program until later.

Gómez Morales once again gathered the main interest groups to agree on a new act. Signed 1 November 1974, it introduced a wage increase of 15% and an increase in equal amount of family subsidies. The minimum wage was raised to \$1,600. Regarding price policy, Gómez Morales did not disappoint anybody and incorporated a new set of rules into the act that allowed firms experiencing increases in cost to raise prices. As Gómez Morales himself explained later, "The policy that we followed to stop inflation in 1973 was a 'shock' policy, prices and wages were frozen, but it was not adopted with enough flexibility. That shouldn't have lasted more than six months; afterward, facing imported inflation, we should have flexibilized the price market. As we didn't, a black market appeared for certain articles. . . . What should be done first is to flexibilize the price system to eliminate the black market" (as quoted in *La Opinión*, 12 November 1974).

These changes were received by the business community with relief. "The increases that the Executive Power has just authorized are a first positive and realistic step toward the organization of a market better prepared for productive activities" (*Clarín*, 11 November 1974). "The third stage begins with the return of the president of the Central Bank [Gómez Morales], now as minister of finance. In this final stage of the year—little more than 60 days—an increased realism seems to be the main characteristic, and old and forgotten worries reappear such as the fiscal deficit, the every-day-bigger black market, [and] the rise in the exchange rate, which the now relatively contractive money supply seems to have stopped momentarily" (*La Nación*, 29 December 1974).

In spite of the positive impression that Gómez Morales made in more orthodox circles, he did little to stop the increase in money supply and to reduce the fiscal deficit (see table 4.2). On the contrary, the fiscal deficit seems to have risen in the last quarter of 1974 and first of 1975. Money growth was strongly positive at the end of 1974. At the beginning of 1975 it declined substantially but remained high. Once again he declared, "The basic outline for the economic policy in 1975 will be to give more importance to savings

and not to excessive consumption, and to fiscal discipline to drastically reduce the fiscal deficit" (quoted in *La Opinión*, 15 January 1975).

By 1 February 1975, prices of public enterprises were adjusted (the price of petrol was increased by 45%, electricity by 26%, railroad fares by 50%, etc.).

In February the CPI and WPI showed increases of 4.6% and 12.5%, respectively. As inflation accelerated real wages continued to decline, falling below the previous lower peak achieved before the November act. On 1 March 1975 a new adjustment had to be made. This time it was part of the so-called Great National Parity. Among the arrangements it contained was an increase in wages of \$400 for all categories, further flattening the wage pyramid. A wage structure with wages at \$100, \$150, \$200, and \$300 by May 1973 was to be transformed at this moment, March 1975, to the following values: \$100, \$100, \$125 and \$168; that is, a wage difference of 200% was being reduced to one of just 68% (Arnaudo 1979). The minimum wage was increased to \$2,000, an increase that "could not be shifted to prices."

Figure 4.2 shows the evolution of the real wage during this period. The real wage increased substantially after the signing of each agreement, meanwhile, in between agreements, it experienced a steady decline. What is perhaps most interesting are the dynamics implicit in the figure. The adjustments are made more and more frequently as the program evolves, with the initial adjustment being larger and larger. As inflation accelerates the decline in real wages also accelerates, generating the need to shorten the length of contracts and raise initial wages in order to compensate for the increased erosion. This was reflected in increased pressure on the government by labor unions to adjust the wages agreed on previously more often and by bigger amounts.¹²

At the end of February the black market exchange rate was trading with a 100% premium over the financial rate. Therefore, on 1 March, the economic team decided to devalue all the exchanges rates. The effective exchange rate devaluation (i.e., that obtained after eliminating trade policy changes) varied substantially across products. For export goods (and particularly for traditional export goods) the devaluation was almost completely compensated, with effective exchange rates moving between 0.6% and 1.4%. For imports the devaluation ranged from 11.5% to 51.3%. The tourist rate was devalued by 36.6% (De Pablo 1980a). The devaluation tried to stop a rage of speculative imports that were being carried out in anticipation of the devaluation. Gómez Morales, in a public communication, stated: "In contrast to what has been done in the past, this exchange reform doesn't include any preventive devaluation, nor has fiscal purposes, i.e., [it] has not been done to improve

12. This situation is analogous to that of nominal price setting, which has been extensively studied in macro literature. The price setter fixes a price and changes it only after the real price drops below a certain threshold value. If inflation increases, the price setter adjusts to a higher real price and does so more frequently. These dynamics are the same as those shown in fig. 4.2 (Blanchard and Fischer 1989, chap. 8).

the resources of the government. . . . Its purpose has been just economic" (*La Opinión*, 4 March 1975).

This contrasted strongly with his own opinions some months before:¹³ "I reject even to consider modifying the exchange rate. A devaluation is useless, it is the last measure I will resort to" (Gómez Morales, press conference, 22 October 1974).

In April, Gómez Morales prepared an alternative emergency program, postulating the need for a contraction in demand basically through a reduction in the real wage. This, it was assumed, would worsen income distribution but would enhance the possibilities of achieving stabilization and increasing investment and efficiency. As he himself explained: "The fundamental problem is the lack of productivity of the society. . . . We have to stabilize an economy that has lost even a minimum of stability. It is not necessary to reach a stability of zero, but we cannot have the inflation that these first months are showing. . . . Without doubt, from May on, the freeze we have implemented will begin to show its effects" (statements made on the TV program "Tiempo Nuevo," 22 April 1975).

Even though monetary growth was almost cut in half in the first part of 1975, economic policy continued to be expansionary (M1 growth between October and March had been an average of 4.2% a month). The adjustment in public enterprise prices was being quickly eroded by inflation. Output growth slowed down substantially in the first two quarters of 1975 (quarterly GNP increased by 3.3% in the first quarter and 1.4% in the second). Nevertheless, unemployment continued to fall until April when it reached an all-time low of 2.3%. Private investment began to fall in the second quarter. Inflation accelerated, with the CPI increasing by 8.1% in March and 9.7% in April.

As inflation accelerated, real balances began to fall. As a percentage of GNP, M1 fell by 3% between the first and second quarters of 1975. The acceleration of the readjustments in the signing of the national acts was both a consequence and a cause of the increase in velocity. The fall in the terms of trade, the closing of the European market for Argentine beef exports, the overheating of the economy and the exchange rate, which continued to be overvalued, weakened substantially the external sector situation. Reserves were virtually disappearing, dropping between November and April from \$1,573 million to \$754 million. At this stage, a run on the Central Bank, as in Dornbusch (1987) or Flood and Garber (1984) was clearly under way.

The acceleration of inflation increased the fiscal deficit through the Olivera-Tanzi effect. The government therefore relied more heavily on money creation in order to finance its disequilibrium. Nevertheless, in the second quarter it was the private sector that accounted for the greatest share of money creation.

13. Of course it would be unwise for a Central Banker to anticipate the market on his planned devaluations. Nevertheless, Gómez Morales's statements reflected a standard position in the government at that time regarding the usefulness of a real devaluation in order to improve the external balance.

Too little had been done too late: the economy could not avoid a drastic readjustment. The public-sector deficit had already jumped from 3.7% of GNP in 1972 to 7.6% in 1973 and to 8.1% in 1974. During the first quarter of 1975 the situation appeared to stop worsening but the deficit remained incompatible with stability of nominal variables (see table 4.2).

4.7 The Readjustment

On 2 June 1975, Celestino Rodrigo, of the right-wing group of the party, was sworn in as minister of finance. He remained in office for 50 days, during which time a major readjustment took place in the economy. His economic measures would be thereafter remembered in popular memory as “El Rodrigazo.”

Rodrigo considered that the balance of payments crisis was the consequence of overvalued exchange rates and expansionary fiscal and monetary policies. On 4 June he implemented a 100% devaluation of the financial exchange rate, of 80% for the tourist rate and of 160% for the commercial rate. In order to reduce the fiscal deficit he increased the price of oil by 181%, of gas by 40%–60%, electricity by 40%–50%, transportation by 75%, and so on. Wage negotiations were to be suspended. The government nevertheless allowed an increase of 65% in the minimum wage but left all other wages to be decided in collective bargaining between workers and firms.¹⁴

On 9 June the president announced that increases above 38% in nominal wages would not be accepted; three days later she had to increase this upper bound to 45% and 17 days later to 80%. Isabel Perón was feeling strong pressure from the unions, which were at this stage in open confrontation with the government. Strikes were proliferating everywhere and the discussion among union leaders was not if they should oppose the government but how far to go. During the month, wage negotiations became almost chaotic. On 18 June the construction union signed one of the first arrangements with a nominal wages increase of 45%, two days later textile workers negotiated an increase of 100% in their wages. The increases finally settled between 203% for the workers of leather and 78% for the (public) employees of water, electricity, and gas. Inflation jumped from 3.9% in May to 21.3% in June and 34.9% in July for the CPI. The WPI raised from 5.2% to 42.5% and 32.2%.

In an attempt to stop the price/wage spiral the government froze the prices of 30 products. On 30 June, Rodrigo addressed the country, explaining the evolution of the economic program:

Also in prices we have advanced fundamentally a new policy that means the correction of real prices that the economy was paying, which were stimulating a black market more and more damaging to the interests of the coun-

14. It is worthwhile to remember that it was in June 1975 when the initial freeze was to end, and open negotiations between workers and firms were to take place.

try. We have defined a basket of basic food over which an efficient control will be imposed. . . . An important effort will be made to increase tax collection. . . . This wage policy is coherent with the economic plan implemented the first of June, and will allow [us] to avoid spectacular increases in the near future in the exchange rate and tariffs. . . . It will avoid unemployment and will make more possible the solution of the external sector problems. (*La Nación*, 1 July 1975)

The real exchange rate recovered, and the external sector showed strong improvement in the third quarter. Nevertheless this seemed much more related to the recession than to the real devaluation; in the third quarter the agricultural-sector production experienced a decline of 3.6%. International reserves continued to decline, reaching a low of \$529 million in the third quarter of 1975. At the values of the first half of 1975 this was not enough to pay for even two months of imports.

By the end of the month the president had lost a great part of her credibility and political support, and the right-wing faction had to step back as more moderate groups, especially those associated with the labor unions, were regaining positions. On 5 July, a long *solicitada* was published by union leaders in the main newspapers of Buenos Aires, which clearly shows the position of the labor sector regarding the economic policy. This *solicitada* contained the following six basic points:

1. Ratify the support of the organized labor movement to the president of the nation, Dona Maria Estela Martinez de Perón, and the unconditional defense of the *Doctrina Justicialista*, core of the National Movement.
2. Oblige firms to apply from the 1st of June the Law 14250 of Collective Bargaining, whose validity was accorded with the Minister of Labor, and therefore is of legal validity and of obligatory compliance.
3. Repudiate the discretionary use of power that is generating unprecedented confrontations in our Movement, between its chief and her workers, as well as [repudiate] the idea embedded in the measures that try to denationalize the economy, and worse than that, the national being; an economic policy that deteriorates the real wage and therefore is contradictory in facts with the *Justicialista* principles of a progressive redistribution of income in favor of the people and the liberation of the country.
4. Call for a general strike for 48 hours, from midnight of Monday, 7 July 1975, until midnight of Wednesday, 9 July, as support of what is explained in this resolution.
5. Give to the Directive Commission of the CGT the task of organizing this measure in essential public services.
6. Declare the Confederated Central Comity of the CGT in permanent session from today on.

It is difficult to determine the exact evolution of the real wage during the period because official statistics incorporate from 1 June retroactive increases

that were obtained months later. Comparison is especially difficult because those increases differed substantially across sectors. The wage increases obtained in the June negotiation generated an important increase in the real wage for that month. Nevertheless the inflationary explosion eroded that increase very quickly (see table 4.4 and fig. 4.2). The fall in real wages induced by the adjustment is clearly perceived by looking at the figures for the following months. In September real wages fell to their lowest level since the beginning of the stabilization program.

As a consequence of the adjustment in the public sector, the strong devaluation, and the explosion of inflation, a strong recession ensued. In the third quarter total output was to fall at an annual rate of 3.2%. For the industrial sector the decline was even larger: 5.6%. Investment also began to decrease as firms were expecting hard times ahead. The third quarter showed an annualized decrease of 8.1% in total investment and of 11% in construction. In October the unemployment rate showed its first increase in almost two years.

The acceleration of inflation further deteriorated the fiscal deficit through the Tanzi-Olivera effect. The deficit increased in the third quarter by almost 3 percentage points. Money creation almost tripled in the third quarter, and monetization continued to drop significantly, falling by more than 3% of GNP between the second and third quarters.

A new devaluation (of about 8% for the commercial rate, 18% for the financial rate) was passed 16 July. On 20 July, Rodrigo's resignation was accepted.

4.8 The End

At this stage the government was strongly discredited and divided in its own ranks. The climate of political violence had intensified, and the military were quietly waiting for the reputation of the president to decline to the level at which they could safely stage a coup to regain power.

But the government of Isabel Perón still had eight months to go until on 24 March 1976, she was finally arrested and removed from power. Still, three ministers of finance were given the responsibility of handling the delicate postadjustment situation and trying to make it last.

The first of these was José Bonnani, a former minister of finance from Perón's first presidency, who had implemented the adjustment program of 1952. José Bonnani had an original idea: instead of gathering the main interest groups to sign a new agreement, as had been common practice with the first two ministers, he gave them the responsibility of formulating an economic program and raising it to the government for consideration. In a declaration on 22 July he said: "To those effects the ministry of which I'm in charge aims to convene all the sectors which represent the community as soon as possible, in order to design in agreement an Emergency Plan that the actual situation imperatively requires."

Several projects were presented to the government. Being the two most

important those completed by the CGT, representing labor unions, and the CGE representing businessmen.

The document of the CGT included, among others, the following recommendations: to reconstitute the state's productive capacity with an efficient plan, to support the policy of workers' participation in management, to freeze and control prices, to reestablish subsidies to basic foods, and to support wage indexation, the nationalization of foreign trade, the reactivation of industrial promotion, special credit lines for private firms, and the creation of a National Council of Economic Emergency.

The document of the CGE was clearly more moderate and included, among others, the following suggestions: authorize the price increases that firms had demanded, allow the increase in costs to be reflected in higher prices, normalize the wage problems derived from the chaotic negotiations of the Rodrigo period, increase in credits, and pursue indexation of the exchange rate for exports after an initial devaluation, reactivation of public investment, establishment of a fiscal moratorium, and the creation of an Emergency Economic and Social Council.

In the meantime, Bonnani put forward a package of measures, among which were an increase of wages of 160% retroactive to 1 June (which Rodrigo had not signed). An increase in tariffs of between 60% and 80% and a 20% increase in the exchange rates.

The general outline of the policy was clear: "The strategy of the Bonnani team is to try to give the most importance to the execution of measures of extreme urgency, . . . but [to] avoid [any] decision that may become an obstacle for the concertation. In this sense Dr. Bonnani behaves as an anti-Rodrigo. At the same time, several enquires are made to establish coincidence points. . . . It has been known that the objective of Dr. Bonnani is to write a document that may function as a draft for a National Economic Program in a multisectoral meeting to be called soon" (*La Opinión*, 27 July 1975).

But the urgency in the execution, or the quickness in the convocation to the different sectors, may have been induced by the weak political support of the minister. No other measures were taken due to lack of time. Shortly after the publication of the "suggestions" and exactly 20 days after taking office, on 11 August, José Bonnani's resignation was accepted.

The next round went to Antonio Cafiero, a respected Peronist leader who had the confidence of the unions. Cafiero faced two serious problems: extremely high inflation, generated as a consequence of the drastic realignment in prices of previous months (inflation in July had been 34.9% for the CPI and 32.2% for the WPI), and a substantial increase in the rate of unemployment due to the recession.¹⁵ The unemployment problem was considered a serious

15. De Pablo (1980a) quotes a survey in which the unemployment rate in greater Buenos Aires was about 6% in August. A consistent methodology produced twice a year by INDEC, shows an unemployment rate of 2.3% in April of 1975 and of 2.75% in October of the same year.

one by the government and was as such understood by the private sector: "FIEL [Fundación de investigaciones económicas latinoamericanas], in a study on the Argentine economy in September 1975, that will be in print soon, emphasizes a fall in sales, production, employment, and predicts that it is not correct to expect that the government will remain insensible to the situation in this respect (basically the wage problem) or that it will assume responsibility of making the burden of price stabilization fall on the working class. To expect wage increases in the near future is basically correct" (*La Nación*, 5 October 1975).

In his first message, on 25 August, Cafiero gave the unemployment problem paramount importance. Regarding inflation, a gradualist strategy was to be implemented. But monetary growth was not restrained; M1 increased at a monthly rate of 15.3% while Cafiero was Minister.

In a public speech on 4 November, Cafiero said:

The Argentines must remember that in August of this year we were confronted with the following situation: threat of massive unemployment in all sectors, a process of galloping inflation under way accompanied by acute illiquidity, and a virtual default on our external payments due to lack of foreign exchange.

Of the three problems not one has been resolved completely. . . . Regarding unemployment . . . firms and even the public administration will be obliged to keep reducing, by direct or indirect procedures, the number of their employees. . . .

In the first ten months of this year prices rose by 261%. . . . This proves that "inflationary pressures" still exist, but we have promised to reduce [them] gradually and we are indeed doing so.

Even days later one could still read:

What are the basic things that Dr. Cafiero considers priorities? To begin a process of growth, he points out that it is necessary to reverse recessive tendencies, stop unemployment and generate expectations of recovery in the external sector. . . .

The head of the Ministry of Finance leaves aside two issues: stopping inflation and achieving a redistribution of income.

What makes Cafiero different from other ministers, especially from those who preceded him, is not the instruments he chooses to stop the crisis, but the "timing." Dr. Cafiero uses a "gradualist" approach. (Daniel Muchnick in *La Opinión*, 28 November 1975)

Regarding the exchange rate, Cafiero implemented a crawling peg in order to avoid an erosion of the real depreciation achieved by Rodrigo. An agreement was signed with the IMF and the World Bank in an important shift of strategy regarding multilateral organizations. International reserves began to recover, bouncing up to \$680 million in the last quarter of 1975, and further to \$725 million in the first of 1976.

It was decided that wages were to be adjusted every three months after an

initial realignment on 1 November, which granted an increase of \$1,500 for all categories and increased the minimum wage to \$4,800. Family subsidies and retirement wages were also increased. Of course real wages were eroded significantly in the following months.

Tariffs were adjusted on 1 November (with an average increase of 25%) and were afterward to be indexed in an effort to protect fiscal revenues from inflationary erosion. Nevertheless the public-sector deficit deteriorated further in the fourth quarter. Data from the Central Bank puts the deficit at 16% of GNP for this period. Data from the *Fundación Mediterránea* puts it at 16.1% of GNP for the whole year, though it may well have been substantially higher for the last quarter (see table 4.2). The deficit was somewhat reduced in the first quarter of 1976 but at 12.9% of GNP remained too high to be compatible with a minimum of stability. Money growth continued unabated. During the whole year M1 had increased by almost 200%. Monetization remained at the low levels of the Rodrigo period.

Prices remained controlled. For basic wage goods, a maximum price was fixed. Twenty-four other important goods were also frozen, and prices of leading firms were supervised and could only be changed with the approval of the secretary of commerce. Inflation decelerated somewhat until November, but remained stubbornly above 10%. After that it began showing a clear positive trend. The CPI increased 8.1% in November, 11.5% in December, 14.8% in January, and 19.3% in February (see table 4.1).

In January the exchange rate market was further liberalized. All tourist transactions were shifted to a free market, and several goods were transferred from one exchange to another. These measures, in addition to the devaluations implemented through the crawling peg (between August and February they accumulated 71% for the financial rate), enhanced the trade balance, which went into surplus in the first half of 1976 (see Dornbusch 1986). This improvement was also a consequence of the strong recession the economy was undergoing. As a result, a deficit of \$425 million in the second half of 1975 gave way to a surplus of \$290 million during the first part of 1976 (table 4.8).

During the year, the GNP showed a strong contraction, which became extremely acute in the last quarter. The GNP fell by 1.3% during 1975. Output growth had been 3.3%, 1.4%, -3.2%, and -6.3% for the four quarters of the year. Construction dropped by 11.3% and 26% in the third and fourth quarters, respectively, while investment dropped by 8.1% and 20.2%. Unemployment also continued to worsen: from a 2.7% rate in October it jumped to 4.8% in April of 1976.

Overall, 1975 finished with a strong reversal in the income redistribution trend. Participation of wage earners in GNP fell by almost 2% (see table 4.9).

By January, criticism of the economic policy began to surface again: "In the absence of substantial changes in the political orientation, nothing makes it conceivable to assume that the bad economic situation of the beginning of the

Table 4.8 Balance of Trade and International Reserves

Trade Balance (By Six-Month Period)		International Reserves (By Quarter)	
1972:		1972:	
I	- 126.1	I	300.3
II	- 91.9	II	321.5
		III	300.7
		IV	529.0
1973:		1973:	
I	393.0	I	694.8
II	317.0	II	892.7
		III	1285.1
		IV	1412.4
1974:		1974:	
I	395.0	I	1582.9
II	- 268.0	II	1972.3
		III	1629.6
		IV	1446.4
1975:		1975:	
I	- 874.0	I	1057.6
II	- 426.0	II	732.7
		III	529.5
		IV	678.0
1976:		1976:	
I	289.0	I	725.7
II	361.0	II	1114.2
		III	1266.2
		IV	1943.9

Note: Both series are in millions of dollars.

Sources: BCRA and INDEC.

Table 4.9 Percentage of Income Accruing to Wage Earners

Year	Percentage
1950	49.7
1965	40.6
1966	43.8
1967	45.5
1968	44.9
1969	44.6
1970	45.8
1971	46.6
1972	42.7
1973	46.9
1974	46.7
1975	44.8

Source: Ministry of Finance.

year may change during 1976" (*La Nación*, 4 January 1976). And after Cafiero's resignation:

The administration of the tandem Cafiero–Di Tella, that initially generated positive expectations in some sectors, finished without any of the problems being resolved. Their action seemed marked by a complete lack of mobility that limited them to some financial arrangements abroad of little result, late adjustments regarding wages, a frustrated tax reform and finally in what most was done, successive and [ever-larger] adjustments in the exchange rate.

The image that he provided was, summarizing, that of someone who thought [he] knew how to "administer the crises" but finally just made it "survive." (*Clarín*, 8 February 1976)

In January, the president, who had been on leave for a month and a half while Italo Luder held the presidency, tried to regain some of her power: the right-wing program was to be given a last chance. Mondelli was named minister of finance on 3 February 1976.

The expectations of his administration are well described below:

It is accepted that the real wage cannot be defended but through an increase in the total product of the economy, which now is stagnant or declining. . . . A realistic readjustment of tariffs, or the cost of public services and the price of energy products [must be expected]. The public administration spending, especially those on employees will be strictly constrained. . . . It is believed that with the help of the IMF and complementary help, the situation in the external sector could be solved. (*La Nación*, 26 February 1976)

Or, as Mondelli himself put it some years later:

At the moment of my arrival there were very serious problems. . . . Let's give an example: Argentina, at that time, had a spectacular balance of payments crisis. . . . That balance of payments crisis had to be dealt [with] as one would handle such a crisis, not more, not less. . . . There was no other remedy than repeating, perhaps not to such a great extent, the measures that Minister Rodrigo had taken. It's very easy to say that such a medicine is sour, but there is no other choice if one has to take it in order not to die. (as quoted in De Pablo 1980b)

In the two remaining months real wages fell even though a nominal adjustment of 12%, which afterward became 20%, was granted. Tariffs were increased: on oil by 77%, on some derivatives by 300%, phone services 70%, transportation 150%, postal services 100%, and so on. The exchange rate market was partially unified in an official market, which unified the previous financial and special financial exchange rates with a devaluation for both of them of 82% and 28%, respectively. (Nevertheless, part of this devaluation was, once again, compensated.) Prices were to be strictly controlled, and

a new arrangement was signed with the IMF. In March the CPI increased by 38%.

The plan once again gained criticism from the labor unions: "To the judgment of the committee gathered in La Plata, the Mondelli Plan will only provoke a fall in the real wage, a fall in consumption, a fall in investment, an increase in unemployment, shortages, and the disappearance of the State as investor" (*La Opinión*, 12 March 1976).

But by this stage the government had no credibility and inflation was clearly accelerating. By mid-March the political events took over, as everybody was expecting from one moment to the other the fall of the president.

The coup finally took place on 24 March 1976. An even sadder period of Argentine history was about to begin.

4.9 Conclusions

As an experiment in economic policy, the Argentine experience between 1973 and 1976 has to be considered a failure. In the end all its initial objectives: stability, redistribution of income, growth, investment and increased standard of living were not only not achieved, but seemed even more distant in 1976 than they were in 1973.

During 1973 the heterodox approach to fighting inflation implemented by Gelbard was extremely successful; it shows that wage and price freezes can be a very useful (and perhaps unavoidable) mechanisms for achieving disinflation without recession. By coordinating expectations, a painful learning process can be avoided if the government is able to convince the public that a new equilibrium has been achieved. In the case of Argentina, the stabilization program was strongly supported by the increase in the terms of trade, which avoided exchange rate problems until well into 1974. The strong increase in money demand gave the government an extended span of time during which it could have tackled the fiscal deficit problem at the root of the inflationary process. Unfortunately, this did not happen; on the contrary, the fiscal deficit increased during 1973, setting the economy on an unstable path toward higher inflation.

If the basics of inflation are not controlled, the heterodox approach is doomed to failure from the start because the expansionary fiscal and monetary policies finally induce wage increases and price pressures that generate, sooner or later, either shortages with a corresponding monetary overhang or black markets and illegal wage rises. Eventually the economy has to be re-adjusted, prices are freed, and the economy reverts to an equilibrium compatible with fiscal and monetary policies.

The obvious question to ask is why, then, do governments follow such inconsistent policies? Given that failure seems to be guaranteed and that such failure entails big costs to the government (as this and other chapters of this

volume document),¹⁶ how can one rationalize, from the perspective of the policymaker, the implementation of these policies?

The first hypothesis that comes to mind is that policymakers are irrational or ignorant. Populist policymakers may not understand or know the basics of macroeconomic theory and therefore may engage in policies that prove to be unsustainable, a fact they would have realized *ex ante* had they known better. Even though this may seem plausible, it basically states that there is no explanation for the emergence of populist policies. The basic problem with this hypothesis is that it cannot explain either the pervasiveness of this phenomena in Latin America or the fact that no learning takes place even when similar experiences failed in the past. Furthermore, a government is a set of individuals who necessarily have *personal objective functions* that they try to maximize. Recognition of this fact implies the need for explanations not based on the irrationality hypothesis.

A more stylized version of the irrationality hypothesis is that policymakers are ideologues whose behavior is constrained by the bounds imposed by their beliefs. Even though ideological elements seem very important in the claims and announcements of government policies (see section 4.3 above on the Three Year Plan), an understanding of the origins and of the social role of an ideology is necessary if any learning is to be obtained from this explanation.

A third possibility is that stabilizations are aborted because of "bad luck." When the government decides to undertake a stabilization program it balances benefits and costs. Costs are an increasing function of the outcome of a certain random variable (e.g., the costs of sustaining a fixed exchange rate system may increase with decreases in the terms of trade). The government decides to begin a stabilization program because it expects benefits will be larger than costs. For a range of realizations of the random variable it may reverse its policy because the *ex post* costs exceed the benefits (Dornbusch 1988b). The problem with this approach is that it seems to work the other way around. The government never did a serious fiscal reform in the first year and a half when external and internal conditions were extremely favorable. On the other hand, it seemed more committed to assume the costs of adjustment with Rodrigo and afterward, that is, after a serious balance of payments crisis.

A fourth explanation is that governments have extremely high discount rates. If they think they may not be around when the stabilization program collapses, then policymakers may try to induce short-run gains even though they know the program is unsustainable in the long run. This interpretation is also not convincing because usually it is the same government that implements these policies and then suffers their consequences. This is not only true

16. In some cases the costs are so high that they cast doubt on the existence of an explanation based on rational behavior. In the case of Chile the populist experience led to the death of the president. After 1976 the leaders of the Argentine government eventually ended up in prison or abroad.

of the Peronist administration discussed in this paper, but of almost all the other experiences discussed in this volume.

A fifth possible explanation is the “interest groups” hypothesis. The government represents a subset of the population and therefore does not care about the implications of its policy for other groups. This hypothesis includes several possible interpretations. Corruption, for example, is the special case in which the subset of the population represented by the government is the government itself. More generally the policymakers may represent either a certain factor of production, a particular region, or specific industries. This thesis is appealing for the experience studied in this paper because all the national agreements signed by the Peronist government included only entrepreneurs and industrial workers and basically consisted of transfers from the government to these two groups. If the government cared only about them, then it may have been willing to incur the inflationary costs of its own policies as the necessary outcome of transferring real resources to those two groups. The problem with this hypothesis is that the policies implemented eventually harmed even these groups, an outcome documented in sections 4.6 and 4.7 above. Nevertheless, this explanation must contain much of the truth.

A sixth explanation relies on the nature of the political environment. In a politically unstable society, and particularly where the policymaker’s horizon is subject to unanticipated changes, it is very difficult for the voter to assign responsibilities. If there is a principal/agent problem in the relation between voters and policymakers we know, from the theory of optimal contracts, that this imperfect monitoring effect leads to a contract that relaxes the agent’s incentives to run an efficient administration as compared to a situation where it is easier to observe directly his actions. (For example, in Argentina it is usually believed that many policymakers or political parties would have never been reelected had they been allowed to complete their constitutional terms without being overthrown by the military.) This explanation has the implausible characteristic that, in reality the consequences of an economic policy are clearly observable, but has the advantage of explaining why almost every government, independent of its ideological position, has been unable to reduce the fiscal deficit in a sustainable way in recent Argentine history. The same argument works for many other Latin American countries, particularly those in which populism has been recurrent.

Another related explanation that also captures the fact that no government has been able to reduce the fiscal deficit in a sustainable way relies on the nature of the budgetary process in Argentina (this being true for many other Latin American countries as well). The fact that spending and taxing decisions are taken arbitrarily by the executive power (when Congress approves the budget it usually does so months after the beginning of the economic period) weakens the position of the government in its relations with different economic interest groups. Instead of deciding fiscal policy in a single process during which all interest groups have to confront each other, the government

has to bargain individually and separately with each one. This decision process generates a bias toward deficits and inflation because when a certain group deals with the government part of the costs of transferring resources to this group will be borne by the other sectors. This externality, which is internalized by everybody, induces a pattern of transfers far greater than the one that would result from a simultaneous bargaining process. If on top of the sequentiality of the spending process one adds the weak position of the government generated by the unstable political process, the bias toward deficits is strongly enhanced.

Finally, Alesina and Drazen (1990) suggest that stabilization may not take place or may not be fully implemented because conflict between interest groups may paralyze the government. Finally one group dominates and imposes the costs of stabilization on the other. This explanation looks particularly attractive in order to analyze the period after Rodrigo and to understand why a strong fiscal adjustment was only possible after the 1976 coup. It nevertheless leaves unanswered the question of why the government engaged itself in an unstable process when initially it commanded overwhelming support and power derived from the electoral outcomes of 1973.

The previous explanations are just partial solutions to the difficult question of understanding why the government engages in unsustainable policies. A complete theory of this phenomena is yet to be found.

The price freeze was a basic instrument in the stabilization program. What sometimes has been overlooked is that it generates optimal responses from price setters in the economy. If a price freeze is anticipated, there is an increase in the rate of inflation in the months before its implementation; firms prepare a price cushion, which they can optimally use by proper adjustment of rebates while the freeze lasts. This explains why, in the months before the change in government, there was a substantial increase in the price level. If the freeze is not anticipated or lasts more than initially expected, then either black markets develop in which commodities are sold above the official prices or, if the price freeze is strictly enforced, shortages and a monetary overhang will begin building up. In both cases an adjustment of official nominal prices takes place when the policy is finally abandoned. This may also have happened and might explain why the adjustment that Rodrigo implemented generated such a strong outburst of inflation. The Peronist government set itself too high standards. Trying to achieve a zero inflation rate, it attached itself for too long to a strict freeze that, soon after its implementation, was already generating strong distortions, shortages, and black markets.

The experience also shows what happens when the authorities consciously or unconsciously forget the need to sustain external balance. As soon as the exceptional price situation of 1973 began to reverse, the economy immediately fell into a deep balance of payments crisis. This made an adjustment unavoidable and generated a strong decline in the real wage, therefore leading to a reduction in the standard of living of the low- and middle-income classes.

In the introduction I remarked that the possibility of expansion was basically justified with old-fashioned Keynesian ideas. I also showed that the idea of increasing returns to scale, multiple equilibria, coordination failure, and externalities in general were also consistent with this idea. Both the Argentine experience and other populist regimes discussed in this volume show that these contentions are dubious. It was not possible to sustain the equilibrium with high levels of activity, which generated in the end a balance of payments crisis and increasing inflation.

Recent contributions by Dornbusch (1988a) and Sturzenegger (1990), study the relations between populist policies and real wages in a general equilibrium context. According to Dornbusch, the increase in real wages, by reducing the profitability of capital, initially generates a process of capital decumulation (this fact is not supported by the data for 1973). This decumulation makes the adjustment even more difficult because real wages have to fall below their initial level in order to make sufficiently profitable the levels of investment that will allow the stock of lost capital to reaccumulate. Dornbusch and Edwards (1989) consider this to be one of the main mechanisms that explains why, when the readjustment takes place, real wages fall below their initial level. Sturzenegger bases his explanation of the fall in real wages on the real depreciation that endogenously takes place with the readjustment of the economy. In the case of Argentina, this can clearly be seen in table 4.2. Real wages eventually declined in 1976 to half the value they had at the beginning of the program.¹⁷

Unfortunately, the strong procyclical spending policy implemented by the government eventually required a substantial readjustment of the economy, which contributed to the discredit and fall of the president and led to a dictatorship that lowered real wages even further. In addition to the capital flight and the fall in real wages (Dornbusch and Reynoso 1989) that accompanies the readjustment process, the military substantially weakens the bargaining power of unions. Finally the working class is made much worse off than it would have been had more moderate and sustainable policies been implemented.

References

- Alesina, A., and A. Drazen. 1990. *Why Are Stabilizations Delayed?* Harvard University. Mimeograph.
- Arnaudo, A. 1979. *El Programa Antiinflacionario de 1973. Desarrollo Economico*. Buenos Aires: IDES.

17. In a neoclassical framework with intertemporal optimization in an open economy, Sturzenegger (1990) shows that it is possible to replicate the basic macro facts outlined for this experience as an optimal response to a small set of fiscal policies.

- Blanchard, O., and S. Fischer. 1989. *Macroeconomic Theory*. Cambridge, Mass.: MIT Press.
- Brodersohn, M. 1974. Política económica de Corto Plazo, Crecimiento e Inflación en la Argentina, 1950–1972. *Jornadas de economía, problemas economicos Argentina, diagnosticos y politicas*. Buenos Aires: Ediciones Macchi.
- Bruno, M., G. Di Tella, R. Dornbusch, and S. Fischer. 1988. *Inflación y Estabilización, la Experiencia de Israel, Argentina, Brasil, Bolivia y Mexico*. Mexico City: El Trimestre Economico.
- De Pablo, J. C. 1980a. *Economia Politica del Peronismo*. Buenos Aires: El Cid.
- . 1980b. *La Economía que yo hice*. Buenos Aires: El Cronista Comercial.
- Diamond, P. 1982. Aggregate Demand Management in Search Equilibrium. *Journal of Political Economy* 90.
- Diaz Alejandro, C. 1966. *Devaluacion de la Tasa de Cambio en un Pais Semi-Industrializado: La Experiencia de Argentina, 1955/61*. Buenos Aires: Editorial del Instituto.
- Di Tella, G. 1983. *Argentina's Experience under a Labour Based Government*. New York: Macmillan Press.
- . 1977. *Los Diarios*. Buenos Aires: Instituto Torcuato Di Tella.
- Dornbusch, R. 1988a. Real Exchange Rates and Macroeconomics: A Selective Survey. NBER Working Paper no. 2775.
- . 1988b. Notes on Credibility and Stabilization. NBER Working Paper no. 2790.
- . 1987. Collapsing Exchange Rate Regimes. *Journal of Economic Development* 27: 71–83.
- . 1986. Special Exchange Rates for Capital Account Transactions. *World Bank Economic Review*, vol. 1.
- Dornbusch, R., and S. Edwards. 1989. Economic Crises and the Macroeconomics of Populism in Latin America: Lessons from Chile and Peru. Mimeograph.
- Dornbusch, R., and A. Reynoso. 1989. Financial Factors in Economic Development. NBER Working Paper no. 2815.
- Dornbusch, R., and M. Simonsen. 1987. *Inflation Stabilization with Incomes Policy Support*. New York: Group of Thirty.
- Ferns, H. S. 1971. *La Argentina*. Buenos Aires: Sudamericana.
- FIEL. 1973–76 (various issues). *Indicadores de Coyuntura*.
- Flood, R., and P. Garber. 1984. Collapsing Exchange Rate Regimes: Some Linear Examples. *Journal of International Economics* 17: 1–13.
- Floria, C., and C. García Belsunce. 1988. *Historia Política de la Argentina Contemporanea*. Buenos Aires: Alianza Editorial.
- Krugman, P., and L. Taylor. 1978. The Contractionary Effects of Devaluations. *Journal of International Economics* 8 (September): 445–56.
- Mallon, R., and J. V. Sourrouille. 1975. *Politica Economica en una Sociedad Conflictiva*. Buenos Aires: Amorrortu Editorial.
- Murphy, K., R. Vishny, and A. Shleifer. 1989. Industrialization and the Big Push. *Journal of Political Economy* 97 (5): 1003–26.
- Poder Ejecutivo. 1973. *El Plan Trienal*. Buenos Aires.
- Rock, D. 1987. *Argentina, from Colonization to Alfonsón*. Santa Barbara, Calif.: Santa Barbara University Press.
- Sturzenegger, F. 1990. Fiscal Policies in an Open Economy: An General Equilibrium Approach. Massachusetts Institute of Technology. Mimeograph, February.

Comment Guido Di Tella

Until not so long ago it was not easy to explain the pervasiveness of populist policies in Latin America. Sturzenegger finds unsatisfactory six common interpretations, ranging from those that assume irrationality to others that assume optimal behavior of the various actors.

However, if not irrationality, at least ignorance of basic economic criteria is a necessary ingredient of any valid explanation. A case in point is the alleged irrelevance of the fiscal deficit, justified quite wrongly on pseudo-Keynesian arguments. Another more complex case has been the role attributed to the state which, at least until the 1960s, was believed to exemplify a benevolent and visible hand that allowed the attainment of public good in a better and quicker way than the market. This, in the real Latin American world of the last three decades, has proven to be erroneous. Whether it was inherent or just a special case is beside the point, but it is clear that this belief is behind the quick adoption of quantitative and price controls instead of (and not in addition to) serious fiscal policies.

If one wants to go behind the reasons for those attitudes and “mistakes,” one can see that the desire to postpone harsh measures was a common denominator.

Populism, as defined in this discussion, is dead in Latin America; a more subtle survival can be detected in the heterodox-orthodox stabilization debate. Despite the efforts of serious heterodox economists to explain their policies, which should be taken over and above fiscal measures, they were interpreted as if they could be taken *instead* of the fiscal ones, repeating—*mutatis mutandis*—the populist propositions of the previous decades. No doubt, many heterodox stabilizers are cousins to yesterday’s populists.

If one should ask, as Sturzenegger does, What are the strong reasons behind the prevalence of populist policies which have been so predominant in Latin America? one has to go back to two basic causes, economic and social. The first is that Argentina, as many other Latin American countries, started its development based on staples. Argentina, and most of the other countries, showed at a later stage the Dutch-disease kind of syndrome, particularly the post-boom sort of problems. When the bounty of nature has to be replaced by the bounty of human diligence, when new nonresource based activities have to be found, it is not unlikely that their productivity will be no match to those of the resource-related activities of the previous stage.

At this juncture, it is not uncommon to see protectionism and state intervention appear so as to create quasi rents as high as the previous rents. What is strange in the case of Argentina is the extent, intensity, and length of time of the protective policies characteristic of the post-boom stage. But one has to

accept that the post-boom redress will not be an easy one, as all Dutch-diseased economies know well.

The other cause for the populist pervasiveness of times past, is indeed the revulsion against extremely unfair distributive patterns and the existence of large sectors below the poverty level. "Direct action" seemed to be the only answer, while confidence on a market "solution" seemed excessively remote and diffuse and because of that, even irrelevant and immoral. But it is obvious that we must add, to these two main causes, an extraordinary degree of ignorance and naiveté about the ways in which these problems had to be tackled. Inevitably, we have to go back to the view that ignorance is one of the more deeply seated roots of this very counterproductive course.

But fortunately a learning process has taken place, as can be seen in the new turn imposed by the popularly based governments of Meném in Argentina, Collor de Mello in Brazil, Aylwin in Chile, and Paz Zamora in Bolivia. They are supported by the same social sectors as the "populists" of previous times; and although they have basically the same social "Weltanschauung," their policies are very different.

We have learned the hard way, and we know the appropriate means, even if we are still stuck with the same problems. But new knowledge and new attitudes mean that the future, populist or not, will fortunately not be the same.