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ARGENTINA: DEBT AND DEMOCRACY

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Argentina is a lushly endowed country with extraordinarily fertile lands, self-sufficiency in oil, an abundance of other raw materials, a high level of technology, and an unusual endowment of human capital. In the late nineteenth and early twentieth centuries, it was self-evident to most observers that Argentina was the country of the future. In 1930, its people were the eighth richest in the world; the country was viewed not just as a proper competitor of similarly endowed countries like the United States, Canada, and Australia, but as a country with a possibly decisive competitive advantage against those others.

Since those glorious years, Argentina has been in a process of almost continuous relative decline. While the rest of the world has grown spectacularly since then, Argentina has grown hardly at all. By 1984, Argentina's per capita income had fallen behind countries like Singapore and Taiwan and was only a little ahead of South Korea. Twenty-five years earlier these latter countries had numbered among the world's poorest, and their prospects were viewed as extremely poor because they utterly lacked Argentina's natural resources, advanced technology, and skills.

The primary reasons for this long-term decline have been social and political. Argentina has always been a deeply divided society: divided between cosmopolitans located in Buenos Aires and a majority throughout the country who preferred to emphasize local tradition; divided among a conservative oligarchical landowning elite, a moderate reformist, democratic middle class, and a working class determined to increase its share of the economic pie regardless of political cost; and divided between military and civilians. It has been a country with no national ideology and many competing group ideologies. It is a country of recent immigrants which, lacking the unity and ideological consensus of the United States, has always been unsure of its national identity and therefore inclined to extremely demonstrative expressions of nationalism which, however, could not hide the disunity that lay immediately beneath the surface. Thus, fiercely competitive nationalism masks a lack of national confidence, and fiercely competing ideologies mask the lack of any national ideology. As a result, no group and no ideology could long govern Argentina, and no stable governing coalition could be formed.

In this fragmented society, each group has sought to protect its own interests and to seize control of the government with little regard for the interests of other groups. Landowners have successfully prevented significant taxation of land. Industries have acquired protection from competition and, in many cases, large subsidies. The military has achieved a protected economic position based on ownership of a large proportion of the nation's industry and has frequently enjoyed political power, but it has very seldom faced the necessity to defend the nation. Urban groups have avoided taxes, and the government has avoided the painful necessity of collecting adequate taxes, by the expedient of taxing agricultural exports and printing whatever money is necessary to make up the remaining difference. The special deals of these groups cumulate to deprive the economy of growth and resilience. Inefficient industry and heavy taxation of agricultural exports have created a chronic shortage of foreign exchange.

In an economy which does not grow, the economic gains of any single group must come at the expense of other groups. This implies much rougher politics, other things being equal, than in economies which manage to grow. In Argentina, the politics of the zero sum economy have been magnified by the existing group conflicts and by the politics of periodic foreign exchange crises. The large, inefficient industrial sector requires large imports of capital goods. Given a weak government which cannot arbitrate intense competition for the needed imports, periodic foreign exchange crises result. When this happens, the country is forced to devalue in order to encourage exports for at least a short time. This greatly alters the shares of the economic pie, in favor of exporters and particularly the agricultural sector, to the great disadvantage of urban workers and others. The income shifts are so drastic as to constitute tragedies for affected groups, which naturally pursue their interests with great force in the political arena. There ensues a vigorous, inflationary struggle by the disadvantaged groups to regain their previous share of national income, causing an explosion of inflation and eventually another foreign exchange crisis. Thus, over time, there is pressure for inflation to rise ever higher, for foreign exchange crises to become ever more severe, and for the game of politics to become still rougher.

This process, in turn, gives rise to the central yearnings that drive Argentine politics: the desire for growth and prosperity; the desire for political peace; the desire for a final fair and equitable division of the national wealth; and a desire for a confident sense of national unity and national prestige.

These central yearnings have, in turn, been embodied in different political forces, each with its own social base. The desire for growth has been embodied in the so-called liberal parties, which are based on the upper class and advocate free, open markets and a cosmopolitan international stance. The yearning for social moderation and democracy has been embodied in the Radical Party, whose social base is the middle class and which advocates democracy, freedom, human rights, and ethical conduct, and usually slights economic interests of other groups. Whereas the liberal platforms are all economics and tend to lack political feasibility and political appeal, the Radicals tend to be pure politicians with no serious economic program. The military has typically embodied desires for social order, national dignity, and national self-sufficiency. The desire for a social compact in which every group would participate and which would ensure a permanently fair distribution of wealth and income, is embodied in the Peronists, who in addition express the cultural legacy of Spanish Catholicism and South European corporatism.

The Peronists' appeal requires special comment, for it is little understood. The Peronists are the only party with a comprehensive message which confronts the economic problem, the political problem, and the problem of national identity. They draw on the cultural and religious traditions of the nation to justify a corporatist approach and then recommend that all major groups sit down at a table and peacefully carve up the pie among themselves. The appeal of the message is that it goes to the heart of the issues: economic distribution, social peace, and an identity based on cultural and religious heritage. The problem with it is the tendency to consolidate all the special deals which make growth impossible and ultimately make competing claims irreconcilable.

These various social groups ally with one another in various combinations, none of which has ever proved to be enduring. The liberals' upper class, the Radicals' middle class, and the military share an interest in preventing national dominance by the lower class Peronists; much of modern Argentine history is a series of efforts by these other groups to blunt thrusts for power by the underclass. But at other times the upper class financiers and industrialists have found it useful to make a deal with the Peronists to ensure the continuation of a system in which their interests were protected from emerging foreign or domestic competition. When Peron, a colonel, rose to power, and also on recent occasions, there have been deals between the military and the workers. The military, has on occasion allied with the upper class in an effort to initiate a new wave of economic development. The result of the shifting alliances is something like the old children's game of "rock, scissors, paper," where no choice can be confident of long remaining dominant.

Since the mid-1970s all these political and economic struggles have reached a crescendo. In the mid-1970s, disaffected upper-class youth, aided by important elements of a Peronist government, formed a vicious communist guerrilla movement and terrorized much of Argentine society, for the first time raising the possibility that a radical leftist movement would achieve power. The military, with other groups which emphasized the need for social order, struck back with great ruthlessness, disregarding all the axioms of Western freedom and human liberties. Thousands of youth and others, including many whose ties to the guerrilla movement were tenuous or purely intellectual, simply disappeared into mass graves which are only now being unearthed. The military leaders felt strongly that they were simply doing everything that was necessary to protect Christian civilization and Western standards of human decency. The repressed left, and much of the center, felt equally strongly that they were dealing with fascist barbarians. A fragmented society thus became far more polarized.

Simultaneously, the military supported an economic policy emphasizing adjustment and free markets, in an effort to reverse the long-term decline of the Argentinean economy. The policy of free markets had two caveats under the military: first, the government maintained a fixed and high exchange rate in order that the inflow of cheap foreign goods would limit inflation; second, out of self-interest, it excluded the military sector from competition. Naturally the protected and subsidized military sector continued to exert enormous inflationary pressure on the economy, while the fixed high exchange rate limited private sector price increases. Between the inflationary pressures of the military sector and the deflationary pressures from the foreign sector, Argentine private business was squeezed nearly to death. Meanwhile, the country was borrowing enormous amounts of money, which primarily financed military purchases, capital flight, and consumption, and therefore did very little to increase the productivity of the Argentine economy. Eventually this system collapsed, and, in a desperate effort to divert attention from their political and economic failures, the military launched an unsuccessful and very expensive invasion of the Falkland/Malvinas Islands.

This episode totally discredited the military's claims to be a competent manager of the economy, to be a promoter of national unity, and even to represent the national interest. Less fairly, it also totally discredited the idea that the economy could be revived by free market policies. Even the military strongly believes that free market policies have been discredited; this is the lesson they draw from their predecessors' failure and also from their self-interest in their protected control of so much of Argentine industry. This left the political field to the Radicals, with their message of democratic decency, and to the Peronists, with their message that every group should sit down around the table and make a deal. In the late 1983 election, the Peronists were deeply divided and poorly led, while the Radicals, although also divided, had a brilliant, charismatic leader, Raul Alfonsin, who embodied the national desire for honesty and fair play and brilliantly articulated the national hopes for an era of democracy.

The Current Regime

Political Leadership

Under the current regime, national leadership is concentrated in one man, the charismatic Raul Alfonsin. President Alfonsin is a great orator and a symbol of political decency. He gains additional stature from the absence of other effective national leaders. He stands in sharp and deliberate contrast to the corruption and the oppression of both Peronist and military governments, and he successfully identified the military regime with the Peronists, both as collaborators and as groups which shared in corruption and oppression. He successfully polarized the nation between Peronists and non-Peronists, so that he would get the support of the center-right as well as his own Radical Party. He is a master of the mass media, especially television, which he uses to display great personal warmth.

Alfonsin, like much of his party, is primarily a romantic. He and his party believe that honesty and goodness are the principal political issues and implicitly that, if these virtues are present, then other difficulties, such as the economic situation, will somehow resolve themselves.

Alfonsin seeks above all to be the founder of the first true, and enduring, Argentine democracy. He must survive for six years and pass on democracy to an honestly elected successor. No other goal, especially no economic goal, will be allowed to compete with this overarching goal. Beyond this, Alfonsin's political ambitions are even more encompassing than Peronism. He speaks of founding the third great historical force, a broad social coalition which would incorporate both the current Radical Party and the Peronists and go beyond them.

Alfonsin has no knowledge of economics or administration. He reached his fifties as an orator who had never held office in any large organization. In response both to his life experience and his political ideals, he reacts to economic problems in a moral rather than a technocratic mode. For instance, on debt, he speaks of bankruptcy rather than default, and views bankruptcy in the way a solid middle-class citizen would. Bankruptcy is simply immoral. At the same time, he reacts with moral revulsion at the idea of having to pay for

the consequences of Reagan's deficit. He also regards debt incurred for the purpose of capital flight as morally illegitimate. On inflation, he is morally repelled by the fortunes made by speculators and by the erosion of working class standards of living. At the same time, he has tended, especially at the outset, to perceive rising real wages as a moral right of the workers rather than as a technical problem which was linked to inflation.

Beneath Alfonsin are advisors who, at this point, gain virtually all of their power simply from their personal relationship to Alfonsin. The Radical Party leadership is divided into a young left, an elderly center, and a technocratic right. The campaign was dominated by the young left, a large group of extremely articulate and equally inexperienced young ideologues. They are callow, idealistic, nationalistic, and inclined to assign blame rather than to analyze or resolve problems. The elderly center is uninspiring and unimaginative but holds the keys to what remains of the traditional party organization. The technocratic right often has technical university training and extensive organizational experience, but is frustrated by the political force of the young left and the dead weight of the old party machine.

The young left dominated the early days of Alfonsin's foreign and domestic policy. They opposed the Grenada invasion, lent \$200 million to Cuba and \$45 million to Nicaragua, and concluded a major agreement with the Russians on energy development. They advocate Third World unity. They reached agreement with the Cubans to process fish in Argentina through a joint venture between the two governments. They pushed for a rapid increase in workers' wages and for a radical rewriting of much of the curriculum of Argentine schools. They are in control of the Ministry of Energy, of foreign policy, and of foreign investment. They have pursued a nationalistic line, for instance interfering with solution of the Beagle Channel dispute with Chile and thereby contributing to the partial defeat of efforts to reduce the military budget.

Given the inflation and the debt crisis and the threatened loss of confidence which followed such policies, the other wings of the party have increasingly gained weight. The March 31 international agreement on debt was a crucial turning point in the factional disputes.

Alfonsin has shown that he can be resourceful and flexible and maneuver among the factions of his party. He can change advisors and change courses with great rapidity. What does not change is his idealism, and his identity as a pure political animal. Alfonsin is the Jimmy Carter of Argentina. He is a good man and a smart man, but he risked all his political goals through early economic ineptitude. In politics, virtue is a wasting asset. To survive more than 18 months, Alfonsin must learn economics.

Institutions

The new democratic Argentine government's ability to implement its policies and to transit the current crisis depends upon the effectiveness and resilience of the nation's principal institutions. Without effective institutions, the best policies in the world cannot be successfully implemented. Unfortunately, in every sector, Argentina's institutions have fundamental weaknesses.

Political Institutions. The new government needs to be able to act decisively. To do this, it must either form a broad coalition or else have the power to override opposition forces. Most successful transitions to democracy (for instance, Venezuela, Colombia, and Spain) have been implemented by broad, cooperative, inter-party coalitions. This is rendered difficult in Argentina because Alfonsin initially chose to launch an attack on the Peronists and the military. Even if he wanted a coalition (as he now does) with the Peronists, this would be structurally difficult, because the Peronists are so divided that they are unable to make authoritative decisions. The Peronists have no agreed doctrine: indeed different factions are deeply committed to quite contradictory policies. The political leaders of the Peronist movement are in many cases educated, flexible individuals who might be willing to make a deal in the national interest. However, they are at odds with the powerful union leaders, who can prevent the party from acting and, in many circumstances, can immobilize much of the urban economy through strikes. This, in turn, provides an example of a more fundamental problem: social forces, such as the military, the Church, and the unions, are very strong, while the political parties are very weak. Therefore, the political parties are unable to discipline their supporting groups into acceptance of policies which may involve compromising short-run interests. In other words, the political institutions are too weak to perform their primary social function.

Alternatively, Alfonsin needs to be able to formulate a correct policy and then impose it on his opponents. But he is committed to democracy, and the mandate of the voters has left him in a relatively weak position. He is a Radical president, with a Radical majority in the House, but the Peronists lead in the Senate and dominate fourteen out of twenty-one states. Any policy on major issues, such as international debt, must be approved by the Senate and, therefore, must be acceptable to the Peronists.

Alfonsin's problems go still deeper. Although the Radical Party gained more than half of the votes in the last elections, its base of support is only 20-25 percent of the electorate. Only two years after he was initially elected, Alfonsin must face the late 1985 election, in which the voters whose basic loyalties are to the liberals will likely revert to voting their liberal instincts and thereby deprive Alfonsin of his majority in the House. Finally, the dynamic leftist youth wing of his own party has strong objections to the kinds of austerity measures which are necessary to achieve successful adjustment of the economy.

Economic Institutions. Argentine economic institutions are nearly as weak as its political institutions. As noted earlier, unlike Brazil and Mexico, Argentina spent only a small fraction, perhaps one-quarter, of its borrowed money on productive investment. Argentina has almost no industrial companies of the scale or competitiveness of Brazilian companies. Because of the financial environment in which they operated, many became by necessity more skilled at financial speculation than at real production. The financial system has organizational problems that go far deeper than its liquidity problems. Its organization, equipment, and personnel were designed for a much larger deposit base, which shrank due to inflation. It is severely constrained by regulations. A majority of the provincial banks have had their

full capital replaced by the government several times. In one bank international department, 75 out of 120 people work filling out central bank forms. According to knowledgeable bankers, key financial institutions can survive only with a minimum 25 percent spread over their cost of funds.

The deep problems of the economy are indicated by the structure of employment. Argentina has 1.2 million people employed in manufacturing, 1.8 million in government, 3 million in services, and 1.8 million self-employed. (Most of the rest are in agriculture.) For a country with Argentina's per capita income, this distribution is extraordinarily skewed in favor of government and services. This means that a large proportion of the country's human resources are unproductively employed and that there is a tremendous bias in favor of higher inflation.

Administrative institutions. The government employs a huge number of people, but is nonetheless weak. Perhaps the most fundamental measure of the strength of a government is its ability to collect taxes. In Argentina, if one sets aside the taxes on agricultural exports, the government's ability to collect taxes is remarkably weak. The collection and production of basic statistics has become another crucial weakness; conflicts among factions, among departments, and between the central government and the periphery have made basic economic statistics unreliable and extremely late to appear. The government has great political and administrative difficulty preparing a basic budget.

Although many people seek civil service jobs in order to have job security and a hedge against inflation, able people generally avoid government service. Standards of living for civil servants have generally declined. An ambassador stationed at home makes \$400 per month. Administration of salaries is chaotic throughout the public service. There are seventy different salary scales, with salaries ranging from \$20 to \$150 per month at the bottom of various ministries and ranging from \$450 to \$1500 per month at the top of various ministries.

The military has long been mainly a political actor rather than a military force. As the military force, it proved incompetent in fighting the British. Politics has deeply divided the military. Younger officers are extremely bitter at the mindless decision of their seniors to enter and fight the Falkland/ Malvinas war. As a political force and an economic manager, the military is totally discredited in the mind of the public.

Other institutions, such as universities, are in even worse shape. Remarkably few of the students who enter universities ever graduate. Those who do graduate have, at best, a dubious education. Faculties are deeply divided and intensely politicized. Similarly, the court system has been terribly weakened and discredited by the political struggles of recent years. Judges frequently bowed to political threats from the leftist guerrillas, in order to save their own lives and those of their families, and subsequently bowed to the dictates of the military. Judges were appointed or transferred based on political criteria. Not surprisingly, the judicial system is demoralized and discredited.

In discussion of Argentina's prospects, attention tends to be focused on current personalities and on immediate policy disputes. However, the condition of Argentina's institutions is a much surer guide to the longer-run future. When one compares Mexico's PRI Party, with its ability to mobilize the nation even for a few years into acceptance of austerity, with Argentine political institutions, or if one compares Brazilian firms like Petrobras, which can compete against private firms internationally and in dozens of product lines, with Argentine counterparts, the grounds for predicting long-term progress are diminished. In principle, the situation is far from hopeless. In theory, businesses can gradually be made more competitive, the military can be rehabilitated, the Radical and Peronist parties can be unified, and universities can be directed to the task of actually educating young people. But this is a painful, politically difficult, time-consuming task which can only yield results after many years of steady effort. In the meantime, Argentina's principal social institutions are functioning on a level that is barely competitive with those of Zimbabwe.

Alfonsin's Social Base

Alfonsin was elected by all those who feared the Peronists, that is, by a combination of the Radical Party's supporters and the supporters of the liberal parties, as well as by some voters who defected from the Peronists because of the antagonism between Peronist factions. The next time around, most of the centrist and conservative voters are likely to desert Alfonsin. This could leave him with support much closer to the Radicals' traditional 25 percent of the vote.

Alfonsin's base is the middle class--in a society where an overwhelming proportion of citizens identify themselves as middle class. But his actual base is a middle class narrowly defined. In the United States and Western Europe, stockbrokers, a large proportion of businessmen, and a large proportion of bankers would identify their interests with those of the middle class and vote for a middle class party. However in Argentina, some 75 percent of stockbrokers and high proportions of big businessmen vote Peronist. Years of protection from competition have weakened Argentine firms of all kinds and accustomed them to dependence on special protective political arrangements.

In this situation, he must seek a strategy for continuing to attract large numbers of votes from traditional adherents of other parties. His spokesmen say he will lose shares in Buenos Aires, but make up the losses in the provinces. How he will do this is obscure. While Alfonsin is a brilliant tactician, his base is weak and there is a terrible tradeoff between the unpopular measures necessary to deal with the economic crisis and the requirements of the 1985 election year.

Alfonsin's Strategy

Alfonsin seeks to create a third great historical force, turning the Radical Party into the dominant party by using the Radical Party to win over and replace the Peronists through force of charisma. That is his dominant

goal. He intends to do this by democratic means and accepts the constraints of the democratic system.

Alfonsin came to power suddenly and unexpectedly. The Radicals, as well as their opponents, expected that the Peronists would win. Thus, upon coming to power, Alfonsin suddenly headed a government with no recent experience at governance, and he headed a party which had not worked out a carefully considered political-economic strategy. Given his own predispositions and those of his party, he emphasized politics almost to the complete exclusion of economics.

Under these circumstances, the new government fell back upon political instinct and the historical experience of the party. Political instinct, in the context of the rough and tumble of Argentine politics, counselled striking out hard at potential enemies. Historical experience reinforced this inclination. The last Radical government, that of Illia, came to power just after a military government had taken needed austerity measures and prepared the ground for a period of growth. Illia raised workers' wages and the increased demand induced a Keynesian boom (by Argentine standards). But, despite his economic success, Illia eventually fell because he failed to expand his political base beyond his initial 23 percent of the vote and therefore became vulnerable to the attacks of the unions, the military, and the press.

With this background, Alfonsin immediately raised workers' wages, following counsel by his economic advisors that this would have the same beneficial consequences as under Illia. Second, he struck at the unions and the military and attempted to dominate the press, while holding off the new potential enemy, the foreign banks. He brought criminal charges against all the leaders of the military juntas, except the last one, which had prepared the way for democratic elections. He retired the last junta and many other senior officers. He announced drastic cuts in the military budget. Third, he attacked the Peronist union leaders by giving their workers real wage increases while seeking legislation which would have enabled to call new union leadership elections supervised by Radical Party intervenors. He attempted to control the press and popular opinion by maintaining the attitude of a campaigner, rather than becoming an administrator, and by attacking the press when it seemed to him to step out of line. Toward the IMF and the foreign banks, he initially maintained an attitude of defiance, refusing to make payments and announcing that he would not accept tough IMF adjustment measures.

Toward the military, Alfonsin has made major gains, but not in the areas of greatest interest to financial institutions. Having relieved the most guilty senior officers, he turned over their prosecution to military courts. These military courts will impose harsh sentences. Younger officers were extremely disillusioned with the way the war with Britain was handled, and their elders believe that unless the managers of the war are severely punished, the younger officers will become disillusioned with the army as an institution and therefore be politically radical when they are senior generals 10 to 15 years hence. Alfonsin has asserted civilian control over the military. He is using the goal of a more professional army as the carrot by which to gain their acquiescence, and this appears to be a wise policy although the different services will resist each of Alfonsin's efforts to

create a unified command. On the critical issue of the military budget, Alfonsin has vacillated. He originally promised to cut that budget by 30-40 percent and promised to use that to reduce the government budget deficit by 2 percent of GDP. Then, however, he discovered that he needed the political support of military officers, and he privately promised to avoid severe cuts and began appearing frequently in public with senior military officers. By early May he was again making speeches seeking to persuade the military that their budget should be cut, but as yet it is not clear that decisive cuts will be made.

Thus, for the meantime, the military is politically discredited in the eyes of the public and in its own eyes, and it is under civilian control. Alfonsin has handled the issues of civilian authority and of punishment for war crimes with considerable finesse. These developments give Alfonsin at least eighteen months to two years before the military could recover its confidence and prestige and intervene once again. However, if the civilian economy is chaotically managed, if civil disorder occurs, and if suits brought in civilian courts by aggrieved members of the public create a continuing irritant to civil-military relations, the military could reappear as a political force two or three years hence. On the military budget, one cannot say that the book is closed, but Alfonsin has lost momentum in dealing with the issue and therefore will have to plead for every cut.

Toward labor, Alfonsin's initial policies were an unmitigated disaster. The wage increases triggered inflation that was explosive even by Argentine standards. The inflation for March 1984 was 20.3 percent, or an annual rate of 917 percent. This did not, however, wean the workers away from their union leaders. The Congress refused to pass his bill for new union elections; the opposition successfully argued that, rather than reforming the old system which allowed the Peronists to control the unions, Alfonsin was simply replacing Peronists with Radicals in an unreformed system. Alfonsin's proposal triggered waves of strikes. Thus, in one stroke, Alfonsin endangered both the prospect for cooling inflation and the prospect for Radical-Peronist cooperation on vital national economic issues.

Toward the foreign banks, Alfonsin continued to reiterate his intention to pay, but did not in fact pay and frequently repeated Argentine opposition to anything which would reduce real wages or make it impossible for the country to have a positive real growth or to implement improved health, education, and welfare programs. The latter are the core of the Radicals' political philosophy. Alfonsin's advisors not only expected their own economy to improve, but apparently also expected that the international banks would back down and offer major concessions. On the contrary, the banks were appalled by the failure to begin adjustment and determined not to increase their potential losses by lending new money to a country which is neither paying nor adjusting. Together with the domestic explosion of inflation, this doomed the initial Alfonsin policy.

In a nutshell, Alfonsin had sought, in his first few months in office, to decimate his opponents, to create a broad coalition through charisma and appeals to patriotism and democracy, and to consolidate the resulting political victory by offering economic benefits to every major social group. Workers were to get real wage increases. Military officers were to get a

professional army. Farmers were to receive a set of interest rate and input price concessions. And so forth. But the enemies proved somewhat resilient, and the economy simply did not provide the resources to undergird the strategy. To stem the economic collapse, Alfonsin would have to turn to some of the policies of the liberals. To construct his third historical force, or even to implement basic economic policies, he would have to abandon short-term economic payoffs and employ some of the methods and appeals of the Peronists, perhaps even seeking formal Peronist cooperation. His problem was that his tools were weak. His economists, and the political support for those economists, did not have the expertise and the coherent program of the liberals. And his political program, although appealing in the short run, lacked the breadth and depth of the Peronist emotional appeal.

Phase II. On March 31, 1984, Alfonsin accepted an international financial arrangement which signaled a major change of strategy. Four Latin American countries put up \$300 million, international banks put up \$100 million, and Argentina put up 100 million to be applied against overdue interest payments. The United States government promised to pay out the Latin American contributors as soon as Argentina signed a letter of intent with the IMF, and also promised to press the IMF for relatively easy terms. For the Latin American countries, this avoided the possibility that Argentina would create a further crisis of international financial confidence that would affect their relationships with the banks. The United States gained foreign policy concessions on nuclear proliferation, on the tone of Argentine relations with the United States, and in addition avoided or postponed a moderately serious financial problem. Alfonsin finessed his earlier denunciations of the IMF and the international banks by transferring key obligations to fraternal Latin American countries. He postponed a financial crisis and changed the tone of relationships with the international financial system without paying very much money. The big loser was the IMF, which came under strong pressure to provide easier terms to a particularly intransigent customer.

Very quickly, Alfonsin put into place the rest of a new strategy. Although in April he still promised the workers an 11 percent real wage increase for 1984, the following month he announced a wage adjustment of only 9 percent, about half the expected inflation. He fired the Minister of Labor, who was the symbol of the confrontationist policy toward the labor union leaders. On April 12, 1984, Alfonsin initially offered the Peronists a cooperative relationship, in which the two parties would jointly work for implementation of the IMF plan. He began speaking once again of the necessity of cutting back the military budget.

The unions responded with a wave of strikes. The Peronists rejected Alfonsin's proposal, even though he went public with a number of variations and continued to press for cooperation. International banks remained skeptical. Negotiations with the IMF went slowly at best, because the government was unable to produce a credible budget. When the completion of the budget was announced in early May, few details were released and many aspects remained controversial.

The crucial aspect of the Phase II program was the cooperative relationship with the Peronists. The Peronists flatly rejected Alfonsin's overtures. First, they said it was humiliating to take the posture that

Alfonsin had taken regarding the IMF: they concur privately that an IMF style adjustment program is necessary, but feel that such a program should be overtly designed by Argentinians as a needed domestic adjustment program, rather than being presented to the nation as an unfortunate capitulation to the demands of the IMF. Second, the Peronists insist that, if they are to be held responsible for such a program, they must participate in its design, rather than being presented with a fait accompli. Third, the Peronist unions refuse to accept the necessity of a serious austerity program.

These are the publicly stated policy calculations. Behind these views, the first two of which are quite reasonable, there are political realities. First, the Peronists still feel intensely antagonistic toward Alfonsin and are completely unwilling to share in the political cost of an austerity program; privately they acknowledge that the program is necessary, but they believe Alfonsin's party will be defeated in 1985 and they will govern if they do not cooperate now. Second, they understand that Alfonsin is in trouble, and are much less willing to bail him out when he is down than they would have been to strike a deal when he was at the height of his power. Third, the Peronists are too divided to make a deal. If the political leadership of the Peronists were to agree to a deal, the union leaders, who have an antagonistic relationship with political leaders, would divide the party further and lead a wave of devastating strikes--as they did against Isabel Peron.

Alfonsin continues to cast around for ways to make his Phase II strategy work. He has invited Isabel Peron to return home from Spain. He has stood up to the first wave of strikes. He has produced the first draft of a budget, despite factional infighting. It is not inconceivable that he will find the magic formula for a deal with the Peronists, or with a large fraction of the Peronists, after which the other problems would be considerably simplified. But the odds appear great, and the burden of proof must remain on Alfonsin to demonstrate a successful strategy. To paraphrase a recent quotation by Richard Nixon, one would not bet the whole farm on Alfonsin's failure, but one would hesitate to bet the outhouse on his success.

Economic Policy

Context and Priorities

As noted earlier, politics has an absolute priority over economics for Alfonsin and the Radical Party. They increasingly recognize that economic disasters can undermine their political goals, but policy is still affected by a moralistic sense that the United States and the rest of the world have a responsibility to help out Argentina's new democracy and that, at home, political virtue will somehow be rewarded in the economic arena.

In all the Radical Party debates and pronouncements on economic policy, there is a striking omission: nobody puts forward a program for growth and development and no one demands such a program. Crisis management, focused on the debt, and distributional issues, focused on wage policy, almost completely dominate public debate. This tendency to ignore growth and development issues is deeply ingrained. For fifty years Argentina has hardly grown economically, so attention has naturally focused on crisis management and how to divide the

existing pie. The whole concept of development is associated in the minds of the Radical Party with a breakaway "Developmentalist" movement led by Frondizi. Moreover, Argentina does not perceive itself as a "developing" nation; it perceives itself as an advanced European society and believes implicitly that a focus on development is more appropriate to its less esteemed neighbors. Of course, even the United States worries about development these days, but Argentine political leaders, except for the liberals, by and large do not.

Argentine economic policy is also affected by the special Argentinian attitude toward adjustment. A large part of the Argentinian political spectrum argues that Argentina cannot be asked to adjust, because Argentina is unique in a variety of ways. It is argued that Argentina is a middle class society, where everyone has a television set and where most people had parents who were also from the middle class. Therefore, it is argued, people insist on their middle class standards of living and cannot be so easily deprived of them as, for instance, Brazilians, who have only recently achieved middle class status and therefore, according to this theory, do not feel so bad about losing it. Others argue that Mexico and Brazil have experienced a decade or more of tremendous growth, so that they can afford a setback, whereas Argentina, after decades of decline, cannot afford any further decline. A more technocratic version of the same argument is that adjustment has already occurred. Measured in dollars, there was an enormous decline in real wages prior to 1983, and to many people this means that Argentina has already endured the suffering that Brazil and Mexico are now accepting and hence Argentina should not be asked by the IMF and the banks to do more. And there is the argument that the world has an obligation to help out Argentina's new democracy.

A common theme in all these arguments is that Argentina is different, superior, and special and therefore the standards that apply to other countries do not apply to Argentina's present situation. Even the seemingly technocratic argument that Argentina has already adjusted is a moralistic view, which usually is unaccompanied by an analysis of how, in practical terms, the economy is to be rejuvenated and the debt is to be paid. These kinds of sentiments appear in other countries, but in Argentina they have a unique political force and hence, a unique ability to delay implementation of reforms.

This is the background to the making of detailed economic policies. As of mid-May, 1984, policy was still in flux so that no confident projections could be made. There was a budget, but it lacked detail and was controversial. There was a wage policy, but it was wildly different from the wage policy of two weeks before, which was in turn very different from the wage policy two weeks before that. Thus, one can only analyze the forces and identify the indicators of the future. The key policies concern control of the public deficit, wages, military spending, exports, and tax reform.

Argentina's public sector deficit, defined as the deficit of the government itself and of the public sector corporations, has been running at about 14 percent of GNP. If one subtracts from this the surplus in the provinces created by federal government transfers to those provinces, the deficit is 9.9 percent. If one adds the deficit created by central bank

payments on required bank reserves, the deficit is about 16 percent. If one adds to this the cost of the central bank's having replaced the entire capital of a majority of the provincial banks, sometimes several times, some observers believe the deficit would exceed 20 percent of GNP. Alfonsin's ministers have fastened on the 14 percent figure and promised, at various times, to reduce it to 6 percent of GNP, to 8 percent, and to 10 percent. The current budget reportedly would make the deficit 13 percent of GNP. There was a considerable effort to persuade the IMF to accept a target of 10.5 percent of GNP, whereupon Argentina would use the consolidated public sector deficit (9.9 percent) as the definition and actually be able to increase its deficit. This has made negotiations with the IMF difficult and prediction of performance for 1984 even more difficult. Instead of predicting, one can only watch what is done with particular components of the deficit.

The central component in control of the public sector deficit is control of wages, which constitute 70 percent of the public sector budget. Alfonsin's most recent wage policy, as noted above, is to adjust wages more slowly than inflation. The key question is whether this policy will survive a current wave of strikes.

A second major component of the public sector budget is the military. As noted, Alfonsin originally made promises to cut the military budget by 30-40 percent or 2 percent of GDP. Subsequently, he promised military leaders that military budgets would not be cut substantially. Most recently, he has publicly argued the need to make cuts in the military budget. Policy in this area has not been clarified, it would be important to note that, in addition to the publicly declared military budget, there is a large secret military budget.

In addition to the direct military budget, the government spends huge amounts on military industry which is owned by the military and constitutes a large fraction of Argentina's total industry. In terms of potential impact on the deficit and in terms of what is politically possible, privatization of much of this military industry could be the single most productive step. As noted earlier, it was the inflationary pressures from this protected sector which destroyed the Martinez de Hoz program of economic adjustment in the late 1970s. However, Alfonsin's socialist ideology, and his deference to military wishes, mean that this option is not seriously discussed.

In addition to the military industries which are identified as such, Argentina has a major nuclear program whose purposes are at least partly military. Like most nuclear programs, this one is enormously expensive. The U.S. has sought assurances that the program will not be used for weapons, but discussions of reducing the scope of the nuclear program or of stretching it out substantially remain controversial.

The government is committed to substantial expenditures on health, education, welfare, subsidies for farmers, and governmental purchase from the principal oil company of contracts which it cannot honor at oil prices. All of these programs can be justified in themselves, but they create an increase in the deficit which must somehow be offset.

Another way to reduce the public sector deficit is to raise taxes. Initially the government focused most of its attention on raising taxes,

saying that it could then reactivate the economy and raise real wages. Increasing taxes remains a key part of the Argentine program.

The first tax-raising step was to declare a moratorium on providing easy terms for the payment of debt if people come forward voluntarily. This program has worked reasonably well, and substantial numbers of people have appeared on the tax rolls for the first time. However, there remains a tremendous incentive for people to delay paying their taxes or to avoid paying them at all. As long as people see inflation accelerating, and as long as the penalties for delayed payment are less than inflation, the government is effectively paying people not to pay their taxes. Therefore the program of increasing collection of current taxes will have its greatest successes only when inflation turns down or when the government drastically raises the penalty for nonpayment.

The government benefits from increased some increased willingness to pay taxes, given the improved political conditions. Most of the benefit from this has already accrued. In addition, the government has worthy ideas for increasing tax revenues, which could, if implemented, raise 1 to 2 percent of GDP in additional revenue. These ideas include taxes on net worth and on cattle, improved collection of the value added tax (where evasion currently deprives the government of 70 percent of its revenues on a tax that is supposed to be levied at a 20 percent rate) a potential big tax on gasoline, and so forth. Unfortunately, halfway through the fiscal year, none of these taxes has been imposed, and the Argentine government has limited ability to implement and enforce such tax programs. They can in principle be implemented eventually, but it will take time and heavy political priority. Therefore, if these ideas are to be successful, observers will have plenty of advance notice.

In 1983, 90 percent of the government budget was paid for by printing money. Most of the remaining 10 percent was paid for by taxes on agricultural exports. This is the easiest way for the government to collect taxes, since collection can be made almost automatic. Under the existing system in April 1984, the farmer sells wheat at the official rate of 32 pesos, and pays 9 pesos of tax. The government collects the 9 pesos of tax and, in addition, keeps the difference between the official exchange rate of 32 and the parallel market exchange rate of 50. Tax revenues from this source will remain high, and the government will retain this tax for the time being because it is so dependent upon this particular form of revenue.

Exports and Imports

Such dependence on agricultural export tax revenues unfortunately is not the ideal way to promote exports. To pay its debt, clearly Argentina needs to promote exports and to squeeze imports. It would be far more rational to impose a big tax on land, thereby penalizing the retention of land as a form of unproductive wealth and encouraging productivity. Then one could reduce or eliminate the agricultural export tax and encourage exports. Many Argentines use their land unproductively, as a way of holding wealth more safely than money, and exports are severely penalized. Argentine agriculture is nonetheless so rich that it survives the huge taxes and severe limits on imports of fertilizer and other inputs. But long-term solution of the debt

problem and elimination of the foreign exchange constraint on Argentine development cannot be accomplished within the present system. Despite this, the government does not propose such alterations. Nearly every major social group is opposed to such changes. Landowners naturally do not want to be taxed. Workers would perceive the encouragement of agricultural exports as skewing the income distribution unfairly in favor of landowners. And there is a widespread sense that taxing land at a substantial rate would be a "communist" policy. (It is generally considered impolite to note that such policies are followed in such uncommunist countries as the United States.)

A second major impediment to drastic improvement of the trade balance is the difference between the official exchange rate and the market exchange rate. This difference creates an overwhelming incentive for agricultural and other exporters to under-invoice their exports and to collect dollars offshore. This problem could be resolved by either getting inflation under control or introducing a systematic policy of mini-devaluation. When either of those policies occurs, it will be a positive sign, but that has not happened yet.

There is considerable room for expansion of Argentina's exports, which in 1983 were less than \$8 billion, whereas in 1981 they were over \$9 billion. However, Argentina faces increasingly competitive markets for wheat, its largest export, and possibly for other grains. Therefore, it will have to make major efforts to encourage higher volume agricultural exports and to make its manufactured exports more competitive. The appropriate policies are not yet in place.

On the import side, Argentina has done considerably better. From 1980 to 1983 imports of capital goods were reduced from \$2.4 billion to \$500 million. Imports of intermediate goods were reduced from \$5.5 billion to \$3.1 billion. Imports of consumption were reduced from \$1.9 billion to \$0.2 billion. Imports of fuels and lubricants were reduced from \$1.1 billion to \$0.5 billion. Overall, imports declined from \$10.5 billion to \$4.5 billion. These sharp declines appear not to place an excessive squeeze on any major economic sector or on any major population group. Hence, this reduced level of imports is socially and economically sustainable so long as there is the political will to maintain the policies.

Overall, Argentina's export performance has been uninspiring, while its import austerity has been impressively successful. There remains, however, a current account gap of \$3 billion in 1983 and nearly \$4 billion in 1984, which needs to be reduced.

Debt Policy

As noted earlier, Alfonsín and the Radicals take the point of view that honest people pay their debts and they intend to be honest. There is no intention in the first instance not to pay the debt.

The first level of complications to this straightforward view arises in the government's view that there is legitimate debt and illegitimate debt. Alfonsín and Minister of Economics Grinspun have stated that Argentina will

pay the legitimate but not the illegitimate debt. Fiduciary loans are explicitly included as illegitimate; as with many other aspects of Argentine policy, the problem with the distinction is the difficulty of identifying the fiduciary loans. Unofficial estimates of the scale of this kind of "illegitimate debt" range from \$5 billion to \$8 billion. Argentine policymakers become particularly upset about the fiduciary loans because one could legally take a fiduciary loan in 1980, get government exchange rate insurance, and make \$90,000 on a \$100,000 loan by 1983. Thus, these debts are viewed not just as contributing to capital flight but also as a means by which wealthy members of the elite make enormous fortunes at the expense of the nation.

Second, many senior members of the Radical Party believe that Argentina has no moral obligation to pay "excessive interest rates." One Argentine economist has noted that a 1 percent increase in the U.S. prime interest rate costs Argentina one wheat harvest. Interest rates have increased 1.5 percent in 1984, and, depending on their level of sophistication, Argentine policymakers regard this either as a morally outrageous levy by the banks or as a morally outrageous effort by the U.S. government to get Argentina to pay for its domestic deficit. Whether Argentina moves to insist that it need not pay "excessive interest rates" depends on its bargaining position and hence on the extent to which it gets help from Latin American neighbors and from policy makers in Washington, D.C.

A third kind of debt which is viewed by some policymakers as illegitimate is arms loans, particularly those loans to the military for arms purchases which were not included in the civilian government balance sheet. However, so far there has been no authoritative effort to label these loans illegitimate.

Just as important as Argentina's attitudes toward its debts to the bank are its attitudes toward the IMF. During the electoral campaign, both Radical and Peronist denunciations of the IMF, and declarations that IMF style austerity programs were unacceptable, were extremely strong. The necessity to deal with the IMF, as part of the March 31 international deal, was accepted only with the greatest reservations. This decision was rationalized in part by noting that Brazil and other countries have repeatedly signed IMF agreements and then failed to meet the terms of those agreements. The Argentine government believes, without any exceptions that this interviewer was able to discover, this is the way the game should be played. The Argentine government intends to reach an agreement with the IMF. There is no intention, in any sector of the government, to attempt to fully achieve any of the goals of an IMF agreement. This does not mean that the agreement will be completely disregarded. It does mean that Argentina approaches its negotiations with the IMF in a mood of cynicism which is completely contrary to the spirit in which Brazil and Mexico initially approached their IMF goals.

Finally, both Peronists and Radicals are enthusiastic promoters of the concept of a Latin American debt club. They face many obstacles to such an agreement. All of them fear the possibility that they would lose access to new money if they visibly make an effort to form a strong debt cartel. Mexico currently gains strong advantages from contrasting itself with Argentina. For its part, Argentina prefers to look down on Brazil and Mexico and therefore not to lump itself together with them. However, particularly since the March

31 international debt agreement, there is increasing momentum of summit meetings and mutual visits by finance ministers and expressions of concern about rising U.S. interest rates so that the emergence of concerted demands by the major Latin American debtors is now increasingly likely.

Conclusions

Argentina has the human and natural resources to resolve its debt crisis. So far it has neither the political unity to adopt the necessary structural adjustment policies, nor the institutional strength to implement such policies promptly. Eventually, crisis conditions may stimulate broader unity and more effective implementation. However, a prudent creditor would act on the assumption of rising disunity and continued indecisiveness of policy until developments create a persuasive case for believing otherwise.