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## THE POLITICAL ECONOMY OF ECONOMIC REFORMS<sup>1</sup>

(a checklist for the successful minister of economics)

Technical consistency is a necessary condition for the success of any program of economic reform. The question of which conditions and policies are sufficient for a successful economic program arises forcefully, however, as one observes the frequent failure of economic policies that were ex-ante considered technically adequate. In practice, nothing short of sufficient conditions is enough for success.

This paper identifies those considerations that, in addition to technical consistency, a policymaker should take into account to achieve in practice the goals of the economic reform<sup>2</sup>.

As Bruno's (1988) description of the Israeli 1985 antiinflationary program illustrates adequately, the economy theory necessary for checking the technical consistency of the program may not exist, so that the technical considerations of the economic reform may be very difficult, in addition to important. They are ignored in this paper, despite their importance and difficulty.

The paper aims at being a tool for reminding policymakers of the crucial factors that should not be ignored in designing, "selling", and implementing economic policies. Implicit in the whole essay is the notion that the minister of economics wants to apply good economic reforms, namely, reforms that from the population point of view may have temporary costs but, if maintained, eventually would result in an improvement of their welfare, although very likely

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<sup>2</sup> I would like to stress once again the importance of technical consistency as a necessary condition for success. Ignoring it is a "capital sin", as it is forgetting the issues that are analyzed in this paper.

would result in a worsening of the welfare of rent seeking groups. The question of why a minister would do such a thing, instead of looking power as such or representing rent seeking groups in government, will not be analyzed here, despite its excitement (some considerations, however, will be included during the analysis of time dynamic issues).

This paper, I hope, is useful not only for potential candidates for the ministry of economics, but also for all those who have to interact with them. It is not a question of accepting everything that comes out of the head of the economic team of a country, it is a question of understanding why he does what he does, in order to improve decision making if it is possible. The reader of this paper should be aware, as the author is, that the analysis presented here is formally less neat than one devoted to the technical consistency of economic policy. In addition, being based primarily on the Argentine experience of the last 3 decades (certainly not a brilliant story), the analysis does not give an exhaustive list of sufficient conditions for success in all circumstances.

Section 1 synthesizes the Argentine reforms on which the analysis is based. A set of tables, containing details of the mentioned reforms, appear in appendix A of the paper. Section 2 presents a checklist of recommendations for policymakers. Appendix B contrasts the Argentine experience against available international analysis on the political economy of stabilization programs and economic reforms, conducted by Nelson (1984, 1988).

Summary of findings for anxious people. In addition to technical consistency of the economic reforms to be implemented, the successful minister of economics should know:

- oo that his personal life will be shocked: greater stress for himself and the family, dramatic deterioration of revenues, loss of true friends, personalization of issues from the lobbyists and the press, future labor difficulties and, perhaps, some time in jail. Government is unbearable for those who are not powermaniacs;

- oo the content of the economic policy he wants to implement before accepting the job;

- oo that policymaking is not merely diagnosing but primarily decision making, normally against the clock and with limited information, so that he has to get a forward looking attitude, and he has to be tough, being prepared to say "no" to resource claims that are made very strongly;

- oo that the President he is serving is simultaneously his pupil, his boss and his friend;

- oo that he faces unavoidable conflicts with the rest of the Cabinet (because all ministers except the economics minister will be remembered for spending more), with the lobbyists (because their sectorial and/or regional groups are going to be worse off as a result of the success of the economic reform) and with the press (because lobbyists advertise heavily, advance information about economic policy is very valuable for the reader, and because criticizing the government per se gives credibility to journalists);

oo that his job is managerial in nature, so that he has to concentrate in identifying (the few, the most important) problems, providing basic guidelines to his economic team, and monitoring the resulting policies;

oo that the population does not know the economic terminology but clearly understands non technical explanations. The minister of economics should help the population to "read" correctly causal connections between policies and results, sometimes by delaying the launching of the economic reform;

oo that for implementing economic reforms he has to create a coalition of the president, some members of government, and the population, on the one side, against the rest of government and the lobbyists on the other side;

oo that time should always be on his side. All costs should be put at the beginning of the program, so that the population feels improvements as time goes on.

oo that he himself, the government within which he works, and the government as an institution, may face credibility problems. Economic reform in incredible (ministries, governments, countries) is possible, but is costlier and slower. There is no alternative to build up credibility upon actions, which may be misread for a long period;

oo that he should never be soft on inflation, and particularly should never trade off inflation for "development".

## 1. ARGENTINA 1958-88: A POLITICAL ECONOMY STYLIZED ANALYSIS

This section of the paper sketches the economic history of Argentina of the last 3 decades from the political economy point of view (a more balanced analysis, namely, one that combines technical as well as political economy considerations, can be found in de Pablo and Martinez, 198?).

Since 1958 Argentina has had 15 presidents (it should have had 5 according to the Constitution) and 31 ministers of economics (implying an average stay of one year in office). Ignoring minor or too incredible policy episodes, I was able to identify eleven policy reforms and/or attempts to reduce the rate of inflation, episodes that will be used in the second section of the paper for synthesizing policy lessons<sup>3</sup>. The episodes to be analyzed are the following: Frondizi, Krieger Vasena and Gelbard's economic policies; Martinez de Hoz on inflation, financial and commercial reforms; Cavallo financial reform and Alfonsin's Austral and Spring

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<sup>3</sup> How different is Argentina from the rest of the developing world, and from the rest of the world, or -in other words- how useful can be for non argentine readers an analysis of lessons derived from the argentine experience?

antiinflationary programs (each episode is described in a table included in appendix A, where the key bibliography is also included).

This is an empirical question (my feeling is that, through a disappointing performance, Argentina has a lot to teach about the issues considered in this paper). To answer it, in appendix B the Argentine experience that emerges from this paper is contrasted with the international lessons derived in a couple of very useful papers by Nelson (1984, 1988).

Frondizi. Politically weak, his presidency resulting from Peronist votes (because in 1958 Peronist candidates were banned); permanently harassed by the military for his "leftist and Machiavellian" attitudes; and facing strong trade union opposition (banks as well as railways employees had to be "mobilized" by the Armed Forces), he was nevertheless able to attract foreign investments, notably in oil and so called "heavy industry" (cars, tractors, chemistry, etc.) through an import substitution policy.

Particularly shocking was his substantial change of mind, notably on economics. Presidential candidate Frondizi had nationalistic ideas about oil, while president Frondizi achieved self-sufficiency in 3 years (from an initial position in which more than half of consumption was imported) through foreign companies (vice-president Gómez resigned as a result of this policy change). The program was negotiated with the IMF (it was the first stand-by of Argentina, who joined IMF just in 1956, after Peron overthrown) and implemented by a couple of ministers of economics that, not being "Frondizi's men", enjoyed high credibility (Alvaro Alsogaray and Roberto M. Alemann).

The opportunities created by the need of the economy to "catch up" after World War II and a decade of Peron, plus specific incentives (particularly explicit high import duties), including a "business atmosphere", resulted in huge foreign investment, disinflation and growth. The large increases of the exchange rate and inflation, as well as recession, after Frondizi's overthrow by the military, are explained more by the political vacuum that followed the mentioned military move, than by existing disequilibria in March 62<sup>4</sup>.

Frondizi's episode shows the importance of political will in successful economic reforms, against the importance of "concertation" with corporate power, as well as the importance of associating with the most advanced economies of the world, the possibility of overcoming domestic political weaknesses with clear signals on economics, and provides the only counterexample during the period, of Kissinger's claim that from the content point of view, decision making in government is based on ideas authorities had before going to office<sup>5</sup>.

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<sup>4</sup> Elaborated in de Pablo (198?).

<sup>5</sup> de Pablo (1989) synthesizes Kissinger's views on government, according to his 2 volume Memoirs (Kissinger, 1979 and 1982). Kissinger asserts that in government it is learnt how to make decisions, but not what decisions one has to make.

Krieger Vasena. The second minister of economics of general Onganía combined an antiinflationary program based on "anchors" with monetary and fiscal policies that superficially looked orthodox.

At the beginning of 1967 Onganía's government was a strong one, in an epoch in which military governments were synonymous of stability, and Krieger Vasena had significant power within government (he was minister of economics, labor and public works), although he had to struggle against the "nationalist" wing of the government in the persons of the minister of interior and the secretary of the presidency. He also had significant support from the business community (the "voluntary price agreement" was widely accepted, without the emergence of black markets) and from international financial centers, and did not have strong opposition from trade unions<sup>6</sup>. In other words, from the point of view of the issues analyzed in this paper Krieger Vasena's position was ideal, similar to the one enjoyed by Martínez de Hoz a decade later.

As shown in the corresponding table, Krieger Vasena succeeded in reducing the rate of inflation and simultaneously increasing the rate of growth of the economy. He left government in mid 1969, as a result of a generalized reshuffling of the Cabinet following "Cordobazo" (riots in Córdoba city), and since then economic indicators deteriorated. In an interview I made to him 15 years after the launching of his program he maintained that the mentioned economic deterioration had a political origin -the weakening of the government as a result of strong differences between the president and the chief of the Army (a constant source of "noise" in military governments)-, and that accordingly it would have happened even if he remained in office (see de Pablo, 1986).

From the political economy point of view Krieger Vasena's episode shows the importance of political power in the hands of the minister of economics to implement and maintain an economic program. From the organizational point of view Krieger Vasena is the minister of economics that shows better the managerial nature of the ministerial job, an issue to be elaborated in the next section of the paper<sup>7</sup>.

Gelbard. The first minister of economics of the last peronist government aimed at eliminating inflation while at the same time increasing the wage share in GDP. A "Social Pact" that changed appropriately relative prices before freezing everything was implemented in mid

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<sup>6</sup> Strictly speaking, non agricultural sectors. Agricultural sectors were angry for: a) the introduction of export taxes, as a result of the compensated devaluation of March 67; and b) the delay in negotiations aimed at reopening the British meat market, after "foot and mouth" was discovered in the Argentine cattle stock once again in 1968; and c) the introduction of a land tax in 1969.

<sup>7</sup> From the technical point of view, Krieger Vasena's antiinflationary program shows the importance of equilibrating as much as possible initial relative prices before freezing anchors. Law 17.224, whose credit should go to Moyano Llerena, introduced a very ingenious mechanism for combining staggered wage contracts with overnight wage freeze, while maintaining social and economic justice (see de Pablo (1972) for details).

1973, namely, one that increased wages and public utility rates, without adjustments on fundamentals (strictly speaking, expansionary fiscal and monetary policies were pursued, like banking credits to finance wage increases). In other words, the program was technically weak, particularly after the increase in the demand for money stopped. Accordingly the initial success could not be maintained and, as shown in the corresponding table, Argentina neared hyperinflation less than 3 years after the launching of the program<sup>8</sup>.

From the political economy point of view the topic that merits attention is the role played by corporative power (trade unions, producers and sellers associations, etc.) on the design and implementation of the program. The "Social Pact" was formally signed in Congress by representatives of the trade unions and all producers and sellers associations; the former since they were part of the government, the latter because through internal reorganization, peronist business leaders took charge of the associations, other members showing accommodating (passive) behavior. No businessman in Argentina in mid 1973 would attempt to challenge economic policy or the government openly, for fear of a tax inspector... or the "visit" of members of guerrilla organizations<sup>9</sup>.

The main lesson that emerges from Gelbard's economic policy from the political economy point of view, refers to the passive role of corporative power at the initial stages of a new government, even if it knows that the economic policy is technically unfeasible or, although feasible, is not the preferred policy of the corporate power. In these circumstances, at the beginning of a new government no explicit challenge is presented, the preferred strategy being to wait until short run macroeconomic difficulties, resulting from the unfeasibility of the program, forces the government to revise the unwanted economic policy.

Martínez de Hoz on disinflation. Martínez de Hoz struggle against inflation had 4 stages: 1) "freedom with responsibility"; 2) price truce; 3) "nothing" (second semester of 1977 to end of 1978); and 4) "tablita" (preannounced decreasing rates of devaluation).

From the political economy point of view the most important topic is the declining degree of voluntarism implicit in each strategy, from 100% in the case of a strategy based on "producers and sellers responsibility", to 0% in the case of tablita. The fact that further stages were necessary implies the failure of the previous ones, in other words, means that voluntarism, that looks a less costly alternative (particularly in the case of new ministers of economics), is

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<sup>8</sup> Krieger Vasena and Gelbard programs had similarities and differences. They were similar in their "cost, inertia and expectations" approach to attack inflation, underestimating the importance of fundamentals. They differed in simultaneous goals of economic policy (particularly wage increases), but most of all they differed in the atmosphere that they, and the governments they belonged to, provided to the business community (for details see de Pablo (1972, 1974 and 1980).

<sup>9</sup> In Hirschman (1970) terminology, at the beginning of a new government corporate power does not use "voice", while individually exercises "exit" (evasion of controls, taxes, etc. ) to the extent that is possible.

finally a dearer one in the sense that, being unfeasible, forces government to change the strategy, starting the new one without the help of the initial "honeymoon effect"<sup>10</sup>.

The main lesson that emerges from the tablita period is that when an economic team feels cornered (after two and a half years in office Martínez de Hoz performance looked fine, except that the rate of inflation remained at the then "intolerable" level of 8% per month, and the economy was emerging from a recession), searches desperately in the "market for ideas", and accordingly does not read carefully the conditions on which the medicine works (assuming that the "doctors" know it, which as Bruno (1988) suggests is not always the case). In late 1978, in countries like Argentina, the monetary approach to the balance of payments and its presumed policy consequence, tablita, were sold by the best professional economists as a tool for reducing the rate of inflation, without recession, and (apparently) without having to pay attention to money creation. This is not an statement about economic theory but on political economy; accordingly the point here is not how the real theory is but how was "sold and bought" from the point of view of decision making.

Martínez de Hoz on structural reforms, financial and commercial. Financial reform, aiming at deregulating the financial industry (through the elimination of ceilings on interest rates, as well as inducing non banking financial institutions to transform into banks... or be regarded second rate institutions in the financial market), started on June 1977. Commercial reform, in turn, on the export side, started at the beginning of Martínez de Hoz period, with a 2 year period program of elimination of export taxes; while on the import side started in November 1976 with specific, overnight reduction of import duties, aiming at eliminating "water" under the tariff, plus a 5 year import reduction program, implemented simultaneously with tablita since the beginning of 1979, that at most would reduce the price of importables (including taxes) by 20-25% in 5 years, starting with a 3% reduction in the first year<sup>11</sup>. The financial reform, as well as the commercial reform from the import side, were reversed during the same military government in which they were implemented (the former by Cavallo in mid 1982, the latter by Sigaut, Martínez de Hoz's successor as minister of economics, in April 1981).

One important difference between the financial and the commercial reforms is that while the former was unavoidable and urgent (because the non-institutionalized segment of the financial market was growing very quickly, while the institutionalized segment, the one who had no alternative but to obey restrictions, was "evaporating"), the opening of the economy was

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<sup>10</sup> After "tablita" was abandoned the rate of inflation increased again in Argentina. Inconsistencies between fiscal, monetary and exchange rate policies, expectations derived from the March 1980 financial crisis, and "noise" generated at the personal level in the transition between presidents Videla and Viola at the end of 1980, explains what happened in Argentina after Martínez de Hoz, the corresponding identification problem generating endless causal discussions.

<sup>11</sup> Neither the financial nor the commercial reforms (except on export taxes) were even mentioned in Martínez de Hoz inaugural address, suggesting the economic team realized the need and/or the convenience of the mentioned reform while in office.

a genuine policy decision in the sense of the selecting one out of several feasible alternatives, precipitated on the export side by the 1975-76 balance of payments crisis.

These reforms, widely analyzed by the World Bank from the time sequencing point of view, illuminate the political economy of economic reforms from the point of view of the coalitions -for and against- that arises as a result of gains and losses of reforms.

In the case of the financial reform, the institutionalized segment of the financial sector, as well as the savers, were pleased, while the manufacturing sector, at that time the main debtor of the financial system, started to criticize the level of interest rates<sup>12</sup>, but they were not able to reverse the reform up to mid 1982 (an episode that will be analyzed later in this essay). Savers, which despite free nominal interest rates were unable to compensate inflation measured by consumer prices during the period, were also unable to stop financial counterreform<sup>13</sup>.

The main lesson that emerges from the export side of the commercial reform is that, contrary to "conventional wisdom", there is no such a thing as a "rigid supply" of the agricultural sector in countries like Argentina. Once the sector perceives clear and sustainable signals from the government, reacts as rationally as any other sector of the economy. The lesson on the import side, in turn, is that the import competing sector produces simultaneously a couple of goods: the merchandises elaborated in their plants, and lobbyist pressure to reverse the policy reform, a "service" that is produced in the producers associations lobbyist activities. And the manufacturing sector, as any other sector, allocates resources in one activity and the other according to the expected profits<sup>14</sup>. In the case of the import duty reform, many manufacturers imported capital goods to update their plants and survive the new competition, but at the same time as a group were able to convince the government that followed Martínez de Hoz, to reverse the import duty reduction program, despite the fact that it was clear that the

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<sup>12</sup> The introduction of the financial reform was particularly painful because during the recession that followed it (but only partially owed to it), entrepreneurs financed involuntary stocks with loans, as they had done in every recession since Second World War, underestimating the effect of the now positive real interest rate (during Martínez de Hoz financial reform real interest rates were "confiscatory" during the end of 1977 and the beginning of 1978, and during the end of 1980 and the beginning of 1981. During the 5 year of existence, nominal active interest rates, deflated by wholesale prices, were 1% per month on average).

<sup>13</sup> \$ 1 deposited in a bank at the beginning of Martínez de Hoz financial reform, and renewed every 7 days at the then current passive interest rate, could purchase \$ .80 of consumer goods in mid 1982, namely, immediately before Cavallo's financial reform. Dollar depositors at the Banco de Intercambio Regional, the largest private domestic bank when went bankrupt in March 1980, have not got "their" money so far, suggesting lack of force of the savers as lobbyists when facing an ambiguous contract.

<sup>14</sup> A point modeled by Findlay and Wellisz (1982).



1980 balance of payments crisis was generated by tablita and not by the import duties reduction<sup>15</sup>.

Cavallo. In mid 1982, exactly five years after Diz financial reform, Cavallo returned (temporarily) to fixed nominal interest rates well below the rate of inflation, to reduce the real value of firms liabilities in the financial system ("liquification", as the action was called in Argentina, implied a 25% decline in the real value of liabilities in the 2 months Cavallo headed the Central Bank).

From the political economy point of view the main lesson is the difference between the ex-ante and ex-post reading of periods in which the "dirty work" is at the center of the policy. From April 1981 on, namely, after the end of Martínez de Hoz period, debtors pressured for a relaxation of the debt terms. Households that bought houses with credits under "circular 1050", as well as firms, lobbied for liquification. Among professional economists the "mood" around mid 1982 implied that "something should be done". In other words, some action on the financial system was expected and recommended by everybody, and in addition to that Cavallo had explained on the record was his ideas were on the subject (see the interview I made to him on April 1982 in de Pablo, 1986).

Cavallo's strategy deliberately increased temporarily the rate of inflation, a very unpopular side effect. In other words, the strategy worked at a cost (some economists also blame him for "destroying the capital markets in Argentina", surely an exaggerated charge). As a result, even today he is widely criticized for the side effects of the reform, from people who at that time had no workable alternatives, without public defense from the entrepreneurs who's firms survived thanks to Cavallo liquification.

There is nothing surprising about all this. Maquiavelo pointed out to the Prince that since (in economists terminology) policies very rarely are Pareto optimal, he had to be prepared for being criticized by those affected by the policy change, and by not being defended by those favored by it. The ministers who make the "dirty work" are my heroes, but they have to know that they are inevitably going to be the evils in the literal reading of the population, and in the interested reading of the rent seekers (Pinedo in 1962, Wehbe in 1972 and 1982, Rodrigo in 1975, Mondelli in 1976, Sigaut in 1981 and Cavallo in 1982, a the "dirty work" ministers of Argentina during the 1958-88 period).

Alfonsín. The 2 more important antiinflationary programs of Alfonsín's government are the Austral and the Spring plan. The former, launched in June 1985, was extensively analyzed as an example of the "heterodox" attack on inflation, also implemented in Israel from July 1985 on, and in Brazil since March 1986 on<sup>16</sup>; the latter was started on August 1988 (the "Spring"

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<sup>15</sup> Some manufacturers imported capital goods, for the reason cited in the text and/or anticipating a policy reversal of the opening of the economy.

<sup>16</sup> See Bruno, Di Tella, Dornbusch and Fischer (1988) for the results of the 1987 Toledo seminar on these programs as well as the bolivian program.

season starts in late September in Argentina, but reality forced an early implementation of the program).

From the political economy point of view Austral-like antiinflationary programs teaches us, first, that under extreme economic conditions any policy generates instant political popularity (Alfonsín in June 1985, Sarney in March 1986, peaked political popularity, and both presidents were able to win the exogenously dated elections that came immediately after the launching of the programs). So in the short run there is no trade off between economics and politics; on the contrary, there is political room for working of the fundamentals.

A second lesson that emerges from Austral like plan is that when the government has credibility, it does not need to "negotiate it" with the corporative power. The population policed price controls at the beginning of Austral plan (and supermarkets, whose market share increased substantially in Argentina in recent years, for bureaucratic reasons have no alternative but to sell at controlled prices). Spring plan, implemented by a much weaker government (last year of Alfonsin's term), had to be negotiated with Unión Industrial Argentina.

President Alfonsín's role in the 2 programs was different. He played a key role at the beginning (you have to feel cornered, but at the same time be very courageous, to implement a program who was not tested before) making a convincing initial address, but in 1987 he contributed to the revival of the rate of inflation when, in the name of political considerations, named a trade union leader as labor minister, and increased substantially rediscounts for the national mortgage bank (... and the Radical party lose the September 1987 election so that, fortunately for economists, bad economics contributed to bad politics). In 1988, forgetting projects like changing the Constitution, moving the Capital from Buenos Aires to Viedma, etc., is backing 100% his economic team, and lobbyists, including governors (most of them peronists), know it.

Summary. Many questions remain unanswered after surveying the rich experience of Argentina of the 3 last decades. Nevertheless, the following relevant facts emerge from the analysis: 1) the importance of political will (coupled with technically correct policies), even when lacking strong political and corporate support, as in the case of Frondizi; 2) no clear evidence of one-to-one relationship between economic successes and failures, and democratic and military governments (remember that in Argentina the minister of economics of the military governments have been invariably civilians; 3) the perverse role of corporate power, in the sense of providing biased information on approval and disapproval of policies to naive policymakers, and in the statu quo nature of the institutions, essentially conflictive with economic reforms; and 4) the absolute need to "do something on inflation" whenever the rate is felt politically "intolerable", thereby postponing conflicting economic reforms.

## 2. A CHECKLIST FOR THE SUCCESSFUL MINISTER OF ECONOMICS

Doing everything possible to achieve a goal does not assure success, but certainly increases its probability. What lessons can be drawn from the economic reforms surveyed in the previous section of this paper, beyond the need of technical consistency, to accomplish the goals pursued?

This section presents the mentioned lessons classified under 3 main headings: hints referred to the minister of economics itself, recommendations related to his (or her) interaction in his capacity as a minister, and ideas referring to the time dynamics of economic policies<sup>17</sup>.

But before starting the analysis, a general remark is in order, particularly important for those who approach the subject of this paper from the technical literature on the theory of economic policy. Designing and implementing an economic policy is not a "once and for all" effort: it is an ongoing process, even in the case of ministers who do not apply time inconsistent policies. Reality is full of unexpected shocks, including those resulting from unavoidable policy errors, that crucially affect the original actions, forcing constant revisions. Just in the movies the economic minister ask the president about the arguments of the Social Welfare Function, maximizes it subject to well known constraints, and everything works according to the textbooks.

## 2.1 Personal issues

The decision to lead the economic team of a country is a major one. It involves, among other things, the following:

1) a true "full time" involvement, with its corresponding tension in personal and family life (particularly strong in the case of the children, who at school are told by their fellow students that because of their father their families cannot earn what they deserve, or that their older brother or sister cannot get a job, or that their grandfather is still working at 75 years old);

2) a dramatic deterioration of revenues;

3) obvious changes in the relationship with friends (some of the old friends disappear, while many other "friends" emerge from the shadows);

4) tremendous pressures from the lobbyists and the press, who tend to <<personalize>> the arguments ("you have no heart", "you will be responsible for the hungry and the desperation of thousands of innocent families"); and

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<sup>17</sup> A partially overlapping checklist can be found in de Pablo (1988).

5) clear risks on future work in the country, walking in its streets, going to jail (at least temporarily) and becoming famous for undesirable reasons. Which of the former ministers of economics of your country is remembered with respect and admiration by the population?. As I said before, just in the movies the economic minister presides his economic cabinet meeting, announces long term policies, spending the rest of the day in a golf course. In practice, when the "red carpet effect" is over, namely, a few days after entering the ministerial office for the first time, reality emerges, and the mentioned personal conditions result unbearable, except for those human beings that regard holding power as its ultimate goal<sup>18</sup> (if you are not one of them, my sincere recommendation for you is to try another job. There are many on Earth)<sup>19</sup>. The minister of economics I have in mind in this essay wants to improve the welfare of the population, but he does not sacrifice himself because he enjoys the use of power.

Those who want to succeed as minister of economics should pay attention to the following couple of important personal issues:

First, clarify yourself what you would like to accomplish, BEFORE accepting the job. In his Memoirs Kissinger (1979, 1982) makes it clear that, contrary to the conventional wisdom, high governmental posts do not create human capital, they consume it. The successful minister does not learn in the job what decisions he has to make, but how he has to make these decisions. In other words, while being minister he learns tactics, that he applies to the stock of ideas he had before becoming minister, since in government there is no time for quite thinking<sup>20</sup>.

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<sup>18</sup> The Tinbergen (1956)-Mundell (1962) view of the minister of economics assumes the head of the economic team knows everything, acts just when through his actions "general welfare" can be increased, and is absolutely incorrupt. To this extreme position 2 other have been added: the one that views the minister as integrating a government that just wants to be reelected (Downs, 1957, and the political business cycle literature, Nordhaus, 1972), and the view in which government is a tool of pressure groups, to get through it resources from the rest of society (Stigler, 1971; Becker, 1983). The Argentine experience shows that the average stay in office of ministers that "represent" pressures groups, is far smaller than the average stay of powermanics. This does not mean that corporate power does not exist in Argentina, it simply suggest that it is not "personalized" in the figure of the minister of economics.

<sup>19</sup> The fact that the supply of candidates for the post of minister of economics, even in countries like Argentina, is unbelievably large, just shows who popular "powermania" is among human beings.

<sup>20</sup> Strictly speaking, this recommendation is primarily directed to future ministers of economics, and particularly to students of economics. The time spent in the university discussing what can be expected, as well as what should be done, in economics, forms the "core" of the wisdom that the incoming minister brings to office and, according to Kissinger, the one that is going to be applied while in office. The interesting implication of this disputable assertion of Kissinger is that when a minister faces a crisis, because his ideas are not correct, his causal reading of the crisis as well as the modification of economic policy is also modeled and bounded by the original ideas.

This clarification of goals and tools is important, not just for yourself, but also for the key conversation you will have to have with the President, or the Prime Minister, when accepting the job<sup>21</sup>. Nobody believes that the promises the President does at that meeting, interested as he is in hiring you, can be expected to hold literally, and in addition to that most of the problems that you will face in office are probably unknown and unforeseeable at the moment of the mentioned conversation; but at least it is important to clarify criteria on what should, and should not, be done, and how, in order to provide guidelines for action and signals to the private sector (the relationship between the minister of economics and the President is analyzed later on, under "interactions").

What as a minister of economics you will try to do depends on your reading of the current economic situation, as well as your causal reading of the performance of the economy of, say, the last decades. From this point of view the notion that your predecessors were either incompetent or corrupt should be resisted. Confronted with a rate of growth of GDP smaller than the one desired, or a rate of inflation greater than a "decent" one, the new minister should ask himself why his colleague could not get better results; if the exercise is made as objectively as possible, normally he will end up with a better understanding of the way in which the economy really operates, an essential ingredient for success.

Second, government means primarily decision making, not merely diagnosis. You can say "the government should care about the poor people", feeling that you have done your job, when you are at the family table, at dinner with friends, or even in the classroom; but not when you are in government. Being minister of economics means transforming problems into actions directed to eliminate, or at least reduce, them.

This implies, by and large, developing the appropriate attitude for identifying difficulties, for checking if the difficulties found are the minister of economics problem (i.e.: there are many problems that are not the minister of economics problems) and for doing something. The proper is an "ex-ante" attitude, one that uses history just for gathering experience, but is forward looking in nature, one that uses always scarce time and energy in searching for solutions instead of searching candidates for blaming for the difficulties. An important portion of the differences that exist between academics and policymakers are due to differences in attitude.

Again, just in the movies the typical day of the minister of economics consist in the inauguration of, say, a bridge (financed with the taxpayer money, an important fact normally forgotten by the minister invited to the inauguration, that behaves as if the bridge was financed by his pocket). The normal correct decision of the minister of economics of a country implies

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<sup>21</sup> A minister of economics is not picked up on the street, although in the case of Argentina (particularly in military governments), there are examples in which the president and the candidate -and eventually minister of economics- had not met before. Anyhow, the need for the initial conversation is clear, since despite the number of "general conversations" that the 2 men could have had before, the one conversation I am talking about relates to specific issues, and specific commitments, given the roles both men are playing.

that "NO" is the most often word used in his vocabulary, having to defend the general public interests, normally absent in audiences, against specific sectorial, or regional, demands for resources.

This point is particularly important in the case of economic reforms. Everybody knows that if inefficient firms are transformed into efficient ones, then there is an improvement in welfare<sup>22</sup>. But in practice that means that the minister himself has to face the inefficient entrepreneurs, its wage earners and its corresponding families, telling them that they have to "adjust or close". When I listen someone recommending the firing of, say, 100.000 public employees, I wonder how long would it take to him (or her) to fire his maid if he considers that her services are not proper.

Decision making is never Pareto optimal in practice, in the sense that even the best policy produces some harm. Affected people, region and/or sector, when bargaining, tend to personalize the argument, and accordingly decision making has a psychological cost<sup>23</sup>. In the design of an economic policy, then, it is important to check how "decision making intensive" the policy to be implemented is.

When someone refers to the economic authorities of a country the expression "economic team" is invariably found. This is because in government the economic issues are not in the hands of an individual but involve many persons. This has an important implication, namely, that the job of the minister of economics is managerial by nature, and it is an important implication particularly because economists are normally trained for working in isolation, having to learn managerial skills while in office... at citizens expense.

What managers want more is to have talented people around. The minister of economics that thinks that he can personally meet without difficulties the challenges of the job, needing at best mere implementators of his decisions, is a clear candidate for failure<sup>24</sup>. With skilled people around, the minister can attempt successfully his job, dedicating his time to identify difficulties, to check if he has to answer these difficulties, to discover who, within his team, can be put in

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<sup>22</sup> Ignore, for the moment, Lipsey and Lancaster (1956) second best considerations, as well as Calvo (1987) credibility considerations about duration of the reform.

<sup>23</sup> The judicial revision of governmental decisions also personalizes. Think, for instance, in the intervention and/or liquidation of a commercial bank. If the stockholders of the liquidated commercial bank succeed in convincing a judge that the governmental decision was wrong or even premature, the president of the Central Bank could go to jail, and not all the "experts" that at that time said that "something should be done" with respect to the commercial bank under consideration.

<sup>24</sup> As mentioned in the first section of the paper, I learnt this managerial approach of the minister of economics from Krieger Vasena. When at the beginning of 1967 he was appointed minister he was in Europe, as representative of Argentina at the ECC. He told me that in the plane back to Argentina he took a paper and wrote names (of potential candidates form his team) before starting writing goals and tools.

charge of doing the homework, monitoring later the evolution of the difficulty under consideration<sup>25</sup>.

Even using managerial techniques, available human and material resources are always scarce in the ministry of economics. Accordingly, the economic policy should concentrate on few, important goals, leaving the rest to ... God. Numerous, very detailed, targets, produce more noise than signals to private sector decision making (the energy of the private sector should not be wasted in calculating how many target failures and successes the minister had in, say, the last week).

On tools, a word on "voluntarism" is necessary. Very often the first round of the economic policy of the new minister is voluntaristic, relying heavily on "honor, responsibility, compromises, non utilization of individual opportunities, etc.". The rationale for this is that voluntarist policies have less costs than those based on rules (think, for instance, in the case of "voluntary restraint" on the prices charged by domestic monopolies, as compared with the opening of the economy as a way of putting a ceiling on prices). The lesson that emerges from the argentine experience is just the opposite, namely, that just in a superficial analysis voluntarism is a cheaper way of implementing economic policies than rules. Normally the ministers that started with voluntarism schemes ended up applying rules-based economic policies. What looks cheaper becomes dearer, so the minister has to resist the natural temptation to start with voluntaristic economic policies<sup>26</sup>.

Last but not least, what is the importance of luck in successful economic policies? Economists that did not have practical experience on policymaking laughs when confronted with this topic, because they tend to see luck as a tautological substitute for homework, either from the technical point of view or from the considerations developed in this paper. And in this sense they are quite right. But the issue of luck emerges very frequently when I discuss their experiences with former ministers of economics, and not just in Argentina<sup>27</sup>. The idea I got from these conversations is that the real world is much complex than the most complex models, so that many "exogenous" factors emerge all the time; in these circumstances, former ministers of economics maintain, luck is sometimes crucial.

## 2.2 Interactions

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<sup>25</sup> The type of skills that are relevant for being useful to a minister of economics is an issue that will be analyzed later on, under "interactions".

<sup>26</sup> If he asks the lobbyists on this issue, they would be given the wrong advice, because in voluntarist-like type of policies lobbyists play a crucial part... at citizens expense.

<sup>27</sup> de Pablo (1980, 1986) reproduces the interviews I made to former ministers of economics, and presidents of the Central Bank, that were in office since late 50's.

Leading the economic team of a country implies constant human interaction, so successful economic policies are impossible without adequate interaction. In this essay the following interactions of the minister of economics will be analyzed: 1) with the President and other members of its Cabinet; 2) with the rest of the economic team and the bureaucracy; 3) with the population; 4) with the lobbyists and corporate power in general (trade unions, producers and sellers organizations, professional associations, etc.); 5) with "institutions"; and 6) with the press.

But before entering into the mentioned analysis a couple of issues common to all interactions have to be presented. First, it was said before in this essay that the essence of government is decision making<sup>28</sup>, and most economists prefer rules over discretionary or voluntarist policies<sup>29</sup>. But this does not mean that the minister of economics is dealing with robots or computers, for which instructions are enough; by and large decision making implies negotiations with other human beings, not unilateral implementation of the minister's views.

The other issue, stressed by Simon (1987), refers to information as a constraint in the interaction (he challenges political explanations based on power, and pressure groups, with one based on the way in which information is processed through the political system. In his words: "To understand politics, we must understand how issues come into focus of attention, hence become part of the active agenda".

The extent to which the economic problems of a country have informational origin is an empirical question, that should be checked and not simply ignored by a successful minister of economics.

Interaction with the President and its Cabinet. The relationship between the minister of economics and the President of a country is complex, since for the former the President is simultaneously his pupil, his boss and his friend.

It is very important that the President understands the economic policy to be applied, its goals, its tools, its costs, its risks, its time dynamics, who is primarily going to be benefited and who is going to be harmed. From this point of view I see no alternative to treat the President as a student, although a very special one, namely, an interested person, normally with more than average coefficient of intelligence, who can understand economic reasoning when it is presented in a non technical fashion.

This "lecture effect" is crucial, not just to introduce relevant economic reasoning in the President mind (not only he need not be an economist, but before being President he may also consider economics too difficult, too dull, or too near Mafia activities to merit consideration),

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<sup>28</sup> Inspiring, creating a favorable atmosphere, is also part of the functions of government, but never a substitute for correct decision making.

<sup>29</sup> The issue of rules versus discretion is still open, as Barro (1986) and Blinder (1987) show.



but also for neutralizing economic proposals that reach the President's mind from other members of the Cabinet, his family, his friends, the lobbyists, etc<sup>30</sup>.

The minister who, in the name of the fear of being repudiated, or trying not to worry the President, underestimates the difficulties of the economic program he is implementing, is surely asking for trouble ahead. Presidents do not like restrictions, adjustments, etc. (who likes them?), but the least they want is to increase restrictions, or introduce them, once the program is in operation and everybody in the country is viewing the current situation as the floor of the future situation (the last section of this paper is dedicated to time dynamic issues in the political economy of economic reforms).

The President is the student of all his ministers, but at the same time is the boss, particularly because he is the ultimate responsible for policy. In economic decision making the President usually provides broader information, economic as well as non economic goals, and sometimes a more comprehensive reading of the behavior of society.

The fact that the President is the boss raises the issue of the resignation of the minister of economics. On paper quitting government looks easy; you have a major policy disagreement, and/or there is an unavoidable personality clash, then you get a piece of paper and write a letter of resignation<sup>31</sup>. In practice this is not so. Ministers always have some projects on which they are particularly involved, so that resignation always implies a trade off between the difficulty that creates the issue of resignation, and the mentioned projects whose continuation could be jeopardized by resignation. In many occasions the minister asks an appointment to present his resignation, but the letter never gets out of the pocket ("don't do this to me, at least now", said by the President who invited you to work with him to begin with, is an irresistible invitation to stay a little bit longer in office, many former ministers told me).

Last but not least, psychological considerations are relevant. The President needs advice, but also understanding and relaxation, given the permanently tense setting in which daily life in government evolves. Friendship between presidents and their minister of economics, when they exist, goes well beyond working obligations, emerging from the very simple fact that they are human beings that spend many hours together under heavy stress. Kissinger (1979, 1982) has pointed out that as time goes on, presidents tend to make decisions

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<sup>30</sup> Argentine historian Felix Luna once suggested rather informally that one day it will be necessary to analyze systematically the influence that the brothers-in-law of military presidents had on design and implementation of policies. Johnson (1988) points out that his brother in law was the only politician trusted by generalissimo Franco.

<sup>31</sup> Should the minister of economics of a country just restrict his opinions to economics, or should he considered himself part of a government, and accordingly have opinions on the overall performance of the government of which he is a member? This is an endless discussion, at least in Argentina; I personally favor the second alternative. The minister of economics of a country has to have an opinion on going to war or not, getting closer to the First, Second or Third World, and the death penalty.

according to who is the Cabinet member that brings issues for consideration, stressing the growing personalization of policies.

The minister of economics is not the only minister of the Cabinet but just one of them, however important and visible his functions are. The minister of economics should know that a country in which the rate of inflation declined during his term, as a result of bridges that were never finished, hospitals in which proper maintenance was not made because of budgetary restrictions, etc., is a country in which he will be remembered for his antiinflationary successes, but at the same time his colleagues will be remembered for bridges not done and hospitals in poor condition. In other words, he has to be prepared for facing serious fights from his colleagues in the Cabinet, particularly on budgetary restrictions, because all ministers, and not just the economics minister, want to be remembered by History.

That means that there is an unavoidable conflict among Cabinet ministers. How is this conflict solved, in other words, how much power the minister of economic has within the organization of the government, how independent from his actions are labor, public works, in addition to the Central Bank?<sup>32</sup> This is an important issue (one of the first the candidate should put in the agenda of the conversation with the President before accepting the job), both from the design and implementation of the economic policy, as from the "signals" to the private sector, points of view<sup>33</sup>. In some countries where the formal organization of government implies a decentralized decision making process, the minister of economics tries to replicate a centralized decision making process introducing "his" men in charge, with variable degrees of success<sup>34</sup>.

In my ideal government the minister of economics is simultaneously above and below his colleagues. It is above them from the instrumental point of view, in the sense that the budgetary restriction implies a simultaneous analysis of the whole government; but at the same time it is below them in the sense that economics, and particularly public sector resources, are an input for ultimate governmental goals (justice, education, etc.).

Interaction with his economic team and bureaucracy. Regardless of whether he is a professional economist or not, the minister of economics should have a team of full time professional economists around him, dedicated to technical and non technical aspects of economic policy.

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<sup>32</sup> Most of the literature suggests that coherent decision making speaks against the "independence" of labor and public works ministers, but at the same time speaks in favor of the independence of the Central Bank.

<sup>33</sup> In crises periods, the minister of economics can get "special powers" (like veto power on expenditures) over his colleagues in the Cabinet, particularly on labor and public enterprises issues (to assure consistency in relative prices).

<sup>34</sup> In many countries the administrator designated to liquidate a public enterprise, returns to the ministry of economics few weeks later... with a 5 year investment plan in his pocket.

As was said earlier, the job of the minister is managerial in nature. That means that the interaction with the rest of the team should be developed on a managerial basis, namely, reserving for the minister the important jobs of identifying issues that are characterized as problems<sup>35</sup>, checking that the mentioned issues are part of the obligations of the minister of economics, picking up the member of the economic team that should be in charge of the problem, and monitoring the evolution of the issue<sup>36</sup>.

What kind of skills are relevant for those that works with the minister of economics?. First of all it is crucial that they have some training in economics, by which I do not mean being able to read Econometrica standing in the subway, but "carrying in the blood" the basic principles of economics (i.e.: opportunity costs, feasible and unfeasible alternatives, etc.)<sup>37</sup>. But in addition to that they have to have a forward looking mind, sense of proportions (policymaking itself is an economic problem, since at the ministry of economics resources are always scarce), the ability for diagnosing against the clock and with limited information and quick response to shocks, a clear idea of the behavior of the population and lobbyists, etc. These skills are not typically learned at the university (although the basic principles should), they emerge from experience; that is why it is so important that the public sector can provide incentives for people to make their professional careers as civil servants<sup>38</sup>.

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<sup>35</sup> From this point of view it is crucial for him that the "honest to God" version of reality is always present on discussions, memoranda, etc. A team that worries about telling the minister bad news as soon as they emerge is a liability, not an asset for him; but do not expect this to happen "naturally", it has to be induced by a genuine attitude of the minister showing that he really wants to know what is going on, no matter what it is.

<sup>36</sup> Note the stepwise nature of the 3 issues, namely: 1) what is the problem?; 2) is it "our" problem?; and 3) what can be done on it?. Buchanan (1988) stresses that from 1 and 2, 3 does not necessarily follows, since governmental action improves welfare just when market failure is smaller than political failure (many horror stories can be found in post Second World War Argentina as a result of ignoring this important principle).

<sup>37</sup> In this connection it is important to have an "adult" approach to economic theory. Strict competitive theorems are proved for markets composed by infinite economic agents. It is not adult to ignore competitive microeconomics in the name that in practice all markets have finite number of agents. My feeling is that economic theory is much more relevant and illuminating for decision making, than what the typical professor of economics suggests to his students.

<sup>38</sup> Can governments hire the people who has the mentioned skills, at the wage rates generally offered by the public sector? This is an important practical issue, not just in the ministry of economics but also in public enterprises. When governments cannot pay competitive wages (adjusted for the desire of power of the typical high rank employees), they hire rich people, unskilled people, corrupt people... or patriots. The most innocent way of supplementing official wages of members of the economic team is to allow them to give paid conferences, in which they say... what everybody knows (members of the private sector are willing to pay for listening what everybody knows, to keep alive personal contacts with the economic team... "just in case").

With regard to the handling of the bureaucracy, Kissinger (1979, 1982) points out that permanent civil servants are accustomed to implement, not to design, policies, and when they are forced to design policies, usually they present its preferred alternative rounded by a couple of utopian options, opposing extremes, so that any blind decision maker could please its bureaucracy by always picking up the intermediate alternative.

Interaction with the population. The successful minister should never underestimate the population. The ordinary citizen does not have the vocabulary of trained economists, but that does not mean that they do not know -and use- the basic concepts of economics that we economists describe with a technical jargon<sup>39</sup>.

People are interested in what is going on in economics (look at the portion dedicated to economics in non specialized papers) and pay attention to explanations that 1) they can understand and 2) are credible. There is nothing worst than a minister of economics that, forced to deteriorate the level of welfare of the population, does not explain what is going on, or makes incredible explanations. The average citizen gets really mad when, realizing in everyday transactions that his purchasing power is declining, are told by the minister of economics that "the situation is improving". If the situation is really improving, but the population does not perceive it, then the minister should use the means of massive communications to show it; but it is always very important that the population feels that they, and the minister of economics, "are living in the same country".

I said before that many economic policies in Argentina ended up in failure because they were based on the wrong assumption that the economic team was cleverer than the population (the minister that thinks that he can fool all the people all the time, normally ends up been fooled by reality very soon). In countries in which the turbulent performance of the economy converted the whole country in a giant school of economics (Argentina, Brazil, Israel), people develop not just rational but hyperrational expectations, namely, after realizing that the current short run macroeconomic policy is temporary in nature, they calculate when the next "Deluge" is going to come, and accordingly when is the optimal moment for buying "tickets for Noa's Arch". The argentine experience suggests very persuasively to ministers of economics who want to success, to read with great caution the political business cycle literature, based on irrational behavior of the population and/or asymmetric information in favor of government, resisting as much as possible the temptation of policy surprises<sup>40</sup>.

The interaction between the minister of economics and the population raises the question of the political cost of an economic policy, and particularly of an economic reform,

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<sup>39</sup> The average citizen is more conservative, more orthodox, and make less reliance on "magic" economic programs, that the average economist. People in the street simply do not believe that "there is such a thing as a free lunch", although clearly are willing to accepted it if they are offered one.

<sup>40</sup> See Alesina (1988) for a recent survey of political business cycle models of different vintages.

namely, the temporary decline in welfare as a result of a policy that, if implemented steadily, eventually would increase the welfare of the population. Assuming that from the technical point of view all tools for minimizing temporary costs of economic reform have been discovered and are going to be applied (i.e.: the role of anchors in "heterodox-orthodox" antiinflationary programs), my advice to the minister of economics is that he must ignore political costs, once it has checked that the policy reform is a sound one, because if this is so then, after the initial deterioration, the population is going to feel better as time goes on. From the population point of view, then, the real issue is not the one of temporary costs, but the meaningfulness of temporary sacrifices in terms of lasting improvements. In other words, what the population does not want is the "stop and go" policies, because then sacrifices are net waste in the sense that the population feels worse today... and even worst tomorrow.

Interaction with the lobbyists and the corporate power. Corporate power, namely, trade unions, as well as producers, sellers and professionals organizations, just have one goal, namely, to defend the interests of sectors and regions that are already in the system (i.e.: the National Association of Producers of Butter is an organization that does not defend the interest of the produces of butter, but the interests of the already established producers of butter<sup>41</sup>). Corporate power, by nature, is then conservative, rent seeking, partial equilibrium oriented; and that is why I always watch carefully economic policies and/or measures backed by corporative power<sup>42</sup>.

On the interaction between government and pressure groups classic references are Stigler (1971), Peltzman (1976) and Becker (1983). For Stigler, "regulation is acquired by the industry and is designed and operated primarily for its benefit". Becker, on the other hand, derives the following propositions: 1) A group that becomes more efficient at producing political pressure would be able to reduce its taxes or raise its subsidies; 2) an increase in deadweight cost reduces the equilibrium subsidy; 3) politically successful groups tend to be small relative to the size of the groups taxed to pay their subsidies; and 4) competition among pressures groups favors efficient methods of taxation.

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<sup>41</sup> At best; at worst the mentioned association defends the interests of the leaders of the association, namely, the interests of the firms whose owners are members of the board of the association in the case of manufacturing associations, the personal interests of the leaders in the case of trade unions, etc.

<sup>42</sup> Rent seeking literature, for instance Tullock (1967) and Krueger (1974), points out that -in addition to the cost derived from the distortionary policy implemented as a result of the pressure of the rent seekers- the resources devoted to lobbying itself should be taken into account in computing costs (rent seeking literature was surveyed by Tollison, 1982). This last point is very important: when a government "signals" that DUP activities will not have high private return, always scarce human resources are devoted to alternative activities, for instance, productive work!. Krueger also points out a cumulative process (a political "vicious cycle"), since when the market mechanism is suspect -as a result of rent seeking activities- greater governmental intervention is demanded.

Accordingly, in principle corporate power is against economic reforms that deregulate economic activities, liberalize markets, opens the economy, etc. So, when implementing an economic policy in general, and economic reforms in particular, the minister of economics should use corporate power as least as possible (there is a fundamental difference between keeping them informed, as the rest of the economic unit, and using them for getting information and/or negotiating reforms).

If introducing economic reforms, the minister of economics should pay particular attention to short run macroeconomic policies that are being implemented simultaneously. When corporate power feels that it cannot confront directly the economic team (for instance, at the beginning of a presidential term), normally waits until the economy runs into trouble as a result of macroeconomic policies. When this happens, corporate power recommends the solution of the existing short run difficulties... through the abandoning of the economic reform (i.e.: if in the midst of an opening of the economy there are short run problems, even independent of the opening of the economy, producers association will blame the opening for the difficulties, suggesting very persuasively that the solution of the problem lies in a reclosing of the economy, or trading off certain short run measures for the mentioned closing of the economy<sup>43</sup>).

Should the successful minister of economic "exploit" conflicts that exist among different members of the corporate power? It should... through the market, not through the formation of a coalition between himself and a portion of corporate power, against the rest of corporate power. This results from the view that "corporations are permanent, while the current authorities are temporary". No businessman would openly help an economic team to eliminate a trade union leader, or viceversa; no businessman would denounce another that is cheating price controls, tax authorities, etc. But the minister can expect other corporations not to speak against openly, if economic policy measures affect the interests of another corporation.

Interaction with "institutions". Well before the current revival of the political economy aspects of economic policies, technical consistency was regarded as an important but nevertheless necessary condition for a successful economic policy. Relevance, namely, that essential aspects of reality have to be captured by the model that underlies the economic policy, was also considered an important aspect for success.

Tautologically defined, relevance means "everything but technical consistency". The operative definition of relevance that will be used here restricts it to the importance for policy design and implementation, of "institutions", namely, of existing modes of behavior outside the economic team and the president, namely, in the private sector as well as in the rest of the public sector (for instance, in public enterprises)<sup>44</sup>.

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<sup>43</sup> At the beginning of 1979 Martinez de Hoz implemented simultaneously a system of preannounced declining rates of devaluation ("tablita") and a 5 year plan for reducing import duties. When in April 1981 his successor Sigaut had to correct a balance of payments imbalance, he got rid of both economic policies, not just tablita, pleasing corporate power.

<sup>44</sup> These are not institutions in the sense of North (1987), namely, resulting from the existence of transaction costs.

"Institutions" in the sense of "non price" constraints to behavior is a broad concept that includes many different situations. If the development strategy of the minister of economics of a strict Roman Catholic country is based on eating meat during Holy Week, in this case there is a clear conflict between "values" and "development", and presumably the minister of economics should prefer the former to the later, particularly if he wants to remain in his job; but most restrictions are not that extreme (think, for instance, in birth control).

What the successful minister of economics should do is to take into account the existence of the mentioned restrictions, but at the same time introduce policy changes to eliminate, or at least reduce its scope. The incoming minister of economics can, at best, make an inventory of assets and liabilities at the beginning of his term. If he realizes that the past behavior of the population as tax payers implies a substantial degree of tax evasion, he cannot just assume that for the very simple reason that he is the new minister of economics, tax evasion will be eliminated; but at the same time he does not have to consider the initial level of tax evasion as "sacred", impossible to modify (I will come back on this, during the discussion of time dynamic political economy issues).

The restrictions under consideration do exist, but in reality they are less in number and intensity of what corporate power, political experts and the bureaucracy, induces the minister of economics to believe. Because very often in the name of restrictions vested interests, or just leisure, are defended. The successful minister of economics should systematically challenge all recommendations of the "this is not going to work" variety, to check if the author of the recommendation have really performed cost-benefit analysis, or is just based on the mentioned non-arguments<sup>45</sup>.

Interaction with the press. A successful minister of economics communicates directly with the population through public addresses, but the rest of the "signals" the people gets from government, as well as the image it has about the macro evolution of the economy, are processed by journalists and media experts. Accordingly the interaction with the press is an important part of his job as minister of economics.

"Independent" journalism means that papers are written to please those who advertise (the lobbyists, the government, etc.) and the people that buy the paper. That is as far as a "free press" goes from the point of view of the owners of the paper; the journalist is an employee of the owner of the newspaper. The successful minister of economics should understand that, whether he likes or not, this is the best press he can get in a free country, and he has also to understand that, in order to gain credibility, the typical paper is normally biased against the government.

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<sup>45</sup> When he presented his recollection as manager of the U. S. airline deregulation process, Kahn (1979) pointed out that lobbyists attended all meetings with copies of the Lipsey and Lancaster (1956) second best theorem, aiming at blocking economics reforms abusing and not just applying the mentioned theorem.

The relationship between the minister of economics and the press is conflictive by nature. Because, in order to minimize capital gains and losses resulting from partial dissemination of information, public officials should hidden future economic measures (i.e.: "there will be no devaluation" is the unavoidable answer of any president of a Central Bank), but at the same time journalists know that people buy papers to know in advance the content of future economic policy, to minimize and sometimes gain from policy changes. Accordingly, frictions between the economic team and the journalists of a country are inevitable, and here the only advice I can make is do as much as possible to maintain the mentioned conflict as a role conflict, not as a personal one.

### 2.3 Time dynamics

The issue of time sequencing among economic reforms, and its interaction with short run macroeconomics policies, was widely studied in the World Bank, mainly from the technical point of view, as a result of the difficulties faced in implementing reforms in the Southern Cone countries at the end of the 70's. The topic will be explored here from the political economy point of view.

The successful minister of economics is the one who permanently, or most of the time, has "the calendar time on his side", namely, the one that most of the time enjoys a situation in which, without new measures of economic policy, the welfare of the population improves, however mildly. This is an important aspect that should be taken into account when the "optimum" type of economic reform is picked up by the economic team ("tablita" and "heterodox" types of antiinflationary programs belong to the "enjoy now, pay later" variety, and consequently present difficulties from the political economy point of view). In addition to that, the successful minister of economics is the one that, in the presence of unexpected temporary improvements of the performance of the economy (particularly in public finance), resists the temptation of spending correspondingly, namely, keeps "security cushions"<sup>46</sup>.

The main instrumental implication of having time always in favor of the minister of economics is that the costs of a successful economic reform should come first and the benefits should appear later, and particularly heavy costs should come at the very beginning of the policy.

The rationale of this assertion is that the political power of governments, as well as the political power of the minister of economics within the government, not only are not infinite,

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<sup>46</sup> In a word, the successful minister of economics is the one that waits until history analysis dedicated to his term label him successful, avoiding systematically to be cornered and hiding temporary opportunities in his talks to the rest of the government while he is in office, to maximize the probability of absorbing shocks with existing cushions.



but normally decline as time goes on. That means that since technical consistency of a policy and political power are substitutes in the short run, as time goes on the demand on economic "results" is going to be higher and higher, while the corresponding demand for political power to compensate technical mistakes and/or introduce necessary adjustments is going to find increasing difficulties.

A corollary of this notion is that economic reforms should be implemented as soon as possible from the term of the government that is implementing them reforms point of view, and this for 2 reasons. First, the beginning of a term is the only moment in which difficulties can be blamed on the previous minister of economics and/or government. Secondly, if -as Calvo (1987) suggest- an economic reform faces credibility problems because the population is not sure that the next government is going to maintain it, this credibility cost is reduced when the program is launched at the beginning of the term of the reformer government, since if the reform succeeds, the next government could be forced to maintain it. The only reason for delaying the launching of a program is the possibility of a wrong causal reading of reality from the point of view of the population. It is crucial for the successful minister of economics that the mess generated by the previous system is clearly attributed by the population to its true causes, so that people can absorb the initial cost of adjustment<sup>47</sup>.

Once the economic reform has been launched, the minister should keep the population permanently informed, helping a correct reading of what is going on, so that he can neutralize the criticisms of the lobbyists, who in their desperation will explain existing as well as nonexistent troubles in the name of the reform under consideration, recommending to solve the mentioned troubles... ending the economic reform!.

This is important because from the political economy point of view economic reforms are a game that develops between rival coalitions. There is, on the one side, the minister of economics, the president and a part of government, and the population, and there is, on the other side, the lobbyists and the rest of the government<sup>48</sup>. It is very difficult for a reform to succeed if, because of a wrong reading due to biased information, the population opposes it or regard it as temporary.

There is a central topic within the time dynamic issues of economic reform, namely, the one of credibility or reputation. Broadly speaking, the economic authorities of a country are credible when the private sector acts, not just on the decisions adopted by the economic team,

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<sup>47</sup> This analysis increases the importance of clarifying oneself the economic policy before accepting the ministerial job, as well as the content of the initial conversation with the presidents, issues already analyzed in this paper.

<sup>48</sup> Nogues (1988) illustrates this point with reference to the commercial reform in Argentina, stressing the importance of generating a political commitment to neutralize the pressure of the lobbyists.

but also on the announcements made regarding the maintenance of current measures as well as on future measures<sup>49</sup>.

It is very important to differentiate levels of (lack of) credibility according to different levels of government. Credibility issues may arise, for instance, at ministerial level in an otherwise credible government and country; but may also arise at the level of the government of which the minister of economics is just one member; or even at the level of governmental institution as such (the regime and even the country as such). (Notice that an economic unit may have, simultaneously, different levels of credibility, regarding different variables. For instance, a man may work in country 1 but save in country 2). Table A illustrates this point using Argentina's rich history on the topic.

How economic policies and reforms should be designed and implemented in "incredible countries", namely, in countries where in the very moment in which the authorities say that the rate of inflation is going to decline, the population starts thinking that it is going to increase, or where as soon as authorities introduce an import duty reduction policy, the population starts calculating when the mentioned economic measure is going to be reversed?.

The literature has some devastating implications for economic reform in settings like this. Calvo (1987), for instance, shows that the "correct" trade policy may harm welfare, and substantially, if it is being implemented by an incredible government, or by a "liberal" government that is presumed to be followed by a new "mercantilist" government, because in this setting the reduction of import duties operates as a distortion inducing socially inefficient behaviors. This notion, on top of second best theorem considerations (all "good" economic policies imply in practice reducing the number of, but not eliminating all, distortions), can paralyze any correctly oriented minister of economics<sup>50</sup>.

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<sup>49</sup> Liviatan pointed out to me that credibility is a trap, in the sense that incredible authorities are forced, because of its lack of credibility, to overact, namely, to adopt 2 or 3 times the measures normal authorities would have to adopt to achieve the same goal. Credibility is a trap in the sense that these authorities, normally, are incredible because of the weakness of the government to which they belong, and consequently they are less able to make decisions that a normal government.

<sup>50</sup> Credibility issues also arise in stabilization policies. Barro and Gordon (1983) and Backus and Driffill (1985) analyze the game that is generated between a government that may be dry or wet, and a population that have to identify the class of government it has from "signals" (on signaling see Vickers, 1986). Dornbusch (1988) suggests that the antiinflationary programs of the 80's challenge conventional wisdom on expectations and stabilization, demanding new theoretical efforts. In his words: "we need a theory to capture how the public forms a judgment of this credibility and how that judgment possibly interacts with the credibility".

On this topic my opinion is the following<sup>51</sup>: lack of credibility is a liability. At the beginning of his term, even in incredible countries a credible minister (particularly if he is a member of a credible government) may enjoy the "honeymoon effect"; but necessarily he should built credibility on actions, not just on words. And very likely for a very long period (years) he may face a setting in which the private sector ignores his reforms from the point of view of their decision making, however good the mentioned reforms are, because in the past those policies were applied just temporarily (for instance, instead of resource allocation, an increase in indebtness to compensate for losses emerges as a result of the reduction in import duties).

In other words, in countries with strong credibility problems, policy reforms are more costly and take more time than in countries in which the government has some credibility; nevertheless, there is no alternative to day to day building up credibility through consistent actions and the corresponding correct information, betting that -because of the continuity of the policy-at some point private sector expectations -and actions- will change.

In incredible countries the political horizon is crucial (in other words, credibility of the government as such is part of economic credibility). The political horizon can be provided if the economic reform is launched at the beginning of the term of the reformer government, and/or there is a clear commitment from opposition parties on the continuity of reforms<sup>51/</sup>.

51/ The Moncloa Pact, signed in Spain in late 70's, as well as the uruguayan pact on the maintenance of exchange and banking freedom (signed even by the communists) are good examples of the advantageous "depolitization" of economic policy.

A couple of topics connected with the credibility issue merit attention. One of them, particularly important in antiinflationary programs, arises when the values of key variables that the private sector "demands" from the credibility point of view, particularly at the beginning of the program, are technically inconsistent with the lasting success of the program and consequently, as time goes on, generates... a credibility crisis.

Let me illustrate this important point with an example. Suppose that a country launches an antiinflationary program like the ones implemented in Argentina, Israel and Brazil in mid 80's, namely, one that includes the freeze of nominal variables, including prices ("anchors"). As part of the program nominal interest rates are fixed at 5% per month, a clear disequilibrium level if the program succeeds. When the minister of economics is asked why did he fixed interest rates at such high level, he states: "because of expectations; if I put a 1% per month interest rate, the private sector is not going to believe in the program and consequently is going to run from the domestic currency"<sup>52</sup>. But the level of the interest rate that generates

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<sup>51</sup> de Pablo and Broda (1989) analyses this issue in detail.

<sup>52</sup> What is the source of the mentioned initial "demand" of the private sector, to set the value of key nominal variables at levels incompatibles with success? Several arguments work in the same direction: 1) there is some money or interest rate illusion (can interest rates decline overnight from 1% per day to 1% per month?); 2) there is the history of past failures of similar programs, that makes the private sector very cautious on any new program; and 3) there is the

"confidence" in the program from the psychological point of view, as time goes on creates uncertainty (strictly speaking, certainty) from the technical angle, since the corresponding increase in the real value of liabilities, being absolutely incompatible with the maintenance of price stability, calls for liquification in the future, and consequently for a revival of the expected rate of inflation.

On this, the successful minister of economics that does not want to risk an initial crisis, and consequently is willing to pay certain costs in the name of the initial expectations effect, should move as quick as possible to equilibrium levels of the key variables in order to sustain the initial success. If from the technical point of view this is impossible (think, for instance, of the need to change the frozen exchange rate, or public utility rates, a couple of months after the launching of the program), then the successful minister of economics should start with the "correct" values from the very beginning, even risking the initial credibility problem<sup>53/</sup>.

53/ A credible presentation, both from the formal point of view (through an address that the private sector can understand), as well as from the power sustainability point of view (the minister address being preceded by a presidential address, or made in front of the Cabinet), can help to reduce the demands on initial disequilibria from the private sector point of view.

The other credibility topic can be labeled "falsification". This issue arises when the authorities, in the name of improving the expectations of the private sector, induce a quick emergence of the equilibrium values of the variables, but using distortionary policies that temporarily "work". Unilateral direct control of prices, expansionary fiscal policies during periods in which the demand for money increases, etc., are good examples of these "policies".

The message for the successful minister of economics on this topic is very neat: do not underestimate the economic operator. Results obtained through the temporary beneficial effects of distortions are nothing when compared with long run costs (think of inflation, for instance, that at the beginning may produce some general benefits, but that after a short while just generates difficulties from the population point of view, and particularly from the poor's point of view). The economic history of Argentina of the last decades is a living example of the horrors that can be generated through strategies like this.

## 2.4 Final caveat

If I have the possibility of giving just a single advice to a future minister of economics, it would be the following: never be soft on inflation. I include this issue after time dynamics since very often, after an antiinflationary program has "worked" for some time, and after many people have forgotten the costs of inflation and just remembers the cost of stabilization, the

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"error type I, error type II" decision mechanism of the policymaker, who wants everything except immediate difficulties as a result of the program.

proposal that emerges from "experts", the press, the lobbyists, etc., is that enough has been done on inflation, and that accordingly now the "era of development" should start.

The policymaker that follows this recommendation is not going to achieve development, but is going to see price stability evaporated. There is not such a thing as a trade off between stabilization and growth. The moment a government begins to play soft on inflation and the economic agents realizes it, the time horizon shortens dramatically, the profits of the firms began to depend more heavily on the election of the correct financial alternative, etc.; and in this setting it is impossible to have genuine growth. The correct approach from the policymaker point of view, then, is a permanent action against inflation, with the provision of a "growth atmosphere" within which price stability is of fundamental importance.

## 2.5 Are successful reforms possible?

After so many warnings, the reader may wonder if successful economic reforms can exist at all. Well, History shows that they do exist, and although very likely successful reformers did not know they were going to succeed at the beginning of their efforts, analyzing reasons for success can help decision making. This is the idea underlying this paper.

As a final synthesis of the analysis of this essay, I would like to stress the importance of the following factors in explaining success of economic reforms:

1) political will. A president, and a minister, who have clear goals, is crucial for success. When high officials do not know what to do, they became slaves of biased advice, for instance, from the bureaucracy and/or the lobbyists; when they do, they are able to confront unavoidable adversaries of the reforms;

2) identification of allies and adversaries of the reform. The government cannot expect the losers of the reform to applaud a policy that, if succeeds, will deteriorate their welfare, nor they can expect even a passive role. On the contrary, they should expect fighting, and they should prepare for it;

3) timing. The moment of the launching of the reform is important. Checked a correct causal reading by the population of the mess created by the previous system, the sooner the program is launched from the term of the reformer government point of view, the better. Time should be on the side of the minister as much as possible; and last but not least,

4) technical consistency. Never is enough for insisting on the importance of implement a good economic policy from the technical point of view, and given the significant uncertainties of real world, the policy should be as robust as possible. Increasing demand of political support to compensate technical weakness of the program is a sure road to failure.

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TABLE A.

CREDIBILITY		LEVELS OF (LACK OF)				
-	-	-	-	-	-	-
Sce-	Government	President				Best examples
nario	as an institution	and/or regime	Minister	Implications		in recent Argentina
-	-	-	-	-	-	-
1	Credible	Credible	Credible	Full effect of announcements		Krieger Vasena, 1967-69 Martinez de Hoz, 1976-79
2	Credible	Credible	Incredible	Temporary wait and see attitude of the private sector, expecting the replacement of the minister		Grinspun, 1984
3	Credible	Incredible	Credible	More serious wait and see attitude of the private sector, expecting the regime to change. The credibility of the minister is normally not enough even for avoiding short run macroeconomic difficulties.		Isabel Peron and Cafiero, 1975
4	Credible	Incredible	Incredible	Private sector decision making absolutely dominated by "Noah's Arch model". The only business in town is calculating the optimum time for buying tickets for the Arch.		Isabel Peron and Bonanni, 1975
	-	-	-	-	-	-
5	Incredible	Credible	Credible	Lack of credibility "in the country", namely, in the ment as an institution, can be interpreted in absolute		

6	Incredible	Credible	Incredible	terms (i.e.: migrating to another country) or in relative terms (i.e.: living and working in a country, but saving in another one).
7	Incredible	Incredible	Credible	Lack of credibility "in a country" shortens the time horizon of decision making, reduces significantly productive investment, generates attitudes toward endogeneizing economic policy at the expense of the general population (rent seeking activities).
8	Incredible	Incredible	Incredible	What difference does it make, in incredible "countries", whether the president and/or the minister of economics is credible or not?. Mild at the beginning, but credibility could be built up again, on the basis of RESULT, after many years of adequate behavior.

## APPENDIX A - EPISODES ANALYZED AND KEY BIBLIOGRAPHY

Table No.	Economic policy
1	Frondizi
2	Krieger Vasena
3	Gelbard
4	Martinez de Hoz, i: disinflation based on responsibility
5	Martinez de Hoz, ii: tablita
6	Martinez de Hoz, iii: financial reform
7	Martinez de Hoz, iv: opening of the economy, exports
8	Martinez de Hoz, v: opening of the economy, imports
9	Cavallo
10	Alfonsín, i: Austral plan
11	Alfonsín, ii: Primavera plan

TABLE 1.

## THE POLITICAL ECONOMY OF FRONDIZI'S ECONOMIC POLICY

-	-	-	
Type of government	Elected	Democratic	
-	-	-	
Date of launching	December 1958	Dec.58	
-	-	-	
Months after starting of pre-sidential period	7, after a semester of an economic policy that put Argentina at the border of hyperinflation		6
-	-	-	
Goals	Stabilization and "development"	Stabilization,	
-	-	-	
Strategy	Elimination of direct controls Unification and liberalization of the exchange market Attraction of foreign investments Stand by agreement with the IMF		
-	-	-	
Ex-ante technical credibility	Reasonable, by 1950's standards. The elasticity pessimism of the decade induced the continuation of import substitution policies. Clearly, the strategy involved systematic balance of payments crisis, wherever new inflows of funds plus "net~ import substitution could not compensate interest and royalties payments		
-	-	-	
Popular support	Fantastic shock at the beginning of the program (it was the first time in Argentina that the annual rate of inflation entered into the 3 digit level). Increasing afterwards, when inflation declined and growth resumed.		
-	-	-	
Entrepreneurs support	Favourable		?



-	-	-
Trade unions support	Openly against, with strikes and mobilization using military forces	?
-	-	-
External support	Very important, both private and public. The inflow of foreign funds was huge, and IMF assistance was crucial. In early 1962 there was a loan from U.S. government (under Alianza para el Progreso) to help falling international reserves.	
-	-	-
Results	<p>In the short run, clear initial shock followed by strong recovery.</p> <p>In the long run, creation of new production capacity, modernization of the manufacture sector, petroleum "autoabastecimiento" (that avoided difficulties during the oil shocks of the seventies).</p> <p>Yearly real GDP growth rates: 59, -6%; 60, 8%; and 1961, 7%</p> <p>Rate of inflation (consumer prices, december to december): 59, 85%; 60, 19%; and 1961, 16%</p>	
-	-	
Lessons	<p>The importance of associating with the leading countries of the world</p> <p>The extent of final disequilibrium was not independent of "power vacuum" that followed Frondizi's overthrown</p>	
-	-	

TABLE 2.

## THE POLITICAL ECONOMY OF KRIEGER VASENA'S ECONOMIC POLICY

-	-	-	
Type of government	Military	Democratic	
-	-	-	
Date of launching	March 1967	Dec.58	
-	-	-	
Months after starting of pre-presidential period	9, after a semester of "hybrid" economic policy under minister Salimei, and 3 months of preparation of the new policy under Krieger Vasena		6
-	-	-	
Goals	Stabilization, "modernization" of the economy, and mild opening of the economy	Stabilization, "development"	
-	-	-	
Strategy	Compensated devaluation, then permanent freeze Wage increases, then freeze for a year and a half Voluntary price agreement Fiscal deficit reduction through Olivera-Tanzi effect and issuing of bonds Monetary reform: return to fractional reserve requirements		
-	-	-	
Ex-ante technical credibility	OK on anchors, no permanent action on fundamentals.		
-	-	-	
Popular support	Increasing, on the face of the reduction of the rate of inflation		
-	-	-	?

Entrepreneurs support	Very favourable, even in difficult times, within the manufacturing sector. Criticisms within the agricultural sector, for the exchange rate freeze, export taxes, and the land tax in 1969.
-	-
Trade unions support	Non aggressive. Trade union leaders were present in general Ongania's inauguration.
-	-
External support	Very favourable. The program was negotiated with the IMF. Foreign assistance, although unnecessary from the foreign reserves point of view, was abundant.
-	-
Results	Fantastic in the short run. Long run doubts (particularly the termination of exchange rate "tablita") are real. On top of very good real GDP growth rates in 1964 (10%) and 1965 (9%), the following growth rates were observed: 67, 3%; 68, 4%; and 1969, 9% Rate of inflation (consumer prices, december to december): 67, 27%; 68, 10%; and 1969, 7%
-	-
Lessons	The importance of adjusting relative prices before freezing (particularly the wage structure) The managerial approach of the ministerial job
-	-

?

TABLE 3.

## THE POLITICAL ECONOMY OF GELBARD'S ECONOMIC POLICY

-	-	-
Type of government	Democratic	Democratic
-	-	-
Date of launching	May 1973	Dec.58
-	-	-
Months after starting of pre-sidential period	0, the "Pacto Social" was launched in the very day in which Gelbard was made minister of the economy.	
-	-	-
Goals	Stabilization Increase of the share of wages within GDP	Stabilization, "development"
-	-	-
Strategy	Change in relative prices in favor of wages and public utility rates, then freeze all prices for a couple of years. Olivera-Tanzi effect on public sector revenues. Increase of public expenditure. Nationalization of the financial system (i.e.: 100% reserve requirements, with discretionary creation of loanable capacity)	
-	-	-
Ex-ante technical credibility	Very small. The impact effect of the freeze was expected to be transitory, enlarged by the initial terror of the economic unit, particularly the entrepreneur, for selling in black markets, evading taxes, etc., as a result of the terrorist presence in government and in the country	
-	-	-
Popular support	Decreasing	
-	-	-

Entrepreneurs support	In paper very great, since they were part of the "Pacto Social", in reality almost null.	?
-	-	-
Trade unions support	They were part of the "Pacto Social", although individually bargained for sectorial wage increases.	?
-	-	-
External support	Inexistent	
-	-	-
Results	<p>Very good, on the surface, in the short run; terrible later on.</p> <p>Yearly real GDP growth rates: 73, 3%; 74, 6%; 75 0%.</p> <p>Rates of inflation (consumer prices, december to december, except in 1973):</p> <p>First semester of 1973 (65% annual equivalent); second semester of 1973 (12% annual equivalent); 40% in 1974; 335% in 1975; 9% in january 76; 19% in february 76; and 38% in march 76.</p>	
-	-	
Lessons	<p>Corporate power, under terror, applauds wrong economic policies</p> <p>Terror, and political power, are insufficient substitutes for the success of a technically inconsistency policy.</p> <p>Exogenous factors (the death of Peron, the reversal of the international situation) complicate reality, but are not sufficient reasons for explaining the failure</p>	
-	-	

TABLE 4.

## THE POLITICAL ECONOMY OF MARTINEZ DE HOZ'S ECONOMIC POLICY

- i. Distinflation based on "freedom with responsibility" -

-	-	-	
Type of government	Militar	Democratic	
-	-	-	
Date of launching	April 1976	Dec.58	
-	-	-	
Months after starting of pre-sidential period	0, it was launched in the very week in which Martinez de Hoz was named Minister of economics		6
-	-	-	
Goals	Quick reduction of the rate of inflation	Stabilization,	
-	-	-	
Strategy	Elimination of direct controls of prices Governmental demand for "entrepreneurs responsibility" Wage control (not freeze, but controlled increases) Olivera-Tanzi effect on public sector revenues		
-	-	-	
Ex-ante technical credibility	Clear impact of the "mess is over" signal, as a result of the change in regime, from Isabel Peron to general Videla. Very small afterwards.		
-	-	-	
Popular support	Decreasing, from very high levels as a result of the change in regime		
-	-	-	
Entrepreneurs support	Absolutely favourable		?
-	-	-	

Trade unions support	Intervened by the military	?
-	-	-
External support	Total	
-	-	-
Results	The rate of inflation dropped overnight from 50% per month in March 76 to 8% per month, remaining in that level. After a year, due to lack of "responsibility" of the entrepreneurs, a 120 days "price truce" was introduced.	
-	-	
Lessons	Voluntarism works ... few days	
-	-	

TABLE 5.

## THE POLITICAL ECONOMY OF MARTINEZ DE HOZ'S ECONOMIC POLICY

## - ii. Disinflation based on "tablita" -

-	-	-	
Type of government	Military	Democratic	
-	-	-	
Date of launching	January 1979	Dec.58	
-	-	-	
Months after starting of pre-presidential period	33, after the failure of disinflation based on "freedom with responsibility", and the 1977 "price truce".		6
-	-	-	
Goals	Gradual reduction of the rate of inflation	Stabilization,	
-	-	-	
Strategy	Preannouncement of decreasing rates of devaluation		
-	-	-	
Ex-ante technical credibility	Conditioned to consistency among fiscal, monetary and devaluation policies		
-	-	-	
Popular support	Increasing, when the rate of inflation really declined		
-	-	-	
Entrepreneurs support	Decreasing, because as a result of the decline in the real exchange rate, agricultural revenues decline, and manufacturers faced increased competition from abroad.	?	
-	-	-	
Trade unions support	Intervened by the military.	?	
-	-	-	
External	De facto extreme support, since in 1979 Argentina was an excellent		



support	country to allocate excess funds resulting from the second oil shock.	-
-	-	-
Results	<p>Very good, after 9 months.</p> <p>During january-august 1979, the rate of inflation (consumer prices) was 9% per month, declining to 5% per month along 1980.</p> <p>GDP growth rates were 8% in 1979 and 1% in 1980.</p> <p>Decline in the real value of the exchange rate, as a result of the lack of consistency among monetary, fiscal and exchange policies</p>	
-	-	
Lessons	<p>The importance of stressing the need of consistency between monetary, fiscal and exchange policies.</p> <p>The importance of differentiating between temporary and permanent changes in the domestic and/or the international enviroment (second oil shock)</p>	
-	-	

TABLE 6.

## THE POLITICAL ECONOMY OF MARTINEZ DE HOZ'S ECONOMIC POLICY

### - iii. Financial reform -

-	-	-	
Type of government	Military	Democratic	
-	-	-	
Date of launching	June 1977	Dec.58	
-	-	-	
Months after starting of pre-sidential period	14, urged by impossibility of maintaining the old financial system		6
-	-	-	
Goals	Deregulation of the financial system Transformation of most of the financial institutions into banks Elimination of interest rates ceilings	Stabilization, "development"	
-	-		
Strategy	Implementation overnight, by law The reform was designed by a commission that worked for a year, with participation of the private sector		
-	-		
Ex-ante technical credibility	Unavoidable, given the increase of the unregulated -partially illegal- segment of the financial market No criticisms were made from professional quarters		
-	-		
Popular support	Increasing, since the average citizen is a saver		
-	-	-	?
Entrepreneurs support	Mixed. In favor for the greater availability of credit, complaining about the cost of credit.		
-	-		?
Trade unions support	Intervened by the military		
-	-	-	

External  
support

-

-

-

Results

Number of institutions, went down from 686 in 1977 to 481 in 1980

Number of banks, went up from 119 in 1977 to 219 in 1980

Number of branches, went up from 3860 in 1977 to 4558 in 1980

The passive real interest rate, against consumer prices, was

-0,3% per month between june 1977 and june 1982

The passive real interest rate, against wholesale prices, was

0,9% per month between june 1977 and june 1982

-

-

Lessons

The importance of "bank superintendence" of the financial system,  
as well as monitoring monetary policy, as the main functions of the  
Central Bank

-

-

TABLE 7.

## THE POLITICAL ECONOMY OF MARTINEZ DE HOZ'S ECONOMIC POLICY

## - iv. Opening of the economy, exports -

-	-	-	
Type of government	Military	Democratic	
-	-	-	
Date of launching	April 1976	Dec.58	
-	-	-	
Months after starting of pre-sidential period	0, it was formally announced in the initial address of Martinez de Hoz		6
-	-	-	
Goals	Increase agricultural exports very quickly	Stabilization,	
-	-	-	
Strategy	Gradual reduction of export taxes It took 2 years to complete the elimination For some products the initial level was 50% ad valorem		
-	-	-	
Ex-ante technical credibility	Reasonable		
-	-	-	
Popular support			
-	-	-	?
Entrepreneurs support	Total		
-	-	-	?
Trade unions support	Intevened by the military		
-	-	-	

External  
support

-

-

-

Results

Exports rose from u\$s 2961 M in 1975 to u\$s 3916 M in 1976, to u\$s 5652 M in 1977, and to u\$s 6400 M in 1978.

Real increases are smaller, since a part of it resulted from the end of smuggling

-

-

Lessons

The agricultural sector in Argentina is as good profit maximizer as any other sector of the economy, provided genuine and credible signals emerge from the government

-

-

TABLE 8.

## THE POLITICAL ECONOMY OF MARTINEZ DE HOZ'S ECONOMIC POLICY

- v. Opening of the economy, imports -

-	-	-	
Type of government	Military	Democratic	
-	-	-	
Date of launching	November 1976, and January 1979	Dec.58	
-	-	-	
Months after starting of pre-presidential period	8, tailor made reduction of import duties to eliminate the "water"; 33, a 5 year reduction of import duties was announced		6
-	-	-	
Goals	To reduce the average of dispersion of import duties To eliminate non tariff restrictions	Stabilization, "development"	
-	-	-	
Strategy	Immediate reduction of "excess" protection Gradual reduction of binding protection The latter implied, at most, a 21% reduction of the price that includes the import duty in five years, and 3% reduction in the first year		
-	-	-	
Ex-ante technical credibility	Reasonable in itself, namely, ignoring changes in the real value of the exchange rate		
-	-	-	
Popular support	Increasing, for the novelty of buying imported goods within the country.		
-	-	-	
Entrepreneurs support	Decreasing within the manufacturing sector. Complaints combined the pure effect of the reduction in import duties, with the quantitatively more important issue of the decline in the	?	

	real value of the exchange rate.		
	Many entrepreneurs used the opening of the economy to import capital goods.		
-	-	-	
Trade unions support	Intervened by the military		?
-	-	-	
External support			
-	-	-	
Results	Imports rose from u\$s 3834 M in 1978, to u\$s 6700 M in 1979 and to u\$s 10500 M in 1980.		
-	-		
Lessons	The maintenance of the real value of the exchange rate is essential for the implementation and the maintenance of a program like this		
-	-		

TABLE 9.

## THE POLITICAL ECONOMY OF CAVALLO'S FINANCIAL REFORM

-	-	-	
Type of government	Military	Democratic	
-	-	-	
Date of launching	July 1982	Dec.58	
-	-	-	
Months after starting of pre-sidential period	75, when after the Malvinas conflict general Bignone took over the presidency to call general elections		6
-	-	-	
Goals	Reduce the real value of financial liabilities	Stabilization,	
-	-	-	
Strategy	Ceiling on nominal interest rates, well below the rate of inflation Indexed deposits for "genuine" savers, namely, with maturity of 1 year or more.		
-	-	-	
Ex-ante technical credibility	Clear on the goal, unclear on the long run implications about capital markets, saving in domestic currency, etc. The professional mood spoke at that time about the need of "doing something" with firms liabilities		
-	-	-	
Popular support	Shock by the inflationary shock		
-	-	-	
Entrepreneurs support	Very favourable (although not publicly recognised)		?
-	-	-	
Trade unions support			?
-	-	-	
External			



support

-

Results

-

The real value of financial liabilities declined 25% in 2 months.  
The rate of inflation (consumer prices) went up from 3% in may 82, and 8% in june, to 16% in july and 17% in august 82.

-

-

Lessons

-

Avoid the NEED of doing something like this

-

-

TABLE 10.

## THE POLITICAL ECONOMY OF ALFONSIN'S ECONOMIC POLICY

## - i. Austral plan -

-	-	-	
Type of government	Democratic	Democratic	
-	-	-	
Date of launching	June 1985	Dec.58	
-	-	-	
Months after starting of pre-sidential period	18, after a year and a half of "hybrid" economic policies		6
-	-	-	
Goals	Immediate and abrupt reduction of the rate of inflation	Stabilization, "development"	
-	-		
Strategy	Equilibrium among relative prices, then freeze of "anchors" (i.e.: prices of goods, wages, public utility rates and exchange rate) Transitory action on fundamentals (Olivera-Tanzi effect, forced savings scheme, imports and exports surcharge, etc.) Scale of conversion and change in the monetary unit		
-	-		
Ex-ante technical credibility	Lack of "jurisprudence", namely, absence of previous programs similar to this one Reasonable, provided attention was paid to fundamentals, and no "getting in love" with freezes.		
-	-		
Popular support	Absolute Alfonsin's popularity was never greater than on the night of the launching of the program		
-	-		
Entrepreneurs support	Absolute Particularly crucial was the role played by supermarkets, much more	?	

-	"efficient" price controllers than governmental inspectors	
-	-	?
Trade unions support	Verbal criticisms, without unbearable actions	-
-	-	
External support	Important, at a psychological level. Reserves increased as a result of a shift in the portfolio of argentines, so funds from abroad were not used to defend the exchange rate.	
-	-	
Results	Overnight elimination of inflation without black markets. The rate of inflation (consumer prices), than in june 85 was 30%, went down to 2% per month during the rest of 1985.	
-	-	
Lessons	The importance of paying attention to fundamentals, to maintain the initial results. Under extreme conditions, good economics increases political popularity.	
-	-	

TABLE 11.

## THE POLITICAL ECONOMY OF ALFONSIN'S ECONOMIC POLICY

## - ii. Disinflation through Spring plan -

-	-	-	
Type of government	Democratic	Democratic	
-	-	-	
Date of launching	August 1988	Dec.58	
-	-	-	
Months after starting of pre-sidential period	56, after the revival of the rate of inflation, following Austral plan, and the october 1987 antiinflationary program		6
-	-	-	
Goals	Reduce the monthly rate of inflation to "one digit"	Stabilization,	
-	-	-	
Strategy	Agreement with manufacturers on future increase of "anchors" Maintenance of free wage bargaining Monetary and fiscal restraint		
-	-	-	
Ex-ante technical credibility	Reasonable, provided "this time" attention is paid to fundamentals	-	
-	-	-	
Popular support	Mild, but increasing in the presence of a falling rate of inflation	-	
-	-	-	?
Entrepreneurs support	Neutral at the beginning, increasing as a result of the falling rate of inflation		
-	-	-	?
Trade unions support	Neutral, given the maintenance of free wage bargaining	-	
-	-	-	
External	Reasonably good		

support

-

Results

The rate of inflation (consumer prices), after peaking 28% in august 88, went down to 11% in september, to 9% in october and to 6% in november 88.

-

Lessons

-

Action on fundamentals, even in incredible scenarios, more than help to get results

The importance of the president not trying to "trade off" political objectives, against public expenditure, or public transfers

-

-



## APPENDIX B

### NELSON'S ADVICES IN THE LIGHT OF THE ARGENTINE EXPERIENCE

-	Nelson	-	de Pablo
-		-	
A10	ON ECONOMIC REFORMS (1)		
oo	When things get bad enough, a government will act, or the depth of the crisis determines the timing of policy decisions.		Sometimes launching of the program is deliberately delayed, to ease the correct causal reading on the part of the population.
oo	A crisis triggered by external events is likely to elicit fairly narrow, short run responses, while problems recognized as mainly domestic in origin are more likely to prompt broader responses.		No evidence of this.
oo	Other things equal, the greater a government's institutional authority and technical and administrative abilities, the higher the probability of its adopting timely and coherent adjustment measures, and the better chances of their full implementation.		Looks reasonable, but can be tautologically defined. Tablita like stabilization policies were implemented with the blessing of economists trained in the best American universities.
oo	Authoritarian governments are more likely than democracies to decide upon and enforce unpopular economic stabilization and adjustment measures.		Untrue. Militaries also want to be popular.
oo	Authoritarian regimes are most likely to adopt strongly orthodox programs. Regimes in transition to democracy are most likely to adopt heterodox programs. Established democracies are likely to pursue orthodox stabilization programs but have difficulty sustaining longer-run programs for orthodox structural change.		No evidence of this.
oo	The approach to elections hampers adoption and implementation of stabilization programs and structural reforms.		Agree, despite the fact that in Argentina good economics helped the government to win the election, while in 1987 bad economics helped the government to lose it.
oo	Institutions and procedures that insulate economic decision makers from pressure by specific interest groups, including not only labor but also business and bureaucratic interests, facilitate timely, coherent, and broad-gauged adjustment decisions.		I hope so.
oo	Opposite views: - Political will is the mayor determinant of capacity to adopt and implement measures: where the political leadership has the required will, the program will carry;		The role of political will was very important in explaining Frondizi's success.

where will is lacking, the program will fall.

- The commitment and the skill of political leaders are largely irrelevant to whether adjustment measures succeed or fail: what counts is the constellation of key pressures groups and political circumstances.

oo Opposite views:

- Both and losers and winners can anticipate the impact of a given measure fairly accurately.  
- Anticipated (or actual) economic loss or gain translates fairly directly into political opposition or support.  
- There is no one-to-one relationship between economic loss or gain and political opposition or support.

People can anticipate if the current economic policy is sustainable or not, it is not so easy to anticipate the timing of the adjustment.

oo The risk of failure rise sharply as the number of groups antagonized increases. Therefore, reform-mongers (Hirschman's phrase) are likely to have to rely on shifting coalitions (or perhaps on log-rolling) to support different measures.

Yes.

oo Organized labor is the most likely interest group to derail adjustment efforts.

All corporate power is conservative by nature.

oo External agencies powerfully influence the timing, scope, and content of adjustment decisions and action.

Sometimes.

oo Detailed conditionality is more likely than broadly defined conditions to induce policy change.

Yes.

## ON STABILIZATION

oo The most common reason for failure is internal political pressures and politician's fears of such pressures, which leads governments to postpone corrective action.

Combination of wrong economic policies, as a result of ignorance, and pressures from organized groups.

oo (on the role of international agencies). Anticipating political reactions and adjusting one's own action accordingly is not tantamount to intervention.

True.

oo Commitment is indeed crucial, but even strong commitment may not be sufficient to overcome political obstacles unless programs are also designed in a manner that addresses those obstacles.

Looks reasonable.

oo Opposite views:

- Failures may create a legacy of cynicism and bitterness that seriously complicates future efforts.  
- Experience with past unsuccessful or only partially

The former looks more important than the later.



successful measures has paved the way for more effective efforts.

oo A firm stabilization program will predictably provoke protest, but so will continued economic deterioration.

oo In some cases, ministers and political leaders simply have very limited economic background and understanding.

oo Sharply divergent lines of advice are an obstacle to commitment. In most cases of effective adjustment programs, one or a few highly committed technocrat-politicians with strong backing from top political leaders have played a crucial role.

oo A full briefing of a wider circle is likely to be helpful. The efforts of the negotiating team in many cases should not end with the formulation of an appropriate program, but should extend to paving the way for fuller understanding on the part of political leadership, a broader governmental elite, and "even" the public (" " is mine).

oo Most of the instances of ambitious readjustment programs have occurred when a new regime takes office, and is in a position to repudiate or depart sharply from the policies and orientation of its predecessors.

oo Degree of unity and discipline is a crucial component of government capacity.

oo Paradoxically, parastatals and even central government agencies may be more difficult to control or influence than parts of the private sector.

oo Budget discipline has proven the most difficult aspect of stabilization programs for governments to observe.

oo Interests groups not just in the private sector. Civil servants, parastatals, and the military, all constitute potentially crucial political interest groups.

oo Governments have at their disposal partial compensation, persuasion, diversion or obfuscation and containment.

oo Partial compensation may be non-economic (i.e.: restoration of civilian political rule).

This is a KEY statement for correct diagnosis, very often forgotten by decision makers because it is not easy to be "bought" by the citizens.

Yes.

Yes.

Definitely yes.

I agree. Delay can only be justified if it improves the causal reading of the population on the previous (wrong) policy.

Very important from the signal point of view.

"There are 2 classes of firms: private firms, under the control of the State, and public firms, under the control of none". L. Sjaastad (my wording).

Yes.

Yes. See Sjaastad, above.

oo Frank and vigorous campaigns of explanations and persuasion can be quite effective in winning temporary public acquiescence, and gaining union acceptance of wage restraint. Scope varies with trust and mistrust of government, as well as "honeymoon effect".

Very important.

oo How the government handles initial protest will strongly affect its future course.

oo More sustained sacrifice by the public at large depend on perceptions that the program is working.

oo The issue of shock versus gradualism cannot be proved right or wrong a priori.

oo The core political problem with a stabilization and adjustment program that must be sustained over several years is usually that middle and upper middle strata must bear substantial losses. These are the groups whose living standards have moved more seriously out of line with what the country can afford. But they are also the most politically potent groups.

Fundamental. At the beginning of a stabilization program, not all the people that would be harmed if the program succeeds realizes it.

oo Stabilization is inherently risky politically, and no combination of strategy, tactics and support measures by governments and outside agencies can do more than somewhat reduce the risks. The disappointing record of most stabilization efforts is a powerful argument for more attention to political sustainability.

(1) As written; it does not mean that Nelson agrees.

Sources: Nelson (1984, 1988)