

Economic Reorganization as a Prerequisite to Growth

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When this century began, Argentina was poised to become one of the most important Western nations. Now that the century is drawing to a close, we look back in disappointment over how far we are from realizing those dreams.

Until 1930, Argentina obtained substantial rewards from an economy that was oriented toward international trade. But in the two decades that followed, world trade declined as a result of the Great Depression and World War II. This resulted in a policy trend toward isolating the Argentine economy that had serious consequences for economic growth in general, and each sector in particular.

Despite the fact that the unfavorable external factors had disappeared by 1950 and a new era of growing worldwide prosperity based on international trade was under way, the Argentine economy remained closed and experienced very slow growth compared with other countries that were able to solidify their development at that time. The economy experienced some growth in the 1950s that accelerated somewhat in the 1960s, but in the 1970s, especially after 1973, this growth was first interrupted and then reversed—a truly unusual case since the country did not suffer any serious natural calamities.

The economic point of departure

Imagine a stagnant economy where the rules of the game that govern relations among the different economic agents are very highly com-

plex and unstable. The economy is so complicated that not even specialists can understand what is happening and each day they discover a new hidden subsidy, a new regulation that hinders private initiatives in one area or another, and that results in a redistribution of resources of which only the beneficiary is aware.

In this economy, the public budget has been characterized by a) the absorption of a steadily larger number of activities, including the production of goods and services that are clearly for private benefit and that should be financed through the price system rather than taxes; and b) steadily disappearing transparency and order resulting in disorderly decisions and insufficient information.

Excessive government intervention in the activities of the private sector tends to delay necessary adjustments to correct erroneous business strategies and the economy loses its agility to correct **disequilibria** between supply and demand. Productive resources are retained in activities of low productivity, bottlenecks become more persistent, and resources are diverted from sectors facing greater demand. Government intervention mistakenly transforms private goods and services into **public** goods and services.

This highly distorted and complicated economy is characterized by what we call "voluntarismo irracional," an easy solution that is appealing to politicians even if it defies basic economic laws. It generally results in a continuous expansion of administrative intervention by the government in economic decisions. Policies are **implemented** that, even from the outset, are known to be impossible to control. The final effect of "voluntarismo irracional," is a loss of respect for the capacity of the government to implement and control its decisions and consequently, to comply with its role as organizer of the overall economy.

This has serious effects on the policy credibility: No one believes announcements made relative to the future unless they are very reasonable and there are forces that will be put into action rapidly in order to support the announcement and to ensure that it will be carried out.

As a counterpart, a distinctive characteristic of the public debate

over economic issues is that each important economic agent, or group of economic agents with common interests, has proposals about nearly all individual economic decisions. It is as if the society as a whole is capable of deciding what each economic agent can do, virtually regardless of their individual assent or interest. As a result of this type of public debate of economic issues, the economic rules of the game tend to be set aside and become unclear as well as unstable.

They are unclear due to inattention to defining the frameworks for assigning responsibilities for decisionmaking, information, and risk taking. They are also very unstable because they have not been sufficiently understood and accepted, and because experience has taught each economic agent or pressure group that it is more profitable to dedicate their efforts to changing the rules in their favor rather than doing things better within the existing framework.

Economists usually also fall into "voluntarismo irracional." We often know very little about the dilemmas that businesses must face but, nevertheless, we try to instruct them concerning the areas in which to invest or we believe that we are able to convince them to choose the most appropriate technology or to discover the most promising markets. This leads to bad policies and, even worse, to a poor economic structure.

One of the worst examples of "voluntarismo irracional," is inflation, which is basically the product of a government that wants to spend more than it is capable of earning through legally mandated taxes—it wants to obtain something for nothing. Since that is impossible, the result is reflected in a tax that lacks legal legitimacy, namely, inflation.

Thus, this form of economic organization imposes a sort of surcharge on economic activity, whether in the form of its organization or the resulting effects. This surcharge blocks the realization of potential development in two ways: it impedes the development of activities and, in the case of productive activities already under way, it imposes an unproductive allocation of resources since resource allocation adjusts to the existing economic structure.

The sources of growth

As is well-known from **Solow's** neoclassical growth model, the sources of economic growth include:

- 1) increases in the labor force;
- 2) accumulation of physical capital, including the effective utilization of natural resources having economic value; and
- 3) increases in productivity — the increases in production that are reached beyond the increase in the workforce and the accumulation of physical capital through taking on underexploited business opportunities, the introduction of more advanced technology, and through improved organization and administration of existing resources.

These three sources of growth are normally found together and are complementary. But history shows that emphasis is sometimes placed on increases in the factors of production while, at other times, it is placed on increasing productivity.

In the economy that we described earlier, the factors of production do not generate the output they are potentially able to produce. The economic structure of this economy generates a form of "negative productivity." Given the inefficiency in resource utilization and the resulting low level of productivity, a vicious circle can appear in which investment is discouraged, leading to stagnation, or worse, economic backwardness.

Changing the rules of the game

Under these conditions, a reorganization of the economy becomes the basic prerequisite to the recovery of economic growth. This reorganization can be associated with an increase in the overall productivity of the economy or the elimination of the "negative productivity" to which we referred. It is the first spark to economic growth.

It is necessary to speak of a comprehensive economic and social reorganization that would ensure greater transparency and better planning in the public sector as well as greater competition and improved performance in everything related to the private sector.

Therefore, it is necessary that the entire private area of the economy accept the rules of competition and the market while the public sector accepts the role of planning and budgeting. At the same time, it must be recognized that mixed areas should be avoided because the degree to which an overlapping of private and public sector functions is avoided will determine the degree to which confusion and the risks of corruption are reduced.

The adoption of this new policy environment reveals a high dosage of realism and the consequent abandonment of the "voluntarismo irracional" to which we referred earlier.

Economic reorganization to realize potential growth: The case of Argentina

Until about a year ago, the Argentine economy had the same organizational characteristics as those of the economy we described above. With this analysis in mind, the need to change the rules of the game that govern the Argentine economy was evident.

The program under way in Argentina is advancing toward an economy of clear and simple rules that are as automatic as possible in order to create a situation where private initiative and entrepreneurial capacity can fully emerge. In order to reach this objective, a reorganization of the public sector, a reallocation of business activities to the private sector, and an increase in the effectiveness of the tax administration in order to increase tax collection and eliminate the fiscal deficit were indispensable.

The main policies implemented (and under way) to achieve these objectives are:

- 1) trade liberalization including the elimination of nearly all taxes on exports, the reduction and simplification of import

duties, the elimination of nontariff barriers on imports, the simplification of related paperwork requirements, the elimination of restrictions and discriminatory treatment of foreign investment, and the incorporation of technology;

2) reform of the state and the re-creation of a market economy based on a substantial reduction in public expenditure and the fiscal deficit; rapid and effective progress in the privatization of state companies; the elimination of controls on prices, wages, interest rates, and foreign exchange transactions; and the elimination of a complex network of subsidies and hidden taxes that distort the operations of a market economy;

3) enforcement of the Convertibility Program that requires the local currency to be backed entirely by foreign reserves and gold at a fixed exchange rate, prohibits indexation, requires contracts to be denominated and enforced in foreign currency, and allows wages to be increased only in line with increases in productivity;

4) reform of fiscal and tax policies to simplify the tax system, reorganize the tax administration, and substantially reduce non-social expenditure by the federal government;

5) restructuring of the internal and external debt as well as the conclusion of agreements with the International Monetary Fund (IMF) in 1991 (Standby Loan) and 1992 (Extended Fund Facility). The most recent agreement with the IMF paved the way toward accession to a Brady Plan agreement with commercial banks. Debt services to creditors that are members of the Paris Club were restructured in 1991 and 1992.

The results have been highly encouraging. Inflation has fallen substantially. Interest rates have also fallen. The increase in the market value of Bonex and rising deposits in foreign currencies are indicators of the credibility of the program under way. Industrial production has increased while unemployment has fallen. The level of exports has been maintained while imports have grown strongly. Tax revenues have risen substantially and the advances made in the privatization of state companies are highly significant: the national telephone com-

pany, the national airline, central and secondary oil fields, the electric power company in Greater Buenos Aires, petrochemical companies, railroad lines, tourist facilities, shipyards, and radio and television stations.

The main objectives are to maintain inflation at international levels, reach substantial levels of economic growth (annual rates of 6 to 7 percent), re-enter the international voluntary credit markets, and solidify efforts to eliminate overregulation and state intervention in the economy.

In conclusion, we can say that the change in the rules of the game has permitted an improved utilization of the productive potential of the Argentine economy. This has been manifested in the utilization of existing idle capacity. Now that this obstacle to economic growth has been overcome, increased investment will permit the achievement of the objective of economic growth.