

Resumo

A proposta deste trabalho é a de analisar em que medida o programa de estabilização argentino no período de 1991-1997 está alcançando o chamado "quadrilátero mágico": a estabilidade monetária, o equilíbrio externo, o crescimento econômico auto-sustentado e o pleno emprego. As fontes de fragilidade são destacadas e a conclusão apresenta sugestões para aperfeiçoamento do programa.

Abstract

The purpose of this paper is to analyze to what extent the Argentine program of stabilization in the period 1991-1997 achieved the so-called "quadrilateral magic": monetary stability, external balance, sustained economic growth and full employment. The sources of fragility are highlighted and the conclusion presents suggestions for improvement .

**1. INTRODUCTION**

Since 1991, with the introduction of the Convertibility Plan, the Argentine government has been implementing a set of constitutional and State apparatus reforms to increase economic openness and diminish governmental intervention in the economy<sup>3</sup>. The program involves tax reform, public reform, social security reforms, changes in provincial finances and the finance system, the use of a fixed exchange, convertibility of the peso to the dollar, privatization, budgetary centralization, and greater autonomy for the Central Bank. Government hopes with these actions to stimulate the increase of tax collection, and the productivity of federal expenditures through better allocation of public resources, as well as to contain the stream of indebtedness. These actions could still increase efficiency and the competitiveness of the economy in the world.

The results of the Convertibility Plan were studied by the International Monetary Fund and the Heritage Foundation. In accordance with the IMF, the program would be able to support sustained economic growth. For the IMF, Argentina had the merit of impeding the collapse of the financial system and preventing the increase in public debt with the maintenance of its expenses around US\$ 48 billion in 1994 and 1995. For Hausmann (1997) the measures implemented by the Argentine government supported the country's quick exit from the crisis of 1995. The Heritage Foundation's Index of Economic Freedom for the period 1996/97 ranked Argentina in 42nd position, while Brazil was assigned to the 94th place. Regarding the Index of Competitiveness, Argentina lies in the 37th position while Brazil is in 42nd. Support for the view of the Heritage Foundation is offered by the research done by the World Economic Forum on the competitiveness and economic development throughout the world. Moreover, the fact that Argentina, even after the crisis of 1995, continues to pay lower international interest rates than Brazil strengthens the value of the rating. In fact, economic growth with price stability explains, at least partially, the two above ratings. GDP growth was 4.8% in 1996, 8.6% in 1997 and 4% in 1998.

The recent strategy of minimum government intervention in the financing of the Social Security system, as well as in the economy, is in line with the latest developments in the area of public finance. The lowest prices charged by the public sector increase the demand for

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<sup>3</sup> The Chilean economy has been following these objectives and has achieved a higher level of growth in Latin America.

public services, and at the same time, retract resources from increasing the production profile, thus, the gap between supply and demand rises. The solution comes down with higher prices in the private sector. The gap can be diminished by charging market prices. In fact, the Public Choice School concludes that a large participation of the State in the economy implies a loss of productivity, with an associated decrease in economic growth and increases in the public deficit. Thus, the prognostic for the mainstream school is in favor of the transference of public actions to the sphere of private initiative, as was done by the government of Argentina. Besides that, privatization, the product of the new redefinition of the State contributed to the improvement of the fiscal situation. According to Gerchunhoff (1992), the receipt of foreign debt bonds in the period 1989-92 as means of payment in the sale of state-owned enterprises contributed to alleviate the Argentine fiscal situation in the short run. The high Argentine public debt, about 36% of GDP, great in comparison to the 20% in countries of rapid growth from Asia was an obstacle to Argentine growth. The entrance of foreign capital utilized in the acquisition of state-owned firms improved the position of the Balance of Payments-BP. In fact, in the period 1990-93, an unheard of accumulated balance of US\$ 28 billion, was a fundamental factor to sustain the exchange parity and compensate for the deficits in the Commercial and Service Balance in the same period. The reduction of the foreign debt calculated at face value with the sale of public goods up to December of 1993 was approximately US\$ 11 billion, equivalent to 19% of the total foreign debt at the end of 1989.

However, for Iglesias (1995) the Argentine program has not succeeded in achieving a balanced growth. The arrangements in the commercial, exchange and budgetary areas would not be propitious for economic development. The overvalued exchange would remove competitiveness from Argentine exportations and encourage imports. The growth of unemployment would be reflected in an economic disarrangement that would have unfavorably impacted some domestic sectors. In this aspect, the increasing external indebtedness would be helping to support the Argentine economic policy. Besides that, the advertised Argentine growth took place after successive economic retractions, in this way, this growth could be put in the "growth by recovery" category particular to periods after economic retraction.

The real growth occurs with increase by generation/exploration, which refers to growth based in new opportunities. This growth is more complex, it requires that part of the production and inputs are, in great measure, produced by its own expansion. Feldstein (1998) reinforces Iglesias' proposition that states that the IMF should not impose either economic reforms on countries in financial trouble or under commercial or financial interest of the USA, Japan or other countries linked by aiding the IMF.

## **2. THE MEASURES**

### **2.1 Tax Reform**

The efficacy of the tax system is not just a question of appropriate tax laws but more importantly the efficiency and integrity of the tax administration., apud Otiaku (1992,p.48).

According to the Inter-American Development Bank (1997) and the IMF (1999), tax reform took place by broadening the base of the value added basis with a reduction of the tax rate. In a general manner, there was a reduction of the tax burden due to an elimination of some taxes that compensated for the increase of the tax burden on profit and other capital taxes in order to make room for a reduction in the payroll taxes (social security contributions) paid by employers in the private sector. The reduction of the tax burden (see Table 2) is recommended by Escolano (1995, p.47) who states: "A concentration of the tax burden in any particular period will increase the inefficiencies created by distortionary taxation. It is known, for example, that under most conditions, intertemporal tax smoothing minimizes the efficiency loss. This is because the efficiency grows more than

proportionally with the tax rate". Regarding greater taxation on capital to soften labor tax, if we consider the supply of labor inelastic, mainly in the situation of large Argentine unemployment, most of the tax burden falls on workers, regardless of the legal kind or imposition of the tax, as pointed out by Krellove (1995). Thus the Argentine governmental concern seems innocuous.

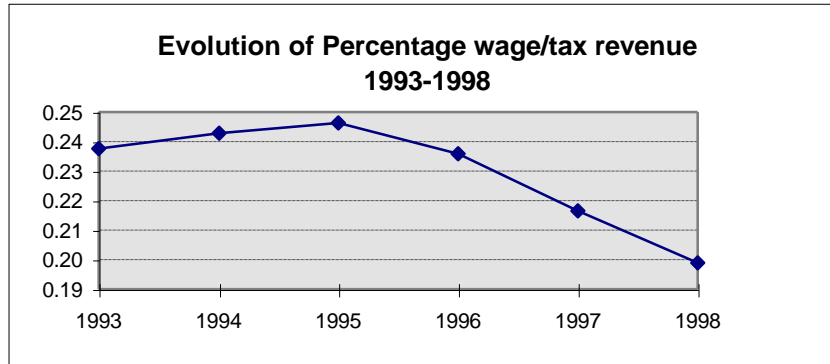
Even after the tax reform, the value added tax-VAT continued to be the most important tax. Tax collection in 1997 was US\$ 52.31 billion, the best result in the history of the country. Regarding 1996, there was an addition of US6 billion. For Corbo & Hernández (1994), the Argentine tax reform took place with the improvement of the tax administration system and its credibility. The tax reform was capable of increasing around 4% of the GDP tax revenue. For Tanzi & Pellechio (1995) Argentina increased tax revenue because it adopted modern practices of tax administration and meliorated measures and procedures. Also for Kumar (1992) these actions can help increase tax revenue. Besides that, the country generated many units of tax inspection formed by an elite group, whose members are the most well trained and least corruptible workers. Still, according to Tanzi & Pellechio (1995) Argentina elevated tax collection with the implementation of campaigns to inform the public of their obligations and of the consequences of non payment of taxes, as well as with the end of their job stability and (as Kumar (1992) also suggests) with a pay increase for the tax inspectors. The importance of publicity campaigns to combat tax evasion in Ghana showing important government expenditures financed by taxes was one of the principal measures that explained the large increase of tax revenue, according to the World Bank (1991).

In view of the fact that there is a trade-off between tax administration efficiency and the values of fines, as pointed out in the specialized literature, the Argentine government reduced the fines. When there is a high tax fine, the collection tends to take a long time because contributors always appeal so the court resists imposing the fine due, as pointed out by Allingham & Sandmo (1972). Instead of charging a high fine, in many situations, the inspectors have opted for the closure of guilty firms. This action produced satisfactory effects.

## **2.2 Civil Service Reform**

Between 1993 and 1995 the wage payment was increasing in the federal government, see following graph 1. In 1993, the federal government payroll was 23.75% of the total tax revenue while in 1995 it was 24.62%. To this respect, Mackenzie & Schiff (1991, p.50) affirm: "the recent evolution of public sector employment and pay in Argentina illustrates the tendency for relatively rapid growth of employment in the public sector coupled with a decline in average real wages and salaries". (...) The number of public sector employees in Argentina is estimated to have grown at an average annual rate of about 2.2 percent in the 1980-88 period, with the fastest-growing component being employment at the regional level. Employment in the private sector is estimated to have increased at about 1.2 percent annually over the same period". Aimed at containing this expenditure, the federal government implemented civil service reform with a group of measures, such as fusion of departments and reduction in the number of public workers. These measures objected to increasing the efficiency of the public sector and adjusting the level of expenditure to equal that of tax revenue to find a financial adjustment in the long term. Civil service reform decreased the wage expenditure and freed up resources for productive investments. Corroborating that, Heller & Tait (1984) did statistic studies about public and private wages and concluded that this relationship was 1.2 in Argentina, a percentage larger than in Sweden, the USA and Great Britain.

**Graph 1**



Sources: IMF 1999.

However, Haque & Sahay (1996) disagree with the civil service reform. According to the insight of those authors, the wage cut in the Argentine public administration would reduce the public sector efficiency as well as increase corruption. This point of view coincides with the ones presented in Klitgaard (1989) and Rijkeghem & Weder (1997) that concluded in their econometric studies that there is an inverse relationship between wage, on one side, and corruption and quality of public service, on the other side.

One should mention that, according to the methodology offered by Alesina & Perotti (1996), one can classify the Argentine fiscal adjustment as one that produces a permanent readjustment because it contains two budgetary items of greater automatic growth: wage and public employment. Since 1993, the World Bank (1993) affirmed that the largest fiscal gain accrued from their civil service reform. Also for the Brazilian case, the World Bank (1997) pointed out that with the civil service reform, the government could obtain the greatest fiscal gain for economic adjustment.

### **2.3 Social Security Reform**

In 1994, the Argentine government implemented a new social security system with the objective of adjusting expenditures to revenue, approaching the values of benefits to contribution paid by the insured. The reform sought gave the workers a better combination between the private and public systems. Murphy and Moskovits (1997) affirm: "the system of social security (...) past from a state financing system to a mixture between private initiative and injection of resources".

All Argentine workers should participate in at least one of the systems. Also, there was a institutional unification, including the centralization of the whole collection process to a single agent, the "*Direccion General Impositiva-DGI*". This department, with specific bases in the collection from each program, delivers the resources for payment of social security benefits, assistance, health programs, unemployment security, among others. The following measures were implemented:

- improvement of the system of benefit payment control with unification of numbers of identification of contributor/beneficiary for aims of tax collection. This simple action has permitted the continual amelioration of civil service system control. The Argentine government expects that the effects of these alterations will be felt in the reduction of levels of tax evasion and avoidance. In Brazil, there is a multiplicity of numbers for electoral, civil, labor and tax identification, which complicates control.
- age of retirement for men 65 years and for women 60 years starting in 2005,
- retirees can receive a basic pension from the private and public models, or only one of them, and they can accumulate with a compensatory pension based in the former social security system.

The Argentine government altered pension concession rules for public workers to discourage precocious retirement and to impede the accumulation of retirement with other

incomes paid by the public sector and to increase the minimum age for retirement for men and for women and other measures that reduce expenditures with social security. Another problem attacked by the government was that of the province pension plan, see Murphy and Moskovits (1997). These plans paid very generous benefits and permitted earlier retirement. To correct this situation, the provincial social security has been transferred to the orbit of the central government that changes rules to end the social security deficit.

The insolvency system is explained by problems similar to the Brazilian ones: demography, and large overlife of retired people due to earlier retirement. The high Argentine life expectancy with greater acquisitive power and the possibility that these people will get earlier retirement, near 53 years of age, results in an imbalance between contributions and benefits. Although, the increasing unemployment that, on one side, reduces the social security revenue and, on the other side, determines that the payment to unemployed workers be elevated and increasing, diminishes the governmental fiscal gain with the project.

The Argentine government expects that the Reform will produce the creation of a social insurance system in the long term, resulting in the development of an Argentine capital market and in the increase of domestic savings due to a major participation in pension funds. The changes in the Argentine social insurance system would act in the sense of cheapening the cost of production, hence, encouraging domestic investment and attracting foreign direct investments. The social reform contains an explosive source of the social security deficit. The link of social insurance reform with macro-economic policy takes place through the implementation of forms of compatible financing with the exigency of the generation of new productive forms in the global environment and favorable to foreign and internal competition .

#### **2.4 Financial System Reform**

The proposal of liberalization of the financial system is that foreign financing act in the sense of stabilizing the consumption and financing the investment growth, including stimulus to the entrance of direct investments. Besides that, one hopes the internationalization of financial markets can impose greater fiscal discipline on economic policy, as pointed out by the Inter-American Development Bank (1997).

The internationalization of the financial system also took place with liberalization of foreign bank operations. In Argentina there are not restrictions imposed by legislation on the opening of foreign banks in the country, which permits that competition among banks can reduce the financial costs in the region. The purchase of Argentine banks by foreign banks to operate in the Argentine economy is substantial. The Argentine government hopes that with financial liberalization it can elevate the levels of savings and investments. King & Levine (1993, p.513) point out an explanation for Argentine success: "(A) Better financial system improves the probability of successful innovation and thereby accelerates economic growth".

In accordance with the Inter-American Development Bank (1997), the Argentine government is taking measures so that interest rates are formed in the market with less governmental influence, including a reduction in more than 20% of the commercial banking reserves. In the present monetary policy, the government restricts itself to the control of a few loan interest rates. For the Inter-American Development Bank, the country implemented measures that modernized the capital market and banking legislation with the improvement of banking supervision.

However, this economic guideline for Sachs (1996) can weaken the economy to a reflux of capital flow since it is easier to send resources to foreign countries by residents and non residents. In Brazil, there are still many restrictions on movement of capital,

inclusively, there is the necessity for a presidential decree to authorize, case by case, the working of foreign banks in the country.

## **2.5 Monetary Policy Reform**

With the Convertibility Plan, the Argentine legislation established that the monetary base could not be larger than the gold and foreign currency of the Central Bank. Besides that, the government can not issue bonds in foreign currency superior to a proportion of these resources of the Central Bank. The Argentine economy was converted to dollar, this acts in the sense of allowing an integration from the domestic market to the international one. Its objective is to retrieve the currency role and revert the flight of capital from the country. Although, the conversion of the economy to dollar represents the inconvenient loss of seignorage and increases the fragility of the banking system.

The neutral monetary policy is recommended by Friedman (1984). He believes that the implementation of monetary policy takes the economy from its natural trajectory in the short term. For Friedman and Schwartz (1963, p.696), the monetary variables do not influence the real variables. This fact makes the monetary policy inoperative in the long term: "In the long run, money is a veil. The real forces are the capacity of the people, their industry and ingenuity, the resources they command, their mode of economic and political organization, and the like". Friedman's finding is similar to that of David Ricardo's and other classic economists: economy under market forces adjusts itself through an invisible hand. The existence of permanent unemployment and, hence, the non-automatic adjustment of full employment was attributed to some market imperfections such as, the rigidity of nominal wages or of interest rates. Thus, David Ricardo also disapproved of monetary policy used as an instrument of economic policy.

Following the guideline of neutral monetary policy, the Argentine government gave more autonomy to the Central Bank, but, according to Barro (1996) and Shah (1994) if the independence of the Central Bank was greater from all governmental echelons, the economic stability could be even better. For the World Bank (1993, p.179), the Argentine Central Bank was the major source of instability in the country: "The Central Bank has been a major source of instability in Argentina. Numerous subsidies and the absorption of the internal and external debt by the public sector severely undermined the balance sheet of the Central Bank during the 1980s. The principal losses were attributable to capital and foreign exchange rate losses associated with the takeover of foreign debt, the uncovered debt from banks liquidated after the collapse of the domestic financial system in 1980-82 as well as later, disguised fiscal expenditures through the Housing Bank (BHN), and, to a lesser extent, the Industrial Development Banks (BANADE), specially in 1986-87. The net worth of the Central Bank (BCRA) was always negative during the 1985-91 period, and the cumulative quasi-fiscal losses of the Central Bank were about US\$ 15 billion by end-1989".

## **2.6 Trade Policy**

"Nation-states are weakening as decision-making becomes either local or global" - United Nations, 1994.<sup>4</sup>

The Argentine government has implemented measures to open the economy to the international market coupled with larger economic liberalization. The government does not utilize subsidies, infrastructure expenditures, privileged financing for exportations, or other expenditures to reduce private industrial costs such as with roads and railroads. According to Datta-Mitta (1997), Argentina reduced exportation and importation taxes, at the same time, seeking to make these taxes flatter. The results of the Argentine commercial liberalization can be seen with the fall in tax revenue from foreign trade. Even after the export tax revenues reached 0.0% of the GDP in Argentina, see World Bank (1993), the

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<sup>4</sup>See Human Development report 1994, p. 83.

country has not yet found foreign trade balance. For Kumar (1992, p.11) "In the long run, reduction of export taxes will generate benefits to the nation from supply-side perspectives as well as considerations of economic efficiency". Maybe, it explains that during the period 1991-97, Argentina presented a percentage of exportation on the GDP greater than in Brazil, see Secretaria de Assuntos Internacionais-SEAIN (1998). For Petri (1995), the opening of the economy made by the countries from east Asia resulted in an expansion of investment and trade in these countries. For liberal economists, tariff barriers tend to protect special interest groups, damaging competitive industries. These rent-seeking people spend money and time to obtain government benefits.

Regarding the incentives for industrial policy, these should be in accordance with the clauses of the Marrakech Agreement from the World Trade Organization - WTO, in the opposite case, the country can suffer retaliation measures. After the generation of the WTO, it is no longer possible to carry out industrial policy as in the 50's and the 60's. The country that adopts measures contrary to WTO norms is subject to punishment. The WTO objects to carrying out barrier reduction for free international exchange in all countries. One result of this orientation is the reduction of subsidy volume at the world level, see IMF (1995). The IMF discourages the implementation of subsidies on exportation, as pointed out by Stotsky (1995). Trade liberalization is applied with the extinction of many incentives that promote exportation. The volume of public money destined for the stimulation of exportation activities was substantially reduced. The Argentine commercial liberalization policy is part of a world movement, as recognized by the World Bank (1997b).

This commercial openness policy and less governmental intervention is in accordance with the proposals of David Ricardo and Adam Smith. For these authors, state intervention results in increasing deficits in the commercial balance and deterioration of exchange terms. Thus, for these authors, a country can stimulate its economic growth more with free trade than with protectionism, which distorts prices and restricts commercial transactions. For Murphy (1994) and the World Bank (1997), the costs of commercial liberalization tend to be less as the flexibility of the production factor is greater. Still in accordance with the World Bank, economic globalization plays in the sense of encouraging access to capital markets and foreign technologies by emergent countries that open their economies. Another advantage of open economies is pointed out by Heller (1997, p.31): "the hoped value of an appropriate fiscal attitude in an open capital regime is more conservative than when the capital is immobile".

Less governmental intervention to protect the acquisitive power of wages and, at the same time, a high level of unemployment can result in lower private wage levels. Elevated unemployment rates weaken the labor unions, impeding them from defending the acquisitive power of wages. In the absence of governmental intervention in the labor market and/or strong labor unions, the wage levels result from direct negotiation between employer and employee, which in an unemployment environment can reduce the wage level. Thus, less governmental intervention serves to propose wage reduction which can produce international comparative advantages. This economic policy is supported in proposals from Olhin (1931) and Samuelson (1946). In fact, Argentina presented a higher percentage taxation on labor than countries from the OECD in the 1986, see OECD (1986). About this, the IMF states: "For developing countries as a group, trade taxes accounted for almost 30 percent of total tax revenue during the period 1975-90, compared with only 3 percent for industrial countries".

For these authors, the increase of imports proper to economies that introduce trade openness would be hoped for and salutary, as happened in Argentina. While in 1990, the country achieved a surplus in *current account* of 1.3% of the GDP, in 1994, the surplus was reversed to a deficit of 3.7% in the GDP. Since 1991, the Argentine economy has

presented deficits in the Trade Balance different from the 80's. In the last seven years, the Argentine imports have increased substantially and, hence, the country would change from an exporter of savings to an importer of it. The IMF affirms that the exportation fall occurred during the first years of the Regime of Convertibility since household demand increased in detriment to the foreign sector. Corroborating this argumentation, there is the fact that with the recession of 1995, the country presented an extraordinary exportation performance.

These authors suppose that the import growth would be explained mainly by the acquisition of advanced capital goods. These imports of intermediary products allow the country to incorporate technologies developed abroad, increasing the productivity in the economy, hence, contributing to greater modernization of the industrial park. According to the IMF (1996), the increase of the deficit in current transactions in Argentina would result in the increase of household gross investment that changed from 14% of the GDP in 1990, to 19.9% of the GDP in 1994. This elevation in investment would be financed, partially, by an increase in foreign savings and restrictions on consumption, which explains an increase in household saving of 1% of the GDP. They assume that the important point of view, economically, is the current transaction and not the trade balance. The deficit in Foreign Balance (table 3), about 3% of the GDP, can not be considered elevated by any criterion of international comparison. Besides that, this deficit has mainly been financed by direct investments. One can see the evolution of direct investment in table 2.

Many developing countries maintain high levels of protection. Frequently, the objective of the policy of import substitution has been to protect domestic producers of goods for final consumption through qualitative or quantitative restrictions. These countries end up having, however, difficulties to elevate the exportation revenue because they can not pass the greater cost of importation on inputs to exported products. Although, these countries can solve this problem with the implementation of a zero tariff on the importation of inputs, see Shome (1995).

The trade liberalization can contribute to the increase of competitiveness in a measure that generates pressure on the Argentine firms for them to modernize themselves and increase their exportations. Thus, Argentina could eliminate the trade deficit. According to the IMF (1993), trade openness has favored the growth of developing countries. Stotsky (1995, p.281) affirms this: "Among developing countries, those that have adopted strongly outward-oriented trade policies seem to have shown better economic performance than those whose policies were inward-oriented or only moderately outward-oriented". The foreign investment would increase, in this way, the level of local and international competition with the introduction of new techniques. This proposal is defended by Amirahmadi & Wu (1994, p.167): "Several considerations lie behind this recognition:(...) advantage of foreign direct investment in providing both capital and technology".

This above insight contradicts the belief of Burton (1989) for whom the success of an exportation economy depends on the association of private initiative and the State. It is supposed that new industries need protection until the moment they can compete with foreign industries. Also Hirschman (1958) defends the adoption of a strategy to promote exportation as well as the protection of some national sectors until the moment that these sectors acquire competency and can survive competition with foreign industries. Certain of the necessity for encouraging foreign trade, Peres (1994) also suggests a group of measures to increase the competitiveness of the country in the international market. Corroborating this vision, Pavitt & Patel (1988) point out technological opportunities and industrial structure as explanatory elements of international competition. Gonçalves (1990) points out the necessity of increasing Brazilian comparative advantages. According to Grasnam & Helpman (1991), the expenditures on Research and Development could contribute to an



expansion of the capital goods sector, which is an important factor for an increase of productivity in the country. Underdeveloped capital sectors cause a deficit in the Balance of Payment. Reinforcing this insight, *The Economist* (1997) asserts that developed governments stimulate exportations through subsidies to exporters, credits for research and development, with credit and aid for exportation activities. The French government, for example, acts in two directions: financing to make a particular sector more competitive and concessions of benefits for the stimulation of exportation, see *Folha São Paulo*(4/5/97).

If one considers that imperfect competition prevails in the international market, the proposal of free trade is weakened. This happens because the enterprises can develop technologies due to the process of "learning by doing", which justifies the initial protectionism. For Lima & Katz (1997), the process of commercial openness should be preceded by an investment in education, health, infrastructure and the absorption of new technologies. Concerning less state intervention, for Freeman (1987), state intervention explained Japanese industrialization and successful exportation growth. Also, List (1844) says that the measures of protectionism are necessary to overcome the technological delays of a nation. According to Cunha (1997), state intervention is indispensable to economic development in the long term since government intervention acts as an agent of technological and scientific capacity. In this way, the country decided not to spend on infrastructure to encourage exportation growth. Thus, the Argentine government did not seek to give larger competitiveness to the economy, which can take place by technological innovation as suggested by Dosi (1984), an increase in productivity as pointed out by Porter (1991), and by productive efficiency as indicated by Chesnais (1981). Also, according to Peres (1997), Argentina is taking measures to reach industrial competitiveness without a global view of industrial policy.

For some authors, the doctrine of free trade is a consequence of the exigency of developed countries that developing countries do not generate restrictions on imports since the former is more competitive and they can expand their exportation to the Third World as long as the international market is free. Although, Argentina carries out a commercial policy coupled with other measures of a liberal nature as recommended by liberal economists and the World Bank, the high unemployment rate is persistent and the country did not increase its exportations. The Latin American products exported and the asymmetry of the trade flow across developed and underdeveloped countries confirm the practice of protectionism in the developed countries to assure income from the process of technological innovation, obstructing its diffusion.

For Iglesias (1995, p.7), the negative effects of appreciable exchange tend to overcome the positive effects of an open economy. According to the author, the export revenue would diminish because part of production would be destined to the household market and because it would lose competitiveness in international trade. The confirmation of this prognostic would be a problem since the Argentine economy is geared toward exportation. The recent results of the Trade Balance indicate that Argentine exportations would be losing competitiveness on the world scene. Nothing guarantees that the economy can accelerate to put itself on a sustainable path with exportations or growth, so that there is not a deterioration in the confidence of its foreign investors. Nothing guarantees, in particular, that the economy will not revert to the possible problems that were pointed out, before eventual foreign disturbances damage the international economic situation. This fact would inspire growing concerns. The overvalued exchange rate, the basis of the Stabilization Plan, would damage the foreign balance.

Another element to analyze the competitiveness of Argentine exportations is the evolution of productivity. In the tradable sector, the IMF calculates an increase of productivity of 12.2% between 1990 and 1995, although a loss of 3.90% occurred in the non-tradable sector. The productivity in the tradable sector regarding the non-tradable

sector grew 14%. The use of real effective exchange as proxy for the competitiveness of the Argentine economy points out an increase in competitiveness since 1994. Also, the Inter-American Development Bank (1997) affirms that there was an improvement in exchange terms owing to the prices of petroleum and agricultural products. The evolution of real effective exchange from 1991 to 1996 can be divided into two distinct periods: from 1991 to 1993, when the exchange rate was strongly appreciated, and from 1994 to 1996, when it was depreciated. Turner & Golub (1997) estimated the evolution of the exchange rate in developing and industrialized countries and found that the Argentine economy lost competitiveness, together with Germany and Japan, while the USA, Brazil, Great Britain, France and Italy become more competitive. Thus, the recent performance of Argentine exports seems to prove that exchange appreciation is a source of diverse problems and it is not offset by supposed productivity growth.

**Table 1**

Argentina: Bilateral Real Exchange Rates with Major Trading Partner  
(Percentage changes, end period)

	Bilateral Real Exchange Rates with Respect to:							
	REER (1)	U.S.	Brazil	Chile	Germany	Japan	France	Italy
1991	7,3	9,5	24,9	7,7	3,1	3,0	4,9	4,0
1992	17,5	14,2	8,8	6,4	14,4	12,6	16,2	34,0
1993	7,0	3,6	-5,1	6,0	11,5	-6,8	13,1	22,1
1994	-6,0	0,9	-27,4	-10,2	-7,0	-6,0	-5,5	-4,5
1995	-3,5	-0,7	1,2	-4,5	-8,7	3,8	-8,5	-6,1
1996 (January-June)	-0,2	-2,3	-3,5	-6,5	4,8	6,3	2,5	-5,2
Since implementation of the convertibility regime	22,0	27,0	-8,6	-2,6	17,1	12,1	22,1	44,6

Source: IMF 1997.

(1) based on 1990 CPI weights.

According to the above table, one can observe that the Argentine currency regarding the currency of its commercial partners has shown a devaluation. However, the recent devaluation only compensated for the valuation of the period 1991/93 in the cases of Brazil and Chile. This can explain why only Argentina obtains a trade surplus within the Mercosul, while it presents a deficit with the North American Free Trade Agreement-NAFTA and the European Common Market-ECM. An examination of the table suggests that the Argentine economy has retrieved competitiveness in the international market since 1994. This is also the understanding of Argentine authorities. For them, the exportation growth is expressive, reflecting the reduction of trade openness and other structural reforms. One should observe that the growth of Argentine exports depends in great measure on the stability of the Brazilian economy, its main importer. Besides that, it will not be possible to constrict the imports more.

Utilizing the findings of Krugman (1992) that for a country to increase its export revenue, it should export more modern products. He also recommends some stimulus for the production of manufactured goods. Gylfason (1997) did an econometric study and concluded that there is an inverse relationship between the percentage of agricultural activity on GDP and the relationship of exportation on GDP. Gylfason (1997, p.11) affirmed that: "specialization in agricultural production for export is likely to reduce total exports compared with other countries that emphasize manufacturing and services".

However, the Argentine export surplus with Brazil has avoided a weakening of the foreign situation of Argentina. This trade result is better explained by lower Brazilian

tariffs than by greater Argentine competitive production. The Brazilian currency overvaluation also contributes to this result. For Fanzylber (1990), trade policy based in exchange devaluation generally does not increase the competitiveness of the country. In this case, the real elements that can improve export performance are forgotten. Price adjustments overextend the terms of delivery and the attributes of quality incorporated in the products, see Fajerberg (1986). Also for Corden (1971) and Balassa (1971), the policy of tariff protection is second best. Nunes (1992) believes that incentives for exportation that encourage the production and diffusion of technology contribute to assure foreign markets. The author adds that concern with generation of technology under State action is present in the U.S. economy. Self-sustained growth requires that the growth of exports finance the capital goods and basic input imports and the payment of the foreign debt.

The competitive country regarding to others is, each day more determined by the qualification of labor, know-how, and science and technology applied towards production. To this respect, Nunes (1992) gives greater importance to the qualification of labor *vis-à-vis* other productive factors. The abundance of cheap labor and primary input has a comparative advantage of decreasing importance since they represent part of the value of final products. This non-reversible tendency makes it improbable that the success of poor countries derive exclusively from cheap labor and natural resources.

## 2.7 Exchange Policy

Since 1991, the country adopted the “*currency board*” regime. Thus, the government can not utilize the exchange rate to combat economic crises ensuing the fall of export competitiveness or sharp changes in the flow of capital. The Argentine authorities think that a currency devaluation will impede the elevation of national productivity. Murphy (1994) justifies the choice of a fixed exchange rate by the Argentine program affirming that in intense inflationary processes there is difficulty to establish monetary aims to control prices.

The adoption of fixed exchange coupled with the convertibility of the peso in dollar was established with the proposal that exchange policy is not utilized to stimulate exportations. In accordance with the IMF (1997), the adoption of a fixed exchange would be to protect the economy from the volatility of foreign currencies. Various authors believe that fixed exchange rates promote greater fiscal discipline than the flexible exchange rate. Regarding inflation evolution, the impact of imports and the stabilizing effect of a fixed exchange rate are different by sectors. In the consumer price index-CPI there is not immediate convergence of domestic prices to the variation of the exchange rate plus international inflation due to a greater proportion of non-tradable goods and services consumed. In the wholesale price index, the convergence is more rapid or the growth rhythm is less than the CPI due to a greater proportion of tradable goods.

For Silva (1997), the adoption of the quasi-currency-board regime<sup>5</sup> by Argentina was inappropriate to protect the country from financial crises. The author believes that the use of discretionary monetary and fiscal policies to seek stabilization of the economy are necessary. According to the author, the currency-board regime does not protect the economy from speculative attacks nor banking crises. According to Frankel (1996), since 1992, most exchange crises in the world resulted from governmental efforts trying to fix exchange rates with non-justified parity by economic bases. The necessity of a real exchange policy is pointed out by Fukasaku and Hellvin (1996) and Fukasaku (1997). Without a doubt, the exit of the English pound and the Italian lira from the European Monetary System-EMS in 1992 and the Mexican crisis in 1994 were due to efforts to defend a fixed exchange.

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<sup>5</sup> Hong Kong, Lithuania and Estonia also utilize a *currency board* regime.

For Friedman, the exchange should be flexible coupled with flexible prices and wages. According to the author, the less rigid the economy, the better context for the flexible exchange to operate efficiently. Still, in accordance with the author, the flexible exchange would isolate the country from internal and foreign instabilities and financial speculation would not be a problem. Being rational individuals, speculation is only the acceleration of a process that produces a new situation of equilibrium.

Although, to definitively contain inflation, it is necessary to reach an internal and external equilibrium. Although, one can combat inflation in a ephemeral way but with rapid results. This is possible with the fixation of the exchange rate to a currency of a country with low inflation. This practice of "importing" low inflation is frequent. The exchange rate is a variable that can and should be utilized to find economic stability. The implementation of the aforementioned reforms, especially the openness of foreign trade, should be coupled with an exchange devaluation to avoid an excessive reduction in the employment level and economic growth. It does not work, however, to only devalue, without fiscal and monetary adjustments. In these cases, the exchange adjustment can generate inflation when higher import prices are passed on to domestic prices and wages. The reforms give credibility to the country which encourages the entrance of foreign resources and, hence, the appreciation of the exchange rate. In the past, governments used successive devaluations to offset inefficiencies and low productivity, in a vicious cycle.

However, the fixed exchange rate makes self-sustainable growth difficult through intense competition imposed by a decrease of tariffs and by real exchange appreciation. The producers of tradable goods have been conducted to make deep structure changes. One of the possibilities is to cut jobs to reduce costs, eliminate departments and product lines and to import more. Thus, for example, OECD studies distinguish two possible paths. One possibility is to merely cut costs. Another is to try to elevate the efficiency of the utilization of available resources. In this case the best result can be found with better worker qualifications to increase the productivity of the production, see OECD 1995.

Thus, there is a risk that the process of openness, exchange valorization and foreign indebtedness are used only to generate an expansion of consumption. The cost of maintaining the convertibility plan is the extreme vulnerability of the economy to capital flight. The over-evaluated exchange rate contributes to contain inflation, but reduces economic growth rates in the medium term and increases the level of commercial deficit. In view this, Frenkel defends the correction of exchange rates to find economic stability.

From the second half of the past century until the present moment, from the Japan of the Meiji dynasty to Asian tigers, we do not know of even one case of a country that has overcome economic underdevelopment by implementing liberal measures. In all countries, the State was the greatest motor of development, to generate conditions of economic growth.

### **3. FISCAL RESULTS AND LEVEL OF EMPLOYMENT**

From the strict point of view of fiscal results obtained, the outcome of Argentine public finances in the last 5 years, can not be considered good. The deficit of the Argentine public sector changed from 0.2%(1992) of the GDP to 2.5% in 1997. In this same period, there was growth in the public debt when the public debt changed from 30.6% of the GDP to 36.2% of the GDP. Also it was worse in the provinces. The debt of the provinces changed from 2.8% of the GDP to 5.3% of the GDP in the same period. Although, in this period, the federal transference to the province had increased. The budget decentralization contributed to undermine the fiscal discipline in the country. The provinces do not worry about economic stability but only about attending to social demands. According to the findings of Datta-Mittra (1997) fiscal imbalance would not be good because the fiscal equilibrium is an essential condition for self-sustainable growth. According to the author,

with a reduction of the public deficit, there is an improvement in the balance of payment and an increase in economic growth rates. Also for Sargent, one can not achieve monetary stabilization without improvement of public finance since the interest and exchange policies only delay the necessity of the implementation of structural reforms. McGann (1996) affirms that the Argentine government hopes to reduce the public deficit with an increase of net tax revenue, therefore, lowering or eliminating tax exemptions and reducing expenditures on health and social security. For the World Bank<sup>6</sup>, the benefits of commercial liberalization are great in relation to the costs. In accordance with the World Bank, the reforms tend to create a net social gain in the long term.

According to the World Bank (1997), although the total external debt diminished in percentage of GDP from 36% (1980-1990) to 33% (1990-95), the relation of external debt to exports increased, reflecting the relative loss of exportation importance.

The level of internal activity has been sacrificed, damaging the employment level. The rapid increase of unemployment can be due to excessive peso overvaluation that stimulated imports and discouraged exports. The lack of exportation dynamism, the bad public finance situation and the low level of investment decrease the capacity for economic growth. When foreign openness is an important instrument for the control of prices, the level of unemployment tends to be greater if it is not offset by a strong increase in exports.

An increase in the employment level can occur with the acceleration of economic growth that raises the labor demand for one given real wage level. While there are available production factors, investments generate an increase in the productive capacity, and at the same time, in the demand, without new inflationary pressures. Another way, would be through the reduction of the relative price of labor, or be that, of real wages, for a given level of demand and technology. However, one can not reduce the wage level much. Therefore, the use of wage policy to increase the level of employment is limited. Thus, the viable way to increase the employment level is to increase the growth rate with a greater volume of investments.

The analysis of the Argentine figures compel us to emphasize that the economic growth recovery is not coupled with employment generation, or jobless growth. The explanation is that the Argentine economy increasingly utilizes technology to substitute labor, as pointed out by Cepal (1996). This kind of technological development, paradoxically, reduces the power of unions even more. For Iglesias (1995) the openness of the economy and exchange appreciation would withdraw profitability from tradable sectors, damaging the level of production and employment. Therefore, the Argentine economic model does not benefit some sectors of society.

Before the analyzed period, the country presented an unemployment rate around 6%, after the convertibility plan, it started to have an unemployment rate around 17%. The reduction of the State and privatization increased the unemployment level.

The unemployment rate has grown even with reductions in real wages since 1992 (see table 2) and new labor laws. These new laws permit the reduction of labor costs due to the minor contribution of social security, partial employment and less intervention from the unions in collective negotiations. The reduction of union power contributes to increase the rotation of labor which can produce greater wage flexibility.

The implementation of collective agreements are increasing through bilateral negotiations at the level of the firm in substitution for negotiation among unions and entrepreneurs in industry.

Financial concentration can be advantageous in the long term when efficiency gains take place. As an example of institutional change, one can cite the constitution of a US\$ 5 billion fund by the Central Bank to protect the banking system against liquid financial

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<sup>6</sup> Ibid.

crises. In case of emergency, the resources would be delivered through buy back agreements with the Central Bank.

#### **4. CONCLUSION**

The recent strategy of minimum government intervention in the financing of the Social Security system, as well as in the economy, is in line with the latest developments in the area of public finance. Also, the neutral monetary policy is recommended by the mainstream school. Those economists believe that the implementation of monetary policy takes the economy from its natural trajectory in the short term since it is inoperative in the long term. Thus monetary policy only generates economic disturbances. Following the guideline of neutral monetary policy, the Argentine government gave more autonomy to the Central Bank, opened its economy, and internationalized the financial system.

However, those liberal measures have been contested by several economists. For these economists since the second half of the past century until the present moment, from the Japan of the Meiji dynasty to Asian tigers, there is not even one case of a country that has overcome economic underdevelopment by implementing liberal measures. In all countries, the State was the greatest motor of development, to generate conditions of economic growth.

The Argentine program's economic performance has been considered ambiguous. There is economic growth, but, the external trade situation is not satisfactory, although, the findings of the IMF are that the Argentine economy is achieving a situation of external and fiscal balance. For the Argentine government, what matters about the Balance of Payment is the perception that the deficit in current transactions should correspond to an increase in household saving and a reduction in the fiscal deficit. This diagnostic seems to be shared by international agencies such as Moody's, Standard & Poor's and Duff & Phelps that classified Argentina with an average evaluation, above the Brazilian one. According to the World Bank, Argentina is the MERCOSUL country that received the most loans from the World Bank between 1993 and 1995, (58.1% of the total loans for this region).

However, for some authors, the Argentine economy has presented increasing dependency on the Brazilian economy. The imbalance in the foreign sector is always a concern owing to the fact that it can be aggravated by problems in the banking system. Exports would be the motor of the process of development. The optimistic conclusion is that the productive structure is still in transformation. The pessimistic one, although, has other motives to doubt the viability of a return to growth without further disequilibrating the trade balance. Also, this paper criticizes greater economic openness coupled with less State intervention in the economy, the slowness of reforms in the provinces and the option for a fixed exchange rate. Thus, the governmental abdication of the use of monetary, fiscal and exchange policies brings credibility to the Argentine economy because it would be assured that the government will not make public deficit. The cost of this option is the deficit in current account that has caused an increase in unemployment, public indebtedness and less economic growth. Yet, these criticisms are softened by inflation control, less labor benefits, increases in productivity, and the implementation of reforms that reduce the State's size. It is important since the movements of finance capital, more than trade, became the main force behind the world economy. The trade and financial sectors did not become autonomous, but their relationship is tenuous and unforeseeable.

There is an absence of an economic development plan that could structure directive rules to increase the competitiveness of firms. The larger technological capacity necessary to make the Argentine productive structure internationally competitive requires effort for the improvement of the educational system and technological experiments. The elements that can increase the competitiveness at the international level such as larger expenditures

on education and infrastructure services quit being politically prioritized in the beginning of the 90's as recommended by liberal economists.

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**Table 2**  
**Argentina: Selected Data**

	1991	1992	1993	1994	1995	1996	1997
GDP rate at 1986 prices	10.5	10.3	6.3	8.5	-5.8	4.8	8.6
Real GDP per capita		8,2	4,4	6,7	-5,3	3,5	7.3
Export of goods	11.978	12.235	13.118	15.659	20.967	23.881	25.516
Imports of goods	8.275	14.872	16.784	21.527	20.122	23.762	30.349
Capital goods		3,888	4,964	7,409	5,552	5,607	7,718
current account in US\$ million	-647	-5.462	-7.672	10.118	2.768	3.787	10.119
Terms of trade		97.6	100.0	101.5	101.8	110.1	107.8
unemployment rate	6.9	6.9	9.9	10.8	18.4	17.1	16.1
External Debt in US\$ million			53,620	61,268	66,999	73,561	74,530
Tax Burden %	15,40	17,70	17,50	17,38	16,62	15,69	16,61
Direct Invest in US\$ million	2.439	4.179	6.305	3.116	4.783	5.090	6.327
overall balance	-2.1	-0.2	-0.8	-2,3	-4,0	-3,7	-2,5
Public consolidated sector debt	68.8	74.7	87.2	100.7	111.2	117.7	36.2
In percent of GDP							
Federal Government		27.5	27.0	28.4	31.8	33.1	32.0
Provinces		2.8	3.1	3.7	5.2	5.4	5.3

source: Ministry of Economy, INDEC, IMF.