

Mimeo, 1995. Una versión en castellano fue publicada en Novedades económicas, enero de 1996.

“RIGHT” ECONOMICS, POLITICAL ASSET: ARGENTINA SINCE 1985¹

Since Second World War, in Argentina "right" economics (i.e.: an approach to economic policy based on the basic principles of the economic science) was a political liability.

Smart politicians, understandable slaves of electoral results, were fond of "populism" (i.e.: "an approach to economics that emphasizes growth and income distribution and deemphasizes the risks of inflation and deficit finance, external constraints, and the reaction of economic agents to aggressive nonmarket policies". Dornbusch and Edwards, 1991). Accordingly, economists interested in interacting with politicians, based their recommendations on populist approaches. "Right" economics, at best, partially and temporarily², was introduced during military regimes.

This scenario changed dramatically in 1985, and has remained since. In other words, from the 1985 Representatives election on, incumbent candidates -national or provincial; in the Executive or Legislative powers- have won in the ballot, if and only if economic policy was "sound" at election time; particularly, if at election time the rate of inflation was near zero or sharply declining.

Smart politicians, still slaves of electoral results, are now finding that "right" economics has become a political asset. Accordingly, the dialogue between them and professional economists have become a lot easier.

This phenomena is also present in other Latin American countries (could Fernando E. Cardoso have won Brazil's presidential election of late 1994, without Plano Real of July 1994?;

¹ I would like to thank Rosendo Fraga and Julio Burdman for providing the political data.

² Since nobody expected the military to stay in government forever, introduction of "right" economics by military regimes had all the disadvantages of incredible reforms, analyzed by Calvo (1986, 1987, 1988).

Could Alberto Fujimori have been re-elected, without introducing economic reforms in Peru?), but in this paper the analysis is constrained to the Argentine case.

The purpose of the paper is to explain why the shift in the perception of "right" economics from the electoral point of view, how President Menem was able to built up credibility during his first term, and how this "honeymoon" between the correct economic approach and practical decision making can be sustained over time.

1. FACTS

Table 1 summarizes the outcome of the last six elections in Argentina, and the rate of inflation observed at each election time. The message that comes out from table 1 is neat: incumbent candidates won elections when economic policy eliminated or at least significantly reduced the rate of inflation, opposition candidates won when the rate of inflation increased sharply or explode.

Puzzle: why "right" economics is not incorporated into the political platforms of all political parties, redirecting electoral campaigns to non-economic issues?

There is no easy answer for this important question. My hypothesis is that, during turning points in the evolution of nations, events and individual decision making, are well ahead of the understanding of the process by politicians, political analysts and the media.

I have substantial evidence to support this hypothesis, although for the time being I am unable to present it in econometric format. As a business consultant, media men and economic unit, I have witnessed very closely individual decision making by consumers and entrepreneurs. At the same time I have followed diagnosis and forecasts by politicians and political experts, many of them -as Keynes said- "slaves of some defunct economist". In transactions and well as in the ballot, time and again argentines showed that did not follow formally neat but empty-of-content politicized economic analysis.

This lag in understanding that "something fundamental happened" in society, that has to be incorporated into analysis and policy proposals, explain why opposition political parties (notably the Radical party) so far ignored the message of their professional economists. The Radical party official explanation of their failure at the ballot is not that they have wrong economic proposals, but that they do not know how to transmit to the voters, (their) correct economic ideas.

2. WHY?

How come that the same population that voted populist approaches to economic policy up to 1973, changed so dramatically since 1985?

The main reason is that the costs of inflation are not proportional to the rate of inflation, but strongly increasing. This is true for the population at large, and particularly so for the poor. Because the poor do not use credit cards, do not have the possibility of spending the day transferring deposits from one bank to the next -or selling stocks and buying dollars-, and are the most misinformed (specific information, in a chaotic scenario, is the most regressively distributed input of decision making!).

This is obvious for any survivor of a hyperinflation, but it does not seem to be so for those who -living in countries where they experience single digit annual rates of inflation- have to imagine what high inflation or a hyper is (watching 30 seconds of a war through CNN does not make you an expert on how people feel during a war). That is why I understand, but at the same time get very angry, when in an academic seminar I find a colleague that is "soft" on inflation, in the name that "the inflation tax is like any other tax".

In practice, high inflation or hyperinflation is not "just" a tax on cash balances. In practice, high inflation shrinks the time horizon of decision making (to hours, in a hyper), because of the incredible difficulties of forecasting. In practice, when facing high inflation governments do what they should not do (i.e.: freeze, control or "administrate" prices, rents, wages, etc.), and do not do what they should do (i.e.: index tax payments, to avoid the so called Olivera-Tanzi effect)³. In practice, under high inflation rich and powerful members of the private sector engage rent-seeking activities, endogenizing economic policy, and shifting their burden of inflation to the poor. In a word: in high inflation or a hyper everyone is so busy trying to survive, that none has time to work (i.e., think and act on behalf of consumers, reduce costs, etc.).

During July 1989 the rate of inflation was, on average, 4% per... day (during the first half of the month was probably two times that much). This fact generated a sufficiently intense experience that, fortunately, for many years argentines are not going to forget, particularly when they vote.

One piece of information relevant for understanding the voting behavior since 1985 is that, contrary to "conventional" or orthodox antiinflationary programs, since Austral Plan on, recession was previous to the launching of the program, so that the sudden elimination of inflation reactivated the economy.

The level of the rate of inflation explains the difference. When the rate of inflation was, say, 2% per month, the economy grew up to the moment when authorities decided that the inflationary situation was intolerable, and that accordingly "something" had to be done. The result was a (temporary) reduction of the rate of inflation, but at the same time a fall of real

³ See de Pablo (1982).

GDP. The issue of the cost of stabilization programs had then some content, i.e. there was a (short run at least) trade off between inflation and growth.

Something different happened when the rate of inflation was, say, 1% per day. Since 1985 on, in Argentina every antiinflationary program ended a recession generated during the last months of the previous inflationary process. With the launching of the antiinflationary program hope and credit returned, generating the recovery of the economy. From the growth point of view, now there are no social costs to end inflation⁴.

Could it be then that since 1985, in Argentina the population voted candidates in favor of disinflation-cum-reactivation-cum-full employment policies, but that would vote opposition candidates the moment price stability is maintained, but reactivation turns into recession and unemployment increases. The May 1995 presidential election is a emphatic no to this conjecture: President Menem was reelected with more than 50% of the votes (21 percentual points above his main opponent), with single digit annual rate of inflation, recession during the second quarter of the year, and 18% unemployment rate (10 percentual points higher than a year before).

Voters privileged maintenance of Convertibility Plan (which among other things implied no devaluation), and said yes to a tough fiscal program launched two months before election day, for a couple of reasons: 1) price stability as such, and belief that none of the existing problems will be solved through inflation; and 2) a "balance sheet" consideration. They bought durables in installments denominated in dollars; and as a result of the privatized Social Security System, they are accumulating funds denominated in pesos.

If you remember what a hyperinflation is, owe dollars and have assets denominated in pesos, you do not need to be a Ph'D in economics to vote candidates that favor "right" economics.

3. HOW MENEM BUILT UP CREDIBILITY

When on Sunday May 14, 1989, I realized that Peronist candidate Carlos Saul Menem had won the presidential election, I was shocked... like other several millions of argentines.

⁴ These results are not atypical nowadays. "An inflation crisis almost invariably involves a reduction in the growth rate, while recovery from a crisis is associated with a resumption of growth which even surpasses the pre-crisis growth rate", discovered Bruno and Easterly (1995) in a cross-section study involving dozens of countries.

That a peronist, and particularly the former Governor of La Rioja Province, led the most fantastic economic transformation that Argentina experienced during the second half of the XX century, is a fact that surprised everybody, inside and outside Argentina⁵.

Menem was not elected president because he was expected to solve economic problems applying "right" economics; he was elected president because voters attributed to the Radical government, the responsibility for the 1989 hyperinflation⁶. In other words, the May 1989 vote was more antiRadical than proMenem⁷.

This means that to end hyperinflation, to open the economy, to privatize and deregulate it, Menem had to build up credibility not from zero but from "minus several billions". And he had to do it overnight, because when the rate of inflation is 4% per day, and increasing, the only feasible successful economic policy is a credible shock therapy. This section of the paper explains how he did it.

He did it by exaggerating, in terms of officials appointed and sequencing of policy reforms.

Officials. Menem was elected President on May 14 and took office on July 8. One day in the meantime newspapers reported that he had visited Bunge & Born offices, the Argentine-based international conglomerate, where he was shown the implications of some arithmetic exercises based on an econometric model.

Non Argentine readers should know that, during the first Peron era (1946-1955), Bunge & Born was considered the "Antichrist" by the government. So, on reading at the newspapers that Menem had visited B&B offices, the first reaction of the Argentines was: "there must be a printing error". There was none.

Recognizing the existence of Bunge & Born by paying a visit to their offices, reminds me the decision of Anwar El Sadat -then President of Egypt- to fly to Jerusalem to

⁵ That is why the title of my book on Argentina's transformation since 1989 is Quién hubiera dicho -Who would have said- (de Pablo, 1994). Menem's case was used to advertise a magazine in Argentina. Below a "before 1989" photograph of his face, the following message was included: "sometime is very difficult to identify a successful man".

⁶ In my opinion, the causal "reading" of the voters was wrong: during the first semester of 1989 Argentina did not suffer a hyperinflation because Radical President Alfonsín was ending his term, but because Peronist (i.e.: "populist, irresponsible") President Menem was expected to start his term.

⁷ Written documents distributed by Menem during the electoral campaign include a remarkable amount of "right" economics among his proposals. This comes out of a cool reading, after Menemnomics has occurred; but my recollection of events is that during the electoral campaign nobody paid attention to his written documents, concentrating in his style.

recognize the existence of the State of Israel by paying a visit to their Knesset. Through a major signal, in both cases the atmosphere had no choice but to change.

The mentioned visit was not just a formal act. The first minister of economics of Menem was an executive of Bunge & Born. And when, as a consequence of a heart attack, six days after taking office Miguel Roig died, Menem replaced him with Nestor Rapanelli, another Bunge & Born executive (appointing Rapanelli indicated that, from the economic point of view, Menem "meant business").

Domingo Cavallo, minister of foreign relations of Menem from the first day of his presidency, and minister of economics since January 91, is not affiliated to the Peronist party.

So, from the appointment of officials point of view, Menem showed that on the instrumental level, he had no constraints. More important, Menem said that, in the name of achieving goals, he was (and still is) prepared to risk "political costs" (table 1 shows that he may be paying political costs in terms of the Peronist party as such, but not from the electoral point of view).

Sequence. Privatization of public sector firms was announced from the very beginning of Menem's presidency.

In mid 1989 the public sector owned several hundreds firms. Had Menem began by privatizing a small catering services company, a repair shop or a restaurant, investors would have thought that he was aiming at pure "window dressing". To signal that he was speaking seriously, Menem started privatization policy by selling Aerolíneas Argentinas and Entel, namely, the airline and telephone companies (the two firms that President Alfonsín tried to privatize since 1987, but was unable to do).

A year later, the airline and the telephone companies were in private (foreign!) hands. As a result of "learning by privatizing", and the increase in credibility, later privatizations (petroleum, electrical energy, gas, etc.) were paid in cash (not through debt-equity-swaps), and no minimum profit rate was guaranteed. Today all public sector firms are in private hands.

Rodrik (1988) suggested that presidents who start their term facing credibility problems, from the very beginning should introduce more aggressive, less gradualistic, economic policies, to convince the population that they really mean it. Menem is a living -and successful- example of Rodrik's recommendation.

4. HOW TO SUSTAIN THE "HONEYMOON"

It is in the interest of Mankind, because it improves the welfare of the human being, that economic policy is based on sound economic principles.

But in democratic regimes "right" economics is going to be applied only if it continues to be a political asset. What can economists do to sustain the "honeymoon" that currently exists between smart politicians and professional economists?

From the content point of view, the profession can be socially very useful if research and advice are redirected to the design and implementation of specific policy proposals. An average student is enough for sketching the overall design of an economic policy (stabilization policy, opening of the economy, etc.). Crucial from the practical point of view, is to provide precise content to broad principles, as well as working on its implementation.

Consider the privatization of a telephone company. You do not need to be a Nobel prize in economics to say that "we should privatize our telephone company", adding that "attention should be paid to the regulatory system, to avoid monopoly exploitation; and to the way in which the offer is made, to avoid arbitrary or discretionary actions by public officials". Successful ministers of economics are successful because they know how to do this: how to design and write the regulatory system, how to implement an agency that monitors it, etc.

In Argentina we now know how to end up a hyperinflation, how to privatize nationalized firm, how to deregulate the production of a commodity. As a result, more specific policy challenges are emerging: how to increase genuine job opportunities, how to adjust the quantity and quality of public expenditure, etc. If professional economists do not provide this crucial input for decision making, an imperfect substitute will emerge.

From the communicational point of view, the profession can be socially very useful showing, at schools as well as in the media, the consequences of implementing "wrong" economics. In Argentina today everybody is aware of the communications revolution that resulted from the privatization of Entel (up to 1989 argentinians bought a telephone with bricks around, not a house or an office. Today, in Buenos Aires, the telephone company will not charge installation costs, if lasts more than 30 days between the placement of an order, and actual installation of the telephone). But as time goes on, memories about the miserable quality of public sector firms will evaporate, and realities about operational deficiencies of the private sector firms will emerge. Like in the case of the Nazis, remembering the Holocaust is a way of postponing the next (hopefully forever).

5. ECONOMISTS AS POLITICIANS?

Why do economists have to convince politicians about the convenience of applying "right" economics? Why not economists themselves occupy, say, the Presidency of a country, and apply "right" economics, even if again becomes a political liability?

Since Peron, Argentina had 19 presidents: 11 generals (sic), 5 lawyers, 2 physicians, 2 "nothing". Roberto M. Ortiz, President from 1938 to 1942, is the only one who had been minister of Economics before (of President Agustín P. Justo from 1935 to 1937)⁸.

After analyzing decades of practical economic policy in Latin America, Harberger (1993) concluded: "Successful economic policy in developing countries is very far from being the product of pure forces of history. Far from it, in every case about which I have close knowledge, the policy would in all likelihood have failed (or never got started) but for the efforts of a key group of individuals, and within that group, one or two outstanding leaders".

Of his "handful of heroes" (head of economic teams like Roberto de Olivera Campos, of Brazil; Alejandro Vegh Villegas, of Uruguay; Sergio De Castro and Hernán Buchi, of Chile; Carlos Salinas de Gortari, Pedro Aspe and Francisco Gil Díaz, of México), Salinas was the only who reached the Presidency (Buchi was presidential candidate).

The Presidency of a country should not be a monopoly of some professions. Accordingly, an economist being future President of Argentina is a possibility that cannot be ruled out. What should be clear is that an economist acting as President of a country, should be understood as a human being trained as economist presiding the Executive power. Which -I hope- is very different from a Homo economicus dictatorship.

6. CONCLUSIONS AND IMPLICATIONS

Four main conclusions and implications emerge from the analysis.

1) From the electoral point of view, an antiinflationary program may be a political asset or a liability, depending of the level of the rate of inflation.

In Argentina, the level of the rate of inflation that was considered socially and politically tolerable increased overtime; roughly speaking, levels labeled "intolerable" during the 60s, were considered goals of the inflationary programs during the 80s. But in any case, the situation changed dramatically when -after 30 months of systematic increase in the rate of inflation- prices started to rise at approximately 1% per day. That is why after the day in which he was elected, President Alfonsín's popularity was never so high, as when responding to a "social demand for action", in June 1985 he launched Austral Plan⁹.

⁸ This should surprise none since in Argentina José María Dagnino Pastore (1969-70; and 1982) and Domingo Felipe Cavallo (1991 on) are the only two ministers of Economics with a Ph'D level degree in economics. Guido Di Tella, who also holds a Ph'D in economics, is minister of Foreign Relations since 1991.

⁹ Less than two months later, Rudiger Dornbusch was the first economist to point out in the argentine case, the importance of "right" economics from the political point of view.

In countries that suffered a hyperinflation, the evolution of the rate of inflation has paramount importance from the electoral point of view, even when -using a crude Phillips curve approach- it is perceived that its reduction is costly in terms of other economic indicators. In Argentina voters seem to use more sophisticated Phillips curve approaches, realizing that none of the remaining difficulties will be solved by returning to inflation.

2) A hyperinflation, and the corresponding collapse of the previous economic regime, provides an opportunity for reform. Opportunities may be ignored, wasted or... used. Menem and Cavallo used it.

Vaclav Klaus, "father" or one of the fathers of the economic transformation of the Czech Republic, described how he used his opportunity. In his words: "The question of choosing the optimal reform package and identifying the appropriate sequencing of the reform is a favorite topic of many confused theoreticians in the discussions about economic transformation. My practical experience tells me that the problem is very often misunderstood.

What is important for the reform to be successful is a clear vision of where to go, a pragmatic reform strategy, and the courage to begin... The transformation of a whole system is a prolonged process, with millions of participating actors -human beings- who play their independent and sometimes conflicting roles... Reform is not a theoretical issue. It takes place in real conditions, it affects real and vital interests of particular groups and strata of the population, and those interests are reflected in politics" (Blejer and Coricelli, 1995. Underlines are mine). Reading this text I thought that Klaus was describing Argentina. In a way he was.

Think, for instance, on the velocity at which Argentina privatized. Since most public sector firms were bought by foreigners, the corresponding capital inflow temporarily overvalued the peso. Would I recommend, say, a 10 or 20 years privatization program, to smooth the impact of capital inflow on the overvaluation of the peso? Not at all. The correct decision was to use the unique opportunity created by the existing mess, suffering the corresponding consequences.

I am not suggesting to ignore all feasible and not very costly measures designed to minimize adjustment costs. But I am saying that, since human and material resources are always scarce, its allocation during a transformation should concentrate on the design and implementation of the new regime, and not on "fine tuning during the transition".

3) The Founding Fathers of economic analysis never thought of it as a mere toy. On the contrary, developing "economic science" they were looking for genuine foundations for action, aimed at the improvement of human welfare. Reading contemporary journals, sometimes I wonder if the current flow of papers improves our understanding of how the world really works, and what can be done about it; but the stock, and particularly the implications of the basic principles, are very important for decision making.

In countries like Argentina the debate about price stability, privatization, deregulation, and opening of the economy, is over. It did not end when privatimaniacs defeated privatifobics, but when as a result of the collapse of the old regime, Menem had no choice but to privatize.

This does not mean that the role of professional economists has ended, it only means that has changed. Economic issues in Argentina are today more specific, related to employment, incentive compatibility, monitoring regulatory schemes, introducing budgetary reforms at provincial and municipal levels, etc.

The crucial role that professional economists can play in countries like Argentina from now on, lies in stopping the reelaboration of overall principles, and starting giving content to specific programs. From this point of view it is very important that economists encourage, through publishing and other "signals" of appreciation, efforts oriented to the design and implementation of specific policies.

4) Last but not least, human beings trained as economists may be presidents in the future. But not because they are economists, or as a result or the failure of politicians. They will be presidents because they like the job, and are able to convince voters that they are the best candidates. Their training as economists will unavoidably affect their vision and behavior, as happens with presidents that are lawyers, physicians or generals, but never to the extent of transforming the country they run into "econoland". Amen.

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