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Argentine Inflation:Why Doesn't It Stop?

A Report to Esso Inter-America Inc.

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EXECUTIVE SUMMARY

This Report concludes that there is no sign of abatement of Argentine inflation at this time. While the present rate of price increases may not continue indefinitely at about 160% yearly, Argentina already is in its fifth consecutive year of inflation above 100%, a record never exceeded in economic history, except by countries at war or in the aftermath of war, and matched in peacetime only by Chile in 1972-76. Except perhaps for the trade surpluses since 1976, none of Argentina's economic and monetary indicators point to a slowing in the pace of price increases. The rate of inflation for the first half of 1979 (63.7%) was slightly higher than in the second half of the crisis year of 1976.

Argentine inflation in the 1970s is the culmination so far of the chronic inflation and economic stagnation that plagued the country during the whole postwar period. I have tried to analyze present Argentine inflation in two time frames in order to explain its persistence. The first of these time frames, encompassed in Parts 1 and 2 of this Report, focuses on the short term, say three years, in which economic stabilization programs usually are implemented with the advice and support of the International Monetary Fund (IMF). This kind of stabilization program usually involves some combination of devaluation, emergency foreign credits, ceilings on internal demand in the form of controls on wages, prices, credit, money supply and/or imports. Sometimes this combination of policies has been helpful in controlling inflation in the short term, but it has succeeded much more rarely in the long term when internal forces are working against productivity and toward a price explosion. These policies have been tried four or five times in Argentina during the postwar decades with some success in the short term, but these efforts always have been truncated or reversed by political resistance. The first part of this study surveys the great variety of economic factors at work in Argentine inflation and the diversity of policy tools used while trying to control it. The present military government seems unwilling to expose itself to the political consequences of more austere fiscal and monetary policies that would slow down the rate of price increases.

Part 3 of this Report discusses the long-term forces behind Argentine inflation, namely trends in urbanization, the country's terms of trade and productivity. I have found these long-term forces to be decisive in setting the pattern of chronic Argentine inflation in the postwar decades. They also have imposed formidable obstacles to short-term policies aimed at reducing rapid price increases and distortions in public finance and foreign trade. The republics of the southern cone of South America (Argentina, Chile and Uruguay) persistently have suffered some of the most severe inflation in the world since 1950 because they urbanized very rapidly in the boom decades before 1914, much earlier than other Latin American countries, and resorted to inflationary public finance to sustain urban concentration and consumption as the terms of foreign trade turned against them in the half-century between 1920 and 1970. In Argentina, intense sectoral conflicts arose from the sudden superimposing of a modern export economy on an incipient and precariously organized national society in the 19th Century; from the patterns of land distribution, public finance and absorption of European immigration during those formative years, and from the promotion of paper currency inflation by landowners and exporters, using their political influence, to reduce their local peso costs.

Argentina is not one of those countries that have developed a phobia toward inflation, as did the United States after 1865, Germany after 1923 and, apparently, Chile after 1973. Both the individual and the state have found ways, for now, of living with inflation without reducing consumption. The government has been able to sustain high levels of public spending, as a stimulus to economic activity, by developing a symbiosis with the radical expansion of international liquidity, which has financed inflationary public spending in a number of Latin American countries ins the 1970s. During 1979 there have been signs of overheating of the Argentine economy, with labor shortages developing and some industries working close to capacity. In July, Treasury Secretary Juan Alemann said on television: "We must clarify our ideas. We either choose high investment of high consumption, but not both of them; we either choose an overheated economy with non-existent unemployment, or we choose monetary stability...one harbors great doubt whether this amiable coexistence with inflation can last."

For the foreign investor, Argentina retains the attractions it always held in terms of untapped potential in agricultural production, energy resources and human skill. Given the present instability of international money markets, it is hard to predict how long Argentina's present exchange rate scheme will last. These programmed minidevaluations, announced well in advance of their implementation, have lagged behind inflation by wide margins, thus generating huge benefits for financial speculators and losses for foreign investors who bring dollars to Argentina to meet commitments for fixed construction and operating costs. One can only say that continued movements of funds from abroad into Argentina, lured by the spread between nominal devaluation and inflation, will play havoc with the money supply if it goes unchecked at present rates and will throw the economy into deep crisis if it suddenly withdrawn. One must look toward a time horizon of a decade or two for financial and political stability to return to Argentina, when the country will begin to consolidate the benefits of the improvement in its terms of foreign trade already underway and to absorb the backlog of technological improvement that the economy was unable to incorporate in the postwar years to a significant degree.

CONTENTS

SUMMARY

Purpose of this inquiry: I have been asked to answer two questions:
(1) Is Argentine inflation now an integral part of the country's functioning organism to the degree that political and economic equilibrium cannot be sustained without large and apparently endless increases in wages, prices and the money supply? (2) To what degree, if any, is Argentina condemned for the foreseeable future to abrupt and radical shifts in economic policies through continuing alternation in power of the rival political elements that have succeed each other every few years over the past generation?

Method: I have tried to take a fresh look at these problems in a number of ways. First, I have tried to establish a a relationship between the present phase of Argentine inflation and the expansion of the world money supply in the 1970s, and between Argentina's stabilization efforts and the anti-inflation policies of other countries in South America. second, I have sought to identify the rigidities in Argentina's political economy that have impeded adaptation to world price fluctuations and greater participation in the extraordinary expansion of trade and diffusion of technology that have taken place in the postwar period. Third, I have tried to find the historical roots of postwar Argentine inflation in the monetary experiences and patterns of human settlement that developed during the country's formative period.

These underlying concerns pervade the present inquiry. Each of them is not developed fully because, to do so, would involve writing a sizeable book that is clearly beyond the scope of this study. I hope, however, that I have managed to convey a clear idea of their relevance. In developing these themes I have had to read widely in Argentine political

economy and history, including several unpublished doctoral dissertations, and in the specialized economic literature on inflation. I also have conducted about 100 interviews with persons concerned with Argentine affairs and inflation in general in Buenos Aires, New York, Washington, Princeton, Santiago, São Paulo and Rio de Janeiro.

Conclusions: The problems of inflation and political instability in Argentina are so intertwined that I have decided to consider them as one. I can see no end to inflation and therefore can see no end to political instability. The pages that follow show Argentine economic policy has siphoned off increasing amounts of the radical expansion of international liquidity in order to sustain public spending and economic activity. The military government that has ruled Argentina since 1976 seems unwilling to expose itself to the political consequences of more austere fiscal and monetary policies that would slow down the rate of price increases.

1. Top of League

> ... inflation at a rate of around 7% per month seems to have become an institution and it will eventually become necessary, if it is ever really believed that the damage suffered by the entire community is excessive, to develop some kind of theoretical apparatus and political means that are really original, to bring down the rate. *Editorial, The Review of the River Plate.* Buenos Aires: *June 8, 1979.*

Argentina's inflationary crisis of the mid-1970s, going far beyond the rapid price increases throughout the world, reached extreme forms because of international disorders and conflicts that, since 1976, have been repressed but not eliminated. Since then, Argentina's fiscal and monetary policies have developed a symbiosis with the explosive growth of international liquidity that does not augur well for a curtailment, in the near future, of the rate of internal price increases which seems to have leveled off at 160% annually for the past three years. The relationship between Argentina's sovereign policies and international economic processes must be explored in some detail to understand the chances for this richly endowed nation - with abundant excess capacity in terms of agricultural potential, human skill and untapped energy resources - to surmount its present difficulties. Let us begin with a survey of the parallel inflationary processes in Argentina, Latin America and the world at large.

World inflation, as a cumulative and widely diffused phenomenon, has reached proportions in the 1970s that were unknown previously in the century since international economy was organized along its present lines . Reversing a tendency toward price stability that continued through the first two decades after World War II,[1] rates of inflation have doubled in the industrialized countries during the 1970s over the averages of the previous decades; have tripled in the poorest nations and have quadrupled in those "middle income" developing countries that participated heavily in the commodity price boom of the early 1970s that was accompanied by large increases in the World money supply.[2] In country after country, economic policy floated away from its fiscal mooring and bobbed about on a witches' brew of international liquidity that is expanding rapidly, as if under the influence of some powerful fermenting agent. As explained by a group of distinguished economists in a report on world inflation to the Organization for Economic Cooperation and Development (OECD), "the size of United States payments deficits over the period effectively removed balance-of-payments constraints in other OECD countries, and facilitated a massive expansion of money supplies", stimulating "all systems go" monetary policies simultaneously in several countries in several countries that was "the most important

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[1] Joseph C. Adekunle, "Rates of Inflation in Industrial, Other Developed and Less Developed Countries, 1949-65", *Iternational Monetary Fund Staff Papers*. November 1968.

[2] For tables, see World Bank, *World Development Report, 1978*. Washington, August 1978, pp. 76-77. "Middle income" developing countries are defined by the bank as those with per capita incomes above $250.

mishap in recent economic policy history"[3]. A former member of the U. S. President's Council of Economic Advisers observed summarily that "the deficits in the U. S. balance of payments have increased the international monetary reserves of other countries and therewith their monetary bases without reducing the monetary base of the United States, and this has led to a vast expansion of in the aggregate of national money supplies." Six major industrial countries, including the United States, experienced increases in reserve money greater than the growth of their real national products, and this pattern since has spread to poorer countries as well.[4]

Now that the industrial countries have managed better control of their money supplies in the second half of the 1979, the magic multiplier seems to have become the Eurocurrency market, which is said to have grown by 25% annually since 1973. To the initial pot in Eurodollars created by the U.S. payments deficits has been added the oil-generated trade surpluses, compounded by booming business of offshore banking without any government supervision or reserves or leverage requirements. Between 1973 and 1977 international banks recycled some $235 billion from surplus to deficit countries, lending another $110 billion in 1978 alone. Most of this money soon find its way back into the international banking system, as import payments or reserves, to be lent out again. The world money supply (currency plus demand deposits) grew at an average rate of 13.2% in the 1970s, while money in the Latin American countries expanded more than three times as fast. In all, the volume of international monetary reserves quadrupled since 1970, after growing at an annual rate of only 2.7% in the 1950 and 1960s.[5] In 1978 the poorer countries borrowed $ 25 billion to cover payments deficits, plus another $13 billion to build up their reserves. The lion's share of these borrowed reserves went to the chronic inflation countries of South America - Brazil, Argentina, Uruguay and Chile - whose conservative military governments adopted foreign exchange conversion schemes that have increased financial yields in dollars and thus have proven to be a powerful magnet for attracting funds from abroad.

As the traumatic Chilean inflation of the mid - 1970s was brought under control, Argentina surged to the top of the world inflation league, averaging 253% over the past four years (1975-78). During the 1970s consumer prices, increased at annual rates of ten% in the world at large, 36.6% in Latin America and 135.6% in Argentina. A three-tier pattern has persisted throughout the postwar years, with chronic high inflation in a

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[3] Paul McCracken et. al., *Towards Full Employment and Price Stability*. Paris: Organization dor Economic Coioperation and Development (OECD), 1977. pp. 51 & 56.

[4] Walter S. Salant, "International Transmission of Inflation", in Lawrence B. Krause and Salant, *Worldwide Inflation: Theory and Recent Experience*. Washington: Brookings, 1977. pp. 185-7.

[5] "Countrolling the Euromarkets", *The Economist*. June 2, 1979, p. 83; "International Banks: Home truths from Basle", *The Economist*. June 16, 1979; "Default threatens those LDC loanas again", *Business Week*. july 2, 1979, p. 79. Also H. Robert Heller, "International Reserves and World-Wide Inflation", *IMF Staff Papers*. March 1976.

small group of countries tending to distort international indexes.[6] In South America, the republics with the most severe inflation over long periods are the three southern cone countries of Argentina, Chile and Uruguay. These are the most "European" in Latin America, with the highest degrees of urbanization and literacy, the slowest population, the largest middle classes, and the strongest traditions of redistributive economic policy. At the same time, these high inflation economies grew much more slowly than the rest of Latin America and the world in the postwar years. While the world economy has grown by 4.8% annually and Latin America's by 5.5% since 1950 at constant prices, Argentina's gross domestic product (GDP) expanded by only 3.2% yearly, Chile's by 3.5% and Uruguay's by 1.1%. In per capita terms, despite slow population growth, these economics have grown at slightly better better than half the pace of the region as a whole.[7]

Consumer prices in Argentina rose by 26% annually from 1949 to 1970, more slowly than any other of the chronic inflation countries.[8] These inflation rates, while considered undesirable, increasingly were being regarded as manageable as long as they did not approach the levels of hyperinflation - monthly price increases of at least 50% - experienced in Austria (1921-22), Germany (1922-23), Greece (1943-44), Hungary (1923-24; 1945-46), Poland (1923-24) and Russia (1921-24).[9] Among the high inflation Latin American countries, Brazil was viewed by some as a special case, although prices rose by 30.6% yearly in 1949-70, because in the same period Brazil enjoyed high economic growth rates (5.6% annually). President Juscelino Kubitschek (1956-61) defied the strictures of the International Monetary Fund (IMF) and pressed forward with ambitious public works and industrialization programs to bring "50 years' progress in five", backed by some leading economists who argued that inflation may be inevitable in the process of rapid development.[10]

To many, persistent inflation seemed less troublesome than violent monthly fluctuations in price levels that made rational business and personal planning extremely difficult, and diverted massive amounts of time and energy into adjustment to these variations. *Surveying Chronic Inflation in Latin America* in the 1950s and 1960s, Felipe Pazos

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[6] Adekunle (op. cit. p. 550) argues that , discounting the very high price increases in Korea and five South American countries (Argentina, Brazil, Chile, Bolivia and Uruguay) during the postwar years, inflation in developing countries from 1949 to 1965 was actually milder than in industrial countries.

[7] CEPAL (United Nations Economic Commission for Latin America), *Economic and Social Development and the External Economic Relations of Latin America*. Document (E/CEPAL/1061) prepared for the 18th meeting of CEPAL, La Paz, 1979. Vol. I, Tables 1-3.

[8] Felipe Pazos, Chronic Inflation in Latin America. New York: Praeger, 1972, p. 14.

[9] Phillip Cagan, "The Monetary Dynamics of Hyperinflacion", in Milton Friedman, ed., *Studies in the Quantity Theory of Money*. University of Chicago Press, 1956. p. 26.

[10] The classic CEPAL expositions of this case are Raúl Prebisch, "Economic development or monetary stability: the false dilemma", and Dudley Seers, "Inflation and growth: a summary of experience in Latin America", both published in CEPAL, *Economic Bulletin for Latin America,*respectively in vol. VI Nº. 1 (1961) and Vol. II Nº. 1 (1962).

observed: "The long duration of these processes means that are not temporary disturbances. Rather they are chronic phenomena that have created self-perpetuating mechanisms to keep them going, as well as compensatory mechanisms that make them tolerable for the societies in which they take place. The fact that these inflations have persisted year after year in countries whose economies have continued continued to function and even progress (although not as much as they should have) indicates that these economies have created institutional mechanisms to offset the disturbances or, at least, to neutralize their effects to a large extent."[11] Another distinguished economist, Albert Hirschman, viewed Chilean inflation in the 1960s "as an almost miraculous way of temporizing in a situation in which to or more parties who are psychologically not ready for peaceable compromise appear to be set on a collision course. It permits them ... to maintain a militant and hostile stance while playing an elaborate, non-violent game in which everybody wins sham victories."[12]

Them came the price explosions of the 1970s. In Argentina the rhythm of consumer price increases accelerated from 21.6 to 335% in 1975 and 347% in 1976; in Chile, from 22% in 1971 to 508% in 1973; in Uruguay, from 19% in 1970 to 107% in 1974. In all these countries, the price explosions helped remove civilian governments from power, replaced by authoritarian military regimes that made war on the two-headed monster of subversion and inflation, with terrorism subsiding much more readily than the price spiral. Meanwhile, chronic inflation, which historically had been confined to Brazil and the three southern cone republics, spread throughout Latin America. Only the smallest and most backward national economics avoided persistent double digit inflation during the 1970s.[13] In 1974 more than four-fifths of the population of Latin America suffered from acute inflation, which consumer prices in 15 of 22 countries rising by more than 20%. Outside the southern cone, the most spectacular inflationary surges came in Peru and Brazil, which have been under military rule since the 1960s. Prices rose in which have been under military rule since the 1960s. Prices rose in Peru from an annual rate of 4.3% in 1972 to 73.7% in 1978, where inflation had subsided from 92% in 1964 to 14% in 1972, experienced average price increases of 42% in 1976-78. Inflation for Latin America as a whole peaked at 64% in 1976 (31% if Argentina and Chile were removed from the population-weighted index), then leveled off to 41% in 1977-78.[14] In took Chile's military rulers three years, applying strict monetarist principles, to cut the inflation rate below half of the peak 508% of 1973; beginning in 1976, however, the rate has been halved in each succeeding year. By contrast, the Argentine government that took power in march 1976 was able to halve the peak inflation rate within a year. However, since 1977 Argentine inflation has remained on a plateau at between 160 and 170%, presently

[11] Pazos, op. cit., p. 15.

[12] Albert O. Hirschaman, Journeys toward Progress. New York: Anchor Books, 1965. p. 295.

[13] Also oil-rich Venezuela, bvecause of its high import capacity, enabling goods from abroad to undercut the sprialiang prices of home goods. But Venezuela in the 1970s had much higher price increases in previous decades.

[14] CEPAL, *Economic and Social*....,op. cit.,p.67.

the world's highest with abrupt monthly fluctuations, known locally as the *serrucho*, or jigsaw effect.

The persistence of chronic inflation in Argentina gives rise to a series of troublesome questions with a theoretical and historical reach that goes far beyond the tribulations of a single country. In the words of two IMF economists: "Why, in certain case, has inflation suddenly risen by several hundred percent, and why is there such a remarkable asymmetry between the rapidity with which an economy enters into a period of high inflation and the slowness with which an economy leaves it?"[15] One also might ask: What are the common causes, and what are the independent causes, of inflation on the three tiers - the general international index, the higher general Latin American rate and the much higher levels of the chronic inflation countries of Latin America? To what degree does national monetary policy remain autonomous, especially in smaller and medium-sized economies, under the external pressure of radically expanding world liquidity and reserves? What is the upper limit for absorption of external liquidity by any economy without provoking major disruptions?

Leaving aside these broader questions, some of which describe the environment but not the purpose of my inquiry, I will attempt at the outset to answer, in a summary fashion, the major one: Will Argentina's chronic high inflation end soon? More specifically, will the trend of price increases return, let us say by 1982, to the historic average of the 1950s and 1960s, below 30%, or if we allow for the higher levels of world inflation today, to a still-tolerable 30-50% annual average?

It might be easy that what goes up eventually must come down. Moreover, in the scores of interviews I have conducted for this study, I have heard nobody argue that the rate of inflation will rise again over the next three years to the crisis levels of 1975-76, or that it will remain indefinitely above 150 %. On the contrary, some reasonable arguments are made for the inevitability of mild and gradual reduction of inflation as a result of policies now being implemented. However, whether or not these eventual reductions approach the government's targets, or the baselines established for this study, is an entirely different question.

I can see no present trend that makes the government's anti-inflation objectives credible at this point. In fact, since work on this study began, Economics Minister José Alfredo Martínez de Hoz himself has said as much. My feeling, moreover, is that it would have been important to establish a clear downward trend during 1979 because economic policy in 1980-81 may be much harder to design and execute independently of the struggle over the presidential succession among Argentina's military-politicians that will be taking place over the next two years. In the course of the rivalry among generals and admirals who seek to replace President Jorge Rafael Videla in 1981, present

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[15] Ke-Young Chu and Andrew Feltenstein, "Relative Price Distortions and Inflation: The Case of Argentina" *IMF Staff Papers*. September 1978. p. 452.

economic policy, now oriented primarily toward sharply reducing inflation, may become a greater political liability if it does not show results soon. Among the military, the main critics of economic policy seem to want a more populist line, embracing substantial increases in real wages. There appears to be no major military candidate for the presidency favoring more severely monetarist policies that would bring Argentina closer to the kind of economic stabilization program that has cut much more deeply into inflation in Chile's smaller and simpler economy. On the other hand, more expansive economic policies may become increasingly hard to resist in a country still afflicted by intense sectoral struggles and now enjoying a large foreign trade surplus and record levels of foreign exchange reserves. Aside from the inflation issue, Martinez de Hoz and his team have taken a number of constructive steps to rationalize foreign trade, the financial markets and the public administration. But the main focus of this study is inflation.

Ke-Young Chu and Andrew Feltenstein of the IMF give the following capsule summary of the inflationary process in the decade preceding the crisis of early 1976, when increases in the wholesale price index reached an annual rate of more than 900%:[16]

> Following a change in government in 1966 (President Juan Carlos Onganía, 1966-70), an anti-inflation program that was markedly different from earlier stabilization attempts, both in its design and outcome, was undertaken. Restraints were simultaneously applied to both wages and prices, so that there was not a significant decline in real wages; the fiscal deficit was reduced; and the public sector was able to finance a high level of investment almost entirely from domestic savings. During 1967 and 1968, moral suasion and various selective price controls continued to be used, mainly taking the form of attempts to limit increases to identifiable input cost increases; and in 1968 and 1969, the country experienced the lowest rates of inflation in recent history, while at the same time the government continued to reduce its use of price controls as policy instruments.
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> The period of relatively low inflation came to an end in 1971, however, as relaxed wage policies were combined with expansionist monetary and fiscal programs. In an attempt to slow inflation, several types of direct price controls were instituted toward the end of the year and, in particular, firms were not allowed to pass on increased wage costs to their output prices. These controls were unsuccessful, however, in slowing inflation, and in 1972 the rate almost doubled. The (Peronist) government that came to power in 1973 brought with it the so-called Social Contract, one of the main goals of which was to increase the real wage level; and in June 1973, prices for a large number of consumer goods were lowered by seven to 20%, while wages were raised by approximately 20%. As a result, business and agricultural profits were squeezed; black markets developed; and, by April 1974, sufficient pressure had been created to force the government to relax its price controls. Since, at the same time, wages were allowed to rise, an inflationary spiral began, weakening the government's fiscal position and aggravating the real price

[16] Ibid., pp. 454-5.

> distortions, especially for public sector tariffs, that were already in evidence. The government attempted to halt wage increases, but its efforts collapsed under union pressure, and inflation sharply accelerated. By the end of 1975, the country's foreign reserves had sharply declined, and the problem of repayment of foreign debt had reached a critical point. In March 1976, the new government (Videla) removed all price controls, leading to an initial burst of inflation that was largely a result of official prices reaching what had previously been black market levels. The rate of inflation sharply decelerated thereafter, and prices, which had risen by 175% during the first half of the year, rose by only 63% during the second half.[17]

Since then, however, inflation has failed to come down. Price increases for the first half of 1979 were slightly higher than the 62.8% registered for the second half of 1976. As the IMF summary suggests, there have been an almost bewildering variety of factors contributing to the inflationary process, as well as a number of competing theoretical explanations and a rich diversity of pragmatic policies applied by successive Argentine governments. Both policies and governments have come and gone, with 14 different Economics Ministers serving eight different President between 1970 and 1976 as Argentina sunk ever deeper into crisis. The pragmatism continues until today, both in terms of policies and explanations. Among the causes commonly given for Argentine inflation in the postwar decades are: massive and irresponsible wage increases in the late 1940s and again in the early 1970s; a radical expansion of credit subsidized by the government, making virtually all bank loans in the three decades of the postwar era at negative real interest rates (lower than inflation); high-cost, heavily protected industries created by an irrational import substitution effort effort; price-control measures that created supply shortages and diversion of stocks into the black market; deficits of public sector corporations and of the central, provincial and municipal governments financed by unbacked printing of money by the Central Bank; inflationary losses of real government revenues caused by lags and evasions in payment and breakdown of the tax collection machinery; sudden surges of meat prices, which weigh heavily in the cost of living index, due to shortages of stocks for the international market generated by high international prices or heavy past slaughtering in the so-called "beef cycle" geared to the cost of maintaining herds in relation to current or anticipated slaughterhouse price trends; foreign exchange bottlenecks created by the voracious demand of newborn postwar industry for machinery, spare parts, raw materials and semi-finished goods in order merely to keep operating, and the inability of Argentina's declining agricultural exports to provide sufficient foreign exchange earnings to pay this growing import bill; the shackling of the agricultural export sector with new taxes, government controls and other disincentives, leading to production declines and technological backwardness; the mushrooming cost of investment caused by rising prices of the world capital goods machinery industry, and by the much grater price inflation in the heavily protected domestic capital goods industry, combined with declining labor productivity in the Argentina construction industry; and, finally, the domestic impact of international

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[17] For a comparative analysis, see Thomas E. Skidmore, "The Politics of Economic Stabilization in Postwar Latin America", in James M. Malloy, ed., *Authoritarianism and Corporatism in Latin America*.

inflation, reinforced by monetary policies that presently suck into the internal money supply large amounts of expanding world liquidity.

This panorama of causes and explanations gives the impression that Argentine inflation today is a far more complex and intractable phenomenon than it was when chronic postwar inflation first erupted during the rule of General Juan Domingo Perón, there decades ago. Perón himself, in the early 1950s, was able to execute a more orthodox and effective stabilization policy than subsequent Argentine governments not only because the problems were simpler, but also because he had the political power to so. But the successful efforts of Generals Perón and Onganía to stop price increases were short-lived, and contributed to their overthrow in each case. The Argentine economist Marcelo Diamand has found deeper and more universal reasons for the persistence of inflationary pressures:[18]

> ...in the real world, any attempt to diminish real wages runs into great resistance. The social pressure which always appears in support of higher real wages becomes multiplied in intensity when it (meets) opposing pressures designed to lower them. Psychologically, the level once achieved by real wages becomes a "normal" standard of reference and its reduction is felt as an attempt against acquired rights. Therefore, *while economic thought treats real wages as a variable to be adjusted according to the forces of the market, to modern society their preservation is a fundamental objective... The struggle between the regressive and recessive effects of the market mechanism in a bottlenecked economy and political and social pressures which strive to annul the lead to the phenomenon - already remarked upon - of recessive inflation,* which exploded throughout the world in the last years. (Italics in original)

Diamand defines a bottleneck as "the insufficiency of an item not very significant in terms of its own value but essential for the carrying out of an activity of a much greater value. In macroeconomics, the main bottleneck appears when a country lacks the foreign exchange required to maintain its productive capacity fully employed." The foreign exchange bottleneck has been a favored explanation of many economist for the persistence of inflation in Argentina and some other countries.[19] According to this explanation, any economic expansion in Argentina soon is tripped up by a shortage of foreign exchange. The expansion generates demand for domestic manufactures, which in turn increases the need for imported machinery and other industrial inputs that

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[18] Marcelo Diamand, "Towards a Change in the Economic Paradigm through the Experience of Developing Countries", *Journal of Development Economics*. Nº 5 (1978), pp. 22-3

[19] This interpretation is given in Carlos F. Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*. Yale, 1970; Marcelo Diamand, *Doctrinas Economicas, Desarollo e Independencia*. Buenos Aires; Paidos, 1973; Richard D. Mallon and Juan V. Sourrouile, *Economic Policymaking in a Conflict Society: The Argentine Case*. Harvard, 1975; Javier Villanueva, "Industrialization Problems with Restrictions in the Foreign Sector", Oxford Economic Paper 18 (july 1966) and Aldo Ferrer, The Argentine Economy. Berkeley, 1967.

cannot be paid for by exports. Then this creates a foreign exchange crisis and shortages, which are inflationary, leading to a currency devaluation, prompting immediate and irresistible demands for compensatory wage and price increases for everyone, eliminating the economic benefits of the devaluation and breeding more inflation. This process continues until it can continues no more. Then the Argentine government of the moment sends emissaries to Washington and to main banking centers of the world to ask for emergency credits and rescheduling of foreign debts under the umbrella of a standby Agreement with the IMF. The IMF requires austere and recessive fiscal and monetary policies that soon meet with escalating protests on the part of the population at large and key groups in the armed forces that the government ultimately cannot resist. Either it is overthrown and replaced by a more "popular" government, or to save itself it embarks upon more expansionist economic policies on its own account. Then the cycle is repeated.

It the theory of foreign exchange bottlenecks is valid, why the does inflation persist today in Argentina, while the country is bathing in more international liquidity than it can rationally absorb? I will try to answer this question in the next section, and then try to analyse the long-range inflationary forces in the Argentine economy.

2. Living With Inflation

> *Ever since 1976 the government has been telling us that it would soon launch a grand offensive against inflation. According to its initial expectations, it clearly hoped to have the inflation rate down to 30% a year by now, with 1978 supposedly being the year of the decisive battle. Instead, however, the inflation rate seems to have been stabilized, for the moment at least, at around 150% a year, an appalling figure by any sane standards and quite incredible for a government that is criticized for its tight-fisted fiscal policies. Making matters even worse, the government appears to have lost its appetite for the fight. Instead of taking the tough and inevitably unpopular measures needed to bring inflation down, it appears to have reconciled itself to trying to explain it away, as though it had to confront a difficult election in the near future. Despite their theoretical powerlessness, the government's many and highly vociferous critics have it off balance. If a de facto military regime is unable to take the steps needed to deal with inflation, the prospect of any government beating it must be considered very small.*
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> *Month after month, Economics Ministry spokesmen produce explanations for the, to them, unexpectedly high rise in the cost of living. In March it was the chronic trade surplus. In April it was the peculiar psychology of the Argentine businessman. In May it was a surge in the price of beef. In June it was the effect of a number of price increases in commodities markets around the world...The real underlying cause... is excessive government spending, which is now in all likelihood is running at a record level, higher even than in the mad irresponsible days of 1975, when the fires that are still blazing were well and truly stoked. The only difference between now and then is that the government is getting about twice as much in taxes.* Editorial, The Buenos Aires Herald. July 5, 1979.

Argentina is emerging slowly from the inflationary crisis of the mid-1970s because of the burden of inertia and because the impact of market forces seems to have declined in national and international economics. Today's high inflation is the product of more than three decades of sharply rising prices since World War II that persisted while the economy stagnated in real terms. The corrective influence of market forces, meanwhile, has been overwhelmed in the 1970s by the expansion of the world money supply, which has been used to underwrite deficits in trade and public finance in many countries.

Let us look back briefly toward the great Baring crash of 1890, Argentina 's last great inflationary crisis, separated from the postwar inflations by a half-century of impressive price stability. Then as now, large amounts of foreign money entered the Argentine economy to reinforce inflationary pressures. British investment in the country nearly quadrupled between 1885 and 1890.[20] To the benefit of landowners anxious to reduce their production costs and burden of debt, Argentine private banks clandestinely printed paper pesos under the umbrella of the large official emissions of the late 1880s as land speculation ran wild. Then the 1888-89 grain crop failed because of drought. Inflation and unemployment generated disturbances in Buenos Aires that led to the

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[20] H.S. Ferns, *Britrain and Argentina in the Nineteenth Century*. Oxford, 1960. p. 493.

overthrow of President Miguel Juárez Celman (1886-90). By 1891 all domestic banks had suspended operations. The Argentine financial panic led to the collapse of Baring Brothers, London's second-largest banking house, and strained the resources of the Bank of England in its efforts to control the ramifications of the crisis, forcing it to enlist the support of the Russian and French governments as part of its containment operations.[21]

Argentina itself rebounded from the inflationary crisis of 1890 with intensified market discipline and productivity. Labor costs became cheaper because of the paper peso devaluation, stimulating intensified economic activity as the terms of trade turned in favor of Argentina's exports. Between 1890 and 1893 the trackage of the Argentine railroads doubled. In 1893-95 alone Argentina exported twice as much wheat as she had in the entire decade since becoming a net wheat exporter in 1882.[22] After 1891 the paper peso revalued steadily against gold until, in 1900, Argentina rejoined the gold standard.[23] Internal prices stabilized to where they merely followed international trends. Between 1914 and 1929, consumer prices in Argentina rose more slowly than in the United States and Canada. From 1930 to the end of World War II Argentine inflation was slightly higher.[24]
The vitality of the Argentine economy in the 1890s made the inflationary surge that reached its climax in the Baring crisis seem trivial in retrospect. Since World War II, however, the Argentine economy has been in deep trouble. Its spurts of growth have been short and fitful. Of the 21 years between 1945 and 1966, nine registered declines in the national product in per capita terms, while nine others showed overall growth rates of more than six%. Few years came close to the overall average of 3.1%. Since the mid-1960s this pattern of abrupt stop-go fluctuations does not seem to have changed much. As in the post-1976 period, increases in exchange reserves since 1949 as a rule took place when GDP declined or during years immediately following these declines.[25] The one hopeful sign is that there have been persistent trade surpluses since 1976, but these surpluses so far have been inflationary because Argentina has not been able to import sufficiently to diminish the impact of this surplus on internal prices and the money supply.

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[21]The historian of the Bank of England, J.H. Claphan, wrote that the bank's reserve of 10.8 million pounds would be "entirely inadequate" to satisty the rush of creditors to buy gold if Baring Brother were allowed to fail. From Clapham, *The Bank of England*. Cambridge, 1944, ii, p. 329, quoted in Ferns, op. cit., p. 458. The rescue operation involved guarantees from the British Treasury and 16 private London banks as well as loans from the State Bank of Russia and the Bank of France. See Charles P. Kindleberger, *Manias, Panics and Crashes: A History of Financial Crises*. New York: Basic Books, 1978. pp. 153-6, 188.

[22] W. Arthur Lewis, *Growth and Fluctuations, 1870-1913*. London: Allen & Unwin, 1978. p. 297.

[23] A.G. Ford, *The Gold Standard, 1880-1914: Britain and Argentina*.

[24] Carlos F. Díaz Alejandro, *Essays on the Economic History of the Argentine Republic*. Yale, 1970. p. 362.

[25] Ibid., pp.351-4.

The monetary indicators tell the story of postwar inflation very dramatically. Around 1950 the Argentine people held about half the national product in currency and various kinds of bank deposits, which is a degree of monetization (M_2/GDP) comparable with the major industrial countries. However, since inflation usually reduces the willingness of people to hold their assets in cash and bank deposits, the M_2/GDP ratio declined to 18% by 1965-67 and, after a modest recovery during the stabilization program of the late 1960s, fell again to 12% in 1975.[26] The demonetization of the Argentine economy in the 1950s and 1960s came, to a large degree, from bank interest rates that were negative in real terms - below the inflation rate - since most credit was subsidized by the government, which fixed all interest rates and guaranteed all deposits. Since 1976 the monetization of the Argentine economy recovered to about 20%, which is the historic average for the 1960s, when annual average price increases were one-sixth of today's inflation. One of the main reasons for the return of people's assets to the financial system was the positive real interest rates that prevailed in 1977 and much of 1978 these positive interest rates were a result of a freeing of money markets and the upward pressure on interest rates created by the reforms under which the governments now finances its deficits by borrowing commercially rather than by unbacked emissions from the Central Bank's printing presses. Over the past year, however, monetary policy has returned to negative real interest rates, at levels low enough to sustain economic expansion, yet high enough to attract capital movements from abroad and to avoid another massive desertion of the financial system by potential Argentine savers.

The quantity of money in Argentina increased annually at an average rate of 23.7% in the 1950s and 1960s, slightly less than the average rise in prices.[27] By 1970 the stabilization program of Economics Minister Adalberto Krieger Vasena had brought the annual money supply increase down to five%, the lowest since the Great Depression. But labor and military revolt led to a change in government and an end to the stabilization program. Beginning in 1971, the rate of money increase began to rise again sharply to unprecedented levels, from 36% in 1971 to 254% in 1976. Under present monetary policy, the rate of increase dropped to 132% in 1977 and 116% in 1978. In the first half of 1979 the monetary base expanded by 46%, giving an annual rate of 113%, about the same as in 1978.

Since Jose Alfredo Martínez de Hoz became Economics Minister in March 1976, Argentina has had a number of different anti-inflation policies. The present policy, outlined by the Economics Minister in a televised speech on December 20, 1978, consists of pre-announced *pautas*, or guidelines, at which three key price variables - peso devaluation against the dollar, public utility rate and basic wage increase - have been scheduled in advance for 1979 below prevailing levels of inflation in a desperate effort to force down other prices. A leading monetary economist recently observed that the

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[26] Felipe Pazos, *Chronic Inflation in Latin America*. New York: Praeger, 1972. p. 118.

[27] Ibid., p. 111.

pautas policy was "exactly the opposite" of the previous anti-inflation strategy announced by Martínez de Hoz on May 11, 1978, which prevailed for the rest of last year. The 1978 policy consisted of (a) freeing the exchange rate in order to control the money supply; (b) requiring a 20% reserve deposit on all capital inflows in order to slow down the entry of funds from abroad, and (c) deindexing public sector goods and services.[28]

There were at least three different approaches tried before 1978. In March 1976 the government freed prices, froze wages and devalued the peso by 88% in nominal and 22% in real terms. After a bout of "corrective" inflation to allow current prices to the distortions created by price controls, monthly increases in the wholesale price index declined from 54.1% in March 1976, to 4.8% in May, averaging 7.2% for the rest of 1976. Annual wholesale price rises declined from 919% in April 1976 to 117% a year later. But when inflation began to resurge in late 1976 and early 1977, Martínez de Hoz went on television again to declare a 120-day price freeze that reduced the indexed monthly increases only slightly. During the four-month "price truce" (March through June 1977), consumer price increases averaged 6.9%, compared with 9.6% for the six months before the truce and, again, 9.6% for the following ten months (July 1977-April 1978).

The reintensification of inflation after the "truce" came from the decontrolling of depressed prices in July-August 1977, which coincided with a reform of the banking system that pushed up interest rates radically by increasing the Central Bank's marginal reserve requirement from 28 to 45%. Simultaneously direct Central Bank financing of the public sector deficit was eliminated forcing government agencies and corporations to seek credit on foreign and domestic money markets. This new monetary policy provoked one of the deepest recessions in Argentina's history, which finally did cut monthly inflation rate to an average 6.8% for June-September 1978, only for prices to rebound again as economic activity revived, averaging 9.3% in the final quarter of 1978 and 8.6% in the first half of 1979.

The trends in the wholesale price index and the money supply over the past three years have been very closely parallel, and there seems to be no immediate prospect of a slowing in the pace of expansion of the money supply. The government seems to be committed now to maintaining a high level of economic activity. The Central Bank in 1979 has intervened repeatedly to strengthen liquidity in financial markets, mainly by lowering the reserve requirement for private banks, so that interest rates again have dropped below the level of inflation. The tight money policies that prevailed in 1977 and part of 1978, generating positive real interest rates and provoking a recession in 1978, have been relaxed, with the bank reserve requirement declining from 45% in July 1977 to 26% as of July 1, 1979.

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[28] Pedro Pou, "La inflación importada", *Mercado*. Buenos Aires: July 5, 1979.

During the half of 1979 there were some signs of overheating of the Argentine economy. First quarter GNP was 12% higher than the depressed levels of early 1978. Labor shortages developed in Buenos Aires, especially in the construction industry, at prevailing low levels of wages and productivity. In a press conference on July 2, Alejandro Estrada, the Secretary of Commerce and International Economic Negotiations, predicted a decline in the pace of economic growth in the second quarter because "there is not enough productive capacity to maintain the rhythm of the first quarter. The economy is very highly reactivated and this is a very positive fact. But it is also evident that production cannot grow at the rate of the past few months."[29] A few weeks earlier an economist formerly with the IMF, Armando Ribas, wrote that "together with the recovery of demand one observes ever more clearly that interest rates are negative in real terms and logically the public turns toward buying goods rather than holding money, as in all inflationary processes with negative interest rates. There is no dollar flight, since the exchange rate policy maintains a spread between internal and external interest rates. So demand floats toward internal goods."[30] The same author wrote elsewhere that "it is puerile to blame the Central Bank for the rate of monetary expansion when it is not within the possibilities of the Bank nor the Economics Ministry to reduce public spending."[31]

"It was said that, upon assuming office in March 1976, Martínez de Hoz was given a broad mandate by the new military junta to whip inflation, with the sole proviso that the stabilization policy should not create large-scale unemployment. Military leaders, fighting an urban guerrilla insurrection as they took power, were said to be afraid that newly unemployed workers would swell the insurgent forces. While this story never has been confirmed officially, it is widely believed. Moreover, government policy is largely consistent with its being true."

To avoid creating unemployment means sustaining the level of economic activity, whatever its quality, and sustaining economic activity in Argentina, where government operations and investment is nearly half of what is called the national product, means continued high levels of public spending. Although tax collections have increased dramatically since 1976, high levels of public spending still means government deficits, which has proven to be a dicey way of stimulating money markets and attracting funds from abroad. The World Bank reported: "To strengthen the balance of payments, stimulate financial savings, achieve an improved allocation of resources, and reduce inflationary pressure from monetary expansion by reducing the velocity of money, the authorities introduced positive real rates of interest. This was achieved through aggressive use of Treasury Bills with high nominal interest rates which were issued so as to set a floor on short-term rates throughout the financial system. The effect was a dramatic rise (415%) in financial savings, defined as money and quasi-money, and an

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[29] *El Cronista Comercial*. Buenos Aires: July 3, 1979, p. 10.

[30] Armando P. Ribas, "Es la recuperación sustenida?", *La Nación*. Buenos Aires: June 10, 1979, p.3.

[31] Armando P. Ribas, "Relación entre Eficiencia e Inflación", *El Cronista Comercial*. June 5, 1979, p. 6.

increase in its share of GDP from a low of 18% in March 1976 to 23% at the end of 1976."[32] The new government signed an IMF standby agreement, which opened the way for nearly $1.1 billion in credits during 1976 from the IMF and foreign banks to roll over existing debt and to increase reserves. Argentina's foreign exchange reserves had declined to only $23 million in March 1976, but then surged to $1.7 billion (five months' imports) by the end of 1976, doubled again during 1977 and reached $8 billion (16 months' imports) in mid-1979.

In the midst of such rapidly expanding liquidity, why haven't interest rates fallen even further? This question is especially relevant since the private sector was reported to be borrowing little during the first half of 1979 in order to avoid being shackled with the level of high-interest debt incurred in the recent past.[33] The answer is that, apparently, interest rates have been kept high in order to attract funds from abroad to finance government deficits.

The Argentine economy was hooked on the medicine that brought it out of its trauma of the mid-1970s. The massive capital transfers continue, piled on top of large trade surpluses, irrespective of what traditionally might be considered the country's legitimate financial needs. This liquidity has gone to sustain public spending at the bloated levels of the mid-1970s, which has become such a breeder of inflation that Martínez de Hoz, like the sorcerer's apprentice, seems to be floating in the elixir that he conjured to solve the country's problems. Following the government's line, the World Bank reported that the public sector's share of money creation fell from more than half in 1975 to 12% in 1977 to 7% in the second quarter of 1978. Meanwhile, private sector credit expanded continuously through 1976, reaching the rate of inflation, and then grew faster than the inflation rate as price increases began to ease off temporarily during 1977.[34] But this kind of accounting tends to overlook the fact that the public sector remains by far the largest consumer of credit, setting a floor for both interest rates and demand.

With the public sector's demand for credit now apparently on the increase again, the economic policy announced in December 1978 amounts to a Faustian bargain with world inflation, with the spread between programmed devaluation and domestic interest rates, both lagging behind domestic inflation, tending to siphon into the Argentine economy ever-growing volumes of expanding international liquidity. A leading Argentine banker wrote recently that the *pautas* policy of programmed monthly devaluations "made possible an extraordinarily expansive monetary policy, since it permitted the free movement of capital but not the free movement of goods... At this moment one must recognize that the Argentine peso is being revalued and that the lag

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[32] World Bank, *Economic Memorandum on Argentina:Report Nº 2208-AR*. Washington, 1978, p.3.

[33] FIEL (Fundación de Investigaciones Latinoamericanas), *Indicadores de Conjuctura*. Nº 159. June 5, 1979, p. 3.

[34] World Bank, op. cit., pp. 11-13.

in exchange rate devaluation will seriously affect the current account of our balance of payments...I cannot understand what sense there is to the country assuming short-term debts in dollars to then create the means of internal payment to permit financing of the absorption of the growing volume of Treasury Bills. There are less inflationary ways of financing public spending."[35] On May 11 the President of the Central Bank, Adolfo Diz, told me that four-fifths of the new money being created at the time was coming from abroad, and that the country's foreign exchange reserves were greater in value, at current conversion rates, than the volume of pesos in circulation.

Both fiscal and monetary policy seem to be caught in a high--level trap. Critics of Martinez de Hoz and his team argue that monetary policy cannot be implemented without like-minded fiscal policies that effectively cut real government spending. They claim that it is government spending, which is still more than 40% of GDP, that is sustaining interest rates and expanding the money supply. According to former Economics Minister Alvaro Alsogaray: "Inflation will continue dramatically high because of the level of public spending irrevocably committed, the total deficit, the greater short-term debt that will be necessary to finance this deficit, the recent salary increases above the 4% (monthly) guidelines and the increases surely to come, and the massive entry of foreign exchange."[36]

Between 1970 and 1975 broadly-defined public spending - including provincial and municipal governments and state corporations and autarchies - increased from 25 to 41% of the national product, while public revenues fell from 29 to 25%, leaving a deficit of 16% in real terms. In the chaotic months of early 1976, four-fifths of Treasury spending was financed by the Central Bank printing presses. Since then, revenues have recovered to about 36% of GDP, while spending has been cut by only 1% below 1975 levels, to about 40% in 1979. A Chicago-trained monetary economist, Pedro Pou, wrote that "the present administration has managed to validate the advance of statism introduced by the previous (Peronist) government: the level of public spending, which during the previous government had no genuine financing and thus was unsustainable in the medium and long term, is on the verge of being financed successfully by the present administration....In the public sector the policy being followed is not of liberalism, but of consolidation of statism. Perhaps the difference between the degrees of success achieved in revenue and spending can be explained by the fact that, while increasing revenues depends mainly on the Economics Ministry, the reduction of public sector spending requires joint action by several ministries."[37]

"Since 1955 many economic ministers have espoused laissez faire views, and yet they have been able to accomplish relatively little in reducing the public sector role in an efficient manner", Professor Carlos Díaz Alejandro of Yale University wrote in a

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[35] Leonardo Anidjar, "El financiamiento externo", *Mercado*. July 5, 1979.
[36] Alvaro Alsogaray, "La inflación reprimida", *Somos*. Buenos Aires: June 8, 1979, p. 59.
[37] Pedro Pou, "Se Consolida el Estatismo", *La Nación*. April 29, 1979.

historical survey of the economic role of the Argentine state. "As in the case of stopping inflation, the remedy can become worse than the disease."[38] Since the fall of Perón in 1955, the public sector's share of the national product fell steadily until about 1970. Aberrations continued during this downward trend, such as the deficit of the state railways, which accounted for nearly 20% of total spending of the central government in 1965.[39] "Since 1955 the shares of wage income and of public expenditure in aggregate income and absorption were, on the whole, on the defensive", Diaz Alejandro wrote elsewhere. "The increase in the net deficit of all public enterprises was due not only to their growing inefficiency, but also to a fall in their real receipts. The weakness of the public revenue machinery (leading to the use of bank credit to finance deficits, as it was not politically feasible to contract expenditures fast enough) and the failure to implement an incomes policy acceptable to the main social groups were consequences of the bitter social and political conflicts that plagued Argentina, threatening at times to erupt into open civil war."[40] After the real contraction of the late 1950s and 1960s, accompanied by a deterioration of the country's infrastructure, public sector finances expanded again in the 1970s as Argentina moved in and out of another Peronist phase. Between 1970 and 1975, public employment expanded by more than one-fourth and the share of state companies in domestic bank credit rose from 8.4 to 23.8%, while their share of foreign loans rose from one-fifth to one-third.[41] Unbacked Central Bank printing of currency for the government account for nearly 9% of the national product in 1975, while tax revenues fell by one-third as a result of lags, evasion and bureaucratic confusion. An IMF economist observed that "many taxpayers faced with very low penalties for tax delay often resorted to a postponement of their taxes as the cheapest form of credit."[42]

Over the past three years the government has taken some major steps to straighten out public finances. Tax revenues have risen dramatically. Real public sector wages have declined. Some state companies have been sold to the private sector or closed. Transfer payments to provincial governments and state companies have been eliminated, although they now are in danger of being revived. However, the Economics Ministry has been unable to cut spending in the large areas of the public sector in which the military traditionally has been involved on grounds of national security, which in many countries serves as the core ideology for economic autarchy. The World Bank reported

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38 Carlos F. Díaz Alejandro, "The Argentine State and Economic Growth: A Historical Review", in Gustav Ranis, ed., *Government and Economic Development*. (1971).

39 Richard D. Mallon and Juan V. Sourrouille, *Economic Policymaking in a Conflict Society: The Argentine Case*. Harvard 1975, p. 29.

40 Díaz Alejandro, *Essays...*, op. cit., pp. 385-7.

41 FIEL, *Las Empresas Públicas en Argentina*. Buenos Aires: Consejo Empresarial Argetino, December 1976. pp. 55-7. Also Aldo A. Arnaudo and Roberto A. Domenech, *El Deficit Fiscal en los Años Setenta*. Cordoba: Fundación Mediterranea, 1979.

42 Vito Tanzi, "Inflation, Lags in Collection, and the Real Value of Tax Revenue", *IMF Staff Papers.* March 1977. p. 164. Also Tanzi, "Inflation, Real Tax Revenue and the Case for Inflationary Finance: Theory with an Application to Argentina", *IMF Staff Papers*. September 1978.

in 1978 that, in terms of reducing the public sector, it is "questionable whether significant further gains can be achieved. There is now a need to raise salaries in the public administration in the future. Moreover, the public sector investment program assumed large current expenditures on research and extension in agriculture, highway maintenance, training and education, public health and sanitation. Taking these pressing needs into consideration, it is unrealistic to expect significant further reductions in current expenditures of the Government. Expenditures can, therefore, be expected to grow at an annual rate of 3.5% during the next five years"[43]

The debate over public spending goes something like this: Alsogaray writes in the newspapers that "money is 'emitted' in an inflationary way because governments spend more than they can finance through transfers from the community to the State (taxes, utility rates, tariff, etc.) and to cover this deficit they resort to credit in an abusive way. In our case this excess of spending and investment is due to (1) pharaonic construction works of a sumptuous nature, such as the installations for the World Cup football championship, which cost more than $700 million; superhighways; underground parking lots and color television; (2) "development" projects such as paper and newsprint factories; chemical and petrochemical complexes; the Sierras Grandes iron mine; the new Sidinsa steel mill and a deep water port. Although some of these projects could be justified in the future, in today's conditions they are inconvenient and inflationary; (3) the accelerated reequiping of maritime, air and petroleum transport fleets as well as the financially unviable projects of other state enterprises; (4) the monetary regulation account of the Central Bank (for "transitory advances" to the government), implying credit subsidies to maintain high economic activity and 'full employment'"[44]

A few days later Martínez de Hoz appears on television to admit that "the State bears the main guilt for inflation, as I have said in the past many times...But the housewife and her husband her family also are part of this. The people ask us to do many things, and with reason. Take public works as an example. People want us to de everything necessary so there are no more electricity blackouts, as we have had recently. They want to travel comfortably on paved roads. We have built 3,000 kilometers of paved roads over the past three years. They want to have good communications. They want to talk easily on the telephone. All this the housewife wants, and all this costs effort and investment. And this investment, all done at the same time, is what makes public spending too high now, which is another cause of inflation."[45]

In the boom years before 1914, Argentina's basic infrastructure was financed to such a large degree by foreigners that, subsequently, its citizens never seemed to get used to the idea of paying for public works out of their own savings. In any event, the

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[43] World Bank, *Report Nº 2208-AR*, op. cit., p. 41.

[44] Alvaro C. Alsogaray, "Punto final en el debate sobre inflación", *La Prensa*. July 1, 1979, p. 9.

[45] "Martínez de Hoz analizó la situación mundial y nacional", *La Nación*. July 5, 1979.

government continues to feed the engine of inflation with its debt, which has expanded radically during 1979. By mid-year there was a growing impression that, aside from rhetorical flourishes, the government seemed to have accepted the inevitability of high rates of monetary and credit expansion to sustain the level of economic activity. Indeed, the government appeared to have acquired a greater stake in inflation than any other sector of the Argentine economy, except perhaps for the financial community, in order to pay its debts and contract more debt. In 1979 public borrowing started high and seemed to grow every day. The 1979 budget grossly underestimated the public sector's financial needs because (1) the budget unrealistically projected 80% inflation (which probably will be reached by August rather than December); (2) programmed utility price rises for 1979 that are lagging far behind inflationary cost increases, causing huge losses for public sector corporations, and (3) overestimated how much money provincial governments and state companies would be able to transfer to the Treasury.[46] An expert on public utilities wrote that "government billings represents 14% of national income, implying that a 20% revenue rate lag caused by inflation would be equal to 2.8% of GDP. This would mean a 70% increase in the fiscal deficit."[47]

The government has attracted money from abroad to finance its deficits by offering a premium to foreign investors: a high peso interest rate on Treasury Bills that in 1979 set a floor of about 6% monthly on local money markets, less the 4% monthly programmed dollar devaluations, thus providing a 2% monthly dollar yield to foreign investors. In the first half of 1979, the government's internal debt in 28-day Treasury Bills grew to $1.5 billion, a 50% increase over December 1978. In the same six-month period, about $800 million in capital flows reached Argentina, compared with $1.03 billion for all of 1978. Fed by the extraordinary explosion of dollar liquidity in the world, second-tier North American banks - such as American Express, Security-Pacific and the Bank of Montreal - waded into the intense competition among takers of the Argentine public debts, offering hairline spreads of 0.125% above the London interbank rate (LIBOR) to place loans with Argentine state corporations. Two monetary economist's explained in a newspaper article how this debt would work to Argentina's advantage:[48]

> If rates of international inflation and dollar interest are maintained at present values, the country could be contracting debt at negative real interest rates. Given the present exchange rate system, and the opening of the capital markets, the Argentine producer may benefit from declining domestic interest rates that could become very negative in real terms. In this case, and depending on investor's expectations of the economic activity would be possible.

The Argentine policy of pre-announced currency devaluations is a variant of the Brazilian system of mini-devaluations which, accompanied by indexation of saving and

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46 FIDE (Fundación de Investigaciones para del Desarollo), *Coyuntura y Desarollo*. March 1979, p. 41.

47 Alieto Guadagni, "Las temidas tarifas públicas", *Mercado*. Buenos Aires: July 5, 1979, p. 25.

48 Pedro Pou and Carlos Rodriguez, "El (Aparente) Fracaso del Plan", *El Cronista Comercial*. June 28, 1979, p. 16.

securities, has been operating since 1967. Under this system a community of interest has been established in both countries between foreign investors and government agencies and corporations. Both profit from a devaluation of the local currency that lags behind local price increases and interest rates, which amounts to a revaluation of the local currency in real terms. This spread makes it cheaper for the public sector to borrow in dollars and more profitable for the foreign investor to move in and out of the local currency. The minidevaluation system also has been adopted in Chile and Uruguay, the two other countries of chronic inflation in South America, with previous announcement of devaluation schedules, as in Argentina. In Brazil minidevaluation was designed to provide for continuous readjustment for evolving price differentials between home goods and tradeables. But the policy came to have a second function, perhaps no less important as devaluations lagged behind inflation after 1974, as an incentive to attract financial resources: if the policy is carried out so that devaluation occurs through the difference between domestic and foreign inflation, as in Brazil, then the local currency revalues in real terms against the dollar; making dollar loans cheaper to pay back and rewarding the foreign investor with a bonus in dollars after an investment cycle in indexed Brazilian securities. The idea of a previously announced devaluation schedule was tried for a year in Chile before being adopted in Argentina, but with a difference. Before Chile's schedule of devaluations was announced in February 1978, there had been two currency revaluations - in 1976 and 1977 - preceded by major cuts in public spending that reached 40% in some state corporations. These policies involved heavy costs in terms of high unemployment and a shrinkage of the national product, but they reduced inflation from 341% in 1975 to 174% in 1976 to 64 in 1977 and 30% in 1978.[49] However, in 1979 inflation began to get out of control again, partly because too much money was entering the country. So on June 29 Finance Minister Sérgio de Castro suddenly announced that Chile was abandoning the minidevaluation scheme. the Chilean peso, he said, would be devalued by 6% and remain at that rate for eight months, while public spending and hiring would be frozen to prevent a resurgence of inflation and borrowing by state corporations would be stopped. Why could not Argentina do the same?

So many comparisons have been made between the Chilean and Argentine anti-inflation efforts that I spent a few days in Santiago trying to get a clear idea of the similarities and differences. I will limit myself here to reproducing some views of two of the men who carried out Chile's stabilization effort. "The Presidency is stronger in Chile than in Argentina, while industry in Argentina is more developed than in Chile and thus able to resist tariff reduction more effectively", former Economics Minister Fernando Lenis told me. "At the same time, Martínez de Hoz was unable to do anything about the state corporation. It is the same old struggles between militarism as under Krieger in the 1960s and Alsogaray in the 1950s, but each time the struggle is more difficult. This time

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[49] The Chilean government's anti-inflation policy is explained in Sergio de Castro, *Inflatión y Disciplina Financiera en el Caso Chileno*. Document presented at the Seminar on Private Enterprise and Inflation, Santiago, Chile, April 5, 1979.

they waited too long to cut tariffs." According to Jorge Cauas, formerly Finance Minister and president of Chile's Central Bank, "you cannot solve budget problems slowly. It must be done quickly, or else the Economics Minister will be bargaining eternally and creating deep conflicts. An Economics Minister deteriorates politically if the cuts come slow. In our case there was no choice between shock and non-shock. We already were in shock and had to cut - period."

Argentine economic policy now has been reduced to blaming world inflation for its failure to control the rise in internal prices while feeding on the explosive growth of international liquidity to finance the government's operations. On July 3 Martínez de Hoz told a radio interviewer: "For some months now we have been seeing important price rises such as grains, meat and industrial products that we either export or import. This foreign inflation has a direct or indirect weight in our economy. If one compares the indices of foreign and domestic wholesale prices for the first five months of 1978, there is a notable difference. This means that, if in 1979 we had the same international prices for these same agricultural and industrial products, our price indices for the first five months of 1979 would be substantially lower."[50] The next night the Economics Minister said on television: "The housewife should not expect a sudden or immediate solution to inflation. I don't want her to be disappointed. I don't want to make false promises, because I never have done this. I want to tell her to her face, as if she were here, that we won't be able to reduce inflation at once. Because it is impossible. But we must insist that we do those basic things that, once done, we will have a solid economy and there will be no more inflation in the country"[51]

Until there is more inflation in the country, however, certain financial games will continue. Among other things, there is stock market, there is gold and there is the bicycle. The persistence of real negative interest rates at the banks have driven savers, investors and speculators into other things, and these other things have been doing well this year. The most colorful of them is the bicycle, which exploits the revolution of the peso against the dollar in real terms. A "well-heeled speculator" explained the bicycle succinctly to *The Wall Street Journal:*[52]

> You borrow $500,00 today. Use the dollars to buy a peso bond with principal and interest indexed to the inflation rate, hold it for a month, then liquidate it to pay off your dollar loan. You can make $14,300 because the inflation has increased the amount of your pesos by 7% plus increasing the real interest on the bond, while the dollar has gone up less than five%.

In 1978 Argentina's national product declined in terms of constant pesos, but her per capita income grew by almost half in dollars. While the dollar lost nearly half its

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[50] *La Prensa*, July 4, 1979, p. 1.
[51] Ibid.,july 5, 1979, p. 9.
[52] Quoted in Everett G. Martin, "Keeping Ahead: Anyone in Argentina Can Give You Lessons On Beating Inflation", *The Wall Street Journal*. July 16, 1979.

purchasing power in Argentina over the past year, the number of Argentines traveling abroad has increased by the same proportion. Stories of overbooked flights, near-riot scenes at the crowded Buenos Aires airports and the evidence of Argentine tourists everywhere abroad have led to a number of economic and sociological inquiries as to how so many people can afford to travel during what has been described, over and over, as a time of national hardship and crisis. "This may seem an exaggeration, but many of them are traveling now with the money they made on the stock market in the past few months," one stockbroker told the magazine *Somos*. "You can't forget that many stocks doubled in value in a few weeks. On the other hand, you have to remember that inflation distorts relative prices and does not permit people of modest means to buy a house or apartment. These people then put their money in time deposits, gold coins and the stock market. It's true that interest rates don't give a positive yield, but to some degree they provide protection against inflation. When interest accumulates to about $5,000, the saver already has enough for an excellent trip, plus money left over for shopping. Remember also that any new car in Argentina costs well above $10,000, so people keep their old cars and with much less money take a trip. In real terms, airplane fares have declined in recent years."[53]

Aside form the tourist trade, the Argentine economy may be passing briefly through a kind of mercantilist phase, sending its exports out into the world and accumulating monetary reserves, much of them borrowed, in exchange. Normally one would expect the movement of so much foreign money into Argentina to play havoc with the money supply under the present exchange and devaluation scheme, or to generate such a high demand for imports that the trade account would be balanced or run into deficit. Either development would mean an end to the *pautas* of programmed devaluations, unless the Argentines decide that it is fun living this way and the superliquidity of the world money supply will support this way and the superliquidity of the world money supply will support this style of living. Meanwhile, the government has announced a five-year program to cut tariffs in state that would (.....) imports in such a way as to balance the trade account. The tariff cuts also are a key element of the government's anti-inflation policy. Officials hope that the competition of cheaper imports will make Argentine industries more efficient and therefore help to cut prices, even if the price cuts force some factory owners to close their plants and switch to importing, or to go out of business entirely. This would be a good time to lower tariff barriers if, as the government says, international inflation is responsible for price increases inside Argentina. Cutting tariffs now would ease the adjustment process for Argentine industry in a period of intense international inflation. But these arguments about the impact of international inflation are hard to certify. Moreover, if the government has been unable to tolerate unemployment or to manage deeper cuts in public spending, there is reason to doubt how far it will be able to go in cutting tariffs in the teeth of opposition from Argentina's manufacturers, heretofore heavily subsidized and protected, who formed part of the old Peronist political axis of high-cost industry and

53 "Argentinos: Cómo hacen para viajar?", *Somos*, Buenos Aires: July 13, 1979, p. 12.

high-cost labor. Some reports say industrial machinery has begun to be imported in significant quantities. Conceivably, the government's plans to facilitate a wider range of imports could have a major impact on domestic prices, but their effect is very hard to measure or predict at this moment.

Martínez de Hoz now has been Economics Minister for 40 months longer than any predecessor since the fall of Perón in 1955, which in the Argentine context is impressive political longevity. Moreover, there seems to be no obstacle now to President Videla transmitting power peacefully in 1981 to a military successor chosen, as presently programmed, by a group of senior officers. Does this amount to political stability? Not necessarily. The main elements of political contention in the postwar decades, the Peronists and Radicals, are still in their places, and there seems to be no lack of ambitious military officers willing to ally themselves politically with these factions. These elements conceivably could turn upon a military President and his Economics Minister as they did in 1969 upon Onganía and Krieger. As in other times and places, inflation is a way of postponing or ameliorating unresolved conflicts that have plagued Argentina since World war II. The quiescence of these conflicts in the presence of inflation and military rule does not mean they have gone away.

One thing that can be said for Martínez de Hoz and his various policies is that they have not made these conflicts worse. It can be reasonably argued that, only after one political faction after another tries and fails to control inflation, will people agree that it is a deep and common affliction that demands more drastic measures to cure. Today's enormous surge in world liquidity, plus Argentina's current trade surpluses, have dissipated the feelings of desperation that charged the anti-inflation efforts of two or three years ago. In the end, a radical improvement in Argentina's terms of foreign trade which took place after the inflationary crisis of 1980 and seems to have begun again during the 1970s, may do more to stabilize the cost of living index for the rest of this century than any policy attempted until now.

Argentina now is in its fifth consecutive year of inflation above 100%, a record never exceeded in peacetime economic history and matched only by Chile in 1972-76.[54] Historical precedent would seem to tell us that a process of such intensity would be bound to exhaust itself soon. That is, if the Argentine experience merely is a manifestation of inflationary processes that have been known in the past, and not a harbinger of a new kind of inflation that is emerging as a result of hyper-urbanization in many countries of the world. This possibility is one of the reasons leading me to examine the relationship between inflation and urbanization in Argentina in the third

[54] Unfortunately, there seems to be no general history of world inflation. The worst inflations seem to have come in wartime and postwar periods. See Charles S. Maier, "The Politics of inflation in the Twentieth Century", in Fred Hirsch and Jonh H. Goldthorpe, eds., *The Political Economy of Inflation*. Harvard, 1978, especially the comparative charts on pp. 45-6. Also Earl J. Hamilton, "The Role of War in Inflation", *Journal of Economic History*. March 1977.

section of this study. For now it many be helpful to remember that, while most writers tend to treat inflation as mainly a 20th Century phenomenon, there are many traces of it in the distant past during the process of urbanization and monetization of agricultural economies. Inflation became worse in the 20th Century only because the adoption of paper money and the urbanization of the human population did not take place on a grand scale until then. But the essential characteristics of the problem already were apparent much early in Europe and China.[55] By the 12th Century, for example, China had become the world's most urbanized society and had experienced printing-press inflation; her scholars and officials already were theorizing about the phenomenon and searching for ways to control it. Indeed, the remedies are so old that Martínez de Hoz could do much worse than to pin on his wall this admonition by Liu Hsuan, a 13th Century Chinese imperial cabinet minister, and send copies to the members of Argentina's military junta:[56]

> National expenditure should be calculated with reference to government income. Thus, if the annual yield from taxation amounts to a value of one million ingots, then annual expenditure should be set somewhere between 500,000 and 700,000 ingots. The remaining surplus of paper money should be destroyed by burning. If we act on these lines for the nest 10 years, then prices will be reduced to half their present level, even if they do not sink to their original level. There is no short cut. Producing a new kind of paper money in order to bolster up the old would only amount to a change of names. It would in no wise be comparable to creating a gold and silver backing, and so preventing further damage to military and administrative finances.

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[55] In his classic study, medieval Cities: *Their Origins and the revival of Trade* (New York: DoubledayAnchor, 1956, p. 159), the Belgian historian Henri Pirenne wrothe in 1922 that "in speeding up the circulation of money a natural result was the decreasing of its value and by that very fact the raising of all prices. The period contemporary with the formation of the cities was a period of high cost of living, as favorable to the business men and artisans of the middle class as it was painful to the holders of the land who did not succed in increasing their revenues. By the end of the 11th Century many of them were obliged to have recourse to the capital of the merchants in order to keep going".

[56] Quated in Mark Elvin, *The Pattern of the Chinese Past*. Stanford, 1973. p. 160.

3. Inflation and Argentine Development

> Generally they have too much of it, but their own idea is that they never have enough... the Argentines alter their currency almost as frequently as they change their presidents... No people in the world take a keener interest in currency experiments than the Argentines. *W.R. Lawson, Bankers' Magazine (1899).*

> In our country, external loans have always provided, with rare exceptions, the sums demanded by the public treasury... The flotation of internal loans has failed because the people prefer the advantage of other investments. Favorable external offers have always made internal efforts unnecessary. *Annual Report of the Argentine Treasury (1917).*

Argentine was a city - the port of Buenos Aires and its virtually autonomous, scantly populated and vaguely defined hinterland - long before effectively becoming a nation. Both city and nation achieved their present form in the boom decades before 1914, when Argentina was in the vanguard of the growth of world trade and, in per capita terms, one of the world's richest countries. The nation moved into predominantly urban settlement patterns long before most other developing countries while its monetary system suffered more than most from the effects of prolonged internal conflicts and divisions, and then from the impact of sudden economic expansion. Since World War II, Argentine politicians resorted to inflationary finance to sustain or expand the levels of urbanization and economic activity attained during the pre-1914 boom. Some of these inflationary practices preceded the boom and some of them continue today, even though these methods were not used at all times. Nevertheless, to a great degree, Argentina's present inflation is a direct descendant of the peculiar way the country was organized during those decades of very rapid growth, and to the way Argentina responded to the decline in world demand for her exports after the boom ended.

Argentina's export economy reached maturity on the eve of the First World War. The war ended the first of the two great expansions of international commerce in the century since the 1870s, when the countries of the industrialized core and the developing periphery of the world economy began trading in an ever-widening variety of commodities and manufactures. In the half-century before 1914, Argentina's economy grew at roughly 5% annually, one of the highest long-term growth rates in economic history. By then Argentina's basic economic infrastructure was essentially in place, after about three decades of fevered construction of railroads, ports, grain elevators, refrigeration and meat packing plants and city utilities, financed mainly by British investors. During the half-century before 1914, railroad trackage increased by 15% annually, crop area by 8% and exports by 6%.[57] It was argued that in 1885 a million pounds invested in Argentine railways contributed to the production of more saleable

[57] Carlos F. Diaz Alejandro, *Essays on the Economic History of the Argentine Republic*. Yale, 1970. pp. 2-3.

commodities than the same money invested anywhere else in the world at the time.[58] Argentina benefited hugely from the dramatic cheapening of ocean freight costs in the 1890s, which coincided with the closing of the frontier in the United States and the absorption of all but about 5% of U.S. wheat production by the expanding domestic market. Thus in the boom years 1905-1913 Argentina produced half the world's wheat exports and in 1907, a bad harvest year for Russia, provided nearly four-fifths of them.[59]

Argentina was still an incipient and precariously organized national society, divided by recurrent civil and regional conflicts, at the time the fertile *pampa*was colonized by immigrants and technology from abroad at the end of the 19th Century. Most of the back country towns and cities were largely creatures of the colonial mule trade with the silver mines of Bolivia, which was dying out when Independence was declared. The interior provinces were virtually autonomous and seamed forever in conflict with Buenos Aires. Each major drought seemed to brings, along with economic depression in the countryside, another round of rural violence in the form of political revolt and Indian raids on frontier settlements. Beginning in the 1860s, more stable settlement of the*pampa* became possible thanks to the same set of inventions - railroads, barbed wire, windmills and rapid-fire weapons - that were used to establish sedentary agriculture on the Great Plains of the United States.[60]

Paper money has been used widely in Argentina since the 1920s, much earlier than in most Latin American republics. In 1900 the historian Jorge Pillado wrote: "Argentine paper money, beside its regular functions as an element of exchange, has served the official finances of all periods as a tax forced upon the country in difficult moments of its political life."[61] It is striking that Latin America scarcely experienced the kind of intense monetary debate between advocates of hard and easy money that was central to the politics of the United States in the 19th Century, perhaps because of the small internal demand for cash and the differences in social structure between the two regions. The American Revolution was financed by the uninhibited printing of paper money, producing "one of the worst inflationary episodes in modern times." Then U.S. internal prices rose by 120% during the War of 1812 and by another 120% during the Civil War,

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[58] H.S. Ferns, *Britain and Argentina in the Nineteenth Century*. Oxford, 1960. p. 407. For additional background,see Charles A. Jones, *European Bankers and Argentina, 1880-90*. University of Cambridge, Center of Latin American Studies, and *Irving Stone*, *"British Direct and Portfolio Investment in Latin America before 1914"*, *Journal of Economic History*. September 1977.

[59] W. Arthur Lewis, *Growth and Fluctuations, 1870-1913*. London: Allen & Unwin, 1978. pp. 280-1, 296-7. Also U.S. Census Bureau, *Historical Statistics of the United States: Colonial Times to 1970*. Vol. 2. Washington: Government Printing Office, 1975. p. 898.

[60] Jonathan C. Brown, *The Commercialization of Buenos Aires: Argentina's Economic Expansion in the Era of Traditional Tecnology*. Unpublished doctoral dissertation, University of Texas, 1976. pp. 209-11, 221-2, and Walter Prescott Webb, *The Great Plains*. New York, Ginn, 1931.

[61] Jorge Pillado, *Papel moneda, apuntes históricos*. Buenos Aires, 1900.

which also was financed by inflation. However, in contrast with Argentina, the U.S. paper money supply was carefully regulated after 1866.[62]

In Argentina the issue of paper money was favored by landlords and merchants who otherwise would be forced to buy government bonds to finance the public deficit. The devaluation of paper currency enabled them to cheapen their local expenses against the gold they received in payment for their exports. The first paper money was issued after a bullion shortage was created by the evacuation of precious metals by the Spaniards during the Independence Wars and by British merchants during the Brazilian blockade of Buenos Aires as part of the struggle with the Argentine Confederation over control of the strategic wedge between the two countries called the Banda Oriental (Uruguay). The first paper money for general circulation was issued in 1822 by the Banco de Buenos Aires, controlled by a group of resident British merchants, in an effort to compensate for the scarcity of bullion and to lower local interest rates, which had risen to about 5% monthly. The new bank carried a yield of 20% in its first year of operation on its capital of two million pounds, but then went out of business less than four years after opening. In the 19th Century there was a long series of ephemeral private banks in Argentina that closed their doors after only a few years in business. A kind of "monetary anarchy" prevailed with three or four kinds of money circulating in each province at values that varied sometimes by 25% between one province and another.[63] However, as Argentine exports grew in the 1860s at the start of the great economic upsurge that was to last until World War I, paper money actually gained in value against gold. As the paper peso continued to revalue in the 1880s, international wheat and wool prices declined sharply, cutting deeply into the profits of landlords and exporters.[64] Their response was to persuade the government to radically expand the paper currency. Between 1883-4 and 1891-2 the paper peso lost two-thirds of its gold value, while rural wages increased by barely one-third of the devaluation.[65] Between 1880 and 1890 alone the volume of paper pesos in circulation doubled, at a time of intense movements of foreign capital into Argentina.

In the years before World War I, Britain was investing about one-tenth of its national product abroad. In the boom year of 1889 Argentina received nearly half of all British overseas investment. Unfortunately, much of this new money went down the drain in a land speculation bubble - climaxed by the multiplication and discounting of Argentine land mortgage certificates, or *cédulas*, in Europe - that overextended Argentina's foreign credit and led to the financial crash of 1890 - the Baring crisis - that badly strained the resources and credit of the Bank of England. Subsequently, the paper peso revalued

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[62] Earl J. Hamilton, "The Role of War in Modern Inflation", *Journal of Economic History*. March 1977. p. 15, and U.S. Census Bureau, op. cit., Vol. 2, pp. 994-5.

[63] Rafael Olarra Jiménez, *Evolucíon monetaria argentina*. Buenos Aires: Editorial Universitaria, 1968, p. 36, and Leland H. Jenks, *The Migration of British Capital to 1875* (1927). London: Nelson, 1971, p. 55.

[64] Lewis, op. cit., pp. 280-1.

[65] A.G. Ford, *The Gold Standard 1880-1914: Britain and Argentina*. Oxford, 1962. p. 92.

again against gold as the Argentine economy rebounded from the Baring crash into the boom of the 1890s. Landowners and exporters then "used their political influence to ensure that the paper peso would be stabilized in terms of gold, before it should appreciate any more, by means of the Conversion Law of 1899",[66] which returned Argentina to *the Nineteenth Century*, H.S. Ferns describes how this system worked before populism and nationalism took hold:[67]

> For 78 out of the 104 years between Independence and World War I, the Argentine economy operated with a paper currency for domestic purposes. Argentina alternated between having no banks at all or operating them under extremely lax legislation or legislation that was systematically ignored even by the state authorities. The Republic was a free-trading state longer than Great Britain, and in few rapidly developing communities did the state make so few and such feeble attempts at industrialization. The debtor class which dominated Argentina wore no ragged overalls nor did they preach cooperation and a descent from the cross of gold on which mankind was allegedly crucified. They sent their sons to English public schools and they built palaces in the Avenue Kleber and on the Riviera, while they allowed their country to accumulate by 1914 the biggest per capita volume of foreign claims of any nation in the world. At the reckoning day their political power always told to their advantage. Things were invariably arranged so that either the Argentine workers and sharecroppers or the foreign capitalists or both carried the burden of economic development.

Why was the economic system that developed so rapidly in the decades before the First World War unable to consolidate and renew itself as the 20th Century unfolded? It is true that there were three major interruptions of world trade in the three decades after 1914, and these interruptions were followed by a price decline for Argentina's traditional exports against the price of manufactures that lasted until the early 1970s. In the decade before 1914 Argentina led the countries of temperate settlement in exports, and these countries led the world in terms of per capita exports and export growth. But in the decades since 1945 Argentina has fallen far behind Canada and Australia, her traditional commercial rivals, in both exports and general output, even though these countries' agricultural commodities also have lost in relative value. While Argentina profited hugely from the expansion of world trade before 1914 that grew at 3.4% annually, she largely stood aside from, and lost ground in, the much greater expansion of world trade, at more than twice the pre-1914 rate, that took place after World War II. Her participation in World trade as a whole shrank from 1.86% in 1938 to 0.4% in 1976, and in Latin America's exports from 35% in 1928 to about 10% in 1958, a level she has maintained since then. Although the world grain trade quadrupled in the 25 years since 1945-49, Argentina's share declined from about 30% in the 1930s to 6.7% in 1970-74, despite a dramatic rise in corn and sorghum production in the late 1960s and early 1970s. Similarly, her share in the beef trade dropped from 50% in the 1930s to 6% in

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[66] Ibid., p. 95.
[67] Ferns, op. cit., p. 145.

1975-76.[68] Yet to new internationally competitive economic activity was launched in the postwar years to take up this slack, only an autarchic import substitution that exhausted quickly the tight supplies of foreign exchange. A new demand for imported raw materials, semi-finished goods and machinery was created by home industries that needed heavy protection and subsidies to stay in business.

It would be too easy to blame Juan Perón for this mess, but the Perón regime (1945-55) provides a useful frame of reference. The economic literature on Argentina abundantly documents the way General Perón and this "shirtless" followers wrestled the country's rural export industries to the ground in the early postwar period in the name of their struggle against the national oligarchy and the foreigners who owned most of Argentina's export infrastructure. Rural exports were heavily taxed to assure that they would be diverted at low prices into the home market and to finance import-substitution industrialization. Because of the depressed rural economy and the artificial expansion of urban incomes under Perón, farm workers migrated in great numbers to the cities, expanding the pool of urban consumers while creating a rural labor shortage that become a major production bottleneck for Argentina's undercapitalized agriculture.

By the time Perón was chased from power in 1955, Argentina had become one of the world's most urbanized countries. While Argentina and the United States both had become predominantly urban countries around the time of World War I, and both had the same proportion (11% of their people living in cities of 100,000 a century ago, Argentina by 1970 had three-fifths of its people living in these cities, proportionately twice as many as the U.S.[69] Although the growth rate of urban population in the Perón era was not greater than in the rest of Latin America, it grew from a much higher base and began an absolute decline of Argentina's rural population that accelerated after his fall. A tug-of-war had begun between export and home consumption of Argentina's food staples that continues today. By the mid-1950s domestic consumption of rural goods rose by more than 40% over 1930-39, although overall rural production had grown by only 14% since the 1930s and output of rural exportables fell by 10%. Despite the great postwar expansion of trade, the physical quantity of Argentina's exports actually declined in the 1945-65 period by about one-fourth below the levels of the 1920s and 1930s. Professor Carlos Diaz Alejandro of Yale University, the leading historian of the Argentine economy, wrote in the late 1960s:[70]

> Few countries in the world can show such a poor export performance during the same period; several can show a decline in the per capita export quantum, but few

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68 Data taken from "La Argentina en el comercio mundial de productos agropecuarios", *Coyuntura y desarollo*. Buenos Aires: FIDE (Foundación de Investigaciones para el Desarollo). Nº 1. September 1978, pp. 36-43.

69 Zulma Recchini de Lattes and Alfredo E. Lattles, *La Población de Argentina*. Buenos Aires, 1975, p. 113.

70 Díaz Alejandro, op. cit., pp. 69 & 76.

> can join Argentina in the sad category of countries whose export quantum declined absolutely... In other words, the failure to put more resources into export and truly import-competing industries and the allocation of too many resources to home goods have given rise to the main problem of the last four decades: a persistent foreign exchange shortage leading to low rates of capital formation an of productivity gains... Since 1930, the growth has been so small, the cyclical fluctuations so violent, and the swings in income distribution so pronounced that it is easy to believe that during some years several groups have been worse off than they, or their parents, were during 1925-29. Furthermore, some public services (e.g. telephones, railroads, the post office and statistical services) and in some import-substituting manufactures, quality has deteriorated so that a quality-corrected growth rate would have been even smaller.

While Argentina was, in per capita terms, one of the world's richest and most productive countries in the years before the First World War, she moved into inflationary finance - both in terms of public spending and support for import-substitution industries - in order not only to sustain but also to expand the levels of urban employment and consumption that were attained during the boom before 1914. As recently as 1929 Argentina ranked 11th among the world's trading nations; had more motor vehicles per capita than Great Britain; boasted low illiteracy and death rates and had become one of the great cultural centers of the Hispanic world. Pampean real wages seemed higher than in some European cities, with hourly wages rates in Buenos Aires in 1911-14 reported to be 80% higher than in Marseilles and 25% higher than for the same jobs in Paris.[71]

In a new study of the formation of the world economy before the First World War, Sir Arthur Lewis argues that the countries of temperate settlement, such as Argentina, "could attract and hold European emigrants, in competition with the United States, only by offering income levels higher than prevailed in North-West Europe." The determinant of income levels and migratory flows was the difference between agricultural yields around 1900 in northern Europe (1,600 1bs. per acre) and in the tropics (700 1bs. grain per acre), explaining the flow of Asians to the tropics and Europeans to the lands of temperate settlement (Argentina, Canada, Australia, New Zealand and, of course, the United States.[72] The Argentine census of 1869 reported a population of only 1.7 million, which over the next half-century was to be the host of proportionately more foreign immigration to native inhabitants than other country, roughly 11% of the 60 million Europeans who emigrated overseas. By 1895 three-fourths of the adult population of Buenos Aires was foreign-born, controlling four-fifths of the city's industry and trade, even though only 2.3% of them had acquired Argentine citizenship by 1914. The incentives to do so were minimal: aliens could hold civil service

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[71] Ibid., p. 41.
[72] Lewis, op. cit., pp. 188-93.

jobs throughout the country and could vote in local elections.[73] Moreover, immigrants found themselves increasingly impeded from acquiring land. Unlike the United States, Australia and Canada, which offered generous land distribution schemes that benefitted immigrants, Argentina made land ownership by foreign settlers practically impossible. "The public domain had traditionally been surrendered to private ownership before there was the remotest possibility of its utilization or occupancy", James Scobie observed in his history of Argentine wheat. He added:[74]

> The Conquest of the Desert - Roca's military expedition against the pampean Indians in 1879-80 - doubled the size of the province of Buenos Aires and added vast areas to the national public domain south of the Negro River. This new-found territorial wealth was disposed of in the traditional manner: sold or granted to established landowners or speculators in huge lots for the mere pittance that it was worth at that moment... By the end of the century it was beyond the power of national authorities or the coastal provinces to create a land policy suited to the needs of the immigrant or the small farmer. The government no longer possessed lands in the agricultural zones.

Unlike the English-speaking lands of temperate settlement, or even Brazil, Argentina was unwilling or unable to absorb rationally the large numbers of European immigrants needed to develop its export economy. This may be one of the main reasons for its chronic internal conflicts in the 20th Century, and for the archaic and xenophobic forms of nationalism that appeared subsequently. Indeed, there is a dramatic contrast between the experiences of Italian rural immigrants in Argentina and Brazil: In São Paulo State the Italian peons who came before 1914 to replace the slaves who formerly grew and picked coffee were able to acquire land and, in some cases, became the "kings" and entrepreneurs of the new sugar economy. In Argentina the Italians, to a greater degree, flocked to the cities or re-emigrated. Early on, in what was called "the golden age of Argentine colonization" (1857-72), more than half the 221,000 immigrants left the country and, of those who remained, all but one-sixth settled in towns and cities. Following his return to the *pampa* in 1918, after spending five years in Córdoba and Tucumán in the 1880s, the American geographer Mark Jefferson concluded:[75]

> The promise of the Argentine government to give land cannot be counted of much value... There have been numerous laws and projects for colonizing the national territory. The evidence comes from so many directions, from Argentines as well as foreigners, that one cannot doubt that probably thousands of individuals have

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[73] Gino Germani, *Mass Immigration and Modernization in Argentina*. Studies in Comparative International Development, Vol. II Nº 2.

[74] James R. Scobie. *Revolution on the Pampas: A Social History of Argentine Wheat, 1860-1910*. University of Texas Press, 1964. pp. 114-8.

[75] Mark Jefferson, *Peopling the Argentine Pampa*. New York: American Geographical Society, 1926. pp. 99, 123, 175.

> fulfilled all legal obligations, have cleared, cultivated, and are settled on land to which they have been promised title and cannot get it and of which they are in some cases even violently dispossessed... Not immigration agencies, nor free passages, not money help to the newcomer unadjusted to any capacity he has shown to pay obligations, but a fair chance to buy land at actual present worth, unaugmented by speculative estimates of the value that his labor will some day give it, makes for successful settlement here as elsewhere.

So the immigrants piled into the cities. Buenos Aires grew in population at an annual average rate of nearly 5% in the half-century before the First World War,[76] but her industrial base was still confined to the processing of exports. Although Argentina led the countries of temperate settlement (excluding the United States) in total exports before 1914, her per capita levels of both production and consumption of manufactures was far below the other.[77] Instead, construction became the major industry of Buenos Aires as growth intensified and projects multiplied. A municipal water and sewage system was installed in the 1880s, followed by street paving in the 1890s, electrification of the trolley system by 1905, the building of a subway in 1911, numerous government buildings, the Colón opera house, hotels, offices and private palaces. Between 1887 and 1910 the number of buildings in Buenos Aires tripled.[78] The early preponderant character of Argentine urbanization, even before the country was solidly constituted as a national society, cut deeply into the economy's capacity for capital formation.

Two-thirds of the cost of urbanization usually is incurred by construction, which in Argentina was financed largely by foreign capital. In the 19th Century, the countries that borrowed heavily (Argentina, Canada, Argentina, United States) may have been richer than the lending countries (Britain, France, Germany), but the rate of growth of their urban populations were probably twice as high.[79] The high cost of urbanization was too much for their savings capacity, so they borrowed abroad from the countries with high productivity and lower social overhead costs. Unfortunately for Argentina, the flow of British capital abroad declined sharply in the period between the two world wars, while Argentina's terms of trade began to turn against her. As these unfavorable trends continued after World War II, reinforced by Perón's autarchic and nationalist economic policies, successive Argentine governments were caught in a series of high-level inflationary traps in order to sustain urban employment and economic activity.

Between the 1947 census and 1954, the population of Buenos Aires grew from 4.6 to 5.6 million, with the high urban wages generated by Perón's populism drawing about

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76 Zulma L. Recchini de Lattes, *La Población de Buenos Aires: Componentes Demográficos del Crescimiento entre 1855 y 1960*. Buenos Aires: Instituto Torcuato de Tella, 1971. p. 37.
77 Lewis, op. cit., p. 196.
78 James R. Scobie, *Argentina*: *A City and a Nation*. Oxford, 1964. pp. 166-7.
79 Lewis, op. cit., pp. 145-51, and W. Arthur Lewis, *The Evolution of the International Economic Order*. Princeton, 1978. p. 39.

200,000 migrants annually from the interior into Buenos Aires, compared with 8,000 yearly before 1935 and 100,000 during the war, plus another wave of European immigration.[80] Diaz Alejandro observed: "At least for some policy makers, the growth rate was not an important objective. They were more interested in generating urban employment and providing some social services, so that... stimulating the growth of home goods appealed to them"[81] Between the 1930s and the 1960s the share of foreign trade in Argentina's national product fell by half. The essence of Perón's industrialization policy is contained in the law to promote industries of "national interest", in effect between 1944 and 1957, that gave high tariff protection and government credit at subsidized interest rates to factories that (1) produced for the domestic market, using only Argentine raw materials; (2) produced articles of basic necessity, or (3) goods needed for national defense.[82] Between 1945 and 1952 cheap industrial credit expanded from 2.7 to 7.5% of the national product, but these loans and advances went mainly to small factories and shops producing processed foods, beverages, tobacco, textiles and clothing. The proliferation of small factories and the stagnation of electrical generating capacity, which between 1929 and 1955 grew by less than one-third of the rise in consumption, led to the chronic power shortages that began to be felt around 1944 and continue today. While employment and production increased dramatically in the officially favored industries, the economy as a whole grew by barely 2% yearly in 1949-58, the decade in which inflation first became a major problem. Meanwhile, Argentina's capital stock had declined, in per capita terms, by 26% since 1929.[83] According to an American economist's analysis of Argentina's industrial credit and protection policies of the 1940s and 1950s:[84]

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80 Scobie, *Argentina*: *A City and a Nation,* op. cit., p. 226.
81 Díaz Alejandro, op. cit., p. 107.
82 Laura Randall, *An Economic History of Argentina in the Twentieth Century*. Columbia, 1978. p. 141.
83 Aldo Ferrer, *The Argentine Economy*. California, 1967. p. 174.
84 Hugh H. Schwartz, "The Argentine Experience with Industrial Credit and Protection Incentives, 1943-1958", *Yale Economic Essays,* 1968, pp. 284 & 307.

> During the 10 years beginning in 1949, Argentina received little economic stimulus from abroad. Both world prices of her exports and new foreign investment declined, the latter to a smaller proportion of GNP than in any comparable period in the previous 80 years... The explanation for the overwhelming portion of the industrialization that took place could not have been other than increased protection... The decision to increase the emphasis on industrialization (and to do so in the manner selected by the Argentine government) probably reduced the economy's potential technological advance. Much technological change comes embodied in new investment, and for a nation such as Argentina which had imported the overwhelming portion of its machinery in the prewar period, the attainment of technological improvement was closely related to the ability to import - or to develop a domestic machinery industry that could compete with foreign products (in quality and in price).

One of the major justifications for Argentina's industrialization policies, and for import substitution programs throughout Latin America, was the fact that there were three interruptions of world trade in the three decades after 1914, followed by the much-discussed "dollar shortage" of the early postwar period. Since 1945, however, there have been three decades of uninterrupted and continuously expanding world trade, climaxed by the dollar glut of the 1970s. Thus industrialization by import substitution is viewed today in a much different light than it was in the early postwar years.

Since the outbreak of World War II, Argentina's industrialization effort has proceeded in three phases. The first was the military-statist defense industries, controlled by the armed forces, which started producing armaments and then diversified into an exotic variety of consumer durables. These became the industrial dinosaurs of the postwar era, providing a nesting place for retired officers, at about half the productivity levels of private industry.[85] The second phase was the light manufacturing promoted by Perón, who initiated a third phase around 1953, two years before his fall, that continued into the 1960s. This third phase promoted "dynamic" capital-intensive industries - machinery, vehicles, metals, paper, chemicals, petrochemicals, cement, petroleum, electricity, communications - with heavy foreign participation and tariff protection. These "dynamic" industries generated barely 13% of the national product, but absorbed 72% of the country's imports, making demands on the declining export sector that could not be fulfilled and thus worsened the celebrated foreign exchange bottleneck.[86]

This foreign exchange bottleneck drastically curtailed the ability of Argentine industry to modernize and expand. After 1945-49 Argentina's import capacity fell and remained at about half the pre-Depression level for most of the postwar period. The bulk of

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[85] Randall, op. cit., pp. 140-1.

[86] "The Problem of the Economic Development of Argentina", in CEPAL, *Economic Bulletin for Latin America*. Vol. 4 Nº 1 (March 1969) p. 18.

available foreign exchange was spent on raw materials, fuels, spare parts and semi-finished goods to keep existing industries going, plus the indispensable electrical generating and transportation equipment needed to keep the economy functioning. According to Aldo Ferrer, "the process of development came to a halt. Shortages of essential materials immobilized a large proportion of installed capacity in industry and prevented new expansion"[87] While most postwar public and private bank credit was awarded at negative real interest, the shortage of foreign exchange limited the access of these privileged borrowers - either political favorites or firms that had borrowed before - to the latest technology. Instead, most new industrial investment with these subsidized government loans was made at prices that were inflated by a heavily protected capital goods industry and by declining labor productivity in construction,[88] in the end providing dubious benefits to the investor. Or else the government loans were used to keep failing firms afloat.

Limitations of time and space prevent me from analyzing in detail the process by which Argentina sank into its inflationary crisis of the mid-1970s. These developments are discussed summarily in Part 1 of this Report. However, to enrich the long-range context of this study, I would like to expand briefly on the relationship between inflation and urbanization in the present and future.

Since World War II the countries of chronic inflation in Latin America have been Argentina, Chile and Uruguay. Not only are these three republics of the temperate southern cone of South America the region's most urbanized nations today, but they already were so at the end of the 19th Century. By 1900, 29% of Uruguay's population lived in Montevideo; 17% of Argentina's lived in Buenos Aires, and 10% of Chile's lived in Santiago.[89] All these countries urbanized rapidly during the boom of commodity exports and immigration in the half-century before the First World War. Although Chile urbanized somewhat more slowly because a settled population struck roots into its fertile Central Valley some two centuries before a similar settlement process occurred in Argentine and Uruguay, the population of Santiago roughly quadrupled in the half-century before 1920, while the share in Chile's population of towns and cities with more than 5,000 inhabitants doubled to 36% in the same period.[90] Buenos Aires more than doubled its population between 1895 and 1914, but provincial cities like Rosario, Tucumán, Santa Fé and Bahía Blanca were growing even faster until policies of the central government truncated their growth in favor of Buenos Aires.[91]

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[87] Ferrer, op. cit., p. 176.

[88] Díaz Alejandro, op. cit., pp. 309-48.

[89] Nicolás Sánchez-Albornoz, *The Population of Latin America: A History*. California, 1974, pp. 178-9

[90] Michael L. Conniff, "Chile", in Richard M. Morse et. al., eds., *The Urban Development of Latin America, 1750-1920*. Stanford: Center for Latin American Studies, 1971. pp. 54 & 58.

[91] See Nathan Laks, "Argentina", in Morse, op. cit. The government truncated the growth of the secondary grain ports through differential freight rates and improvement of the port facilities of Buenos Aires. According to Laks: "The federal government, ostensibly concerned with the security of customs-duties collection, gave Buenos Aires a virtual monopoly for importing consumer goods,

By 1975, 85% of Uruguay's population, 81% of Argentina's and 78% of Chile's were living in towns and cities, according to United Nations estimates.[92] In the same year, Chile had and inflation rate of 341%; Argentina of 335% and Uruguay of 67%. Obviously, there are countries in the world with similar levels of urbanization - such as Britain, the Netherlands, Canada, Germany, Australia - that do not suffer the same levels of inflation. Why then are these countries of South America saddled with these intense price increases, and why are they now spreading to other countries of Latin America?

The answer to this question must lie in developing high levels of industrial and agricultural productivity that can sustain large urban concentrations that do not themselves produce the food, fuel and raw materials needed by city populations. Otherwise, urbanization without development produces distortions in relative prices between rural food production and urban wage goods: between the prices of domestic and internationally traded industrial goods and between private and public sector activities as the government and heavily protected industries tend to preempt national resources and to set the standard for economic performance.

The process of postwar urbanization in Latin America has not been accompanied by the development of levels of agricultural and industrial productivity that, elsewhere in the world, have sustained human concentrations of comparable size. Thus all the larger republics of Latin America (i.e., with more than 10 million inhabitants), except for Venezuela, suffered serious inflation during the 1970s. All these countries experienced consumer price increases of more than 20% in at least four years during 1970-78 and, outside the southern cone, the worst inflation was bunched in the 1975-78 period. Significantly, the four countries apparently now threatened with chronic inflation - Brazil, Colombia, Mexico and Peru - all urbanized rapidly since 1950. By 1975, more than 60% of the people in these countries were living in towns and cities; this proportion is expected to exceed 75% by the year 2000. Taken together, the urban populations of these countries grew by roughly 6% annually in the quarter-century between 1950 and 1975.[93] Some smaller republics - Haiti, Honduras, Nicaragua and the Dominican

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while the railroads, to protect their investments in a system long since centered on Buenos Aires, preferred to ensure the profitability of existing lines rather than construct new ones..." These policies especially undercut the growth of La Plata, the new capital of Buenos Aires province, which had become an important grain port until 1895, growing in population from 1,000 in 1869 to 45,000 in 1895 and to 90,000 in 1914.

92 Brazil (6.3%), Colombia (6.5%), Peru (5.8%), Mexico (5.3%). Recent urbanization data and projections in this paragraph taken from CEPAL, *Tendencias y Proyecciones a Largo Plazo del Desarollo Económico de América Latina*. Document (E/CEPAL/1027) prepared for the 17th meeting of the United National Economic Commission for Latin America, Guatemala City, March-April 1977. pp. 114-21.

93 All the countries afflicted again, or for the first time, with chronic inflation in the 1970s radically expanded their sectors in the 1970s with the help of international bank loans, producing the kind of

Republic - have been urbanizing at an even faster rate in the postwar decades. But they started from a smaller urban base and, moreover, the size and poverty of their economies prevented them from attempting import-substitution industrialization and expanding their public sectors on the scale of the larger countries. Their inflation rates, perhaps consequentially, have been much lower.[94]

The case of Brazil, now the largest debtor ($45 billion) among developing countries, is especially dramatic. Having urbanized at an annual rate of 6.3% between 1950 and 1975, Brazil's annual inflation of 30% during this quarter-century was tolerable because her national product was growing faster (at 6.5%) than her towns and cities. Moreover, during 1960-76, her per capita income increased spectacularly, by 4.8% yearly, as considerable progress was made in curbing inflation. Indeed, Brazil was alone among the world's major economies in being able to reduce inflation in the early 1970s below the average level of the 1960s. Since 1975, however, the picture has changed. Over the past three years inflation has averaged more than 40% and in 1979 it is expected to approach 60%, while real economic growth - net of foreign loans - has been less than the rate of urbanization in three of the past four years. Meanwhile, Brazil's foreign debt service exceeded 70% of exports in 1979, a burden that can be sustained only as long as expanding international liquidity supports the fragile debt structure of developing countries. In Brazil as in Argentina, public spending grew during 1970-76 at triple the rate of the 1960s, with international liquidity serving increasingly as the main support for inflationary government finance.

I have tried to show that radical increases in urban population without corresponding productivity gains tend to generate inflation, with enlarged government spending emerging as one of the main economic distortions that exert upward pressure on prices. On these points it is fruitful to compare the southern cone republics of South America with the other countries of the world that received large-scale European immigration at the beginning of this century. By 1975 all these lands of temperate settlement, except South Africa, had absorbed about 80% of their people in towns and cities, but the ones outside South America - Canada, New Zealand, Australia - experienced inflation rates of about 11% in 1970-76, a striking contrast to the kind of price increases seen in Argentina, Chile and Uruguay in those years. Again in contrast with Argentina, public spending in Canada and Australia increased at a slower rate in the 1970s than in 1960s, as it did in industrialized countries as a whole.[95] To understand the deeper reasons for the differences in economic performance between the former lands of temperate settlement inside and outside South America, it may be useful to draw upon some

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community of interest berween foreign bankers and public sector officials that was described with reference to Argentine inflation in Part 2 of this study.

[94]Urbanization and inflation rates taken from World Bank, *World Development Report, 1978. Washington, 1978. pp. 77 & 103*.

[95] Ibid., pp. 83-5.

comparative studies of Argentine and Australian development.[96] In 1928 the per capita exports of Argentina were nine-tenths of Australia's, but by 1960 they had declined to one-fourth and by 1976 to one-sixth. Part of this difference undoubtedly lies in the fact that Argentina's population is twice the size of Australia's, and thus Argentina must withhold more exportable food staples from the world market. Between 1860 and 1960 Argentina's population grew twice as fast as Australia's from roughly the same numerical base, though since 1960 Australia's has grown much faster. While only about 3% of Australian territory is suitable for intensive cultivation, Australia's farms are far more mechanized than Argentina's and are associated with a far more productive industrial plant. In both countries the government played a major entrepreneurial and developmental role, but import-substitution industrialization began intensively after the First World War in Australia and only after the Second Word War in Argentina. Moreover, Australia received uninterrupted transfers of capital and technology from foreign investors, while these transfers were reduced to a trickle in Argentina during the postwar years. While Argentina released large areas of its most fertile lands to private speculators long before they could be cultivated, Australia adopted a policy akin to the U.S. Homestead Act of 1960, heavily taxing absentee owners and ceding Crown lands to settlers on the basis of long-term usufruct leasing rather than outright ownership.[97] Moreover, Australia under Crown rule did not venture into the bizarre public finance to which Argentina became accustomed, consistently incurring public spending deficits equal to about one-third of revenues between 1880 and 1905.[98] One recent analysis of Australian inflation made the same complaint as Martínez de Hoz about the impact of price increases of internationally-traded goods on the internal price structure. However,

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[96] I have drawn heavily on Ruth Kelly, "The Foreign Trade of Argentina and Australia between 1930 and 1960", *Economic Bulletin for Latin America*. October 1965. See also Héctor L. Diéguez, *Argentina y Australia: Algunos aspectos de su desarollo económico comparado*, Buenos Aires: Instituto Torcuato de Tella, 1968; Aldo Ferrer and Wheelwright, *Industrialization in Argentina and Australia: A comparative study*. Buenos Aires: Instituto Torcuato de Tella, 1966; Arthur Smithies, "Argentina and Australia", *American Economic Review*. May 1969; Jorge Katz, "The Sources of Manufacturing Growth in Australia and Argentina in the Period 1946-1960", *The Economic Record*.

[97] The 11th Edition of *The Encyclopaedia Britannica* (1910) makes the following observation (Vol. 2, p. 964) on how Australian land laws related to urbanization: "Taking the states as a whole, agrarian legislation has been the most important subject that has engrossed the attention of their parliaments, and every state has been more or less engaged in tinkering with its land laws. The main object of all such legislation is to secure the residence of the owners on the land. The object of settlers, however, in a great many, perhaps in the majority of instances, is to dispose of their holdings as soon as possible after the requirements of the law have been complied with, and to avoid permanent settlement. This has greatly facilitated the formation of large estates devoted chiefly to grazing purposes, contrary to the policy of the legislature, which has everywhere sought to encourage tillage, or tillage joined to stock-rearing, and to discourage large holdings. The importance of the land question is so great that it is hardly an exaggeration to say that it is usual for every parliament of Australia to have before it a proposal to alter or amend its land laws. Since 1870 there have been five radical changes made in New South Wales. In Victoria the law has been altered five times, and in Queensland and South Australia seven times".

[98] The same edition of *Encyclopaedia Britannica* (Vol. 2, p. 467) carries an excellent discussion of the ins and outs of Argentine public finance. The article reports a cumulative public deficit of $408 million from 1864 to 1900.

while the weight of traded goods in Argentina's national product is about one-third greater than in Australia's, Argentina's inflation rate in the 1970s has been about 10 times Australia's, even though the two countries export many of the same commodities.

This study has emphasized the relationship between inflation and urbanization and international liquidity in order to place Argentina's immediate problems in the broader context of worldwide trends. I believe that world inflation is far more the product of the cumulative impact of urbanization of the human population and the ever-more prolific use of money than to any event or combination of events, such as the Vietnam War or the oil price increases of the 1970s. While well over three-fourths of the people in the major industrialized nations, as well as the former lands of temperate settlement, now live in towns and cities, it may be worthwhile remembering that, as recently as 1850, only one country in the world, Great Britain, had developed enough agricultural and industrial productivity to settle more than half of its people in urban areas.

Viewed in this broader perspective, and in a somewhat longer time frame than the one established for this study, Argentina may have reason to hope for a brighter future than if its economic performance so far in this century were considered alone. Let us consider four possibilities: (1) Internal strife will gradually end; (2) internal strife will continue; (3) world trade will continue to flow without interruption over the next two decades; (4) world trade will be impeded again by war, depression or some other calamity. My impression is that the Argentine people are getting very tired of sectoral struggles and may be able to bury their hatchets over the next decade. Another *caudillo* may yet arise to mobilize the masses, but he is unlikely to awaken the kind of popular fervor of Perón's following. However, if political strife continues, Argentina's weary people may come under the rule of a latter-day Rosas who will give them plenty of stability and, perhaps, economic autarchy as well. The political and economic stabilization of Argentina would be fortified greatly by a continued upward trend in the prices of its agricultural exports, as began to happen in the 1970s. Conspiring in Argentina's favor is not only increasing world demand for basic foodstuffs, which few countries have the unused capacity to supply that Argentina still has, but also the fact that the world's leading exporter, the United States, has been encountering difficulty in increasing production, both in terms of area and yields. However, if world trade is interrupted and economic autarchy imposed on Argentina, few countries in the world remain with the kind of satisfactory balance between natural resources and material needs that Argentina still enjoys. Argentina's political future remains very iffy, but not as iffy as some of the countries that today are repositories of some of the world's most prized natural resources.[99]

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[99] John D. Pitchford, "Inflation in Australia", in Lawrence B. Krause and Walter S. Salant, eds., *Worldwide Inflation: Theory and Recent Experience*. Washington: Brookings, 1977.