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THE IMPACT OF POLITICAL INSTITUTIONS
ON PROGRESS WITH FISCAL REFORM:
THE CASE OF ARGENTINA IN COMPARATIVE PERSPECTIVE

DISSERTATION

Presented in Partial Fulfillment of the Requirements for
the Degree Doctor of Philosophy in the Graduate
School of The Ohio State University

By

John Mark Payne, B.A.

* * * * *

The Ohio State University
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ABSTRACT

Despite the tremendous costs to economic well being entailed by runaway inflation and severe economic recession, there was substantial variation among Latin American governments in their capacity to make the adjustments in fiscal policies necessary to avoid such outcomes in the 1980s and 1990s. This study examines the question of why some governments are more willing and able to withstand the heavy social costs associated with fiscal adjustment and reform. In examining this question, it focuses on the sharply contrasting experiences of the Raúl Alfonsín and Carlos Menem governments in Argentina analyzed within a broader comparative setting, which includes, in particular, the experiences of governments in Brazil, Colombia, and Uruguay. The contrasting capacities of governments to preemptively carry out fiscal adjustments and reforms cannot adequately be accounted for by approaches that center the attention on international economic and political pressures, societal group pressures, or the role of the state. Rather I argue that a political institutional approach, in which it is assumed that politicians, operating with a given set of political, social, and economic constraints, rationally weigh the political costs and benefits of different courses of action, can best explain the differences in the outcomes observed. The key political institutional factors which are found to affect governmental willingness and capacity to carry out fiscal adjustments and reforms are: the extent of the government’s power to command a majority in the Congress and its power to influence the fiscal behavior of subordinate levels of government. The stance of these factors, however, is
shaped by the degree of fragmentation and polarization of the party system, the cohesiveness and discipline of party organizations, the strength of the governing party’s electoral mandate, and the degree of centralization of central governmental authority over the public sector budget. Aside from the above factors, the security of the president’s mandate, which is potentially undermined by threats from the military or guerrilla groups or by mid-term elections, and nature of the relationship between the governing party and key interest groups, is also viewed to influence the willingness and capacity of governments to carry out fiscal adjustments and reforms.
ACKNOWLEDGMENTS

I would like to thank the numerous people who contributed to my research, including all of those who generously offered their time to be interviewed, and the librarians, archivists, and public officials who provided me access to important documents. I would especially like to thank Mario Damill, Roberto Frenkel, and Guillermo Rozenwurcel at El Centro de Estudios del Estado y Sociedad in Buenos Aires for providing me a place in which to base my research, valuable advice, and logistical support in gaining access to key institutions and persons. Carlos Acuña also provided early written and oral feedback on my research ideas and helped orient me in Buenos Aires.

I benefited enormously from the advice, comments, criticism, and support provided by my committee members, Felipe Agüero, Richard Gunther, and William Liddle. They taught me a lot about the art of grant writing and helped me focus my ideas as I was preparing to do the field research. And, their criticisms and suggestions on earlier drafts of these chapters helped sharpen the clarity of the argument and made them more readable. But, they share none of the responsibility for whatever deficiencies that continue to exist in respect to the presentation of the argument or the conceptual and empirical rigor of the research.

I gratefully acknowledge the generous financial support of the Tinker Foundation and the Latin American Studies Center at Ohio State University, the Graduate School at Ohio State University, and the Fulbright Commission. Grants from these institutions permitted me to go to Buenos Aires for an initial round of research and then a seven month trip the following year. The
people at the Argentine Fulbright office were also particularly helpful in providing me important information and other forms of support during my stay in Buenos Aires.

I also thank my good friends in Buenos Aires, Martin Pierrepont and Eduardo Feldman, who taught me a lot about Argentine politics and culture, helped improve my Spanish, and introduced me to several of the people with whom I interviewed or from whom I asked advice. Only through their friendship was the long time away from family made bearable. Tom Rotnem was also an inspirational friend in Columbus whose example showed me that diligent work pays off eventually.

I also owe a debt of immense gratitude to my parents who provided me much guidance and support throughout my whole life and whose example motivated me to pursue an advanced degree.

I am indebted greatly to Patty McAndrew, who provided constant love, encouragement, and support despite my frequent, and at times, long physical absences from the family and the absorption of time and attention entailed by the thesis work. Finally, Andrew and Megan, who were born while this project was underway, provided me much inspiration, helped keep my life in balance, constantly lifted my spirits, and provided much amusement.
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CHAPTER 1
EXPLAINING PROGRESS WITH FISCAL ADJUSTMENT AND REFORM IN LATIN AMERICA: THE ROLE OF POLITICAL INSTITUTIONS

Introduction

In the early 1980s Latin American economies were subjected to shocks emanating from the international economy which rivaled the magnitude of those experienced during the Great Depression. The effects on Latin American economies were so profound because these shocks - the sudden contraction of foreign lending and investment, the sharp rise in world interest rates, and the world economic recession - came at an especially inopportune time. Not only were most countries’ economies saddled with very large, and now more costly, foreign debts, they were also suffering from the exhaustion of the state-led and inward-oriented development model which most had been following since the 1940s. Since most of the debt was owed by governments, the abrupt increase in the costs of debt servicing not only entailed a large transfer of real resources to the creditor countries, it also had a traumatic impact on the stability of Latin American countries’ public finances.

The state’s fiscal crisis in most cases, however, was not just a product of the debt crisis. The waning capacity of the import substitution development model to produce sustained economic growth and of the state to finance the interventionist role entailed by this model contributed to the accumulation of foreign and domestic debt during the previous decade. Thus, the fiscal crisis of the state in most cases could not be solved merely by lowering the costs of debt
servicing, imposing across-the-board spending reductions, or introducing a few new taxes.
Rather, a more durable fiscal adjustment which would not sharply reduce the economies' future
growth possibilities, in most cases, required significant improvements in the state’s revenue
collection capabilities and/or reductions in the state’s scope and level of activism in the economy.
But, efforts to increase tax rates, to close tax loopholes, and to reduce the state’s size and its
level of involvement in the promotion of economic activity carried great risks for politicians since
these measures were very harmful to powerful and well-organized societal groups with a vested
interest in the status quo fiscal arrangements.

However, as the experiences of Argentina, Brazil, and Peru in the 1980s demonstrated,
the failure to contain the size of budget deficits often entailed the loss of external economic
support, increasingly onerous debt service burdens, a sharp acceleration in the inflation rate, and
a further depression of economic activity, which contributed to mounting social tensions and
increasing dissatisfaction with the political system. By contrast, governments in Colombia and
Uruguay, which managed to profoundly adjust their fiscal accounts, spared their citizens the
traumas of runaway inflation and severe contractions of economic output (See Table 1.1).\(^1\)

Given these hefty economic and political stakes, why were some governments willing
and able to impose on their citizens the heavy costs and income distributive effects of fiscal
adjustment, while others were not? Why did some countries manage to advance rapidly and
profundly with fiscal reforms, while others progressed hesitantly or not at all? Why did some
governments succeed in implementing reforms which made their tax systems more economically
neutral and less complex to administer, while others either failed to enact fundamental reforms or
adopted changes which closed budget deficits only at the price of a reduction in the equity and
economic efficiency of the tax system and economically damaging and socially costly spending cuts?

In an effort to improve our understanding of the factors which permit governments to impose on their citizens the heavy costs associated with fiscal adjustment, this study will examine the sharply contrasting experiences of successive post-authoritarian governments in Argentina: the remarkable achievements of Carlos Saúl Menem's government (1989-1995 and 1995 - present) compared with the failed efforts of the preceding government led by Raúl Alfonsín (1983-1989). Facing a heavy debt interest burden and the threat of runaway inflation, why did the Alfonsín government fail to implement more far-reaching reforms of the tax system and the public sector? Why was it unable to keep the fiscal deficit within reasonable bounds and to prevent inflation from sliding out of control? By contrast, how was the Menem government able to dramatically reform the tax system, curb the Argentine people's propensity to evade taxes, and overhaul the public sector? How was Menem able to sustain the fiscal reform drive and the budgetary balance despite repeated initial setbacks and the lack of congruence between these policies and the interests of his party's traditional core constituency?

The conventional wisdom, which has been applied as well to the experiences of Bolivia (1985-1986) and Peru (1990-1992), is that the implementation of radical fiscal reforms and adjustment policies was made possible, in large part, by the previous exposure of citizens to the economically devastating and socially disruptive effects of high or (hyper-) inflation and “hyper-stagnation”. Given the particularly severe experience with hyperinflation and the unusual circumstances surrounding Menem’s inauguration, it would be difficult in a study focused solely on the Argentine case to disentangle the influence of this experience from the role of other, less
episodic, factors. Thus, in order to better ensure the generalizability of the theoretical findings and to more adequately delimit the impact of severe economic crises on the initiation and implementation of fiscal adjustment measures, this study also examines the divergent records of governments in Brazil, Colombia, and Uruguay.

Though the Julio María Sanguinetti government (1985-1989) in Uruguay inherited economic and political problems of a similar kind and magnitude to that confronted by the Alfonsín government, it responded more quickly and was much more successful in sustaining control over the budget and the rate of inflation. But, in contrast with the Menem government, Sanguinetti’s successor, Luis Alberto Lacalle (1990-1994), though still able to keep inflation at moderate levels and to limit the size of the fiscal deficit, was considerably less successful in restructuring the tax system or reforming the public sector.

Even though it inherited more favorable initial economic circumstances, the Brazilian government of José Sarney (1985-1990) was, if anything, less diligent than the Alfonsín government in imposing fiscal austerity measures, and also failed to prevent a rapid escalation of the inflation rate and a precipitous collapse of the economy. However, Fernando Collor de Melo (1990-1992), who adopted a governing style comparable to that of Menem and also used the severe economic crisis to justify the adoption of draconian austerity measures and the concentration of decision-making power in the executive, failed to carry out significant fiscal reforms or to sustain initial accomplishments in respect to the public sector’s deficit.

In contrast with the cases of Argentina and Brazil, the Belisario Betancur (1982-1986) government in Colombia responded to the country’s worsening external balance and public sector deficit with a significant fiscal adjustment program, including tax reforms, which rapidly closed
the budget deficit and kept a lid on inflationary pressures. With public sector finances already in relatively good shape, the Virgilio Barco government (1986-1990) enacted a major tax reform, further reduced the fiscal deficit, and kept the inflation rate comparatively low.

Thus, if the cases of Uruguay and Colombia show that the sharp degeneration of the economy experienced by Argentina and Brazil was avoidable, the failure of the Collor de Melo government in Brazil raises questions about the centrality of economic conditions in accounting for governmental success in imposing costly fiscal adjustments and reforms. Similarly, the experience of the Lacalle government in Uruguay suggests that the requisites for short term management of an economic crisis may be different from those necessary for carrying out more fundamental transformations of the economy.

Clearly, the variation in the pace of governmental progress in carrying out fiscal adjustment and reform cannot be accounted for by focusing solely on differences in initial economic conditions. Rather, this dissertation will argue that the severity of the economic crisis is one among a number of environmental factors which affect the calculations of politicians about the political costs and benefits of supporting fiscal adjustment measures and reforms. Other such factors are public and elite perceptions of previous governments’ policies, the magnitude of international economic and political pressures, and the pressures of societal groups. Thus, by substantially increasing the costs of inaction and magnifying the potential political benefits, experiences with high inflation definitely increase the incentives for politicians to support far-reaching reforms.

But, political institutions and other more contingent political factors are viewed to play a central role in mediating the influence of such forces on governmental policy choices and in
affecting governments' capacity to sustain the reform effort once the initial crisis dissipates. These political factors structure the incentives faced by governing politicians and affect the chances for building and sustaining a pro-reform political coalition. In particular, the level of polarization and fragmentation of the party system, the degree of centralization of governmental authority, and the nature of the governing party's relationship with key interest groups are viewed to play an important role in influencing the possibility that a sufficiently broad national political coalition can be forged and sustained around the objective of reforming the fiscal system. But, the nature of the influence of these institutional factors is affected importantly by more contingent political factors, such as the extent of the president's and governing party's electoral mandate and the security of the government's tenure in office, which can be undermined either by impending elections or by threats from the military or guerrilla forces. Taken together, these institutional factors and more circumstantial political factors influence how governing politicians weigh the political costs and benefits of carrying out fiscal adjustments and reforms and their power to command a majority in the congress and to control the fiscal behavior of subordinate levels of government.

Though the role of institutional factors in accounting for variations in economic policy choices and performance has been a principal focus of recent research focused on the advanced industrialized countries, such factors have, until recently, been largely ignored in investigations of developing countries. Research on the political economy of development in Latin America has been dominated by neo-Marxist/dependency and state-centered explanations. Given the broad variations in the timing and scope of fiscal policy reforms, and the rapid and sweeping nature of such changes in particular cases, neo-Marxist and dependency type explanations, which
emphasize such factors as the constellation of domestic or international social classes, are clearly inadequate. The balance of power between domestic classes or social groups could not have changed so rapidly as to have allowed such dramatic shifts in development policy. Though the pressures of business and labor groups clearly exert an important influence on fiscal policy-making, their particular weight in the decision making process is determined not only by their economic and political power but by the manner in which they are represented in the political system and the power and resources of the executive.

Similarly, while changes in the international capitalist system, such as the reversal in the direction of capital flows and pressures from foreign creditors, may help explain the general shift toward more market-oriented development policies, they cannot explain the variation in the pace of reform between different countries in the region. Because of the intervening role of political institutions, the pace and scope of government responses to these pressures varies, even though all may be pushed in a similar direction.

State-centered explanations, which attempt to relate policy choices to “state interests” and the implementation of dramatic policy shifts to attributes of the state, including its “relative autonomy” from social forces, and its “cohesiveness” and “capacity,” also do not provide much help in accounting for the particular ways in which governments responded to the debt crisis. The insulation of the state (or, particularly, economic decision-makers) from the pressures of societal interests undoubtedly helped governments to carry out reforms which were harmful to groups with a vested interest in the continuation of statist and protectionist policies. But, because of the lack of attention to the role of political institutions, studies of economic policy-making focused on the state have not been very successful in operationalizing the concept of autonomy or...
in accounting for why some states (or governments) appear, by their policy actions, to be more insulated from societal forces than others.

The Argentine Case: The Contrasting Experiences of Menem and Alfonsín

In much of the post-War period Argentina was notorious, even within the Latin American context, for the ineffectiveness of its tax system and constant difficulties in managing the budget and controlling inflation. Underlying the recurrent bouts with inflation and budgetary instability was the high level of conflict between opposing social and political groups and the resulting policy stalemate, which prohibited any consistent policy solution from being applied over a long period of time. Though repeated attempts were made to stabilize the economy, the impossibility of developing a consensus at the political level prevented these attempts from bearing fruit. Neither the governments of the first bureaucratic authoritarian regime (1966-73), nor the popularly elected Peronist government (1973-76) were able to raise taxes or curb spending in a sustained manner and each failed to permanently lower the budget deficit or contain inflation. The government of General Jorge Videla during the “Process of National Reorganization” (1976-83) managed to significantly increase tax revenues but, partly because of conflicts between the military’s corporate interests and the free market objectives of the economic team, it was unable to control the growth of spending and could not maintain control over the deficit of the public sector. The consequent collapse of the government’s monetarist economic experiment produced a public financial and economic crisis which was unprecedented even by Argentine standards.

One of the manifestations of this prolonged social and political stalemate and the poor performance of the economy was the steady deterioration in the quality of the public
administration, which also severely eroded the effectiveness of the tax administration (Dirección General Impositiva - D.G.I.). In addition the scope of tax exemptions grew over time and the Argentine public became more willing and adept at eluding the D.G.I. The frequent granting of tax amnesties exposed the government's incapacity to adequately enforce tax payments and further sanctioned and encouraged taxpayer non-compliance. The pervasiveness of tax evasion and the ever-expanding reach of tax exemptions severely undermined the importance of potentially more efficient taxes such as the income tax, and later on, the VAT. Governments satisfied the state's growing appetite for revenues by relying increasingly on non-generalized indirect taxes and taxes which were easy to administer but which subjected the economy to great distortions. The other areas of the public sector were in bad shape as well. The social security system was being sustained only by recourse to emergency sources of funding and reductions in benefits; the provinces were being starved of federal revenues; and many public enterprises were staying afloat only through extensive state subsidy.

Despite the severity of the economic crisis bequeathed by the military regime and its previous governments, there was considerable hope that the new democratically elected government of Raúl Alfonsín would finally be able to get the economy on a positive and sustained growth track. Conflict between social and political groups appeared to be attenuated as a consequence of prolonged economic stagnation, the severity of the immediate crisis, and the highly traumatic and violent experiences of the preceding decade. In response to the crisis, the Alfonsín government at first attempted to employ the populist formulas used in the 1960s by previous Radical Party governments. But, when inflation began to march out of control, the government launched the Austral Plan - an innovative adjustment package combining wage and
price controls and a serious attempt to reduce the fiscal deficit. As a part of this plan, the government proposed a significant tax reform which aimed to markedly increase revenue collection, broaden the income tax base, strengthen the government's capacity to monitor taxpayers and punish offenders, and restore some measure of redistributive equity. But, while revenues surged in the first year as a result of the sharp reduction of inflation, the reactivation of the economy, and the imposition of temporary taxes, the reform itself failed to correct the problems which plagued the tax system and the buoyancy in revenue collections quickly turned flat (Ministerio de Economía, 1989; Carciofi, 1990).

In addition, the government could not hold down public sector expenditures, especially in the months prior to the October 1987 congressional elections and proposals for deeper reforms of the public sector were blocked both by disagreement within the government and by opposition in the Congress. Though the government achieved some control over growth in spending by the central government, given the absence of an explicit revenue sharing regime, it could not contain the rapid increase in spending by the provincial governments.

Most analysts agree that the failure of the government to more permanently increase revenues and contain spending was an important cause of the revival of inflationary pressures and the breakdown of the Austral Plan (Machinea, 1990; Broda, 1987; Heymann, 1990; Heyman and Navajas, 1989; Machinea and Fanelli, 1988; Canavese and di Tella, 1988; Carciofi, 1990). The government could not rescue the adjustment package or brake the inflationary inertia with the emergency tax measures it managed to enact at the end of 1987 and 1988. As a result of its failure to more aggressively attack the causes of inflation, in the midst of runaway inflation and
massive capital flight, the Alfonsín government and the Radical party were sharply rebuked by
the Argentine public in the 1989 presidential and congressional elections.

Carlos Menem, the candidate of the historically populist Peronist Party, seized on this
disillusionment by winning a landslide electoral victory over his Radical Party opponent -
Eduardo Angeloz. Given the well-founded fears that society and the economy would descend
into chaos if Alfonsín's lame-duck presidency continued for six more months, Menem assumed
office six months ahead of schedule in July 1989. Confronted by these extremely unfavorable
economic circumstances and given special leeway by the extra-constitutional nature of his
inauguration. Menem surprisingly launched a series of tough adjustment programs and initiated
sweeping free market reforms. In marked contrast with his predecessor. Menem managed to
dramatically increase revenue collection through successive tax reforms which greatly expanded
the bases of the income and value added taxes, eliminated many low yield and inefficient taxes.
lowered top marginal tax rates, eliminated export taxes, and significantly reduced the level of tax
evasion. Though the tax system still fell far short of that of most advanced industrial countries in
terms of the level of compliance and the emphasis placed on direct taxation. it was made much
more neutral in its economic effects and much simpler to administer. As a result of the
revolution in the tax system and far-reaching reforms of the public sector, the Menem
government sustained a fiscal surplus from 1992-1994 - a feat not accomplished since the 1940s -
and brought inflation down to American and Northern European levels. The revenue collected
from modern and efficient taxes such as the VAT and the income tax jumped from 5.6% and
2.8% of total public sector financing in 1989, respectively. to 31.2% and 10.6% in 1994
(Secretaría de Hacienda, 1995).
Political Dilemma: Choosing between Unappealing Alternatives

The political-institutional explanation advanced in this dissertation centers attention on the role of politicians who are viewed to rationally weigh the political costs and benefits of carrying out fiscal adjustments and reforms in the face of institutional and environmental incentives. This section examines in more detail the nature of the dilemma which politicians confronted in choosing how to respond to the debt crisis.

The sharp reduction in commercial bank lending and higher world interest rates in the early 1980s meant that debt burdened Latin American countries suddenly had to generate sizable trade surpluses in order to earn the hard currency necessary to finance large interest payments. But, since, in most cases, the bulk of the external debt was owed by the public sector, the hard currency earned from exports had to be purchased by governments using resources from the national budget. Thus, at the same time that foreign borrowing was no longer a viable option for financing recurrent budget deficits, huge foreign debts suddenly had to be serviced almost completely out of government revenues. Governments had a range of options for dealing with the predicament arising from this abrupt reversal in the flow of international capital, but each alternative presented serious risks and costs. First, governments could take a hard line approach with international creditors and refuse to make full debt payments, declare a moratorium, or openly default on debt payments. But, since open default would likely bring strong retaliation from creditor governments and deprive such countries of access to foreign capital, without cooperation among debtor countries, it was not perceived as a viable option. In fact, though governments in Peru, Brazil, and Argentina suspended debt servicing for short periods during the 1980s, each made it clear that this action did not signify a default.
In the short run, the approach with the lowest political cost was to delay fiscal adjustment by printing money or incurring in more domestic public debt. Borrowing from national citizens was less inflationary than money creation but it added to governments' already large debt service burden and increased interest rates. In addition, in many cases governments were not sufficiently creditworthy or the financial system not sufficiently strong for such financing to be at a level that would be helpful. Printing money could only buy time for a more fundamental adjustment since the inevitable result was increased inflationary pressures, which eroded the value of wages, generated great uncertainty and risks for investors, and diminished the credibility of the government. As more well-to-do individuals increasingly took refuge in capital flight, the rate of inflation needed to finance a given fiscal deficit grew appreciably (Labán and Sturzenegger, 1994). In addition, the increasing rate of inflation reduced the real value of tax collections and increased interest payments on the government debt, which added to the size of the budget deficit. Thus, in the medium to long term such a strategy tended to exacerbate social conflict, reduce investor confidence, and increase the risk of hyperinflation.

Another alternative was to finance the debt by reducing public expenditures. The initial response of governments to the onset of the crisis was typically to let public sector salaries lag relative to inflation and to reduce investment spending. But, further cuts in investment spending would seriously undermine the future growth prospects of the economy and additional reductions in pension benefits and public salaries would be highly detrimental to the welfare of an important part of the population and might provoke wide-scale protests and rioting. In addition, a large portion of the increase in government expenditures - interest payments on the foreign debt - could not be reduced unless rescheduling agreements with creditors could be brokered or a unilateral
moratorium declared. Thus, given the already poor state of public services and infrastructure, and heavy public resentment against paying fully for debts incurred in most cases by private corporations or illegitimate governments, without far-reaching reforms of the public sector it was doubtful that the deficit could be lowered substantially.

The fourth way for governments to finance deficits was to increase tax revenues. One of the major obstacles which stood in the way of tax reform was the intense resistance of organized social groups to absorbing a larger tax burden. Because of stagnant economies and extremely high interest rates, the bulk of the business sector found itself in a weak financial position and was fiercely opposed to paying higher taxes or having existing privileges revoked. With real salaries in decline and living conditions worsening, workers also ardently resisted tax increases. In addition to the resistance of organized groups, the weakness of tax enforcement agencies and the high level of social tolerance for tax evasion were typically other important barriers blocking the ability of governments to increase revenue collection.

Though governments faced broadly similar tradeoffs in choosing among these options, as we have seen, there was great variation in the nature and timing of policy responses. In some cases fundamental fiscal reforms were implemented after a relatively short delay, while in others reforms were postponed until the economy reached the brink of hyperinflation. Thus, what needs to be explained is why some governments decided to initiate, and succeeded in implementing, fundamental reforms before the economy suffered the evil effects of runaway inflation, while others failed to head off such traumas.

As we have seen, one of the principal driving forces behind the initiation of tax reforms was the need to replace inflationary means of financing fiscal deficits with genuine tax revenues.
The goal of economic stabilization, however, could be addressed either through piecemeal changes in the tax system or more comprehensive reforms. That is, one approach, which could be effected more immediately and with less political risk and administrative difficulty, was to leave rate structures and tax bases relatively intact while increasing tax rates and creating new, often temporary, taxes on specific goods or types of economic activity. Though this approach sometimes boosted tax revenues it also greatly reduced the equity and efficiency of the tax system and often provided only a temporary improvement in the fiscal situation.

Another approach which required a longer time frame and was more difficult politically (and administratively) was to carry out a more comprehensive restructuring of the tax system entailing an expansion of tax bases, a simplification of rate structures, the elimination of small, economically inefficient taxes, and an improvement in the efficiency of tax collection. In the case of this more sweeping approach to fiscal adjustment, the objective of tax reform merged with the broader liberal economic project of reducing state interference in the economy which became more influential in the late 1980s and early 1990s.

From the perspective of the World Bank, IMF, and creditor governments, for whom neoclassical economics had become the operative paradigm, interventionist and market-distorting features of tax systems had detrimental effects on economic performance as serious as those arising from other vestiges of the post-War import-substitution development strategy such as trade protection, price controls, large public business sectors, and foreign investment restrictions. Excessively high top marginal tax rates, sectorally or regionally targeted tax exemptions or deferments for industry, export taxes, high payroll taxes, and sector-specific taxes were all seen as producing inefficiencies in resource allocation and discouraging needed investments. Given
the scarcity of international financial capital, low domestic savings rates, and large government budget deficits, the need to attract foreign investment also became a factor guiding tax policy changes. The manipulation of tax rates and bases to promote industrial development or to redistribute income was considered to contribute to widespread tax evasion and to impose undue hardships for tax agencies which typically had limited resources, antiquated information systems, and poorly trained and under-compensated staffs.

Proponents of this neoliberal view of the role of tax policy in developing countries advocated the following types of reforms to correct the above deficiencies and to make tax systems compatible with more open trade regimes: the broadening of tax bases, elimination of tax exemptions and loopholes, rationalization of rate structures, lowering of top marginal income tax rates, reduction of the role of trade taxes and sector-specific taxes, elimination of low-yield and inefficient taxes, adoption of a generalized value-added tax (VAT), and the strengthening of the tax administration. The broad aim of these changes in terms of free market thinking is the creation of a more economically neutral tax system - one which encourages resources to be allocated optimally and does not discourage engagement in profit-making activities or impose biases against production for export (World Bank, 1991; Bird and Casanegra, eds., 1992; Gillis ed., 1989; Khalilzadeh-Shirazi and Shah eds., 1991; Bird, 1992).

Redistributive Characteristics of Neo-liberal Tax Reform

There are few public policy changes with such a far-reaching and profound redistributive impact as tax reforms. Because changes in the tax system typically entail important transfers of income from some social groups and economic sectors to others they typically give rise to intense conflict and opposition. This section will briefly examine the income redistributive
characteristics of neo-liberal tax reforms in order to anticipate the pattern of societal support and opposition which they are likely to provoke. In addition, it will show that concerns that such reforms would significantly widen income disparities between the rich and poor were overdrawn.

Neo-liberal tax reforms, which have entailed sharp reductions in the reliance on taxes from foreign trade, reinforce the harmful effects which other steps toward trade and capital liberalization have on the previously protected, import-competing sectors of the economy (Tables 1.2 and 1.3). Import-competing sectors were favored and export sectors harmed by tax subsidies targeting industries producing for the local market, and by revenue systems which relied heavily on import tariffs and export taxes. In addition, export-oriented industries benefit from the adoption of a VAT (or another form of general sales tax) which allow them to recoup the taxes paid on inputs.

On the other hand, small and medium-sized business, in many cases, have seen their tax burdens increase as a result of the more efficient collection of payroll (social security) taxes, which became a major revenue source for many countries, VAT and income taxes. In many countries, small businesses, which are far more abundant in the underdeveloped South American context, greatly under-reported the extent of their sales and the size of their income. Though small businesses continued to elude the tax collection agency, reforms of the tax administration and increased penalties for evasion, enabled them to be taxed more heavily than in the past. Improved collection of social security contributions also entailed a larger tax burden for self-employed workers who routinely ignored their obligations in the past.

Economic interests tied to foreign corporations have also benefited in some cases as a consequence of the equalization of tax burdens for multinational corporations with that of local
companies. In addition, partly because of enforcement difficulties, the elimination of taxes to capital, and the exemption of interest income from the income tax, the finance sector in many countries has not shared equally in the increase in the overall tax burden.

Looking only at changes in the legal tax system, neo-liberal reforms would appear to impose greatest sacrifice on lower-income citizens. The importance of indirect taxes has increased markedly, in some cases as a result of substantial increases in sales or value-added tax rates and the application of this tax to a broader range of goods and services (Tables 1.4 and 1.5). The goals of neutrality and administrative efficiency have in some cases led policy-makers to eliminate exemptions or special treatment for goods which are central to the livelihood of poor individuals such as food, medicine, and clothing. The increases in indirect tax rates, including excise taxes (on fuels, cigarettes, alcohol etc.) often added to substantial increases in the costs of public services which were usually subsidized in the past. All things being equal, the increased reliance on broad-based sales taxes and social security taxes would be expected to be more detrimental to low-income taxpayers who spend a disproportionate share of their earnings on immediate consumption and whose income is primarily derived from salaries. In addition, the decreased role of property taxes and capital gains taxes and the lowering of top marginal income tax rates for individuals and corporations would appear to reduce the tax burden for more affluent taxpayers.

However, if a comparison is made between the previous tax system as it functioned in practice and the post-reform environment, neo-liberal reforms do not appear as regressive. While the pre-reform tax structures in many cases were characterized by high rates and progressive scales, only a very small proportion of total revenues were collected from property and income
taxes because of the high levels of tax evasion and the pervasiveness of tax loopholes (Tables 1.6 and 1.7). Thus, though marginal tax rates have been lowered, the elimination of tax exemptions and deductions and more rigorous enforcement means that in some cases the tax burden for corporations and upper-income taxpayers may have actually increased. Widespread evasion of sales (and value-added) taxes meant that though consumers paid higher prices, retailers and wholesalers often retained the income from these taxes for themselves. In addition, the substitution of legal and transparent taxes for the inflationary tax has had a progressive effect since inflation has a much more erosive effect on the income of the poor. As Juan Lopez points out, pre-reform tax systems not only permitted proprietary classes to pay a disproportionately low share of their income in taxes but also allowed many of these same taxpayers to reap large profits lending money at high interest rates to a state unable to finance the government through normal taxes.8

On the other hand, if one does not accept the assumption that administrative constraints limit the feasibility of more adequately enforcing direct taxes on income and property or establishing less regressive sales taxes, then the debate is still open regarding whether a more progressive tax system is compatible with a stabilized economy. Thus, taking into account the impact of the inflation tax on real wages and the high levels of tax evasion, pre-reform tax systems may have been as regressive as reformed tax systems. Still, this does not mean that a more proportionate or progressive tax reform could not have been adopted as a part of a strategy for adjusting fiscal imbalances and stabilizing the economy. In fact, recently, Argentina, Brazil, and Mexico have reintroduced taxes to economic wealth in their search for additional tax bases and ways to restore some equity in the tax system.
But, while the objective impact of tax changes is what is most important to academic economists, what is likely to be most important in determining reactions to reforms are public *perceptions* about their redistributive impact. In this sense, there is little doubt that the large increase in the taxation of consumption goods has, in many cases, been perceived as highly regressive and unjust.

**Why In Many Cases Are Economically Beneficial Reforms Delayed?**

Thus, because they usually entail significant shifts in income from certain social groups and economic sectors to others and often imply increases in the absolute burden of taxation for each taxpayer, initiating fundamental fiscal reforms is thought to be highly risky and costly for politicians. But, if fiscal reform holds the promise of increasing economic growth (by making the tax system more economically efficient) and reducing the heavy social and economic costs of high inflation, one can question why, in the context of runaway price increases and large budget deficits, political leaders would fail to initiate, and societal groups would oppose, such reforms. In other words, if high inflation makes everyone worse off and erodes the popularity of the government in power, why are reforms not adopted more preemptively?

Without assuming that policy makers or interest groups are myopic or irrational there are several explanations which have been put forward to explain the delay of necessary policy reforms. One explanation centers on the short time horizons of government leaders and policy makers. Since fiscal reforms, like other types of economic reform, impose immediate costs on social groups but yield benefits only in the medium to long run they present an important political "dilemma" for governing politicians. When presidential or parliamentary elections are imminent, or there are serious threats to the government's tenure arising from the military,
guerrilla movements, and/or labor union militancy, the time horizons of government policymakers and congressional politicians are likely to be compressed (Ames, 1987; Haggard and Kaufman, eds., 1992; Haggard and Webb, eds. 1994). Thus, when governments face mid-term congressional elections or feel threatened by non-electoral challenges to their power, they are likely to be less willing to initiate reforms which entail large short term costs and provide benefits only in the future. The time lag between costs and benefits also means that reforms are more likely to be initiated and successfully implemented soon after a newly elected government takes office and are least probable in the period preceding major elections.

Another reason why reforms which are optimal for society as a whole are nonetheless difficult to implement is that the costs of tax reform tend to be concentrated on already well-organized and powerful groups while the benefits are diffuse and potential beneficiaries are poorly organized. Thus, because of the distributive characteristics of tax reform, the potential losers tend to have the upper hand. For example, while individual taxpayers and export-oriented industries would benefit, at least indirectly, from reforms which eliminate tax shelters promoting import-competing industries, they are likely to be less well-organized and less actively involved in the policy process than industries which have long benefited from import substitution policies.

The emergence of a pro-reform coalition is more unlikely if it is assumed that there is uncertainty about the nature of the reform which will result from the negotiation process and about what its impact will be on the performance of the economy (Fernández and Rodrik, 1991; Ascher, 1989). Groups may prefer the status quo despite the high costs of inflation if they are uncertain what proportion of the costs of adjustment they will be forced to absorb or if they are not convinced that the proposed reforms will really help reduce the inflation rate (Labán and
In addition, reform may not be the preferred option if there are philosophical disagreements about the optimal approach to solving the fiscal crisis. Some groups supporting greater fiscal responsibility and lower inflation may prefer reductions in spending to increased taxes. Other groups, such as labor and those on the Left, may refuse to accept the consensus of economists that eliminating fiscal deficits should be a top priority, or may think that the adjustment burden should be shouldered by the wealthy.

Similarly, a stalemate in respect to reform can result from a struggle between social groups of comparable strength regarding how the burden of taxes and expenditure cuts should be shared. Groups which fear that the costs of proposed adjustment policies will exceed the costs of living under moderate levels of inflation will initially oppose reforms. From this perspective, economic crisis (or hyperinflation) alters the calculus of costs and benefits for social and economic groups and makes reform more likely. When inflation becomes very high reform is more likely, in part, because all groups suffer and are now more prepared to accept sacrifices. But, as Labán and Sturzenegger point out, very high inflation may also help end the stalemate which may exist between groups representing capital and labor since workers tend to suffer more under high inflation and are, therefore, prepared to make deeper concessions (Labán and Sturzenegger, 1994; Alesina and Drazen, 1991; Drazen and Grilli, 1992).

Though recent contributions by political economists have helped explain why rational agents often delay carrying out necessary fiscal reforms (Rodrik, 1996), because of their deficient attention to the role of political institutions they are unable to explain why the pace of adjustment varies significantly between countries and governments. What characteristics of particular
polities and societies permit more timely "agreements" to be reached among societal groups about how the costs of adjustment should be shared?

**Approaches to Explaining Fiscal Policy Choices**

A cumulating body of literature has examined the factors affecting the timing and scope of developing country government policy responses to the debt crisis (Nelson ed., 1990; Haggard and Kaufman, 1989; Haggard and Kaufman, eds. 1992; Nelson, 1993; Stallings and Kaufman, eds., 1989; Nelson, ed., 1989). In this literature government adjustment policy choices have been distinguished by their "heterodox" or "orthodox" character and the extent to which structural reforms, considered as a general package (including trade liberalization, privatization, tax reform, and deregulation), were pursued. The basic approach followed in these studies was inductive, with a wide array of factors being considered as potentially exerting an influence on adjustment policy choices and policy implementation. While this research provides a valuable starting point by providing a preliminary survey of the factors affecting adjustment decisions and by generating hypotheses for further examination, the lack of more focused comparisons limits progress in building theory.

Particularly absent in this literature is any attempt to examine the political factors underpinning variations in the degree and nature of changes in tax systems adopted across the region. Most studies focused on tax reform to date have been carried out by economists. They tend to treat the decision to launch tax reform as springing automatically from prevailing economic conditions and view the process of policy-making as one limited to the resolution of technical issues. Though these scholars frequently make general references to the political constraints impeding tax reform, the political dimensions of reform are not systematically
brought into the analysis. While there is little doubt that in most cases perceptions by policy elites of an existing or impending economic crisis helped put tax reform on the policy-making agenda, this does not go far in explaining the specific actions taken in particular countries. Fiscal crises can be resolved by short-term expenditure reductions and tax increases or through more fundamental reforms. Government diagnoses of economic problems and proposed solutions are clearly shaped by the political interests and ideologies of government officials and the lobbying of other social and political groups as well as by technical criteria.

Though there has been little attempt to systematically examine the political factors affecting governmental tax policy decisions per se, much insight can be drawn from the substantial body of research which has examined the impact of political variables on economic policy reform and the reciprocal effects of processes of economic adjustment on the consolidation of new democracies (Przeworski, 1991; Bresser Pereira, Maravall, and Przeworski, 1993; Haggard and Kaufman, 1995; Nelson, ed., 1994; Smith, Acuña, and Gamarra, eds., 1993; Bates and Krueger, 1993).

Societal Theories

Among the approaches which squarely addresses the political determinants of economic policy is that focusing on the influence of socio-economic groups or classes. According to this perspective, government policies reflect the outcome of conflict among competing social groups. While a pluralistic conception of the policy process has generally prevailed in the study of advanced industrial democracies, the study of public policy in Latin America has been dominated until recently by those taking a class analytic or neo-Marxist/dependencia approach. For these scholars, major economic policy changes result from shifts in the class or class alliances which
provide the principal base of political support for the government (or, in neo-Marxist terminology which "comprise the state"). An important contribution of this type of approach is the attention that it places on the need for coalitional support for policies and the constraint imposed on the range of policy alternatives by the balance of societal forces.

But, society-centered explanations do not appear to be capable of accounting for the swift and profound nature of the economic reforms which took place in many Latin American countries during the 1980s and 1990s (including that in Argentina from 1989 to 1993) or the variation in the timing and scope of reforms between cases. Cases studies focused on the developing countries have not found that free market and public sector reforms were adopted in response to demands by significant societal groups. Rather, such reforms typically were strongly resisted by labor unions and industrial organizations, which had a vested interest in the maintenance of the protectionist and statist development model (Bates and Krueger, 1993; Haggard and Kaufman, 1995). While it is likely that export-oriented and internationally competitive economic sectors were strengthened by changes in the international economy, such as the increased globalization of production and the increased dependence of governments on domestic sources of capital and foreign exchange, it does not appear that reforms resulted from interest group pressure. In addition, since these international forces operated fairly uniformly across the region they cannot explain the variation between cases in the timing of fiscal adjustment and reform.

One of the major deficiencies of explanations focused on the role of societal groups is that they neglect the institutional factors which shape the political power and interests of social groups. I will argue that the reaction of societal groups to given policy changes and the extent of
their influence on policy outcomes is importantly conditioned by political institutions, including the structure of the party system and the organizational characteristics of political parties and the nature of parties' links with societal groups. In addition, the reaction of important economic groups to policy initiatives and the extent of their influence on policy formulation often depends as much on reform tactics, their political identities and attachments, and the president's popular appeal as on the expected material impact of policies.

For example, an important insight of class-analytic approaches to the analysis of economic policy-making in capitalist economies is the notion that governments are constrained by the need to maintain a climate favorable toward business investment (Block, 1975; Cardoso 1973; Evans, 1979; Hirschman, 1981; Lindblom, 1977). If owners of capital decline to make productive investments or choose to invest their capital abroad, then the economy will stop generating jobs, incomes will fall, the state will go broke, and the government will likely lose its legitimacy. The need for the government to maintain the confidence of large business interests is likely to be especially critical to the task of reforming the tax system. The ever-present possibility (especially in small, underdeveloped economies) that local and foreign capitalists will exercise the option to "exit" - investing in speculative, rather than productive activities or sending their capital overseas - is an important constraint on efforts to increase taxes on business activity. If capitalists exercise their market "veto" against a tax reform either by refraining from investment or by evading tax payments, then the resulting fall in economic output and loss of revenues could make the reform counterproductive. Maintaining the confidence of business in the government's management of the economy seems especially important in the case of tax reforms which eliminate many of the tools which were previously used by the state to induce
businesses to invest (such as tax deferrals and exemptions and lenient and discretionarial
enforcement).15

But, while the need to foster capital investment undoubtedly imposes a constraint on
government policy-making, the government’s overall relations with business groups and its
broader economic policy agenda is likely to affect the intensity of the "voice" or "exit" response
to tax reform. If business groups are confident that the paying of higher taxes will be
compensated by other policies and overall economic trends conducive to the profitability of their
investments, then their opposition to tax reform will probably be less strong. The government
can help obtain the confidence of business groups by establishing a record of consistency in
regard to economic policies and rhetoric; by providing clear signals that it will not be tempted to
pursue destabilizing, populist policies; by adopting and committing to other policy reforms
favorable to the interests of the more powerful business sectors; or by offering to business
interests a larger share of power in government decision-making. Business opposition to the
elimination of tax exemptions and increases in particular taxes may also be reduced by
compensating changes in tax policy (such as reduced taxation of investment and profits).

The State in Economic Policy-Making

Recently a body of literature has emerged which has asserted that the state should be
considered to be more autonomous from societal pressures than conjectured in previous models
of policy-making. From this perspective, the state has interests and policy preferences of its own
and is sometimes able to impose these preferences despite societal resistance. For example,
development country specialists have identified relatively autonomous, cohesive, and strong
states as a principal factor permitting dramatic shifts in development policy and rapid rates of
economic progress in the newly industrialized countries (NICs) of East Asia and Latin America (Haggard, 1990; Evans, Rueschmeyer and Skocpol, 1985; Wade, 1990). Such states have also been seen to have an advantage in efforts to carry out economic adjustment programs and to implement free market reforms (Skidmore, 1977; Nelson, 1990; Haggard and Kaufman, 1992).

Research centered on the state has made an important contribution by confirming that public officials often are able to act independently of powerful societal interests and by identifying some characteristics of the state structure which can affect the policies which are chosen. But much of the research on economic stabilization and adjustment which has followed this approach has been less successful in specifying what state autonomy is or where it comes from, and in providing an explanation of policy choices. The vague and overly abstract nature of the state autonomy variable complicates its operationalization since it is difficult to measure independent of the outcomes which it is predicted to influence. As a result, the notion of state autonomy does not provide the analyst much leverage in accounting for the particular policy choices governments make or their capacity to implement them (Liddle, 1992). If the formation and implementation of technically sound responses to economic crises requires the insulation of economic decision-making teams from societal pressures, then what characteristics of the state, political, or social system provide these buffers? And, if government officials are insulated from societal influences, then what determines their policy choices?

One approach through which scholars have attempted to relate characteristics of the state more directly with policy choices is to focus on the notion of "state capacities". For instance, Stephan Haggard has argued that the economic policy instruments which a government chooses to emphasize in response to international market shocks are partially determined by the capacities
of the economic bureaucracy (Haggard, 1990). Following this logic, it is reasonable that
government choices of fiscal reforms would be influenced by policy-makers' perceptions of the
capacity of the tax administration. For example, when the tax administration is known to be
weak, one would expect policy-makers to emphasize tax measures which are relatively simple to
enforce. Of course, a longer term goal of tax reform then might be to improve the efficiency of
the tax administration in order to permit more complex taxes to be effectively applied.

Clearly, the ability of decision-makers to adopt and implement policies which are
harmful to the interests of powerful societal groups depends on the organization of society as
well as on the organization of the state. Thus, a better understanding of the bases for state
autonomy and capacity requires a more complete consideration of state-society relations and the
institutions which structure this relationship. As Peter Hall argues, the "state appears as a
network of institutions, deeply embedded within a constellation of ancillary institutions
associated with society and the economic system... We must be careful not to search for, and even
postulate, autonomy, when we should be sketching the institutional outlines and limits of societal
influence" (Hall, 1986).

A Political-Institutional Approach

In order to understand the willingness of political leaders to initiate controversial
economic reforms and their capacity to implement such reforms, it would seem to be more
fruitful to focus on particular sets of political institutions. Political institutions not only mediate
the influence of organized societal interests, they also structure the incentives facing politicians.
For example, it is expected that representative and electoral institutions which afford narrow
sectoral and regional interests greater influence will constrain governmental efforts to carry out
tax reforms aimed at simplifying the system and eliminating tax exemptions and loopholes. In addition, presidents are more likely to initiate and succeed in implementing comprehensive tax reforms when they can count on the backing of a majority of legislators in the Congress or when the constitution provides them with ample powers to control the legislative agenda.

Four sets of inter-related institutional variables are posited to have an especially important impact on the ability of governments to successfully carry out fiscal reforms: the degree of fragmentation and polarization of the party system, the cohesiveness and discipline of party organizations, the nature of the governing party's relationship with key interest groups, and the degree of centralization of governmental authority. But, the influence of these more durable features of the political system is affected importantly by more contingent political factors, such as the extent of the president's and governing party's electoral mandate and the security of the government's tenure in office. Government's sense of the security of their mandate can be undermined by the approach of elections, election defeats, or threats presented by the military or guerrilla forces. The combination of the party system structure, the cohesiveness of party organizations, and the fiscal federalist structure and the scope of the government's electoral mandate contribute and the security of its tenure in office affect the alignment of two variables considered to be critical to the enactment of comprehensive fiscal reforms: the government's power to command a majority in the Congress and it power to influence the fiscal behavior of subordinate levels of government.

However, institutions and these other more contingent political factors also mediate the influence of environmental variables, which, at least indirectly, affect the timing and scope of fiscal adjustments and reforms. The most important environmental factors are the severity of the
economic crisis and the magnitude of international economic and political pressures. In addition, the legacy of the country's recent political and economic history constrains economic policy-making decisions. The manner in which governments respond to economic shocks is affected by public and elite perceptions of previous governments' policies.

Due partly to the fact that democracy as a form of government has not thrived in most of the developing world, and also as a result of the previous dominance of approaches which downplayed the importance of the policy-making process, there has been little effort to study the impact of different democratic institutional arrangements on economic policy choices and outcomes. Several studies examined the question of whether significant differences in adjustment policy choices and outcomes could be found between authoritarian and democratic political regimes. However, it was understandable that a simple dichotomization of a variable as multi-faceted and multi-dimensional as political regime was found to lack predictive power when a broad range of cases were considered (Skidmore, 1977; Haggard, 1985; Remmer, 1986). But, a growing body of literature focused on the advanced industrial democracies has begun examining the importance of institutional differences in accounting for variations in government capacities to adjust to international economic shocks, to maintain low inflation rates and high levels of employment, and to contain budget deficits. 17

For example, the ability of governments to keep budgets in balance has been related to whether they control a majority of seats in the parliament, are supported by a coalition of parties, or control only a minority of the seats (Roubini and Sachs, 1989; Edin and Ohlsson, 1991; Grilli, Masciandaro, and Tabellini, 1991). Though differing somewhat in their conclusions, the starting point for each of these studies (whose sample of cases includes both parliamentary and
presidential systems) is the notion that governments which have to negotiate with other parties, and particularly non-governmental parties in the parliament, are less likely to be able to obtain a consensus behind spending reductions and tax legislation. Research focusing exclusively on the U.S. presidential system has found that presidents or governors facing legislatures controlled by the opposing party are less able to increase taxes or lower spending in response to fiscal shocks (Alt and Lowry, 1994; McCubbins, 1991; and Poterba, 1994). It is alleged that in the case of divided government there is a lack of accountability, as no party is uniquely responsible for policy, and this encourages the government and opposition party to engage in bidding wars rather than to work out a compromise solution (Schick, 1993).

Although differences in the structure of party systems and in the capacity of the president to command a majority in the Congress would be expected to affect the president’s ability to implement economic reforms, the role of these factors has not received much attention in the political economy literature focused on the developing countries. Nevertheless, the general literature on presidentialism presents a pessimistic view of the likely effectiveness of presidential governments, especially in the context of relatively fragmented and polarized party systems in which majority support in the Congress is improbable (Linz and Valenzuela, eds., 1994; Mainwaring and Shugart, eds., 1997). As Scott Mainwaring points out, executive/legislative deadlock is likely in presidential systems unless "(a) the president's party enjoys a majority in the legislature and regularly backs the president; (b) a coalition of parties provides a majority and regularly supports the president; or (c) the president does not enjoy a stable majority in congress but is able to govern by creating shifting coalitions" (Mainwaring, 1993). But, in the context of presidential systems there is less incentive than in parliamentary systems for legislative coalitions
to hold together because of the lack of clear lines of responsibility for policy outcomes and since parties and individual legislators which break from the government coalition do not risk the calling of new elections.

Clearly the likelihood of a fiscal policy stalemate within a presidential system depends on the level of party system fragmentation and polarization and the extent to which parties are disciplined. In cases of presidentialism where two relatively undisciplined and non-ideological parties compete for power, such as in the United States, not only is majority government more likely but also legislative compromises have a greater chance of being reached even when the opposition party controls the Congress since cross-party, ad hoc coalitions are possible. In addition, the parties' moderate, catch-all character reduces the chances that electoral competition will result in competitive bidding and an increasing polarization between the policy alternatives presented by the opposing parties.

In the context of two-party systems composed of highly disciplined and fairly ideological parties, governments enjoying a majority in Congress are likely to be quite powerful. On the other hand, if the opposition party controls the Congress, there is a greater likelihood of gridlock since deeper compromises are needed and there is a greater incentive for the opposition party to pursue a strategy of obstructionism to make the government fail and to maintain the ideological distinctions between it and the governing party.

Minority governments, where the governing party controls less than half of the congressional seats, are likely to be the norm in the case of political systems in which social cleavages, ideological divisions, and/or electoral rules (particularly proportional representation) result in fragmented party systems. If the party system is relatively polarized and parties are
highly disciplined, governments would be expected to have an especially difficult time holding
majority coalitions together and would be tempted to resort to extraordinary measures which
might threaten democratic stability. In addition, such systems have a tendency to produce an
increasing level of ideological polarization and the application of more extreme policy
approaches (Sartori, 1976). On the other hand, if the parties in such a system are not
programmatic and are relatively undisciplined there is a somewhat greater chance that
governments can put together ad hoc majorities. But, given the lack of institutional incentives for
legislators in presidential systems to support the government. the costs in terms of material and
other concessions to sectoral or regional interests may be quite high.

In summary, the most propitious circumstances for the enactment of comprehensive
fiscal reforms is expected to exist when the president's party and/or allied parties control a
majority of seats and the legislators and/or legislative block are/is well disciplined. When the
governing party does not control a majority of the seats in the legislature. the president is likely to
have an easier time building congressional support for major reform when there is only one
significant opposition party and when the parties are relatively undisciplined and non-ideological.

Significant reform is least likely in the case of presidents whose party controls a small
share of legislative seats and who confront a legislature divided between many parties. It is less
clear in this case what electoral rules and party structures would be more favorable toward the
passage of major tax reform. When parties are non-ideological and undisciplined, presidents may
have an easier time constructing ad hoc cross-party coalitions to approve legislation. But, if
parties are weak and undisciplined and electoral rules encourage legislators to prioritize the
interests of local constituencies rather than the interests of the national-level party, it may be
more difficult to gain approval for tax reforms which aim to make the tax code more equitable across economic sectors and regions (Shugart, 1995).

The analysis of the impact of such institutional differences on the likelihood of economic reform is complicated, however, by the fact that many Latin American political systems, either because of explicit constitutional rules or the lack of an independent and strong judiciary, allow the president extensive powers to declare states of emergency and to enact legislation by decree. Thus, presidents who lack congressional majorities may in some cases be able to avoid the difficult, and sometimes impossible, task of building legislative coalitions because they can bypass the legislature altogether. In addition to decree power, some Latin American constitutions grant presidents the power to partially veto legislation and provide the president exclusive powers to make decisions in respect to certain aspects of the budget and other economic policy issues. Such powers obviously affect the president’s leverage over congressmen, whether they are used explicitly or not. Thus, variations in the powers granted explicitly or implicitly to presidents also need to be considered in the examination of the impact of institutions on economic policy-making.

The process of fiscal adjustment and reform inevitably involves not just the central government but every level of government that controls a significant share of the total budget of the public sector. In the federalist systems of Argentina and Brazil subnational governments control close to half of all of the spending of the public sector. For public sector imbalances to be stabilized in a durable manner, then, it is necessary for the central government to induce lower levels of government to impose the costs of adjustment upon their citizens. When the fiscal federalist structure is relatively decentralized it is more difficult for the central government to
influence the budgetary behavior of subordinate levels of government and to gain approval for fiscal reforms in the national congress. But, this task is even more difficult when the governing party is weak and controls a relatively small share of the seats in the national Congress and of the political offices at lower governmental levels. Governments in such fragmented political systems face the difficult task of forging coalitions for reform which cut across both party and regional lines and have less leverage with which to influence the fiscal behavior of state governments. In such systems the process of forging majorities for particular reform measures typically entails sizeable handouts or concessions to regional political interests which undermine the fiscal adjustment process (Mainwaring, 1997).

Another institutional characteristic which is expected to influence the capacity of governments to carry out economic reforms such as tax reforms is the degree of institutionalization of the governing party and the nature of the relationship between the governing party and key interest groups. Presidents who enjoy the backing of parties with firm bases of political support and with close historical linkages with key interest groups, are likely to be better able to muffle societal resistance and retain broad-based political support. Aside from the links between the parties and key interest groups, the organizational strength and cohesiveness of such groups affects their level of influence on policy. A governing party with strong ties with the labor movement is likely to be better able to diffuse labor mobilization against policy reforms damaging to working class interests (Kelsey and Levitsky, 1994). But, when labor unions are weak and fragmented such ties may not be as necessary to the success of fiscal adjustment efforts.
When policies are formed with the explicit or tacit approval of organized groups they maintain a greater stake in ensuring their full implementation and success. But such inclusion of organized groups in decision-making may also require such great concessions that the consistency and efficacy of government policy is undermined. The most auspicious scenario for fiscal adjustment and economic reform is one in which the government, by virtue of strong institutional linkages between the party and labor or business groups, can coopt them, thus gaining their acquiescence without greatly compromising policy objectives.

But, the source of policy change is not found in the political institutional structure. Pressures from society, the economy, and the outside world are the principal forces triggering the process of policy change. In respect to fiscal adjustment and reform, perceived inefficiencies or inequities in the tax system, the deterioration of economic conditions, and/or mounting external economic and political pressures are usually the primary forces raising these issues on the agenda of policy-makers. And, in addition to the structure of political institutions, more circumstantial political factors, such as the size of the president's electoral mandate and the security of his tenure in office affect his capacity and willingness to undertake major changes in fiscal policy.

As argued above, severe crises alter the trade-offs for politicians in choosing between significant reforms and muddling through the crisis, and make societal groups more willing to accept short term sacrifices for the sake of future, and uncertain, benefits (Nelson, 1990; Bates, 1993; Haggard, 1990). External pressures from international financial institutions and creditor governments also affect the calculations of politicians regarding how best to respond to the fiscal crisis. By making the provision of additional loans and the rescheduling of foreign debts conditional upon the achievement of particular economic targets (typically lower budget deficits.
and reduced inflation) international financial institutions increase the incentives for politicians to carry out fiscal reforms. Certainly the worsening of the economic crisis and the tightening of international economic constraints help account for the fact that by the early 1990s many countries which had delayed reforms in the 1980s were enacting far-reaching reforms of the economy and public sector (Stallings, 1992; Kahler, 1992). In fact, the most radical fiscal reforms and most sweeping liberalization efforts were implemented in Argentina, Bolivia, and Peru, where citizens had just experienced the trauma of hyperinflation. Nevertheless, it is clear from the record of Latin American countries in the 1980s and 1990s that the nature of the responses of governments confronting similar economic conditions and comparable external constraints varies considerably. Political institutions play a critical role in structuring the incentives faced by politicians (in choosing how to respond to economic crises) and in affecting the possibilities for building and sustaining a social and political coalition in favor of reform.

Government policy responses are also shaped by perceptions of the effectiveness of previous governments’ policies. In Argentina and Uruguay, for instance, the catastrophic failure of the military governments’ neoliberal stabilization plans and economic programs and the association of these policies with authoritarian and exclusionary political regimes, had an important influence on the public’s perceptions of such policies. But, analysis of the contrasting experiences of the first post-authoritarian governments in Argentina and Uruguay will demonstrate the critical intervening role of political institutions in shaping how these past experiences influence policy choices.

Politicians’ freedom to maneuver in responding to economic crises is also affected by more circumstantial characteristics of the political context, including in some cases, the nature of
the transition from military rule. Each of the new democratic governments in Latin America faced important constraints on policy-making stemming from the need to subordinate the armed forces to civilian authority and to reconstruct, and reestablish respect for, democratic institutions. The relative lack of security of their tenure in office shortened their time horizons for designing policies and dissuaded them from undertaking controversial and politically risky economic reforms or adopting overly tough fiscal controls (Stallings and Kaufman, eds., 1989; Haggard and Kaufman, 1989; Nelson, 1993). But, depending upon the extent to which the military was able to control the process of democratic transition and dictate its terms, new civilian authorities faced different kinds of constraints.

For instance, the Argentine transition was characterized by the unplanned withdrawal of the military from power after its humiliating defeat in the War of the Malvinas. As a consequence, the military was temporarily demoralized and fragmented and was unable to impose conditions for the transferal of power or to secure its formal influence in the new democracy. However, the lack of negotiations between the political forces involved in the democratic transition meant that there was a greater chance for civil-military relations to become inflamed in respect to issues still in open contestation (such as the highly sensitive matter of human rights prosecutions). The sudden disintegration of the military regime also meant that there was no need for the two principal political parties to come to any kind of understanding regarding the policies which would be followed in the new democracy or how the parties would relate to one another. Therefore, in choosing economic policies, the Alfonsin government had to consider how alternative courses of action would affect its ability to stand up to acts of rebellion by the military and to maintain the stability of the new democracy.
In the Brazilian case, where the military was much better able to control the pace and terms of the transition to democracy, the armed forces retained much greater formal influence and were even able to prevent the direct election of the president. As a result, José Sarney, the first civilian president, faced more direct constraints on policy from the military and lacked popular legitimacy (a condition which was further aggravated by the fact that he came to the presidency only as a result of the sudden death of the candidate who was actually selected by the electoral college).

The security of a government’s tenure in office is affected not only by threats from the military and other non-electoral forces (such as guerrilla movements), but also from the scheduling of midterm congressional and gubernatorial elections. When a government must face such tests frequently it tends to shorten the time horizons of government policy-making, thus reducing the chances that reforms which have long term payoffs will be adopted. Of course, midterm elections may affect a government’s chances to bring about economic reforms more directly by reducing the share of congressional seats and local governments controlled by the governing party/coalition. In addition, the timing of elections is expected to influence the timing of the initiation of significant fiscal reforms. Newly elected governments enjoying a recent electoral mandate and facing a discredited or disorganized opposition are more likely to launch fiscal reforms and are also more likely to successfully implement them (Ames, 1987; Remmer, 1986 and 1993).

But, while institutional factors and these other more contingent features of the economic and political context importantly affect the trade-offs for politicians in choosing between different policy options and constrain politicians in their efforts to carry out economic reforms.
they alone do not determine governmental success in turning the economy around. Rather, the skill of politicians in seizing the opportunities presented by the institutional resources at their command, their initial support base, and the economic context is also critical to their success or failure. By manipulating the timing and sequencing of reforms, dividing potential sources of opposition, making timely concessions and other tactics, politicians can affect the scale of social protest which mounts against their policy proposals and the reaction of legislative politicians (Ascher, 1984; Hirschman, 1963; Liddle, 1992).

The Selection of Cases

The primary focus on two successive Argentine governments allows some measure of control over important aspects of the political institutional setting and social structure. Both governments operated within a presidential, democratic system and faced a Congress which was divided mainly between two major political parties - the Peronist Party and the Radical Party. They each formulated policy within a society which was comprised by one of the strongest labor movements in Latin America and well-organized and established industrial and agricultural lobbies. The Alfonsin and Menem governments also faced similar external economic constraints and domestic economic conditions: a large debt servicing burden, a highly restrictive international financial environment, and a severe crisis in public sector financing.

Nonetheless, there is little question that the ultimate failure of the Alfonsin government's economic policies, the growth in public disenchantment with the quality of public services, the experience with hyperinflation before Menem took office helped prepare the Argentine people for tough economic measures and profound reforms. In addition, the successful democratic transfer of power, the lower salience of the human rights issue, and the eventual
diffusion of tensions in civil-military relations during the early part of Menem's first term, provided the Menem government with a stronger political foundation for governing. Nevertheless, this study will argue that though the experience with hyperinflation and the failure of the Alfonsin government's economic policies eased the way for more fundamental fiscal reforms by the Menem government, this circumstance was not a necessary or sufficient condition for success. Rather, important features of the political institutional setting, such as the two-party system, Menem's ability, on most occasions, to count on majority support in the Congress (due to the hierarchical nature of the Peronist Party and the closed list electoral system), the Peronist Party's control over a majority of the provincial governments, and the strong historical ties between the Peronist Party and the union movement greatly contributed to the Menem government's capacity to sustain the austerity policies and fiscal reform drive despite repeated setbacks in the fight against inflation.

In order to more extensively examine the influence of political institutional and other more contingent economic and political factors on the timing and scope of fiscal policy reforms, the study also examines, albeit in less detail, the experiences of democratic governments in three additional South American countries during the 1980s: Uruguay, Brazil, and Colombia. As with most comparative analyses involving few cases, there is no perfectly scientific justification for the selection of these cases over others and there is the ever-present danger of selection bias. However, there are a number of plausible reasons why the analysis of these countries can help in clarifying the influence on fiscal adjustment and reform of the political factors argued to be important in the Argentine case.
First, there is considerable variation in the outcomes among these countries in respect to the timing and scope of fiscal reform and adjustment. Second, some broad institutional characteristics and environmental factors related to these countries are roughly controlled. All four countries were presidential democracies throughout the period. Each of these countries' economies absorbed the shock, albeit with different degrees of severity, of the sharp increase in international interest rates, the cut-off of international lending, and the pull-back of foreign investment accompanying the debt crisis which erupted across Latin America in the early 1980s. At the same time, there are important differences between the countries in respect to factors which are hypothesized to have an impact on governmental success in implementing fiscal reforms, such as the structure of party systems, the degree of centralization of governmental authority, the extent of the president's constitutional powers, the union movement's structure and ties to political parties, the severity of the economic crisis, and the prevailing perceptions of previous governments' policies. In addition, the set of cases presents some theoretically interesting paired comparisons with the Argentine case which can help clarify the links between the hypothesized causal factors.

For example, the first post-military governments in Uruguay faced constraints which were quite similar in type and magnitude to those faced by the Alfonsín and Menem governments in Argentina but the outcomes were very different. While the Sanguinetti government (1985-1989) was able to increase taxes and reduce the budget deficit in a sustained manner, keep inflation within manageable limits, and maintain positive rates of economic growth, the Alfonsín government could not maintain control over the budget or inflation and could not keep the economy growing steadily. At the same time, neither the Sanguinetti nor the Luis Alberto
Lacalle government (1990-94) proceeded as far with tax reforms and other reforms of the public sector as did the Menem government. The analysis of the causes of these different outcomes is facilitated by the fact that in each case the transfer of power to the new democratic governments took place in the context of severe economic crises characterized by especially large foreign debts, large public sector deficits (about 15% of GDP in each case), successive years of negative economic growth, and a long term fall in real wages. Both countries' economies are similarly structured, with grain and beef making up a large share of total exports. But, the small Uruguayan economy was, if anything, more vulnerable to the fluctuations in the international prices of grain and beef which significantly affected Argentina's fiscal accounts and its ability to service the foreign debt during the 1980s. In addition, both governments were preceded by exclusionary military governments which pursued liberal and monetarist economic programs which ultimately collapsed and caused great economic distress. These basic similarities between the two countries and the conditions facing the different governments permit the role of other factors, such as the differences in the structure of the countries' party systems, electoral laws, the nature of the democratic transition, and the political orientation and economic beliefs of the elected presidents to be more carefully examined.

The similarities with Argentina in terms of economic structure and the legacy of military rule are not as strong in regard to Brazil but are still great enough to allow meaningful and revealing comparisons. Given the strong record of economic growth through the late 1970s under the military government's relatively statist and protectionist economic policies, in Brazil there was perhaps a greater consensus at the elite level and within the business community in favor of maintaining a heavy state role in the economy (Bresser Pereira, 1994; Sola, 1994). But.
in light of the highly unequal distribution of the proceeds of the economic growth, just as in Uruguay and Argentina there was a strong expectation among the broader population that democracy would bring a greater emphasis on income distribution. Though he also faced large foreign debt payments and relatively high inflation, Sarney enjoyed the potential advantage of an economy in recovery, a large trade surplus, and a budget deficit reduced by the departing military government’s prior efforts at fiscal adjustment. Another difference with the Argentine and Uruguayan cases is that the Brazilian economy is larger and composed of a more diversified and vibrant export sector, which made it somewhat less vulnerable to international price movements. The large absolute size of the foreign debt gave governing authorities more bargaining leverage in relation to foreign creditors.

In the Brazilian case the “transition” was less complete at the time Sarney took office and thus the legacy of military rule was likely more constraining than in the other cases. In accordance with the terms established by the military and pro-regime political elites the popular president-elect - Tancredo Neves - was not chosen in a direct election but was elected by the legislature. When Neves died unexpectedly, Sarney, the former leader of the official government party (Social Democratic Party, PDS) and compromise vice presidential candidate, assumed office. Thus Sarney lacked the popular legitimacy enjoyed by elected presidents such as Alfonsín, Belisario Betancur (in Colombia), and Sanguinetti (in Uruguay). In addition, given the fact that the military was sufficiently cohesive to negotiate the terms of its withdrawal from power and had achieved some success in institutionalizing its authority, the new civilian government had to operate in a context in which the military retained domains of policy influence, a large contingent of elites supportive of the military government held political office.
and the constitution was in need of a democratic overhaul (Stepan, 1988; Mainwaring and Share, 1984).

What makes the comparison of Brazil with Argentina particularly interesting is the sharply different outcomes, particularly in regard to the second post-authoritarian civilian governments. Sarney's Cruzado Plan did not entail as significant an attempt at fiscal reform and adjustment or as restrictive a wage and monetary policy as the Austral Plan. As a consequence of this and other factors, the Cruzado Plan's success in reducing inflation was more short-lived than was the case with the Austral Plan. In both cases, however, the presidents' elected successors inherited very high, if not hyper-inflation, large public sector deficits, and severely contracting economies. Through a heavy use of extraordinary powers and with little congressional input both Collor and Menem imposed harsh adjustment programs but in contrast with Menem, Collor failed to implement far-reaching fiscal reforms and failed to achieve a lasting reduction of the fiscal deficit or inflation. As a consequence of his involvement in flagrant corruption and the weakness of his base of political support, Collor was impeached by the Congress in the third year of his five year presidential term. Even under the interim government of Itamar Franco (1992-94) and the Cardoso government (1995-) despite much effort on the part of the executive, comprehensive fiscal reform has (through mid-1997) remained largely elusive.

Colombia is the only one of the four cases to have not undergone a full change of political regime in the period following the outbreak of the debt crisis. Most of the provisions of the National Front regime, which was established in 1958 by the two traditional political parties in response to the longest and most intense period of violence in Colombian history - La Violencia (1946-1958), had expired by the time Betancur assumed office in 1982. This
consociational arrangement, which stipulated that control of the presidency would alternate between the Liberals and Conservatives, that the legislature, executive, and other major government offices would be divided equally between the parties regardless of the election results, and that no new parties could participate in elections, was scheduled to end in 1974. But, as a consequence of the 1968 constitutional reform, which specified that the executive should be divided "in such a way that gives adequate and equitable participation to the major party distinct from that of the president," the practice of granting opposition party members positions in the cabinet continued during the López Michelsen (1974-78), Julio César Turbay (1978-82) and Belisario Betancur (1982-86) administrations (Hartlyn, 1994). When the Liberal candidate, Virgilio Barco, was elected by a wide margin in 1986, the Conservative party leader, Misael Pastrana, decided that the party's future electoral chances would be best served if it refused the limited cabinet participation offered (Martz, 1997).

Though party elites decided to partially maintain one of its central features, it was clear by the 1980s that the political system inherited from the National Front period was experiencing a severe crisis of legitimacy and authority. Partly because of the inability of opposition movements to gain a voice in the political system and the ineffectiveness of the traditional parties in channeling dissent, the nonelectoral opposition, including militant labor organizations, civic movements, and guerrilla groups, became more active and stronger. In addition, state authority was increasingly undermined during the 1980s by terrorist acts committed by guerrilla organizations and paramilitary and criminal violence related to the drug trade (Martz, 1997; Kline, 1996). Thus, unlike the other three cases, Colombia in the 1980s was a case of regime continuity rather than regime transformation. But, when Betancur assumed the presidency in
1982, just as the effects of the regional debt crisis hit Colombia, it was clear that the existing two-party system of co-optation inherited from the National Front period was in crisis. The regime crisis and escalating guerrilla, paramilitary, and criminal violence generated pressures for an increased military role in politics and political initiatives to open the political system to a broader range of political forces, but did not lead to an abrupt breakdown of democracy. Nevertheless, the political crisis affecting the regime was an important constraint faced by Colombian governments in managing the externally-induced economic crisis during the 1980s.

In pointed contrast with governments in most Latin American countries, including the three in this study, Colombian governments in the mid-1970s refrained from borrowing heavily in international capital markets so as to attempt to avoid the potentially inflationary impact of the boom in international coffee prices. As a result, when Betancur took office in 1982 the foreign debt, though increased as a result of the less cautious policies of Julio César Turbay Ayala (1978-1982), was considerably smaller and less burdensome than that faced by governments in Argentina, Brazil, or Uruguay. And, while the rate of economic growth declined to its lowest level in the post-War period by 1981, it remained positive in contrast with the severe downturns experienced by Uruguay and Argentina. However, the fall in international coffee prices and the tightening of international capital markets in the early 1980s contributed to growing balance of payments difficulties and public sector deficits approaching 8% of GDP in 1981-83. What is remarkable (in the South American context) is that in the face of this more moderate economic crisis the Betancur government adopted, after only a brief period of delay, a significant adjustment program, including successive tax reforms which significantly increased revenues and rapidly closed the budget deficit (Schloss and Thomas, 1986; Thorp, 1991). As a result, inflation
- already low in comparison with other South American countries - slowed in the mid-1980s and economic growth picked up. Despite the fact that his predecessor had already re-equilibrated the country's finances and the increase in international coffee prices had alleviated the crisis in the external sector, the Barco government (1986-90) adopted a major tax reform (aimed at making the tax system more neutral), increased tax collection, and further reduced the budget deficit. The subsequent government led by César Gaviria further reformed the tax system, maintained relatively balanced budgets, privatized numerous public firms, and significantly lowered import barriers. Thus, juxtaposed next to other countries in the region, and particularly the cases of Argentina and Brazil, it is interesting to examine why democratically elected governments in Colombia were able to more rapidly respond to the budgetary crisis induced by changing international economic conditions and maintain the country on a positive growth trajectory with a manageable inflation rate.

**Plan of the Dissertation**

The analysis of the Argentine case is carried out in Chapters two through four. Chapter five examines the fiscal policy experiences of governments in Brazil, Uruguay, and Colombia during the 1980s and 1990s. Chapter six considers the usefulness of the political institutional approach advanced in this dissertation in relation to alternative theoretical approaches.

Chapter two begins the discussion of the Argentine case by examining the political and economic legacy of past history. It relates Argentina's chronic fiscal deficits, difficulties with inflation, and long term economic decline to the high level of political conflict and instability which prevailed in the country in the period after Perón was expelled from power. In doing so it focuses attention on political institutional characteristics of the Argentine political system which
remained in force to some degree at the time of the inauguration of the new civilian government and which are hypothesized to have affected its capacity to respond to the onset of the debt crisis. But, it focuses in particular upon the legacy of the *Proceso* military regime, both in terms of its impact on the economy and in terms of its effects on societal attitudes. The failure of the military government’s monetarist experiment not only eroded the cohesiveness of the regime and initiated a process leading to the armed forces’ departure from power, it also had an important influence on society’s and political elites’ perceptions of liberal and orthodox economic policies. The discussion of the fiscal and economic policies followed during the military regime provides an opportunity to elucidate the scope and particular dimensions of the crisis in public sector finances and to highlight the political barriers hindering its solution. The final section of this chapter discusses the social, economic, and political constraints faced by Alfonsín in terms of the explanatory approach put forth in the first chapter.

Chapter three analyzes the Alfonsín government’s experience with fiscal adjustment and reform. Three stages of fiscal policy-making are analyzed: the initial phase of delayed adjustment, the more serious effort at inflation stabilization represented by the Austral Plan, and the post-Austral Plan stage in which the government adopted an increasingly orthodox diagnosis of the crisis but the practical policy efforts focused on preventing hyperinflation. The central question driving the analysis is that of why significant fiscal adjustment was delayed, and second, why a more far-reaching effort to increase revenues and correct the fiscal imbalance was not made along with the government’s principal effort at economic stabilization – the Austral Plan. I conclude that the failure of the government to implement more significant fiscal reforms and cut the budget deficit in a sustained manner was due to the lack of support in the Radical party and
the rest of Argentine society for more fundamental reforms, the government's lack of a majority in the legislature and its deficient influence over the fiscal policies of the provincial governments, the centripetal character of the competition between the two major parties, and the intense resistance of a strong union movement tied to the principal opposition party.

The fourth chapter takes on the task of examining the surprising policy reversal undertaken by Menem when he assumed power and his government's eventual, largely successful, effort to reform the tax system and reduce the public sector deficit. The chapter first discusses the changed context resulting from the experience with hyperinflation and the stronger political position gained by Menem and the Peronist party as a consequence of their sweeping electoral victories. Then it seeks to explain Menem's surprising decision to fully embrace the reform agenda of economic liberals and to bring into the cabinet representatives of one of the largest multinational grain trading companies, Bunge & Born, and leaders from the principal liberal Right party, the Unión de Centro Democrático (Union of the Democratic Center - UCeDé). It argues that though the experience with hyperinflation may help account for the profundity of the economic transformation undertaken by Menem, the choice to adopt a neo-liberal oriented economic program was motivated less by this more immediate manifestation of the crisis than by the calculations of a pragmatic politician cognizant of the longer term crisis of the economy and the deepening of the external economic constraints. In addition, Menem's success in liberalizing the economy, balancing the fiscal accounts, and implementing far-reaching tax reforms, though aided initially by the wide room for maneuver afforded the head of an economy in grave crisis, was based importantly on the formidable political resources he controlled at the outset and craftfully, and sometimes undemocratically, used to divide potential
sources of opposition and overcome obstacles to reform. As a result of the government's alliance with the UCeDé and other center-Right parties from the provinces, the government was able on most occasions to obtain majority support in the legislature. With Menem leading the Peronist party from a left-populist orientation to a liberal-conservative stance, and the Radical party torn between a liberal-orthodox faction and a more social democratic wing led by the discredited former president, the government faced little staunch opposition. In addition, by virtue of the Peronist party's traditionally strong support from workers and close ties with the national labor movement, and due to the divisions among union leaders and the government's "carrot-and-stick" strategy, the government was able to prevent a major rebellion against its policies by organized labor.

The fifth chapter examines the cases of Uruguay, Brazil, and Colombia. The discussion of the Uruguayan case highlights the close similarities with the Argentine case in respect to the policy legacy associated with the period of military rule and the structure of the two countries' economies. But, the discussion of the country's institutional structure points to important differences in respect to the structure of the party system, the linkages between the parties and the union movement, and the nature of the president's constitutional powers which are each argued to have produced more conservative fiscal policies in the initial post-military government led by Sanguinetti and to have contributed to their continuation during the Lacalle government (1990-1994). But, the relatively high level of fragmentation of the party system and both governments' inability to hold together majorities in the Congress is viewed to have impeded their ability to adopt fundamental fiscal and public sector reforms and to have contributed to the erosion of the simplicity and neutrality of the tax structure.
The second section of chapter five examines the case of Brazil. The first post-military civilian government in Brazil also was confronted with a large foreign debt, but as a result of a prior fiscal adjustment was not facing budget deficits or inflation of the same magnitude as the previous two cases. Following the same format as used for the discussion of the Uruguayan case, this section first describes the structure of the party system, the nature of the president's constitutional powers, the structure of the union movement and its ties to the party system, and the nature of the relationship between the central government and lower levels of government. Then, it examines the experience of fiscal adjustment under the Sarney government. The expansionary character of the Cruzado Plan and the absence of a more diligent effort to contain the budget deficit is argued to be closely related to the incomplete nature of the transition to civilian rule (including the president's lack of a popular mandate and the need to adopt a new constitution), the weakness and lack of discipline of the parties in the congress, and the continued influence of populist and statist attitudes among the political elites leading the protracted process of democratic transition. Collor's election by a popular majority and the adoption of a new constitution (in 1988) overcame some of the important handicaps facing Sarney. But, I argue that Collor's lack of party support in the Congress and the extreme fragmentation of the party system played an important role in preventing the adoption of fundamental fiscal reforms and a sustained reduction of the public sector deficit. Along with these strong institutional constraints, it is argued that Collor's imperious and arrogant style of leadership prevented him from realizing the potential provided by his initial electoral mandate. Cardoso's relative success in containing the imbalances in the public sector and reducing the inflation rate is attributed to the growing consensus among political elites and the society at large that serious steps had to be taken to solve
the economic crisis, his landslide electoral victory, and his skill in building coalitions in the Congress.

The third section of this chapter examines the case of Colombia, which unlike the other cases, did not undergo a change of political regime in the period immediately before or after the onset of the debt crisis. Nonetheless, while its party system was far more institutionalized than in the cases of Argentina and Brazil, the Colombian political system continued to face the challenges of restoring more open competition for political office after the quasi-democratic National Front period (which officially ended in 1974) and dealing with the serious threats to democracy posed by the various guerrilla movements and drug trafficking. The discussion of Colombia's institutional structure emphasizes the historical strength of the two main parties and the weakness of union organizations. The strong partisan attachments of the electorate and the non-programmatic, clientelistic nature of the parties is argued to have discouraged politicians from appealing to the electorate on the basis of populist economic policies and to created strong incentives for moderate and centrist policies. In addition, the National Front regime is seen to have left an enduring legacy of technocratic and relatively conservative patterns of economic policy-making and provided continued incentives for inter-party cooperation. These characteristics of the Colombian institutional context made it easier for Betancur to abandon his initially expansionist economic course and adopt meaningful fiscal reforms. Similarly, Betancur's success, Virgilio Barco was able for these same reasons to carry out a significant tax reform and sustain the relatively smooth adjustment to the external crisis of the early 1980s.
Chapter six pulls together the lessons that can be drawn from the four cases about the factors affecting the timing, pace, and scope of governmental efforts at fiscal adjustment and reform.
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Table 1.1: Real GDP Growth, Inflation, Non-Financial Public Sector Deficits in Selected South American Countries, 1988-1995

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Table 1.2: Revenues from Foreign Trade Taxes as a Percentage of Total Tax Revenues

¹) Argentina (1996); Bolivia (1995); Brazil (1993); Chile (1995); Colombia (1994); Ecuador (1990); Mexico (1994); Peru (1995); Uruguay (1995); Venezuela (1994)

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Table 1.3: Revenues from Foreign Trade Taxes as a Percentage of GDP.

1.) Argentina (1995); Bolivia (1995); Brazil (1993); Chile (1995); Colombia (1994); Ecuador (1990); Mexico (1995); Peru (1995); Uruguay (1995); Venezuela (1994)

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Table 1.4: Taxes to Goods and Services and the VAT as a Percentage of Total Tax Revenues

1.) Argentina (1996); Bolivia (1995); Brazil (1994); Chile (1993); Colombia (1994); Ecuador (1990); Mexico (1994); Peru (1995); Uruguay (1995); Venezuela (1994)

2. In Bolivia in 1985 hydrocarbon taxes were 85% of collection from taxes to goods and services and 54% of total tax revenues. In 1993 only 16% of goods and services taxes and 9% of total tax revenues were from these taxes.

3.) In Mexico the tax on hydrocarbon goods and services tax represented 53% of total collection from taxes on Goods and Services and 39% of total tax revenues. In 1990, these percentages were 43% and 27% respectively.

Note: For Bolivia in 1980 and 1985 "VAT" represents a general sales tax. The VAT was adopted in 1986.

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Table 1.5: Taxes to Goods and Services and the VAT as a Percentage of GDP

1.) Argentina (1995); Bolivia (1995); Brazil (1993); Chile (1995); Colombia (1994); Ecuador (1990); Mexico (1995); Peru (1995); Uruguay (1995); Venezuela (1994)

2.) In Bolivia in 1985 hydrocarbon taxes were 85% of collection from taxes to goods and services and 54% of total tax revenues. In 1993 only 16% of goods and services taxes and 9% of total tax revenues were from these taxes.

3.) In Mexico the tax on hydrocarbon goods and services tax represented 53% of total collection from taxes on Goods and Services and 39% of total tax revenues. In 1990, these percentages were 43% and 27% respectively.

**Note:** For Bolivia in 1980 and 1985 "VAT" represents a general sales tax. The VAT was adopted in 1986.

### Table 1.6: Revenues from Profits, Income, and Capital Gains Taxes as a Percentage of Total Tax Revenues

| Country      | 1980 | 1985 | Year of Most Recent Data
|--------------|------|------|--------------------------
| Argentina    | 8.2  | 5.9  | 15.5                     
| Bolivia      | 16.5 | 2.9  | 3.8                      
| Brazil       | 16.4 | 29.1 | 21.0                     
| Chile        | 22.0 | 14.8 | 21.0                     
| Colombia     | 28.9 | 25.2 | 40.8                     
| Ecuador      | 46.6 | 66.4 | 57.9                     
| Mexico       | 38.6 | 26.6 | 39.3                     
| Peru         | 28.6 | 10.6 | 18.6                     
| Uruguay      | 11.5 | 8.3  | 10.3                     
| Venezuela    | 79.4 | 72.3 | 47.4                     
| **Average**  | 27.9 | 26.2 | 27.6                     
| **Average (Oil Excluded)** | 18.3 | 14.6 | 18.1                     

1.) Argentina (1996); Bolivia (1995); Brazil (1993); Chile (1995); Colombia (1994); Ecuador (1990); Mexico (1994); Peru (1995); Uruguay (1995); Venezuela (1994)

2.) In Ecuador 100% of the corporate income tax comes from profits of oil production. This amounted to 78%, 89%, and 89% of total income tax collection in 1980, 1985, and 1990 and 36%, 60%, and 52% of total tax revenues.

3.) In Venezuela 100% of the corporate income tax comes from profits of the state-run oil company. This amounted to 97%, 79%, and 75% of total income tax collection in 1980, 1985, and 1990 respectively and 77%, 57%, and 47% of total tax revenues.

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| Average      | 5.1  | 4.4  | 4.2                      |
| Average (Oil Excluded) | 2.9  | 2.3  | 2.7                      |

Table 1.7: Revenues from Profits, Income, and Capital Gains Taxes as a Percentage of GDP

1.) Argentina (1995); Bolivia (1995); Brazil (1993); Chile (1995); Colombia (1994); Ecuador (1990); Mexico (1995); Peru (1995); Uruguay (1995); Venezuela (1994)

2.) In Ecuador 100% of the corporate income tax comes from profits of oil production. This amounted to 78%, 89%, and 89% of total income tax collection in 1980, 1985, and 1990 and 36%, 60%, and 52% of total tax revenues.

3.) In Venezuela 100% of the corporate income tax comes from profits of state-run oil company. This amounted to 97%, 79%, and 75% of total income tax collection in 1980, 1985, and 1990 respectively and 77%, 57%, and 47% of total tax revenues.

1. Argentina, Mexico, and Peru rebounded impressively with relatively high growth rates and much lower inflation. Mexico, however, slid backwards in 1994-1995 as an unsustainable balance of payments situation forced a sharp devaluation in Dec. 1994. The tremor which this caused in international capital markets then shook other economies in the region, including Argentina, which also suffered a recession in 1995. Chile and Colombia continued on the low inflation/moderate to high growth path which they had commenced in the mid-1980s while Bolivia did the same on a lower growth trajectory. Economic recovery was less robust and inflation more persistent in Brazil, Ecuador, Uruguay, and Venezuela.

2. Some noteworthy exceptions are the recent cross-national comparative studies of economic adjustment and policy reform by Stephan Haggard and Robert Kaufman (1995) and the edited volume of Robert Bates and Anne Krueger (1993). Barbara Geddes (1991), in an intriguing study of public administration reform, found that institutional factors, such as the cohesiveness of party organizations, affected politicians’ incentives to support reform.


4. While income taxes collected about 2.5% of GDP in the mid-1960s they collected only 0.5% of GDP in 1983 and 1984. The revenues from the VAT (introduced in 1975) or general sales tax (before 1975) have fluctuated greatly reaching a peak of about 5.0% of GDP from 1980-1982. But by 1983 revenues from the VAT declined to just over 2.5% of GDP (Secretaría de Hacienda. 1986: Using the pre-1992 GDP series).


6. Financing government expenditures via local capital markets either was impossible or raised domestic interest rates exorbitantly (increasing the servicing burden of the internal debt) while the alternative of printing money fueled inflation.

7. The erosion of the real value of tax revenues in an inflationary context - the Olivera-Tanzi effect - results because of the time lag between when the amount of tax is determined and when the tax is paid to the treasury.


administration in these terms.

10. For instance, Raúl Labán and Federico Sturzenegger (1994) argue that eventually the poor are hurt more by escalating inflation levels since they do not have access to capital markets. Therefore, fiscal reform is achieved when this group acquiesces to costs which it was previously unprepared to accept. See also Allan Drazen and V. Grilli (1993) and Alberto Alesina and Allan Drazen (1991).

11. The few books which have studied the political dimensions of tax policy from a comparative perspective have focused on the industrialized countries. See Steinmo (1993), Peters (1991), Levi (1988), and Weber and Wildavsky (1986). For a comparative study of the politics of tax reform in Latin America see Ascher (1989). There are also a few articles in which the politics of taxation in a single country is explored. See, for example Abente (1990) and Elizondo (1994).

12. For examples of this type of study see Bird (1992), Gillis, ed. (1989); World Bank (1991).

13. For a few examples of this approach see Poulantzas (1973), Cardoso and Faletto (1979), and O'Donnell (1973).

14. Carlos Elizondo (1994) confirms the importance of this variable in his study of tax reform in Mexico.

15. Depending upon the nature of the economic activity, business sectors may respond differently to increased levels of taxation. As Jeffry Frieden (1991) argues business groups representing industries characterized by specialized skills, machinery, and technology or other barriers to exit will be more motivated to give "voice" to their preferences, while those in sectors with more mobile assets will express their preferences through the market (the "exit" strategy). For additional discussions of these differences across economic sectors in regard to political behavior see Alberto O. Hirschman (1970) and Robert Bates and Hsiang Donald Lien (1985).

16. Other approaches include the "bureaucratic politics" model elaborated by Graham Allison (1974) and the social learning model in which public policies are seen to stem at least partially from existing state structures and policy legacies. See also Margaret Wier and Theda Skocpol (1985).

17. An example of the use of such an approach in the examination of developing country economic policy choices is the recent book by Stephan Haggard and Robert R. Kaufman (1995).

18. John M. Carey and Matthew Soberg Shugart (1992 and 1994) point out that when presidents carry out major policy changes through the issuance of executive orders, it is often the case that the authority to legislate by decree was previously delegated to the executive by the Congress. But, there are important differences between political systems both in the constitutional rules regarding presidential use of decree power and in the extent to which an independent judiciary exists which can limit the ability of presidents to overstep the bounds of the authority delegated to them. As Carey and Shugart argue, there are many factors that likely affect the willingness of the legislature
to delegate authority to the executive, including: the share of legislative seats controlled by the
governing party, the degree to which parties are cohesive and disciplined, and the nature of
presidential veto powers. In addition, congresses are more likely to be willing to delegate legislative
authority when the country is facing a serious national crisis. See also Mainwaring and Shugart
(1997).

19. Public opinion data for the 1980s reveal a steady growth in levels of support for the
privatization of major public services and an increasingly negative evaluation of the quality of
services delivered by public companies. As Echegaray (1993) argues this shows that the experience
with hyperinflation was not so decisive in changing public attitudes and making Argentines more
receptive to public sector reforms. Hyperinflation, however, may have been more important in
respect to increasing the willingness of key socio-economic groups and the public at large to tolerate
higher taxes and austere economic conditions.

20. Though smaller in absolute magnitude, Uruguay's foreign debt was larger than Argentina's
on a per capita basis and a proportion of total export revenues.
CHAPTER 2

SETTING THE STAGE FOR ALFONSIN AND MENEM: THE LEGACY OF ARGENTINA'S PAST POLITICAL AND ECONOMIC HISTORY

In the post-War period the Argentine political economy has been characterized by high levels of political instability and conflict, recurrent boom-bust economic cycles, and great macroeconomic instability. From 1955 - when Juan Perón was overthrown by a military coup - until the inauguration of the Alfonsín government in 1983 Argentina experienced four military governments which failed to accomplish their political and economic objectives and three constitutional governments which were not able to complete their terms of office. In parallel with the turbulence at the political level, the economy was subjected to frequent swings in macroeconomic policies and repeated balance of payments and inflationary crises. As a consequence, Argentina, which was ranked among the most prosperous countries in the world before the onset of the Great Depression, grew at an annual average per capita rate of barely one percent (from 1946-1980) and slipped to the ranks of a middle income developing economy.

One group of analysts portrays Argentina's tumultuous political history and the inability of governments to sustain a given set of growth-promoting development policies over a long period as resulting from a stalemate between social forces of relatively equal strength (O’Donnell, 1973, 1978; Portantiero, 1973; Ramos, 1992). This perspective, most clearly articulated in the influential works of Guillermo O'Donnell, views Argentina's egregious problems in maintaining political and economic stability as primarily stemming from the
incapacity of a single “alliance” of social classes from dominating the political system and the consequent colonization and fractionalization of the state (O’Donnell, 1978). A contrasting approach, which has not been advanced as profoundly or coherently, views political institutions and other historically defined features of the political system as importantly having shaped the “orientations, interests, and values of social forces” and to have influenced the prospects for achieving a more enduring social and political compromise (Cavarozzi, 1986a; Manzetti, 1993).

The task of explaining Argentina’s long term economic decline and unstable political history is well beyond the scope of this dissertation. But, clearly the latter perspective, which emphasizes the deficiencies in the party system and the particular manner in which labor was incorporated into the political system, is more consistent with the framework which was developed in chapter 1 and which will be tested in the examination of the Argentine, Brazilian, Colombian, and Uruguayan cases in chapters 3 to 5. Therefore, this chapter, which provides the essential historical background necessary for commencing the analysis of the fiscal policy experiences of the Menem and Alfonsín governments, elucidates not only the persistent socio-economic problems and constraints identified by O’Donnell but also those constraints stemming from the structure of political institutions. Thus, one of the aims of this chapter will be to describe those enduring characteristics of Argentina’s political and economic system which, while changed to some degree by the traumatic experiences of the 1970s, remained as constraints on the fiscal reform efforts of the post-military governments of the 1980s and 1990s. Given the focus of the dissertation, the role of fiscal policy, and the nature of the distributive conflicts surrounding it, will be highlighted in the course of this discussion. The second objective of the chapter is to examine the legacy of the Proceso military regime (1976-1983), both in terms of its direct impact on the economy - especially the fiscal system, and in terms of its effects on societal
attitudes toward social and economic policy and the political system. Coming to grips with the
economic experience under the military regime is necessary in order to understand the full
dimensions of the crisis in the tax system and the public sector inherited by the Alfonsin
government and also to understand the initial mindset of politicians and the public in confronting
this crisis. Taking into account the impact of the military regime and the experience under the
preceding Peronist government, the third section discusses the social, economic, and political
constraints faced by Alfonsin in terms of the explanatory framework presented in Chapter 1.

Economic Policy-Making and Social Conflict in the Post-Perón Period

From 1860 to 1930 the Argentine economy advanced steadily on the basis of liberal
trading policies which allowed a continual expansion of cereal (and later, beef) exports to Great
Britain and other rapidly industrializing countries in Europe. In exchange, Britain provided
investment and technology to support the export sectors and finished goods for a narrow
domestic market comprising the oligarchy and the emerging middle class.

In parallel with economic stability and growth, Argentina experienced unprecedented
political stability. The PAN - a conservative party representing the landowning elites - governed
the country on the basis of an extremely limited electoral franchise and fraud from 1862-1916.
After the split of the PAN in 1909 and the approval of the Sáenz Peña electoral reform law in
1912, Radical party leaders were elected to the presidency from 1916 to 1930. Consistent with
the party’s middle class roots, the Radicals made progress in improving electoral procedures and
making the law apply more equitably. But, the Radical party, which was constituted by many
members of the landowning elite and remained largely conservative in orientation, did not alter
the country’s open trade policy or carry out significant labor or social reforms in order to extend
its base of support to elements of the growing working class (Collier and Collier, 1991; O'Donnell, 1973; Manzetti, 1993).

But, in 1930 the Great Depression, which had a devastating effect on such an exposed economy, encouraged the landed oligarchs, who were already disenchanted with the steady erosion of their influence in the personalistic governments of Yrigoyen and the growing levels of social polarization, to back a coup by conservative military officers. The military coup restored power to political groups, including the antipersonalist Radicals and National Democratic party, who represented the landowning and upper middle classes which had ruled before 1916.

Nevertheless, the sharp deterioration in the international terms of trade, the fall in the world price level, and the drastic reduction in the volume of exports which accompanied the Great Depression discredited the liberal development model followed since 1860. The change in relative prices naturally produced a reallocation of resources from the traditional export sector to the industrial sector, which had grown steadily in the preceding decades. But, the rapid expansion of the manufacturing sector after the Depression was also encouraged by the deliberate policy actions of the Concordancia regime (1932-1943), which included the erection of protectionist barriers, the adoption of a system of multiple exchange rates (which discriminated against the rural sector), the devaluation of the currency, the pursuit of expansionary policies, and investment by the public sector in infrastructure projects (Díaz Alejandro, 1970). The governments of this period also adopted innovations in respect to fiscal policy such as the establishment of an income tax and the granting of fiscal subsidies to the rural exporting sector (Mallon and Sourrouille, 1975).

The surge in import-substituting manufacturing accelerated the pace of social change by rapidly expanding the size of the working class and increasing the rate of migration of persons
from remote provinces to urban centers, particularly Buenos Aires. Given the scarcity of labor (i.e., the absence of a sizable peasantry), the high geographical concentration of the expanding industrial sector, and the organizational efforts of communist, socialist, and syndicalist labor activists, by 1943 the Argentine labor movement had become the largest and most autonomous in Latin America. Nevertheless, the bulk of urban and rural workers remained non-unionized (O’Donnell, 1978, Manzetti, 1993).

Juan Domingo Perón, who was among the group of officers which seized power in 1943, realized better than anyone else the dangers, and political opportunities presented by this large, yet mostly unrepresented political force, and capitalized on the strong undercurrent of nationalist sentiment which had accumulated in Argentine society over the preceding decades of oligarchic rule. By granting labor a wide range of rights and privileges (including obligatory paid vacations and guaranteed social benefits), and by unionizing marginal workers who had recently arrived in the cities, Perón built a substantial base of political power which he used to propel himself into the presidency in 1946. Once the head of government, Perón granted massive real wage increases in order to solidify the support of workers and to expand the market for emerging national industries, which were now to be the central driving force behind Argentine development. At the same time, he ensured organized labor’s complete allegiance to him by using the state’s legal and coercive authority to reward loyal labor leaders and unions and to repress dissidents. The national labor organization, the General Confederation of Labor (CGT), which was previously dominated by socialists and communist unions, was subordinated to Perón’s leadership and independent unions were purged (Waisman, 1987; Collier and Collier, 1991).
The Peronist government greatly extended the more modest state interventionist and protectionist policies followed by the Concordancia regime. Industrialization was promoted aggressively through monetary and credit expansion, exchange controls, high tariffs, expansionary fiscal policies, and an overvalued exchange rate that subsidized the importation of raw materials and capital goods. Such policies were aimed at providing full employment and forging an urban-based constituency of entrepreneurs and workers. Though rural producers and foreigners might be harmed all other Argentines were expected to gain by policies which simultaneously fostered industrialization and expanded domestic consumption. An export marketing board – the Argentine Trade Promotion Institute (IAPI) – was established which, in effect, taxed export producers by purchasing their goods at prices well below the world price while selling them to foreign customers at much higher prices. Utility companies, railways, and manufacturing industries – many of which were fully or partially owned by foreign interests - were nationalized and new industries were created under state ownership (Díaz Alejandro, 1970; Mallon and Sourrouille, 1975; Manzetti, 1993).

Though favorable external conditions and a large stock of foreign currency reserves permitted the economy to expand rapidly in the government’s first three years, the radically populist and protectionist policies predictably resulted in growing balance of payments deficits and increasing inflation once export demand and prices fell. The great shift of relative prices against the rural sector in favor of industry discouraged investment and reduced the rate of growth of production of the country’s principal export goods. Given the great expansion of consumption by the urban population, the proportion of beef and cereal production exported steadily decreased. At the same time, the growth of the industrial sector led to a net increase in the demand for imports because what was saved by the internal production of finished goods was
more than offset by the importation of raw materials and intermediate and capital goods (Wynia, 1978; Díaz Alejandro, 1970).

In response, Perón eventually was forced to impose on his working class supporters a two-year wage freeze and higher prices for basic goods. In addition, he pragmatically opened the petroleum sector to foreign investment and extended credit to the rural sector. But, these policy changes, the stagnation of the economy, and Perón’s personalistic and increasingly authoritarian style of government alienated most of the social groups which had originally comprised his nationalist populist coalition (Mallon and Sourrouille, 1975; Wynia, 1978). In 1955, with only the CGT and officer friends supporting him, Perón was sent into exile by a military uprising.

Thus, a pattern (repeated frequently in subsequent years) emerged in which an upward movement of the economy ran into a foreign exchange ceiling which then required recessionary adjustment policies, which reversed most of the gains made in the upward “populist” phase of the cycle. The balance of payments crises were typically eased by devaluing the currency, imposing tighter monetary and fiscal policies (usually entailing lower levels of public investment and reduced subsidization of the industrial sector), cutting wages, reducing export taxes, and lowering the subsidization of the prices of internally consumed exportables. Such policy adjustments were strongly supported by pampean landowners, represented by the Argentine Rural Society (SRA) and the Argentine Rural Confederation (CRA), and the more oligopolistic and internationally-connected sectors of industry represented by the Argentine Industrial Union (UIA). Stabilization policies usually succeeded in easing the foreign exchange crisis but resulted in a strong redistribution of income against wage earners and a sharp contraction of economic activity (O’Donnell, 1978).
As O’Donnell points out, the redistributive impact of such adjustments was more severe than in most other South American countries because the main export goods were also important wage goods (O’Donnell, 1978). Currency devaluations increased the domestic price of beef and cereal which further reduced the purchasing power of workers’ wages and sharpened the slowdown in industrial production arising from the shortage of imported raw materials and capital goods. Such stabilization policies, therefore, brought a strong reaction from labor unions and the nationalist sector of industry.

Another feature of the socio-economic system which made the foreign exchange constraint (to ISI) more difficult to manage was the fact that Argentina’s principal export products - cereal and beef - did not respond readily to short term movements in prices. Stabilization policies were made more severe and prolonged by the fact that currency devaluations, which increased the domestic price of beef and cereal and raised the international price received by farmers, did not translate immediately into increased exports as a consequence both of the cattle cycle and the lag between investment and improvements in yields. Increases in beef prices tended perversely to lower exports in the short term as farmers turned grain fields into grazing land and tried to build up their herds. Thus, though they benefited greatly from policies aimed at adjusting the balance of payments, rural producers could not be expected to significantly increase production unless such favorable prices were maintained over a long period of time.

But, the unusual strength of what O’Donnell calls the “defensive alliance” of labor unions and small and medium-sized local businesses (organized in the Peronist-created General Economic Confederation (CGE)) made it especially difficult for any government – civilian or military-led - to sustain such policies for very long (O’Donnell, 1978). Peron’s pro-labor policies had resulted not only in a level of unionization exceeding that of any other Latin American
country, they also greatly increased the economic power of the labor movement by granting unions control over the administration of a wide range of social services and providing a steady stream of income (from mandatory employer and worker contributions) (Manzetti, 1993). After Perón’s overthrow, labor leaders gained great autonomy from the state and competed with each other to gain leadership over the Peronist movement, which became largely synonymous with the labor movement. In their efforts to restore the labor conditions of the “Peronist Golden Age” and to gain political power and influence, labor leaders drew upon the massive electoral power of the working class and the power of unions to paralyze the economy. As a result, when they were not repressed by military coercion, labor unions responded to stabilization measures with massive strikes and protests which typically led to wage concessions that eventually undermined the effects of a currency devaluation (Cavarozzi, 1986a and 1986b).

Though they benefited from wage reductions, local industrialists joined the unions in opposition to adjustment policies since the increased costs of imported inputs, the reduction of state subsidies (including, low interest rates, tax incentives, exchange rate controls, and import tariffs and controls), deregulation of foreign investment, and the shrinking domestic market, reduced their profits and placed many on the verge of bankruptcy. The larger industrialists, represented by the UIA and the Argentine Chamber of Commerce (CAC), tended initially to support stabilization policies because they generally favored moves toward economic deregulation and liberalization and supported controls over the growth of wages. But, because of their opposition to restrictions on the importation of needed inputs and to increased foreign competition in respect to goods which they produced, and because of their desire for more growth-oriented policies, they eventually joined smaller corporations in opposition to stabilization policies. The desertion of the large industrialists and mounting opposition by the
unions and the local industrialists typically forced governments to give in to demands for higher wages, lowered interest rates, more expansionary fiscal policies, and an easing of import controls (O’Donnell, 1978 and 1973). While the populist phase of the cycle brought a revival of industrial production and allowed workers to recover lost purchasing power, in a short period of time the balance of payments bottleneck resurfaced. The extreme instability of key macroeconomic policies over time undermined the capacity of future policy-makers to affect production and investment decisions by entrepreneurs since it increasingly put into question the durability of any changes in relative prices or other incentives.

A national land tax, which would be levied at a rate proportional to the potential productivity of the land, was proposed by successive governments as a means to provide an incentive for farmers to increase production even in the presence of modest prices. This tax was also intended to reduce tax evasion by farmers, whose income tax payments were well below their share of total national income. It is possible that such a tax, if implemented effectively, might have eased the foreign exchange bottleneck and moderated the economic and political cycles related to it (O’Donnell, 1978). But, each time that it was proposed, the most powerful rural organizations - the Argentine Rural Society (SRA) and the National Rural Confederation (CRA) - managed to block either its enactment into law (during the Frondizi (1958-1962) and Illia (1963-1966) governments) or effective implementation (during the Argentine Revolution (1966-1973) and the second Peronist government (1973-1976)) through concerted opposition (Manzetti, 1993). The group which represented the interests of smaller and tenant farmers – the Argentine Agrarian Federation (FAA) – supported such efforts to force large landholders to pay more taxes and to make productive use of idle lands but, despite a larger membership, it was no match for the economic and organizational power of the SRA and CRA.
“Retentions”, which were another way of taxing the profits of the rural sector, also potentially could be used to limit the distributive conflict surrounding efforts to adjust the balance of payments and slow inflation. In this approach, applied by General Ongania’s government (1966-73) and by the Alfonsin government, a devaluation is imposed which is sufficient to spur increased export production and lower imports. But, in this case the devaluation is “compensated” by an export tax which is large enough to prevent domestic beef and grain prices from rising sharply and to permit the continued subsidization of imports of raw materials and other inputs for industrial producers. As inflation ate away at export profits (by increasing the value of the currency), threats by rural organizations to launch a tax rebellion or withhold produce from the market typically mounted to the point that governments were forced to lower the retentions.

Drawing on the profits earned by the rural sector, starting with Frondizi (1958-62), governments also began to use extensive fiscal incentives, including full exemption from the payment of income and sales taxes, and subsidized credit to attempt to ease the balance of payments constraints to import substitution industrialization. By promoting the development of capital and durable goods industries and the growth of non-traditional (mostly manufacturing) exports it was thought that exports could be increased and the demand for imports curtailed. But, at least in the short term, these approaches failed to provide a solution to the balance of payments restrictions and deepened the vested interests in the continuation of protectionist and state interventionist policies. The ever-expanding network of fiscal incentives entailed heavy revenue losses for the treasury and contributed to the mounting difficulties governments experienced with financing the state’s extensive activities and controlling inflation (O’Donnell, 1977). Tax exemptions not only cost the treasury the revenues from the targeted economic activity, they also
severely complicated the administration of the tax system and opened up diverse opportunities for tax avoidance and evasion.

In fact, tax collection, and the will of the citizens to voluntarily comply with their tax obligations, declined significantly after the mid 1950s as a consequence of the decreasing morale, competence, and professionalism of the tax administration, rising revenue losses due to inflation, the constant granting of tax amnesties, and the decreasing legitimacy of state institutions. Given lax enforcement, delayed payment of taxes and evasion became a key source of financing, and implicit subsidy, for credit-starved and highly inefficient import-competing industries (Mallon and Sourrouille, 1975; Díaz Alejandro, 1970; O'Donnell, 1977).

While conflicts of interest among powerful social groups certainly contributed to the extreme difficulties which Argentina experienced in managing the economy and maintaining stable governments, it is necessary to take into account political institutional factors in order to explain the incapacity of the political system to reconcile and manage such conflicts. For several reasons the party system and representative institutions did not effectively articulate and channel the demands of social groups. Because of the sharp polarization of society into pro-Peronist and anti-Peronist camps after Perón’s government and the exclusion of the Peronists from the right to compete for important political offices, the two major parties remained weakly institutionalized. Instead of taking on the features of true party organizations, they continued to exhibit the characteristics of political movements serving the primary purpose of mobilizing electoral support for charismatic and popular leaders (McGuire, 1995).

But, the capacity of the party system to organize and channel the interests of powerful social groups was undermined more directly by Perón’s exile and the curbs on Peronist electoral competition from 1955-1973. As a consequence, the two elected governments during this period...
began their terms of office with limited legitimacy and the majority of the electorate did not view them as representing their values and interests (Cavarozzi, 1986a; O'Donnell, 1973)

The unions, which had been represented primarily through Peronism, were not fairly represented in the formal institutional system but remained a powerful and now more autonomous political force. Thus, relegated primarily to expressing their demands outside the party and parliamentary system, the unions used strikes, factory occupations, and protests to put direct pressure on the executive for more labor-friendly policies.

But, it was not just the unions whose representation through the formal political system was limited. Because of their small numbers, the lack of a sizable peasantry, and regional political divisions, the economically powerful landowners (and their allies in the internationally oriented industrial and finance sector) had little electoral clout and did not have a significant party which represented their interests (Gibson, 1996). To compensate, just like the union movement, the landowning classes used their strong organizations – particularly the SRA and the CRA – and their economic power to lobby the executive branch directly (Cavarozzi, 1986a).

Thus the weak legitimacy of governments, the weakness of party organizations and their shallow roots in society, and the sharp polarization of society between Peronists and anti-Peronists prevented the political system from adequately managing the conflict between social groups and from permitting compromises which might have helped solve Argentina's prolonged development crisis. The last section of this chapter will elaborate upon these political institutional constraints to economic adjustment, while discussing how the relation of social and political forces may have been altered by the traumatic events during the second Peronist government (1973-76) and the Process of National Reorganization (1976-1983).
The Military's Failed Experiment in Economic Liberalism

The armed forces intervened in March 1976 for the second time in ten years with the objective of solving the economic crisis left by the Peronist government and reconstructing the social order in order to eradicate the symptoms and causes of the multiple ailments which they diagnosed in Argentine society. For the military, which in the preceding years had worked to increase its level of professionalism, autonomy, and internal discipline, the guerrilla violence, labor unrest, internecine power struggles, and high inflation of the Juan Perón and Isabel Perón governments (1973-1976) provided solid confirmation of the ungovernability of Argentine society. The burgeoning public sector and the continuation of highly interventionist and protectionist economic policies were perceived to have strengthened the power of corporative groups such as the Peronist unions and the General Economic Confederation (CGE). The capacity of these groups to block attempted solutions to the country’s economic and social problems was viewed as a primary cause of the country’s political and economic instability, which created ripe conditions for subversion. Therefore, the liberal economic program promulgated by the military government sought not only to permanently alter the model of economic growth -- by curtailing the state’s role in the economy, exposing industries to foreign competition, and shifting resources back towards Argentina's comparative advantage in agricultural exports -- but to refound the social and political order (Canitrot, 1980 and 1981; Fontana, 1992).

In an effort to prevent the designated president from obtaining too much autonomy from the armed forces -- as was the case with Ongania in the late 1960s - it was agreed that the commanders of the three military branches would participate equally in the military junta which would hold the final authority over the government. In addition, it was agreed that the President.
who would be subordinate to the junta, could not at the same time be a commander of one of the forces.

But, this structure of power, which was intended to maintain the internal unity of the armed forces, was violated at the outset and did not prevent sharp internal conflicts from emerging in respect to fundamental policy issues. When Jorge Videla, who was appointed as the first President, refused to resign as the Army Commander after much internal discussion, the branches of the armed forces agreed that, for a provisional period, the holding of both positions would be allowed and that they would share control over the cabinet ministries (Fontana, 1992). Aside from the control of the cabinet ministries, which itself represented a more extensive participation by the military in government than in 1966-1973, members of the armed forces were also given control over the provincial governments and leadership positions in state banks and enterprises (Remmer, 1989). In practice, the need to obtain the consent of the commanders of all three branches made it exceedingly difficult for the government to make important decisions regarding its overall mission and strategy. At the same time, the division of the departments and agencies of the government among active officers from the three branches of the armed forces led to a feudalization of the state apparatus and undermined the coherence of public policy-making (Manzetti, 1991; Fontana, 1992).

Martínez de Hoz, who was a prominent long-time advocate of economic liberalism, was appointed by the military government to head the economic ministry. He initially adopted an orthodox stabilization program entailing a drastic reduction of real wages, increases in the real prices charged by public enterprises, and reductions of public spending and employment. But, in contrast with the more corporatist approach followed under the Onganía government, this time the goal of the economic team was to more thoroughly restructure the economy regardless of the
impact this might have on the distribution of income. Thus, taxes on traditional exports were markedly reduced, subsidies for non-traditional exports eliminated, and import tariffs gradually lowered. In the following year, there was a major liberalization of capital markets: interest rates were freed and barriers to the movement of foreign capital were eliminated (Canitrot, 1980; Calvo, 1986). In addition, the government aimed to privatize many public enterprises and to force those which remained in the state's control to rationalize their operations. Thus, free markets were eventually to replace political repression as the instrument intended to discipline the behavior of labor and business groups.

As a part of its efforts to reduce the immense fiscal deficit bequeathed by the tumultuous government of Perón's second wife, Isabel, the Videla government (1976-1981) increased revenues dramatically through a crackdown on tax evasion, improved administrative procedures, broadening of the VAT and an increase in its rate (from 13% to 16%), and a centralization of the management of provincial finances. The replacement of elected governors by military officers markedly increased the capacity of the central government to enforce financial discipline on the part of subordinate levels of government (see Table 2.1) (Schvarzer, 1982; World Bank, 1985). Despite the practical elimination of export taxes, total tax revenues as a percentage of GDP increased from about 17% of GDP to 27% of GDP between 1975 and 1980 -- a 60% increase in relative terms (Table 2.2).

Unlike its neo-conservative counterparts in Uruguay and Chile, however, the Argentine military government did not profoundly simplify the tax system. The tax structure continued to contain about 40 different taxes - most of which were administered by the national tax agency (Dirección General Impositiva - D.G.I.). Though export taxes, the national land tax, and inheritance taxes were eliminated, several small emergency taxes were created and amnesties for
tax debts were granted which boosted revenues in the short term but further lowered the incentive of taxpayers to comply. Tax legislation was simplified somewhat and there were improvements in the capacity of the tax system to adapt to inflation (Carciofi, 1993). But, despite rates which were as high as those in advanced economies, the income tax and other direct taxes continued to play an extremely minor role in the tax system. Because of the inadequacies of the tax administration, the culture of non-compliance which had cumulated over the previous years, high inflation, and narrow bases (due to the exemption of most types of investment income, excessively high personal exemptions, and the prevalence of industrial promotion incentives), direct tax revenues remained much closer to the levels of highly underdeveloped countries than to that of industrialized countries or other middle income South American countries (about 1.5% of GDP or 7% of total national revenues in 1980 -- significantly down from their levels of the 1950s and early 1960s (see Table 2.3).

Revenues from the value added tax increased as a result of an increase in its rate, a broadened base, and stepped up enforcement, but ubiquitous tax evasion and continued macroeconomic instability kept revenues far below expectations. As a result of increased rates and improved enforcement, revenues from other indirect, but less efficient, taxes (such as the fuel, provincial turnover, and excise taxes) and payroll taxes also increased. Indirect taxes at the national level accounted for revenues equivalent to 6.8% of GDP in 1980 -- a 225% increase from the 2.1% of GDP which they collected in 1975. The more economically efficient VAT was responsible for 135% of this increase. Social security revenues increased by a smaller amount from 8.9% of GDP in 1975 to 10.5% of GDP in 1980. Tax receipts at the provincial level increased from a paltry 1% to about 4% of GDP. Because of the marked increase in the importance of indirect taxes, the reduction in the importance of export taxes, the extension of the
VAT to many wage goods, and the elimination of inheritance taxes, changes in the tax system likely exacerbated the highly regressive characteristics of the stabilization program.6

Because of the unprecedented degree to which the military regime was isolated from civil society, the economic team did not have to concern itself with the reaction of societal groups to the income distributive consequences of its policies. But, the economic team’s ability to implement the liberal economic program and the harsh stabilization plan was constrained by the veto power of the various interests and factions of the armed forces and by the fact that it exercised limited control over the bulk of the public sector, whose management rested with active military officers who were not strictly accountable to the economic team or the presidency (Canitrot, 1980 and 1981). In fact, the implementation of Martinez de Hoz’ economic plan caused increasing discontent within diverse sectors of the Armed Forces, because of fears about the national security implications of high unemployment and the weakening of the country’s industrial base (Fontana, 1992). For example, the Minister of Planning, General Díaz Bessone, resigned after his nationalistic alternative approach was rejected by the armed forces and Naval Commander Massera was replaced because he did not share the indefinite time frame envisioned by the economic team and others in the government. Partly because of military resistance to the continuation of the orthodox (demand management) approach to fighting inflation, and its apparent failure, the economic team shifted toward an increasingly unorthodox set of policies beginning in the middle of 1977, including price controls (Canitrot, 1981).

Finally, in December 1978 Martinez de Hoz completed the break from orthodoxy by implementing an exchange rate “table” (tablita) which announced in advance a schedule of gradually declining rates of currency devaluation. By the operation of the “law of one price” the reduction of the rate of devaluation was intended to lower the domestic rate of inflation to world
levels. But, when the reductions in the rate of inflation did not keep pace with the rate of
currency devaluation, the result was a strong overvaluation of the currency, high domestic
interest rates, large capital inflows, and an import consumption binge by the middle and upper
classes and local industry in the second half of 1979 and 1980. The Plan had a devastating effect
on domestic firms which were squeezed by the astronomical costs of credit and the competition
from foreign imports. The collapse of industry – especially small and medium sized firms -
contributed to the bankruptcy of several of the country’s largest financial institutions and a flight
of capital. Though previously supportive of the government’s free market policies, wheat
farmers and cattle ranchers, who saw their exports drop and their earnings fall as a result of the
currency appreciation, joined the chorus of opposition to the government.

The growing current account deficit and unsustainably high interest rates increased
speculation about an imminent currency devaluation which accelerated the speculation against
the currency and the rate of accumulation of foreign debt (Sjaastad, 1989; Calvo, 1986). This
speculation was fueled by the uncertainty related to the internal struggle over the presidential
succession and, later, the designated future president’s lack of public commitment to the tablita
plan. Finally, in February 1981, as Roberto Viola was about to take over the presidency from
Videla, de Hoz was forced to devalue the currency which shattered all remaining confidence in
the tablita program and produced a surge of inflationary pressures and a deepening of the crisis
affecting industry and the financial sector.

A key reason for the failure of the economic team was its excessive faith that principles
taken from classical (or neoclassical) economic theory would operate predictably in an economy
whose characteristics bore little relationship to those assumed in economic models. But,
defenders of economic liberalism could also point to serious deficiencies in the implementation
of the economic program which undermined its effectiveness. A major factor in the eroding credibility of the tablita program in 1979 and 1980 was the growth of the public sector deficit from 4.8% of GDP in 1977 to 8.4% of GDP in 1980 (Calvo, 1986; Corbo, de Melo, Tybout, 1986). It turned out that the increase of government expenditures (from 37.7% of GDP to 43.8% of GDP) more than offset the strong increase of tax revenues which occurred over the same period (Table 2.4).

The economic minister was not able to reduce government expenditures because the other government ministries with authority to make budgetary decisions were controlled by active officers in the armed forces who sought to promote the corporate interests and goals of the military. The military’s concern for national security prevented deeper cuts in public employment or a more profound rationalization of unprofitable public enterprises. At the same time, the military markedly increased spending on military equipment and personnel and undertook massive investments on infrastructure which were seen as vital to national defense (Lewis, 1990). The military officers’ adherence to the national security doctrine and desire to maintain their own power base led them to block privatizations of enterprises in the military industrial complex. Fabricaciones Militares, and enterprises in other sectors considered vital to national defense such as electricity, petroleum, transportation, steel (Manzetti, 1991; Lewis, 1990).

Economic liberals could also point to the fact that import tariffs remained high across the board and were reduced unevenly across the economy. Out of concern for excessive unemployment the military greatly slowed down the implementation of scheduled tariff reductions, which became more threatening in light of the sharp appreciation of the currency after
1978. In addition, the military blocked tariff reductions in a broad range of manufacturing sectors deemed to be vital to national security (Nogues, 1986; Lewis, 1990; Manzetti, 1991).

Thus, despite the radical free market agenda proclaimed by the economic team, the military government left in its wake an economy in which the state remained highly active as both a direct producer and investor and importantly influenced the allocation of resources. The currency appreciation and sharp changes in interest rates had more strongly affected the economy's productive structure than the tariff reductions. The collapse of industry and the crisis in the banking sector which followed the debacle of the stabilization plan led the military government to return the state to its place as the primary protector and benefactor of the national economy. Thus, after the devaluation worsened the precarious state of indebted enterprises, the state assumed responsibility for the massive private foreign debt, raised import barriers, and extended subsidies to the faltering industrial sector (Dagnino Pastore, 1984).

Though the military government temporarily improved the tax system's effectiveness, at the time of Alfonsin's inauguration it was, if anything, in a worse condition. The precipitous fall in tax collection resulting from the sharp deterioration of macroeconomic conditions was exacerbated by the changes in the tax system introduced by the military from 1980-1983. A tax reform, enacted in 1980, sought to aid Argentine industries harmed by the strongly overvalued currency and to limit the proportion of total tax revenues transferred from the nation to the provinces, since in accordance with the 1973 revenue sharing law the provinces received a fixed percentage of the growing level of VAT and other nationally collected tax revenues (FIEL, 1993; Carciofi, 1994).

Labor costs for industrial establishments were reduced through the elimination of employer contributions to the social security system, which were to be compensated by increased
revenues from the VAT, which was extended to almost all previously exempt goods and many
services and given a higher rate (20% instead of the previous 16%).

As a result, the provinces' share of total VAT revenues was cut, but the increased level of revenues was expected to keep the absolute level of transfers the same. Although this reform potentially could have yielded benefits in terms of economic efficiency, since it replaced what is basically a tax on employment by a tax which is neutral in regards to the use of productive factors and not biased against production for export, this change entailed a still greater sacrifice from fixed income earners.

In the face of deteriorating economic conditions and higher levels of evasion, however, the large increase in the VAT rate brought only a small and temporary increase in revenues -- far short of what was needed to make up for the lost social security revenues. Though VAT revenues increased by 19% from 1980 to 1981, revenues from social security contributions fell by 57% and the pension system went from a condition of surplus to being a drain on the treasury (Table 2.5). The reduction of VAT transfers and the prior assignment of revenues from other taxes traditionally subject to revenue sharing (for other purposes), along with the devolution of numerous government services previously provided at the federal level, provoked a profound crisis in the financing of the provincial governments. This undermined the efficacy of the existing revenue sharing law - which was due to expire at the end of 1984 - and raised anew the historically fierce tug-of-war between the national government (centered in Buenos Aires) and the provinces over governmental rights and responsibilities, creating an additional problem for the future civilian government which would be very difficult to resolve.

In addition, despite the military government’s proclaimed intention to limit the state’s role in the economy, after 1978 the military government greatly expanded the scope of tax exemptions aimed at promoting industrial investment. Though the government suspended tax exemptions for
non-traditional exports and imposed limits on the national industrial promotion system, in 1979 it established a series of special regimes for several poor provinces which would turn out to be far more generous than the previous national-level promotion regime. These regimes, like the national promotion system, provided the promoted businesses exemptions from import duties on the purchase of capital goods, exemptions from income, capital gains and stamp taxes, and allowed investors in the promoted projects to defer tax payments amounting to a fixed percentage of the amount invested for five years. But, unlike the newly reform ed national system, full exemption was extended for the VAT (by far the most costly privilege for the treasury), the period of exemption was extended from 10 to 15 years, and the provincial governments were given authorization to approve new projects and monitor the firms' compliance with their investment commitments and legal norms. The provincial promotion regimes created a strong incentive for the rapid expansion in the number of promoted projects since the provinces stood to gain from the establishment of industries and paid only a very small share of the costs of the subsidies.

As the mass of promoted projects grew, the fiscal cost of the industrial promotion system multiplied year by year throughout the 1980s to the point where in 1987 its estimated cost reached more than 3.0% of GDP, which still did not take into account all of the revenues lost due to the tax evasion facilitated by the promotion system (World Bank, 1990). The promotion incentives greatly undermined collection from the more modern and efficient taxes such as the VAT and the income tax, and forced the government to look for alternative taxes which led to greater distortions in the allocation of productive resources.

As part of a general effort on the part of the military rulers to retain some legitimacy and authority during the transition process and to prevent reprisals by the succeeding civilian
government, at the beginning of 1983 the government made most foods and medicines again exempt from the VAT and lowered both the general and special rates from 20% and 8% to 18% and 5%, respectively. Though these changes reduced some of the inequities in the tax system, they deepened the crisis in the pension system and provincial government finances. In addition, to offset the effects of the strong real devaluation of the currency in 1981-1982, the retentions on exports were restored.

Thus, while the policies of the military government brought important changes to the country's socio-economic structure -- including a more concentrated and smaller industrial sector and a substantial redistribution of income from the working to the upper classes -- the scope of the state was not reduced significantly and the walls protecting the economy were readily resurrected (Schvarzer, 1983; Azpiazu and Basualdo, 1989). In addition, the military government left to the next civilian government a tax system which was, if anything, in a weaker state than before the coup. As a result of the sharp reduction in revenues, increased transfers from the national treasury to the social security system, indebted public enterprises, and financially strapped provinces, and increases in salaries for public employees, in 1983 the public sector deficit equaled that left by the Peronist government (about 15% of GDP). But, this time, given Argentina's large foreign debt and the scarcity and high costs of international capital, it was much more difficult to finance.

**Constraints to Fiscal Adjustment and Reform: The Legacy of the Past**

The experiences during the Peronist government (1973-1976) and the military regime (1976-1983) had an important impact not just on the socio-economic structure but on societal attitudes and political behavior, which affected the context for economic policy-making in the new democracy. The high levels of violence experienced during the 1970s as a consequence of
guerrilla and paramilitary warfare and then the repressive actions of the military's security apparatus convinced the majority of citizens and political elites of the intrinsic value of democracy and undermined esteem for extremist ideological positions. And, more subtle changes in the political party system, described below, also occurred partly as a consequence of these convulsions. But, the experience of the preceding decade also left for the new democratic government an economic crisis of unprecedented proportions, a still more contentious relationship between civilian politicians and military authorities, and what Andrés Fontana calls the "pernicious effects of a long period of freezing the conduct and the activity of political parties and the unions" (Fontana, 1992). Taking into account the changes which resulted from these traumatic experiences, this section discusses the social, political, and economic context confronted by Alfonsín in light of the explanatory framework presented in chapter 1.

**Severity of Economic Crisis/Magnitude of International Pressures**

As a consequence of the debacle of the military's economic program and the onset of the international debt crisis, Alfonsín assumed the presidency in the context of a severe economic crisis. Service payments on the foreign debt had climbed from 10% of total exports in 1980 - a year in which exports were suppressed by an overvalued currency - to 54% in 1983. The size of the external debt relative to the value of exported goods and services exceeded all countries in the region except Nicaragua (ECLA, 1985). Thus, the country tottered on the brink of non-compliance with its debt obligations and constantly needed debts to be rescheduled and loans to be extended just so that creditworthiness could be maintained. And, partly as a consequence of the large interest payments on the public debt, the public sector deficit had reached unprecedented levels.

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While, on the one hand, the deep crisis in external and public sector financing signaled the need to undertake a profound adjustment and enact major fiscal reforms, it also meant that the sacrifice on the part of the Argentine people necessary to restore financial equilibrium would be enormous. In these circumstances, significant hardship in the short term would not necessarily translate into a major reduction in inflation or other long term improvements in the economy. Thus, given the pent-up demand among the working and middle classes for improved living conditions and the depth of the economic crisis, it was understandable that politicians may have initially viewed the political costs of fiscal reform and adjustment to exceed the potential benefits.

Argentina's difficulty in servicing the massive foreign debt inherited from the military government put pressure on the new civilian government to negotiate with international creditors and external agencies for loans and rescheduling and to accept their policy conditions. The debt interest burden entailed a greater constraint on government policy-making in Argentina than in Brazil or Uruguay. Interest payments were least constraining in the case of Colombia, where the total public debt in relation to the volume of exports was considerably lower (See Table 2.6)\(^\text{16}\). Brazil enjoyed a much more buoyant and diversified export sector and thus could more easily cover its debt obligations (Kaufman, 1990). Since a large proportion of exports continued to be centered around the agriculture and livestock sector, Argentina's capacity to service the debt varied significantly according to fluctuations in international markets.

**The Legacy of the Military Regime and the Transition to Democracy**

Given the fact that the military government's economic program was widely condemned as privileging a small minority at the price of impoverishing the working and middle classes, and, given the depth of the economic recession, "it became difficult to separate the objectives of redemocratization from substantive policies aimed at the rapid improvement of depressed living
standards" (Kaufman, 1990). After the dramatic failure of the military's economic program, which was widely seen as a pure test of economic liberalism, much of the public held a negative view of market-oriented and orthodox policy recipes. The interim government of General Reynaldo Bignone, in attempting to control social tensions surrounding the transition process, had responded to these strong public pressures for improved economic conditions by granting large real wage increases. Thus, while prolonged experience with economic stagnation and price instability lowered expectations in respect to how well the economy could perform, the Argentine popular sectors had high expectations that the restoration of democracy would bring an improvement in their relative economic position and the return of a state at the service of the population. Thus, with the return of competitive politics and open political expression there were strong pressures for more redistributive and expansionary economic policies.

Given the fact that the transition to democracy was precipitated by the military government's demoralization and collapse following the dramatic breakdown of the economic program and the armed forces' humiliating defeat in the 1982 Malvinas/Falklands war, the Alfonsin government had less reason initially to fear a military backlash against its policies than the Sarney government in Brazil, where democratization resulted from a prolonged and negotiated transition and the military retained extensive domains of power and authority and remained relatively cohesive as an organization (Viola and Mainwaring, 1984; Mainwaring, 1984; Kaufman, 1990). However, the long history of intervention by the military in Argentine politics and the historical weakness of democratic institutions and civilian capacities in relation to the military made it more likely that when the Alfonsin government set out to assert civilian supremacy over the military and prosecute military officers for human rights abuses it would run the risk of raising civilian-military tensions. Thus, the legacy of the country's past political
history and the absence of a civilian-military pact, which left Alfonsín the burden of establishing
civilian authority over the military and punishing the military for human rights violations,
arguably compromised the freedom of maneuver which the government otherwise might have
had in respect to economic policy-making. By increasing the tensions between the government
and the military, such confrontations - necessary for progress in consolidating democracy -
tended to unify an otherwise divided military and increased the need for the government to
maintain the allegiance of civilian sectors to democracy.

The situation of Alfonsín in Argentina contrasts significantly with that of Sanguinetti in
Uruguay, where the long history of democratic governance and strong political institutions, and
the military’s sound defeat in the 1980 plebiscite and internal party elections in 1982, meant that
the armed forces more passively acceded to civilian control. The human rights issue also did not
result in the same level of civilian-military tensions as in Argentina since the scale of the abuses
was smaller and did not give rise to such strong pressures to prosecute those responsible, and
since the transition resulted from a pact with the military which placed clearer limits on how far
the civilian authorities could go without provoking a military backlash (Stepan, 1988; Gillespie,

The Party System and Party Links with Societal Organizations

Because of the authoritarian characteristics of Perón’s first regime (1946-1955), the
proscription of Peronism from full political participation from 1955-66, and the successive
military coups of the late 1960s and 1970s, the two major political parties had experienced only a
very brief period of cohabitation in a competitive, democratic system from 1973 to 1976.17 As
James W. McGuire points out, instead of being political organizations which recognized the
legitimate role of opposition parties in the political system and which established durable
philosophies and programs, Peronism and Radicalism tended to "seek a form of national unity in which political opposition withers away", to "try to achieve or retain power by the most expedient means at hand", and to "exalt leadership and give their leaders great programmatic and procedural flexibility." McGuire concludes that given the lack of recognition by each party of the legitimate role of opposition parties in the political system, the absence of prolonged periods of free and fair democratic competition, and the weak institutionalization of both parties, until 1983 Argentina had lacked a true party system (McGuire, 1994).

Despite the absence of a defined pattern of interaction between the parties in a democratic setting, the two parties and their followers comprised subcultures which were highly adversarial. Conflicting feelings toward Perón and the policies followed during his regime, differences in class and group loyalties and memberships, and different outlooks toward political organization and representation were part of the basis for the high degree of polarization between these two subcultures. Both parties had traditionally resorted to confrontation as a mechanism for mobilizing their followers and making their positions known. Thus, unlike the cases of Uruguay and Colombia, but similar to Brazil, Argentina's new democracy was one in which a stable and legitimate political party system was never consolidated. Some progress was made toward building a true party system when Ricardo Balbín - the head of the (then) newly unified Radical Party - signed an agreement - “la Hora del Pueblo” - with Perón in 1971 in which both leaders accepted the right of each party to coexist within a democratic system (Cavarozzi, 1986b). And, the experience of extreme violence and repression during the 1970s had certainly reduced the weight of the far right and the far left in the Peronist movement and convinced most politicians from both parties of the intrinsic value of democracy. But, since the democratic experiment was so short-lived and the founders of inter-party agreement both died before 1983, "the tradition of
exclusivistic alternative parties [still] had to be overcome" in the new democracy (Cavarozzi and Grossi, 1992). Thus, given the weakly institutionalized and polarized nature of the party system, and the absence of a civil-military pact preceding the transition, there was little chance that the parties would cooperate in the formulation of economic policies (Cavarozzi, 1992; de Riz and Feldman, 1991)).

The Alfonsín government was handicapped in its efforts to confront the economic crisis by the historical weakness of the links between the Radical party and important economic groups. Past leaders of the two major factions of the Radical party, including Frondizi, Illia, and Balbin, had deliberately avoided attempts to build close ties with economic interest groups, viewing this as antithetical to their goal of representing the average citizen. As discussed above, both parties lacked ties with the major rural organizations since the economic interests of landowners were seen as incompatible with those of the majority of the Argentine electorate. The industrial sector was divided between the smaller, local capitalists, who tended to be represented by the General Economic Confederation (CGE) - created by Perón - and large local and foreign capital interests, who were represented primarily by the Argentine Industrial Union (UIA) and the Argentine Chamber of Commerce (CAC). The CGE usually backed populist policies and governments and was incorporated, along with the CGT, into Perón’s attempt to solve the economic crisis through a social pact in 1973-1974. Given its ties to Peronism, the CGE was banned during each authoritarian period and had its assets confiscated during the Videla government (Manzetti, 1993). With the CGE weakened by repression, industrial organizations in the 1980s had weak ties to the main political parties and were disposed to provide political support only if given adequate representation in decision-making and if policy decisions took their interests into account.
The unions, on the other hand, remained firmly tied to Peronism, but, by the early 1980s, were divided into several factions. Harsh repression of the union leadership and rank and file during the Peronist government and during the *Proceso* severely weakened the leftists unionists (both Peronists and non-Peronists) but also left some prominent right-wing union leaders in jail. As a consequence, the more traditional Peronist bosses regained control over the bulk of the labor movement and obtained important positions in the party and in the electoral lists for key political offices. In the first year of Alfonsin's administration, leadership in the labor movement was in dispute as the procedures for electing union officials had to be recreated after the restrictions imposed in 1979 with the Law of Professional Associations enacted by the military government. Thus, the Alfonsin administration had to confront a union movement which, mirroring the Peronist party itself, was divided into different factions which were each seeking to increase their power in the political system and to restore labor union rights and privileges abolished by the military government (McGuire, 1992; Epstein, 1989; and Epstein, 1992). Though the Alfonsin government could potentially take advantage of these divisions by playing them off each other and forging an alliance with a more conciliatory faction, such a strategy would not likely succeed given the fact that most union leaders and members considered themselves as Peronists, many held positions in the party and the legislature, and the rank and file retained a basic allegiance to Peronism.

Thus, given the union movement's internal struggle for power and influence and its interest in the electoral victory of Peronism, unions had little to lose in confronting the Alfonsin government. Though a given faction might be tempted to strike a deal with the government, labor unions taken as a whole were inclined to oppose the Alfonsin government's stabilization efforts as much for political as strictly materialistic reasons.
Party Ideologies

Though because of their movementist characteristics neither party had a clear ideology or political program, both parties, when in power, supported a strong economic role for the state and protection of industry from foreign competition. In addition, surveys conducted in the early to mid-1980s showed that supporters of the Radical Party and the Peronist Party differed little in terms of their self-placement on a left-right ideological scale or on key issues such as the proper role for the state in the economy. Despite the low salience of ideology among the electorate, until recently the parties (or movements), especially Peronism, have been comprised of numerous factions which espoused highly conflictive positions regarding the economy and how the political system should be organized.

By the late 1960s, Peronism, though held together loosely by loyalty to its exiled leader, came to embody factions ranging from the far left to the far right. When he was elected president again in 1973, after pushing aside his appointed stand-in, Héctor Cámpora, Perón finally banished from the movement those on the extreme left, and pursued a heterodox stabilization program which relied on price and wage controls and adopted some mildly distributive and nationalistic policy reforms. Directed by her personal advisors, after the death of her husband, Isabel Perón veered toward the extreme right, carrying out an aggressive campaign against subversive groups (including those claiming ties with Peronism) and union activists and implementing a harsh austerity program backed by the heavy hand of the state (Di Tella, 1989). Thus Cámpora's left-wing policies, Perón's more middle-of-the-road approach, Isabel Perón's shift to the right, and the violent conflict between the government and parts of the Peronist union leadership and subversives, revealed the depth of the ideological rifts represented in the Peronist movement. The support of nearly every sector of Argentine society for the March 1976 military
coup indicated the political bankruptcy of the Isabel Perón government and the inability of the various factions of Peronism to turn themselves into a viable political party (Cavarozzi, 1986b).

Thus the chances for cooperation between the two major parties were undermined not only by the basic historical antagonism between Peronism and Radicalism but by the deep divisions in the Peronist party which were perpetuated by Perón’s death, the dismal performance of Isabel Perón’s government, the absence of strong leadership, and the freezing effects of political repression during the military regime. Thus, given the internal competition for leadership and the need for the party to distinguish itself from the Radicals and to recapture its working class base, the rational electoral strategy for each faction appeared to be one of staunch opposition to the government’s efforts to solve the economic crisis (de Riz and Feldman, 1991: Cavarozzi, 1986b).

Alfonsín first came to prominence in national politics when in the late 1960s he spearheaded a dissident group within the Unión Cívica Radical del Pueblo (UCRP) - Renovation and Change (RyC) - which allied with student activists in the Junta Coordinadora Nacional to push the party to take a more militant line against the military dictatorship (1966-1973). In order to broaden the appeal of the party and to compete with the aging leader of the party - Ricardo Balbín - this movement attempted to mobilize the popular sectors, including those that had traditionally been part of the Peronist constituency, and the youth. As evidenced by the policies followed during the truncated presidency of Arturo Illia (1963-1966), the UCRP was more strongly nationalist and populist in orientation than Fronidizi’s UCRI - the faction which split from the Radical Party in the late 1950s (Table 2.7). But, the Renovation and Change Movement wanted to strengthen the party’s popular base and supported a more anti-imperialist, anti-corporative, and redistributive agenda than espoused by traditional party leaders, such as Balbín -
who headed the more conservative National Line (Linea Nacional) branch of the reunified Radical party of the 1970s (M. Acuña, 1984; Guerrero, 1990; Cavarozzi, 1986a).

Though Alfonsín lost by a relatively close margin to Balbin in the 1973 presidential primary, this surprising electoral success established his leadership credentials. When Balbin died in 1981 this cleared the way for Alfonsín, who defeated his more conservative opponent, Fernando de la Rúa, in the 1983 primary election by convincingly making the case that he had the best chance to defeat the Peronist candidate. Though in the presidential campaign Alfonsín put the greatest emphasis on the issues of democracy and human rights, he pledged also to work on increasing the living standards of those who had suffered the most under the dictatorship's policies and the economic crisis. The Radical party platform continued to support an active role for the state in promoting the development of the country, protecting the national interest, and in bringing about greater social equality (Guerrero, 1990; M. Acuña, 1984). His stance toward the economy was consistent with his allegiance to the traditional statist and populist orientation of popular radicalism and the more nationalist and redistributive objectives of the Renovation and Change movement. Thus, the Alfonsín government and Radical party, in making economic policy choices was motivated by its social democratic orientation as well as by pure considerations of power.

The Extent and Limits of Alfonsín’s Electoral Mandate

When Alfonsín received the support of 50% of Argentine voters to the Peronist Italo Luder's 40% on October 30, 1983, it marked the Radical party's first victory in a free and competitive election since 1928 and its first victory over Peronism in such an election ever. Only ten years earlier Ricardo Balbin was humiliated by Perón's stand-in candidate, Héctor Cámpora, receiving only 21% of the vote to Cámpora's 50%. Lasting memories of the intra-party violence
and ineptness which characterized the previous Peronist government (1973-1976), an undemocratic nomination process, rumors of a "union-military pact," and the caustic rhetoric and authoritarian behavior of union leaders during the campaign, eroded the initial advantage of Luder in respect to the partisan attachments of the electorate. By contrast, the strong appeal of Alfonsin's pro-democratic discourse and firm stand on human rights, and the mobilizational and organizational efforts of his colleagues in the Renovation and Change Movement within Radicalism, helped secure the Radical Party victory.20

Alfonsin obtained this surprising victory by capturing a relatively large share of the votes of the working class - the sector on which the Peronist party traditionally had an iron grip - and by gaining the support of moderates and conservatives that had traditionally favored center-right parties (Mora y Araujo, 1986; Catterberg, 1991; Floria, 1987). While the Radical party continued to receive its strongest support from upper and middle socio-economic sectors and center-right voters, in sharp contrast with the 1973 elections, it managed to out-perform the Peronist party among relatively skilled workers. Only among unskilled workers did the Peronists receive more votes than the Radicals.21 In addition, Alfonsin received the backing of the majority of pampean farmers. Despite the fact that the working class was not a major part of the Radical party's historical constituency, Alfonsin's success in capturing an important portion of this sector's votes planted the hope among party leaders that the dream of breaking the control by the Peronist party over the labor movement could possibly be fulfilled.

Even though the Radical party received an absolute majority of the popular vote and secured a majority of the seats in the Chamber of Deputies (129 of the total of 254 seats)22, the concentration of its share of the vote in a small number of underrepresented industrialized provinces left it with only eighteen out of 46 seats in the Senate (compared with 21 for the
Peronists) and control of only seven provincial governments as compared to the twelve that went to the Peronists.\textsuperscript{23} Despite having received a majority of the popular vote, given organized labor's basic allegiance to Peronism, the Radical party's lack of close ties with important business or agricultural groups and the lack of control over the Senate and the majority of the provincial governments the government was perceived by many observers as starting from a relatively weak political position.\textsuperscript{24}

**Centralization of Governmental Authority**

Given the federalist nature of the political structure and the impending expiration of the federal revenue sharing law (as well as the discretionary nature of this law), the weakness of the Radical party government in the provinces and the Senate was highly significant. In the Argentine federalist system the provinces were responsible for about one half as much expenditures as the central government but collected only one third as much revenues. Therefore, transfers to the provinces represented a significant share (about two sevenths) of the current expenditures of the consolidated public sector (Argentine Treasury Secretary, 1995). But, since the revenue sharing system, especially after December 1984 (when the prevailing law expired), did not impose strict limits on the amount of these transfers or upon the exact distribution of total transfers among the individual provinces, there was little incentive for provincial governments to improve their own tax collection or to cut back on spending. In fact, the amount of discretionary funding received by a given province was likely to be proportionate to the degree to which its finances were out of balance.

But, the Radical party’s weakness in the provinces and lack of majority in the Senate represented a serious handicap for fiscal adjustment under these circumstances. Senators, who were (until 1994) elected by the provincial legislatures, tended to defend the interests of their
provinces against encroachments by the national government. Thus, obtaining approval for key economic legislation in the Senate typically entailed concessions to provincial interests, often in the form of additional financing or the extension of fiscal subsidies or incentives. Similarly, attempting to reform the federal revenue sharing system, industrial promotion system, or provincial tax systems, or to impose fiscal austerity upon the provinces, risked jeopardizing this crucial support. In addition, the predominance of Peronism in the provincial governments made it even more likely that the provinces as a whole would take full advantage of the distorted incentives created by the federal revenue sharing system.

Special Executive Powers

As mentioned in chapter 1, the lack of control of a congressional majority or deficient governing party legislative support does not necessarily prevent a president from enacting controversial legislation if the constitution and other features of the institutional context permit him to enact legislation by decree or to exercise control over legislative outcomes through extensive powers to shape the legislative agenda. In Argentina the constitution permits the executive to enact decrees when such authority is delegated to it by the congress through legislation and directly in the case of executive rule-making decisions. Of course, a president is more likely to be delegated decree-making authority by the legislature the greater his party's share of the congressional seats or the greater is the sense of crisis.

Unlike the cases of Brazil and Colombia, but similar to Uruguay, the Argentine Constitution (until 1994) did not grant the President independent law-making authority except under exceptional circumstances. Thus, on the few occasions in which presidents had issued so-called "decretos de necesidad y urgencia" (necessity and urgency decrees) - that is, made laws without having such authority delegated to them by the legislature - it was based on the claimed
existence of a social emergency. But, given the brief period in which the Argentine political system had functioned under the strict guidelines of the 1853 constitution, after the transition to democracy in the early 1980s there was not a firm consensus among legal experts and politicians about the constitutionality of such decrees (Ferreira Rubio and Matteo Goretti, 1994). As Menem's presidency would plainly illustrate the constitution was not sufficiently clear (because it did not explicitly forbid such decrees) and the courts not sufficiently independent to block the executive from appropriating legislative powers. Since the constitution and legal system did not seal off the decree option, such factors as leadership style and the nature of economic and social circumstances influenced the extent of the president's actual powers for passing legislation. Thus, given the fact that Alfonsin won the presidency on the basis of strong democratic credentials, was committed to the goal of strengthening democratic institutions, and was associated with a party which had a stronger democratic tradition, he was not inclined to heavily use urgency and necessity decrees to enact controversial legislation. But, also because of the government's minority status in the Senate and weak ties to organized groups, he would likely have encountered stiff protest from the Peronists and their union allies if he pursued a strategy which relied strongly on extraordinary powers.

In addition to decree power, in practice the executive has had fairly extensive powers to veto legislation. Though the Constitution leaves the matter unclear, the Supreme Court has permitted the executive branch not only to veto bills outright but also to partially veto pieces of legislation, even when the constitutional requirement that the integrity of the legislation be preserved is violated (Mustapic and Ferreti, 1995). Since it takes a 2/3 majority of each house of congress for the legislature to insist on the passage of its own version of the bill, the partial veto gives the executive a great deal of power over the legislative process. But, as with the use of
decree powers, given the questionable constitutional status of the partial veto, the extent to which this power would be used by the executive to exert influence over legislative outcomes depended on the strength of the president's allegiance to democratic principles and, possibly, the severity of the economic crisis.

An Opportunity to Break the Impasse?: Context for Policy-Making in the Alfonsin Government

Thus, Alfonsin assumed office in circumstances in which there was a better chance than ever before that conflicts between social groups could be managed within the institutional system, but there remained great obstacles to sustained economic adjustment and growth. A silver lining in the otherwise tragic events of the 1970s was the fact that the experience of civil and state violence had forged a consensus among nearly every significant group in society behind the need to protect civil liberties and democratic procedures of governance. Building on the foundations laid by the “La Hora del Pueblo” agreement (1970) the two major parties were both committed in principle to democracy and accepted each others’ right to exist. The chances that democratic practices and rules would flourish was greatly enhanced by Alfonsín’s clean electoral victory over Peronism, which previously had never lost an open electoral contest. In a complete break with the past, the country would be led by an individual with an untainted electoral mandate who was fully committed to strengthening democracy.

In addition, the military’s corrupt and inept management of the economy, flagrant violations of basic human rights, and ignominious conduct in the Malvinas War had severely weakened its internal cohesion and its reputation in society. Thus, these factors increased the possibility that civilian authority over the military could be established and that the military
would not, initially, constitute a major threat to the new democratic government or be able to strongly assert its preferences.

But, the Alfonsin government still faced some powerful constraints. As a result of the disintegration of the military government following the defeat in the Malvinas, the Peronists and the Radicals were not forced to reach an agreement in order to compel the military to give up power and the military was not able to impose any conditions, including civilian respect for an amnesty for officers suspected of committing human rights violations. While this was positive from the standpoint of the completeness of the new democracy and the possibilities for victims to obtain justice, it contributed to a more hotly contested election and a more adversarial relationship between the two major parties and increased the chances for a later escalation of civilian-military tensions. Given the parties' lack of experience cohabitating in a competitive democracy and the continued high level of animosity, it was doubtful that economic problems could be solved through inter-party agreements. Thus, given these underlying institutional constraints, the restricted scope of Alfonsin's electoral mandate was a great handicap to his ability to manage the severe economic crisis which he inherited.

At the same time, the military left an economy which suffered from deep structural imbalances, including a massive publicly held foreign debt, a huge public sector deficit, a weak and porous tax system, and high levels of unemployment and underemployment. While these severe economic problems suggested the need for major reforms, it was equally tempting for politicians and society to blame them on the corrupt and inept management of the military. And if anything, the conclusion drawn by society was that liberal economic policies had redistributed income in favor of the rich, large domestic and multinational corporations, and financial speculators and at the same time had failed to make the economy grow or to lower inflation.
<table>
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<tr>
<th>Year</th>
<th>National Tax Revenues</th>
<th>Provincial Tax Revenues</th>
<th>Total Tax Revenues</th>
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<tr>
<td>1980</td>
<td>14.46</td>
<td>3.22</td>
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<td>1989</td>
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<td>1994</td>
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<td>3.22</td>
<td>19.48</td>
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Table 2.1: Total Tax Revenues of the Consolidated Central Government as a Percentage of GDP, 1980-1994.

Source: Secretary of Public Revenues. "La Recaudación Tributaria en el Cuarto Trimestre de 1994."
Table 2.2: Tax Revenue Collection by Source as a Percent of GDP, 1973-1980.


Note: This data is constructed on the basis of the GDP series used prior to 1992 when a new methodology was devised and applied for fiscal data going back to 1980. Thus, budgetary and tax figures (taken as a percent of GDP) for years following and including 1980 are not comparable.
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<th>Mexico</th>
<th>Colombia</th>
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Table 2.3: Tax Revenues in Selected Countries (Percentage of Total).


Note: Figures refer to 1980 except in the case of the OECD where they refer to 1983.
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<td>12.4</td>
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Table 2.4: Public Sector Expenditures and Revenues by Major Institution, 1975-1983 (as a Percent of GDP).

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<td><strong>Total Gross Tax Revenues</strong></td>
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<td><strong>Total Net Tax Revenues</strong></td>
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<td>12.28</td>
<td>17.35</td>
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Table 2.5: Tax Revenues by Source (as a Percent of GDP), 1980-1985.

1.) Includes other direct taxes which collect very little revenues.
2.) Includes revenues from cigarette taxes (approximately .50% of GDP) which are assigned to the pension system.
3.) Includes revenues from amnesties for past due taxes.


110
Table 2.6: Comparison of Foreign Debt Burden in the 1980s: Argentina, Brazil, Colombia, and Uruguay (in Percent).

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1916-1922  Hipólito Yrigoyen (Unión Cívica Radical)
1922-1928  Marcelo T. de Alvear (Unión Cívica Radical)
1928-1930  Hipólito Yrigoyen (Unión Cívica Radical)
1930-1932  José F. Uriburo (Military)
1932-1938  Agustín P. Justo (Military-Concordancia)
1938-1940  Roberto M. Ortiz (Concordancia)
1940-1943  Ramón S. Castillo (Concordancia)
1943      Arturo Rawson (Military)
1943-1944  Pedro P. Ramírez (Military)
1944-1946  Edelmiro J. Farrel (Military)
1946-1955  Juan Domingo Perón (Partido Justicialista)
1955      Eduardo Lonardi (Military)
1955-1958  Pedro E. Aramburo (Military)
1958-1962  Arturo Frondizi (Unión Cívica Radical Intransigente)
1962-1963  José María Guido (Military-dominated interim president)
1963-1966  Arturo Illía (Unión Cívica Radical del Pueblo)
1966-1970  Juan Carlos Onganía (Military)
1970-1971  Roberto M. Levingston (Military)
1971-1973  Alejandro A. Lanusse (Military)
1973      Héctor Cámpora (Partido Justicialista)
1973      Raúl Lastiri (Partido Justicialista)
1973-1974  Juan Domingo Perón (Partido Justicialista)
1974-1976  María Estela Martínez de Perón (Partido Justicialista)
1976-1981  Jorge Rafael Videla (Military)
1981      Roberto Viola (Military)
1981-1982  Leopoldo F. Galtieri (Military)
1982-1983  Reynaldo B. A. Bignone (Military)
1983-1989  Raúl R. Alfonsín (Unión Cívica Radical)
1989-      Carlos S. Menem (Partido Justicialista)

Table 2.7: Argentine Presidents since 1916
Endnotes to Chapter 2

1. For an analysis of the political logic behind the military government’s economic program see Canitrot (1980)

2. This occurred in 1976, before the massive overvaluation of the currency which occurred under the final, and more lasting, stabilization plan of Martínez de Hoz (from September 1978 to April 1981. As it turned out, export taxes would likely have been highly punitive to the agricultural sector and counterproductive, given the currency appreciation accompanying the Tablita program. Export taxes were restored gradually beginning in 1981 after the major currency devaluations, which improved the terms of trade for the agricultural sector.

3. In terms of the previous GDP series total tax revenues of the national and provincial governments were 27% of GDP in 1980 from only 17% of GDP in 1975. In 1975, the overall public sector deficit was 14.4% of GDP (Consejo Técnico de Inversiones S.A., 1986). For a description of the changes to the tax system adopted by the military government see FIEL (1991).

4. Figures compiled for years prior to and including 1980 are based on the pre-1992 methodology for determining GDP. Figures cited for 1980 and afterwards use the new methodology which increased the estimated GDP by about 30% and, therefore, reduces by this proportion expenditure and tax revenue figures calculated as a percentage of GDP.

5. Clarín. July 26, 1984. This estimate of evasion should be measured against tax revenue figures from data series using the pre-1992 methodology for calculating GDP. According to this data series total tax revenues for 1984 were only 18% of GDP.

6. The creation of a temporary wealth tax to individuals and corporations in 1976 could potentially have offset the regressivity of these changes. But, in practice the wealth tax, and particularly that applied to individuals, was weakly enforced and collected very little revenue (about .10% of GDP in the case of individuals).

7. In fact, though numerous small enterprises which cost the state little to run were privatized at extremely low prices, large enterprises were left untouched or grew in size. Jorge Schvarzer (1982) argues that the net effect was a continued increase in the size of the state sector (J. Schvarzer, 1982). See also Corbo, de Melo, Tybout (1986).

8. The real value of revenues collected is reduced by inflation because of the time lags between when the tax amount is determined and when the revenues enter the treasury. This is the so-called Olivera-Tanzi effect.

9. The VAT was extended to most goods previously excluded including food, medicine, inputs for construction, and public utilities. The law (Law 22.294) established that the general rate should be 25% but gave the executive the power to lower it at a later date. The government in a short period of time lowered the general rate to 20% and established a differential rate of 10% for most of the
goods which were previously exempt (Carciofi, Barris, and Cetrángolo, 1994).

10. The general rate was raised from 16% to 20% while the unified rate structure established in 1976 was replaced by one in which differential rates were applied to certain goods such as food and medicine (Schvarzer, 1986 - *El Bimestre*). The rate for independent workers was raised from 12% to 15% in 1980 (World Bank, 1993).

11. The provinces suffered a sharp drop in the revenues they received from the national government between 1980 and 1983. While only 10.4% of the mass of revenues shared with the provinces went to social security in 1980, this figure had risen to 47% by 1983. The loss of financing for the provinces was compounded by the fact that, as we have seen, the total quantity of shared revenues shrunk considerably over this period (Carciofi, 1990).

12. The previous revenue sharing law (Law 20,221) was approved in 1974 at a propitious moment for the rapid resolution of the issue. Perón and his political party had just won a landslide electoral victory which gave them control of the both houses of Congress and most of the provincial governments. Law 20,221 provided that 48.5% of the mass of revenues from taxes collected at the national level (including all the taxes which were not assigned for specific purposes) were to be transferred to the provinces and the same amount would stay in the national treasury. An additional 3% of total revenues was assigned to a regional development fund. The secondary distribution of revenues among the provinces was determined by a formula which tended to strongly favor the less developed and underpopulated provinces (Carciofi, 1990, 16-18; FIEL, 1993, 144-146).

13. Through Law 21,608 (1977), which replaced the previous promotion law from 1973, the Videla government aimed to limit the number of new industrial projects granted tax exemptions by establishing a quota in the budget for the total costs of the promotion system. These limits were in practice circumvented. In 1977 through Law 21,636 the government sought to limit the extent of tax deferments granted in practice to future promoted projects by indexing them to inflation. In 1978 and 1979 the military government sought to restrict the extent of the exemption granted for the VAT, but by June 1982 these benefits were restored in full. Contradicting these efforts to reduce the scope of tax privileges, however, in 1979 the government enacted a law which established a special industrial promotion regime in the poor province of La Rioja (Law 22,021). This regime was more generous than the national promotion law since it provided full exemptions for the VAT and gave the provincial government the authority to approve new projects (with projected investments of up to about 1 million dollars). In 1982 practically the same benefits were extended to Catamarca and San Luis (Law 22,702). At the end of 1983, when the military was about to transfer power to the new civilian authorities the same benefits were extended to San Juan (Law 22,973) where the Bloquistas - a party favored by the military over the Peronists - was about to assume control of the government. The laws provided a period of exemption from tax payments of 15 years instead of the 10 years specified in the national law. In August 1983 the period of benefits under the national law was also extended to 15 years (Schvarzer, 1987; FIEL, 1991).

14. By the end of 1987 virtually all investment activity was subsidized to some extent (except for that in the Federal Capital). This greatly complicated the efforts of the D.G.I in monitoring business compliance with the tax laws (World Bank, 1990, p. 26).

16. In 1983 debt service payments amounted to 10% of GDP in Argentina and only 4% of GDP in Uruguay and 3% of GDP in Colombia. See ECLA (1990; V. 1).

17. An agreement was reached in 1970 called "La Hora del Pueblo" in which the two parties agreed to respect each other's free participation in a competitive, electoral system. As a consequence of this accord, during the short nine months of Juan Perón's tenure as president in 1973-74, the two parties, or more accurately the two party leaders (Perón and Balbin) for the first time cooperated to some extent on policy-making and accepted each other's right to compete freely in the political process. But, as Marcelo Cavarozzi (1986) points out, many of the factions within Peronism at the time remained strongly opposed to the idea of establishing a party-dominated political system.

18. The parties' supporters did differ, however, in terms of their views in respect to the role which corporate sectors, such as unions and business organizations should be given in decision-making. The Peronist party and its followers tended to favor a more active role for sectorally organized economic groups. See McGuire (1994).

19. Alfonsín received 50% of all those who voted but 52% of those casting legitimate ballots in which a presidential selection was made.

20. For analyses of the democratic transition see Cavarozzi (1986a), Floria (1987), and Cavarozzi (1992).

21. Edgardo Catterberg divides the lower classes into the "structured lower classes" which include specialized workers, technicians, salespeople, and semispecialized workers and the "unstructured lower classes" which include unqualified and nonspecialized workers. In the 1983 elections the Peronist party only outperformed the Radical party among the unstructured lower classes. In 1973 Miguens estimated on the basis of pre-election surveys that almost 90% of the lower sectors backed Peronism, which represented 72% of the votes for the Peronist Party. See Catterberg (1991) and Miguens (1983).

22. The Peronists received 111 seats. The rest were taken primarily by smaller regional parties whose support is concentrated in individual provinces.

23. Though Alfonsin gained more votes than Luder in 14 provinces the Peronists prevailed in elections for provincial deputies and governors in seven of these provinces. The governorships in three out of the twenty-one provinces - Corrientes, Neuquén, and San Juan - were captured by historically strong provincially-based parties. See Liliana de Riz and Gerardo Adrogué (1991).

24. Interviews with former officials in the Ministry of Economics.
CHAPTER 3

THE GOVERNMENT OF ALFONSIN: LIMITED FISCAL REFORMS UNDER HEAVY CONSTRAINTS

Introduction

Given Argentina's long term economic decline and the extreme crisis inherited from the military government, those subscribing to the conventional wisdom or those holding "voluntaristic views" of policy-making would have expected the Alfonsin government to immediately undertake aggressive actions to steer the economy in a more steady and favorable direction. If the existence of a severe economic crisis is viewed as a necessary and sufficient condition for politicians to undertake socially costly and politically risky economic reforms, or is viewed to lead automatically to technically correct policy responses, then a dramatic record of economic reform would have been expected. But, this, clearly, was not the case. The Alfonsin government first responded as if the same economic policies applied during the 1950s and 1960s would work effectively in the 1980s, when the Argentine economy was highly indebted, foreign capital scarcely available, and state finances crippled. Then, even when the government took more complete notice of the seriousness of the economic situation, it still proceeded rather slowly in putting forth an agenda of significant reforms, had great difficulty in managing the budget, and was unable to implement many of the fiscal and other public sector reforms which it proposed.

What were the main factors that delayed the government’s response to the crisis? Why was the government unwilling or unable to implement sufficient fiscal and public sector reforms to stabilize the economy, even though the failure to do so ultimately resulted in the revival of
inflationary pressures and the steep erosion of its popularity? One possible explanation, which has also been employed to account for Argentina's historic failure at political and economic development, is that the conflicting pressures of powerful social and economic groups prevented the formulation and implementation of a coherent response to the crisis. However, as this chapter's analysis of the Alfonsin government's fiscal policy-making record shows, societal organizations were not as heavily involved in the formulation of fiscal and other economic policies as hypothesized in neo-Marxist and other societal-based approaches. In most instances the government's fiscal policy choices did not appear to have been a direct product of interest group pressures. And, while opposition from business and labor groups certainly contributed to the government's failure to sustain the fiscal adjustment effort and to implement fundamental reforms, I argue that to truly account for the influence of such forces one must consider the critical intervening role of political factors.

At the same time, supposing that the outcome resulted from a low level of state autonomy and a weak state does not add much to our understanding of the Alfonsín experience. Rather, I argue that it is more fruitful to concentrate on the particular political factors that contributed to the fragmentation of decision-making at the governmental level, and which, therefore, opened the way for the uncoordinated exertion of influence by individual economic pressure groups.

In parallel with explanations of economic policy reform centered on domestic economic conditions, those focusing on the role of international economic and political forces would have predicted radical policy reforms on the part of the Alfonsín government. The large debt servicing burden, the scarcity of international capital, and the globalization of international financial markets certainly restricted the policy options available to the government and gave external agencies and creditor governments some leverage. The demand of international creditors and prospective foreign investors for more stable economic conditions and free market reforms may
help account for the gradual movement of the Alfonsin government toward a more orthodox
diagnosis of the economic crisis and toward the initiation of more far-reaching free market
reforms. But, this chapter will show that the Alfonsin government, like other governments in the
region, at least acted as if it retained substantial room for maneuver. By raising the social and
political costs associated with fiscal adjustment and making more uncertain the potential payoffs,
the large foreign debt burden also generated political pressures in the opposition direction. Thus,
I argue that international economic and political forces are best seen as constraints and not as
determining the timing and scope of the governmental responses to economic crises.

The factors which I find to be central in the Alfonsin government's failures to control the
public sector deficit and to carry out more profound fiscal reforms are the polarized nature of the
party system, the organizational and political affinity of the labor movement to the Peronist
opposition, the strongly federalist fiscal structure, and the limited scope of the Alfonsin
government's electoral mandate. The initial constraints imposed by the limited size of the
electoral mandate were compounded further by the threats to the president's mandate emanating
from the military – especially as civil-military tensions increased – and by the two scheduled
midterm congressional and gubernatorial elections. The long history of military interventionism
in politics, the armed forces' abysmal human rights record, and the absence of a civil-military
pact preceding the transition complicated the task of fully subordinating the military to civilian
authority and constrained the Alfonsin government in confronting the economic crisis. Another
legacy of the military period was an aversion on the part of politicians and important elements of
society toward liberal economic policies and conservative fiscal policies.

The examination of the Alfonsin government's experience is organized chronologically
into three periods. In the pre-Austral Plan period the government's progress in adjusting the
fiscal accounts and carrying out reforms was limited as much by decisions willingly taken by the
government and governing party as by external political opposition. The populist and nationalist thrust of economic policies during this period was due to the appointment of Radical party, and especially Renovation and Change, politicians to key economic policy-making positions, societal reactions to the socially regressive and economically recessive policies of the military government, and the process of democratization. In this period the Alfonsin government and the Peronist opposition were not very far apart in terms of how they viewed the crisis and their recommended solutions.

The second period examined spans from the appointment of the new, more technocratically-oriented economic team and the initiation of the Austral Plan to the breakdown of the Plan and the government’s electoral defeat in October 1987. The launching of the Austral Plan signaled the government’s adoption of a more profound diagnosis of the crisis and willingness to implement socially costly fiscal and monetary measures. Even during this period the economic team continued to be constrained by countervailing forces within the government and the governing party. These forces contributed to the government’s failure to fully take advantage of the opportunity for significant reform created by the Austral Plan’s tremendous initial success. But, as this chapter will show, the antagonistic relationship between the two major parties, the government’s lack of control over the Senate and weak presence in the provinces, and the threats to Alfonsin’s mandate entailed by mid-term elections and the military imposed significant limits on the extent of fiscal reforms which were possible. These factors not only impeded the implementation of some proposed public sector reforms but also deterred their initiation.

After its defeat in the October 1987 congressional and gubernatorial elections and the demise of the Austral Plan, the government was in a considerably weaker position in relation to the Congress and the provinces and had less clout with which to stand up to union and business
group protests and an increasingly rebellious military. At the same time that the government’s approach to the economic crisis became more orthodox and liberal, it was much less capable of advancing its agenda. During this last period, then, the principal obstacle to progress with fiscal reform and adjustment was the external opposition which the government confronted from the Peronists in the Congress, provincial governments, the Peronist-affiliated union movement, and business organizations.

**Economics Follows Politics: Neo-Keynesian Adjustment under Grinspun**

Upon taking office, Alfonsin rewarded Radical party politicians - and especially those from the Renovation and Change faction - for their help in his election victory by appointing them to head the cabinet ministries, state banks, and public enterprises, and to take up lower level positions being vacated by personnel from the military government. Government offices central to running the economy, such as the finance ministry, planning ministry, the Central Bank, and the General Tax Directorate (D.G.I.) were filled with long-time Radicals and personal friends of the President (de Riz and Feldman, 1991). While party politicians were given a prominent role in economic policy-making, the renewal of electoral competition led to a large increase in pressures on the public purse based in political patronage. Given the social democratic orientation of the Renovation and Change faction of the Radical party and the popular pressures for economic improvement after the experience under military rule, it was understandable that the government’s initial economic policies were populist and statist in character and did not adequately take into account the depth of the economic problems which the government inherited.

Thus, Bernardo Grinspun, who was appointed finance minister, vowed, despite the apparent inconsistency between the stated objectives, to increase the rate of economic growth to
5%, raise real wages by 6-8 percent, reduce annual inflation below 100 percent, and lower the fiscal deficit to 4 percent of GDP. The initial policies of the government included a real wage increase (on top of the fairly large increase in 1983), adjustments in public services tariffs, and the establishment of a system for controlling industrial prices. In contrast with the stabilization programs applied by the Isabel Perón government and the military regime, the anti-inflationary plan was intended to be gradual and to not impede economic growth or to reduce the purchasing power of wages. Inflation was to be brought down by government monitoring and control over key variables such as wholesale and retail prices, wages, the exchange rate, public services tariffs and interest rates with an expectation that over time the rate of price increases would be reduced (Damill and Frenkel. 1990; Economic Survey of Latin America. 1984).

Consistent with these goals the government adopted a tough stand toward the renegotiation of the foreign debt with foreign creditors and the IMF. Despite the large sum of overdue debt payments and future maturities, the government refused to pursue a stand-by agreement with the IMF and attempted to gain relief from debt payments through direct talks with creditor banks and the Paris Club. The government suspended all payments on debt principal and delayed interest payments in order to force the IMF, creditor banks, and foreign governments to provide bridge loans and to reschedule the debt.

The public sector deficit was to be lowered in a manner which minimized the impact on lower income groups. Tax revenues would be increased by reducing tax evasion, maintaining the taxes on exports, and increasing taxation of upper income groups. On the expenditure side defense and security spending would be reduced so that social spending, particularly on food and housing, could be increased.

Already in March 1984 the government received the first indication of the difficulties it would have in enacting major legislation through the Senate, where it lacked a majority, when the
proposal to restructure and democratize the Peronist-controlled unions - the so-called Mucci bill - was narrowly defeated. This bill, which would have weakened the power of traditional Peronist bosses over the union movement and potentially increased the government’s capacity to limit union wage demands, was defeated by one vote despite the intense effort by the government to influence the votes of the provincial party Senators. Though the government agreed to accept a labor-supported union electoral law later in the year, it sought to maintain some leverage over the unions by deliberately delaying legislation which would restore the labor unions’ right to collective bargaining and to administer social welfare programs for workers. In addition, it used the legal mechanisms held over from the military government to control wages and prices (C. Acuña, 1995). The goal of normalizing labor legislation, became a central rallying point for the CGT against the government.

The failed effort to establish a more democratic union electoral law temporarily united an otherwise divided union movement and demonstrated the continued dominance of union leaders and orthodox politicians in the Peronist party relative to the incipient reformist (Renovador) faction, which was led by Antonio Cafiero. Carlos Menem - then governor of the small northeastern province of La Rioja - and a few others. The renewal faction sought, against the proclivities of the orthodox branch, to downgrade the position of union leaders within the party and to democratize internal party elections and procedures (M. Acuña, 1995; C. Acuña, 1995; Damill and Frenkel, 1990). In the aftermath of this legislative defeat a more militant and independent union leader, Saúl Ubaldini, displaced more orthodox (conservative) Peronist unionists, such as Lorenzo Miguel, as the leading figure in the CGT. He organized numerous general strikes and protest actions in the government’s first year and a half in order to bolster his own power and to limit the influence of conservative unionists or reformist Peronist politicians (Epstein, 1989; McGuire, 1994).
With their expectations dashed that democracy would provide them with greater participation in decision-making and with economic conditions deteriorating, the principal business organizations, including the UIA, CAC, SRA, and CRA became more vocal in their protests against the government’s economic policies. Each of these groups was bitterly opposed to the price controls, which they criticized for causing great distortions in relative prices and harshly penalizing certain economic sectors. Each complained about excessive public spending and the lack of control over the money supply. But, by pushing for easier access to credit and state subsidies to promote investment, industrial groups showed that they did not intend that austerity policies should be applied universally across the economy. Export taxes were once again a key source of agitation for rural groups (M. Acuña, 1995; C. Acuña, 1995). A few months into its term, the Alfonsín government was confronted with the prospect of a united front of societal opposition since, in an unprecedented development, the most powerful business groups agreed to join forces with the CGT in organizing against the government’s policies.

In order to counter the mounting opposition from societal groups, the government attempted to forge a political pact with the opposition parties (through the so-called Acta de Coincidencias). The agreement, which was signed by Alfonsín, Isabel Perón (who was still president of the Peronist party) and leaders of the other centrist parties, did not have any effect and did not last long. It failed, in part, because the Peronist party, as a consequence of the electoral defeat and continuing disputes over the procedures used for selecting candidates, was sharply divided and lacked any central leadership. Because of her deficient leadership capabilities and the abysmal performance of her government, Isabel Perón commanded little authority in the party – a fact which was punctuated by her residence abroad in Spain. Union leaders denounced the agreement from the start and showed immediately, through the use of general strikes, that the unions were the power to be reckoned with within the otherwise
rudderless Peronist movement (M. Acuña. 1995; Smith, 1989; C. Acuña, 1995). But, the long history of mutual intolerance and distrust between the two major parties and the absence of a political agreement preceding the democratic transition, also contributed to the disposition of Alfonsín to govern alone and of the Peronists to pursue a strategy of confrontation (de Riz, 1991).

As a consequence of the sudden change in personnel at all levels of the government, the paucity of reliable information, and the divergent outlooks represented in the key economic ministries, the government was late in formulating the 1984 General Budget and in putting forth proposals to reform tax laws (Economic Survey of Latin America, 1984). These delays, plus a sluggish decision-making process in the Congress – which resulted partly from obstructive tactics on the part of the opposition - meant that the 1984 Budget was not approved until September and the proposals to reform tax laws were not considered by the legislature in 1984. As a consequence of the failure of the government to increase taxes, improve tax collection, or to control inflation, tax revenues barely changed from their depressed levels of 1983. Revenues from the main taxes - including the VAT (-15%), excise taxes (-10%), income and net wealth (-30%), and foreign trade (-13%) decreased significantly. A sharp increase in revenues from fuel taxes (+30%) prevented overall revenues from registering a large decline.

The reduction of the fiscal deficit from 15% of GDP to 12% of GDP⁴, therefore, was achieved almost completely on the expenditure side (Table 3.1). Since the costs of servicing the external debt and spending on personnel increased, sharp cuts had to be made elsewhere such as on public investment (-20%) and on transfers to other public bodies such as state enterprises and decentralized agencies (-35%) (Economic Survey of Latin America, 1984). Thus, the limited fiscal adjustment achieved by the government in its first year was of the type most detrimental to
future growth: large cuts in public investment were made in lieu of enforcing the tax code more efficiently or rationalizing the public sector.

Because of the fall in the collection of revenues designated to the federal revenue sharing regime, the inefficiency of provincial tax administrations, and the narrowness of provincial tax bases, the provincial governments, which steadily increased their expenditures on personnel, relied increasingly on discretionary transfers from the National Treasury in order to cover their budgetary shortfalls. These discretionary dispersions from the central government became the main source of financing for the provinces in 1983 and 1984 and assumed a still larger importance after the expiration of the federal revenue sharing law at the end of 1984. To some extent this was due to the fact that the quantity of funds available for distribution through the revenue sharing system declined because of the disproportionate reduction in the collection of shared taxes (e.g., income, wealth, and value added taxes) relative to unshared taxes (e.g., fuel and trade taxes). But, also the flexibility in the revenue sharing system provided an incentive for provincial authorities to raise spending and broaden the public payroll since they knew that they could make ends meet by requesting extra financing from the central government for which they only had to pay a fraction of the cost. Though provincial governments controlled by the Radical party also took advantage of the expiration of the revenue sharing system. Peronist-controlled governments, which were more numerous, had little incentive to heed central government orders for greater fiscal discipline and had a strong political incentive to spend beyond their means (see Table 3.2). Peronist provincial governors also refused to accept a new revenue sharing law or temporary revenue sharing arrangement which did not provide a substantial increase in the proportion of centrally collected revenues transferred to the provinces and strongly opposed budgetary caps on the fiscal subsidies which industries (located in their provinces) could receive under the industrial promotion system (Ambito Financiero, various issues 2/86-4/86 and 8/8/86).
The government's ability to check the loose budgetary policies of the provincial
governments was limited partly by fears that the Radical party would be hurt in the 1985
congressional elections if provincial banks were allowed to go bankrupt and patronage spending
was cut back. In addition, the government could not afford to take a tough line with the
provincial governments because it needed to obtain the support of non-Radical senators in order
to enact critical legislation in the national congress. The political pressure on the government to
maintain the solvency of provincial finances and to promote job-creating investment projects is
also evidenced by the heavy emission of rediscounts to provincial banks by the Central Bank,
which until 1985 was headed by traditional Radical party politicians. This practice added to the
real public sector deficit and fueled inflationary pressures (Machinea, 1990).

Given the acceleration of inflation to a 1.200 percent annual rate, the accumulation of
large arrears on external interest payments, and the refusal of international banks to increase
lending without the seal of approval of the IMF, Grinspun was forced, in September 1984, to
negotiate a standby agreement. This agreement, which was sharply criticized by the Peronist
party, the CGT, the UIA, and the CRA, but initially supported by the SRA and the CAC, was
embarrassing for the government since it contradicted Alfonsin's commitment to protect the
country's sovereignty and to not submit to the "usory" of foreign creditors (Smith, 1989). The
recessive implications of this agreement spoiled any chance that the new effort of the government
to form a social pact with the unions and industrial and rural groups would succeed (M. Acuña.
1995).

The IMF-supported stabilization plan called for tough austerity measures, including the
reduction of the public sector deficit (to 5.4% of GDP by the end of 1985), increases in public
services tariffs, increased tax revenues, a large devaluation of the currency, and a tighter
monetary policy (Damill and Frenkel, 1990). But, the immediate impact of the devaluation and
the increases in the prices of public services was a resurgence of inflationary pressures (24 percent per month, 1300 percent annual rate) in the first quarter of 1985 (30% per month by May 1985), a fall in real wages, a steady demonetization of the economy, and a downward trend in the pace of economic activity. Even though public sector salaries were reduced and military spending cut, the fiscal situation did not improve much because of the deleterious effect of inflation on tax collection. In March 1985 the IMF cut off the extension of new credit until Argentina made progress in meeting the agreed economic targets.

Seeking to demonstrate government decisiveness in respect to its handling of the economic crisis and to break the impasse caused by disagreements in the economic team, in February 1986 Alfonsin replaced Grinspun with Sourrouille, who had been the Secretary of Economic Planning. Sourrouille, a respected academic economist, and most of the other persons he brought with him from the Economic Planning Ministry, were not tied to the Radical party. Sensitive to the negative reactions that could be triggered within his own party by the appointment of technocrats to head the economic team, Alfonsín left the other key economic cabinet positions unchanged and replaced the former Central Bank President, Enrique García Vázquez, with a UCR economist, Alfredo Concepción. It was a few months later before the initial political appointees were replaced in the Treasury Secretariat.

**Fiscal Adjustment and Tax Reform Under The Austral Plan**

Finally, after preparatory price adjustments had been made, Alfonsín announced the launching of the "Plan of Economic Reform," known as the "Austral Plan", which aimed to dramatically reduce inflationary pressures while avoiding the strong recessive effects of traditional stabilization plans. The program's design reflected the diagnosis of the newly formed economic team that inertial forces (related to price indexation), as well as pressures on the
demand side, were responsible for feeding the inflationary process. This diagnosis suggested that
the fiscal and monetary restrictions typical of traditional IMF stabilization programs needed to be
supplemented with measures aimed at "deindexing" the economy and breaking the inertial
component of the inflationary process. The belief was that such an approach would permit the
economy to reach a low-inflationary equilibrium much more rapidly and with far less impact on
the level of economic activity and the distribution of income than was the case with more
orthodox programs (Machinea, 1990; Canavese and di Tella, 1988; Heymann, 1986). Given the
renewal of the downward economic trend (as of the end of 1984), and the unions' and business
groups' strong opposition to measures which would further erode living standards, such a
program had great political appeal. The non-recessive nature of the stabilization plan also stood a
better chance to boost the Radical party's chances in the September 1985 congressional elections
against an opposition advocating nationalist and populist solutions to the debt crisis.9

Thus, the Austral Plan, which was announced just a few days after the standby agreement
was renewed with the IMF, sought to restrain pressures on the demand side by sharply reducing
the budget deficit and drastically slowing the growth of the money supply. But, at the same time,
the plan aimed to contain the inertial forces behind inflation by imposing a price freeze (which
included the fixing of the already devalued exchange rate) and wage freeze and by introducing a
new currency - the Austral - in order to signal more definitively that a profound change in policy
was taking place. In addition, the Austral Plan incorporated elements of the long-term economic
growth plan developed by Sourrouille while he was in the Economic Planning Secretariat, which
called for an expansion of exports through gradual tariff reductions and exchange rate and fiscal
incentives.

Prior to the launching of the heterodox shock plan a set of measures was taken to
establish a group of relative prices which could be sustained for the longest possible time after
the price freeze, including increases in fuel prices (which also raised the intake from fuel taxes for the duration of the price freeze) and a short-term increase in real wages. The government committed itself to reduce the fiscal deficit to 2.5% of GDP in the second half of 1985 from its 1984 level of 12% of GDP. The remaining deficit, which still entailed the independent payment of two thirds of the services on the external debt (7% of GDP), was to be financed not by monetary emission (or, the so-called "inflationary tax") as in the past but through foreign credits guaranteed as a consequence of the IMF agreement. The goal for the budget was to be achieved primarily by increasing revenues from explicit taxes and public tariff increases. Expenditures were to be reduced somewhat by lowering real wages paid to public sector employees, imposing a freeze on the hiring of new public employees, and cutting subsidies to public enterprises, but no plans were made to rationalize the public sector and the government was committed to maintaining key social programs.

In order to bring about a sudden change in inflationary expectations the Austral Plan focused on fiscal measures which were of a temporary nature but could be applied immediately. These included increases in the real rates for public utilities, a 12% increase in export and import tariffs (which captured for the state the windfall received by exporters as a result of the currency devaluation), a reduction in the payment period for the VAT, a compulsory loan (to the state) equal to 40% of the taxes paid on income and wealth in 1984, and increases in taxes for cigarettes and alcoholic beverages (as well as the prior increase in fuel taxes). In addition, tax revenues were expected to increase as a result of the lowering of the inflation rate due to the reduced impact of the Olivera-Tanzi effect. Of the specific legal measures only the last two sets of measures required congressional approval.

But, the government realized that these measures could only temporarily close the budget gap since the compulsory loan, which the government planned to repay in five years at a level
10% below its inflation-adjusted value, was intended for only one year: since high export taxes depended on reasonably high international prices and a devalued currency (which was prone to appreciate because of a residual inflation rate above international levels); and since the continued reliance on fuel taxes would contribute to inflationary pressures. Therefore, before the formal launching of the Austral Plan a major tax reform was sent to Congress which included fourteen separate laws (including those later announced as a part of the Austral Plan) that according to the government

had the purpose of introducing a profound and integral reform in the tax system....This reform was necessary not only for reasons of urgency in regard to tax collection, but also because the inherited tax system blocked the possibilities of growth with stability and equity, that constituted the ultimate ends pursued with the economic reform program initiated with the Austral Plan.

The government emphasized that the primary goals of the tax reform were

to achieve a growing level of tax collection; to improve the equity of the tax system by increasing the level of imposition on individual income and wealth; to increase the neutrality of the imposition between economic sectors by reducing the dependence on taxes on specific goods such as fuels or on particular economic sectors (such as exporting or importing sectors); to broaden the bases of the main taxes by eliminating exemptions and deductions and closing tax loopholes or procedures which facilitate the evasion or elusion of tax payments.\textsuperscript{10}

The government expected that the fiscal measures which could be applied in 1985 - the increase in export and import tariffs, fuel tax increase, shortened payment periods for the VAT, the forced savings scheme, the increase in employer social security contributions, and the increase in the bank debit tax - would yield revenues equivalent to 3% of GDP.\textsuperscript{11} But, the tax reform aimed to supplant the revenues derived from these mostly short-term instruments with stronger income and wealth taxes and a VAT which would incorporate small businesses and would be more effectively enforced. Thus, the tax legislation submitted to the Congress
proposed to broaden the bases, increase the rates, and limit evasion of the income, personal wealth, net worth, and capital gains taxes. Reforms were also proposed to the other main components of the tax system: the VAT, the unified internal taxes (i.e., excise taxes), the stamp tax, and the tax to the transference of debt instruments. In addition, the government proposed to restore the inheritance tax (abolished during the military government), to give greater powers to the DGI to investigate taxpayers (including the right to use information held by financial institutions and stock exchanges) and to impose punishment (including the ability to, at its own discretion, close businesses which failed to pay the VAT or maintain sales records), and to increase the penalty for tax evasion (including a prison term after a previous conviction). Toward the end of 1985, the government began work on the design of a national land tax, which would penalize farmers who did not make the most efficient use of their land. This tax was to eventually replace export taxes which tended to discourage production for export (La Prensa, 7/18/85, 7/23/85, 8/7/85).

The income tax reform aimed to increase revenues, make the tax more progressive, and increase the level of personalization of the tax in respect to companies (thus applying the progressive rate scales to the profits of owners). Specifically, the reform eliminated the exemption of dividends from the income tax (enacted by the military government in 1977), increased the rates to a range of 7% to 45%, reduced the period in which business losses could be carried over (from 10 to 5 years), improved the mechanisms for inflation adjustment (which would also reduce the size of future reported losses which traditionally had been greatly exaggerated by their indexation to inflation), and reduced to a limited extent the basic deductions for individual and family expenses (still leaving the minimal non-taxable income quite high). The principal changes entailed by the proposed reform of the VAT were the unification of the rates at 18%, the inclusion of small taxpayers through a simplified system, and the exemption
of many general consumption goods which were previously taxed at the lower, 5% rate and many
services.

The broadening of the income, net worth, and net wealth tax bases\textsuperscript{14}, the effort to
reduce evasion, the unification of the VAT rate, the planned phasing out of export taxes, and the
adoption of a national land tax could have gone some way toward improving the neutrality of the
tax system. In fact, however, the exemption of a larger number of goods from the VAT, the high
reliance on fuel and export taxes (which despite the government's plans were maintained), and
the ever-expanding scope of the industrial promotion incentives - which were extended to
additional provinces in early 1985 and to industrial and high technology exports in 1986 and
1987 - significantly undermined the neutrality of the reformed tax system (\textit{Ambito Financiero},
2/15/85; 5/9/86; 9/2/86).

\textbf{Explaining the Government's Tax Policy Decisions}

The government's tax reform choices sharply contrasted with those of its military
predecessors, who, as we have seen, decisively shifted the burden of taxation onto lower and
middle class consumers and away from employers, large corporations, and export producers.
Under the military government, indirect taxes, such as the value added, excise, and fuel taxes
were given a central place in the tax system and more progressive taxes, such as export
retentions, employer contributions to social security, inheritance taxes, and taxes on stockholder
dividends were eliminated. Despite their historical weakness (typically collecting only about
1.5% to 2.0% of GDP or 10% to 15% of total tax revenues), the Alfonsin government reform
concentrated on the modification of direct taxes - whose legal incidence is especially skewed
towards upper income persons in Argentina\textsuperscript{15} - as the primary source of needed revenues. In
regard to the value added tax, the government decided to further expand the range of basic
consumer goods which were excluded,\textsuperscript{16} thus attempting to make the tax less regressive. By focusing its reform efforts on income and wealth taxes, relying heavily on export taxes, attempting to restore the inheritance tax, imposing a forced savings scheme, and exempting a broad swath of basic consumer goods from the VAT. the Alfonsin government demonstrated its desire to overturn the regressive changes to the tax system implemented by the military government.

The goal of creating a more equitable tax system was present from the time of the presidential campaign among Radical party officials and economic consultants to the party who would later serve in the finance ministry.\textsuperscript{17} However, an additional factor favoring the adoption of more redistributive tax policies, was the widespread public disapproval of the highly inequitable economic and social policies of the military government and the fairly universal support among politicians and the general public for a shift away from taxes (such as those on consumption) which put an undue burden on the poor. Treasury officials whom I interviewed each said that neo-liberal reforms, such as generalizing the VAT to basic consumption goods and increasing its weight in the tax system, would have brought an intense public reaction and was an approach which was not even considered by the government at this time.\textsuperscript{18}

The particular contents of the reform were also shaped by technical considerations. For example, several of the taxes, including the bank debit tax, fuel taxes, cigarette taxes, and export taxes, were chosen because they could be relatively easily collected - an important criteria given the ineffectiveness of the DGI. Aside from the fact that they represented an effective means to tax an otherwise elusive sector of the economy, export taxes made sense given the decision to generate an external surplus (to finance the foreign debt) via a currency devaluation.\textsuperscript{19} If the government wanted to capture the surplus profits from farmers in order to pay the foreign debt it needed to apply a tax to their exports.
The forced savings scheme was chosen by the Treasury since as a loan, and not a tax, revenues did not have to be shared with the provinces. Since it was a surcharge to taxes paid in the previous year by taxpayers known to the tax collection agency, enforcement difficulties would not be as great as for the direct taxes themselves. The proposals to suppress the secrecy of banking and stock exchange information, to shift the burden of proof to the taxpayer in the auditing process, and to increase the penalties and streamline the procedures for prosecuting violators (previously treated as a misdemeanor offense by the legal system) were aimed at increasing the level of compliance, which was known to be a severe problem, especially in the case of income and wealth taxes. At the same time, the government was aware that in order to increase collection of direct taxes the bases had to be expanded. Too much income and wealth escaped taxation due to exemptions and deductions and too many potential taxpayers could avoid filing forms under the existing law. Thus, many of the changes to direct taxes aimed to recapture income and wealth lost from the tax base as a result of legal exemptions and deductions and ill-designed mechanisms for inflation adjustment.

The national land tax - the impuesto a la tierra libre de mejoras - which was to replace all of the existing taxes applied to the agricultural sector, was an integral component of the Alfonsín administration's National Agricultural Program (Pronagro), which aimed to increase the output of cereal production by 50 percent during the 1984-1989 period. Though Pronagro called for export tariffs to remain in place for a brief time (partly so that they could be used as a compensation fund during times of low international prices), they were to be phased out once the land tax began to be applied effectively. The land tax reform, though primarily pushed by the Agriculture Ministry, was consistent with the Economic Ministry's goals to promote export production and to improve the productivity of the agricultural sector and received its general
blessing. This reform had been recommended for many years by the World Bank which this time offered a Sectoral Adjustment Loan if it was successfully implemented.\(^\text{21}\)

Thus, it appears that the particular changes adopted to the tax system were a consequence of the ideological orientation of the governing party, general societal attitudes shaped partly by the experience under military rule, and technical criteria. They were not a direct result of international or societal pressures. The Austral Plan was first devised by the economic team and then financial help was sought from the IMF, foreign governments, and international banks. Foreign actors were not directly involved in the design of the plan and the economic team’s decision to set strict fiscal and monetary targets was made independent of their demands.\(^\text{22}\)

International pressures also do not appear to have had an important influence on the specific changes adopted to the tax system since the reform was not consistent with the advice of international financial institutions and the trend in thinking among international tax experts. And, as officials in the economic ministry confirmed in interviews with the author, the negotiations with the IMF and creditor banks did not address which tax instruments should be chosen to reach the program’s targets for the budget deficit.\(^\text{23}\)

The government’s tax policy choices also do not appear to have been heavily influenced by pressures from organized societal groups. Far from pushing for the tax reform, the major groups representing financial, industrial, and rural interests were staunchly opposed to the majority of the tax measures. Each of these groups, and particularly rural and financial groups, argued that the government should not increase taxes when public spending is excessive, enforcement of existing taxes so poor, and fiscal exemptions so pervasive (Diario de Sesiones: Senado, 9/24/85). All of the producer groups strongly rejected the forced savings scheme as an unconstitutional form of expropriation by the state. Rural groups rejected the continued reliance on export taxes, the proposed national land tax, and the changes to the wealth and income taxes.
Groups representing bankers and stockholders were especially opposed to the elimination of secrecy in respect to financial assets and the forced savings scheme. But, in most cases the opposition of these groups to the reforms did not prevent their enactment into law (Ambito Financiero, 1/6/85; 4/2/85; Diario de Sesiones: Camara de Diputados, 8/14/85; La Prensa, 8/4/85, 8/11/85).

Nor can the nature of the tax reform be accounted for by reference to the core social groups providing the government electoral support. Given the fact that Alfonsin drew much more heavily on support from middle and upper class voters than did the Peronists, one would not have expected that his government would focus on strengthening progressive taxes (Catterberg, 1991). And farmers, who gave their political support to Alfonsin and the Radical Party in large numbers in the 1983 elections, were justified in feeling betrayed by the government. Export taxes, which the government saw as compensating for the high level of income tax evasion by rural producers, were a central component of the government's effort to adjust fiscal accounts and to finance the foreign debt. In part, the *retenciones* only offset the surplus received by farmers as a consequence of the currency devaluation. But, even taking into account the favorable exchange rate, the data show – especially after the fall in international grain prices - that rural producers were being forced to shoulder a large share of the tax burden relative to past years (Table 3.3). The government's choice to ignore, for some time, the demands of rural producers was based not only on the fact that their voting power was relatively small and that they had few other electoral options, but also on the desperate need of the government for foreign exchange and fiscal revenues.
The Austral Plan's Honeymoon Phase: Missed Opportunity for Deeper Reforms?

Though the unions and Peronist politicians condemned the Austral Plan from the beginning as highly recessionary, harmful to workers, and a sell-out to the foreign banks and the IMF, the general public responded favorably to this bold initiative as evidenced by the strong surge in popular support for the government, the broad respect for the price freeze, and the return of deposits in the financial system. In economic terms the shock plan at first exceeded expectations. The rate of price increases plummeted from 30.5% per month in May to only 2.0% per month in August and prices only increased by 20.2% for the whole of the second half of 1985. The fiscal deficit target of 2.5% of GDP was achieved for the second half of 1985. And, by the last quarter of 1985 the economy began to make a strong recovery as a result of the resurgence of consumer demand. The stringent goal for the fiscal deficit was reached as a result of a remarkable increase in tax revenues (equivalent to 9% of GDP between the first and second half of 1985) and despite an increase in fiscal expenditures of about 2% of GDP. Given the fact that many of the government's proposed reforms to tax legislation, even if enacted, could not take effect until 1986 at the earliest, the revenue increase came from the drastic reduction in the inflation rate (reverse Olivera-Tanzi effect), heavier taxes on foreign trade and fuels, the forced savings scheme, and a slight improvement in the control of tax evasion (Machinea and Fanelli, 1988).

As a result of the initial success of the Austral Plan in lowering inflation without inducing a severe recession, in the November 1985 elections the government extended the size of its majority in the Lower House and sent the Peronists to defeat (in the elections for national congressmen) in all but three provinces. At the same time the relative success of the Renovador (Renovator) faction at a time of the general defeat of the party seriously undermined the more
verticalista and orthodox Peronists - led by Herminio Iglesias - and contributed to the creation of a more electorally viable and unified Peronist organization, ready to capitalize politically on the first signs of economic trouble (Cavarozzi and Grossi, 1992).

But, despite the improvement in the aggregate economic picture and an actual increase in the purchasing power of wages, organized labor carried out a large number of strikes in protest against the wage freeze. Though the more conservative union factions led by Jorge Triaca and Lorenzo Miguel were disposed to restraining labor demands, Ubaldini, had gained great stature within, and was finally elected president (in September 1985) of the union movement by taking a confrontational approach. In line with the Peronist opposition, he called for a total change in the government’s economic policy, including a unilateral moratorium on servicing the foreign debt and an immediate restoration of union control over workers’ social welfare programs.

Industrial groups on the whole initially supported the Plan, though they had reservations about its recessionary effects and smaller and more state-dependent producers were concerned about the cuts planned in state-supported investment and the planned trade opening. But, by early 1986 industrial groups became increasingly critical of the price controls and individual manufacturers responded by renewing capital flight, reducing planned investments, and withholding their products from the market (M. Acuña, 1995; Smith, 1989). Similarly, rural organizations initially gave lukewarm support to the economic plan, but by late 1985 denounced the “unsupportable fiscal pressure”, the continued high levels of public spending, the plans to impose a national land tax, and the declining profitability of the sector resulting from the falling international prices of export products (La Nación, 10/28/85; La Prensa, 12/10/85).
The Unraveling of Budgetary Controls: A Tax Reform Which Did Not Bite

As had been anticipated when the plan was initially formulated, by early 1986 large changes in relative prices, a steady appreciation of the currency and increasing pressures from organized groups were forcing the government to loosen the controls over wages, prices, and the exchange rate. Thus, in April 1986 the government belatedly made the administration of prices more flexible. Though this brought about a gradual re-equilibration of prices, it permitted inflationary inertia to be rekindled and lifted the restraints on group conflict over income shares. Residual inflationary pressures could not be blamed on fiscal policy since the budget deficit was relatively small and was financed fully from external sources. In part, the residual core rate of inflation can be attributed to flaws in the plan's design which allowed for an overly rapid increase in consumer demand.  

But, especially by the middle of 1986, more politically driven forces lay behind the increasing rate of inflation. On the one hand, monetary policy was far too passive because the Central Bank's president and board of directors, who were long-time members of the Radical party, were ideologically opposed to the restrictive approach supported by the Economic Ministry and were more susceptible to the pressures by Radical party leaders for financial relief for the deficit-ridden provincial governments and banks. Thus, a negative real rate of interest and large rediscounts to the Mortgage Bank and provincial banks contributed greatly to an excessive increase in consumer demand.

On the other hand, even though somewhat successful, the government's tactic of having wages negotiated between individual unions and employers (on a sector by sector basis) allowed wages as a whole to grow at a rate in excess of that stipulated by the April 1986 economic plan. Excessive wage increases were granted in some cases because of the exceptional power of
particular unions (De Riz, Cavarozzi, and Feldman, 1987; Epstein, 1989). But, wage increases above official targets were also provided to the more accommodationist unions (tied to the pragmatic, non-Renovador "Group of 15" whose leaders had collaborated even with the military government) as a part of a strategy to divide the union movement and weaken the more militant unions led by Ubaldini. In addition, when the government increased the salaries for the armed forces in order to reduce rising civil-military tensions related to the prosecutions of officers for human rights violations and military budget cuts, there were spillover effects on the rest of the public sector. Wage pressures also resulted from the fact that some Radical Party politicians, whether in the central administration or as managers of state enterprises or banks, favored a more generous wage policy (Machinea, 1990).

Finally, in late August 1986 Alfonsin extended the economic technocrats' control of economic policy to the realm of monetary policy by replacing the Central Bank president and board of directors. Thus, beginning in September 1986 the government was able to impose greater restrictions on the growth of the money supply. But, it was at this time that the fiscal deficit exploded from 3% of GDP (in the first quarter of 1986) to 9% of GDP (including the deficit of the Central Bank), despite the 19% reduction of central government expenditures relative to the same period in 1985.

Part of the government's problems in managing the budget was beyond its control. International prices for Argentina's agricultural exports declined markedly after 1984 (by 35% between 1984 and 1987) - a trend which was accelerated by the U.S. government's decision to sell large quantities of grain stocks to the Soviet Union. This greatly intensified the protests of rural groups against export taxes (who in their jornadas de protesta agropecuaria threatened to withdraw produce from the market and to not pay taxes) which made it very difficult for the government to maintain them at their prior levels. The lowered tax rates along with the severe
flood in the pampas, which reduced the volume of Argentine exports, caused a fall in export tax receipts from 2.2% of GDP in the second half of 1985 to 0.2% by 1987 (see Table 3.4). But, the fiscal gap widened also as a result of the disappearance of the forced savings scheme, the reduction in the real price of public services (which was allowed in order to help control inflation), and the return of inflation (caused mostly by the previous lack of control over the money supply). Given that the government could no longer fix the exchange rate or other prices in the economy without risking huge distortions in relative prices, and the fiscal deficit was so large, a tighter monetary policy was now not sufficient to restrain the growth of prices and the increasing speculation against the national currency.

Thus, by the latter part of 1986, it became apparent that the only way the government could reestablish the credibility of its anti-inflationary program was to reign in the budget deficit. But, in order to accomplish this task the tax reform had to provide all of its expected revenues and some progress had to be made in reforming the bloated and highly inefficient public sector. In particular, something had to be done to reduce the volume of central government transfers to the social security system (which as of the early 1980s was no longer self-financing), the provinces, the industrial promotion system, and public enterprises (which in many cases required large subsidies to remain in operation).

Partly as a result of the Austral Plan's success in keeping inflation relatively low (82% increase over the entire year) and in sparking an economic recovery, tax revenues increased during the first three quarters of 1986, especially when compared with the first half of 1985. But, as mentioned above, the expiration of the forced savings scheme and the decrease in export tax revenues abruptly reduced revenues in the fourth quarter of 1986 and contributed to a big increase in the fiscal deficit (Tables 3.4 and 3.5). Though the government's tax reform proposals encountered some delays in Congress, the majority of the measures eventually were enacted. All
of the proposed laws dealing with the main direct taxes were enacted in October 1985, thus permitting them to be applied in 1986. As a result of delaying tactics by the Peronists, who conditioned their cooperation upon the implementation of a new revenue sharing law (biased toward the provinces which they controlled) and discussion of the government's policy toward the foreign debt, the reforms to the VAT, internal taxes, and DGI enforcement powers were not approved until the middle and latter part of 1986. Of the government's tax reform proposals, the only ones rejected by the Congress were the plan to restore the inheritance tax (which in the past did not collect much revenue and could not have been applied until a new revenue sharing law was enacted) and the reforms to the penal tax code, which would have imposed prison sentences and steeper fines for tax evasion, and the national land tax.\textsuperscript{30}

From the fiscal data in Table 3.4 it is evident, especially for 1987 - the first year in which all of the reform measures were in place - that the tax reform failed to deliver the revenues promised. The additional revenues collected from direct taxes (+0.51% of GDP between 1985 and 1987) and the VAT (+0.06% of GDP between 1985 and 1987) were not sufficient to replace those lost from the expiration of the forced savings scheme (-0.5% of GDP between 1985 and 1987), the reduction in export taxes (-1.27% of GDP) and fuel tax earnings (-0.70% of GDP).

Thus, the failure of the tax reform can only partially be blamed on the obstructionist behavior of the Peronist opposition. The national land tax, which was a project promoted mainly by the Agriculture Ministry, was opposed by Treasury ministry officials because they thought that it would be too complicated to implement effectively and would reduce the amount of tax revenues obtained from the agricultural sector. Thus, the failure of this legislative proposal was probably not of great significance to the fiscal adjustment effort and could not mainly be attributed to the opposition of rural groups or the Peronists in Congress.\textsuperscript{31}
Congress' rejection of the proposal to increase penalties and streamline procedures for prosecuting tax evaders, which reflected the strong resistance of business groups to closer government scrutiny and the closing of an important safety net, certainly placed limits on the tax agency's capacity to step up enforcement. But, enforcement problems were exacerbated by the scarce progress made in improving the effectiveness of the tax administration, the unanticipated size of the losses which corporations still maintained on their balance sheets (due to defects in inflation adjustment mechanism in place since 1978), the huge losses in VAT and income tax revenues due to the industrial promotion incentives, and the revival of inflationary pressures.

Given the magnitude of these problems, the government would likely have been more successful had it concentrated more on trying to increase revenues from easier to administer taxes such as internal taxes and the VAT. Or, with the same reform, the government needed to scale back the industrial promotion system and to limit the capacity of businesses to deduct past losses.

The continued deficiency of the tax administration and the inefficiency of tax collection is partly attributable to the deteriorated state of the broader public administration inherited by the Alfonsin government, the difficulties of systematically reforming such a large bureaucratic agency in a short period of time, and the generalized attitude of non-compliance prevalent in the Argentine population. The low public sector salaries made it extremely difficult to maintain qualified people in the tax agency, provided little incentive for hard work, and sewed conditions for corruption between tax auditors and taxpayers. The high rate of turnover at the supervisory levels - due partly to poor salary and work conditions and the practices of political patronage - prevented the agency's departments from developing and implementing strategic plans to improve the systems for monitoring and controlling taxpayers. The initial appointment of party officials (particularly from the Junta Coordinadora faction) to run the agency certainly slowed the government's progress in improving its effectiveness. But, also the economic ministry, which
applied much effort to the redesign of tax laws, failed at first to put sufficient energy into improving the effectiveness of the tax administration, which continued to lack adequate systems for collecting and utilizing information and for monitoring and controlling taxpayers.35

Another major problem deterring improvements in the collection of taxes (particularly the VAT and income taxes) was the increasing fiscal cost of the industrial promotion system. Since the system was administered in a highly decentralized fashion and the provinces had little incentive to monitor compliance, the Treasury lacked reliable information about the magnitude of the revenues which were being lost. But, even when the Treasury became more fully aware of the size of the problem (in 1985 and 1986) it was limited in its capacity to reform the system by formidable legal and political obstacles.36 Though the government was legally free to halt the granting of tax breaks for future projects, it risked huge lawsuits if it sought to curtail benefits already granted. In addition, reducing fiscal benefits for industrial promotion was strongly opposed by the major industrial associations (including the UIA), the provincial governors, and Peronist, as well as some Radical, congressmen.37 The government itself was internally divided in respect to how much the fiscal incentives should be scaled back. At the same time that Treasury officials were documenting and publicizing the enormous costs and the high level of corruption associated with the industrial promotion system, the Secretary of Industry, Roberto Lavagna (who was a Peronist) was working with Congress to pass a new regime of fiscal incentives aimed at promoting export manufacturing (Ambito Financiero, 5/9/86; 4/18/86).38

Thus, the immediate failure of the tax reform cannot be attributed solely or mainly to legislative gridlock. Rather, its design did not take into account the gross deficiencies of the tax administration and the pervasiveness of tax loopholes. The government chose to emphasize direct taxes because, after the experience under military rule, there was a strong consensus among the major political parties and the public at large that there was a need to make the tax
system more progressive. The social democratic or populist orientation of the Radical party also contributed to the choice of tax reform and the deficiency of controls over spending and the growth of the money supply. But, once the shortcomings of the tax reform and the need for additional public sector reforms was realized, the government’s lack of a majority in Congress, its deficient political strength in the provinces, and its lack of ties to important economic groups greatly limited its ability to deepen the fiscal adjustment. Peronist party opposition in the Congress was particularly instrumental in blocking government efforts to reform the industrial promotion system, to put in place a new federal revenue sharing law, and to carry out more far-reaching reforms of the public sector.

Political Obstacles to Reforming the Public Sector

In addition to the lack of progress in increasing tax collection, the fiscal adjustment effort was hindered by the limited nature of expenditure reductions. Though public salaries declined and public investment was at an all-time low (producing a grave problem for the public infrastructure and the future provision of public services), transfers to the social security system, public enterprises, and the provinces and rising debt service payments continued to put great pressures on the budget (Table 3.5).

In the beginning of 1986 the government took its first tentative steps in the direction of reforming the public sector by announcing proposals to privatize the state-owned iron and steel manufacturing enterprise - SOMISA - (thereby creating a business with mixed state and private ownership), to sell stock packages corresponding to six state-owned petrochemical plants (the Houston Plan), to remove some of the legal and bureaucratic obstacles to future privatizations, and to improve the budgetary control and financial monitoring of public businesses (Carciofi, 1990). But, the proposal to privatize SOMISA was met with intense protest from the Peronist...
Party and the unions (including the C.G.T. and, particularly, the State Workers Association (A.T.A.), which feared the great loss of jobs which would probably result, and was also opposed by sectors within the Radical party. Since the government lacked a majority in the Senate and had little bargaining leverage with the unions the project was dropped. Opposition from within the Radical party also delayed implementation of the plan to open oil exploration to the private sector.39

The government also began to address the problem of the accumulating debt owed to pensioners, which was resulting in mounting lawsuits against the government. However, rather than attempting a more profound reform of the social security system (such as increasing the retirement age or lowering the ratio between pensions and wages) the government applied by decree a measure which recalculated the benefits owed to a cross-section of pensioners, thus reducing in a controversial manner the backlog of lawsuits against the government. At the end of 1987 the government allocated more resources to the system through taxes applied to key public services (fuels, telephones, and gas). But, this had detrimental effects on the balance sheets of public businesses (since their earnings were reduced), siphoned resources away from the Treasury, and contributed to inflationary pressures (Carciofi, 1990; Machinea, 1990).

In addition, the government continued to be unable to control the growth of spending at the provincial level. A temporary revenue agreement, which locked in the previous years' increases in the provincial revenue share, was reached between the central government and the individual provincial governments in March 1986. But, since this agreement lacked full legal status and did not resolve many of the issues dividing the central government and the provinces, it was not long before the provinces resumed their direct appeals to the treasury for additional funds.40 Even though the Treasury Ministry was prepared to concede to the provinces a substantially larger share of centrally collected revenues (than was provided under the previous
law), it could not obtain agreement for a new revenue sharing law because of disagreements between the provinces over how the total should be distributed. Partly as a result of the absence of a revenue sharing law and the Peronist party's control over most of the provincial governments, the level of total transfers from the national government to the provincial governments increased from 6.2% of GDP in 1984 to 7.4% of GDP in 1986 - a 27.2% increase). Public employment rose by 22% in the provinces compared with the 4.6% increase experienced in the national administration from 1983 to 1987 (World Bank 1990b). Thus, while the national government was relatively successful in controlling the expenditures of the central administration (by reducing salaries, imposing a hiring freeze, speeding up retirements, and lowering public investment), the fiscal behavior of the provincial governments undermined the stabilization policy. Though increased central government transfers were able to partially offset growing provincial budget deficits in 1986 and 1987, with the sharp decline in the collection of shared taxes (especially the income tax, unified internal taxes, and VAT) at the national level, by 1988 the financial situation of the provincial governments reached crisis proportions (Carciofi, 1990; Machinea, 1990; Sanguinetti, 1992).

Thus, though the government exerted some effort in confronting the public sector financial crisis, it made little effective progress during the period critical to the success of the Austral Plan. The lack of control which the government exercised over spending combined with the fall in tax revenue collection increased the fiscal deficit which fed an inflationary process that itself undermined revenue collection. In part this was because the government was late in deciding that the economic crisis and the crisis in public sector finance required profound reforms of the state and its relationship to the economy. The delay in the government's arrival at this diagnosis was partly a consequence of deficiencies in the quality of information, due in part to the sweeping changeover of personnel which accompanied the democratic transition. But, the
government's late decision to pursue more fundamental reforms also resulted from more explicitly political factors: the large role initially given to politicos, the preoccupation of the government with political-institutional issues (i.e., prosecuting military officers for human rights violations and consolidating democratic institutions), and the continued prevalence of statist and populist economic thinking in the Radical party and among some government officials. Once the economic team arrived at a more complete diagnosis of the problems affecting the public sector, it was hindered by the reluctance of members of the government and the Radical party to give their backing to reforms, partly because of the continued sway of populist thinking, but also because of the emphasis placed on the pursuit of political objectives. To some extent, the government was slow in taking action against the state’s fiscal crisis because of Radical party politicians’ delusions that the Austral Plan’s success and the divisions within the Peronist party had created conditions for a “Third Historical Movement” in which the Radicals, led by Alfonsín, would capture much of Peronism’s populist base and come to be a hegemonic party. In line with this notion, much emphasis was placed on attempting to reform the constitution to allow for the reelection of Alfonsín. Thus, the limited and fragmented nature of the government’s reform proposals, which seemed to be geared more toward putting out fires than forming the basis of a coherent strategy, was partly due to the fact that parts of the government and much of the Radical party were slow to endorse a more ambitious agenda of market-oriented economic reforms.42

But, the economic team was also deterred from promoting or implementing more radical reforms of the public sector because of the government’s limited power in the Congress, the provinces, and in respect to key socio-economic groups. Because of the Peronists’ strength in the Senate and the provinces and their close relationship with the powerful labor movement, they retained a capacity to block government policy initiatives. Given the balance of power in the Senate, where the Radicals controlled 18 seats, the Peronists 21 seats, and the provincial parties 7
seats, one can question why the government was not able to form a coalition with (typically conservative) provincial party senators to gain passage of important reforms. Ad hoc coalitions were, in fact, constructed in order to gain approval for many key pieces of legislation, including the annual budgets and tax laws. However, such ad hoc agreements, which were normally reached as a product of government concessions of public works spending, Central Bank loans, or extra financing for the provincial governments, were very costly for a government which was financially poor.

But, why did the government not seek to establish a more permanent coalition with some of the provincial parties in order to enact key legislation? One possible explanation suggested to the author by a political advisor to the economic minister is that the government feared - as was the case with the everyday conduct of economic policy - that it would be accused by the Peronists and political observers of moving to the right and would lose its claim to the political space just slightly to the right of the Peronist party (which under the leadership of the Renovadores was sharply criticizing the government's economic policies as being "recessive", "monetarist", and dictated by the I.M.F.). Since two of the provincial party senators - both from the province of Neuquén - were representatives of a populist provincial party with Peronist origins, this strategy would likely not have succeeded (as occurred in respect to the labor law reform). In addition, one of the most important lines of conflict surrounding many of the needed reforms, including those related to the social security system, federal revenue sharing system, and the industrial promotion system was that between the central government and the provinces. Thus, on these issues the provincial party senators were more likely to take the side of the Peronist senators who were defending the interests of the provinces against the centralizing interests of the national government.
With the Austral Plan unraveling and congressional and gubernatorial elections approaching, the Peronists had less incentive than ever in 1987 to cooperate with the government on economic policy. Whatever benefits which would result from the possible improvement in the economy would accrue politically to the Alfonsin government, while the Peronists would share equally in the political costs associated with the harmful social impact of the reforms. In addition, if they backed public sector reforms this would conflict with their most important pretension of being the party most truly representative of the popular majority, and especially the workers (Canitrot, 1991). The Peronists adopted the more politically advantageous strategy of strongly criticizing the economic program and espousing well-worn populist formulas, while not fully obstructing the functioning of democratic institutions. Thus, given the relative novelty and intensity of inter-party competition and the conflicting aspirations of the Peronist and Radical Parties to represent the popular majority, there was little chance of an agreement between the parties for the sake of confronting sectoral opposition to public sector reforms.

Thus, toward the end of 1986 and the beginning of 1987, with the apparent failure of the tax reform, it became increasingly clear that a credible effort to halt the acceleration of inflation would require tough new fiscal measures and more fundamental public sector reforms. At this point, the government faced a dilemma which according to Damill and Frenkel (1990) amounted to a trade-off between deepening the stabilization policy at the expense of increased political isolation, or focusing more on recuperating political space through alliances with different interest groups in exchange for some concessions whose cost to the stabilization plan, though potentially high, would be manageable. A third alternative, that of trying to advance toward a political coalition backing economic stabilization and reforms appeared to be blocked as much by a certain hegemonic pretension in sectors of the government which made difficult the search for agreements with the opposition, as by obstacles derived from the internal conflicts of Peronism and the 'double discourse' (pro-democratic but critical of the government economic plan) of the Renovador Peronist sectors...That game between the then most important sectors in the major political parties resulted in polarization.
which was not favorable to collaboration in regard to a stabilization-reform agreement (My translation from Spanish, Damill and Frenkel. 1990).46

Given the unviability of an agreement between the two major parties, the government also was not willing to follow a more confrontational approach in respect to socio-economic groups. On the one hand, with elections approaching the government did not want to risk further antagonizing labor, industrial, and agricultural groups and losing more power in the congress and the provinces. On the other hand, the government still feared that the armed forces, who were becoming increasingly incensed about the human rights prosecutions, media and politician denunciations of the military, and defense spending cuts, could attempt a coup (Manzetti. 1993; Norden, 1996).47 This threat became more credible after April 1987 when a group of mostly infantry junior officers led by Lt. Colonel Aldo Rico carried out a rebellion against the army leadership. In order to protect democracy in the face of such threats, the government perceived that it could not alienate the support of important civilian sectors. The continued military threat to democracy, arising partly from the transition by ruptura and the historical insubordination of the Argentine military, had additional negative consequences for the government. The April uprising was put down only after the government agreed to force the army chief of staff and many other generals into retirement and to push Congress to adopt the Due Obedience Law, which dismissed the charges against all officers below the rank of colonel, thus leaving only twenty or so officers on trial. These concessions, as well as the ones which were made in response to the Villa Martelli mutiny in December 1988, left an image of government capitulation to military pressures and damaged the government's reputation.

Thus, the ultimate path taken by the government was one of seeking partial alliances with major interest groups, while seeking to continue, but in practice, backing off in the fight against inflation. The appointment of Carlos Figueras - a party politician who was also a member of the
Argentine Rural Society (SRA) - to the position of Secretary of Agriculture was followed by concessions in respect to export taxes and prices. These decisions were widely seen as part of a strategy to regain electoral support from farmers in the upcoming congressional elections (Ambito Financiero. Dec. 24, 1986). Similarly, representatives of industrial groups, which denounced the government's failure to reduce the fiscal deficit, the continuation of price controls, and the concessions made to the unions, were given positions in the cabinet. The incorporation of industrial representatives tended to dissuade the government from imposing higher taxes or curbing fiscal incentives (Cavarozzi and Grossi, 1992; Machinea, 1990; Manzetti, 1993).

More detrimental to the stabilization plan was the government's decision in 1986 to ally with the "Group of 15" unions, whose leaders were associated with the conservative anti-reform wing of the Peronist party and had previously collaborated with the military government and supported lenient treatment for officers accused of human rights violations. This alliance, which at first amounted to favoring the "Group of 15" unions (generally representing workers in the more dynamic sectors of the economy) in wage negotiations in exchange for labor peace, culminated with the appointment in April 1987 of one of their leaders, Juan Carlos Alderete, to head the Ministry of Labor (McGuire, 1992; Epstein, 1989). The appointment of Alderete, which was aimed at weakening the leading Renovador politician - Antonio Cafiero - and reducing union opposition and wage pressures, failed on both counts. Not only did Cafiero win the race for governor of Buenos Aires Province in the September 1987 elections, the unions were granted more generous than programmed wage increases and the Labor Minister committed the government to support legislative bills restoring global collective bargaining (previously limited to negotiations at the company level) and the right of labor leaders to control and manage welfare funds derived from workers' dues (Nun, 1995). In addition, the attempt to coopt the anti-Renovador union faction harmed the public image of the Alfonsin government - since this action...
seemed to contradict its stances against corporatist-style decision-making and in support of democracy and justice - and undermined the possibility of more extensive cooperation with the Renovadores. The result of this strategy of concertation with major economic interests was, therefore, "an increase in the obstructionist capacity of corporate interests... conspiring against the possibility of a coherent economic policy and compromising the autonomy of state decisions" (Cavarozzi and Grossi, 1989).

The limited attempt at social concertation in respect to everyday management of the macro-economy was not extended to the realm of longer term economic planning where the economic ministry unilaterally advanced toward a more orthodox position. In July 1987 Sourrouille and members of his economic team announced a further set of measures aimed at liberalizing the economy, including the gradual reduction of tariffs and other trade restrictions, the deregulation and demonopolization of state control over telecommunications, the freeing of domestic oil prices, and the privatization of enterprises in the petrochemical sector. In respect to many of these reforms as well, political opposition from within and outside the government slowed or blocked their implementation (Machinea, 1990).

Thus, though the drop in revenues, rising fiscal deficit, and accelerating inflation rate called for new fiscal measures and a tougher wage policy toward the beginning of 1987, the government limited itself to approving a tax amnesty and did little to halt wage increases. Clearly, the upcoming congressional and gubernatorial elections deterred the government from proposing, and likely would have prevented the Congress from enacting, any important fiscal measures. At the same time, the new Central Bank directors, though in full agreement with the economic ministry's restrictive approach to monetary policy, were forced, due to electoral considerations and political pressures, to bail out the Mortgage Bank (1.1% of GDP in rediscounts in 1987), which under the former Central Bank administration had expanded the subsidized housing
program. Thus, the growth of the money supply greatly exceeded the limits of the anti-inflationary program. In this political and economic context the new wage and price freeze announced in February 1987 was designed mainly to stave off a likely inflationary spiral and to buy time until after the elections when more decisive action could be taken. Though inflation slowed in the second quarter of 1987 it accelerated markedly in the months prior to the election, especially after the unpopular wage controls and monetary restrictions were abandoned in June (see Table 3.6) (Machinea, 1990).

The sharp fall in consumer purchasing power and the loss of confidence in the government's handling of the economy contributed to the Radicals' defeat in the September 1987 elections. The Radical Party lost the elections for national legislators 41.4 percent to 37.5 percent and, as a consequence, lost their majority in the Chamber of Deputies and saw the size of their plurality over the Peronists reduced from 18 to 10 seats. The victory was more resounding in the elections for provincial governors, with the Peronists winning 16 out of 22 contests, including that in Buenos Aires Province, and the Radicals only two (de Riz and Smulovitz, 1991: de Riz and Adrogué, 1990).

Fiscal Adjustment through Negotiation: The Constraints of Divided Government

Thus the election outcome, by altering the partisan composition of the legislature and further reducing the government's leverage vis a vis the provinces and its prestige and credibility, practically sealed the failure of the Austral Plan and the main objectives of the government became that of avoiding hyperinflation, ensuring the continuity of the democratic regime, and creating optimal conditions for the Radical Party's future presidential candidate. The more equal division of forces in the Congress, the increased Peronist strength in the provinces, and the rise to leadership of Cafiero's Renovation faction paradoxically facilitated some degree of cooperation
between the government and the Peronists which enabled postponed legislation to be enacted. However, each measure aimed at reducing the budget deficit was offset by concessions made with socio-economic groups, the Peronists, or the provinces (Damill and Frenkel, 1990).

Towards the end of 1987 an agreement was reached between the two major parties which permitted congressional approval of a set of fiscal measures, including a tax reform, a financing package for the bankrupt social security system, and a new federal revenue sharing law. These measures were essential in order for the government to adhere to the fiscal and inflation targets set forth in the new IMF-supported stabilization plan (announced in October). A modest reform of the industrial promotion system, which called for stricter quotas on the fiscal cost of new projects and a more regional equity in the application of the system, however, met the strong opposition of the Argentine Industrial Union and the Peronist legislators and was not approved.49

To secure passage of these reforms the government had to permit the passage of legislation providing for the renewal of free collective bargaining between employers and employees and the restoration of union control over worker welfare programs; to concede to the provinces a larger share of the revenue pie (57% to the provinces, 42% for the nation compared with the equal division of 48.5% in the previous law); and to accept modifications in the package of tax measures which reduced the projected revenue gain from (an optimistic) 4.0% to 2.3% of GDP and directed a larger proportion of the revenues from the tax package to the provinces and the social security system (Ambito Financiero, Dec. 21, 1987). The enactment of the federal revenue sharing law was facilitated by the fact that the Peronists now controlled most of the provinces, including Buenos Aires, which was by far the largest. The two leading presidential candidates for the Peronist Party - Carlos Menem (governor of the small and underdeveloped province of La Rioja) and Antonio Cafiero (governor of Buenos Aires province) - now had a political interest in reaching an agreement.50
The tax reform, which focused almost exclusively on distortive, but easy-to-collect emergency taxes, such as the bank check tax, taxes on public services, a two-year forced savings scheme, and fuel taxes, reflected the government's admission of the failure of its original emphasis on the improvement of direct taxes. One important change adopted was the suspension of the right of businesses to deduct past losses from their current income tax declarations. On the other hand, intense lobbying by business and agricultural groups forced the government to drop its plans to increase the net wealth tax, to impose an emergency real estate tax, and to allow the bank check tax to be deducted from the income tax (Diario de Sesiones, various issues 12/87 and 1/88). Along with these changes in tax laws, about the same time the government unveiled its new strategy for improving the collection of the VAT and income taxes which entailed using the 300 largest taxpayers to retain taxes from their customers and suppliers. This plan was strongly resisted by the leaders of the major business organizations, but eventually began to be implemented.51

Given the fact that the government now lost much, if not all, of its previous capacity to control wages and the public sector deficit exploded, the stage was set for an acceleration of distributive pressures and increased inflation. Inflation was fueled also by the large increase in public sector tariffs - designed to reduce Treasury financing of the public enterprises and to help finance the social security system - and increasing speculation against the Austral. At the same time, the country's commercial trade balance, which recorded surpluses of $4.6 billion in 1985 and $2.1 billion in 1986 dwindled to $500 million in 1987 due first to the fall in international grain prices and then to the sharp fall in the volume of grain exports. With tax revenues falling from 14.2% of GDP in 1987 to 13.0% of GDP in 1988 (despite the tax reform), the public sector deficit expanded from 5.3% of GDP in 1986 to 7.1% and 9.3% of GDP in 1987 and 1988, respectively. Several provinces reached the point of financial bankruptcy in early 1988 forcing
the government to impose new taxes on financial transactions and on cigarettes, which again had the sole merit of being easy to collect. With the inflation climbing back to its pre-Austral Plan level of 27% per month and the trade surplus evaporating, the government fell out of compliance with IMF agreements (both the October 1987 Standby Agreement and the February 1988 letter of intent) and was forced in March 1988 to suspend interest payments on all of its outstanding foreign debts (Damill and Frenkel, 1990; Smith, 1989).

Despite its lame-duck status and the relative proximity of the presidential elections, the economics ministry became more bold in its endorsement of a free market economic agenda. In 1988 the government suspended Treasury financing of public enterprises and announced proposals to restructure the national Railroad Company, to increase private participation in oil production, to partially privatize Aerolineas Argentinas and Entel (the national telephone company), to permit public enterprises to purchase supplies abroad, and to more profoundly curtail fiscal incentives for industry. Despite growing disenchantment in the general population with the quality of many government-provided services, as a result of strong opposition from the Peronists and the unions, the exigencies of anti-inflationary policy, and the lack of bidders, the privatizations were not carried out (Machinea, 1990).

Meanwhile Carlos Menem's victory over Antonio Cafiero in the Peronist Party's first open internal election and the approach of the presidential election greatly reduced the already limited possibilities for cooperation between the parties. The defeat of Cafiero despite the backing of much of the party organization, reflected Menem's greater personal appeal as well as the loss of prestige suffered by the Renovador faction as a consequence of its bargaining with the Alfonsín government and its closer association with the faltering economic program. As a challenger to the party's standard bearer and as governor of a peripheral province, Menem could portray himself as the outsider and the candidate closer to the people and more faithful to
Peronist traditions. He distinguished himself as the true Peronist unfettered by the political deal-making in Buenos Aires, by accusing Cafiero of wanting to transform the PJ into a "little liberal or neoliberal party" and suggesting that a Cafiero presidency would be indistinguishable from that of Alfonsín (McGuire, 1992; Sobrino, 1992). Menem's presidential candidacy and the increasing likelihood of his triumph over Eduardo Angeloz - the Radical Party candidate and governor of the province of Córdoba - added to the pressure on financial markets, since investors became increasingly fearful that his pledges to suspend interest payments on the foreign debt, increase wages by 100%, and reduce taxes would become reality.

With inflation spinning out of control and foreign reserves declining, the government put forth the Plan Primavera (Spring Plan) in August 1988 as its last ditch effort to improve the Radical's prospects in the upcoming election. Despite the government's suspension of interest payments on the foreign debt and its repeated failure to comply with IMF performance targets, the U.S. government and the World Bank, but not the IMF, provided important financial support for the plan (four loans amounting to $1.25 billion). Given the government's inability to control wages or to immediately enact major fiscal changes through congressional action, it reached an agreement with the most important industrial organizations - the UIA and CAC - in an effort to moderate price increases and to provide the plan with important political backing. These groups pledged to respect price guidelines for a brief period of time in exchange for the government's commitment to reduce the VAT rate from 18% to 15%. This concession, of course, contradicted the central budgetary objectives of the stabilization plan (Fanelli and Frenkel, 1989).

The principal components of the shock package were a sharp increase in public sector tariffs, the creation of a two-tiered exchange market aimed at raising fiscal revenues from the export sector, a tighter monetary policy, continued restrictions on Treasury financing of public enterprises, and a tax reform (requiring Congressional approval). Rural organizations refused to
participate in the program mainly because they rejected the exchange rate system (Machinea, 1990; Damill and Frenkel, 1990). Nevertheless, the government sought to contain the protests of rural groups somewhat by promising to reunify the exchange rate within a few months. Despite the fact that the stabilization plan stood to benefit workers in the short term - by reducing inflation without restricting the freedom of wage negotiations - the CGT, partly because of its allegiance to Peronism and Menem in the presidential campaign, repudiated the program and the agreements with the IMF and World Bank (Ambito Financiero, Oct. 2, 1988).

Given the huge revenue losses being experienced as a result of the industrial promotion system and the continued difficulties with the tax administration, treasury officials made the reduction of fiscal incentives a top priority but were torn in regard to how to raise further revenues. The VAT was strongly favored by the World Bank which was providing the Argentine government with extensive technical and financial assistance. But, given the pervasiveness of tax incentives (with 80% of the costs falling on the VAT) and the problems with the tax administration, there was some support in the government for a deep reduction in income and VAT rates in exchange for sales taxes applied at the wholesale level and higher excise taxes. Instead, partly because of the desperate need of the government for external financial support and for more revenues, the government proposed to Congress a tax reform which called for a significant broadening of the VAT's base (still excluding many staples) while setting the general rate at 14% and applying a 7% rate to some previously exempted goods (Ambito Financiero, Dec. 15 and Dec. 20, 1988 and Diario de Sesiones de la Camara de Diputados, Dec. 20, 1988). It did so despite the resistance of Radical legislators, who like the Peronists, saw the reform as highly regressive. The tax reform also would increase excise tax rates on some goods, increase the D.G.I.'s powers to enforce tax laws, and reduce income, net worth, and net wealth tax rates.
In addition, at last Congress was willing to consider the government's proposed reform of the industrial promotion system which would temporarily suspend the approval of new projects and replace the blanket exemption given to promoted firms with a non-negotiable tax bond.\textsuperscript{55} In contrast with the reform enacted in a bi-partisan fashion by the Congress a few months earlier, the government's proposed reform called for an end to the use of tax breaks as a means to promote industrial investment and, when fully implemented, was expected to significantly reduce the Treasury's future losses.\textsuperscript{56} As with the previous year's tax reform, the government obtained the Peronists' acquiescence to the industrial promotion system reform and some of the tax measures only by granting major concessions: the proposal to generalize the VAT was dropped and two bonds totaling 5 billion Australes were approved for the provinces (Machinea, 1990).

Though the shock plan brought a significant decline in inflation in the first months of its implementation (from 27.6\% in August to 5.7\% in November) this achievement rested on the fragile foundation of a fixed official exchange rate in a context in which the government lacked foreign reserves. Any chance the plan had to keep inflation under control was undermined by wage trends, the still large fiscal deficit, and a severe drought which greatly reduced exports and electric power generation. Wage increases in the public sector greatly exceeded the guidelines because of the government's unwillingness to face a major confrontation with the unions, who in their bid to help the Peronist candidate, stepped up their pressures. Even with a reduction of expenditures the fiscal deficit remained high because revenues continued to fall as a consequence of the continued defects of the tax administration, rising inflation, and the increased reluctance of Argentines to pay taxes in the existing economic climate (Machinea, 1990).

The economic climate further deteriorated as a consequence of the military uprising by the \textit{carapintadas} at Villa Martelli in December 1988 and the violent left-wing ambush at the La Tablada military barracks in mid-January 1989. Though Colonel Mohamed Ali Seineldin, who
led the Villa Martelli rebellion, undermined support for the rebels among the military establishment by the pursuit of more personal and ideological goals, the government was once again forced to grant concessions, including salary increases and an increase in the armed forces budget. The La Tablada incident, which left 28 of the attackers (from the "Todos por la Patria" movement) and 7 soldiers dead, greatly increased the pressures by the military and the political right for a full amnesty for military officers and for public vindication of the role of the armed forces in the war against subversion (Peralta-Ramos, 1992).

The considerable lead which Menem acquired in the polls as a result of his charismatic appeal and the precipitous fall in the purchasing power of wages, raised fears that there would soon be a massive flight to the dollar. Though advocating a deepening of the neo-liberal path launched hesitantly by Alfonsin, Angeloz pressed for the dismissal of Sourrouille so as to try to distance himself from the government and the crumbling economy. In April, Alfonsin replaced Sourrouille with Juan Carlos Pugliese, the president of the Chamber of Deputies, but this change failed absolutely to stabilize the financial markets or to slow the inflationary spiral. When declining reserves and the World Bank's refusal to make a loan disbursement forced the Central Bank to suspend sales of the dollar in February 1989, the dollar's value skyrocketed and the monthly inflation rate soared from 9% per month in February to 114% by May and 196% by June (see Table 3.6) (Smith, 1989; Machinea, 1990; Fanelli and Frenkel, 1989).

With real wages falling (to levels 20% below that of 1983), unemployment rising (to close to 9.0%), and the economy in a deep recession, it surprised no one that Menem defeated Angeloz 47% to 32%. As a result, the Peronists won a majority in the Senate and a sizeable plurality in the Chamber of Deputies (120 out of 254 total seats compared to 90 seats for the Radicals) (de Riz and Adrogué, 1990; de Riz and Smulovitz, 1991). After the collapse of its final
stabilization attempt and the election defeat, the Alfonsin government could only take solace in having enabled the first constitutional transfer of power to take place since 1916.

**Conclusion**

Though the Alfonsin government was confronted at the outset with a profound economic crisis characterized by a large foreign debt, a huge public sector deficit, and high inflation, it did not immediately initiate, and eventually failed in its efforts to implement, far-reaching fiscal or public sector reforms and was unable to achieve permanent reductions in the budget deficit. Thus, in contradiction with economistic or “voluntaristic” views of economic policy-making, political factors clearly intervened in shaping how the economic crisis was viewed by government policy-makers and congressional politicians and in influencing the possibilities for the implementation of significant policy reforms. However, given the gradual movement of the government toward support for more far-reaching fiscal and other economic reforms, it is clear that the failure of the initial policies to alleviate the crisis and the deterioration of economic conditions influenced how the crisis was viewed over time.

Because of the large debt servicing burden and the increased cost and scarcity of foreign capital, the Alfonsin government also faced strong external pressures to carry out fiscal reforms and adopt stabilization policies. But, the examination of economic policy-making during the Alfonsin government shows that it is best to view these pressures, associated with the foreign debt and the need for conditionality-based financing, as constraining, rather than directly determining, policy choices. The experience of the Alfonsin government, which initially adopted a defiant position toward foreign creditors and on several occasions stopped servicing the debt, shows that within the constraints imposed by the debt crisis there was still some room to maneuver. Though the IMF and foreign banks were persuaded to back the Austral Plan, the
stabilization program was hatched within the Alfonsin government and its heterodox design ran counter to their advise. The foreign debt burden and the terms of conditionality for an IMF agreement raised the stakes for the government of not seriously attacking the budget deficit and raising tax revenues. But, it appears that regardless of the requirements for obtaining international financial support, the economic team was convinced of the importance of maintaining conservative fiscal and monetary policies. And, just as was the case in respect to the broader stabilization plan, the government did not follow the advise of external agencies in choosing how it would reform the tax system. Clearly, international pressures contributed to the unsustainability of Grinspun’s initial expansionist and populist approach and pushed the government toward a more orthodox diagnosis of the economic crisis. But, political factors played a key intervening role in shaping how exactly the government responded to these constraints and in influencing its capacity to implement policy reforms.

While the implementation of the stabilization program and the effort to carry out fiscal and other public sector reforms was certainly constrained by the pressures of socio-economic groups, these groups do not appear to have had an important influence on their formulation and initiation. In the case of the Austral Plan, and the fiscal reforms which accompanied it, business, rural, and labor organizations were mostly excluded from the process of policy formulation. But, pressures from business and rural organizations contributed to the relaxation of price controls, the inability of the government to sustain increases in tax collection and to crack down on evasion, and the loosening of controls over public spending and the money supply. Once the government arrived at a deeper diagnosis of the economic crisis and began pursuing more fundamental reforms, business group opposition constrained the government’s capacity to scale back fiscal exemptions, credit subsidies, and import protection. The general strikes by the CGT and the wildcat strikes and factory occupations by individual unions contributed to the government’s
inability to contain wage pressures, control government spending, privatize public businesses, and rationalize the public administration. The armed forces also acted as a pressure group, impeding the government’s effort to control spending on public salaries and the military and limiting the government’s perceived ability to impose painful economic reforms. Though interest group pressures certainly impeded the implementation of stabilization policies and more fundamental reforms, I argue that the extent of their influence was magnified by characteristics of Argentina’s political system and the limited scope of the Alfonsín government’s electoral mandate.

Aside from the pressures for and against policy change emanating from the economy and society, the Alfonsín government also faced important constraints stemming from the legacy of military rule and the context of democratic transition. The dramatic failure and socially regressive nature of the military government’s monetarist stabilization program, combined with the transition to a more open political system, brought strong public pressures for more redistributive and expansionist policies. In particular, the widespread public disapproval of the military government’s inequitable tax policies contributed to the consensus among politicians and the general public behind the establishment of a more progressive tax system. In addition, the long history of military interventionism in politics, the armed forces’ abysmal human rights record, and the absence of a civil-military pact preceding the transition complicated the Alfonsín government’s task of establishing the supremacy of civilian authority over the military and managing civil-military relations. The deepening of civil-military tensions (and the latent coup threat) weakened the government’s appetite for pursuing a more aggressive stabilization policy or risking the isolation which would have resulted from a unilateral attempt to implement public sector reforms.
But, the important constraints stemming from the international system and domestic economy, societal forces, and the context of democratic transition were made less manageable as a consequence of the deficient scope of Alfonsín's mandate in the context of a political system characterized by a polarized and non-institutionalized party system and strong fiscal federalism. Given the fact that the governing Radical Party and the Peronist Party were sharply antagonistic and had experienced only one very brief period of cohabitation in a fully competitive system, the possibilities for bipartisan cooperation in respect to economic policy-making were quite limited. The possibilities for cooperation were also reduced by the absence of a pact between the political parties and the armed forces preceding the democratic transition, which produced a hard-fought electoral campaign and increased the level of polarization between the parties. Instead of cooperation, this party system led the Peronist opposition to bid aggressively for the support of Radical party votes by blocking unpopular reforms and pushing for more nationalist and populist policies. The government was more responsive to the demands of electoral competition with such an opposition party because of the fact that mid-term elections were held twice in Alfonsín's six year term. The government's willingness to hold the line on spending and clamp down on the money supply was especially affected during the run-up to the October 1987 congressional and gubernatorial elections, which was also a period critical to the survival of the Austral Plan. In addition, the combination of a strong, but loosely structured, fiscal federalist system and the disproportionate representation of the provinces in the national congress impeded the Alfonsín government's ability to extend the process of fiscal adjustment to the provinces and to construct viable reform-oriented coalitions in the national congress.

But, the impact of these features of the political system on Alfonsín's chances to successfully manage the economic crisis and carry out reforms was much more pronounced as a consequence of the fact that the government lacked a majority in the Senate and the governing
party was weakly represented in the provinces. Using its power in the Senate, the Peronists were able to define their differences with the government by blocking some important tax measures and proposals to reform the public sector and the economy. The Peronist plurality in the Senate made it more politically risky for the government to elaborate a more ambitious agenda of fiscal and free market reforms.

In addition, the Radical Party’s weakness in the provinces, especially after the September 1987 elections, limited the government’s ability to restrain spending by the provincial governments, to establish a new revenue sharing law, to reform the industrial promotion system, and to limit transfers from the national to the provincial governments. Given the strong weight of provincial interests in the national congress, and particularly the Senate, the government’s weakness in the provinces also compounded its difficulties in constructing legislative coalitions in support of important fiscal and other economic reforms.

The Alfonsin government was also hindered in its capacity to implement tougher fiscal measures and control inflation by the Radical Party’s lack of close ties with important social groups and the labor unions in particular. Not only did the government face the deficit of not having these ties - as would a Peronist government in respect to most business and rural interests - it confronted a labor movement which was politically allied with the opposition party. Thus, even when the stabilization policies - such as the Austral Plan and the Spring Plan - were (at least initially) favorable to the objective economic interests of labor, the core of the labor movement remained in staunch opposition to the government and was not readily prepared to compromise.

Taken together, the constraints stemming from political institutions, the president’s limited electoral mandate, and the legacy of military rule represented powerful obstacles to a durable solution to the state’s fiscal crisis and the implementation of significant economic reforms. But, tactical mistakes and other more idiosyncratic factors also limited the Alfonsin
government's ability to take full advantage of the political resources which it enjoyed at the outset and as a consequence of the initial success of the Austral Plan. The Alfonsin government was initially slow to take serious steps to address the economic crisis partly because of the appointment of a large number of party politicians to key economic positions who shared the Renovation and Change movement's populist economic views and desire to expand the Radical Party's popular base. The continued prominence of populist economic ideas and delusions about building a "Third Historic Movement" within the Radical party hindered the government's willingness to adopt more profound controls over public spending and to seek support from Renovador Peronists in managing the economic crisis. Instead, the Alfonsin government vacillated between governing in a centralized and plebiscitarian manner and attempting to coordinate policy-making (in a limited fashion) with powerful socio-economic groups. But, in each case the decision to consult with the unions and business groups in the making of economic policy weakened the government and undermined the effort to stabilize the economy. Party organizations and labor and business groups were not sufficiently centralized or unified to permit such a strategy to succeed in solving collective action problems. The concessions which were made weakened the government and they were not nearly sufficient to produce a marked improvement in economic conditions.
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<td>7.6</td>
<td>6.8</td>
<td>7.3</td>
<td>7.5</td>
<td>5.6</td>
<td>3.5</td>
</tr>
<tr>
<td>Overall Balance</td>
<td>-15.1</td>
<td>-11.9</td>
<td>-6.0</td>
<td>-5.3</td>
<td>-7.1</td>
<td>-9.3</td>
<td>-7.2</td>
</tr>
</tbody>
</table>

Table 3.1: Total Public Sector Finances, 1983-1989 (As a Percent of GDP).


Note: From 1988 onwards figures exclude the Provinces, the national territory of Tierra del Fuego and the Municipality of the City of Buenos Aires.
<table>
<thead>
<tr>
<th>UCR-Governed Provinces</th>
<th>% Change in Spending 1983-1986</th>
<th>% Change in Employment 1983-1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Capital</td>
<td>29.9</td>
<td>NA</td>
</tr>
<tr>
<td>Buenos Aires</td>
<td>18.2</td>
<td>21.0</td>
</tr>
<tr>
<td>Chubut</td>
<td>26.8</td>
<td>33.8</td>
</tr>
<tr>
<td>Córdoba</td>
<td>36.2</td>
<td>9.9</td>
</tr>
<tr>
<td>Entre Ríos</td>
<td>22.1</td>
<td>40.7</td>
</tr>
<tr>
<td>Mendoza</td>
<td>40.2</td>
<td>6.5</td>
</tr>
<tr>
<td>Misiones</td>
<td>21.9</td>
<td>15.4</td>
</tr>
<tr>
<td>Rio Negro</td>
<td>40.9</td>
<td>20.4</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>25.8</strong></td>
<td><strong>17.8</strong></td>
</tr>
</tbody>
</table>

**Peronist-Governed Provinces**

<table>
<thead>
<tr>
<th></th>
<th>% Change in Spending 1983-1986</th>
<th>% Change in Employment 1983-1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Catamarca</td>
<td>31.7</td>
<td>12.9</td>
</tr>
<tr>
<td>Chaco</td>
<td>21.0</td>
<td>14.1</td>
</tr>
<tr>
<td>Formosa</td>
<td>8.3</td>
<td>37.6</td>
</tr>
<tr>
<td>Jujuy</td>
<td>17.8</td>
<td>11.8</td>
</tr>
<tr>
<td>La Pampa</td>
<td>49.5</td>
<td>18.2</td>
</tr>
<tr>
<td>La Rioja</td>
<td>80.0</td>
<td>41.3</td>
</tr>
<tr>
<td>Salta</td>
<td>73.0</td>
<td>29.1</td>
</tr>
<tr>
<td>San Luis</td>
<td>39.6</td>
<td>27.0</td>
</tr>
<tr>
<td>Santa Cruz</td>
<td>25.5</td>
<td>50.4</td>
</tr>
<tr>
<td>Santa Fe</td>
<td>28.3</td>
<td>41.0</td>
</tr>
<tr>
<td>Santiago del Estero</td>
<td>1.8</td>
<td>0.6</td>
</tr>
<tr>
<td>Tucumán</td>
<td>37.9</td>
<td>13.5</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>31.9</strong></td>
<td><strong>24.8</strong></td>
</tr>
</tbody>
</table>

**Other Provinces**

<table>
<thead>
<tr>
<th></th>
<th>% Change in Spending 1983-1986</th>
<th>% Change in Employment 1983-1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corrientes</td>
<td>22.0</td>
<td>40.7</td>
</tr>
<tr>
<td>Neuquén</td>
<td>44.7</td>
<td>16.6</td>
</tr>
<tr>
<td>San Juan</td>
<td>8.4</td>
<td>17.1</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>25.2</strong></td>
<td><strong>28.3</strong></td>
</tr>
</tbody>
</table>

**All Provinces**

<table>
<thead>
<tr>
<th></th>
<th>% Change in Spending 1983-1986</th>
<th>% Change in Employment 1983-1986</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>27.2</td>
<td>21.5</td>
</tr>
</tbody>
</table>

Table 3.2: Percent Increase in Provincial Government Spending and Public Employment between 1983 and 1986 Related to Party In Charge of Government.

<table>
<thead>
<tr>
<th>Period</th>
<th>Agriculture as Share of GDP</th>
<th>Agricultural Exports/Total Exports</th>
<th>Agricultural Taxation as Share of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971-1975</td>
<td>13.2</td>
<td>76.2</td>
<td>18.0</td>
</tr>
<tr>
<td>1976-1980</td>
<td>13.5</td>
<td>76.5</td>
<td>25.4</td>
</tr>
<tr>
<td>1981-1985</td>
<td>15.1</td>
<td>74.2</td>
<td>45.6</td>
</tr>
</tbody>
</table>

Table 3.3: Tax Burden of the Agricultural Sector.

Table 3.4: Tax Revenue Collection by Source, 1983-1989 (As a Percent of GDP).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Revenues</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax</td>
<td>10.0</td>
<td>10.2</td>
<td>14.1</td>
<td>13.9</td>
<td>13.4</td>
<td>12.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Non-Tax</td>
<td>2.1</td>
<td>2.1</td>
<td>2.7</td>
<td>1.7</td>
<td>1.3</td>
<td>1.0</td>
<td>0.9</td>
</tr>
<tr>
<td>Surplus of State Enterp.</td>
<td>-</td>
<td>0.4</td>
<td>0.8</td>
<td>1.4</td>
<td>1.4</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Current Expenditures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personnel</td>
<td>2.7</td>
<td>2.9</td>
<td>2.7</td>
<td>2.4</td>
<td>2.7</td>
<td>2.5</td>
<td>2.3</td>
</tr>
<tr>
<td>Goods and Services</td>
<td>1.8</td>
<td>1.3</td>
<td>1.6</td>
<td>1.5</td>
<td>1.5</td>
<td>1.4</td>
<td>1.2</td>
</tr>
<tr>
<td>Interest Payments</td>
<td>3.6</td>
<td>3.3</td>
<td>4.0</td>
<td>2.8</td>
<td>2.6</td>
<td>2.0</td>
<td>2.6</td>
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<tr>
<td>Transfers</td>
<td>9.5</td>
<td>9.0</td>
<td>10.6</td>
<td>11.0</td>
<td>10.9</td>
<td>10.6</td>
<td>9.7</td>
</tr>
<tr>
<td>Provinces and MCBA(1)</td>
<td>4.7</td>
<td>4.0</td>
<td>4.5</td>
<td>5.0</td>
<td>4.9</td>
<td>4.9</td>
<td>4.8</td>
</tr>
<tr>
<td>Pensions</td>
<td>3.9</td>
<td>4.0</td>
<td>4.8</td>
<td>4.8</td>
<td>4.5</td>
<td>4.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Others</td>
<td>0.9</td>
<td>1.0</td>
<td>1.3</td>
<td>1.2</td>
<td>1.5</td>
<td>1.3</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Savings</strong></td>
<td>-5.7</td>
<td>-3.8</td>
<td>-1.5</td>
<td>-0.7</td>
<td>-1.6</td>
<td>-2.8</td>
<td>-1.3</td>
</tr>
<tr>
<td><strong>Capital Resources</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.1</td>
<td>0.1</td>
<td>-1.5</td>
<td>-0.7</td>
<td>-1.6</td>
<td>-2.8</td>
<td>-1.3</td>
</tr>
<tr>
<td><strong>Capital Expenditures</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4.2</td>
<td>3.4</td>
<td>3.3</td>
<td>3.1</td>
<td>3.8</td>
<td>4.2</td>
<td>3.0</td>
</tr>
<tr>
<td><strong>Total Revenues(2)</strong></td>
<td>12.3</td>
<td>12.8</td>
<td>18.2</td>
<td>17.8</td>
<td>16.5</td>
<td>14.6</td>
<td>15.2</td>
</tr>
<tr>
<td><strong>Total Expenditures</strong></td>
<td>21.9</td>
<td>19.8</td>
<td>22.3</td>
<td>20.8</td>
<td>21.5</td>
<td>20.7</td>
<td>19.0</td>
</tr>
<tr>
<td><strong>Overall Deficit</strong></td>
<td>-9.6</td>
<td>-7.0</td>
<td>-4.0</td>
<td>-3.0</td>
<td>-5.0</td>
<td>-6.0</td>
<td>-3.8</td>
</tr>
<tr>
<td><strong>Primary Surplus</strong></td>
<td>-6.0</td>
<td>-3.7</td>
<td>-0.0</td>
<td>-0.2</td>
<td>-2.4</td>
<td>-4.1</td>
<td>-1.2</td>
</tr>
<tr>
<td><strong>Primary Surplus Excl. Capital Resources</strong></td>
<td>-6.1</td>
<td>-3.8</td>
<td>-0.2</td>
<td>-0.3</td>
<td>-2.5</td>
<td>-4.3</td>
<td>-1.6</td>
</tr>
</tbody>
</table>

(1) Municipality of the City of Buenos Aires
(2) Includes balances from previous years and financing under economic emergencies.

Table 3.5: Execution of the Budget of the National Public Sector (as a Percentage of GDP).

<table>
<thead>
<tr>
<th>Year/Quarter</th>
<th>Inflation Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td></td>
</tr>
<tr>
<td>Qtr. 1</td>
<td>433.7</td>
</tr>
<tr>
<td>Qtr. 2</td>
<td>352.6</td>
</tr>
<tr>
<td>Qtr. 3</td>
<td>276.5</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>555.6</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>626.2</td>
</tr>
<tr>
<td>1984</td>
<td></td>
</tr>
<tr>
<td>Qtr. 1</td>
<td>688.0</td>
</tr>
<tr>
<td>Qtr. 2</td>
<td>527.9</td>
</tr>
<tr>
<td>Qtr. 3</td>
<td>616.1</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>1079.9</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>626.7</td>
</tr>
<tr>
<td>1985</td>
<td></td>
</tr>
<tr>
<td>Qtr. 1</td>
<td>385.4</td>
</tr>
<tr>
<td>Qtr. 2</td>
<td>1230.9</td>
</tr>
<tr>
<td>Qtr. 3</td>
<td>1898.8</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>55.3</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>34.4</td>
</tr>
<tr>
<td>1986</td>
<td></td>
</tr>
<tr>
<td>Qtr. 1</td>
<td>81.9</td>
</tr>
<tr>
<td>Qtr. 2</td>
<td>44.5</td>
</tr>
<tr>
<td>Qtr. 3</td>
<td>68.3</td>
</tr>
<tr>
<td>Qtr. 4</td>
<td>140.6</td>
</tr>
<tr>
<td></td>
<td>87.1</td>
</tr>
</tbody>
</table>

Table 3.6: Argentine Inflation Rate, 1983-1989.

Source: Adapted from Machinea (1990; Table 11.1).
Endnotes to Chapter 3

1. About two-thirds of the important state positions went to Renovation and Change leaders, in proportion to the faction’s strength in the party. For more information on the political background of Alfonsín’s initial cabinet choices see Marcelo Cavarozzi (1986b) and Liliana de Riz and Jorge Feldman (1991).

2. On the government’s initial policies see for example Luigi Manzetti (1991) and José Luis Machinea and José Maria Fanelli (1988). On the government’s strategies in its negotiations with foreign creditors see Kendall W. Stiles (1987) and Roberto Bouzas and Saúl Keifman (1988).

3. Hours before the congressional vote the government thought that an agreement with some provincial senators would ensure the bill’s passage. But one of the two senators from Neuquén of the Movimiento Popular Neuquino - a neo-Peronist party formed during the period in which Peronist participation in politics was proscribed - changed his position at the last minute. Sourrouille said in an interview with the author that the defeat of this bill made the “government take note of its weak parliamentary situation...the first defeat in respect to a matter basic to the government’s program.” See Liliana de Riz and Catalina Smulovitz (1990) and McGuire (1992) for more discussion of the Mucci bill.

4. These figures, drawn from the Inter-American Development Bank, Economic and Social Progress in Latin America, 1991 are based on the old methodology for determining GDP. These figures are cited instead of those from the more recent data series since they are the ones which policy-makers and political actors confronted at the time.

5. The relative fiscal laxity of the provincial governments is evidenced by the fact that while employment in the national administration increased by 4.6% from 1983 to 1986, it rose by 34% in the provinces (Machinea, 1990). Peronist-controlled provinces, many of which were very underdeveloped and underpopulated, tended to experience the greatest increases in public employment and expenditure occurred. Six out of eight of the provinces in which employment increased the most in percentage terms were controlled by the Peronists (the other two were controlled by a provincial party and the UCR). Transfers from the central government to the provinces increased by 1.4% of GDP from 1985 to 1987 (World Bank, 1990c).


7. Machinea (1990) argues that the lack of a majority in the Senate constrained the government’s ability to resist provincial government demands for extra financing since the government could not afford to lose any more votes. The implications of the government’s minority status in the Senate for its ability to extend the fiscal adjustment to the provinces was also a key constraint cited by the former Treasury Secretary, Mario Brodersohn and the Subsecretary of National-Provincial Relations, Juan Santiere, in my interviews with them. They also downplayed the extent to which the discretionary allocation of resources could be effectively used to obtain majorities in the Senate since special treatment for a given province would cause other provinces to demand similar treatment, thus entailing great fiscal costs. The anarchy in national-provincial fiscal relations was unquestionably a net liability for the government, given the fact that its party controlled only a small fraction of the provincial governments.

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8. This account of these decisions by the government was given to the author by former Central Bank President, José Luis Machinea in an interview (June 27, 1995). See also Liliana de Riz and Jorge Feldman (1991).

9. The Peronists were calling for the cessation of debt interest payments, the abandonment of recessionary, IMF-dictated stabilization programs, and the adoption of growth-oriented economic policies.

10. My translation from the Spanish (Secretaría de Hacienda. 1989; p. 87)


12. But, payment of taxes on dividends could be applied as a credit (of up to 27.5%) toward the payment of income taxes for corporations.

13. The simplified regime entailed the assessment of the tax payments owed by small taxpayers on the basis of objective indicators of economic activity. The aim was to increase the control over small taxpayers without having to establish a set of monitoring systems which would have exhausted the administrative capabilities of the tax agency (Carciofi, Barris, Cetrángolo, 1994).

14. The direct tax base broadening included the forementioned incorporation of dividends and interest income in the income tax, the reduction of loss carryovers, and the inclusion of agricultural property in the net wealth tax as well other changes.

15. In terms of its formal design the income tax was progressive not only because the tax rate increased with the level of income but also because generous allowances were allowed for individuals and families which in practice excluded all lower-income families as well as a large share of the middle class from having tax withheld from their paychecks and from having to file an income tax form. Even after the enactment of the 1985 income tax reform, which reduced the basic deduction for individuals and families, the minimal taxable income amounted to 81 percent of per-family GDP (in 1987) or about $1,200 per month for individuals. The high level of personal deductions was seen to be necessary in order to offset the high payments for social security (16% of salary for dependent employees). On the other hand, high levels of evasion and legal forms of exemption meant that more well-to-do taxpayers paid far less in practice than would be implied by the legal attributes of the income tax. See Argentina: Tax Policy for Stabilization and Economic Recovery. (Washington, D.C.: The World Bank, 1990).

16. With this reform nearly all foods and medicines were to be excluded.

17. Based on interviews with the former Subsecretary of Tax Policy and Administration, Juan Carlos Gomez Sabaini (April 4, 1995) and the former Treasury Secretary, Mario Brodersohn (June 14, 1995).

18. Based on interviews with Juan Carlos Gomez Sabaini, Mario Brodersohn, and Alfredo Fólica.

19. In 1985 the government estimated that instead of the $400 million which it expected in income tax revenues from rural producers it received only $70 million (Luigi Manzetti, 1994; p. 273).

20. The D.G.I. estimated for 1984 that of about 1.5 million registered taxpayers only about 500,000 bothered to file income tax forms and only 43,000 - less than 3% - according to their own reporting were required to pay taxes (Memoria de la D.G.I., 1986).
21. Based on interview by author with former Subsecretary of Tax Policy, Juan Carlos Gómez Sabaini.

22. Sourrouille said in interviews with the author that he saw himself as an orthodox economist who believed that budget deficits could not be financed through monetary emission and that it was absolutely essential for the success of the stabilization plan that the budget be balanced and the growth of the money supply restricted. The negotiations with the IMF centered around the proportion of the country’s debt servicing obligations which would be financed by new loans and thus the allowable size of the financial public sector deficit.

23. Sourrouille and his economic advisor, Roberto Frenkel said in interviews that the negotiations with I.M.F. representatives did not address the specific measures which the government should choose to achieve the specified monetary and fiscal targets.

24. It is estimated that while the agricultural sector paid 25.4% of the value of its production in taxes from 1976-1980, it paid about 45% in the early 1980s. Part of this increased tax burden also came from higher property taxes imposed at the provincial level (Manzetti, 1994; p. 274).

25. Alfonsoin’s positive ratings had fallen from 82% in May 1984 to 68% in April 1985 - still high for an acting president. After the launching of the Austral Plan his positive ratings increased to 74%. The image of the government, however, increased from 35% before the Plan to 47% afterwards (Estudios, cited in Catterberg (1991).

26. Though the Austral Plan permitted wage increases of only 90% of the previous month's inflation rate, an increase in purchasing power of wages resulted from the dramatic reduction in the rate of price increases, which kept the real value of earnings from eroding during the time between paychecks (Machinea and Fanelli, 1988).

27. Despite the fact that real wages fell according to traditional measures in the first months of the Austral Plan, the sharp drop in the rate of inflation increased the effective purchasing power of wages. This redistribution of income in favor of workers and the fall in nominal interest rates contributed to the increase in consumer demand.

28. In an interview with the author, José Luis Machinea, the former Central Bank President who succeeded Concepción in August 1986, said that in contrast with most countries of the world, when he discussed the monetary program with the Central Bank directors they came to the table with large expansionary plans aimed at helping out particular provinces and ending the recession which they thought the Austral Plan was causing. He, as a representative of the Economic Ministry admonished them, often unsuccessfully, to end such loose monetary practices. Interview, June 27, 1995.


30. Information on the legislative consideration of the separate tax reform proposals is gathered from Carciofi (1990 and 1993) and from the records of the congressional debate contained in the Diario de Sesiones de la Camara de Diputados and Diario de Sesiones de la Camara de Senadores. Interviews with the former Secretary of the Treasury, Brodersohn and former Secretary of Tax Policy and Administration, Gomez Sabaini also provided information about the causes for the tax reform’s failure.
31. Interview with former Subsecretary of Tax Policy, Juan Carlos Gómez Sabaini.

32. The Treasury Secretary said that of the 570 largest companies 31% filed tax reforms which claimed that they did not owe any income tax (Ambito Financiero, July 21, 1987).

33. The former Treasury Secretary, Mario Brodersohn informed the author in an interview that if he had focused originally on generalizing the VAT at a 15% rate he would have collected more revenues than with all of the reforms to the income tax. But, he said that there was a consensus within the government at that time that the tax system should promote equity which was also shared by legislators of both parties and the public at large (Brodersohn, June 14, 1995).

34. Information about the difficulties inherent in improving the tax administration comes largely from an interview with the director of the D.G.I. at the time, Marcelo Da Corte, (August 1995) and from Annual Reports (Memoria) of the DGI. See also World Bank (1990a).

35. Interviews with José Luis Machinea (former Central Bank President), Juan Carlos Gomez Sabaini (former Subsecretary of Tax Policy and Administration), Roberto Frenkel (former advisor to the Economics Minister), Alfredo Fólica (former Subsecretary of Tax Policy and Administration). One indication of the lack of effort on tax administration is the fact that while the D.G.I. was allocated only 1.2% of the total national budget from 1985-87, its share increased to about 2.6% in 1992-94 under the Menem government (Memoria de la D.G.I., various years).

36. Previous to the launching of the Austral Plan the government extended the benefits contained in the special promotional regimes to additional provinces (Decree 261/85: Feb. 21, 1985) and later in 1986 additional fiscal incentives were granted for companies exporting manufactured goods. But, in the VAT reform sent to Congress in April 1985 the government proposed to eliminate exemptions from VAT payments for promoted firms (Ambito Financiero February 11, 1986) and in the 1986 and later Budget Laws it sought unsuccessfully to limit the cost of the system by establishing quotas in the budget. The conflictual nature of the government's policies in respect to industrial promotion reflected divisions within the government between the Minister of Industry and External Trade, Roberto Lavagna, and the Treasury Ministry over the issue (interview with former Subsecretary of Tax Policy, Juan Carlos Gomez Sabaini and former Treasury Secretary, Mario Brodersohn).

37. When the government sought to establish quotas in the budget for each province with special promotion regimes in 1985, a Radical party legislator proposed an amendment which actually extended the scope of the tax exemptions in respect to the VAT. In addition, the provinces and the promoted firms conspired to get around the quotas imposed through the budget, which themselves could only limit the rate of increase in the system's total cost (Interviews with Mario Brodersohn, former Secretary of the Treasury, Juan Carlos Gomez Sabaini and Alfredo Fólica former Subsecretaries of Tax Policy and Administration).

38. The resulting report carried out with the collaboration of IMF staff documented that in many cases the promoted industrial projects cost more in fiscal terms than the value added which they produced. In fact, many of the industries which located in the promoted provinces merely produced invoices for products produced by existing factories in other provinces. Since the bulk of the subsidies went to the four provinces enjoying special regimes, the other provinces were in effect paying much more in lost tax revenues than they were getting back.

40. In particular, it did not settle the timing of the dispersal of funds, which in the context of relatively high inflation, had an important impact on the real value of the transfer for both the treasury and the provinces. Interview with Juan Santierie, former advisor to the economic minister and former Subsecretary of Provincial Relations (June 9, 1995).

41. The treasury minister, Brodersohn, told the author in an interview that the government was prepared to increase the provincial share of “coparticipated” revenues from the 48.5% present in the previous law to as much as 56%. But, because of the disputes between the provinces - particularly between the Radical party-controlled province of Buenos Aires and the interior provinces controlled by the Peronists - he could not obtain an agreement for a new law.

42. This assessment is supported by economic ministry officials and radical party legislators whom I interviewed. See also Canitrot (1994a and 1994b) and Cavarozzi and Grossi (1992).

43. This is one possible theory suggested by Juan Carlos Torre, former political advisor to Juan V. Sourrouille. (July 7, 1995).

44. The Peronists could potentially have blocked legislative debate and votes in respect to many important government bills, including tax and budget laws, by refusing to appear and denying the governing party the necessary quorum in the Senate. Though this tactic was used frequently in order to force concessions from the government, the Peronists often helped the Radicals obtain a quorum, even when they then voiced their opposition to the legislation under consideration. See Ana M. Mustapic (1986) and Mustapic and Matteo Gorette (1992).

45. In the extensive literature on the execution of the Austral Plan there is a debate in regard to whether an agreement/coalition between the Alfonsin government and the Peronist opposition and/or the corporate sectors (labor, business, agriculture) was possible and whether this would have facilitated the implementation of a more sustained adjustment effort. Gerchunoff and Cetrángolo (1990) argue that for the initial achievements of the Austral Plan to have been sustained it would have been necessary for the government to have supplemented the Austral Plan with structural reforms. It may have been possible to carry out such reforms through political concertation in the honeymoon following the initiation of the Austral Plan, but the government was deluded by the Plan's initial success into thinking that the economic difficulties were resolved. Palermo (1990) argues that an inter-party coalition (between the Radical Party and the Renovador faction of Peronism) such as that which implemented profound neo-liberal reforms in Bolivia could have permitted the Alfonsin government to take a more confrontational approach in respect to social groups and to implement progressively-oriented structural reforms. Even without such a coalition, the government may have been able to carry out significant structural reforms through state initiative taking advantage of the increased state capacities and electoral legitimacy following the success of the Austral Plan and the Radical party victory in the 1985 elections. Instead, the strategy followed by the Alfonsin government of avoiding confrontation with social groups had the negative effect of weakening the government's political capabilities and lowering public confidence in the efficacy of democratic institutions. Canitrot (1991), who served in Alfonsin government's economic ministry, is highly skeptical of the possibility that an agreement between the political parties would have been possible and fearful of the consequences for democracy of the confrontational strategy.

46. For additional discussions of this dilemma facing the Alfonsin government see Vicente Palermo (1990), Canitrot (1991), Liliana de Riz and Jorge Feldman (1991) and Marcelo Cavarozzi and Maria Grossi (1992).

47. Canitrot (1991) emphasizes this point in his reply to Palermo (1990), who argues that a strategy of confrontation with the support of a political pact with the Renovador faction of Peronism might have enabled
the government to achieve a more durable adjustment. The importance of the military factor was also brought out in interviews by the author with the former Central Bank President, José Luis Machinea, the former Economic Minister, Juan Sourrouille, and a former advisor to Sourrouille, Juan Carlos Torre. In particular, Torre said that Alfonsin and others in the government were very aware of the fact that the CGT leaders did not join the civilian demonstrations against the April military rebellion until the outcome was clear.

48. The president of the Mortgage Bank was the deputy vice-president of the Radical Party, who, given the approach of the elections, was reluctant to curtail the Bank’s activities (Machinea, 1990).

49. The economic ministry was in favor of the elimination of industrial promotion through fiscal incentives and its replacement by limited bank credits. This proposal was not well received at this time by either party. Instead the reform the Congress agreed to debate, and eventually approved a bill initiated by UCR representative Hugo Socchi which sought to make the system more transparent and more equitable across regions, and to limit only marginally the costs of the system (Interviews with the former Subsecretaries of Tax Policy and Administration Juan Carlos Gómez Sabaini and Alfredo Fólica and Ambito Financiero, Sept. 18, 1987 and Sept. 30, 1987).

50. Unlike the previous Radical governor, Cañiero would no longer allow the government to use Buenos Aires' share of national revenues to cover the extra demands of the provinces. Thus, some agreement had to be reached between the Peronist governors on how to divide revenues between Buenos Aires and the rest. In addition, neither candidate during the run-up to the election wanted to leave the matter of revenue distribution to a national government controlled by the Radical Party (Interviews with the former Secretary of the Treasury, Mario Brodersohn and the former Minister of Economics, Juan Sourrouille).

51. The conflict between the economic ministry and the major business groups, such as the Argentine Industrial Union (UIA), over the government's tax policy reached such an intensity that the Treasury Secretary challenged the President of the UIA to a national television debate. The decision to focus on the large taxpayers made sense given the fact that 95% of the revenues collected from the VAT came from a mere 5% of the businesses which presented tax declarations. Interview with former Secretary of the Treasury, Mario Brodersohn.

52. According to surveys conducted in the Buenos Aires metropolitan area 49.5% of the people supported privatization of public companies in January 1986. Partly as a result of the publicity surrounding the Alfonsin government's privatization efforts, this proportion had increased to 59.9% in January 1988. Support for privatization had particularly increased among those of higher education, middle class voters, and Radical party supporters (Surveys conducted by Estudio Kolsky in Eccegaray (1993)). Survey data cited by Manuel Mora y Araujo (1993) also show an increase in public support for privatization.

53. This was the strategy favored by the Director of the D.G.I. at the time, who had the most complete knowledge of the difficulties of the tax administration. In addition, the Subsecretary of Tax Policy and Administration was not in favor of focusing on the VAT (Interviews with Marcelo Da Corte, former Director of the D.G.I., August 1995 and Alfredo Fólica, former Subsecretary of Tax Policy and Administration, August 1995). See also Ambito Financiero November 28, 1988.

54. Interviews with former Treasury Secretary, Mario Brodersohn and former Subsecretary of Tax Policy and Administration, Alfredo Fólica.

55. This replacement of the blanket tax exemption with a bond equivalent to the subsidy calculated at the time of the approval of the project would greatly lower the revenue losses for the treasury since the provincial governments generally did not require promoted firms to stick to their original contract. In many cases the
original fiscal costs of projects were deliberately kept low so that the firms and the provincial authorities could get around limitations set in the national budget. Thus, the original "theoretical fiscal costs" usually underestimated the eventual level of investments made (World Bank, 1990; Diario de Sesiones, various issues).

56. The congressional reform (Law 23,614), which was spearheaded by two members of the Industry Commission - Hugo Socchi (UCR) and Humberto Roggero (PJ) - was enacted after more than a year of debate in September 1988. This reform reflected a vision, strongly opposed by Treasury officials, that tax breaks were still an effective way to promote industrial development. The reform sought to make the system more equitable across regions and more transparent, but would not have restrained its fiscal costs. It was opposed by the representatives from the four provinces covered by special promotion regimes which were responsible for the majority of the fiscal losses for the Treasury (Interviews with former Subsecretaries of Tax Policy and Administration, Juan Carlos Gómez Sabaini and Alfredo Fólica).
CHAPTER 4
A PERONIST BREAKS THE IMPASSE: MENEM'S TAX REVOLUTION

Introduction

After the failure of successive governments to tame inflation, reign in the budget deficit, and spur economic growth, there was little expectation that Menem - who in the campaign remained faithful to the populist traditions of Peronism - would succeed either. With inflation at levels seldom reached in world history (4,300% and 152,000% annual rates in June and July 1989), the public sector deficit once again approaching 15% of GDP, a gargantuan debt burden (US$65 billion) in arrears since April 1988, and severe capital flight, the economy was, if anything, in a more desperate condition than at the time his predecessors assumed office. In a dramatic departure from positions taken in the electoral campaign and Peronist dogma, Menem implemented a wide range of free market reforms entailing a sharp reduction in the size of the state, an opening of the economy to foreign competition, a massive deregulation of prices and other business conduct, and a markedly more efficient tax system. As a consequence of repeated rounds of "unanesthetized" economic surgery and an ever-deepening process of economic liberalization, the budget was brought into surplus for three consecutive years (1992-1994), the inflation rate reached a level tolerable even to the Bundesbank (under 4% annually), and the economy grew robustly for four years in a row (1991-1994). Given the economic recession and budget deficits experienced in 1995-96, the relatively low rates of capital formation, and the egregious rise in the unemployment rate (from about 8% in 1989 to over 17% in 1995-96).
however, the record of the Menem government certainly cannot be viewed as an unequivocal, nor necessarily enduring, success story (see Table 4.1).

The adjustment and reforms carried out by Menem were, if anything, more harsh and far-reaching than the more hesitant and inconsistent program attempted during the military government, and certainly far more ambitious than the reforms proposed towards the end of the Alfonsin government. Yet, while the liberal tone and redistributive impact of the military government's policies were sharply repudiated by the public and the Alfonsin government's limited proposals for structural economic reform were blocked by intense opposition from societal organizations and the Peronist Party, the Menem government managed to carry out a sweeping free market revolution and to substantially increase the state's revenue generating capacity while repeatedly renewing and extending its mandate at the ballot box and maintaining broad public support. What is most surprising is that Menem, despite betraying his electoral promises (vague as they were) and the populist ethos of the party, managed, at least during his first term of office, to maintain the support of much of the working class and poor - groups that comprise the traditional backbone of Peronismo and which are expected (in much of the literature) to be most harmed by structural adjustment policies.

This chapter will address three fundamental questions related to the experience of the Menem government. First, why did Menem - despite his Peronist roots and populist campaign rhetoric - decide to give his absolute endorsement to this dramatic shift in development strategy and why did he maintain this commitment despite initial setbacks? Second, how did Menem succeed in profoundly restructuring the economy and implementing far-reaching fiscal reforms, despite the failure of the preceding governments? Third, how did the Menem government manage to implement such harsh fiscal adjustment measures and costly structural reforms while
holding onto a large share of the Peronist party's traditional social base and adding support from social sectors which have historically been strongly anti-Peronist?

Both within and outside of Argentina it is common for scholars, journalists and more casual observers to attribute the country's newfound economic stability and free market orientation to the experience with hyperinflation. It is believed that the experience with hyperinflation forced a sudden ideological conversion on the part of Menem and Peronism and induced societal groups to acquiesce to draconian adjustment measures and structural economic reforms which they adamantly resisted in the past. There is no doubt that the experience with hyperinflation and the deepening of the state's financial crisis helped forge a consensus in society behind the need for dramatic policy change and contributed to the relative free reign the Menem government enjoyed in its first months in office. But, I argue that this experience was not a necessary or sufficient condition for its success in stabilizing the economy and implementing far-reaching public sector reforms. Argentina had endured deep crises before in 1975-76, 1982-83, and in 1985 but such experiences did not result in an enduring stabilization of the economy or radical economic reforms. The honeymoon associated with the initial braking of inflationary pressures could not last forever. When inflation returned, the social costs of adjustment deepened, and the government's popular support eroded. Menem had to rely on strong party backing in the Congress and the provincial governments and the Peronist party's ties to the labor movement to sustain the fiscal adjustment and economic liberalization effort.

Another related explanation for the Menem government's decision to pursue radical free market reforms and an orthodox approach to economic stabilization focuses on the role of international economic and political pressures. With numerous Latin American governments - including many led by parties traditionally associated with economic populism - adopting orthodox adjustment programs and market-oriented reforms, such explanations have some prima
facie validity. Certainly, the Argentine government’s extremely low financial credibility, the large public sector deficit and debt, and the mounting arrears in foreign debt payments had placed the country in a still worse external predicament than that faced by the Alfonsín government. The need for international credit, foreign investment, and the rescheduling of the foreign debt increased the incentives for the Menem government to pursue policies which would bolster the confidence of international and domestic investors and helped persuade politicians of the necessity of such policies. But, it would be going too far to contend that external pressures determined the Menem government’s policy choices and its success in carrying out reforms and stabilizing the economy. I argue that there remained a range of possible approaches to the crisis and that the successful implementation of fiscal adjustment measures and public sector reforms depended importantly on intervening political factors.

It might also be argued that the Menem government’s record of policy reform resulted from changes in the international system - such as the globalization of international financial markets and the reversal in the direction of capital flows - which markedly increased the political power of export-oriented productive sectors and the banking and financial sector in domestic politics. Though Menem’s initial decision to seek an explicit alliance with a leading multinational exporting conglomerate would appear to lend support to such claims, I argue that changes in the strength of socio-economic groups - which tend to occur fairly slowly - cannot explain such a dramatic shift in policy. An explanation narrowly centered on the influence of societal forces would have to contend that business groups, which successfully resisted key fiscal and public sector reforms during the Alfonsin government, suddenly became dominated by socio-economic interests supporting such reforms. The record of the Menem government’s economic policy-making shows that it was not captive of particular societal interests and that reforms were undertaken despite opposition from the same groups which had opposed such reforms in the past.
Though such changes in the international economy may have affected the relative power of socio-economic groups, it is clear that changes in the political setting (and the economy) played a key intervening role in shaping the strategy of these groups and their particular influence on policy-making.

But, I argue that the Menem government's ability to command a majority in the Congress and the governing party's strength in the provinces and strong ties with the labor movement were key factors which intervened in shaping the strategies of societal organizations and their influence on policy-making. The lowered threat of military rebellion which followed the pardons of officers convicted of human rights violations and the forceful defeat of the main rebel faction in the December 1990 uprising, put the Menem government on more secure footing in confronting the economic crisis. In addition, the Menem government's unwavering commitment to the goal of inflation stabilization and liberal economic reform, and its tacit alliance with major business groups, limited the potential voice of business interests harmed by the public sector and free market reforms.

**Menem's Initial Policies: A Peronist Establishes Liberal Credentials**

Shortly after Menem's electoral victory Argentine society descended into chaos, with hyperinflationary conditions sewing panic as the purchasing value of wages earned one day vanished the next and the looting of retail businesses and homes, as well as rioting, became widespread. As a consequence, a state of siege was declared by the executive and was later ratified by the Congress. Though some measure of social calm was restored, it was obvious to everyone that the government lacked the political clout to implement any credible policy (Cavarozzi and Grossi, 1992). Some emergency fiscal measures were taken at the end of May by a newly appointed economic minister - including the partial and temporary suspension of
exemptions granted under the industrial promotion law - but they alone had little hope of reversing the slide towards the abyss (La Nación, 6/2/89).

According to the peculiar rules of Argentina's constitution, Menem was not scheduled to assume office until December 1989. In the existing circumstances it was obvious that the incumbent government could not by itself govern the country through this long transition period. But, Menem had no interest in collaborating with the Alfonsín government to implement proposed tax reforms and other necessary adjustment measures since this would jeopardize much, or potentially all, of his recently earned political capital (Wynia, 1990). Facing an ever-accelerating inflation rate and volatile social conditions, and lacking cooperation from the president-elect, Alfonsín decided to swallow his pride by resigning from office. In negotiations over how to effect the transfer of power, Alfonsín and the Radicals agreed to not impede the passage of emergency economic legislation until the renewal of Congress on December 10 (Cavarozzi and Landi, 1992).

This commitment by the Radicals provided Menem with the ability to enact legislation through the existing Congress - in which the Peronists remained the minority party in the Lower House. But, for the period after December 1989, the sizable electoral victory of the Peronists in the May 1989 elections gave Menem an ample majority in the Senate (25 out of 46 seats compared with 14 seats for the Radicals) and a large plurality in the Chamber of Deputies (120 out of 254 seats compared with 90 seats for the Radicals and 11 for the Union of the Democratic Center (UCD) (de Riz and Adrogué, 1991). Since governors were not up for reelection in 1989, the Peronists maintained the virtual monopoly they acquired in 1987, with control of 17 out of 22 provincial governments compared with only 2 for the Radicals. Surveys indicated that the Peronist Party achieved such a victory by virtue of the return of much of its historic electoral base which had abandoned the party briefly in 1983 and 1985. Though support among middle and
upper socio-economic groups remained relatively scarce, much of the lower educated, working class, and poor returned to the Peronist fold in 1989. As a result of deep dissatisfaction with the state of the economy, the Radicals lost support across the board: lower class voters who had supported the Radicals in 1983 went to the Peronists and middle and upper class voters switched to conservative parties (see Tables 4.2 and 4.3) (Catterberg, 1991; Mora y Araújo, 1991; Gibson, 1996).

Already in early June Menem gave some indication of the future direction of policy by his appointment of long-time enemies of Peronism on the political right, executives from a leading multinational agro-export conglomerate, and business organization advisors to key economic posts in his cabinet. Menem invited Alvaro Alsogaray, the leader of the small conservative Union of the Democratic Center Party (UCD), former economic minister, and persistent and forceful national spokesman for economic liberalism for many decades, to join his administration as personal advisor to the president on the negotiation of the foreign debt. As a candidate for the UCD during the 1989 presidential race, Alsogaray had called for an orthodox, free market solution to the economic crisis. Menem named Miguel Roig, a former vice-president of Bunge and Born - the largest multinational firm in Argentina and one of the world's largest agro-businesses - as economic minister (Smith, 1992). In compensation for the influence awarded the sector, leading grain exporters offered to lend the Central Bank $2.5 billion in order to forestall the state's bankruptcy and bolster the future economic program (Peralto-Ramos, 1992). Other key appointments were Domingo Cavallo (former Central Bank president during the post-1976 military regime responsible for statizing the private sector's public debt) as Minister of Foreign Relations and Javier González Fraga (liberal economist and business consultant) as president of the Central Bank (Smith, 1992).
Another indication of Menem's intentions to abandon past Peronist dogma and social alliances was his appointment of Jorge Triaca - the head of the "Group of 15" - as Minister of Labor. "The Group of 15", which was the union faction from which Menem had most actively sought support in the primary election and the presidential campaign, comprised the unions from the more dynamic sectors of the economy and was conservative and pragmatic - as evidenced by its leaders' previous collaboration with the military government and the Alfonsín administration (McGuire, 1992; Epstein, 1992). By appointing this more cooperative faction of the labor movement, Menem deprived the more militant factions of an important political resource. Thus, in order to carry out his plans to restructure the Argentine economy and to construct a new base of political power consistent with these reforms, it became apparent that Menem intended to forge a new conservative alliance which would replace Peronism's traditional base in the union movement.

Immediately upon assuming office Menem declared his intention to "pulverize the crisis" by implementing "a tough, costly, and severe adjustment," and creating what he called a "popular market economy". He reaffirmed his commitment to an orthodox adjustment plan by making public his consultations with Jorge Born in his replacement of Miguel Roig - who died unexpectedly several days after Menem's inauguration - with Néstor Rapanelli, another former executive of Bunge & Born (Acuña, 1993; Damill and Frenkel, 1990; and Smith, 1992). The first package of adjustment measures (dubbed the Plan Bunge y Born - or Plan BB) included large nominal increases in the prices of public services (200-640%), comparable increases in fuel taxes, a half year suspension of all tax exemptions and incentives for industry, and a devaluation of the currency by 170% to the level of the parallel rate with a 30% and 20% tax (called retentions) on the dollars exchanged by the agricultural and industrial sectors, respectively. In order to break the heavy inertial forces propelling inflation Rapanelli obtained direct agreements
with 350 of the largest firms to slow their price increases in exchange for the government's promise to lower interest rates and refrain from altering the fixed exchange rate (at 650 Australes to the dollar) or public sector tariffs until March 1990.³ This action was a first indication of Menem's willingness also to renounce Peronism's traditional preference for a corporatist style of decision-making (in which the central Peronist-affiliated confederations of business owners and unions were consulted) in exchange for one in which the executive deliberately bypasses representative organizations and acts either autonomously or strikes deals with more atomistic business and labor units (Acuña, 1993).

The Plan BB and the declarations of the newly appointed officials in the Menem cabinet had an immediate calming effect on the financial markets and slowed the exodus of capital. The government made plain its goal to restore the country's status as a reliable debtor by making a symbolic payment of interest to the International Monetary Fund (Latin American Weekly Report, 8/3/89). As a result of the adjustment measures and changed expectations the inflation rate fell from 200% in July to 38% in August and 5.6% in October and the fiscal deficit shrunk markedly. However, the truly revolutionary aspects of the Plan BB, including the plans to eliminate the fiscal deficit, privatize many public enterprises, deregulate markets, and restructure the state bureaucracy were contained in two major pieces of legislation - the State Reform Law and the Economic Emergency Law. Both of these proposed laws were sent to Congress in August. In addition, a tax reform law, aimed at radically reforming the tax system, was to be sent to Congress several weeks later.

The State Reform Law would give the president the authority to place trustees in charge of state enterprises for a period of 180 days and to privatize many of the largest public enterprises, including the airlines, TV and radio stations, petrochemical companies, telecommunications, the port authority, and steel companies according to terms set, for the most
part, by the executive (Smith, 1992; Clarín, 8/18/89). Given the $5.5 billion deficit of the public enterprise sector, government spokesmen repeatedly referred to privatization as a matter forced upon the government by the bankrupt condition of the state. The Economic Emergency Law would give the executive the authority to modify by decree many existing laws pertaining to the regulation of economic activity, the conditions of employment in the public sector, and several laws related to the tax system. Among the more important measures immediately contemplated by the executive were the suspension for an additional 180 days of the industrial promotion benefits (in exchange for a bond to be paid one year later), reductions in import tariffs and other quantitative restrictions on trade, changes in the salary structure and rules for dismissal of public employees, and modifications of the penal code for tax violations which would make evasion and fraud a felony offense subject to imprisonment (Ambito Financiero, 9/1/89; Clarín 9/2/89).

Explaining Menem's Embrace of the Liberal Reform Agenda

Given Menem's political background as a life-time Peronist and record as a three-time governor from the small, poor, northern province of La Rioja, few observers doubted his promises to carry out a "salariazó" (taken to mean a sharp increase in real wages) and to take a tougher stand on the repayment of the foreign debt. In fact, by an overwhelming majority the Argentine electorate saw Menem as the candidate most likely to defend the interests of workers, unions, and the poor, while Eduardo Angeloz (UCR) and Alvaro Alsogaray (UCD) - who each pledged to deepen the path of economic liberalization begun by the Alfonsín government - were seen as likely to favor the interests of the middle and upper classes. Supporting his reputation as a populist was his record as governor of the poor northern province of La Rioja. In the first three years of his term as governor he had increased the size of the public payroll by 40% to almost half the work force and practically doubled public spending (see Table 3.2) (World Bank, 1990). He financed this profligate spending by requesting extraordinary transfers from the UCR-
controlled central government and even by having the state-owned provincial bank print its own money (Manzetti, 1993).

In the presidential primary against Cafiero, he cultivated an image as a telegenic and charismatic caudillo who spoke the language of the common people and was removed from the corrupt party system and the centralism practiced by Buenos Aires politicians. Despite the fact that the Peronist party organization firmly backed Cafiero, Menem won the primary by wooing the support of the unions, which resented the Renovador's efforts to downgrade their influence in the party, and by presenting himself as the more authentic heir to Perón: in part, by the substance of his discourse but, more importantly, in regard to his style of communication (Nun, 1995; Portantiero, 1995; Cavarozzi and Grossi, 1992; Manzetti, 1993). In the style of Perón and other populist leaders in Latin America, he developed a personal connection with his followers, seeking their support not mainly on the basis of his policy positions, but on the basis of their trust in his personal leadership qualities and his capacity to identify with their problems.

Mindful of the need to broaden his popular appeal and to widen his future freedom of action, in the presidential race Menem softened the populist edge of his rhetoric and sought to moderate, and distance himself from, the behavior of the more militant union factions, who might revive voters' perceptions of Peronism as an incohesive and unruly political force (Wynia, 1989). Thus, his pledges to redistribute income and his opposition to privatization became more ambiguous and he soothed the fears of foreign creditors by backing off on his promises to take unilateral action to reduce the country's foreign debt burden.5

I argue that Menem's decision to give his full endorsement to a free market reform agenda was based on his calculation that, given the severity of the economic crisis and the near-bankrupt state of public finances, and the country's deep foreign indebtedness, this was the path which was most likely to permit him to sustain and extend his base of political support. In
reality, this decision was consistent with Menem's highly pragmatic approach to politics—an essential trait also of Perón—Menem's chief mentor (Palermo, 1994). To the extent that Menem's political orientation was guided by an ideology, it was the conservatism shared by Peronist politicians of the poor, remote provinces, where, given the scarcity of economic resources and opportunities, the government plays a disproportionate role in the provision of employment and in consumption and investment. In such provinces, Peronism came to be identified with traditional political, religious, and social values and not the union-based populism of the more densely populated provinces (Manzetti, 1993; Gibson, 1996). Thus, lacking strong budgetary constraints (given the absence of a strict regime for sharing revenues between the central government and the provinces), and given his shrewd pragmatism, Menem was able to build an important base of personal political power in La Rioja and the Peronist movement by giving out jobs and extending state contracts.

But, a completely different set of constraints and opportunities prevailed when he assumed the presidency. The Menem government faced an economy which had been virtually stagnant over the preceding two decades, with a public sector deficit amounting to 15% of GDP, a large internal debt financed through high interest rates, and a foreign debt of $60 billion which had not been serviced since April 1988. In addition, as a consequence of the high level of currency instability and rampant inflation, the economy had been subjected to massive capital flight, which on top of the debt burden, made the country a net exporter of capital.

In order to revive the economy, Argentina desperately needed foreign aid and investment and a lighter debt service burden. Menem knew that in order to make Argentina a candidate for international loans and, potentially, for debt reduction under the auspices of the Brady plan, he had to regain the support of international lending institutions and creditor governments, such as the United States. Thus, by carrying out a sweeping privatization program, reducing the size of
the state, opening the economy to foreign trade, and reforming the tax system. Argentina could regain the confidence of lending institutions and attract foreign investment, which would expand its otherwise restricted growth possibilities and help in the financing of the public sector. Just as importantly, the alliance with the most internationalized fraction of the business sector and the political right, and the adoption of liberal economic reforms, could help restore the confidence of the Argentine financial sector and business community - which, by partaking in the speculative frenzy (in February through May 1989) had generated the price explosion (the so-called "golpe de mercado") which caused the early exit of Alfonsín. Such market reforms thus were expected to help stabilize the economy and increase the rate of economic activity by reducing the fiscal deficit, improving economic efficiency, and restoring the confidence of the more powerful economic sectors (thus encouraging them to undertake productive investments).

The other alternative approaches to addressing the economic crisis - a populist-style heterodox adjustment or an orthodox adjustment with few structural reforms - were viewed as not likely to lead to favorable economic outcomes over the medium term and not likely to allow Menem to consolidate his base of political support. Given the near bankruptcy of the treasury, the low level of monetization of the economy, and the extremely low creditworthiness of the government, any approach not based on fiscal responsibility would almost certainly have produced a renewed explosion of inflation. Partly because the public sector deficit was large and structural in character and there was a great need to impress the international financial community (to permit Argentina to receive foreign aid and a reduction of the debt burden), the "muddling through" option (orthodox adjustment with few structural reforms) was rejected. But, the radical reform approach was also likely to have been preferred by Menem because it fit well with his leadership style - permitting him to present himself as the heroic, daring leader carrying out difficult, but "unavoidable", decisions in order to save the Argentine people from the disaster.
left by the Alfonsín government. As Luigi Manzetti points out, by further emasculating the
unions' base of influence within Peronism, and by providing a global mission around which to
rally support, this "all or nothing" approach to the crisis permitted him to consolidate his own
base of political power (Manzetti, 1993).

Menem's decision to embark on a free market reform agenda and form alliances with
Bunge & Born and the conservative right was apparently not a last-minute conversion forced
upon him by the extreme characteristics of the immediate crisis, but was made much earlier. In
an interview with a popular news magazine almost four years after he took office Menem said
that

The three golden rules of leadership are 1) to be perfectly informed; 2) to guard
in secret that information and 3) to act by surprise. This is what I did all my life.
If I in the electoral campaign told the people "We are going to resume relations
with Britain" I would lose 20% of the votes. If I said to the people "I am going
to privatize the telephones, railroads, and airlines" I would have the labor
movement opposed to me. There was still not a consciousness that it was
necessary to do it (Nun, 1995)

In addition, a campaign official confided to a North American political scientist that Menem
made the decision to turn the economic ministry over to Bunge & Born immediately after he
defeated Cafiero in the Peronist presidential primary, a full year before assuming office (Stokes.
1995). If a large part of the economic program was planned well in advance (and hidden from
the public) it lends further support to the notion that Menem's decision was based on very
pragmatic and self-interested political calculations (drawing on the constraints and opportunities
presented by the more enduring characteristics of the socio-economic context) and was not just a
hasty, improvised response to emergency economic conditions. Of course, the advisors
surrounding Menem during the campaign and after, including businessmen, liberal economists.
and conservative union leaders, likely had a considerable influence on the specific policy decisions made.

Liberalizing the Economy by the Stroke of a Pen: Implementing the First Wave of Reforms

Despite their apparent contradiction with Menem's campaign pledges, the initial policy announcements were warmly received by the Argentine public, which was prepared to support any decisive action which promised to bring some respite from the insanity of hyperinflation. Over two-thirds of the population registered its approval for the president and, only slightly less, for his first economic decisions. After overcoming their initial disbelief the major business groups forming the "Group of 8" (which included the Argentine Industrial Union (UIA), the Argentine Chamber of Commerce (CAC), and the Argentine Rural Society (SRA)) voiced their strong approval for the government's plans to reduce the size of the state and eliminate the fiscal deficit (La Prensa, 8/9/89). Union leaders were caught by surprise but most voiced their solidarity with the government's efforts to deal with the crisis. Even Ubaldini - the militant CGT leader who orchestrated many of the general strikes against the Alfonsin government - was initially hesitant to criticize a recently elected Peronist leader. The plan also brought the international support which it was designed to attract. Despite $5.3 billion in unpaid interest on the foreign debt, the IMF immediately sent representatives to Argentina and a loan agreement was reached in November.

The Menem government obtained legislative approval for the two omnibus reform laws with little serious difficulty. Because of the heavy tradition of party discipline (buttressed by the large powers of the party leader to select legislative candidates and to determine their position in the party list) and the strength of his recent electoral mandate, Menem was able to convince Peronist congressmen to back the Reform of the State Law despite the open opposition of some to parts of the legislation - especially the plans to privatize state holdings in the petro-chemical
sector (La Prensa, 8/9/89; Latin American Weekly Report, 9/7/89). Consistent with the position of Alfonsin during the latter period of his presidency and Angeloz' statements during the campaign, Radical party legislators supported the idea of privatizing many public firms. But, they opposed the proposed law because they thought that it delegated too much discretion to the executive branch to select the procedures and instruments by which individual public firms would be privatized. Instead, they wanted the privatizations to be administered through separate laws enacted by the Congress. Given their commitment to not block the Menem government's economic legislation until the inauguration of the new Congress (in December 1989), Radical party deputies abstained from the final vote, thus permitting a coalition of legislators from the Peronist party, UCD, and provincial parties to enact the bill into law (La Prensa, 8/9/89). The bill was passed largely in the form desired by the executive. But, in a concession to a sector expected to be harmed by the privatizations, preferential rights to purchase public enterprises were given to private firms whose livelihood depended on the sales of goods and services to the public sector (Peralta-Ramos, 1992).

The Economic Emergency Law faced intense criticism from some business groups and provincial party legislators, who were particularly opposed to the elimination of subsidies, the suspension of tax benefits for industries, and the increased penalties for tax evasion. In addition, Ubaldini and other leaders of the labor movement, objected to the law because of their concerns that it would cause massive layoffs in the public and private sector. As a result, the government and Peronist legislators decided to suspend only 50% of the tax benefits for firms within the industrial promotion system and to exclude from the enacted legislation the reform of the penal code for tax law violations. They promised, however, to include this measure in the forthcoming tax reform proposal. In addition, Peronist and Radical party lawmakers, at the urging of labor leaders (including those within the Menem government), added an amendment which increased
the level of indemnization to be paid by employers to laid off workers. Since it was expected to increase labor costs by 11% in both the private and state sector, this measure was opposed by business groups and the government. Menem gave some consideration to vetoing the legislation passed by the congress, or testing the constitutional limits of executive power by vetoing only this part of the bill. But, to speed its passage, he signed the bill into law, promising at the same time to overturn the amendment through new legislation (Ambito Financiero, 9/6/89, 9/7/89, 9/8/89; Latin American Monitor, 9/89).

Staying the Course in the Face of Societal Resistance

After this initial honeymoon period the relations between the government and societal groups and sectors became more tense: provincial governments protested against the sacrifices being demanded by the central government; an oppositional union faction emerged within the CGT; business groups protested against adjustment measures damaging to their interests; and the general public repudiated the Menem government's decision to grant pardons to members of the armed forces indicted or awaiting trial for human rights violations or participation in revolts against the civilian government. In addition to growing tensions in government-society relations, divisions within the government over fiscal and monetary policy erupted out into the open.

Though rural groups praised the government's plans to roll back the state, reduce the fiscal deficit, and lower import barriers, they were angered by the imposition of a 5% tax to the first sale of agricultural goods and the high level of agricultural export taxes. While Menem's announcement that retentions would be reduced immediately and eliminated altogether within two months was applauded at the Rural Society's annual exhibition, rural producers stepped up their pressure - by refusing to exchange their hard-currency earnings for australes - when the government did not follow through on the latter commitment (Smith, 1992; Acuña, 1994).
Though most business groups remained supportive of the general direction of economic policy, individual business groups, such as the Argentine Industrial Union (UIA) and the Argentine Business Council (CEA), gave voice to the discontent prevailing in some sectors regarding the elimination of state subsidies, the retentions on industrial exports, the suspension of pre-financing for exports, and the sharp cuts in foreign trade protection. Industries producing mainly for the domestic market feared being wiped out if they no longer received state contracts and if subsidies were withdrawn. Business groups also complained about the preferential treatment in tariff setting and price adjustments given to the agricultural and petrochemical sectors because of their centrality to the government's goal of increasing exports (Ambito Financiero, 9/1/89 and 9/4/89; Peralta-Ramos, 1992). Intense pressures by business groups led the government to resume the pre-financing of exports only 15 days after its initial suspension (Damill and Frenkel, 1991). Nevertheless, the principal national business organizations remained strongly supportive of the basic direction of economic policy and hesitated to disrupt the actions of a newly elected government aggressively combating the deep economic crisis. 

The Menem government knew that in order for its market reforms to bring about the hoped for "productive revolution" - i.e. to succeed in lowering inflation, increasing investment, and creating jobs - it had to restrain labor union strikes and protests, implement a restrictive wage policy, and deregulate the labor market. The government's cabinet appointments, initial policy pronouncements, and calls for labor peace brought an angry reaction from some labor leaders and rank-and-file members. But, the government achieved a partial success in October when labor leaders supporting Menem managed to persuade a majority of the union delegates to the CGT Congress at Teatro San Martín to elect Guerino Andreoni - a pro-Menem union leader - to be the new head of the CGT. This outcome, decided on the basis of a thin vote margin and with the abstention of several key unions, was preceded by a three-month campaign on the part of
*Menemista* labor leaders to pressure Ubaldini to resign, which included an offer of a post in a foreign embassy. Jorge Triaca, the new Labor Minister, and Luis Barrionuevo, the newly appointed head of ANSSAL (the National Administration for Health Insurance), which controlled the health benefit funds collected by the government on behalf of workers, spearheaded the effort to replace Ubaldini with a more cooperative leader. Delegates from unions which continued to support Ubaldini, including such powerful ones as the Metalworkers (headed by Lorenzo Miguel, leader of the traditionally "orthodox" Peronist 62 Organizations) and several unions connected with the state sector, such as Teachers, State Workers (ATE), and the railway workers, walked out of the Congress and refused either to recognize the election of Andreoni or to abandon control of the traditional CGT headquarters on Calle Azopardo. Thus, though the division of the central union confederation into the pro-government CGT "San Martin" and the dissident CGT "Azopardo" may not have been the outcome most favored by the government, it eventually weakened the position of Ubaldini and the more confrontational unions (Epstein, 1992).

Nevertheless, in the short term, the schism in the union movement led to an intensification of labor conflict and increased wage pressures, as the dissident union leaders sought to enhance their power within the labor movement and the government sought to reward unions which aligned with the officially recognized CGT.

The government also faced the intense opposition of provincial governors - including Menem's rival in the presidential primary election, Antonio Cafiero - to the government's requirement that the provinces impose wage adjustments equal to those being applied in the central government. Rapanelli threatened to eliminate extraordinary revenue transfers (amounting to 25-30% of total provincial budgetary resources), but with the consent of Cafiero and other Peronist provincial leaders, an agreement was reached to provide extra resources to
those provinces which complied with the salary guidelines laid out in the Economic Emergency Law (Ambito Financiero, 9/5/89, 9/6/89).

In addition, Menem's early-October decision to pardon military officers convicted or awaiting trial for crimes during Argentina's 'dirty war', or for their involvement in three military uprisings during the Alfonsin government, was opposed by between 70% and 80% of the population and greeted with large protests (Fontana, 1992; Acuña and Smulovitz, 1995). Though the pardon did not include four junta members from the 1976-83 military regime, two generals accused of flagrant human rights violations, or the former leader of the Montoneros guerrillas. Menem pledged that the pardon would be extended to these individuals shortly. This decision, which was anticipated by government discussion and announcements almost immediately after Menem took office, fell short of the military's desire for vindication of its role in the war against subversion. But, Menem hoped that by meeting one of the armed forces' principal demands the pardon would dispel the threat of military rebellions, which had seriously eroded the prestige of the Alfonsin government and limited its ability to address the economic crisis.

The pardon, along with the appointments of Italo Luder as Minister of Defense and "carapintada"-sympathizer Humberto Romero as Subsecretary of Defense and the forced retirement of generals denounced by the rebels, appeared at first to confirm a tacit alliance between Menem and the nationalist rebel leaders. Lieutenant Colonel Aldo Rico and Colonel Mohamed Ali Sieneldin, who had strongly supported Menem in the presidential campaign (Norden, 1996; Fontana, 1992). But, Menem's decisions to allow military courts to pursue prosecutions against the rebels and to support the decision of army commanders to dismiss the rebel leaders from the army sent a clear signal that future insubordination would not be tolerated.
Tensions within the government and between the government and its business allies emerged over the proposed tax reform and the economic minister's decision to restructure the treasury secretariat. A central element of the tax reform proposal being debated among members of the economic team, the government's advisory commission on tax reform, and advisors from the IMF and World Bank was the plan to generalize the VAT to include practically all goods and services, thus absorbing previously excluded items such as food, medicine, banking services, and entertainment while permitting numerous excise (so-called "internal") taxes to be eliminated. The proposed broadening of the VAT, which in the past was assailed by politicians of both major parties as a highly regressive tax, was to be more comprehensive than the reform enacted in 1980 by the military government or the reform proposed by the Alfonsín government's in December 1988, which was defeated by the staunch opposition of the Peronists. As with the reform attempted during the Alfonsín government, the principal content of the proposed tax reform emerged out of investigations carried out by teams of technical advisors organized and financed by the World Bank.

Much of the business community, including many of the organizations representing industry and agriculture, key business leaders such as Jorge Born, persons in the government, including Treasury Secretary Rodolfo Frigeri and Agriculture Secretary Felipe Solá, and at least one of the members of the government's advisory commission on taxation, opposed the plan to make a generalized VAT the core of the tax system (Ambito Financiero, 9/1/89; 9/18/89; 9/25/89; 10/12/89; 10/18/89; 12/22/89). In addition, most rural groups, except the Argentine Rural Society (SRA), opposed the extension of the VAT to agricultural products since they thought that this would entail an inordinate additional fiscal burden on top of the many taxes they already paid (i.e., export taxes, the tax on the first sale of agricultural products, the income tax, and local
property taxes) (Ambito Financiero, 9/25/89; La Prensa, 10/14/89). Born argued vehemently for a national sales tax instead of the VAT since this type of tax would tend to favor large, well-integrated companies (such as the one he co-founded) (Ambito Financiero, 10/12/89; 10/18/89). Though the Argentine Industrial Union (UIA) initially supported the national sales tax, business leaders associated with the organization were heavily divided in respect to their opinions toward a generalized VAT. Given the fact that exporters can be reimbursed for indirect taxes paid on inputs in the case of the VAT, they had a reason to support this type of tax over a national sales tax. Inward-oriented industries, which tended to rely more heavily on state subsidies and contracts, were more concerned about the VAT, since with the Economic Emergency Law's suspensions of tax incentives, firms incorporated into the industrial promotion system were no longer fully exempt from the VAT.

Despite the economic inefficiencies and horizontal inequities associated with a national sales tax, many Argentine tax experts preferred this tax to the VAT since they believed that, based on past experience, the D.G.I. was not capable of effectively enforcing such a tax in a country in which there are so many small businesses - especially with the 600,000 taxpayers (on top of the existing 100,000) which would be added to the tax rolls as a consequence of the generalization. Minimally they thought that the VAT rate should be lowered to around 5% so that there would be less evasion. In fact, it was estimated that with the existing VAT, which collected only 1.9% of GDP in 1988 (with a rate of 13%), only 22% of registered taxpayers presented declarations showing a debt to the tax administration, and evasion, according to some sources, reached 80% (Ambito Financiero, 9/1/89; 9/6/89; 9/25/89; 10/18/89). Nevertheless, against the opposition of most economic groups, including the government's chief business ally (and financier), Rapanelli and the economic team decided to stick with the plan to apply a generalized VAT at the new (higher) rate of 15%. The strong
preference for a generalized VAT among World Bank and IMF advisors to the Argentine government, including the world-renowned tax expert, Vito Tanzi, may have influenced Rapanelli’s decision to opt for the VAT. The Menem government desperately wanted the IMF to approve a $1.5 billion credit, which it needed to resume making interest payments on short term debts, and wanted eventually to qualify for debt reduction under the Brady Plan. But, while IMF approval depended on the government’s demonstrated will and capacity to sharply cut the fiscal deficit, it is unlikely that it hinged on the adoption of a particular tax instrument. The main impetus for the economic team to opt for the VAT was the absolute priority it placed on eliminating the fiscal deficit, because of the need to contain inflationary pressures, to establish credibility with domestic investors and economic actors and to qualify for desperately needed foreign assistance and debt reduction.

In order to reach the public sector deficit target of 2% of GDP set in the letter of intent to the IMF the government calculated that tax revenues would have to be increased from 16% to 24% of GDP, which would require a marked increase in the performance of some existing taxes or the creation of new taxes. The economic team was convinced that a modernized and aggressive tax administration could turn the VAT into a core revenue source of the tax system (providing about 6% of GDP). Rather than hindering enforcement, the elimination of loopholes and exemptions would make the job of the DGI easier, since, given the inherent characteristics of the VAT (where firms have to report input purchases and sales receipts), it would be possible to more systematically compare the tax declarations of companies in order to detect violations. The economic team also figured that for a national sales tax to raise the 6% of GDP expected of the VAT it would need to be applied at such a high rate that it would lead to huge distortions in the economy (Ambito Financiero, 10/19/89).
Thus, the choice of tax reform was influenced somewhat by the policy advice of the World Bank and IMF and the country's need for loans to ease the burden of making interest payments on the foreign debt. But, the government's decision to opt for a universal VAT was more a product of the Menem government's overall strategy of political coalition-building in the context of a profound fiscal crisis than international pressures per se. The VAT reform, along with the rest of the tax reform, was an integral component of Menem's plan to use an unrelenting attack on inflation and economic restructuring as a tool for extending his base of political support. Given the opposition of rural and industrial groups to the VAT generalization and other taxes in the proposed reform, it is clear that the choice of tax reform was not heavily constrained by the demands of societal groups.

Not wanting to be seen as totally obstinate in the face of sectoral demands, the government agreed to lower the proposed VAT rate to 13%, while giving itself the power to raise the rate as high as 15.6% or lower it to 10.4% without consulting Congress. In addition, because of fears of feeding inflation and administrative concerns, the government decided (against the advice of the IMF) to extend the VAT to previously excluded products (such as food and medicine) in a gradual manner - applying at first a 5% rate, but keeping the 5% tax to the first sale of agricultural products (Ambito Financiero, 10/11/89). It was also decided to delay the application of the VAT to many types of previously excluded services, such as banking and insurance, so as to give the DGI time to prepare for the large number of new taxpayers.

If the economic team was confident about the DGI's ability to improve the enforcement of the VAT, it was more skeptical in regard to the income tax. Given the extremely high level of evasion and legal elusion in regard to the corporate income tax (only 3.8% of registered taxpayers submitted declarations showing a debt to the treasury and less than 0.5% of GDP was collected), the government considered replacing it with a tax to assets (Ambito Financiero, 9/6/89). A tax to
corporate assets would have the advantage of extracting a minimum tax from all firms, even if they did not, on paper, owe income tax because of exemptions under the industrial promotion law or because of losses (fictional or not) carried over from past years. However, an assets tax is less equitable and economically neutral since it does not take into account the liabilities of companies (or whether they made profits or incurred losses) and tends to discourage investment in fixed capital. Because of its desire to not discourage foreign investment (by preventing multinational companies from being able to deduct against home country income tax requirements), the government decided to keep the corporate income tax, but with a reduced rate of 20% instead of the 33% which was applied previously. In addition, firms were once again permitted to deduct losses carried over from past years (World Bank, 1993). At the same time, following the example of Mexico, the government proposed the creation of a 1.5% assets tax with payments deductible from income tax obligations. This would ensure that firms would minimally be responsible for paying this tax, and most likely would still not pay much income tax. The income tax burden of profit-making foreign companies would potentially be reduced by the lowering of the income tax rate from 45% to 36%. The personal income tax would also be maintained with a smaller spread between the top marginal rate and the lowest rate (ranging from 10% to 30% instead of 5% to 45%) but also with a higher minimal taxable income (40% higher) and lower personal and family allowances (Ambito Financiero, 9/15/89, 11/27/89).

Following the recommendations of the World Bank, the tax reform aimed to simplify the tax system by eliminating many low yield taxes that absorbed the scarce resources of the DGI. Among those taxes eliminated were the net worth, net wealth, and capital gains taxes (which together collected under 1.0% of GDP). The VAT generalization permitted many low yield excise taxes and the special VAT regime for small taxpayers also to be eliminated. The government also proposed to increase the rates of fuel taxes and to transfer a smaller proportion
of the revenues from these taxes to the social security system, thus leaving more for the treasury.19

Given the extremely low level of income tax payments, it was predictable that the assets tax was strongly opposed by industrial groups, with every major group, as well as Bunge and Born, weighing in against it (Ambito Financiero, 10/11/89, 10/18/89; Clarin 11/5/89). The reduction of the corporate income tax rate did little to allay the fears of businesses that their tax burden would increase.

Despite significant societal opposition to two of its main planks, the tax reform was enacted by both houses of Congress with relatively few significant changes. In order to ensure passage of the generalized VAT, this portion of the reform was delayed until the convening of the new Congress in which the Peronists controlled a plurality of the seats. Radical Party and several provincial and other smaller national party legislators, including the liberal UCD, objected to the VAT’s extension to popular consumption items such as food and medicine because they thought that an already regressive tax system would be made still more inequitable. Despite the opposition of these legislators, and the lukewarm support of Peronist legislators - who left their seats vacant during most of the floor debates - a coalition of Peronist and Christian Democratic deputies was able to ensure its passage. As a concession to the demands of the CGT leadership, which feared that the VAT extension would increase the price of basic consumption items, the public revenue secretary agreed to provide a one-time compensation to workers’ salaries for any price increases which resulted. In addition, the Peronist legislators agreed to exclude water, milk, bread, and print media (Ambito Financiero, 12/1/89; 12/21/89; 12/22/89; Diario de Sesiones de la Camara de Senadores, 12/21/89).20

The other tax reforms were approved in early December while the reform of the penal code for tax violations was enacted in February. The only significant modifications were the
rejection of the executive's attempt to transfer fuel tax revenues from the social security system to the treasury and of the proposed tax to tourism. A coalition of Peronist, UCD, Christian Democratic, and provincial party legislators enabled the reform to be approved despite the opposition of the Radical Party to the dilution of the income tax and the elimination of other direct taxes which the Alfonsin government had sought to strengthen. The passage of these reforms was again eased by the Radical Party pledge to not obstruct the passage of emergency economic legislation and the decision of UCD legislators to vote for the reform, despite serious points of disagreement, because of their solidarity with the government's broader economic plan (Ambito Financiero, 11/22/89).

Aside from the conflicts which erupted within the government in respect to the tax reform, tensions also arose as a consequence of Rapanelli's decision to elevate the public revenue subministry to Secretarial status and to place the DGI and the Customs Administration directly under its jurisdiction, instead of the Treasury Secretariat. The Treasury Secretariat would now have as its primary responsibility the management of spending decisions and would lose much of its control over decisions related to taxation and revenue collection. This decision caused the Treasury Secretary, Rodolfo Frigeri - one of the few politicians and renovador Peronists appointed to the cabinet - to resign. Aside from the affront to his power - and the other politicos in the cabinet - Frigeri opposed separating the revenue function of the government from the body making spending decisions. Rapanelli appointed Raúl Cuello, the head of the tax advisory commission, to be the new Public Revenue Secretary and another renovador politician, Saúl Bouer, to replace Frigeri as the Treasury Secretary. Ricardo Cossio, who had been the D.G.I Director during the Proceso, when revenue collection peaked, was renamed to this position, replacing José Sbatella, who resigned (Southern Cone Report, 9/16/89: 12/21/89; Latin American Monitor: Southern Cone, 12/89). Thus, in order to overcome the problems of coordination
between the economics ministry and the DGI experienced during the Alfonsín administration and speed up the process of tax administration reform. Rapanelli restructured the economic ministry.21

The Exit of Bunge and Born and the Second Round of Hyperinflation

Already by November - long before the tax reform was to go into effect - tax revenues increased dramatically to a level 70% higher than that achieved during the previous year as a consequence of the sharp slowdown in the inflation rate (down to 6% per month in October), the partial suspension of tax subsidies, and the imposition of heavy export taxes, which together with import tariffs accounted for 25% of total revenue collection (Damill and Frenkel, 1992; Carciofi, Barris, and Cetrángolo, 1994). As a result, despite a 16% increase in Treasury expenditures, a surplus was obtained in the operating fiscal accounts. But, given the government's pledge to eventually eliminate export taxes and the high and growing costs of servicing the internal debt, these achievements were fragile and failed to halt the cycle of public sector borrowing and domestic debt accumulation (Smith, 1992).

Despite the initial achievements with the budget, confidence in the stability of the fixed exchange rate began to erode by mid-October as a consequence of the discord within the government and between the government and its principal business allies over fiscal and monetary policy. The emergence of a dissident labor faction, whose unions carried out strikes to demand wage increases and to protest the government's privatization plans, also threatened to undermine the stabilization plan. In November, a week-long bus driver strike, which was marked by violence and also supported by metro and railway workers, seriously disrupted transportation in and around Buenos Aires. This strike was ended only by the labor minister's threats of tough legal action and the imposition of an arbitrated wage agreement. More damaging for the economic plan was the threatened strike by the powerful metalworkers' union (UOM), led by
Lorenzo Miguel, which was averted only by permitting a wage settlement between the employers and the union which far exceeded official guidelines (Latin American Regional Reports, 9/21/89). The loss in confidence in the sustainability of the fixed exchange rate led exporters to maintain their earnings in dollars and encouraged speculation, which increased the dollar’s market value to nearly double that of the official rate. Despite intense efforts by the Central Bank to discourage currency speculation, foreign reserves plummeted and expectations of a change in policy intensified (Damill and Frenkel, 1992). As a result of his rejection of the fixed exchange rate - favored by Bunge and Born - and the efforts to prop up the austral, the Central Bank President, Javier González Fraga, resigned from the cabinet (Latin American Monitor, 12/89).

The rise in the parallel exchange rate had an immediate impact on inflationary expectations, given the fact that many goods are priced in dollars.

Finally, in early December Rapanelli announced a new shock plan. The exchange rate was devalued by 53%, public sector tariffs increased by between 60% and 70%, fuel prices increased by 59%, export taxes increased by 11%, and controls over prices partially eliminated. Another component of the plan, which soon proved to be counterproductive, was the rescheduling of the payment of Treasury bonds over a two year period in a vain attempt to slow the pace of public sector borrowing (Damill and Frenkel, 1991: Smith, 1992). But, the devaluation, tariff increases, and the refinancing of the internal debt only served to fuel inflationary expectations and a massive flight to the dollar, with the unofficial exchange rate increasing by 35% only two days after the plan’s announcement.

In the face of intense criticisms from Peronist politicians, business organizations, and the labor unions, Rapanelli was forced to resign, thus ending the Menem government’s close alliance with Bunge and Born. Erman González, a Christian Democrat who had served as finance minister for Menem during his tenure as governor of La Rioja, was named as Rapanelli’s
successor. González' plan (dubbed "Erman I" by the newspapers) entailed a deepening of the
government's commitment to economic liberalization. It called for the introduction of a unified,
freely floating exchange rate, the elimination of almost all price controls, and the abandoning of
any attempt at establishing an incomes policy. In addition, to satisfy the claims of the export
sector, which was seen as the primary force behind currency speculation, González rescinded the
recently adopted export tax increases and import tariff cuts, restored prefinancing for exports, and
pledged to accelerate the pace of the privatizations and advance payments on the recently
reprogrammed internal debt if the fiscal situation permitted (Latin American Monitor, 1-2/90;
Damill and Frenkel, 1992). However, declining currency reserves and predictions of a monthly
rate of inflation in excess of 40% led to another sharp increase in the exchange rate and interest
rates, further exacerbating the problem of financing the internal debt.

Thus, with the imminent threat of a run on the banks, González announced at the
beginning of January the third economic plan in less than a month - the "Plan Bonex". The
centerpiece of this plan was the compulsory conversion of fixed-time deposits (of greater than
$500) into dollar-denominated ten-year external debt titles. This action eliminated most of the
short-term interest charges on the public sector debt, replacing it with medium-term external debt
(Damill and Frenkel, 1993; Smith, 1992; Peralta-Ramos, 1992). It also was expected to induce
holders of dollars to convert them into australs to meet their fiscal obligations, thus strengthening
the state's finances. A week later tough restrictions were imposed on spending by state
enterprises, including the prohibition on starting new construction projects or importing capital
goods, and a requirement that all future purchases and contracts of state agencies be authorized
by the Economic Minister (Damill and Frenkel, 1993).

As intended, the plan brought a drastic fall in the money supply, but it did little to reduce
the inflation rate and only temporarily strengthened the value of the austral. On the other hand.
the fall in liquidity aggravated the already severe recession. After falling by 4.4% in 1989, the GDP declined an additional 2.7% and industrial production 15% in the first quarter of 1990. Confidence in the currency was undermined by the IMF decision to suspend the release of loans and the government's submission of a new letter of intent with revised, and more pessimistic, targets for 1990. In the second half of January the dollar set off on an ascending course (Damill and Frenkel, 1992). The adjustment of public sector tariffs carried out at the beginning of February contributed to another surge in the monthly rate of inflation from 62% in February to 96% in March and to further increases in interest rates.

In this worsening economic climate - again characterized by episodes of looting and violence - public support for Menem and the economic program plummeted and the government came under increasing attack not only from Alfonsin and the Radical Party, but also from leaders of his own party (Table 4.4). Cafiero, the president of the Peronist Party and governor of Buenos Aires, publicly called on Menem "to return to the founts of Peronist doctrine" (Latin American Regional Reports: Southern Cone, 4/19/90). Ubaldini, the head of the 'rebel' CGT, gained the support of members of the Peronist party's Frejupo electoral alliance, comprising the Partido Intransigente, Christian Democrats, Movimiento de Integración y Desarrollo, Partido Socialista Auténtico, Izquierda Nacional, and the Movimiento Patriótico de Liberación, for an alternative economic plan entailing a complete reversal of much of the Menem government's economic program. Eight Peronist congressmen (the so-called Grupo de los Ocho) publicly backed Ubaldini's program and his call for a general strike against the Peronist government. Thus, the government's commitments to reduce the scope of the state and to hold the line on salaries increased the enmity of state sector unions. But, the delays in imposing layoffs and the revival of labor unrest weakened the confidence of business groups that Menem would follow through on his plans to downsize the state.
Public confidence in the government deteriorated to the point that Menem felt obligated to publicly state his commitment to serve out the complete presidential term. Menem's decision to authorize the military to intervene in cases of threats to internal security (despite their exclusion from this responsibility in the Defense Law of 1988) and rumors about a government plan to close Congress and replace the governors of troubled or bankrupt provinces, led the opposition to warn about the possible suspension of democracy (Southern Cone Report, 4/19/90).

In addition, reflecting his declining political position and his strong pragmatism, Menem offered Angeloz a key position in the cabinet. In making this choice, Menem implicitly rejected Angeloz' and Alfonsín's call for a "pact of governability" between the two major parties, preferring to incorporate persons into his government as individuals rather than as representatives of political parties. Menem made the offer to Angeloz and not Alfonsín - still the president of the UCR - because Angeloz was more sympathetic to the liberal and orthodox direction of the government's economic program and because it was of strategic value to keep Alfonsín on the outside as an object of blame for the economic crisis. Angeloz refused the offer, however, when Menem rejected the Radical Party's demand for a popular referendum on the state reforms and the privatizations (Fontana, 1992; Latin American Regional Reports, 3/15/90).

After heavy restrictions on the money supply failed to halt inflation or the steady climb of the dollar, in early March the government promulgated a mega-decree containing severe fiscal and monetary measures ("Erman III") which finally put the brakes on hyperinflation. This decree included sweeping increases for fuel prices and public utility rates, a downgrading of the top positions in the public administration, a 5% increase in export taxes, the reimposition of a 2% tax on company net worth, a 2-month delay in payments to public sector contractors and suppliers, the cancellation of all wage contracts in the public sector, the termination of tax benefits for numerous promoted firms, the suspension of promoted firms' exemption from the VAT for input
purchases, and the transfer of the authority for industrial promotion from provincial administrations to the Secretary of Public Revenues (Latin American Regional Reports, 4/19/90; World Bank, 1993). The combined result of the fiscal and monetary restrictions applied in February and March was a sharp reduction of the inflation rate to between 10% and 15% per month for the remainder of 1990.

Despite the severe recession and hyperinflation in the first three months of 1990, the fiscal shocks applied by Rapanelli and González produced a surplus in the current budgetary accounts. Though revenues in the first quarter of 1990 were 12% lower in real terms than in the final quarter of 1989, tax receipts through April exceeded that collected during the same period in 1989 by 60% (Southern Cone Report, 6/30/90). With part of the VAT generalization in place (as of February) and a reformed penal code (effective as of March 1990), which provided the DGI with powers to prosecute tax evaders with penalties ranging from fines to imprisonment, the government sought to dramatically increase VAT collection. In order to increase the pressure on businesses to comply with the new tax laws the public revenue secretariat greatly increased the number of full time and temporary tax inspectors, published lists of businesses known to evade taxes, established a special court to try cases involving tax evasion, and established a special system for monitoring large taxpayers (World Bank, 1993; Southern Cone Report, 4/90; La Prensa, 8/26/90; La Prensa, 9/19/90). The more effectively enforced and generalized VAT would begin to have a perceptible impact on overall tax collections in the second half of 1990 and in 1991 (see Tables 4.5 and 4.6).

But, the improvement of the fiscal situation in early 1990 came primarily from the sharp cutbacks in current expenditures, which were 46% lower than the previous year (see Table 4.7). These cuts produced a visible deterioration in the quality of public services, a sharp cut in the
salary of public workers, and an increase in strikes and demonstrations, particularly by unions representing public sector employees.

The government's success in ending this second traumatic episode of hyperinflation, despite the calls for a retreat from orthodoxy by leading politicians of both parties, restored the standing of Menem among the general public and business elites and increased the population's tolerance for a strong executive. In April a broad spectrum of Argentine society (from traditional Peronists to conservative businessmen), participated in a pro-government rally (la marcha del "Si") whose attendance greatly surpassed that of a protest rally organized by the dissident CGT-Azpardo a couple of weeks before. This rally and public opinion polls demonstrated the renewed public backing for the government's anti-inflationary fight and privatization program and its intolerance of the disruptive strikes and protest actions by the dissident state sector unions (Table 4.4).

This second experience with hyperinflation revived and reinforced the public's fear of instability and placed the control of inflation (and, therefore the containment of fiscal deficits) at a still higher position in its order of priorities (Fontana, 1992). But, the rapid erosion of support for the Menem government which occurred from December 1989 to March 1990 indicates that the initial experience with hyperinflation did not provide an unlimited window of opportunity for stabilizing and restructuring the economy. The Menem government could weather the reemergence of societal resistance, the erosion of popular support, and the deterioration of economic conditions because of its formidable political resources. Menem's control of a disciplined political party which held an ample majority in the Senate and a broad plurality in the Chamber of Deputies allowed him to continue to deepen the adjustment and to enact free market reforms despite the failure of the initial economic plans to reduce inflation in a sustained manner. It is true that a large proportion of the measures embodied in the successive shock plans were
enacted by executive decree and that Menem’s authority to use such powers derived in part from
the severe nature of the economic crisis. But, without solid party backing and the command of
working majorities in both houses of Congress it is likely that the authority to legislate by decree
would have been withdrawn - particularly as economic conditions worsened and the
government’s popular support eroded. The Menem government’s ability to withstand repeated
setbacks in its economic program and in its popular support was also facilitated by the close
historic ties between Peronism and the union movement. By exploiting the ample political,
material, and symbolic resources enjoyed by a Peronist president, Menem succeeded in dividing
the union movement and restraining union demands (Kelsey and Levitsky, 1994; Epstein, 1992).

Inflation Containment, Privatization, and Economic Stagnation

Menem immediately sought to take advantage of this increased breathing room by taking
steps to augment the powers of the executive branch to manage the economic crisis and to
implement reforms. In April 1990 Congress approved a law which expanded the size of the
Supreme Court from five to nine justices, thus allowing the pro-Menem majority in the Senate to
appoint judges which would be more likely to overlook constitutional obstacles to the procedures
used to privatize state firms, to the confiscation of savings deposits, or to plans to flexibilize labor
markets (Southern Cone Report, 5/31/90; Latin American Monitor 5/90). Taking advantage of
his improved public standing and this increase in the executive branch’s power, Menem proposed
a bill to restrict the constitutionally guaranteed right to strike in the state sector, where work
stoppages in protest of layoffs, wage cuts, and pending privatizations were disrupting the delivery
of important public services and endangering the achievements made vis a vis inflation. In order
to pressure unwilling Peronist legislators and other congressional allies, Menem threatened to
implement the measure by decree if Congress failed to act within 45 days. After six months in
which Peronist congressmen refused to bring the legislation up for a vote, Menem finally enacted
the strike restriction by decree on October 17, 1990 - ironically the 45th anniversary of the mass rally which precipitated Perón's release from prison and his election as president. (Wynia, 1995).

In the second half of 1990 the Menem government accelerated the pace of the privatization program and steadily deepened the fiscal adjustment. In July Aerolíneas Argentinas and Entel, the state-owned telecommunications monopoly, were successfully sold. Steps were also taken to open up oil and gas fields to private investment and to privatize national highways, the state gas company (Gas del Estado), national electric company (Segba), much of the military industrial complex (Fabricaciones Militares), the railways, and several other important state companies (Latin American Economic Report, 7/31/90). In order to streamline the process, power in the economic ministry was further concentrated in the hands of the economic minister, González, who was granted increased powers to restrict spending by public agencies and to manage the operation and privatization of state enterprises.

When inflation accelerated again to nearly 16% per month by September and reports of corruption by government officials surfaced in the news media, public confidence in Menem and the economic plan again fell (Table 4.4). In late August and early September another round of far-reaching adjustment measures was promulgated by decree. Trade barriers were lowered, restrictions on spending by public agencies and state enterprises were further tightened, more public workers were slated for dismissal or early retirement, the monitoring of firms benefiting from the industrial promotion system was increased, and the internal debt was rescheduled. In response to mounting pressures from rural organizations, who complained about the steady appreciation of the Austral, the government finally enacted a long-promised reduction of export taxes (amounting to 50% for many products) which increased the pressure on the tax agency to step up enforcement of the VAT (La Prensa, 8/4/90).
When this latest surge of inflation was forced into retreat (falling to 7.5% in October), the government once again reaped a reward in terms of public opinion, which seemed little affected, for the time being, by the depressed state of the economy or charges of government corruption (see Tables 4.8 and 4.9). The ever-tightening squeeze on expenditures, which up to this point was concentrated at the central government level, exacerbated the slowdown in industrial production and caused a collapse of imports, a further reduction in real wages (to only 86% of their level of 1980), and massive layoffs. Given the reduction in funding for government food and medical assistance, the conditions of the poor and unemployed markedly worsened (Wynia, 1991).

Another Round of Tax Reform Fails to Balance the Budget

After several months of delay and persistent pressure by the executive, the second "Omnibus" tax reform bill, whose central objective was to extend the coverage of the VAT to nearly all services, was finally enacted by the Congress in late September. The legislation proposed by the government also aimed to restore the capital gains tax, increase some excise taxes and the tax on currency operations, eliminate tax benefits for new industrial investment, and impose a tax on the transference of debt instruments.

Given the fact that eight dissident Peronist legislators and the Radical Party legislative bloc refused to show up for the debate on the bill, the government needed the support of nearly all of the UCD and provincial party legislators in order to obtain the necessary quorum for the debate and votes to take place. The UCD bloc held back its support for some time because of its reluctance to support new tax legislation without an approved budget for 1990. In addition, Peronist legislators from the Province of Buenos Aires and provincial party legislators made their support contingent upon the provision of extra financing for their provinces in order to fund social programs and fill growing budgetary gaps. The bill was approved after several
concessions were made to these different groups of legislators: 1.) some additional services, such as most forms of health services, were made exempt from the VAT; 2.) the proposed tax on the transference of debt instruments and real estate was eliminated; 3.) the executive was deprived of the power to independently decide to which financial services the VAT would be applied; 4.) the proposed increase in the tax on currency operations was reduced; 5.) and increased funding was provided for Buenos Aires and other provinces facing financial emergencies (La Prensa, 8/24/90; 8/30/90; 9/6/90). Thus, even with a high level of party support in the Congress and in the provinces, the Menem government was forced to make concessions. But, without such a strong political position, it is probable that more sizable financial concessions to the provinces and other political interests would have been necessary to gain congressional support for this and other public sector reforms.

By the latter part of 1990 the economy was in a less precarious condition. The tax reform promised to increase revenues a further 0.6% of GDP, the inflation rate was declining, and a large trade surplus ($7.9 billion for all of 1990) was helping to build up a large quantity of foreign currency reserves ($3.5 billion). Nonetheless, the IMF halted the release of a scheduled standby credit in late September because of the government's failure to deliver the promised budgetary surplus. In an attempt to advance closer to IMF budgetary targets, the government raised the VAT rate from 13% to 15.6% (thus taking advantage of the discretion granted it in the 1989 tax reform law), extended the duration of the economic emergency law, and stepped up its inspection of VAT taxpayers (with 3,000 DGI agents combing the streets) (La Prensa, 8/15/90. 8/18/90).

But the actual and impending layoffs and deteriorating working conditions led to increased protest activities by the Ubaldini-led CGT and by public sector workers in the
provinces. In November the CGT threatened its first general strike against the Menem
government and organized a major protest rally (Southern Cone Report, 8/18/90, 11/22/90).

Far more threatening to the government, however, was the brief, but extremely violent, early December 1990 rebellion by nationalist military officers headed by the now retired Colonel Seineldin. Whereas the military rebellions during the Alfonsin administration were backed by much of the officer corps and ended only by negotiations between civilian and military authorities, this time the loyalist forces responded rapidly and forcefully to Menem's orders to squash the rebellion. Officers responded to the orders of the general staff to put down the rebellion in this case as a consequence of the pardons already granted to officers indicted or under prosecution for human rights violations, the imminence of a second pardon of the junta members and high-level commanders (announced in late December 1990), the rebels' overtly political, as opposed to purely institutional, objectives, and the fact that the rebels broke a deep-seated taboo within the armed forces by killing loyalist soldiers (Acuña and Smulovitz, 1995; Norden, 1996; Zagorski, 1994).

Menem's swift repression of the rebellion and the severe punishment imposed on those involved bolstered his image of authority and political efficacy and allowed him to temporarily deflect public attention away from the serious corruption charges leveled against the government. These corruption charges and a less decisive outcome in respect the military rebellion might have seriously weakened the government's legitimacy and hindered its ability to address the impending currency crisis and renewed threat of high inflation (Damill and Frenkel, 1993). The so-called "Swiftgate" affair broke out into the open when a memo from U.S. Ambassador Terrence Todman, which accused high officials in the executive branch (including relatives of the president) of demanding bribes from U.S. multinational corporations (including the Swift-Armor meat-packing company), was leaked to the press. The corruption scandal and the slide of the
austral against the dollar led to a major cabinet shake-up, which included the resignation of the minister of public works and the elimination of this cabinet department, and the resignations of the labor, justice, health and social action, and defense ministers. Several days later the economic minister, González, was replaced by foreign minister, Domingo Cavallo (Southern Cone Report, 2/7/91; Latin American Economy and Business, 1/91; Cavarozzi and Landi, 1992)

Inflation Subdued: Cavallo Ties the Government's Budgetary Hands

Facing a collapsing austral, a quick surge of inflationary pressures (rising from single digits to 27% in February), and declining government popularity, Cavallo set as his number one priority the strengthening of Argentina's tax system and the elimination of the fiscal deficit, which still amounted to $200 million per month (1.8% of GDP). This effort entailed the implementation of an emergency tax reform, raising public sector tariffs (15%-20%) and the tax component of fuel prices (33%) by decree, and a plan to drastically reduce the number of public sector workers. The tax reform, by concentrating on inefficient, emergency taxes, departed significantly from the objectives of simplification and neutrality emphasized by the Mediterranean Foundation (the Córdoba-based think-tank founded by Cavallo) in reports provided to Menem in the presidential campaign. Nonetheless, one of the characteristics of the tax reform, which helped sell it politically, was that it attempted to focus much of the tax increase on those who up to this time had evaded their tax obligations. The tax package would: increase the tax on bank debits while allowing for deductions against VAT and income tax declarations; increase the tax on the purchase and sale of foreign currency; increase the assets tax rate from 1% to 2% while now allowing the assets tax to be credited against income tax payments instead of the reverse (which was the structure stipulated in the 1989 reform); suspend the carryover of tax losses from the period of high inflation in 1988-89; increase the general VAT rate to 16% (from 15.6%); create a special VAT rate of 25% for public utilities (for commercial customers);
increase the VAT rate for non-registered taxpayers; and impose a tax on the transference of real estate property. In addition, the tax proposal aimed to increase compliance by forgiving past delinquency in exchange for full compliance in the present year, making it easier for the DGI to close businesses, and limiting the rights to appeal (La Nación, 2/17/91; AmbitoFinanciero, 2/7/91).

The proposed tax increases were opposed especially by rural groups, who except for the Argentine Rural Society (SRA), continued to demand that the VAT not be applied to the agricultural and livestock sectors and that the tax to the first sale of agricultural products be eliminated. They opposed the increase in the assets tax called for in this reform. But, their strongest protests, which included a threat by the Argentine Rural Confederation (CRA), the Argentine Agrarian Federation (FAA), and the Confederation of Agricultural Cooperatives (Coninagro) to urge producers to not pay their taxes, were lodged against export taxes, which the government had long promised to eliminate (La Prensa, 1/31/91, 2/16/91; Manzetti, 1992).

Industrial groups especially opposed the increases in the assets tax and the bank debit tax, while they also strongly criticized the government's lack of progress in curtailing fiscal expenditures. But their opposition was muted somewhat by fears of another acceleration of inflation and the possible breakdown of an economic program whose basic outlines they supported.

Though the reform was enacted by Congress less than two weeks after it was proposed, obtaining a majority in the Lower House was not easy. Peronist deputies strongly criticized the tax plan, charging that it was unnecessarily severe and insufficiently sympathetic to the financial plight of the provinces. In response to the misgivings of Peronist legislators, who threatened to withhold their support, Cavallo replied "If you don't like the economic plan, then tell Carlos [Menem] to appoint another minister of the economy" (Acuña, 1994; La Nación, 2/7/91). Strong pressure from the president was necessary to get the Peronist legislators to go along with the
Criticizing the regressivity of much of the Menem government's changes to the tax system and the piecemeal nature of the reform, Radical party legislators were more strongly opposed. Nevertheless, when the government accepted the Radical legislators' demand that Congress be allowed to debate the regulatory framework to be applied to future privatizations, party leaders decided to help the government reach the quorum necessary to have the tax bill debated and voted upon. Given the opposition of the so-called "Group of Eight" (dissident Peronist legislators) and many of the legislators from small national or provincial parties, the government enacted the bill only with the support of the 11 UCD congressmen and some of the provincial party legislators, who responded to the government's threat of a reduction in financial transfers to the provinces should the reform not be approved. In order to win the support of some wary Peronist legislators and representatives of provincial parties the government was forced, despite bitter complaints from Cavallo, to grant some concessions. On the one hand, a larger share of the revenues from the increases in the bank debit tax, the currency operations tax, and the assets tax was assigned to the provinces and the national pension fund. In addition, congress rejected items in the legislation which would have granted the executive the power to increase the VAT rate again by as much as 20%, reduced the planned increase in the assets tax for small businesses, and set the term of the assets tax increase to one year (Diario de Sesiones de la Camara de Diputados, 2/14/91; Diario de Sesiones de la Camara de Senadores, 2/16/91; La Prensa, 2/13/91, 2/15/91, 2/16/91).

In February and March speculation against the austral continued despite the expenditure of substantial foreign currency reserves by the Central Bank and inflation rose to 27% (in February). These economic trends, which eerily recalled those which preceded the previous experiences with hyperinflation, were accompanied by a strike by railway workers, which crippled services for much of February, and a strike by three of the principal rural organizations
in March. Armed with the decree banning the right to strike in public services, the government immediately declared the railway strike to be illegal and then carried out massive layoffs. The strike was lifted after negotiations in which the unions rescinded their demands (Acuña, 1994; Southern Cone Report, 4/25/91). Though Cavallo threatened to be as tough with the farmers as he was with the railway workers, the strike by the rural organizations was ended after two days when the government made several concessions: specific taxes on agricultural exports were abolished; the SRA and CRA were given representation on joint commissions with the government to negotiate new tax and credit policies; and new lines of credit were established for the rural sector. In exchange, the rural organizations were to urge their members to pay the VAT, income, and property taxes (Southern Cone Report, 4/25/91; Manzetti, 1994; Acuña, 1994).

Blessed with ample foreign currency reserves and supported by the recently enacted fiscal measures, in the middle of March Cavallo launched a bold new economic plan which established the free convertibility of the austral into dollars at a fixed rate. Within a year the austral was to be replaced by a new peso which would trade at a one to one parity with the dollar. Core elements of this latest stabilization program - the Convertibility Plan - were the enactment of a law by the Congress forbidding the Central Bank from printing money to cover budget deficits (unless these emissions were fully backed by gold or foreign currency) and the banning of price or wage indexation (Smith, 1992; Acuña, 1994). In addition, the privatization of state enterprises was to be accelerated, tariff and non-tariff trade barriers reduced, the economy further deregulated, government expenditures cut (mainly through massive cut-backs in public sector employment), and a high priority placed on renegotiating the external debt. Given the absolute dependence of the Convertibility Plan on the maintenance of a balanced budget (a surplus in the
operating budget if Argentina was to comply with IMF targets and qualify for Brady debt reduction), a major effort was put into increasing tax collection, centered primarily on the VAT and social security contributions (Rozenwurcel, 1994; World Bank, 1993).

In respect to inflation the Convertibility Plan achieved what all previous stabilization plans had failed to accomplish. The rate of price increases fell in a sustained manner to less than 1% per month by the end of the year and continued to diminish, falling to a 17.5% annual rate in 1992 and only 7.5% in 1993. In addition, the stabilization of the economy and the sharp increase in consumer demand fueled a strong economic recovery (through 1994) and a boom in the long-quiescent stock market. The country's GDP expanded at an average annual rate of 7.7% between 1991 and 1994. The program's achilles heal was the steady appreciation of the peso (resulting from inflation rates which remained for some time above industrialized country levels), which caused growing trade and current account deficits, harmed industrial and agrarian businesses competing with foreign goods, and tended to discourage export production and encourage investment in non-tradeables - in direct contradiction with the objectives of the liberalization effort. But, the stabilization of the economy and the privatizations (along with the favorable conditions in international capital markets) led to massive amounts of foreign investment which offset the negative trade balance and bought time for the government to take steps to lower the high "Argentine cost" (of production) entailed by large employer contributions to social security and other worker welfare programs and by inflexible labor markets.

The government's success in stabilizing prices and restarting the economy restored the public's confidence in Menem and the government's handling of the economy and contributed to an important victory for the Peronist party in congressional and gubernatorial elections in September and October 1991 and congressional elections in October 1993 (Tables 4.8 and 4.9). Despite the regressive redistributive impact of the adjustment policies and free market

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reforms, election polls revealed that the government retained the support of much of the working class and poor (Sidicaro, 1995).24 The Argentine population seemed willing to overlook conspicuous evidence of government corruption (including indictments of cabinet officials, advisors, and friends and relatives of the president) and the heavy concentration of power in the executive. In 1993, economic stability and growth continued to outweigh such considerations as well as the costs of fiscal adjustment and structural economic reform, which became increasingly apparent due to the rising rate of unemployment, the weekly protests by pensioners, and the riots and demonstrations in many of the provinces (Verbitsky, 1991; Southern Cone Report. 5/30/91: 9/12/91; 2/6/92; 7/2/92; De Riz, 1996).

Taking advantage of its strengthened political position, the government became more aggressive in its efforts to restructure the economy. It swept aside mountains of government regulations by decree (including the dismantling of agrarian marketing boards established during the Perón government), eliminated more jobs in the central administration, gained congressional approval for the privatizations of many large state companies (including the railways, the national gas company, defense industries, and the national oil company), partially privatized the pension system, and reached an agreement with the country's foreign creditors for debt reduction and restructuring under the Brady Plan. The privatizations, which brought in 17 billion dollars in cash and debt amortization between 1991 and 1993 (equivalent to an annual average of 1.0% of GDP in cash proceeds) and the reductions in interest payments on the external public debt (from 4.4% of GDP in 1989 to only 1.4% in 1992)25 greatly contributed to the balancing of public sector accounts.

In addition, the government's successes with the economy and the Peronist victory in the midterm elections allowed Menem to achieve his most prized goal: reforming the constitution to allow his reelection. Given the fact that the Radical Party was divided and weakened and
Frepaso - a new party coalition comprising defectors from the Peronist party and several small left-of-center parties - lacked a strong organizational presence outside of Buenos Aires province. Menem won a decisive victory in the May 1995 presidential and congressional elections. But the honeymoon following Menem's second inauguration was short-lived. When the bi-annual government survey of the labor market revealed that the unemployment rate had jumped above 17% (from just 10.8% a year earlier) and when the fallout from the Mexican crisis sharply slowed economic activity the government came under great pressure to change the economic plan and its popular support further eroded (Table 4.13).

**Imposing Adjustment on the Provinces: The Fiscal Pacts**

By restructuring the tax system, privatizing most state enterprises, reducing the public payroll, holding public pensions to an extremely low level, and partially privatizing and reforming the pension system (September 1993), the Menem government effectively addressed several of the most important sources of public sector imbalances at the level of the central government. But, most of the provincial governments had not undertaken comparable adjustments or structural reforms. As a consequence of the bonanza in central government transfers (resulting from the dramatic increase in the collection of taxes shared with the provinces, such as the VAT), the increase in the collection of local taxes by provincial governments (who benefited from improvements in the tax administration at the national level), and the crisis affecting some regional economies, spending by provincial governments increased substantially (from $13.3 billion in 1989 to $25.7 billion in 1993) (see Table 4.10). Provincial government spending on personnel nearly doubled from $6.5 billion in 1989 to $12.7 billion in 1993 (Economics Ministry, 1994; Durán and Gómez Sabaini, 1994).

In order to induce the provincial governments to undertake fiscal adjustments and implement structural reforms similar to those carried out at the national level the Menem
government obtained the assent of the majority of the provinces for two "fiscal pacts" signed in successive years (October 1992 and August 1993). Through previously enacted executive decrees, which altered the existing Federal Revenue Sharing Law (1988) and increased the tensions in central government-provincial relations, the provinces' share of VAT and income tax proceeds had already been reduced. The October 1992 "Federal Pact" permitted the national government to withhold 15% of the pool of shared tax revenues so that pension payments could be increased to the minimum level required by law, required provincial governments to hold the increase in current spending for 1993 to no more than 10%, and guaranteed the provinces a minimum of $725 million (per month) in revenue transfers from the central government.28

Under the Federal Revenue Sharing Law (of 1988) the provinces would have received about 20% (220 million pesos) more revenue and would have been able to share in the growth in revenue collection occurring at the national level. Thus, in order to obtain provincial support for the agreement, the government relied heavily on its capacity to exert political pressure on the 17 Peronist governors. In addition, the government threatened to take the four non-adhering provinces (controlled by the Radical party and provincial parties) to the Supreme Court (which, as a result of Menem's appointments was likely to favor the executive) and also to deny them a share in the special emergency financing fund established by the pact (Clarín, 8/7/92; 8/11/92; 8/14/92; Economics Ministry, 1994; Durán and Gómez Sabaini, 1994; Presman, 1992).

The August 1993 "Fiscal Pact for Employment, Production, and Growth" increased the minimum guaranteed revenue transfer slightly to 740 million pesos (per month) and set 800 million pesos as the maximum which could be devoted to current expenditures.29 If this maximum level was surpassed, then the excess funds could only be used to cancel previous debts or finance investments or state reforms. In addition, the pact aimed to create better harmony between the national and provincial tax systems and to make the national tax system more
efficient, more neutral in its impact on resource allocation, and less burdensome for export producers (Durán and Gómez Sabaini, 1994). The national government committed to phase out the assets tax and gradually reduce the employer contributions to the social security system (in both cases at a pace dependent on the level of adhesion by individual provinces to the requirements of the pact) and reduce the statistical tax on imported goods. In exchange the provinces would be required to replace the inefficient turnover sales tax with a general consumption tax applied to final sales; eliminate the stamp tax on financial transactions; eliminate taxes applied to public services; lower real estate taxes below an established ceiling; improve provincial tax administrations; and privatize enterprises run by the provincial governments (Clarín, 8/7/93; 8/13/93; Durán and Gómez Sabaini, 1994). Despite strong pressure from the Menem government and heavy financial incentives, seven (out of 24) provinces (controlled by the Radical party and provincial parties) initially refused to sign the agreement. 30 Given the increasing national and provincial unemployment rates and the large role of the public sector in supplying jobs at the provincial level, serious social disturbances and protests erupted as provincial governments began to undertake some of the required adjustments. As a result of the national economic recession in 1995, which caused financing difficulties to reemerge at the national level and deepened the economic troubles facing many provinces, the reforms required by the August 1993 pact were, in many cases, delayed. 31

The Menem government was able to restructure the nation's financial relationship with the provinces because of the Peronist party's control of the majority of the provincial governments and its strong position in the national congress and particularly in the Senate, where provincial interests are most strongly represented. Given its command of a majority in the Senate and ample plurality in the Chamber of Deputies, and its capacity to legislate by decree (in part due to the condition of economic emergency and congress' tolerance of the usurpation of its
powers), the Menem government could modify to its advantage the federal revenue sharing regime and cut industrial promotion benefits (which were another form of revenue transfers to the provinces) without provoking a serious backlash by provincial representatives in the Congress or severely compromising its legislative agenda (Presman, 1992). The Alfonsín government, by contrast, was much more heavily constrained in its abilities to manage national-provincial financial relations.

**Taking Taxes Seriously: The D.G.I. Steps up the Pressure**

One of the Menem government's most significant achievements after the launching of the Convertibility Plan was the dramatic increase in tax collection (82% in real terms between 1989 and 1994). Revenues for the VAT, which was the primary focus of the government's collection efforts, increased from 1.6% of GDP in 1989 to 6.1% of GDP in 1994 (or 472% in constant prices). But, striking improvements were also registered for social security contributions (with receipts increasing from 2.7% of GDP in 1989 to 4.8% of GDP). And, to a lesser extent, for the income tax (with receipts increasing from 0.8% of GDP in 1989 to 2.1% of GDP in 1994 - a 276% increase in constant prices) (Tables 4.5 and 4.6). Though strong economic growth and stable prices played a significant role in this achievement, a crucial contribution was made by changes in tax laws (most of which had been enacted before the launching of the convertibility plan) and the marked improvement in the efficiency of the tax administration (Rozenwurcel, 1994; Durán and Gómez Sabaini, 1994; World Bank, 1993).

Cavallo, who was given unprecedented powers within the economics ministry, had long viewed tax evasion and the extremely weak tax administration to be central causes of the chronic instability of the Argentine economy. Knowing that the achievement of a fiscal surplus was crucial to the sustainability of the Convertibility Plan and to regaining the financial support of the IMF and creditor banks, Cavallo set as top priorities the restructuring of the tax administration.
the elimination of loopholes, and the launching of an aggressive campaign against tax evasion. In addition, he sought to make the tax system simpler and more economically efficient by eliminating tax handles (such as the bank debit tax and the stamp tax) and reducing the weight of taxes which discourage investment or cause a misallocation of resources (such as export taxes and the heavy tax to work entailed by the high rate of payroll taxes). In order to compensate for the loss of revenues from these sources, the VAT rate was increased to 18% (April 1992). Later, the VAT rate was increased an additional three percentage points to 21% in March 1995 in an attempt to reverse the fall in revenue collection resulting from the economic recession caused by the so-called tequila effect (the disruption of foreign capital flows to Latin America brought on by the December 1994 Mexican currency devaluation and ensuing financial crisis) (World Bank, 1993; Durán and Gómez Sabaini, 1994; Latin American Weekly Report, 3/30/95).

The dramatic increases in the compliance rate for the VAT and social security taxes, and the smaller improvement in respect to income taxes resulted from legal changes and from improvements in the efficiency of the tax administration. Important legal reforms affecting the rate of enforcement were the introduction of a tougher penal code (February 1990), reforms of the industrial promotion system, and the substitution of loss carry-overs for the income tax with a bond credit (April 1992). The huge fiscal losses and large amount of evasion stemming from the industrial promotion system were curbed by the implementation (by Decree 2054, November 1992) of the reform approved by Congress in the final year of the Alfonsin administration. This law replaced open-ended tax exemptions with the issuance of bonds with values equivalent to the typically underestimated expected fiscal costs specified in the original contracts for the promoted projects. But, before the full implementation of this law, fiscal losses and evasion were curtailed by the partial (and temporary) suspension of industrial promotion benefits provided by the Economic Emergency Law (August 1989), the suspension of the approval of new projects.
(March 1990), the phased elimination of the exemption from the VAT, and the transfer of authority for monitoring promoted firms from the provincial governments to the economic ministry (Decree 435 - March 1990). These reforms, many of which were enacted by executive decree, significantly enlarged the tax base and simplified the task of the tax agency in monitoring business compliance with tax laws (World Bank, 1993; Durán and Gómez Sabaini, 1994).

But, the marked improvements in the efficiency of the tax administration and the aggressive and highly visible campaign against tax evasion carried out by the public revenue secretariat were also critical to the increase in tax revenues. Major reforms of the tax administration were carried out. First, making use of a significantly larger operating budget, the D.G.I.'s staff was increased, salaries raised, and the training of personnel expanded and improved (Table 4.11). Second, the Menem government built upon the progress of the Alfonsín government by developing and computerizing the roster of taxpayers and expanding the systems for monitoring compliance by large taxpayers and withholding income tax and VAT payments. Third, with the help of an enlarged and better paid staff, modernized information systems (including a tremendous expansion in the number of computers and the amount of computer memory), and a tougher penal law, the D.G.I. dramatically increased the number of audits carried out and the number of businesses closed or fined (Table 4.12). The collection of social security taxes was improved by the transfer of this responsibility from the Ministry of Labor to the D.G.I., where more elaborate information systems and withholding mechanisms could be utilized. In regard to the VAT, which was seen as the linchpin in the campaign against tax evasion, a coherent strategy was adopted entailing the establishment of a unique invoice (numbered sequentially) for transactions; the computerization of a roster of all VAT taxpayers; aggressive auditing campaigns (in which thousands of tax agents and student volunteers took to the street); the employment of large taxpayers (in different economic sectors) as agents to retain tax
payments from their suppliers and clients; and aggressive publicity campaigns (urging consumers to demand an invoice for their purchases and educating the public about the damage to society caused by tax evasion).\(^{35}\)

The increase in the rate of taxpayer compliance, which was observed much more strongly in the case of the VAT and social security contributions than for the income tax or the new personal wealth tax (August 1991),\(^{36}\) was facilitated by the technical and organizational improvements made to the tax administration during the Alfonsin administration.\(^{37}\) But, the increase in the enforcement of taxes was also very much a product of a changed balance of political power between the executive and the other branches of government and between the executive and societal groups. The progress made in the rate of tax collection was furthered by the strong political backing given to the issue by Menem and his economic team - especially Cavallo - and the high level of coordination which existed between Public Revenue Secretary Carlos Tacchi and D.G.I. Director Ricardo Cossio, who both had gained expertise while serving in the same positions during the Videla government (1976-81) (when revenues reached their highest levels of the 1970s and 1980s). Tacchi, in particular, earned a great deal of public respect and admiration as a zealous, impartial, and incorruptible crusader against tax evasion, which lent legitimacy to the government's effort.\(^{38}\) The government's greater leverage in the congress and its willingness and ability to implement legislation by decree permitted the enactment of legislation which empowered the tax agency in relation to taxpayers. As a result of legal changes and executive resolutions, the D.G.I. could carry out more complete audits of taxpayers, could more severely and efficiently punish tax evaders, and could expand the use of withholding regimes to prevent evasion by smaller companies. Thus, the establishment of a more powerful and invasive tax agency was facilitated by a politically strong executive committed to reform as
well as by the experiences with hyperinflation, which made business groups and society as a whole more willing to tolerate such incursions.

At the same time, the continued high levels of evasion of the income and personal wealth tax reflect both the greater administrative difficulties entailed in the enforcement of these taxes and political impediments. A major obstacle to income tax collection in an economy like Argentina's is the preponderance of small businesses and independent professionals who are very difficult to control. Several important steps were taken to improve direct tax collection, including the replacement of accumulated loss carryovers with a bond, the increase in the corporate income tax rate (from 20% to 30% in April 1992), the increased integration of the income tax and social security contributions, and the reintroduction of a tax to personal wealth (Durán and Gómez Sabaini, 1994). More recently, the tax administration has also stepped up its efforts to enforce payment of the personal wealth tax by auditing persons with vacation houses, yachts, and imported luxury cars (Clarín, 9/2/95). Nevertheless, partly because of the desire to encourage foreign investment and to protect the financial sector, the government adopted some changes, such as the elimination of interest income taxation and the personalization of stock shares, and the introduction of banking secrecy, which hindered the collection of income and wealth taxes.39 Thus, the continued weakness of income tax collection reflected, to some extent, the unwillingness of the government to confront (as vigorously as in the case of the VAT) the sources of capital generation.

Explaining the Menem Government's Success in Implementing Fiscal Reforms

What explains the Menem government's capacity to enact such previously "unthinkable" reforms to the tax system and the public sector when the Alfonsín government failed to gain approval for far less ambitious versions of the same reforms? Clearly the successive experiences with hyperinflation (April-July 1989, and February-March 1990) and the deep and prolonged
recession helped awaken the Argentine population, politicians, and societal groups to the depths of the country's problems and made them more prepared to tolerate tough economic measures. As Palermo argues, most of those who supported the government's economic plan were not motivated by a "blind belief" that reforms would result in a more prosperous future but by the desire "to escape from an intolerable present or by the fear of returning to a situation whose extreme severity had already been experienced" (Palermo, 1994; Palermo and Torre, 1992). Similarly, the experiences under high inflation and long term economic stagnation softened the opposition of business organization to painful economic reforms and adjustment measures, including the imposition of higher tax rates and the elimination of fiscal subsidies. The fact that the government's policies immediately slowed inflationary pressures, and later brought economic stability and growth, certainly helped reinforce the notion that continuing with economic reforms was less costly than the available alternatives.

The Menem government benefited as well from the longer term decline in public esteem for state enterprises and the unions, which resulted from the deteriorating quality of public services and the selfish obstructionism practiced by the unions during the Alfonsin administration. By 1989 public opinion polls revealed that the general public clearly supported the privatization of many public businesses and favored a tougher posture toward the unions (Mora y Araujo, 1991, 1993; Echegaray, 1993).

The main obstacles for the Alfonsin government in carrying out proposed public sector reforms were the staunch opposition of Peronist legislators in the Senate (where the government lacked a majority), the constant strikes and protests - including 13 general strikes - by the Peronist-affiliated labor unions, the demands by the provincial governments (most of which were in the hands of Peronist politicians) for more resources and subsidies, and the resistance of business organizations - which never trusted the government or its management of the economy.
Given the relatively high level of antagonism between the two major parties and the lack of previous experience sharing power in a democratic setting, cooperation between the two parties in respect to economic policy was highly improbable. But, given the government's minority status in the provinces and the Senate, the unlikelihood of cooperation presented a great obstacle to the Alfonsin government's capacity to carry out fiscal reforms and to manage the financial relations between the central government and the provinces. Aside from not cooperating, the Peronist party's overtly obstructionist strategy inflamed public discussion of the economy and increased the political risks for the government and the governing party of supporting more restrictive fiscal policies and more far-reaching reforms.

In addition, the Alfonsin government was impeded from adopting tougher austerity measures by the insecurity of his mandate resulting from the continued threat of military intervention and the calendar of congressional and gubernatorial elections (two mid-term national elections in his six year term). The Alfonsín government's need to secure civilian allies against the possibility of military intervention was greater than in other cases of democratic transition (such as in Uruguay) because of the unconstrained nature of the transition and the government's inability to place limits on the scope of lawsuits brought by victims of human rights abuses against military officers.

By contrast, as a result of the sizable Peronist electoral victory and Menem's high degree of influence over Peronist legislators, and initially because of the severity of the economic crisis and the succession pact with the Radical Party, the Menem government was in a much stronger position in relation to the Congress and the provinces. Though the harsh adjustment policies and state and labor market reform efforts caused open rancor within Peronist ranks, the Menem government was generally able to rely on the backing of Peronist legislators because of the tradition of strong loyalty to the party leader, the president's powers to fill leadership positions
and appoint candidates to political office, the extreme nature of the economic crisis, and the fact that the policies did not lead to a great loss of popular support (Acuña, 1994; Sidicaro, 1995). This support was maintained, even among the working class and poor, partly because of the high premium which the public placed on fighting inflation, but also because of Menem's personal charisma and the continued influence of the Peronist social identity among the working class and the rural poor. Menem enhanced his authority in respect to the Peronist party and the Congress by his success in the 1991 and 1993 congressional elections, by stabilizing and reviving the economy, and by nominating and backing candidates for political office who were friends and/or were committed to the liberal economic approach but often not from the Peronist party.

In addition, instead of the sharply antagonistic opposition faced by Alfonsin, Menem confronted an opposition party which was divided and less prone to obstructionism. Given the fact that Angeloz in the presidential campaign, and Alfonsín in the latter part of his presidency, had generally endorsed the free market reform agenda eventually pursued by the Menem government, the Radicals were thrown into turmoil in deciding how to respond. While Angeloz and his followers tended to support the government's economic policies and were willing to lend it some political support, Alfonsín led a faction of the party which adopted a more independent and critical posture.

The Menem government also had more clout with the provinces than the Alfonsin government because the governing party controlled most of the provincial governments and held a majority in the Senate, which given the accountability of senators to the provincial legislators (until the 1994 constitutional reform), was the locus of provincial representation at the national level. This meant not only that the Menem government was in a better position to induce the provincial governments to undertake fiscal adjustments and reforms and to eliminate fiscal
subsidies, but also that the government was not as compelled to make financial concessions to the provinces for the sake of enacting reforms in the national congress.

In addition, the government's strategic alliance with Bunge and Born and the political right, and the liberal and orthodox nature of the economic plan, provided the government with a reserve of support among a broad cross-section of the business community. Though business groups were not afraid to express their opposition to particular policies, they generally did not want to press their demands to the point of putting the basic economic plan at risk or undermining the government. Some businesses, particularly those oriented toward the domestic market and heavily dependent on state subsidies and contracts, were harmed greatly by the adjustment plan and the liberalization of the economy. But, these businesses had a difficult time getting the major business organizations to take up their complaints, since the leaders of these groups were generally pleased with the direction of economic policy and realized that a confrontational approach would not be productive for industry as a whole - which had seen its weight in the economy fall by half over the preceding 15 years (Acuña, 1994).

Given its basic Peronist identification, the union movement, though divided over strategy, was fairly united in its opposition to the policies of the Alfonsin government. But, with a Peronist in the presidency, the union movement was thrown into a quandary. In part, the reform efforts of the Renovador movement, which Menem ultimately opposed in the primary elections, had already weakened the political position of the unions, since labor leaders now had few legislative seats and were not heavily represented in the party leadership (Palermo, 1994). As a Peronist president, Menem could exploit political, material, and symbolic resources, which were unavailable to Alfonsin, in order to influence labor union behavior. Some measure of cooperation from the unions was obtained by appointing union leaders to government positions and key political posts in the Peronist party and by nominating union leaders to top positions in
the Peronist electoral lists. These leaders were less likely to call for strikes or protests against the government since they had a vested interest in the political fortunes of the government and the Peronist party. In addition, the Menem government strategically targeted wage increases as a means to keep pivotal unions from aligning with Ubaldini's dissident union movement or launching large-scale protests and strikes. As we have seen it also imposed legal restrictions against strikes by public sector unions and denied official recognition at times to striking unions and to the dissident CGT-Azopardo. Menem benefited greatly as well from the continued identification of much of the rank and file (at least in the first few years) with the Peronist Party (Kelsey and Levitsky, 1994; Epstein, 1992). Thus, despite the severe restrictions on wage settlements, the privatization of most important public enterprises, and the widespread layoffs, there were no general strikes in the government's first three years and strike actions by individual unions did not seriously endanger the economic program or halt reforms to the public sector.

The experience of fiscal reform under the Alfonsin and Menem governments shows, in contrast with pluralist and Marxist societal explanations, that socio-economic groups' reaction to governmental policy reforms is not determined solely by their objective material impact but by the manner in which groups are organized and the nature of their ties to the political party system. At the same time, the tempered nature of the response of business groups and unions to the draconian adjustment measures and policy reforms implemented by the Menem government was also a product of the fact the additional costs entailed by these efforts did not appear to be so great relative to the costs of hyperinflation and prolonged economic stagnation.

Freed from any firm commitments in respect to the human rights issue, and benefiting from political capital expended previously by Alfonsin, Menem was able to adopt a politically expedient approach toward the military. Menem granted a blanket pardon to most military officers convicted or awaiting trial for human rights violations in exchange for the military's
acceptance of subordination to civilian authority (Acuña and Smulovitz, 1995). With the decisive defeat of the carapintadas in the December 1990 rebellion, Menem was able to purge dissident officers and markedly diminish the threat of future rebellions, which could potentially have undermined his credibility or constrained his room for maneuver in managing the economic crisis.

More than any other democratically elected president in Argentine history Menem relied upon exceptional and constitutionally questionable presidential decree and veto powers to enact laws and control the legislative agenda. In part, and especially toward the beginning of the presidential term, the Menem government took advantage of legislative authority specifically delegated by the Congress with the aim of facilitating the executive’s capacity to manage the economic crisis. But, when it could not obtain the support of provincial party or Peronist legislators, or when it did not want to be delayed by congressional deliberation of reform proposals, the Menem government frequently resorted to so called “necessity and urgency” decrees which lacked a firm constitutional basis. Even though such powers were, if anything, more dubious in the case of tax policy, this was one of the areas in which they were most heavily used (Ferreira Rubio and Goretti, 1994; Mustapic and Ferreti, 1995). Menem adeptly took advantage of the state of economic emergency, a broadened interpretation of the Economic Emergency Law, and the public’s desire for decisive action to justify the frequent resort to such constitutionally questionable powers. In addition, by obtaining congressional support for the law which enlarged the Supreme Court and replacing the attorney general, Menem weakened some of the potential remaining institutional obstacles to such a concentration of executive power.

Alfonsin, who was elected to office on a platform emphasizing the goal of strengthening respect for democratic values and building Argentina’s much maligned democratic institutions, could not contemplate such breaches of the constitution. But, Menem, who entered the presidency in a
super-constitutional manner at a time when the Argentine public was clamoring for drastic solutions to the grave economic and social emergency, was less constrained by such concerns.
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<tbody>
<tr>
<td>Real GDP Growth</td>
<td>-1.9</td>
<td>-6.2</td>
<td>0.1</td>
<td>8.9</td>
<td>8.7</td>
<td>6.0</td>
<td>7.3</td>
<td>-4.6</td>
</tr>
<tr>
<td>GDP Per Capita Growth</td>
<td>-3.1</td>
<td>-7.4</td>
<td>-1.2</td>
<td>7.6</td>
<td>7.4</td>
<td>4.8</td>
<td>6.2</td>
<td>-5.7</td>
</tr>
<tr>
<td>Industrial Production % Change</td>
<td>-4.9</td>
<td>-7.1</td>
<td>2.0</td>
<td>11.9</td>
<td>7.3</td>
<td>4.5</td>
<td>4.2</td>
<td>-7.0</td>
</tr>
<tr>
<td>Public Sector % of GDP</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Overall Balance</td>
<td>-6.0</td>
<td>-3.8</td>
<td>-1.5</td>
<td>-0.5</td>
<td>0.6</td>
<td>1.1</td>
<td>-0.1</td>
<td>-0.5</td>
</tr>
<tr>
<td>Primary Balance</td>
<td>-2.7</td>
<td>-1.2</td>
<td>-0.5</td>
<td>-0.5</td>
<td>0.6</td>
<td>2.3</td>
<td>1.0</td>
<td>0.2</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>348.3</td>
<td>3086.9</td>
<td>2313.7</td>
<td>171.7</td>
<td>24.9</td>
<td>10.6</td>
<td>4.2</td>
<td>3.4</td>
</tr>
<tr>
<td>Real Wage Growth</td>
<td>-5.5</td>
<td>0.1</td>
<td>-8.9</td>
<td>-11.2</td>
<td>-5.0</td>
<td>-1.6</td>
<td>0.7</td>
<td>-1.3</td>
</tr>
<tr>
<td>Unemployment Rate¹</td>
<td>6.3</td>
<td>8.1</td>
<td>8.6</td>
<td>6.9</td>
<td>6.9</td>
<td>9.9</td>
<td>10.8</td>
<td>18.6</td>
</tr>
<tr>
<td>Debt Service/Exports</td>
<td>42</td>
<td>51</td>
<td>38</td>
<td>36</td>
<td>29</td>
<td>23</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Total External Debt/GDP</td>
<td>41</td>
<td>46</td>
<td>41</td>
<td>37</td>
<td>35</td>
<td>33</td>
<td>33</td>
<td>37</td>
</tr>
</tbody>
</table>

Table 4.1: Key Economic Indicators, 1988-1995.

¹). Based on May survey of 25 urban centers by INDEC.

Table 4.2: Vote by Socioeconomic Level, 1983 and 1989

<table>
<thead>
<tr>
<th></th>
<th>Upper and Upper Middle Classes</th>
<th>Middle Classes</th>
<th>Lower Structured</th>
<th>Lower Unstructured</th>
</tr>
</thead>
<tbody>
<tr>
<td>UCR</td>
<td>71%</td>
<td>48%</td>
<td>67%</td>
<td>53%</td>
</tr>
<tr>
<td>PJ</td>
<td>20%</td>
<td>23%</td>
<td>25%</td>
<td>27%</td>
</tr>
</tbody>
</table>


Note: The lower structured class is defined as comprising specialized workers, technicians, employees, and salespersons while the lower unstructured class is defined as comprising unspecialized workers.
### Social Composition of UCR and Peronist Voter Coalitions (City of Buenos Aires, Congressional Elections, 1989)

<table>
<thead>
<tr>
<th>Socioeconomic Status</th>
<th>UCR</th>
<th>PJ</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower</td>
<td>11.8%</td>
<td>21.2%</td>
</tr>
<tr>
<td>Lower Middle</td>
<td>10.2%</td>
<td>12.3%</td>
</tr>
<tr>
<td>Middle</td>
<td>49.1%</td>
<td>47.0%</td>
</tr>
<tr>
<td>Upper Middle</td>
<td>18.7%</td>
<td>13.0%</td>
</tr>
<tr>
<td>Upper</td>
<td>10.1%</td>
<td>6.5%</td>
</tr>
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</table>

Source: Gibson (1996).
<table>
<thead>
<tr>
<th>Month/Year</th>
<th>Percent Positive</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 1989</td>
<td>38.8</td>
</tr>
<tr>
<td>September 1989</td>
<td>58.8</td>
</tr>
<tr>
<td>December 1989</td>
<td>21.3</td>
</tr>
<tr>
<td>February 1990</td>
<td>10.8</td>
</tr>
<tr>
<td>April 1990</td>
<td>32.1</td>
</tr>
<tr>
<td>June 1990</td>
<td>26.5</td>
</tr>
<tr>
<td>July 1990</td>
<td>38.8</td>
</tr>
<tr>
<td>September 1990</td>
<td>15.3</td>
</tr>
</tbody>
</table>

Table 4.4: Evolution of Public Opinion Toward Economic Policy (Percentage of Positive Opinions).

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>DIRECT TAXES¹</td>
<td>1.84</td>
<td>2.31</td>
<td>1.20</td>
<td>1.21</td>
<td>1.54</td>
<td>1.97</td>
<td>2.31</td>
<td>2.47</td>
</tr>
<tr>
<td>Inc. and Cap. Gains</td>
<td>0.93</td>
<td>0.84</td>
<td>0.49</td>
<td>0.55</td>
<td>1.10</td>
<td>1.67</td>
<td>2.06</td>
<td>2.31</td>
</tr>
<tr>
<td>Wealth</td>
<td>0.54</td>
<td>0.65</td>
<td>0.65</td>
<td>0.59</td>
<td>0.39</td>
<td>0.24</td>
<td>0.20</td>
<td>0.16</td>
</tr>
<tr>
<td>Interest on Deposits</td>
<td>0.34</td>
<td>0.44</td>
<td>0.05</td>
<td>0.03</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>CONSUMPTION TAXES</td>
<td>6.00</td>
<td>5.26</td>
<td>5.73</td>
<td>7.12</td>
<td>8.56</td>
<td>8.28</td>
<td>8.21</td>
<td>8.62</td>
</tr>
<tr>
<td>VAT</td>
<td>1.87</td>
<td>1.64</td>
<td>2.31</td>
<td>3.40</td>
<td>5.82</td>
<td>6.37</td>
<td>6.47</td>
<td>6.91</td>
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<tr>
<td>Excise</td>
<td>0.92</td>
<td>0.78</td>
<td>0.84</td>
<td>1.01</td>
<td>1.00</td>
<td>0.91</td>
<td>0.76</td>
<td>0.76</td>
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<tr>
<td>Fuel and Energy</td>
<td>1.86</td>
<td>1.27</td>
<td>1.66</td>
<td>1.39</td>
<td>1.15</td>
<td>0.86</td>
<td>0.88</td>
<td>0.90</td>
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<tr>
<td>Bank Debit</td>
<td>0.72</td>
<td>0.66</td>
<td>0.30</td>
<td>0.89</td>
<td>0.29</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Other²</td>
<td>0.63</td>
<td>0.91</td>
<td>0.63</td>
<td>0.42</td>
<td>0.36</td>
<td>0.14</td>
<td>0.10</td>
<td>0.05</td>
</tr>
<tr>
<td>TRADE AND INT'L TRANSACTIONS</td>
<td>1.24</td>
<td>2.84</td>
<td>1.50</td>
<td>0.92</td>
<td>0.94</td>
<td>0.97</td>
<td>0.99</td>
<td>0.74</td>
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<tr>
<td>Import Tariffs</td>
<td>0.82</td>
<td>0.50</td>
<td>0.32</td>
<td>0.46</td>
<td>0.87</td>
<td>0.95</td>
<td>0.97</td>
<td>0.73</td>
</tr>
<tr>
<td>Export Tariffs</td>
<td>0.16</td>
<td>1.95</td>
<td>1.05</td>
<td>0.29</td>
<td>0.03</td>
<td>0.01</td>
<td>0.01</td>
<td>0.01</td>
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<tr>
<td>Currency Trading</td>
<td>0.11</td>
<td>0.21</td>
<td>0.01</td>
<td>0.06</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Other</td>
<td>0.15</td>
<td>0.18</td>
<td>0.12</td>
<td>0.11</td>
<td>0.05</td>
<td>0.01</td>
<td>0.01</td>
<td>0.00</td>
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<tr>
<td>OTHER TAX REVENUES³</td>
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<td>0.07</td>
<td>0.20</td>
<td>0.33</td>
<td>0.39</td>
<td>0.48</td>
<td>0.34</td>
<td>0.35</td>
</tr>
<tr>
<td>SOCIAL SEC. TAXES</td>
<td>3.22</td>
<td>2.74</td>
<td>3.62</td>
<td>4.04</td>
<td>4.74</td>
<td>4.99</td>
<td>4.75</td>
<td>4.39</td>
</tr>
<tr>
<td>QUASI-TAX REVENUES</td>
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Table: 4.5: Tax Revenue Collection by Source (as a Percent of GDP).

1.) Includes other direct taxes that collect very little revenues.
2.) Includes revenues from cigarette taxes (approximately .50% of GDP) which are assigned to
the pension system.
3.) Includes revenues from amnesties for past due taxes.

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Table: 4.6: Tax Revenue Collection in Millions of Pesos at December 1995 Prices.

1.) Includes other direct taxes which collect very little revenues.
2.) Includes revenues from cigarette taxes (approximately .50% of GDP) which are assigned to the pension system.
3.) Includes revenues from amnesties for past due taxes.

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<td>1.8</td>
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Table 4.7: Execution of the Budget of the National Public Sector as a percentage of GDP.

1. Municipality of the City of Buenos Aires.
2. Includes balances from previous years and financing under economic emergencies.

Table 4.8: Evolution of Public Opinion Toward the President, the Government, and the Economic Plan (Percentage of Positive Opinions).

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Source: Manuel Mora y Araújo (provided to author, April 1994).
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Table 4.9: Evolution of Public Opinion Toward the President, the Government, and the Economic Plan in the Federal Capital and Greater Buenos Aires (Percentage of Positive Opinions).

Source: Manuel Mora Y Araújo (Data provided to the author, April 1994).
Table 4.10: Total and Provincial Spending by the 24 Provincial Governments (In Billions of Constant Pesos).

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1. Figures for 1992 and 1993 do not include spending on salaries for public servants carrying out services (secondary education and some health services) which were transferred from the central government to the provinces beginning in 1992.

Source: Ministry of the Economy (1994)
Year | DGI Share
--- | ---
1983 | 0.90
1984 | 1.10
1985 | 1.20
1986 | 1.20
1987 | 1.14
1988 | 0.99
1989 | NA
1990 | 2.35
1991 | 2.21
1992 | 2.58
1993 | 2.76
1994 | 2.57


Source: La Dirección General Impositiva. Argentina.

1. Estimates based on first seven months of 1993.

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<th>Economic Plan</th>
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<tr>
<td>Jan.-Dec. 1990 (Ave.)</td>
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Table 4.13: Evolution of Public Opinion Toward the President, the Government, and the Economic Plan (Percentage of Positive Opinions).

Source: Centro de Estudios: Unión para la Nueva Mayoria. Data provided to the author.
Endnotes to Chapter 4

1. The remaining 33 seats were held by representatives of provincial parties and other small national-level parties.

2. Though Menem allied most closely with the "Group of 15" during the election campaigns he also received support from the other main union factions present in the CGT, including the more left-leaning and militant Ubaldinista and "Group of 25" factions. It was partly or mainly to keep some distance between himself and the less predictable and more militant components of Peronist unionism that Menem most closely associated himself with the "Group of 15" (McGuire, 1992).

3. The inability of the economic ministry to obtain a commitment by business leaders to give up previous increases in industrial prices designed to cushion the impact of expected adjustment policies, put the balance of relative prices on a more precarious foundation. This also indicated the limits on the extent of the business sector's support for the program (see Damill and Frenkel, 1990).

4. A survey of residents of the Buenos Aires metropolitan area by Lynch Menéndez Nivel and Associates found that 67.6% thought that Menem's policies would be most beneficial for the lower class while only 15.1% and 4.5% thought that his policies would be most beneficial for the middle and upper classes. By contrast only 3.5% of the people thought that Angeloz's policies would be most beneficial for the lower class (Fraga, 1989).

5. He replaced his pledge of a debt moratorium with promises to negotiate in good faith with the nation's creditors in order to obtain a lighter debt burden. His total opposition to privatization was replaced by a pledge to privatize only inefficient firms while still ruling out the privatization of utilities and the state-owned oil companies (Stokes, 1995).

6. Based on survey data of Lynch Menendez & Assoc. provided to the author by El Centro de Estudios: Unión para la Nueva Mayoria. The surveys of residents of the Buenos Aires metropolitan area were conducted in August 1989. Also see survey data in Manuel Mora y Araújo (1993: p. 310).

7. Gilberto Montagna, the leader of the UIA, said that on a scale of 1 to 10 Rapanelli is an 11 (interview in La Semana quoted in Ambito Financiero, 9/1/89).

8. Another apparent indicator of Menem's conciliatory attitude toward the "carapintadas" was his decision to invite Seineldín to dine with him at the presidential palace, which caused the Army Chief, General Cáceres to resign. One of the demands of the "carapintadas" in their rebellions was the ouster of Cáceres, who they saw as not adequately defending the interests of army officers.

9. The pardon applied to crimes processed in the civilian courts but did not pertain to rulings by military courts.

10. The Advisory Commission on Tax Reform was headed by Raúl Cuello and included such persons as former economic minister (from Ongania government) Krieger Vasena, Ernesto Malacorto, and Amalio Petrelli.

11. Interviews with former Subsecretaries of Tax policy and Administration, Juan Carlos Gomez Sabaini and Alfredo Fólica, and former Secretary of Public Revenue, Raúl Cuello.
12. Frigeri endorsed the decision to focus the tax system on the VAT eventually, but initially favored a national sales tax (Interview with former economic ministry official).

13. A sales tax applied at a particular level, such as the retail or wholesale stage, favors well-integrated companies since of the total volume of the profit-making activities which they undertake only a small proportion is subject to taxation. On the other hand, obviously a retail company would tend to be most hurt by a sales tax applied to the retail level. Thus, such a tax would lead to inefficiencies by encouraging firms to extend their activities beyond that for which they are most suited.


15. This point of view was offered by a former participant in negotiations with foreign governments and international lending institutions from the Alfonsín administration (interview with Roberto Frenkel, economist and former advisor to the Economic Minister). The head of the advisory commission on tax reform and former Secretary of Public Revenue in the Menem administration, Raúl Cuello said that the economic team was unanimously behind the VAT. A different opinion, however, was aired by tax experts outside the government, who contended that IMF pressure was key to the government decision.

16. Given the government's planned expenditures this was the increase necessary to achieve the balanced budget required by the IMF for 1990 (Figures are based on pre-1992 GDP series).

17. Interview with Director of Fiscal Investigations and Analysis, Guillermo Barris (April 1995).

18. Even with these reductions in the minimal non-taxable income and with the reduction in family allowances, the World Bank still concluded that the threshold for paying personal income tax was too high (World Bank, 1993).

19. In addition, the bank debit tax was maintained at a lower rate (.003 instead of .007) but without the possibility of deducting payments from the income tax.

20. Interview with Raúl Cuello, former Secretary of Public Revenue (June 1995).

21. The former Subsecretary of Tax Policy and Administration during the Alfonsín government told me that he thought that this was an important change. Within the institutional structure existent during the Alfonsín administration, he did not have direct control over the DGI and this impeded his ability to implement reforms. At this time, the DGI tended to report directly to the president or to presidential advisors, not to the Secretary of the Treasury or to him (Juan Carlos Gomez Sabaini, April 1995).

22. According to one survey, from September 1989 to February 1990 the percentage of respondents who had a positive opinion of the government's handling of the economy fell from 58.8% to 10.8% (Fraga, 1990: El centro derecha....). A government-commissioned survey found that Menem's popularity had fallen from 80% to 54% before the outbreak of hyperinflation in January. In addition, the support of business leaders had fallen from 58% to 38% (Fontana, 1992).

23. In the 1989-91 Congress the Peronists had 120, the Radicals 90, and the UCD 11. But, after eight Peronists (the "Group of 8") broke ranks and moved into the opposition the governing party in effect controlled only 112 seats. As a result of the elections of September and October 1991 the Peronists increased their total back to 119 while the number of seats held by the Radicals fell to 85. The UCD held onto 10 seats (Southern Cone Report, 11/21/91; De Riz and Feldman, 1992).
24. A Gallup poll showed that while 43% of the total electorate voted for Peronist candidates in the October 1993 congressional elections, 53% of workers and 57% of voters from lower socio-economic strata did. Menem maintained this support despite the fact that the acquisitive power of salaries virtually stagnated over the period, public spending on social services declined, and the rates of unemployment and underemployment increased (Sidicaro, 1995).

25. The causes of this considerable reduction in interest payments included the reduction of debt principal through the deal reached with foreign creditors, the reduction of the debt as a result of the privatizations, the appreciation of the peso as a consequence of the convertibility plan, and the decrease in international interest rates (Durán and Gómez Sabaini, 1994; Rozenwurcel, 1994).

26. The partial privatization of the pension system actually implied increased costs over the short term. But, the reduction in the amount of pension payments, the increase of the retirement age, and the partial privatization substantially lowered the costs (especially in the future) that would have resulted without these reforms. The deficit in the pension system was also reduced by the earmarking of funds from the privatization of the national oil company and deducting from revenue transfers to the provinces.

27. The figures on personnel spending for 1992 and 1993 do not include the payment of salaries for those public servants carrying out services which were transferred from the central government to the provincial governments at the end of 1991.

28. Of the 15% of the mass of shared revenues withheld by the government, a portion also went toward funding tax administration improvements in the provinces (6%) and toward a fund to alleviate fiscal disequilibria in some provinces facing financial difficulties (12%). Collectively, the provinces were guaranteed a minimum of 725 million pesos to cover current expenses and an additional 100 million pesos to cover the education and medical services recently transferred from the central government. In addition, in the next year (1993) the provinces were permitted to increase expenditures (funded by revenue transfers) by only 10% over 1992. If national revenue transfers exceeded 10% above the minimum guarantee, the extra resources would have to be used to cover provincial debts or capital expenditures. In effect, the agreement meant that the provinces were denied 200 million pesos in revenues to which they would have been entitled under the Federal Revenue Sharing Law of 1988. Nonetheless the pact gave the provinces greater budgetary flexibility than originally intended by the government (Economics Ministry, 1994; World Bank, 1993).

29. These figures apply to the total amount of revenues transferred to the 24 provinces. The implications of these figures for individual provinces could be determined by multiplying these totals by the percentage specified in the Federal Revenue Sharing Law.

30. Those provinces not adhering to the pact's conditions would not benefit from the gradual lifting of the tax to gross business assets or the reduction of employer social security contributions. The provinces which initially did not sign were Catamarca (1/20/94), Chubut (12/29/93), Córdoba, Neuquén (1/21/94), Río Negro (1/21/94), Santa Cruz (1/19/94), and Tierra del Fuego (12/17/93) (Dates when they eventually signed are in parentheses) (Secretary of the Treasury, 1995).

31. A report published by El Centro de Estudios para la Nueva Mayoría found in August 1995 that only three provinces had significantly restructured their public sectors, reduced public spending, and cut public employment. It also found that those provinces which had cut public employment the most also experienced the largest increase in unemployment (Ambito Financiero, 8/1/95).

32. This includes employer and employee contributions to pension insurance and payroll taxes earmarked for health insurance, the family fund, housing fund, and unemployment insurance (World Bank, 1993).
33. Durán and Gómez Sabaini (1994) estimate that the compliance rate for the VAT increased by 30% from 1990 to 1993 (from 55% to 73%).

34. This greatly reduced fiscal losses as a result of accumulated losses since in order to qualify for the bond businesses had to fully document them, which many were unable or unwilling to do (interview with Guillermo Barris, National Director of Fiscal Investigations and Analysis, April 1995).

35. Every retail store was required to display close to the cash register a notice calling attention to the consumer's right to demand an official invoice for their purchases. An aggressive advertising campaign was launched on television, radio, newspapers, and billboards using slogans such as "Don't let them rob you" and "Always demand your factura (invoice)," "those who do not give you an invoice are robbing you" in order to raise the consciousness of the Argentine public about the harm caused by tax evasion. In addition the public was asked to anonymously provide names to the D.G.I. of firms evading taxes and lists of those firms committing fraud were published in the newspapers. A lottery - the LOTERIVA - for consumers which submitted official invoices was established to give individuals an added incentive to demand invoices from retailers.

36. In September 1995 the Treasury Secretary said that of the estimated 500,000 persons who should pay some amount of personal wealth tax, less than 100,000 present declarations and pay the tax (Clarín, 9/2/95). Evasion also continued to be a pervasive problem in respect to social security contributions. Cavallo estimated that only 5 million out of 10 million who should make social security contributions actually do so (Clarín, 3/28/96).

37. Under the leadership of D.G.I. Director, Da Corte the following important steps were made: a database of taxpayers with unique identification numbers was created; the D.G.I. was restructured along the lines of a modern organization; a system was established to monitor taxpayers and identify instances of (large-scale) evasion; and a withholding system for large companies was established in which a few hundred of the largest corporations were responsible for retaining VAT and income tax from their suppliers and customers. There was not sufficient time for the taxpayer monitoring system, which still lacked the necessary computer software and data, to be made fully operational (Interview with Marcelo Da Corte, former Director of the D.G.I., August 1995).

38. In fact, Tacchi was forced to resign in August 1995 when he refused to make any exceptions for soccer teams or firms favored by the government who had debts with the treasury in respect to social security contributions.

39. Under the Alfonsin government every stock had to be registered in the name of an official titleholder, which would remain regardless of who might at any point in time be its carrier. Now, there is no requirement for stocks to be registered and thus it is more difficult for the tax agency to tax this form of wealth and income (Interview with Alfredo Fólica, August, 1995).

40. For instance, support for privatization increased from 49% in early 1986 to 60% by 1988 (Ecchegaray, 1993). Unions were viewed positively by 66% of the people in 1984 but only 45% in 1988 and only 30% in 1991 (Mora y Araujo, 1993). Another source found that the unions were viewed much more negatively than the armed forces in April 1989, with only 13.7% looking upon them favorably and 52.7% viewing them negatively (Fraga, 1989).
CHAPTER 5

EXPLAINING THE PACE AND SCOPE OF FISCAL ADJUSTMENT AND REFORM: ARGENTINA COMPARED WITH BRAZIL, COLOMBIA, AND URUGUAY

Introduction

The examination of the sharply contrasting experiences of the Alfonsín and Menem governments in Argentina supports the contention that political institutional factors and more contingent political forces are central to explaining the success of governmental efforts in implementing fiscal adjustment measures and reforms. The political institutional factors which have been seen as particularly important are the structure of the party system, the degree of centralization of governmental authority, the nature of the ties between societal organizations and the party system, and the constitutional powers of the president. But, the interaction of these institutional factors with more contingent factors such as the scope of the government's electoral mandate and the security of its tenure in office are viewed to strongly affect the capacity of governments to carry out fiscal adjustments and implement reforms.

Though slow in responding to the crisis, and constrained by the continued sway of statist and populist thinking within the Radical party and in society at large, the Alfonsín government eventually became more determined in its efforts to stabilize the economy and carry out reforms of the public sector. But, as the analysis in chapter 3 showed, the government was hindered by its inability to command a majority in the Congress, by the history of bitter antagonism and mutual distrust between the two major parties, by the Radical party's lack of power at subordinate levels of the federalist governmental system, by the militant resistance of a union...
movement affiliated with the Peronist opposition, and by the insecurity of Alfonsin’s mandate resulting from the threat of military intervention and the occurrence of two mid-term elections. Alfonsin’s limited mandate (in the Congress and in the provinces) combined with the relatively polarized two party system and the federalist fiscal system greatly impeded his ability to implement fiscal reforms in the national congress and to extend the fiscal adjustment to the provincial governments.

But, Alfonsin’s government was also constrained by factors which pertained to that particular juncture in Argentine history and whose restraining effects dissipated to some extent by the time Menem took office. As the first elected president following the highly repressive and socially exclusionary military authoritarian regime, Alfonsin faced the pressing need to build democratic institutions, to subordinate the military to civilian authority, and to achieve some form of social reconciliation in respect to the massive abuses of human rights committed by the armed forces. In addition, the widespread perception that the military government’s neo-conservative economic program was highly inequitable and a complete failure led much of the public, as well as the principal political parties, to reject “liberal” or “orthodox” approaches to dealing with the crisis. Thus, despite the existence of a severe crisis, economic policy goals were at first subordinated to the objective of re-democratization. And, there was little comprehension of the fact that the state could no longer finance the populist formulas used in the past. The failure of the Alfonsin government’s initial expansionist policies, the steady deterioration of the economy and the quality of public services, and finally, the traumatic experience with hyperinflation convinced a larger segment of the population of the need for harsh economic medicine and for substantial changes in the import-substitution development model.

Thus, when Menem took office in the midst of full-blown hyperinflation, the social, economic, and political context had evolved considerably. Alfonsin did preside over the first
fully democratic transfer of power in the country's history. But, falling living standards, the spread of unemployment, and rampant inflation contributed to a diminished public esteem for politicians and political parties and threatened to undermine the democratic system. Thus, in such a context, the public now expected Menem to place the fight against inflation and the revitalization of the economy above all other objectives and was willing to grant him considerable initial latitude in choosing how to address these problems.

Though there is little doubt that the protracted economic crisis and the experience with hyperinflation contributed to the Menem government's success in implementing far-reaching fiscal reforms and in adjusting the fiscal accounts, I argue that this was not a necessary or a sufficient condition. The Alfonsin government (as well as the Videla government) faced a severe and protracted crisis in public sector financing and a prolonged stagnation of the economy but failed to carry out far-reaching reforms or to stabilize the economy. Without the deep base of support provided by a disciplined party that was heavily represented in the congress and the provinces, it is doubtful that Menem could have sustained the process of fiscal adjustment and reform during 1990 when the resurgence of inflationary pressures (on several occasions) sharply lowered public approval for the government and galvanized the resistance of business groups and dissident labor unions.

In more general terms, I argue that while the deterioration of economic conditions certainly increased the costs of failing to respond and placed reform on the top of the policy agenda, it did not determine the persistence and amplitude of Menem's adjustment and reform efforts. There were, as in all cases, important intervening steps between the identification of the economic need for reforms and their final implementation. Menem first had to decide that such an all-or-nothing reform strategy was in his political interest. Then, only because of his initial endowment of political resources and the shrewd and pragmatic way in which he used these
resources was he able to put together and sustain the necessary social and political coalition behind the policies. Thus, both his decision to aggressively pursue a free market reform agenda and draconian adjustment policies and his capacity to implement these policies were not merely a product of the economic crisis but were conditioned by political institutional and other more contingent political factors.

However, it is difficult to discern the exact nature of the role of political institutional factors and these other more contingent political factors because of the other changes which occurred in the social, economic, and political context between the two presidential administrations. By the time Menem assumed office the economic situation was viewed as more desperate and societal groups and the public at large were more accepting of the need for tough fiscal policies and significant economic reforms. In addition, Menem was less constrained by the problem of managing civil-military relations and maintaining the stability of the democratic system.

In order to more adequately examine the influence of the above set of political institutional factors on fiscal adjustment and reform, this chapter will analyze the experiences of post-debt shock (1982) democratic governments in Uruguay, Colombia, and Brazil. These cases greatly expand the range of outcomes under examination and provide significant variation in the political factors believed to influence these outcomes. Thus, the analysis of these additional cases should provide some measure of control over factors which interfered with the examination of the role of political institutional factors in respect to the Argentine case.

The analysis of the case of Uruguay centers around an attempt to address two principal empirical questions. First, how was the Sanguinetti government (1985-1990) able to sharply reduce the country’s huge public sector deficit and avoid a rapid escalation of the inflation rate despite the fact that it faced constraints which were similar in kind and magnitude to those faced
by the Alfonsin government? Not only did Sanguinetti's government also succeed a repressive authoritarian regime which had followed neoconservative economic policies, but it also confronted a large foreign debt whose financing would rely heavily - as in the Argentine case - on continued international demand for grain and beef - the country's principal exports. Second, why were neither the Sanguinetti government nor its successor (the Lacalle government (1990-1995)) able to implement significant reforms aimed at restructuring the tax system or the public sector as did the Menem government?

I argue that the moderately polarized nature of the party system and the catch-all character of the two traditional parties contributed to the capacity of the Sanguinetti government to significantly raise the tax burden and to keep the budget more closely in balance. The party system provided strong incentives for cooperation among the principal parties. The unusual electoral system, which encouraged the formation of factions within parties but discouraged factions from establishing new parties, lessened the possibility that the leftist but ideologically heterogeneous Broad Front would further the polarization in the party system. The negotiated nature of the democratic transition helped limit the intensity of the competition between the political parties and the potential for a future escalation of civil-military tensions. These constraints on civil-military and inter-party relations, along with the absence of mid-term elections, gave Sanguinetti a greater level of security and a freer hand for managing the economic crisis.

Sanguinetti's efforts to maintain control over the budget were also facilitated by the special presidential powers granted by the 1967 constitution, including the right to veto legislative spending initiatives and to exert control over hiring decisions in the public sector. In contrast with the Alfonsin government, the Sanguinetti government did not face such intense budgetary and price pressures arising from union wage demands since the labor movement was
weaker and its loyalties were divided among several parties on the Left. In addition, the unitary character of the system of government meant that national legislators were not as subject to the pressures of regional interests and thus their support was more easily obtained for the adjustment measures proposed by the national government. At the same time, the Sanguinetti government’s adjustment efforts were less strained by the loose spending practices of subordinate levels of government.

However, the relatively fragmented nature of the party system and the incohesiveness of party organizations impeded efforts by the Sanguinetti and Lacalle governments to implement more significant reforms of the public sector. With each of the three parties split into many factions, neither of these presidents’ parties held a majority in the Congress, let alone their specific factions. Thus, it was difficult for either government to put together a coalition of legislators to support more costly structural economic reforms. When the Lacalle government did manage to enact an important privatization bill, part of it was later overturned by a public referendum. While furthering the accountability of legislators to the electorate, this provision of the constitution lowered the prospects that politicians would absorb the risks associated with the implementation of controversial reforms.

Among democracies in South America, Colombia was the most successful in adjusting to the shocks associated with the debt crisis. And, in contradiction with the conventional wisdom. Colombian governments implemented several extensive reforms of the tax system and kept the budget in rough balance and inflation in check despite the relative mildness of the economic crisis. Not only did Colombian governments keep the inflation rate relatively steady, they also enacted several extensive reforms of the tax system which improved its efficiency and kept the budget in rough balance. Though Colombia did not experience a change of political regime during the period under consideration, governments were constrained by the depleted legitimacy
of the restrictive democracy inherited from the National Front (1958-1974) and by the constant violence and lawless activities of guerrilla forces, paramilitary groups, and drug traffickers. Thus, while Colombia is not completely comparable with the cases of Argentina, Uruguay, and Brazil - which underwent transitions from military-authoritarian rule to democracy - it was far from being a model of democratic continuity and stability. It is surprising, therefore, that in such a turbulent and violent political context and without having first experienced the traumas of severe economic instability, that Colombia should be heralded by creditor governments and international financial institutions as a showcase of successful adjustment to the debt shock and fiscal reform.

The examination of the Colombian case corroborates the notion that non-polarized, cohesive (i.e., small number of parties) party systems composed of catch-all parties are conducive to the achievement of agreements among social and political groups in respect to balancing the budget and implementing fiscal reforms. Along with the legacy of inter-party cooperation left by the National Front experience, the party system discouraged parties and politicians from competing with one another on the basis of programmatic appeals and encouraged the relative depoliticization of economic policy-making. The predominance of two highly factionalized and clientelistic parties might be expected to hinder the achievement of agreements on fiscal legislation in the Congress and to lead to a heavy reliance by politicians on pork barrel spending, which could make it more difficult to make fiscal adjustments. But, the analysis of the Colombian case shows that when the party label still has significant meaning and lower level politicians are dependent upon factional bosses for patronage resources, they have an incentive to support policies which will ensure a steady expansion of the revenue pie. The possibility that such a party system might lead to excessive pork barrel spending was held in
check to some extent by the unitary system of government (until the 1988 and 1991 constitutional reforms), which limited the discretionary spending authority of regional politicians.

At the same time, the analysis of the relatively successful experiences of the Betancur (1982-1986) and Barco (1986-1990) governments in managing the budget and controlling inflation also must consider the impact of the division of executive and legislative powers established by the 1968 constitutional reform. Not only did this reform grant the president the right to legislate by decree following the declaration of a “state of national economic and social emergency.” it also weakened the powers of the congress to alter the budget or initiate legislation pertaining to economic and social development. The weakness and incohesiveness of the labor movement, the president’s powers to limit strike activity by declaring states of siege, and the constitutional ban on strikes by workers in the public sector, also are viewed to have facilitated governments’ fiscal adjustment efforts.

Brazil lies at the opposite end of the spectrum from Colombia in respect to the smoothness of its adjustment to the debt crisis and the timing of fiscal reforms. Aside from the large foreign debt, the Sarney government (1985-90) faced more auspicious initial economic conditions than Alfonsin. Nevertheless it was soon forced to adopt a stabilization plan - the Cruzado Plan - which in its basic design was comparable to the Austral Plan. But, as a consequence of its lower emphasis on controlling the fiscal deficit and limiting the growth of wages, imbalances between consumer demand and supply were wider and the plan collapsed more quickly. Similar to the case of the Alfonsin government, the politically weakened Sarney government was unable to launch an effective successor to this stabilization effort and the fiscal deficit and inflation eventually grew uncontrollably. However, in sharp contrast with the Argentine case, even Sarney’s successor - Fernando Collor de Melo, who like Menem inherited an economy ransacked by high inflation and a bankrupt state, could not implement major fiscal
reforms or sustain initial achievements made in respect to the budget. Even Itamar Franco (1992-
1994), who became president after Collor’s impeachment on corruption charges, and the next
elected president - Fernando Henrique Cardoso (1994-present) have not been able to implement
the fiscal reforms necessary to balance the budget in a durable manner.

In terms of the central theoretical propositions of the dissertation, it is not surprising that
Brazil lagged behind most other Latin American countries in respect to the adoption of fiscal
reforms and the reduction of the public sector deficit. As a result of its highly fragmented and
relatively polarized party system, the incohesiveness and weakness of party organizations, and
the strongly federalist political structure, governments faced great difficulties in forging
agreements at the national level behind belt-tightening measures and fiscal reforms. Not only
was the possibility of building legislative coalitions undermined by the number of parties and the
extreme lack of discipline and weakness of party organizations, it was also hindered by the strong
representation of regional interests in the national congress. The problems of adjusting the
national fiscal accounts was complicated still further by the decentralized nature of the fiscal
federal system, which was accentuated by the 1988 constitutional reform.

Since Cardoso likewise confronted a highly fragmented congress and a vigorously
federalist system, one must draw on other explanatory factors to account for his relative success
in balancing the budget, reviving the economy, and controlling inflation. One important factor,
which has also been considered of great importance in the examination of the other cases, is the
size of the president’s electoral mandate and his ability to command a majority in the congress.
Clearly, Sarney’s stabilization efforts were undermined not only by his weak popular mandate
but also by the incompleteness of the democratic transition, including the need to establish a new
democratic constitution. However, just as in the case of Argentina, the deepening of the
economic crisis and the failures of past governments’ policy efforts eventually made politicians
and the public more receptive to the need for more far-reaching economic reforms and, thus
made the implementation of such reforms less difficult. But, I argue still that political
institutional factors and these other more contingent political factors are the most important ones
to consider in accounting for the “lateness” of Brazil’s adjustment to the debt crisis relative to
other countries in Latin America.

Uruguay: Fiscal Adjustment Despite Delayed Structural Reform

On March 1, 1985 Julio María Sanguinetti entered the presidential office after more than
11 consecutive years in which Uruguay was governed by an authoritarian regime led de facto by
the military from 1973-76 and directly from 1976-85. The departing military regime, which in
close parallel with the Argentine military regime had adopted an anti-inflationary program
centered on pre-programmed devaluations of the currency and had pursued free market economic
reforms, left the economy in practical ruin. In per capita terms the total foreign debt was the
largest in Latin America. The public sector deficit was almost 11% for the year preceding the
transition and much higher at the moment power was transferred. From 1981 to 1984 the
economy contracted by an unprecedented 17%, real wages fell by 30% (to less than half of their
1974 level), and unemployment increased from 6% to 15% (Economic Survey of Latin America
and the Caribbean, 1985 and 1986) (Table 5.1). Thus, very much like Alfonsin in Argentina, the
newly elected president faced the heavy challenge of allaying a critical financial crisis and
responding to strong popular demands for improved living standards. Sanguinetti also faced the
problem of how to deal with the legacy of human rights violations committed by the military
regime. Yet, in sharp contrast with Alfonsín, Sanguinetti managed, mainly by increasing taxes,
to keep the budget more closely in balance and to avoid a rapid acceleration of inflationary
pressures or a severe economic recession. Sanguinetti’s successor, Lacalle, continued the
process of fiscal adjustment. But, without progress in the implementation of fundamental tax and other public sector reforms, this was again achieved through tax increases that had deleterious consequences for the rate of investment and economic growth.

Institutional Structure and Legacy of the Authoritarian Regime

Despite the relative longevity of the military regime (1973-1985), as a result of the defeat of the military-proposed constitution in the 1980 plebiscite, the basic institutional framework present in the period immediately preceding the 1973 coup was restored when democracy returned in 1985. Of all Latin American countries Uruguay had the longest history of broadly participatory democracy, supported by one of the region’s most extensive social welfare systems. In addition, until the early 1970s the military scarcely interfered in the political system. Mass democracy, which began about 1918, was continuous until 1973, except for the years 1933-42 when a “mild” authoritarian regime was created by an inter-party agreement (Gillespie, 1986; González, 1991).

Understanding the party system and the way in which it structures the incentives for politicians to support or reject the executive’s economic policy reforms, requires some acquaintance with the unusual electoral system used by Uruguay until 1996. In the double simultaneous voting system voters elect both the president and legislators by choosing simultaneously among parties and among competing lists within the parties. The winning lists (and presidential candidate) are (is) those (that) which receive(s) the most votes within the party that receives the most votes. This system, along with the prohibition on ticket-splitting and the concurrence of presidential and legislative elections, tended to solidify the electoral hegemony of the Blancos and the Colorados while tending to encourage the fragmentation of the traditional parties and to undermine the parties’ programmatic coherence and discipline (Gonzalez, 1991).
The two party system was also supported by constitutional arrangements, which during two periods (from 1918-1934 and from 1952-1966), provided for a collegial executive (with minority party participation) and which (since 1931) guaranteed the minority party a share of all appointed public sector jobs (Gillespie, 1992). The consequent reliance on clientelism to establish ties with voters and the strength of the traditional parties tended to discourage class-based or populist appeals by presidential candidates. Thus, the sharp swings in economic policy experienced in other South American countries (such as in Argentina, Brazil, Chile, and Peru) were largely avoided (Gillespie, 1986).

But, given the high level of internal factionalism within the parties, the relative equality in the two parties' level of popular support, and the presidential nature of the political system, elections tended to produce governments that lacked stable legislative majorities. The resulting stalemate and conflict between the executive and the legislature and the parties' reliance on state patronage as an instrument for building electoral support prevented the adoption and maintenance of policies aimed at overcoming Uruguay's long term economic decline. As a result, the party system became more fragmented and polarized. In 1971, the Broad Front - an ideologically heterogeneous leftist party coalition was created (Gillespie and González, 1995; Collier and Collier, 1991; González, 1995; Gillespie, 1991). All things being equal, one would expect the emergence of this third political force to have further complicated the task of the new democratic government in managing executive-legislative relations and the economic crisis.

The November 1984 elections, which brought Sanguinetti to the presidency, produced nearly the same three-way division of the vote between the Colorados, Blancos, and the leftist Broad Front as occurred in the 1971 election. And, there was also little change in the high degree of factionalism within each of the parties. The legitimacy of the election result was marred by the fact that two prominent popular leaders, Blanco leader Wilson Ferreira and recently freed Frente
Ampio leader Liber Seregni, were outlawed as candidates by the so-called Naval Club Agreement between the military junta and leaders from the Colorado party and the Broad Front. But the election still gave Sanguinetti a fairly strong mandate since with the Blancos and the Broad Front putting forth other presidential candidates and candidate lists for the legislative contests, the election was broadly seen as legitimate.

But, the conditions that had previously produced political paralysis and crisis were not repeated in their entirety. As a consequence of the experience with guerrilla violence, the military government’s harsh repression and poor performance, and the deepening of the economic crisis, the 1982 internal party elections and the 1984 general elections resulted in a marked drop in support for pro-regime and right-wing party factions in the two main parties and a substantial shift in support within the Frente Amplio away from the more leftist factions (i.e., away from the Independent Democratic Left to the relatively moderate “List 99”). While support for right-wing factions in the Colorado Party fell from 56% in 1971 to 24% in 1984, support for the Right practically vanished in the Blanco Party, falling from 34% to 3% (González, 1991; Rial, 1986; Gillespie, 1986). As Haggard and Kaufman argue, the traditional catch-all character of the traditional parties and the incentive structure entailed by the double simultaneous vote system facilitated the accurate representation at the political level of the fairly centrist orientation of the electorate (Haggard and Kaufman, 1995). In addition, the Tupamaros, which represented a significant anti-system threat outside of the party system, were defeated even before the military assumed direct control of the government in 1976.

Thus, Sanguinetti, whose moderate Battista faction received 35% out of the total 41% captured by the Colorado party, confronted a Congress which was significantly less polarized than that faced by Jorge Pacheco Areco (1967-1971) or Juan Maria Bordaberry (1972-73) in the years preceding the coup. However, in addressing the severe economic crisis Sanguinetti still
faced the considerable difficulty of composing parliamentary majorities in a context in which the legislature was divided between three parties (the Blancos with 35 seats, the Broad Front with 21 seats, and his own Colorados with 41 seats) and in which the parties, including his own, were composed of numerous factions.

A factor which offset the implications of the continued fragmentation and factionalism for economic policy-making was the change in executive-legislative relations entailed by the 1966 constitutional reform. The collegial executive (in place since 1952) was replaced with a pure presidential executive with augmented powers. The president’s term was extended from four to five years while the conjunction between legislative and presidential elections was still maintained. In addition, the president was given the power to veto legislative initiatives which increase public spending, to send bills to the parliament with a "declaration of urgency" designation (under which they become law unless acted on by the legislature within a specified time limit), and to limit the legislature's ability to create new state jobs (González and Gillespie, 1994; Collier and Collier, 1991). The peculiar quasi-parliamentary feature of the earlier constitution, which permitted the legislature under special circumstances to remove the president for political reasons, was eliminated. But, the president’s power to call new legislative elections if parliament censures a member of his cabinet without sufficient backing was maintained (González and Gillespie, 1994). Nevertheless, while the formal constitutional powers of the Uruguayan president may have been greater than some other Latin American cases, including Argentina, the stronger tradition of checks and balances from a relatively powerful legislature and court system, made it less likely that the president could exceed the bounds of his ample constitutionally-provided authority.

However, the constitutional reform that allowed for popular referenda to reverse enacted legislation was a constraint against the implementation of controversial policy reforms. Though
this change potentially increased the accountability of elected officials to the voters, it meant not only that the public could overturn policies enacted by the legislature but also that legislators might be discouraged from backing unpopular government reform initiatives.

The union movement, which was characterized by a moderate level of unionization, also had the potential to undermine the new government’s efforts to balance the public sector’s accounts and contain inflation. As a consequence of the mode of its initial incorporation into Uruguayan politics in the early part of the 20th century, the labor movement did not develop close ties with the traditional parties or the state. Instead unions were organized by parties on the left which, until the late 1960s, received little electoral support (Collier and Collier, 1991). The economic crisis of the 1960s and the repression under military rule left a union movement divided between two central union confederations - the National Convention of Workers (CNT) and the Plenario Intersindical de Trabajadores and more subject to the influence of grass roots militants (Gargiulo, 1988; Gillespie, 1992).

The sharp decline in real wages, the liberalization of politics, the increased sway of radical union activists, and the competition between the different sectors of the labor movement favored a strong increase in labor demands in the new democracy. But, the unions’ lack of ties with the two traditional catch-all parties (and, therefore, lack of common stake in the patronage implications of state sector reform) and the electoral ambitions of the now more moderate Broad Front were factors which limited the impact of labor protests on the government’s economic adjustment policies. By contrast, the strong historic ties between the Peronist party and the union movement in Argentina and the higher level of unionization made organized labor a much more potent opposition and more closely integrated in the political conflicts between the Alfonsin government and the Peronist opposition.
The democratic transition was one in which the military authorities were sufficiently cohesive to require the civilian politicians to negotiate the terms of the transfer of power. But, given the defeat of the proposed constitutional reform, the collapse of the economic program, and the absence of strong political allies or a clear-cut mission, the military rulers lacked the will and solidarity to impose most of their more hard-line demands. As a consequence, the only explicit constraints on the democratic transition arising from the Naval Club Accord between the armed forces and the Colorado and Blanco parties were the prohibition on the presidential candidacies of Ferreira and Seregni and the temporary retention of the National Security Council and a role for the junta in the nomination of the armed forces' commanders. In addition, while the human rights issue may have not been explicitly discussed, some observers believe that there was a tacit understanding between the military and some important civilian politicians that there would be no trials of military officers for human rights abuses (Linz and Stepan, 1996; Gillespie, 1991). Even if such an agreement did not take place, the public pledge by Sanguinetti (who served as the principal civilian negotiator) that there would be no revenge trials meant that the military could be assured that the executive, at least, would not pursue or condone prosecutions against military officers. Thus, the quasi-negotiated nature of the transition contributed both to the containment of inter-party conflict and to the management of civil-military relations. Though the possibility of a popular referendum and victim-initiated law suits still held the possibility of unsettling the consensus among centrist politicians and the military against holding soldiers accountable for human rights abuses, the danger of an escalation of military disenchantment with the government was for the time being held in check (Gillespie, 1991).
Sanguinetti: Successful Fiscal Adjustment in a Newly Reestablished Democracy

Unlike the Alfonsin government, the Sanguinetti government wasted little time in squarely addressing the country’s economic problems. Within the first five months, the government had concluded a stand-by agreement with the IMF and had reached an agreement with the country’s foreign creditors to reschedule the foreign debt. In the agreement with the IMF the government committed itself to reduce the annual rate of inflation to 60% and to lower the public sector deficit from 11% to 6% of GDP by the year ending June 1986 and to 5% of GDP by the end of 1986. But, in contrast with the shock plan being applied across the River Plate, the government favored a gradual economic program that would promote an adjustment of fiscal and balance of payments accounts while reviving the economy. Thus, the economic plan called for moderate increases in real wages (Economic Survey of Latin America, 1986).

As a consequence of a significant increase in tax revenues and reductions in public spending, the government exceeded the IMF targets in respect to the budget. The public sector deficit fell from 11% of GDP to 6.9% of GDP in 1985 and 4.3% and 4.1% in 1986 and 1987, respectively (Table 5.2). Given the fairly sizable increase in average real wages (14% in 1985), inflation initially increased somewhat (from 57% in 1984 to 72% in 1985) but fell to 64% by 1987. After three previous years of recession the economy recovered strongly (7.0% growth in 1986 and 5.3% in 1987) (Economic Survey of Latin America, 1986-1988). Taxes increased substantially as a result of an increases in the rate of the VAT (from 18% to 20%) and social security taxes, public sector tariff increases, and significant improvements in the tax administration (Table 5.3). Despite increasing spending on social programs, raising public sector wages, and re-instituting thousands of public employees who had been dismissed for political reasons under the military, the government also managed to reduce public expenditures by over 4% of GDP between 1984 and 1987 (Roldós, 1993). A favorable external climate characterized
by lowered interest rates, relatively high international commodity prices, falling petroleum prices, and strong economic growth in Argentina and Brazil contributed to the strength of the fiscal adjustment and economic turnaround.

The last two years of the Sanguinetti presidency brought a sharp economic slowdown, an increase in the inflation rate, and a slight widening of the budget deficit. The contraction of external demand from Brazil and Argentina, falling commodity prices, and the application of a more restrictive monetary policy put pressure on the budget. However, unlike the cases of Argentina and Brazil, economic growth did not turn negative and there was no rapid acceleration in the rate of inflation. The fiscal deficit grew even though the Sanguinetti government continued to increase revenue collection by further reforming the VAT (increasing the rate an additional 1%, broadening its base, and reducing payment lags), increasing excise taxes, raising the bank assets tax, improving the application of income taxes in the agricultural sector, and enhancing the procedures for enforcing net wealth taxes (Roldós. 1991).

As was the case in most other South American countries in this period, the performance of the economy disappointed Uruguayans who were hoping for a marked turnaround under the new democracy. Similar to the case of many other countries in the region, the governing Colorado party lost the subsequent presidential election (November 1989) and saw its electoral support diminish (-10%). But, relative to the experiences of Argentina and Brazil, and considering the state of the economy before the democratic transition, the Sanguinetti government managed the economy (and the fiscal accounts) remarkably well. However, like Alfonsín and Sarney, Sanguinetti did not carry out significant reforms of the public sector or substantially liberalize the economy. Fiscal deficits were reduced at the cost of exorbitant tax rate increases and reductions in the tax system’s simplicity and neutrality. Given the high costs of
the social security system, which were raised greatly by the 1989 public referendum, and the very
large public payroll, the state's finances remained on shaky grounds.

The relative success of the Sanguinetti government in balancing the fiscal accounts and
stabilizing the economy was facilitated by the lack of sharp ideological divisions between the two
parties, the long history of inter- and intra-party power-sharing, and the gravitation of both parties
back toward the center as a consequence of the 1984 elections. The cooperative disposition of
the party leaders in respect to economic policy-making was reinforced also by the recent
experiences of democratic breakdown and harsh authoritarian rule and the electoral competition
on the Left from the Broad Front. The factionalized and catch-all character of the traditional
parties tended to discourage a bidding war between the parties or factions over contrary
approaches to dealing with the economic crisis - as occurred in Argentina. The Broad Front,
which was a full partner in the Naval Club Accord, also had an incentive to participate in the
dialogue with the government in order to enhance its chances of capturing the presidency and
other important offices, and in order for the party to be given the right to share in the spoils of
power (e.g. appointments in state agencies) heretofore divided between the Blancos and the
Colorados (Gillespie, 1991).

In keeping with the structural incentives presented by presidential systems of
government, the Blancos and the Broad Front turned down Sanguinetti's invitation to participate
in a "national unity" government. Though neither the Blancos nor the Broad Front were willing
to give up their independence of action, both parties committed themselves to maintain the
"governability" of the political system and showed a strong willingness to compromise. In fact,
before the government came to power the three largest parties approved an agreement on the
basic outlines of the economic policy which was to be followed (Southern Cone Report, 3/8/85).
In supporting this fairly conservative economic approach the Broad Front abandoned its demands
for expansionist policies and a moratorium on debt payments. Though not a formal coalition
government, the president’s cabinet included two Blanco sympathizers (in the foreign and health
ministries) and another official from the small Civic Union party (in the defense ministry).

The consensual approach to decision-making withstood several initial tests, including
decisions pertaining to the release of political prisoners and the refinancing of the private sector’s
internal debt (Southern Cone Report, 3/8/85; Latin American Weekly Report, 3/15/85, 3/22/85,
12/13/85). But, the relatively collegial relationship between the government and the opposition
parties broke down when it came to devising the budget and deciding whether an amnesty should
be granted to the armed forces. The opposition parties protested loudly when Sanguinetti vetoed
most of the amendments that the Congress made to the budget bill, which he believed increased
social expenditures beyond what the country could afford. When the Supreme Court ruled that
the president had overstepped his constitutional authority, the government immediately returned
to its conciliatory tone. A budget compromise was worked out with the Blancos and the
government opened discussions with the opposition parties in the hope of reaching another
"national accord" on many of the major issues facing the country. Though, again, the
government did not achieve the hoped-for coalition cabinet, a consensus was reached on a broad
range of policy measures and three individuals with Blanco leanings were given positions in the
cabinet. Even the Broad Front, which opposed the proposed labor legislation, signed the
“national accord” (Southern Cone Report, 1/31/86, 4/18/86; Latin American Weekly Report

The other major issue, which caused the Broad Front to adopt a more thoroughly
oppositional stance to the government, was the question of whether an amnesty should be granted
to military officers suspected of human rights violations. The Broad Front opposed the
compromise “law of limitations” reached by the Blancos and the Colorados and combined with a
leftist faction of the Blancos to push for a referendum to overturn the law. Partly because of the cohesion of the military on the issue, the consensus among centrist politicians and the military, and the less severe nature of the human rights violations, the referendum was defeated and the military was not forced to openly contest the Sanguinetti government (Gillespie, 1991; Linz and Stepan, 1996). The lower threat of military intervention and the absence of mid-term congressional elections put Sanguinetti in a more secure position for confronting the economic crisis compared to Alfonsín in Argentina.

Thus, the moderate and catch-all nature of the two main parties led to a consensual style of policy-making which permitted the passage of relatively conservative budgetary laws and tax reforms and allowed the important immunity law to be approved. In contrast with Alfonsín in Argentina, Sanguinetti did not have to contend with a cohesive popular party such as the Peronists pressing for unrealistic, yet appealing, populist and nationalist approaches to solving the economic crisis and enjoyed a continuous five-year term without an electoral test of his approach. In managing the state’s finances Sanguinetti also took advantage, especially in the first couple of years, of his constitutional powers to veto congressional initiatives to increase public expenditures and to limit hiring of public sector workers (Rial, 1996). Given the fact that Uruguay has a unitary government with a fairly centralized fiscal system, the Sanguinetti government’s adjustment efforts were not seriously undermined by spending pressures originating at lower levels of government as was the case with the Austral Plan in Argentina (González and Gillespie, 1994).

The Sanguinetti government’s effort to restrict wage increases to close to the rate of inflation and to restrict the occupation of workplaces gave rise to strikes and factory occupations across much of the economy, and more intense strife in the public sector, in 1985 and 1986. The initial wave of strikes in the private sector was abated somewhat in the second half of 1985 by the
granting of sizable wage increases and the restoration of the wage councils (suspended in 1968).
However, a much tougher wage policy in respect to the public sector, where wages could be set by administrative decree, led to widespread strikes by government workers toward the end of 1985 (Gargiulo, 1989; Southern Cone Report, 5/24/85, 6/28/85, 10/11/85; Latin American Weekly Report, 4/19/85, 7/19/85, 9/6/85, 9/13/85, 10/18/85, 11/22/85). In February 1986, as a result of concerns about increased inflationary pressures, the government chose to bypass the tripartite wage councils in favor of granting wage increases based on its projections of future inflation. The adoption of this more restrictive wage policy and proposals to curb the right to strike led to a series of general strikes in the middle of 1986. But, the success of the government in defeating strikes by individual unions, the strengthened position of the more pragmatic communists, the reestablishment of union leadership, and the increasing focus of the political Left on electoral politics contributed to a reduction in industrial conflict in the second half of the Sanguinetti presidency (Gillespie, 1991; Latin American Weekly Report, 3/21/86, 9/18/86).

With an estimated 1,114 labor conflicts (two thirds of which were in the public sector) and several general strikes in its first two years, organized labor definitely constrained the government's effort to adjust the fiscal accounts and stabilize the economy. But, the strikes and protests of the Uruguayan labor unions were less disruptive to governmental adjustment efforts than those carried out by Argentine unions for several reasons. First, a far smaller percentage of Uruguayan workers were unionized (only 19% in Montevideo and an insignificant percentage in the rest of the country) and, in contrast with the Peronist unions in Argentina, the Uruguayan unions lacked control over social welfare funds raised from salary contributions (Gargiulo, 1989). Second, as the walk-out at the October 1985 labor convention clearly showed, the labor movement was sharply divided (especially in the first years of the Sanguinetti government) between the more pragmatic and cautious communists and the more radical unionists (Southern
Cone Report, 12/20/85, 7/2/86). Third, the unions were tied to a wide array of parties on the Left which were united only loosely in the Broad Front, as would become clear when the more moderate parties in the coalition broke off to form the New Space. Given these divisions in the Left in respect to both the political parties and the union structure it was difficult for the two forces to unite around a common strategy of opposition to the Sanguinetti government. The concern of the moderate sectors of the Broad Front for enhancing the electoral appeal of the Left and their commitment to the consolidation of democracy (resulting from their participation in the Naval Club Agreement) led them to press for restraint on the part of the unions (Gillespie, 1991).

Lacalle's Government: Raising the Fiscal Pressure in Lieu of Structural Reform

In the November 1990 elections Luis Alberto Lacalle, who positioned himself to the right of the two other Blanco presidential candidates by suggesting the need for free-market economic reforms, was elected President. Lacalle received 28% of the vote, while his party (with 40% of the vote) outdistanced the Colorados (30%), the Broad Front (22%), and the New Space (8%). His Herrerista faction obtained 24 out of the 99 seats in the Chamber of Deputies and the Blancos got 39 seats overall. The Broad Front and the New Space captured an unprecedented 48% of the vote in Montevideo, where the socialist, Tabaré Vásquez, was elected mayor.

When Lacalle assumed office the inflation rate had returned to near 90% (reaching 129% toward the beginning of 1991), the growth rate had slowed to 1%, and the overall public sector deficit had climbed to 7% of GDP (Table 5.4). The financial hole facing the incoming government was exacerbated by the public referendum (approved November 1989) which changed the method for indexing pension payments. This change was expected to increase the already exorbitant costs of the pension system by about 2% of GDP (Roldós, 1993). Thus, in order to reach its declared goals of lowering the fiscal deficit to 2.5% of GDP and the inflation
rate to 50%, and in order to become eligible for Brady Plan debt reduction, the government immediately sought congressional approval for a tough fiscal adjustment program and announced plans to reform the social security system, privatize some public businesses, reduce the size of the public payroll, and reform the labor market.

Facing a divided Congress and a capital city (with nearly one half the country’s population) controlled by the Left, Lacalle immediately sought to form a true coalition cabinet. But, as was the case with Sanguinetti, the new president had to settle for something less: a "national confluence" with four Colorado "technocrats" in the cabinet and a basic agreement between the parties on proposed measures such as curbs on the right to strike and reforms of the tax, social welfare, and educational systems (González and Gillespie, 1994; Latin American Weekly Report, 3/8/90).

With the support of Blanco and most Colorado legislators, the tax and other fiscal measures were approved by the Congress in the first month of Lacalle’s administration. The tax reform included an additional increase in the basic VAT rate from 21% to 22%, increases in excise tax rates, an increase in the rate of social security contributions by employers (by 3.5%), a temporary increase in corporate income tax rates, changes in property taxes, and an increase in import taxes. In addition, separate legislation increasing fuel prices and public service rates was approved. The Colorados agreed to back the fiscal adjustment measures because the proposed policies were little different from their own and because they did not want to lend more weight to the campaign by the now more powerful Broad Front against the government’s free market policies. The Socialist mayor of Montevideo deepened the rift between the executive and the Broad Front by raising property taxes by 280% in order to fund increased expenditures on social programs (Roldós, 1993; Latin American Weekly Report, 4/5/90, 4/12/90, 4/19/90; Southern Cone Report, 4/19/90, 10/18/90).
The government experienced far greater difficulties, however, in its efforts to enact structural reforms. After a year of congressional deliberation, and the withdrawal of Sanguinetti's *Foro Batlista* Colorado party faction from the cabinet, the congress finally approved the government-proposed privatization law by a narrow margin in September 1991 (*Southern Cone Report*, 6/91, 10/91). But, the public image of the government (which fell from a 38% to 14% positive rating) had suffered as a consequence of the continued economic recession, the effort to impose unpopular free market policies, and the frequent strike actions by the labor movement (including seven general strikes in Lacalle's first year). By comparison, in a sign of the public mood Vasquez' approval rating in Montevideo soared to 46% (*Southern Cone Report*, 12/90, 1/91). The passage of the privatization bill galvanized the Broad Front and the unions, who immediately launched a referendum campaign to try to repeal some of the privatizations called for in the approved law. Despite having been frustrated during his presidency by Congress' failure to consider his proposals for pension system reform and privatization, Sanguinetti sensed the shifting political climate and joined the anti-privatization and anti-state reform bandwagon.

Though referendum supporters failed to get the necessary 25% of the electorate to support the call for a plebiscite on privatization in their first attempt in July 1992, they were successful in October. The government's exaggerated public claims that the first vote indicated approval for privatization and the administration's economic program, and the president's arrogant tactic of advocating a referendum, helped make the second vote as much a referendum on the government as on privatization *per se*. With voting mandatory in the actual referendum, the privatization law was partially repealed in December 1992 by the lopsided vote of 72% to 27% (*Southern Cone Report*, 11/92, 8/92, 1/93; *New York Times*, 2/21/93). The referendum defeat led to a further erosion of the government's public stature and its clout with the Congress.
despite the fact that the economy rebounded finally in 1992 (with 6.5% growth) and inflation fell to 60%. Not only did the remaining Colorado factions withdraw their support, two factions of the Blanco party also pulled their representatives out of the cabinet (Southern Cone Report, 4/93).

Thus, to gain congressional approval for the pressing reforms of the social security system and state sector, which were strongly opposed by groups representing state pensioners (who numbered 650,000 in a country with 1.3 million economically active persons) and public employees (who numbered 300,000), the government was now left to the almost impossible task of forging ad hoc legislative agreements (Southern Cone Report, 9/10/92). The legislature, including representatives of the Blanco party, effectively closed off the option of implementing some of the reforms by administrative decree when it enacted a law banning such an approach in July 1993 (Latin American Weekly Report, 8/12/93). The government faced additional general strikes (10 overall) and a tax rebellion by the Rural Federation, who complained about the "intolerable" tax burden and excessive government spending. Nevertheless, the implementation of the 1990-1991 fiscal adjustment program led to a reduction of the inflation rate to 45% by 1994, raised tax revenues by more than 3% of GDP, and lowered the public sector deficit to 3.0% of GDP (Tables 5.5 and 5.6). Partly as a consequence of the government's stabilization efforts, the economy experienced fairly strong economic growth rates from 1991 to 1994. But, the ever-increasing transfers to the social security system (26% increase from 1993 to 1994 alone) and the bulging public payroll continued to put great strain on public sector accounts and made it impossible to lower the high prevailing tax rates (Economic Survey of Latin America, 1995).

Thus, the factors which appear to have facilitated Sanguinetti's ability to manage the severe economic crisis better than Alfonsín and Sarney do not appear to have been sufficient for the task of carrying out more fundamental public sector reforms. As a result of the president's special constitutional powers, the relative weakness of the unions, and the generally cooperative
relationship between the two traditional parties, both Sanguinetti and Lacalle were reasonably successful in containing spending, keeping a lid on wages, and increasing taxes. But, the relatively fragmented character of the Uruguayan party system and the lack of discipline within the parties impeded efforts to implement structural reforms which require a broader social consensus and entail greater redistributive costs. Lacalle had to govern in a context in which his party held only 39 out of 99 seats in the Lower House and one faction of his party was staunchly opposed to free market reforms (Financial Times, 10/19/90).

The constitutional provision allowing for public referenda also complicated the government's efforts to implement reforms. Though a privatization bill was enacted with the bipartisan support of Blanco and Colorado congressmen, the possibility of a referendum allowed this legislation to be repealed and undermined the will of opposition politicians to back additional reform proposals. At the same time, the modifications to the pension system enacted through the 1989 referendum made it much more difficult for the Lacalle government to maintain the budget in balance. A referendum approved in November 1994 represented a further setback for reform of the social security system since it required (retroactive to 1992) any changes to the system to be made by a specific law (not as a mere amendment to the budget law) (Inter-American Development Bank, 1995).

While Lacalle faced important structural constraints, it also seems clear that tactical errors cost him a great deal of public and congressional support. In the Uruguayan institutional context, Lacalle would likely have advanced further with reforms had he consulted more closely with the political parties and social groups before submitting his reforms to Congress and had his administration worked harder in explaining the need for the reforms. Though Sanguinetti clearly had his eyes on reelection, given the strong similarity in the policy orientation of the two leaders.
it should have been possible for Lacalle to have kept this pivotal leader on his side had he been more willing to compromise and to proceed with reforms in stages.

Sanguinetti, who was reelected in November 1994, managed at last to put together a true coalition cabinet, with the leader of one important Blanco faction - Dr. Alberto Volonté - a near equal partner in the government. Lacalle, who felt betrayed by Sanguinetti during his own presidency and is planning to seek reelection in 1998, was a lukewarm supporter of the coalition. But, in the first two and a half years of the Sanguinetti government a major reform of the social security system (including its partial privatization) was enacted, payroll taxes were significantly reduced, the educational system reformed, and the public workforce was scaled back. In addition, at the end of 1996 a major reform of the electoral system was approved by Congress (with the support of the Colorados, Blancos, and New Space), and later the electorate. The reform, which dissolves the double simultaneous vote system and replaces it with a more traditional proportional representation system, holds the prospect of creating a less factionalized party system with more easily manageable relations between the executive and the legislature.

Colombia: Smooth Fiscal Adjustment and Timely Fiscal Reforms

As a consequence of the collapse of coffee prices, the external debt shock, and the previous government's pursuit of expansionary fiscal policies, Belisario Betancur (1982-1986) inherited an economy plagued by growing balance of payments and budgetary deficits. Tax revenues had fallen from about 16% of GDP in 1978 to just over 13% of GDP from 1980 to 1982 and the fiscal deficit approached 8% of GDP (Ocampo, 1993; Economic Survey of Latin America, 1982, 1983; Carciofi, Barris, and Cetrángolo, 1994) (Table 5.7). However, given the country's lower foreign debt burden and still sizable foreign reserves, and the continuation of economic growth (albeit at a much slower rate), the crisis inherited by Betancur was milder than
that faced by most other South American presidents during this period. The relative mildness of the economic crisis was largely due to the more moderate and consistent macroeconomic policies, and more outward-oriented trade policies followed by Colombian governments in the previous decades. As a consequence of this past record, Colombia's export sector, though still centered on coffee, was fairly diversified and the state's finances were more stable and business confidence stronger than in many other countries in the region.

But, in strong contrast with the performance of the Alfonsin and the Sarney governments (in the context of more severe economic crises), the Betancur government avoided a further deterioration of the economic situation or a worsening of the inflation rate by adopting important fiscal reforms and a succession of adjustment plans of an increasingly orthodox character (Carciofi, Barris, and Cetrángolo, 1994; Stallings, 1990; Sarmiento, 1991; Sardi, 1991; Urrutia, 1989). His successor, Virgilio Barco (1986-1990), adopted another significant reform of the tax system and solidified the budgetary equilibrium despite the lack of serious strain on the country's finances. Despite the continued prevalence of violence connected with armed guerrillas, paramilitary groups, and drug cartels, and the continued weakness of the state in applying the rule of law, Colombia emerged from the external shocks of the early 1980s with an economy which grew at a steady and strong pace through the mid-1990s.

Institutional Structure and Legacy of the National Front Regime

Though for almost 140 years - interrupted by only two brief periods of military rule - Colombian presidents have been chosen in direct elections, only for short interludes in previous history, and very recently, were the elections fully competitive and fair. Since the 19th century Colombia's political system has been dominated by the Conservative and Liberal parties, which organized intensely loyal followings based on tradition and patron-client ties. Given that periods
of open party competition and hegemonic practices by the ruling parties usually resulted in large-scale violence, on several occasions the opposition party or both parties chose to voluntarily limit the scope of political competition for the presidency and other political offices or to share power. *La Violencia* (1948-1958), which was fueled by the April 1948 assassination of a Liberal party leader, resulted in the inter-party pacts giving rise to the National Front (1958-1974) - the first formal, constitutional manifestation of this tradition of coalition rule (Hartlyn, 1988; Dix, 1987; Solaún, 1980; Kline, 1980; Archer, 1995).

The Liberals and the Conservatives maintained a multi-class and regionally diverse character and were organizationally weak and fragmented. The fragmentation of the parties was bolstered by the high level of control exercised by regional and local party elites and also by electoral rules which prevented party control over list creation and which specified that seat allocation procedures be applied to lists rather than to parties (Archer, 1995; Martz, 1997; Dix, 1987; Shugart, 1992). As a consequence, politicians who were not at the head of the official party lists had a better chance of winning a legislative seat if they formed their own list within the same party, thus still taking advantage of the broad meaning which the party label had for voters. Though the votes for lists and separate presidential candidates were not pooled for a given party as in the Uruguayan case, the possibility of ticket splitting for different races, the seat allocation procedures, and the non-simultaneity of elections for different government offices produced an equal incentive for party factionalism.

The National Front experience had a profound impact on the relationship between the two main parties and on the style of policy-making that would affect the way Colombian governments responded to the crisis which hit the economy in the 1980s. With power sharing between the two parties guaranteed by the National Front pacts, and participation by new parties forbidden, the National Front tended to both maintain the dominance of the traditional parties and
further their level of factionalism. Instead of the populist cycles experienced by other South American countries, the two well-entrenched catch-all parties and National Front regime tended to make economic policy-making more of a pragmatic and technical exercise rather than a process characterized by sharp partisan conflict. The party factions, which became to an even greater extent dependent on patronage as the principal means of mobilizing the vote, had an incentive to support growth-oriented policies which would ensure growth in the total revenue pie and larger public expenditures. At the same time, they feared sparking high inflation since this would erode the support for their party and undermine support for the National Front regime. Thus, the National Front regime and the legacy of inter-party violence permitted an otherwise difficult-to-achieve coalition between two highly factionalized parties in a presidential system (Hartlyn, 1988; Berry, 1980; Urrutia, 1991; Bagley, 1984; Stallings, 1990). Those groups that did not share the basic moderate approach followed by the traditional party elites were excluded from participating at the cost of a growing and increasingly powerful anti-system struggle. Even though after 1974 electoral competition between the parties was restored, the opposition party retained a share of governmental power through 1986 and the pattern of inter-party dialogue and moderate economic policy-making during the National Front had an enduring influence.

Given the two-thirds majority required for the enactment of most laws and the fairly large share of the seats garnered by anti-National Front forces in the mid-1960s to mid-1970s, most important reforms were implemented by the president on the basis of extraordinary powers granted him by the Congress or by decrees emitted under the state of siege provision of the constitution. Though legislation adopted through state-of-siege powers was no longer valid once the state of siege was lifted, presidents could choose to delay doing so until they could count on the necessary majority in the Congress. In addition, the president could control the agenda and
shape congressional decisions through the use of the line item veto, the ability to declare certain legislative proposals “urgent”, and broad appointive powers (Dix, 1987).

The powers of the president were strengthened further as a consequence of the enactment of the 1968 constitutional reform. The congress lost the powers to initiate legislation in regard to social and economic development and to increase expenditures without government assent. In addition, the president gained the power to legislate by decree following the declaration of a “state of national economic and social emergency” as long as the full cabinet was in agreement (Hartlyn, 1994; Hartlyn 1988; Dix, 1987; Archer and Shugart, 1997). The state of emergency powers were used by President Misael Pastrana (1970-74) to implement his development plan and by President López Michelsen (1974-78) to enact a major reform of the tax system.

Thus, despite the fact that Conservative President Belisario Betancur faced a sizable Liberal majority (63 out of 114 seats in the Senate and 115 out of 199 seats in the Chamber of Deputies) and his own party was comprised of several factions, he was still in a fairly strong position for addressing the growing economic crisis. The fact that there were no significant ideological differences between the parties, that Liberals were incorporated into the cabinet, and that there was a tradition of bipartisan decision-making meant that Betancur could still enact legislation and there were few pressures within the formal political system for populist economic alternatives. In addition, the constitution appeared to grant Betancur the right to legislate by decree under (declared) economic emergencies and blocked the Congress from taking autonomous action in relation to government spending or taxation or other matters pertaining to economic development.

Given its absence of strong ties with the traditional parties, its low overall membership, and its fragmented nature, the union movement did not present a great obstacle to the implementation of fiscal adjustment measures. The union movement’s overall impact was further
reduced as a consequence of legal restrictions and repression imposed through state of siege powers and the constitutional prohibition of collective bargaining and strikes by all public sector and "public service" sector workers (Londoño Botero, 1989; Hartlyn, 1988).

Until recently Colombia's form of government was highly centralized with the president appointing the departmental governors, who, in turn, appointed the mayors (Hartlyn, 1988; Shugart, 1992). Though the division of responsibilities and authority remained concentrated in the center, the popular election of mayors, which began in 1988, and fiscal reforms which increased the flow of resources to the departmental and municipal levels, contributed to some degree of decentralization by the 1990s. But, in undertaking the adjustment of the state's finances the Betancur and Barco governments did not have to concern themselves to as great an extent as the Argentine and Brazilian governments with fiscal pressures arising from budgetary decisions or political pressures emanating from lower levels of government.

**Betancur's Government: Averting a Fiscal Crisis**

Betancur, who as a result of a division in the Liberal Party became the first Conservative president voted into office in a fully competitive election since 1946, inherited an economy with growing fiscal and balance of payments deficits and a worsening financial sector crisis. At the same time, the political regime itself was clearly in a state of crisis. The high level of state repression applied under the National Security Statute decreed by the previous president, Turbay (1978-1982), had not succeeded in curbing the growth of guerrilla violence or drug-related crimes. But, it had greatly increased the power and influence of the armed forces and further eroded the legitimacy of the regime among the lower classes. In addition, the military increasingly found itself being drawn into efforts to slow down the expansion of the drug industry (Hartlyn, 1988; Martz, 1997; Bagley, 1984; Archer and Shugart, 1997).
In this context of growing regime crisis, Betancur successfully sought to reach beyond the traditional Conservative support groups to incorporate segments of the urban poor and the working and middle classes by espousing a reform-oriented and somewhat nationalist political and economic program. Though his Liberal rival, López Michelsen, had championed the cause in the presidential campaign, soon after his election Betancur took advantage of the political consensus in favor of a more conciliatory approach to the guerrillas by proposing a general amnesty if they would agree to lay down their arms. Complementing his peace initiative, Betancur proposed a large-scale public housing program targeted particularly at areas of greatest guerrilla activity. Though the constitution required that the Liberals be given an equal role in the cabinet, in an unexpected maneuver, Betancur chose to not negotiate directly with the Liberal Party leadership but to incorporate mainstream and dissident Liberal politicians on an individual basis (Bagley, 1984, Hartlyn, 1988).

Betancur responded to the declining economic situation initially with "heterodox" measures aimed at adjusting the balance of payments and public sector deficits while reactivating the economy. The government carried out a mild fiscal adjustment, imposed stringent import and exchange controls, raised tariffs and export subsidies, increased the rate of currency devaluation, expanded credit to the public sector, and raised real wages. After having declared a state of economic and social emergency the government took steps to increase the state's involvement in the banking sector, including the outright takeover of some banks.

Departing somewhat from this initial gradual approach, Betancur declared a second state of economic emergency toward the end of 1982 in order to enact by decree an important tax reform whose central goals were to reduce tax evasion, to promote savings, and to a lesser degree to raise revenues (Urrutia, 1989; Hartlyn, 1988; Thorp, 1991). Indicative of the continued technocratic orientation of economic policy-making in Colombia, the design of the tax reform...
was principally based on the work of a technical commission formed during the Turbay government. The reform prepared the sales tax for conversion into a VAT by extending it to the retail level, broadening its base, and unifying its rate. It also modernized municipal and department taxes, introduced a new system of presumed income, lowered income tax rates, expanded the use of withholding provisions for the income tax, improved the method for adjusting real estate values for inflation, and increased penalties for tax evasion (Carciofi, Barris, and Cetrángolo, 1994; McClure, 1989; Sardi, 1991).

When the Supreme Court ruled that the decree was unconstitutional (based on the argument that its consequences would have been enduring and not limited to the immediate crisis circumstances), the tax laws being reformed - not just the proposed changes - were suspended. Unable to bypass the Congress, Betancur was forced to negotiate with the Liberal leadership directly and recompose his cabinet. As a consequence of the urgency of restoring the affected tax laws and addressing the short term revenue crisis, and of the fact that some major business complaints were accommodated, sectors of the Liberal party joined a majority of the Conservative legislators in approving the tax reform, which differed little from the original (Urrutia, 1989; Stallings, 1990; Hartlyn, 1988; Hartlyn 1994).

Though the tax reform resulted in a small increase in revenue collection from domestic taxes, total tax revenues remained virtually unchanged due to the fall in foreign trade tax revenues as a result of the world recession and neighboring country trade policies. But, the fiscal deficit continued to increase (to 8% of GDP) because of the expenditure increases required to offset the monetary effect of the drop in international reserves (Economic Survey of Latin America, 1984) (Tables 5.8 and 5.9).

The "heterodox" approach to the economic crisis brought some positive results. The trade balance went into surplus, the inflation rate dropped significantly, the pace of economic
activity increased, and the situation in the financial sector was made more stable. But, despite these apparent improvements, in the middle of 1984 Betancur replaced Gutiérrez Castro as Finance Minister with Roberto Junguito, who was a frequent consultant for the IMF and World Bank and was known to have more orthodox views. With foreign reserves shrinking to a dangerously low level and the fiscal deficit growing, it was clear among some of the president’s more conservative advisors that without a significant change in policy it would be impossible to sustain the level of consumption experienced in the late 1970s.

In keeping with the traditional moderation of economic policy-making in Colombia, Junguito avoided a “shock” adjustment program but turned toward a more orthodox adjustment strategy which more heavily emphasized demand management. The government sharply cut investment and public sector wages, imposed a hiring freeze, raised taxes, and increased the rate of currency devaluation. Junguito persuaded Betancur to get behind the austerity measures despite the fact that they entailed the abandonment of planned social and economic reforms by flexibly addressing his particular objections. The cut in wages was made more palatable to both Betancur and the unions by the fact that it was implemented on a sliding scale. In addition, rather than seeking a formal stand-by agreement with the IMF, which Betancur opposed, Junguito negotiated an “enhanced surveillance accord” by which Colombia received loans from private banks in exchange for stepped up external monitoring of the economy (Hartlyn, 1988; Schloss and Thomas, 1986).

By skillfully arguing before the Congress and the people that the fiscal and external crises were severe, Junguito obtained the support of a majority of the legislators for an additional package of tax measures at the end of 1984. He states in the Memoria of the Finance Ministry that the Congress’ enactment of all of the fiscal measures surprised him at the time and meant that the level of fiscal austerity achieved went beyond the economic ministry’s plans (Thorp.
Revenues were expanded by increasing public sector tariffs, introducing an import tax, extending the VAT to some previously exempted popular consumption goods, and forcing high-income economic agents to invest in public debt securities (Carciofi, Barris, and Cetrángolo, 1994; Sardi, 1991; Economic Survey of Latin America and the Caribbean, 1985).

Though business associations and the labor unions, especially the more militant public sector unions, opposed the tough austerity measures, neither could do much to thwart the government's plans. The labor movement, spearheaded by the leftist Colombian Workers Union Confederation (CSTC), attempted to carry out a general strike in the middle of 1985. But, given the union movement's weakness and internal divisions, the high level of unemployment, and the government's cooption of several union confederations, the effort to launch a general strike failed (Hartlyn, 1988; Londoño Botero, 1989). The unions' structural weakness and the illegality of strikes by public sector workers facilitated the government's ability to restrict the growth of wages in the public and private sectors.

As a result of the relatively orthodox adjustment program, by the March 1986 congressional elections (three months before the presidential elections), the public sector deficit had been cut in half (to under 4% of GDP), the economy was in a sustained recovery, and the already moderate rate of inflation fell slightly. In addition, the resurgence of international coffee prices toward the end of 1985 brought the current account into surplus and practically ended the external crisis. A high and rising level of unemployment (14.2% in 1985), however, detracted from these positive achievements.

But, with the failure of the Betancur administration's peace efforts, the M-19's return to a military strategy (marked by their dramatic takeover of the Palace of Justice), and the increase in the overall level of violence (including by drug traffickers and paramilitary groups), the economy was not the most important issue on the voters' minds. After his party swept the congressional
Barco’s Government: Fiscal Reform in the Absence of Crisis

As a result of this decisive victory, for the first time since the formation of the National Front regime, Barco formed a single party government with the Conservatives fully in the opposition. But, given the high level of factionalism, the governing party’s control of a healthy majority of the legislative seats would not ensure the Barco government’s capacity to implement its agenda. Barco aimed to fight poverty, carry out agrarian reforms, further open up the political system, and continue the dialogue with the guerrillas begun under Betancur. But, Barco continued to view a growing economy with expanding exports as the principal means by which jobs could be created for the ever-increasing urban population and basic needs met. Thus, despite the coffee bonanza and the favorable trade and budgetary balances, Barco insisted on maintaining the restrictive fiscal policies followed during the second half of the Betancur government. Based on the fiscal measures introduced by his predecessor and the coffee-fed economic boom, public sector accounts were balanced by the end of 1986 (Martz, 1997).

The technocratic portrayal of policy-making in Colombia is supported by the fact that even in this context the Barco government proposed a significant tax reform to Congress within months of assuming office. This reform, which was not expected to have a great impact on revenue collection, was aimed primarily at increasing the neutrality and administrative efficiency of the tax system. It entailed measures which would more closely integrate the individual and corporate income taxes and lower their top marginal rates and which would eliminate many exemptions and increase the enforcement rate through increased use of withholding mechanisms and improvements in the tax administration. To offset the possibility that the rate reductions
might temporarily lower tax revenues petroleum profits were to be taxed more heavily (Carciofi, Cetrángolo, and Barris, 1994; Shome, 1995; McLure and Pardo, 1992; McLure, 1992).

Assisted by the skillful lobbying of his finance minister and successor in the presidency, César Gaviria Trujillo, Barco gained Congress’ approval of the reform in early 1987 with modifications which did not alter its essential features and purposes (New York Times, 5/28/90). Contrary to the reputation of legislative bodies in most political systems, Congress decided, against the executive’s wishes, to phase in the reduction in corporate tax rates because of fears of increasing the budget deficit (Gas Daily Risk Monitor, 2/3/87). Despite some additional modifications, according to one international tax policy specialist, the reform left Colombia with “one of the best income taxes of any developing country” (McLure, 1992).

The relatively swift action of the Congress in respect to taxation, however, did not carry over to the President’s social and political reform agenda. Of the 20 or so projects sent to Congress in the government’s first year, only one - a heavily watered down agrarian reform - was approved by the end of 1987 (Martz, 1997). And, while $1 billion was designated for infrastructure improvements and agricultural development projects in rural areas especially affected by guerrilla activity, peasant and community groups complained that little of the money was, in fact, being distributed, and little was being done.

The goals of political decentralization and political liberalization were furthered, however, by the transference of a host of responsibilities, including education and health, from the federal to local governments and the holding of mayoral elections for the first time in 1988. In addition, initiatives for constitutional reform by the executive and some leaders from both parties, and a groundswell of popular support for reform, resulted finally in a “referendum” on constitutional reform and the election of a constituent assembly (in December 1990). A broad goal shared by most of those favoring reform was that of strengthening national level party
organizations vis a vis local party bosses and increasing the scope of democratic participation (Shugart, 1992; Kline, 1996). These changes promised to make policy more responsive to the needs of local constituents but held the risk of complicating the management of public sector finances.

The administration’s goal of increasing expenditures on social services and reducing poverty was undermined by the escalation of violence, which led the government to put greater stress on security spending. The FARC’s resumption of violent actions in 1986 brought the final denouement of the cease fire accord which all of the guerrilla forces had signed with the Betancur government in 1984. The breakdown of the peace process and the unification of all the guerrilla forces in the Simon Bolivar Coordinadora increased the frequency of guerrilla attacks. At the same time, paramilitary groups, who many observers suspected of having close links with the armed forces and the police as well as the drug traffickers, stepped up their killings of peasant organizers, labor leaders and activists, leftist politicians, and journalists. In addition, the government’s crackdown on drug traffickers, including the commitment to extradite indicted criminals to the United States, provoked an extremely violent response, including the murder of scores of elected officials, judges, journalists, and politicians (including three of the candidates for the presidency in 1990).

Even with the increased expenditures on national security and foreign debt servicing, the Barco government maintained the budget roughly in balance (Economic Survey of Latin America and the Caribbean, 1987 and 1988; Martz, 1997). Revenues increased as a consequence of the 1986 tax reform, which increased the efficiency of tax collection, and adjustments in public service rates and fuel prices.

Labor organizations, which for the first time united in a single, non-partisan, national union confederation - the Central Unitaria de Trabajadores (CUT), in early 1987 organized
national strikes and protest actions against the fall in real wages, the layoffs of public sector employees, and the increases in fuel prices. However, the effectiveness of the labor movement was still undermined by organizational weaknesses (including the low level of unionization), the continued political loyalty of the rank and file to the mainstream political parties, restrictive union laws, and the president’s ability to suspend strikes or annul the legal status of unions using state-of-seige powers (Londoño Botero, 1989; Collier and Collier, 1991; Kline, 1996). In addition, union organization and activism were discouraged by the high level of unemployment and the murder of many labor leaders and workers by death squads and, in some cases, allegedly by the military (Andean Group Report, 1/29/87).

Thus, the Barco government carried out a significant reform of the tax system and managed to restrict the growth of government spending by limiting the growth of public sector wages, cutting back on public investment, and instituting a hiring freeze. This fiscal restraint enabled the government, despite the prevalence of violence and the breakdown of the state’s authority in other areas, to maintain a relatively balanced budget and contributed to its ability to keep inflation under control and the economy growing. But, like most other Latin American democratic governments during the 1980s, the Barco administration did not proceed very far in restructuring the public sector or liberalizing the economy. However, just a few months before leaving office Barco started Colombia down this road with the unexpected announcement of a five year plan to liberalize foreign trade and the immediate elimination of many rules affecting foreign investment (Latin American Monitor, 4/90).

Restructuring the Public Sector and Liberalizing the Economy under Gaviria

Before the 1990 presidential elections, the Liberal Party reunited after the party’s defeat in the Bogotá mayoral election in 1988 convinced the party chiefs to accept Galán - a long-time
critic of the clientelist party structure - as a presidential candidate and to allow an open
presidential primary (Kline, 1996; Martz, 1997). When Galán was assassinated by drug
traffickers in August 1989, his followers announced their support for César Gaviria Trujillo, who
was viewed in a more favorable light by the traditional party leadership. Successfully placing
himself in the political center, Gaviria won the party’s first presidential primary election by a
decisive margin in March 1990 and then handily defeated the two Conservative Party candidates
Liberals also prevailed in the Congressional and mayoral elections, while the Conservative share
of the vote shrunk to a new low.

The Colombian electorate, which following an executive ploy to circumvent the
Congress and constitutional obstacles to reform was given a chance to vote for or against the
convening of a Constituent Assembly, overwhelmingly chose the former option. In a clear
indication of the voters’ disenchantment with the existing political system, the M-19 received the
most votes for any single list (27%) and gained 19 out of 64 seats in the Constituent Assembly.
In July 1991, the Assembly adopted a new constitution which established the direct election of
department governors and the selection of Senators from a single national district and abolished
the pork-barrel funds (called auxilios) guaranteed to each legislator. In addition, the reform
limited the “state of siege” powers of the president, prohibited congressmen from holding other
elective positions or being absent for extended periods of time, provided voters with new rights to
call ballot initiatives and recall legislators, and established an independent Central Bank (Kline.
governors were elected under these rules in October 1991.

Given his commitment to power-sharing and his desire to allow broader participation in
decision-making, Gaviria appointed a multi-party cabinet in which each of the important factions
of the two major parties as well as the M-19 were represented. Despite the inclusive character of
the cabinet and his more consultative approach to decision-making, in the first several months of
his term Gaviria embarked on an ambitious agenda of neoliberal economic reforms, including a
more far-reaching liberalization of trade and investment, public sector reform, and tax reform.
But, Gaviria also proposed a national development plan - called the “Peaceful Revolution” in
which $6 billion was to be invested in education, water, and health sanitation in order to improve
the conditions of the poor (Martz, 1997; Economic Survey of Latin America, 1991, 1992; Latin

In part, the Gaviria government decided to accelerate the process of economic
liberalization in order to curb the rate of inflation, which had increased in 1990 to its highest level
since the early 1960s (33%) (Table 5.10). Though not a major contributor to the increase in
inflationary pressures, the fiscal deficit had grown in the first part of 1990 as a result of the
continued war against drug traffickers and the guerrillas and the large losses recorded by state-
But, in a fashion customary for Colombia, the Gaviria administration immediately responded to
these developments by reducing expenditures. In addition, it gained the congress’ approval for a
tax reform which increased the VAT rate from 10% to 12%, extended the VAT’s coverage to
many services, and eliminated the capital gains tax on the sale of stocks (Urrutia, 1994; Latin

When the government decided to accelerate the pace of trade liberalization from a five-
year schedule to a single year it proposed another tax reform in order to compensate for the lost
revenues (Latin American Monitor, 9/91). Again the government preferred to focus the tax
increase on the VAT by raising its rate and extending its base - this time to professional services.
In addition, the Gaviria government sought to induce more foreign investment by decreasing the
dividend remittance tax for foreign companies. Despite the strong opposition of nearly all private sector organizations, the Congress approved the tax increase after nearly seven months of debate. But, citing the VAT's regressiveness, the legislature decided to increase the VAT by less than the government planned (only to 14%) and to raise corporate income tax rates instead. Given the lack of discipline within the Liberal Party, the income tax increase was approved by a combination of Liberal and M-19 congressmen. The increase in the VAT was approved by some of the Liberal legislators in coalition with the Andres Pastrana wing of the Conservative Party, which favored trade liberalization. Against the government's wishes, the Congress also increased taxes on oil exports and kept the dividend remittance tax for foreign companies the same (Urrutia, 1994: Latin American Monitor, 2/92, 7/92). As a consequence of these tax reforms and continued budgetary austerity, the budget deficit was eliminated in 1991 and a surplus was obtained in 1992 and 1993 (Table 5.11, 5.12). As a consequence of the fiscal performance, the conservative monetary policies of the now independent central bank, and the trade liberalization, inflation was reduced and the economy recovered fairly strongly after 1991 (Table 5.14).

Despite the fact that his popularity plummeted in 1992 because of the severe electricity shortage, the escape of drug kingpin Pablo Escobar from a luxurious prison, and the breakdown of talks with the remaining guerrilla organizations, Gaviria continued pushing for the adoption of free market and public sector reforms. A portion of the communications industry was opened to private competitors and the state railway, port network, many state banks, and several businesses in the energy and mining sector were privatized. In addition, numerous state agencies were eliminated and public sector jobs were cut. In order to solve its deepening crisis, the social security system was partially privatized (Latin American Monitor, 2/94; 3/94). Though public sector reforms were slowed by technical and bureaucratic obstacles as well as opposition by
militant unionists (particularly in the case of the state telephone company), few reforms were blocked altogether.

Thus, among the Latin American countries governed by democratically elected presidents there is little doubt that Colombia adjusted the most smoothly to the external shocks of the early 1980s. Though the country faced serious budgetary and balance of payments deficits in the early 1980s, the Betancur government acted fairly quickly and prevented a large surge in the inflation rate or a severe recession. This outcome can be explained partly by the long tradition of moderate, technocratic economic decision-making inherited from the period of coalitional rule. But, the party system, in which two clientelistic “catch-all” parties monopolized power and maintained the loyalties of the vast majority of the electorate, undergirded this pattern of decision-making. In Colombia’s system politicians generally do not build a popular following or advance in the party’s leadership hierarchy by resorting to class-based or programmatic appeals. Instead, individual politicians ensure their political success by maintaining a steady expansion of patronage resources either by supporting a sustained increase in the revenue pie or by building strong connections with the local or regional political bosses. The clientelistic two-party system, combined with the unitary system of government and a powerful presidency, appears to have contributed to the relative absence of populist political movements and the conservatism of fiscal policy in Colombia. Given the tight grip of the parties on their clienteles, populist policies stood to gain the governing party little support at the cost of inflation (which would alienate party followers and support for the political regime) and a long term loss in patronage resources. But, complementing the incentives following from the party structure, congressmen and regional politicians were limited in the their discretionary powers over the public sector budget because of the unitary system of government (with appointed department governors and mayors) and the strong powers of the president over the budget and tax policy. In addition, the time horizon of
presidents was relatively long since their parties did not face midterm congressional elections and
did not face gubernatorial or mayoral elections until 1988 and 1991, respectively. Economic
policy was also less subject to pressures from unions, since they were weak, not closely tied with
either political party, and public sector workers were not permitted to go on strike. At the same
time, business organizations were generally not very effective in pushing their demands since
they were, for the most part, not united in national confederations and did not have strong ties
with most politicians (Urrutia, 1989).

Brazil: Delayed Fiscal Adjustment and Public Sector Reform

Though the Sarney government enjoyed the potential initial advantages associated with
an economy in recovery, trade surpluses sufficiently large to service the huge foreign debt, and
comparatively modest budget deficits, by the end of its five-year term the inflation rate had spun
out of control, the fiscal crisis had deepened dramatically, and the economy had plunged into a
deep recession. In the context of an economic crisis closely approaching the magnitude of that
faced by Menem in Argentina, the Brazilian public initially granted elected president Fernando
Collor de Mello (1990-92) a similar degree of freedom to impose harsh economic medicine.
However, in stark contrast with Menem, Collor failed to squelch inflationary pressures or
implement significant fiscal reforms before he was impeached on charges of flagrant corruption
in December 1992. Vice President Itamar Franco (1992-94), who replaced the ousted president,
at first loosened controls over spending, backtracked on public sector reforms, and allowed the
budget deficit and inflation rate to expand appreciably. But, a new stabilization program
launched by Fernando Henrique Cardoso, Franco’s finance minister and victorious candidate in
the 1994 presidential election, finally succeeded in slowing inflation. Though the Cardoso
administration (1995-) has succeeded in keeping inflation at low levels, in spurring economic
growth, and in privatizing many important state enterprises, Congress continued to block key
public sector reforms, including public administration, social security, and tax reform. Without
such reforms a more stable and enduring solution to the state’s financial difficulties was still not
achieved.

The Institutional Structure and the Legacy of the Authoritarian Regime

Before the recent transition to civilian rule in 1985, Brazil’s experience with democracy
was quite limited. Even during the fairly liberal and democratic period from 1946 to 1964,
democracy was limited by military interference in politics, continued restrictions on voter
eligibility, and the proscription of the Communist Party. The Getúlio Vargas dictatorship from
1937 to 1945 and the military-backed authoritarian regime from 1964 to 1985 each had far-
reaching and enduring effects on the country’s institutional development (Skidmore, 1967; Roett,

Partly as a consequence of the late expansion of citizenship, the federalist character of
the political system, and the limited experience with fully competitive elections, mass political
parties (which emerged for the first time in 1945) were weakly organized, ideologically
heterogeneous, decentralized, and clientelistic. Given the fact that Vargas did not attempt to
mobilize popular sector political support or create a political party (until the end of his regime),
the Estado Novo regime left a less polarized legacy in the party system than was the case in
Argentina. But, the party system’s weakness and fragmentation allowed for an increasing level
of polarization under Goulart’s populist leadership and contributed to the breakdown of
democracy in 1964. The non-programmatic and undisciplined character of the political parties
enabled the military leaders to impose a new party system composed of a pro-government party
(the National Renovating Alliance (ARENA)) and an official opposition party (the Democratic
Brazilian Movement (MDB)), to keep a politically enfeebled Congress functioning, and to hold regime-regulated elections for non-executive posts. As Scott Mainwaring points out, by abolishing the previously existing parties and by denying the Congress a serious legislative function, the military "encouraged the formation of parties and politicians whose main function was obtaining patronage for their constituencies" (Mainwaring, 1995).

Thus in the New Republic (1985-) the party system tended toward increased fragmentation and, with the exception of the Worker's Party (PT) and the Democratic Workers Party (PDT) on the left, the parties remained undisciplined and ideologically heterogeneous. The structure of the party system greatly complicated the task of forming and maintaining stable, or even ad hoc, legislative coalitions to enact critical economic reform measures (Mainwaring, 1997; Sola, 1994; Lamounier, 1994).

But, the task of building legislative support for fiscal adjustment and reform policies was made that much more difficult by the federalist political and fiscal structure. Given the weak and decentralized nature of the catchall political parties, the political power of governors and mayors (who beginning in 1982 were again directly elected), and the overrepresentation of underdeveloped and lightly populated states, state and local interests have great prominence at the national level. The federalist nature of the political system thus accentuated the factionalism and lack of discipline of political parties in the national congress and entailed a still greater fragmentation of the political system. In order to enact important legislation presidents must construct coalitions that not only cut across several faction-ridden parties but also which encompass the demands of local politicians from multiple and socio-economically diverse regions. In this context of strong federalism and a weak party system, the goals of fiscal and monetary restraint conflict with the pork-barrel practices required to build congressional coalitions. Such a context also makes it more difficult for the national government to extend the
adjustment process to the local and state levels (Mainwaring, 1997; Hagopian, 1996; Lamounier, 1994; Power, 1991; Campello de Souza, 1989). However, the 1988 constitutional reform complicated matters further by increasing the share of nationally collected revenues allocated to the states and municipalities (without increasing their responsibilities), reducing the tax-raising powers of the federal government, and limiting the ability of the government to lay off public sector workers (Shah, 1991; Bruneau, 1992; Baer, 1995).

The difficulties of governing in this institutional context encouraged presidents to try to circumvent the parties and the congress through the use of exceptional constitutional powers. Until the promulgation of the constitutional reform in October 1988, Sarney could bypass Congress through the use of the decree powers specified in the authoritarian constitution of 1967. According to this constitution, by executive decree the government could enact laws that would take effect immediately and stay in effect unless the Congress (within 60 days) explicitly voted to overturn the decree. The 1988 constitution also allowed the president to enact laws through "provisional measures" as long as they met the criteria of "urgency and relevance". These measures were equivalent to laws but if the Congress did not approve them within 30 days they would expire. However, Sarney and his successors were quick to take advantage of the fact that the constitution did not explicitly prohibit "provisional measures" from being reissued in the case that they were not approved by Congress and the fact that the legislature did not enforce the requirement that a true situation of emergency exist (Power, 1994; Mainwaring, 1997).

In addition, under the new constitution the president was granted the power to fully and partially veto legislation approved by the Congress. The weak and factionalized character of the parties and the poor attendance records of legislators made it difficult, in practice, for opponents to obtain the absolute majority necessary to override a presidential veto. In relating with the fragmented legislature the president was assisted by two other provisions of the 1988
constitution. On the one hand, he could declare a bill "urgent", thus obligating the Congress to act upon it within forty-five days. On the other hand, if the legislature failed to approve the budget on time, the executive's proposed budget automatically went into effect on a month-by-month basis. Thus, to offset their minority status in the Congress, Brazilian presidents could take advantage of constitutional powers which Shugart and Carey (1992) determined were exceeded by only one of 43 democracies which they studied (Mainwaring, 1997).

The 1988 constitution also transformed the rubber stamp Congress of the 1967 authoritarian constitution into a formally more powerful institution. The new constitution now gave Congress the power to amend the budget (i.e., to reallocate expenditures) and its approval was now required for all debt agreements. However, the legislative branch was not permitted to change the total level of expenditures specified in the executive's budget proposal or to initiate legislation in regard to numerous public policy areas (Bruneau, 1992; Mainwaring, 1997).

The Vargas regime, which established very restrictive labor laws and heavily repressed existing leftist and autonomous unions, left as one of its legacies a weak, fragmented, and financially dependent labor movement. Though the military re-imposed the strict limits on the rights of labor unions to organize and strike contained in the Estado Novo labor code, during the political opening of the late 1970s a new, more autonomous union movement formed which was closely affiliated with the newly founded PT and the PDT (Moreira Alves, 1989; Keck, 1989). The power of the unions in affecting real wage levels and governmental economic decisions, however, was still limited by the relatively low level of unionization, divisions among unions, and continued legal restrictions. Before the adoption of the 1988 constitutional reform and the enactment of necessary supplemental legislation (in June 1989), the labor code still prohibited most strikes and provided few job security guarantees for striking workers (Tavares de Almeida, 1993; Hunter, 1996; Moreira Alves, 1989). Thus, while not as great an obstacle to fiscal
adjustment as the Argentine union movement (and its Peronist party allies), the labor movement in Brazil was more influential than that in Colombia.

The legacy of the authoritarian regime and the nature of the democratic transition imposed significant constraints on policy-making during the Sarney administration. First, Sarney, who in March 1985 became the first civilian president after 21 years of authoritarian rule, was not popularly elected as were the first post-military regime presidents in Argentina and Uruguay. Rather, Sarney came to the presidency as a consequence of the sudden death of Tancredo Neves - the consensual presidential candidate of the democratic opposition, who himself was elected by an electoral college in which a majority of the seats were held by members of the pro-military Social Democratic Party (PDS). Moderate leaders of the Brazilian Democratic Movement Party (PMDB) and the Liberal Front Party (PFL) had selected the former president of the PDS as the opposition's vice presidential nominee in order to ensure Tancredo Neves' victory over Paulo Maluf, the regime's candidate. The president's weak claim to rule certainly restricted his capacity and will to implement tough adjustment policies and controversial fiscal reforms.

Second, the capacity of the military to control the pace of the transition enabled it to retain a substantial political presence and influence in the first years of the new democracy (Stepan, 1988; Linz and Stepan, 1996; Share and Mainwaring, 1986). The continued weight of the military in policy-making limited the scope of redistributive reforms, restricted the size of potential cuts in the defense budget, and influenced the process of constitutional reform. In addition, the military used its continued clout to force the government to take a stronger stance against union strike activity (Hunter, 1996; Moreira Alves, 1989). However, Sarney's political weakness and vulnerability to military pressures was aggravated by his lack of democratic legitimacy and credibility.
In addition, the relatively institutionalized nature of the military regime brought considerable pressure for a reform of the constitution - not just the restoration of the 1946 constitution (Bruneau, 1992; Lamounier, 1994). The process of electing a new Congress (and Constituent Assembly) and the prolonged deliberation about the rules of the future democratic system (in respect to such crucial issues as the length of Sarney’s and future presidents’ term of office), definitely reduced the possibility that the Sarney government or legislators would support more aggressive fiscal restraints.

Given the perceived success of the Brazilian military regime’s state-led industrialization policies, there was a broader and deeper consensus in Brazil among political and economic elites about the continued desirability of a large state role in the economy than in Argentina or Uruguay (Bresser Pereira, 1994; Sola, 1994). On the other hand, the prolonged mobilization of the democratic opposition against the military regime and its exclusionary economic policies produced a strong expectation that democracy would bring a greater emphasis on income redistribution and a more equitable sharing of the costs of anti-inflationary policy. Thus, in Brazil it likely took longer for a coalition of political and business elites to emerge which favored a major overhaul of the post-war development policies.

The Sarney Government

Sarney assumed the presidency in March 1985 beginning from a position of political weakness. Not only did he lack an electoral mandate and national stature as a politician, the party to which he was most closely allied - the PFL - held only 15% of the legislative seats. Formally Sarney was a member of the PMDB since he had to change party membership in order to be named Tancredo Neves’ vice presidential candidate. Though the PMDB held 40% of the seats in the new Congress, its extreme heterogeneity and weak discipline and Sarney’s weak reputation
among its members meant that this would not be of great help (Lamounier and Lisboa Bacha, 1994; Mainwaring, 1995).

After three years of external adjustment under the IMF-supervised austerity program applied by the government of General João Baptista Figueiredo (1979-1985), the economy began a fairly strong export-led recovery in 1984. Though Brazil had the largest foreign debt in the region in absolute terms, given the surge in the volume of exports it had become possible to service the debt without endangering the stockpile of foreign currency reserves. As a result of cuts in public investment and public sector wages, the fiscal deficit declined from about 8% in 1980-82 to 4% in 1983-84. Inflation, however, had accelerated from an annual rate of 94% in 1982 to 197% in 1984 (Baer, 1990; Cardoso and Fishlow, 1989) (Tables 5.13 and 5.14).

The transition to civilian rule brought increased claims on state resources to satisfy societal demands for improved public services and increased wages and politicians' appetite for patronage resources. Increased expenditures on public sector salaries and on transfers to the states and municipalities widened the fiscal deficit and increased the inflation rate (Economic Survey of Latin America, 1985; Baer, 1990). Sarney's cabinet, which had been appointed by Tancredo Neves and designed to represent the wide diversity of opinions among the forces supporting the democratic transition, was initially sharply divided over economic strategy. Finance minister Francisco Dornelles favored a relatively orthodox approach that would prioritize the fight against inflation and the budget deficit even at the expense of short-term economic growth. But, planning minister João Sayad, who was closely linked to the leftist wing of the PMDB and shared its developmentalist orientation, supported a more nationalistic approach to the foreign debt and a stronger emphasis on economic growth. Finally, in August 1985 the policy drift resulting from this stalemate was ended when Sarney replaced Dornelles with Dilson Funaro, a São Paulo industrialist. Funaro immediately broke off negotiations with the IMF and
adopted more expansionary monetary policies, which spurred consumer demand and brought the inflation rate at the end of 1985 to near 400% (Kaufman, 1990; Coes, 1995; Economic Survey of Latin America, 1985; Sola, 1991).

Like their counterparts in Argentina, the team of advisors surrounding Funaro had developed a diagnosis of Brazilian inflation that placed great emphasis on “inertial” factors related to the pervasive indexation of prices in the economy. The apparent success of the Austral Plan convinced them of the practicality and effectiveness of such an approach. In preparation for the forthcoming heterodox shock plan, the government obtained the reluctant support of Congress for a tax reform. It included measures to reduce the permeability of the income tax to inflation-induced losses, increases in tax rates on upper income brackets, a 40% tax on profits from financial investments, and steps to curb tax evasion.

At the end of February Samey implemented the heterodox Cruzado Plan by decree. Closely resembling the Austral Plan in its basic design and in the mode of its implementation, the Cruzado Plan imposed a wage and price freeze, eliminated most forms of indexation, and created a new currency. But, relative to the Austral Plan it put a higher priority on promoting short-term economic growth and redistributive objectives. Before the wage-price freeze was put into effect the real wage was increased by 8% and public tariffs and key consumer prices were frozen at relatively low levels. In addition, workers were guaranteed automatic wage adjustments at any point when prices increased twenty percent.

The Sarney government’s choice to adopt a stabilization program which put so little emphasis on getting the “fundamentals” right and which transferred income to workers can be explained in large part by Sarney’s weak political standing. The progressive wing of the PMDB - led in the Congress by Chamber of Deputies President Ulysses Guimarães – had recently joined the chorus of opposition to the government led by Lula da Silva’s Workers Party (PT) and Leonel
Brizola's Democratic Workers Party (PDT). Given his weak democratic credentials and limited base of party and societal support, Sarney was more inclined to listen to the advice of those advocating a more growth-oriented approach to economic adjustment (Lamounier and Lisboa Bacha, 1994; Sola, 1991; Fleischer, 1990). The approach of the all-important congressional (and constituent assembly) elections and the strong societal pressures for more equitable economic policies also dissuaded the government from initially taking tougher actions in controlling consumption and hindered it from making mid-course corrections later in the year (Bresser Pereira, 1991 and 1994; Sola, 1991). In addition, as Robert Kaufman points out, the large absolute size of the foreign debt and Brazil's relatively strong external position made it possible for the Sarney government to adopt a stabilization plan that did not have the blessing of the IMF (Kaufman, 1990).

Just like the Austral Plan, the Brazilian stabilization plan was highly successful initially in stopping inflation, which because of the price freeze quickly dropped to near zero. In contrast with conventional approaches to economic stabilization, the Cruzado Plan achieved this price reduction without slowing down the already dynamic economy, which grew 7.9% in 1985 and continued at 7.5% in 1986. Not unexpectedly, the stabilization of prices and the boom in consumption produced a sharp upswing in public approval for President Sarney and temporarily smoothed the relations between the executive and the PMDB legislative delegation (Lamounier and Lisboa Bacha, 1994; Fleischer, 1990).

But, much earlier than was the case for the Austral Plan, the extent of unsatisfied consumer demand and the magnitude of relative price distortions was revealed by rationing and the pervasiveness of black market trading. In addition, the budget situation deteriorated as a result of the increase in real public sector wages, the lag in public utilities prices, and the disappointing yield of the December 1985 tax reform (Cardoso and Fishlow, 1989) (Table 5.15).
Thus, already by May 1986 some of Sarney’s economic advisors were pushing for adjustments in the level of prices and for tighter fiscal and monetary policies. But, given the great popularity of the price freeze, the mixed messages coming from members of the economic team, and the approaching congressional elections, Sarney rejected any major revisions in the economic plan. With a thin basis of party support in the Congress, Sarney did not want to impair the prospects of the PMDB and the PFL in the elections for the constituent assembly (and congress), which would be empowered to define the length of the presidential term and the scope of presidential power. The dangers of tampering with the plan were exacerbated by the provision which specified that wages would be increased automatically every time cumulated inflation reached 20% (Kaufman, 1990; Lamounier and Lisboa Bacha, 1994).

Though the Cruzado’s plans weaknesses were becoming manifest, the continued low rates of inflation and strong economic growth brought a massive victory by the PMDB and the PFL in the November elections. The PMDB won the governorships in twenty-two out of twenty-three states and obtained an absolute majority in both the Lower House and the Senate. But, the wide diversity of opinions represented under the PMDB label and the extreme lack of party discipline meant that this majority was only helpful to Sarney to the extent that he remained popular (Fleischer, 1990).

After having successfully hidden the severity of economic distortions being caused by the Cruzado Plan, six days after the elections Sarney announced dramatic changes. The prices of several key goods and public utility services were increased by a wide margin, the crawling peg exchange rate system was restored, and financial contracts were again indexed to inflation. Cruzado II allowed a rapid acceleration of the inflation rate and Brazil was forced to unilaterally suspend foreign debt interest payments (Cardoso and Fishlow, 1989; Coes, 1995). As a consequence of the collapse of the economic program and outrage at the cynical electoral
manipulation of the economy, Sarney’s popularity plummeted and his relations with the PMDB in Congress became more stormy.

In order to pull the economy back from the precipice of hyperinflation, Funaro’s replacement, Luiz Carlos Bresser Pereira, implemented a new stabilization plan which called for another short term wage/price freeze and a serious attempt to reduce the fiscal deficit and tighten the money supply. As a part of this plan, the Central Bank was barred from financing the budget deficit and expenditures by all governmental departments were limited to the level of revenue receipts (Baer, 1995; Coes, 1995). A significant devaluation of the currency was intended to restore the trade surplus and put Brazil in a better position to begin talks with the IMF.

Though this plan succeeded temporarily in reducing the inflation rate, its success was limited by Sarney’s decision to give in to striking public sector workers’ salary demands and the inability of the government to exert greater control over public spending (Baer, 1995; Coes, 1995). Bresser Pereira failed to receive the support of Sarney for tighter controls of the public purse or for the deeper fiscal reforms he proposed in November 1987. Sarney’s preoccupation was with holding together a coalition of conservative and machine politicians from the PMDB, PFL, and PDS (the Centrão, or Big Center) and maintaining the support of the armed forces so that he could hold onto his five year term. However, this support was obtained only at the cost of substantial concessions in respect to policy (i.e., less fiscal austerity) and a large amount of resources and jobs. Pressured by nine of the most important business groups, Sarney and conservative-leaning congressmen refused to support Bresser Pereira’s plan to raise taxes. This led to Bresser Pereira’s resignation in December 1987 (Bresser Pereira, 1994).

The new finance minister, Mailson Ferreira da Nóbrega, decided to act within the constraints imposed by the Sarney government’s political weakness. Rather than seeking to implement structural reforms or shock therapies, he centered the adjustment effort on modest
fiscal controls. But, given Sarney’s lack of influence with powerful state governors and national legislators, even many of these mild measures failed to be implemented and the so-called “rice with beans” approach allowed inflation to accelerate to unprecedented levels by the end of 1988 (Fleischer, 1990; Baer, 1995; Coes, 1995).

Though with much arm-twisting Sarney was able to win the crucial votes on the length of the presidential term and on the scope of presidential powers, in respect to economic and social issues the constitution (ratified in October 1988) incorporated many of the demands of nationalist and left-wing legislators. Revealing his total isolation and lack of credibility, Sarney’s warnings on national television that the (draft) constitution would make Brazil ungovernable, if anything, widened the margin of the final vote on the first draft (403 to 13) (Roett, 1989; Hunter, 1996).

The new constitution restored most of Congress’ pre-1964 powers, provided organized labor with extensive freedoms to organize and strike, and dramatically changed the federal fiscal structure. It also hindered future public sector reform efforts by restricting the possibilities for privatizing certain economic activities, circumscribing foreign investment in mining and other industries; preventing the government from laying off public employees with more than two years of service, and setting a floor for pension payments (Coes, 1995; Mainwaring, 1997; Baer, 1995).

In order to prevent an Argentine-style slide into hyperinflation, in the beginning of 1989 Mailson Nóbrega imposed another wage and price freeze and introduced a new currency. Despite huge increases in public sector tariffs and promises to dramatically pare down the size of the public administration, the failure of previous heterodox plans and the high level of political uncertainty undermined the credibility of the so-called “Summer Package” from the start. As a lame duck and very unpopular president Sarney unsurprisingly could not obtain congressional support for proposed layoffs of public employees and privatizations of state enterprises during a presidential election year (1989). In addition, the labor movement, recently empowered by
expanded constitutional rights and the electoral success of the PDT and PT (in the 1988 municipal elections), adopted a more confrontational strategy and fueled the distributive struggle (Roett and Tollefson, 1990). By the date of the inauguration of the next president in March 1990 the monthly rate of inflation reached a record 81%.

Given the recent electoral success of Brizola’s PDT and Luis “Lula” Ignácio da Silva’s PT there was much speculation about the possible victory of a leftist candidate. But, the meteoric rise of an obscure, young governor from the small, poor, northeastern state of Alagoas diffused this possibility. On the basis of a populist style campaign which attacked corruption by government and legislative officials, overpaid and under-worked state workers, and the clientelistic practices by the parties in Congress, Fernando Collor de Mello decisively won the first round of the presidential election over 22 other candidates. Then, he narrowly defeated Lula in the highly polarized run-off election.

Collor and the Fragility of an Organizationally Thin Base of Political Support

Though portraying himself as a political outsider, Collor came from a family with strong roots in the traditional political oligarchy. Collor himself had served in the ARENA and PDS parties during the military regime and switched only in 1986 to the PMDB. For the purpose of the election campaign he formed a new party - the Party of National Reconstruction (PRN) – which held only 4% of the congressional seats when Collor assumed office. In keeping with his plebiscitarian style and his denunciation of traditional politicians, Collor selected his cabinet without consulting with any of the political parties and refused the endorsement of established forces, including groups such as the powerful Federação das Indústrias do Estado de São Paulo (FIESP) which offered their backing. Due to his populist and arrogant political style most
conservatives distrusted Collor and supported him only to ensure the defeat of Lula who they feared more (Mainwaring, 1995 and 1997; Schneider, 1991; Weyland, 1993).

Similar to the case of Menem in Argentina, runaway inflation and successive failures of economic policies throughout the 1980s generated expectations that drastic measures would be necessary and gave the new government considerable initial political leeway. In addition, as the clear winner in the first round, and with the broad mandate generated by the runoff election, Collor began his term with the approval of 71% of the population - a sharp contrast with the initial position of Sarney (Mainwaring, 1997; Schneider, 1991). However, since Brazil did not experience full-fledged hyperinflation, Brazilian society and politicians were probably not prepared in the same way as Argentines were for draconian adjustment measures (Sarles, 1995).

Seeking to capitalize on this political opportunity, Collor introduced a harsh adjustment plan to attack inflation and announced plans to carry out public sector reforms. In keeping with previous plans, a temporary wage and price freeze was imposed and a new currency - the Cruzeiro - was introduced. But, the most audacious measure, which was intended to drastically contract the money supply, was the freezing of all transactions and savings accounts exceeding US$ 1300 (at the then prevailing exchange rate). In addition, “Collor I” imposed an extraordinary, once-and-for-all tax on financial transactions (IOF), established the immediate indexation of all taxes, took steps to reduce tax evasion, eliminated several types of fiscal subsidies, and raised public sector tariffs. The government also announced its plans to eliminate many government agencies, to lay off 360,000 public sector workers, to liberalize the exchange rate, reduce trade barriers, and carry out privatizations (Baer, 1995). Despite the severity of these measures, polls showed high levels of popular approval for Collor and the economic plan.

In order to avoid having to negotiate with Congress and to maintain the element of surprise, Collor implemented the plan through the use of provisional measures. Drawing upon
the mandate conferred by 31 million voters Collor used his decree authority frequently (a record 37 times in his first 60 days) in order to implement most major policies in the first year. Despite his brazen attitude toward legislators and his lack of strong political allies, Congress approved the provisional measures mostly because the Plan was viewed as a fait accompli and because many members received promises of high level public sector jobs for themselves and other benefits for their constituents (Mainwaring, 1997). But, already in May 1990, when his standing among the general public was still relatively high, Collor lost a key battle with Congress over the pace of wage adjustments.

The freeze on bank accounts and the fiscal austerity measures led initially to a drastic slowdown in production, distribution and sales throughout the economy and a sharp reduction in the inflation rate, which fell from over 80% per month to single digits. But, within a month a rapid process of remonetization began as a consequence of pressure from socioeconomic groups that led to the release of many blocked financial assets ahead of schedule. In addition, the windfall gain in tax revenues received by state and local treasuries (as a consequence of the taxpayers' ability to pay taxes using frozen deposits) was used for political purposes in the run-up to the congressional elections (to be held in October 1990) (Moura, 1993; Baer, 1990). Thus, after the initial collapse of economic activity, the economy rebounded somewhat in the middle of the year and the inflation rate climbed to 12% to 15% per month.

The government achieved its goal of transforming the fiscal deficit (previously at 8% of GDP) into a surplus. But, this was achieved mostly through artificial or temporary measures. Partly because of its desire to avoid becoming embroiled in long policy debates in Congress the government did not attempt to carry out more fundamental fiscal reforms. At the same time, though succeeding in demoralizing and lowering the efficiency of the public administration, the plan to eliminate 30% of the public sector workforce from each government agency did not reach
its objectives in budgetary savings. Barriers imposed by the 1988 constitution and the government's weak influence in Congress resulted in only one third of the projected cuts being made (Schneider, 1991).

The October 1990 elections served only to aggravate Collor's difficulties in relating to the Congress and regional centers of political power. Though Collor's "flash" party expanded its share of the seats from 4% to about 8%, the October 1990 elections resulted in an even more fragmented Congress and federalist political structure. Twenty parties received representation in the Congress and candidates from nine different parties won the governors' races (Mainwaring, 1995). The defeat of Collor's favored gubernatorial candidates meant that his influence with the governors, who generally controlled their state congressional delegations, would be even less.

With the local governments in control over a larger share of total public sector spending their behavior played a more critical role in determining the success of fiscal adjustment efforts.

With inflation reaching 20% per month and the economy mired in a serious recession, finance minister Zélia Cardoso de Mello unveiled a second stabilization plan in January 1991 which was also imposed by decree. This plan applied new wage and price controls, large increases in publicly administered prices, new fiscal austerity measures, and instituted a "reference interest rate" (Coes, 1995; Flynn, 1993). With eroding popular support (down to 23% in March 1991) and increasing dismay in Congress about the president's imperious style, the government decided to negotiate several key aspects of the plan. In the process the plan was diluted significantly and the inflation rate slowed only briefly. At the same time, the effort at conciliation did not earn Collor much sympathy with legislators, who came within a whisker of obtaining the three-fifths majority necessary to pass a constitutional amendment prohibiting the president from reissuing decrees when they are not explicitly approved by Congress. This warning signal to the president, however, persuaded Collor to refrain from reissuing the many

Of the structural economic reforms proposed by the Collor government, trade liberalization - which pertained to an area of policy almost exclusively under the authority of the executive - proceeded the furthest, with tariff levels being reduced significantly. The privatization program proposed in the first months of the administration did not reach its final formulation until the middle of 1991 and the first sale - of a large steel company - was not completed until October 1991. However, by the end of 1992 several steel, petrochemical, machinery and other enterprises were sold. The privatization of public companies was slowed in part by the 1988 constitution, which limited the extent of foreign capital participation and required public ownership in monopolistic economic sectors. However, the strong opposition of the CUT and cartels of suppliers, and delays by the Congress dragged the process considerably. In addition, the constant scandals which plagued the government and the lack of societal participation in the formulation of the program negated the efforts of the economic team to project an image of transparency and equity. Only $4 billion out of a projected $25 billion was raised by the end of the second year of the program (Flynn, 1993; Sola, 1994; Sarles, 1995).

With government revenues 65% lower than the preceding year and the fiscal deficit expanding, toward the end of 1991 the Collor government submitted to Congress a tax reform which would raise income tax rates, eliminate many deductions and exemptions, abolish many minor taxes, and improve the tax administration. But, only by agreeing to roll over the large debt that state and local governments owed the federal government and by granting other concessions was a much more limited emergency fiscal reform approved by the Congress (Baer, 1995: Mainwaring, 1997). Proposals for constitutional amendments to eliminate several of the constitutional obstacles to public sector reforms never came up for a congressional vote because
of Collor’s eroding base of support and the growing corruption scandals surrounding the
government beginning in April 1992 (Coes, 1995).

After he was accused of having personally profited from an extensive influence-peddling
scheme by his brother in May 1992, Collor sacrificed all efforts to contain the budget deficit to
the goal of delaying his impeachment (Mainwaring, 1997). Despite these efforts to save himself,
with the public angrily demanding his impeachment, the Chamber of Deputies suspended
Collor’s presidential powers in September 1992 and the Senate removed him from office in
December (Weyland, 1993).

Clearly the government’s involvement in flagrant acts of corruption did not help the
cause of implementing fundamental fiscal reforms or stabilizing the economy. But, before the
public revelations of the president’s brother, popular support for the government had already
practically vanished and the topic of impeachment was regularly brought up in Congress. While
the Menem government was also beleaguered by serious corruption charges and the failure of its
initial economic plans, it weathered these difficulties and eventually pushed through far-reaching
economic reforms and stabilized the economy. And, even though Menem implemented many
policies by decree he did not face the same backlash in the Congress and in society.

The central difference between the two cases is that Menem’s political influence rested
not just on his popularity among the voters but was supported by the backing of a strong and
cohesive political party (with an effective majority in Congress and great strength in the
provinces) and by the strong historic ties between his party and the union movement. By
contrast, Collor obviously was not associated with a strong party organization, lacked party
support in the Congress, and faced a labor movement that was autonomous from the government
and tied to leftist parties firmly in the political opposition. Aside from his weak institutional base
of political support, Collor also faced the considerable obstacles presented by the 1988
constitution, which meant that supra-majorities were required to implement many types of reforms. While it is doubtful, given these institutional impediments, that any Brazilian leader could have restructured the economy and public sector to the extent that Menem did in Argentina, it is also true that Collor’s unwillingness to negotiate with the Congress and his failure to build alliances with parties and socioeconomic groups certainly contributed to the problems he had in advancing his reform agenda.

Working With the Congress: Franco and Cardoso Gradually Break the Impasse

Vice-President Itamar Franco replaced Collor in what appeared to be inauspicious circumstances for tackling the country’s deep fiscal and economic crises. Similar to Sarney, Franco lacked electoral legitimacy and popularity and was also steeped in the nationalist and statist tradition shared by many other Brazilian politicians. But, after the disastrous governments of Sarney and Collor, political elites were initially committed to ensuring the governability of the system. Given his lack of broad-based popular support, Franco sought to build support in the Congress by enlarging the cabinet and filling it with ministers from parties across the political spectrum (Sarles, 1995; Mainwaring, 1997).

The Franco government was ineffective initially in curbing inflation or reviving the economy. No clear plan for economic policy was developed as a consequence of the turmoil within the cabinet resulting from conflicts between Franco, who was more concerned about promoting economic growth, and his finance ministers who emphasized the need to fight inflation. Reflecting this lack of government cohesiveness, within the first eight months three finance ministers resigned. Franco, who as Vice President opposed the Collor government’s first major sale of a public corporation, temporarily halted the privatization program in order to root
out corruption and to establish some means to protect workers who might lose their jobs (Financial Times, 4/27/93; Bresser Pereira, 1996).

The government made some efforts to contain the public sector deficit, which was swelling as a consequence of pervasive tax evasion (estimated at between US$ 40 billion and US$ 70 billion), the uncontrolled spending and accumulating arrears of state and local governments, and constitutionally-mandated increases in social security payments. In March 1993, after lengthy negotiations with all of the parties in Congress and the governors, Franco obtained final legislative approval for the creation of a new tax on financial transactions. But, as was customary, this support was obtained only after the president agreed to direct a large part of the expected revenues toward new social programs, to remove the proposals to set up special tax tribunals, to waive the confidentiality of bank accounts, and to establish two additional taxes on fuel and corporate assets (Financial Times, 1/20/93, 3/12/93; Flynn, 1993). However, even this relatively modest step forward was partially reversed later in the year when the Supreme Court ruled that this tax could not be implemented until the following year (Latin American Economy and Business, 10/93).

Finally, with inflation surpassing 30% per month, increased coherence and competence was brought to the economic team by the May 1993 appointment of Fernando Henrique Cardoso as Franco's fourth finance minister. Capitalizing on the growing consensus that inflation (and the fiscal pressures underlying it) had to be brought under control, Cardoso launched the "Immediate Action Plan," which was the first phase of a comprehensive anti-inflationary strategy. In this first phase Cardoso aimed to cut federal government spending, tighten tax collection, rein in spending by state and local governments, control the loose credit policies of state banks, and speed up the privatization of state enterprises. But, while some progress was made in reducing tax evasion, the opposition of legislators and governors and negative Supreme Court rulings prevented
Cardoso from making great progress in respect to the other goals. Another package of tax measures was gutted by the Congress in early 1994 leaving only a few items.

As a consequence, in order to achieve the balanced budget required to implement the second phase of the stabilization program - the implementation of a U.S.-dollar-pegged money index (the Unit of Real Value (URV)) - Cardoso was faced with the necessity of gaining congressional approval for the "emergency social fund". This fund would amend the constitution in order to temporarily (until December 1995) divert to the treasury 15% of the resources transferred to the states and municipalities. Partly because of the corruption scandals afflicting the Congress and its low public esteem, Congress assented to the passage of this emergency fund despite the forceful opposition of state governors and the inauspicious political climate in the months before the October presidential and legislative elections. With the fiscal situation temporarily under control, the government was free to go ahead with the URV in March 1994 and then the introduction of the new currency - the Real - in July 1994 (Bresser Pereira, 1996; Rocca, 1995: Latin American Weekly Reports, 2/17/94, 3/10/94)

Unlike its many predecessors, this stabilization plan proved to be highly successful. The inflation rate, which neared 50% per month by the time the Real was introduced, quickly dropped to under 2% per month. In addition, the economy, which had been growing since the middle of 1993, continued at a strong pace. Thrilled about the sudden turnaround of the country's economic prospects, in October 1994 the Brazilian electorate rewarded Cardoso with a landslide victory in the presidential elections over Lula, who had been leading in the polls several months before (Lins da Silva, 1995). In addition, the parties comprising the broad political alliance crafted by Cardoso prior to the elections also won a large share of the seats in Congress, thus providing the new president with a stronger base of legislative support than his predecessors.
Cardoso wasted no time in putting forth a full agenda of constitutional reforms necessary to reform the tax system, social security system, and public administration and to accelerate and expand the scope of the privatization program. In marked contrast with Collor's approach, however, he promised to carry out changes gradually and through consensus (Latin American Monitor, 2/95). Drawing upon his strong electoral mandate and the more robust consensus among politicians in favor of structural economic reforms, Cardoso gained congressional approval for several tax measures, constitutional reforms (ending discrimination against foreign investors and permitting private ownership in monopolistic economic sectors), and an extensive number of privatizations. He also succeeded in controlling the credit practices of some state banks and in de-indexing wage increases. Given the failure of Collor and Franco to carry out any of these actions or to stabilize the economy, these were remarkable achievements. But, because of continued difficulties in building consensus among the many parties in the Congress and among the governors, by July 1997 he still had not been able to win congressional support for constitutional amendments on administrative reform, tax reform, and social security reform. In addition, gaining congressional approval for tough fiscal measures continued to require the dispersal of resources and patronage, which tended to reduce the net improvement in the fiscal picture (Mainwaring, 1997; Latin American Monitor, 7/95; 2/96; 7/97; Financial Times 3/25/96, 3/30/96). As a consequence, the Real Plan's great achievements - the defeat of inflation and the generation of economic growth - remain on a fairly weak foundation.

Given the substantial institutional obstacles which were seen to have impeded fiscal adjustment and reform during the Sarney and Collor administrations, it is puzzling that with little apparent change along these dimensions Cardoso has been able to roughly balance the fiscal accounts, stabilize the economy, and carry out significant reforms. Clearly, with important public sector reforms being held up by congress, the high level of fragmentation of the political system
can still be seen as a major factor hindering the consolidation of the economic program. But, the progress that Cardoso has made still by far surpasses the achievements of Sarney, Collor, and Franco. Cardoso was better able to overcome these institutional obstacles as a result of his extensive electoral mandate, broader base of party support in the Congress, the stronger consensus among political elites and the general public in support of structural economic reforms, and the extreme sense of crisis that pervaded Brazil shortly before the introduction of the Plano Real. But, aside from these more auspicious circumstances for reform, Cardoso's success was facilitated by his strong leadership qualities and his competent team of ministers. Not only was he able to articulate a clear vision of his plans and cultivate public backing for reform, but he forged political alliances in the Congress by demonstrating a willingness to negotiate and compromise while being willing to utilize his influence and resources to twist votes in his favor.

Conclusion

In general terms the cases analyzed in this chapter support the political institutional approach advanced in this dissertation. The structure of party systems, the degree of centralization of governmental authority, the extensiveness of presidential powers, and the scope and security of a president's electoral mandate influenced the ability of governments to enact fiscal adjustment measures and control the fiscal behavior of subordinate levels of government. Aside from its affect on the capacity of governments to command majorities in the legislature, the structure of the party system also affected the extent to which inter-party cooperation was possible.

The fact that Brazilian governments were the least successful in implementing public sector reforms and balancing the fiscal accounts has much to do with the high level of fragmentation of the political system, both in terms of the party system and in terms of the
divisions in power and fiscal responsibilities between the central government and the states and municipalities. The high level of party system fragmentation meant that the governing party never controlled close to a majority of the legislative seats. But, even Cardoso, who nominally enjoys the support of several parties, which together control a majority of the seats, still has difficulty pooling together majorities because of the extreme lack of party discipline and the strong pull of regional interests in the Congress. This high level of fragmentation produced multiple access points for business and labor groups to exert pressure and thwart fiscal reforms and adjustment measures.

By contrast, the Colombian party system, with two factionalized catch-all parties, tended to facilitate cooperation in respect to economic policy-making and allowed the government to put together legislative coalitions in support of important fiscal and public sector reforms. The implications of the party system were reinforced by the experience of the National Front, which institutionalized a cooperative relationship between the parties. The unitary structure of government (until the late 1980s) meant that regional fiscal and political pressures did not seriously undermine the adjustment program of the central government or impede the process of building congressional support for fiscal reforms. The constitutional division of powers between the executive and the legislature also provided the means for Colombian governments to maintain control over public spending.

With the emergence of the Broad Front, the Uruguayan party system had become moderately polarized and fragmented. But, the overwhelming endorsement of the political center by the electorate in the 1984 elections and the non-programmatic character of the two traditional parties facilitated considerable cooperation in respect to adjustment policy-making. The Broad Front’s heterogeneous character and the double simultaneous vote electoral system discouraged a sharpening of differences over the fiscal adjustment program. Under this system, a politician’s
(the party faction's) success is determined mostly by the extent to which he (it) can successfully distinguish himself (itself) from competing politicians (factions) within the same party. Thus, it is unlikely for parties as a whole to conflict sharply over policy and legislative compromises cutting across parties are easier to forge. The negotiated nature of the democratic transition also contributed to the relative moderation of inter-party relations during the Sanguinetti government. At the same time, the high level of party factionalism and the moderately fragmented nature of the party system impeded the possibility of building congressional coalitions in support of reforms, such as pension and public administration reform, which entailed great costs for large and well-organized constituents. As clearly revealed by the privatization and pension reform efforts during the Lacalle government, the right of citizens to legislate by popular referenda also contributed to the relatively slow progress in implementing public sector reforms.

In Argentina the impact of the party system and the federalist fiscal structure was mediated importantly by the scope of the president's electoral mandate. In the context of a relatively polarized two party system, Alfonsin was heavily disadvantaged by the Radical party's minority status in the Senate and in the provincial governments. Given the cohesive and forceful opposition of the Peronist party, every fiscal measure passed by Congress entailed concessions to the Peronists and/or to provincial interests. And, by inflaming public debate over economic policy, the Peronists raised the costs for the Alfonsin government of implementing fiscal adjustment measures. By contrast, with practical majorities in both houses of Congress and control over the majority of the provincial governments, the Menem government could take advantage of the high level of discipline within his own party to control the legislative agenda and to gradually force some adjustments upon the provincial governments.

The examination of these cases also supports the notion that the influence of labor and business interests on policy-making depends critically on the institutional setting as well as on
how these interests are organized and how their organizations relate to the party system. This
was demonstrated most clearly in the examination of the Argentine case. Given the close ties
between the Peronist party and the union movement, and the stronger position of the Peronist
party in the Congress, the Menem government’s adjustment efforts were less compromised by
labor union pressures than was the case for the Alfonsin government. Even though the Menem
government’s adjustment measures and public sector reforms were far more ambitious and
imposed far greater costs on workers, the reaction of labor unions, taken together, was more
subdued. Part of this difference may be attributable to the deepening of the economic crisis and
the increased insecurity of employment. But, it is also clear that strong links between Peronism
and the labor movement gave Menem considerable resources with which to diffuse the unions’
reaction to his policies.

In Uruguay and Colombia unions were not as influential since the level of unionization
was much lower than in the Argentine case and since the unions lacked the additional clout
associated with being closely tied (in terms of shared memberships and identities) with the major
political parties. In the Colombian case union influence was also deterred by presidential state of
siege powers and the prohibition on strikes by public sector workers. In Brazil, an independent
union movement was relatively new and was still subject to repressive actions by the state and
restrictive labor laws during the Sarney government. But, because of effective leadership by
individuals who became serious contenders for high political office and organized political
parties, the union movement gained increasing clout.

In emphasizing the role of these political factors I do not want to dismiss the role played
by changed public perceptions about the severity of the economic crisis and the constraints
imposed by the external environment. After the demise of Alfonsin’s economic program and the
hyperinflation there was certainly a broader consensus in society behind the need for dramatic
changes in economic policy, which markedly changed how Menem's free market reforms were received. A similar evolution of perspective towards the economy occurred in Brazil after the failure of the Cruzado Plan and the eruption of high inflation. And, it could be argued that Uruguay's relatively lackluster progress in the area of public sector reform during the early 1990s, in part resulted from the absence of obvious signs of crisis. But, as the Brazilian case shows, even a profound crisis does not necessarily provide the means for governments to implement and sustain sweeping economic reforms. In addition, public financial crises and runaway inflation can be avoided altogether — as in Uruguay and Colombia — when the political structure permits a consensus to be reached about how the burden of fiscal adjustment should be shared.
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Table 5.1: Changes in Key Economic Variables in Uruguay, 1984-1990

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Table 5.2: Revenues and Expenditures of the Consolidated Public Sector: Uruguay 1984-1990 (As a Percent of GDP)

Source: Adapted from Table 3 (p. 13) in Jorge E. Roldós (1993).
Table 5.3: Revenues of the Consolidate Central Government: Uruguay 1984-1990. (As a percent of GDP).

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Source: Adapted from Table 27 in Roldós (1993). p. 56.
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<td>2.2</td>
<td>4.8</td>
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<td>21.2</td>
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<td>14.4</td>
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Table 5.4: Changes in Key Economic Variables in Uruguay, 1989-1995.

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<td>30.66</td>
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Table 5.5: Revenues and Expenditures of the Consolidated Central Government: Uruguay, 1988-1995 (As a Percent of GDP).

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Table 5.6: Revenues of the Consolidated Central Government: Uruguay 1988-1995
(As a Percent of GDP)

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<td>19.8</td>
<td>16.1</td>
<td>24.0</td>
<td>18.9</td>
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<td>29.1</td>
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<td>Interest Due/Exports</td>
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<td>26.7</td>
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<td>28.9</td>
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<td>20.5</td>
<td>20.7</td>
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<td>19.0</td>
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Table 5.7: Changes in Key Economic Variables in Colombia, 1981-1990.

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Table 5.8: Revenues and Expenditures of the Consolidated Public Sector Colombia, 1981-1988 (As a Percent of GDP).

Source: Adapted from Table 2 in Sardi (1991; p. 15).
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Table 5.9: Revenues of the Consolidated Central Government: Colombia, 1981-1989
(As a Percent of GDP)

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Table 5.10: Changes in Key Economic Variables in Colombia, 1989-1995.

Table 5.11: Revenues and Expenditures of the Consolidated Central Government: Colombia, 1988-1994 (As a Percent of GDP).

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Table 5.12: Revenues of the Consolidated Central Government: Colombia 1985-1994
(As a Percent of GDP)

Table 5.13: Changes in Key Economic Variables in Brazil, 1984-1995.

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<td>-0.8</td>
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<td>5.7</td>
<td>4.2</td>
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<td>125</td>
<td>233</td>
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<td>1289</td>
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<td>2149</td>
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Table 5.14: Revenues and Expenditures of the Consolidated Central Government: Brazil, 1984-1993 (As a Percent of GDP).

### Table 5.15: Revenues of the Consolidated Central Government: Brazil, 1984-1993
(As a Percent of GDP)

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<td>3.96</td>
<td>5.32</td>
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<td>7.08</td>
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CHAPTER SIX

POLITICAL INSTITUTIONS AND THE PROBLEM OF FORGING AND SUSTAINING A CONSENSUS FOR FISCAL REFORM

Latin American countries face new, daunting challenges as the new millennium approaches. While the inflationary crises of the 1980s appear largely to have been overcome, now they must set their sights on reforming public sector institutions so that they can efficiently provide the social, regulatory, and legal functions and services essential to sustainable economic growth and social progress. This dissertation has examined the question of what factors affect the willingness and ability of governments to absorb the heavy and uneven social costs associated with the implementation of fiscal reforms – the essential ingredient of successful responses to the main challenge of the 1980s. But, it is likely that the lessons drawn from the analysis of this experience will also be applicable to the next stage of reforms, which share some of the principal characteristics of fiscal and liberal economic reforms. Just as with the broad macroeconomic reforms, the costs of institutional reforms tend to be concentrated (probably to an even greater extent) on organized societal groups and active societal support tends to be very limited. Given the fact that the implementation of these second stage reforms will necessarily involve a wider range of state and private actors and will take longer (Naim, 1995), it is likely that the political institutional factors emphasized in this dissertation will be even more important.

In this dissertation, the plausibility of several hypotheses for explaining the variation in governmental progress with fiscal reform and adjustment has been examined. A supposition advanced both by casual observers and serious academic researchers is that in some countries a
severe economic crisis must be experienced before the social stalemate blocking the adoption of sound fiscal policies can be overcome. To some extent, the examination of the Argentine, Uruguayan, Colombian, and Brazilian cases confirms this view. In Argentina the policy approach of the Alfonsin government and the opinions of the Radical party and broader public clearly evolved toward greater orthodoxy as the crisis continued and deepened. And, after the traumatic experience with hyperinflation there were few who did not accept the fact that dramatic policy changes were essential to save the country and its economy. As Argentina’s economic minister, Domingo Cavallo, asserted on numerous occasions, this experience made it possible for him to propose, and to gain sufficient acceptance for, policy reforms which were unimaginable only a short time before.

In Brazil a similar evolution of opinion among politicians, socio-economic groups, and the general public can be observed. The collapse of Sarney’s Cruzado Plan and the sharp acceleration of inflation broadened the political space for Collor’s initially popular, though harsh, adjustment program. Similarly, there is little doubt that Cardoso’s success in implementing the fiscal reforms critical to the Real Plan was facilitated by the imminent threat of hyperinflation and the prolonged nature of Brazil’s economic crisis. The importance of the economic crisis variable is also indicated by the fact that structural reforms were rarely implemented by the first governments to confront the debt crisis.

But, the cases examined in this study also show that the political institutional setting plays a critical intervening role in determining how governments, in effect, respond to economic crises. As economic conditions become sufficiently onerous all governments would eventually be forced to adopt economic reforms. What must be explained is why some governments adopt reforms preemptively so that their countries escape the serious general welfare losses associated with high inflation and deep economic recessions. I argue that the Betancur government in
Colombia and the Sanguinetti government in Uruguay were able to avoid such large losses because of political factors, including the structure of their party systems, the strong control of the central government over public sector spending and taxation throughout the country, and the exceptional powers of the president over budgetary matters. On the other hand, the Alfonsín and Sarney governments were unable to adopt fiscal reforms sufficient to prevent a further deterioration of the crisis despite strong signals that such reforms were necessary. And, while the hyperinflation facilitated Menem’s adjustment and reform efforts, this was not a necessary or sufficient condition for his success. As the experience of Collor de Mello illustrates, without the sturdy support of a political party or other types of organizations, the breathing room provided by such crises is ethereal. Once the immediate crisis dissipates politicians and interest groups return to their normal mode of behavior and popular support becomes more contingent upon concrete achievements in improving economic conditions. In fact, an experience with very high or hyperinflation cuts both ways since it also raises the social costs and the level of fiscal discipline and policy consistency required for inflation to be permanently lowered and the government’s credibility to be restored.

Though recently moved from the center stage of explanations of economic policymaking, international economic and political pressures have also been hypothesized as influencing the nature and scope of the policy changes that have occurred in Latin America in the 1980s and 1990s. According to this view, the more dependent a country is on external financial support, foreign investment, and favorable international price trends, the more likely it is to succumb to the policy demands of external creditors and international financial institutions. The importance of the influence of external forces is supported by the universality of the trend toward more conservative fiscal management and free markets across the region. The Menem government was only one of several examples of populist party-led governments that sought to
implement liberal economic reforms and to adopt more stringent fiscal policies. Clearly, large debt servicing burdens, the policy conditionality attached to foreign credit and debt forgiveness, and the need to attract foreign investment heavily constrained Argentine and other governments' policy choices. Menem's decision to betray past Peronist dogma and resolutely attack the fiscal deficit through far-reaching tax and public sector reforms was no doubt influenced by the country's desperate need for external credit and foreign investment and the need to improve its tarnished international credit reputation.

Though external factors were highly constraining, the variation in the timing and scope of fiscal reforms across the region indicates that they were not determinant. Both the policy formulation and implementation processes were mediated importantly by political institutional and other political factors. This is clearly illustrated in the contrasting policy choices and outcomes among the cases examined in this study. Though the external constraints confronting the Alfonsin, Sarney, and Sanguinetti governments were roughly similar, the Sanguinetti government stands out in terms of the relative speed of its response and its comparative success in managing the country's public financial crisis. At the same time, the Betancur government (in Colombia) responded in a fairly expeditious manner to a mounting fiscal deficit even though the country's external crisis never approached the magnitude of that faced by Argentine, Brazilian, or Uruguayan governments. Barco continued the fiscal conservatism followed by Betancur even though the external crisis had largely been solved and his government faced minimal external pressures to adopt such policies. Sharply contrasting outcomes also characterized the Menem, Collor, and Lacalle governments despite the continued similarity in their external economic situation.

External forces were still less influential in respect to the particular policy instruments which governments chose to adopt in response to the public sector financial crisis. For example,
the Alfonsín government devised the Austral Plan, and the tax reform that accompanied it, independent from the IMF and creditor governments, and then submitted it for their approval. The Austral Plan's emphasis on price and income controls and the tax reform's redistributive aims clearly contradicted the preferences of the IMF and the U.S. government. By contrast, the Menem government appeared to go out of its way in economic and foreign policy to please the most influential international actors. But, this deliberate cultivation of favor was not a direct product of international pressures. Rather, it was a strategic decision made possible, in part, by Menem's strong political position in respect to the Congress and the unions. Thus, it is best to view the international economic environment as one set of factors shaping the incentive structure confronting elected politicians, rather than as directly determining policy choices and outcomes.

A related hypothesis is that structural changes in the international system, including the increased mobility of financial capital and the sudden reversal of capital flows, contributed to an increase in the relative power of the more internationalized and monopolistic sectors of business and forced a change toward more orthodox and free market policies. According to the view of some Argentine scholars, the asserted shift in the balance of power among domestic social classes was also fed by the traumatic economic events of the late 1970s and early 1980s. The dramatic opening to foreign competition (resulting from currency overvaluation), followed by the mass exodus of capital and the sharp rise in the cost of credit, caused many of the weaker and less competitive industries and financial enterprises to go bankrupt. At the same time that inwardly-oriented businesses shrunk in number and influence, the state became more dependent upon the foreign currency earnings and production provided by internationally-oriented industrial, financial, and agricultural conglomerates (Peralta Ramos, 1992; Azpiazu, Basualdo, and Khavisse, 1986).
This kind of social class explanation would appear to have some merit given Menem’s betrayal of his past policy positions and his explicit alliance with Bunge and Born and Peronism’s traditional enemies on the economic liberal right. It could be argued that the country’s desperate financial position and requirement for foreign exchange gave Menem no choice but to turn to the now dominant economic groups, who were given representation in the government in exchange for their much-needed dollars. And, it might be argued that the weakening of local, import-competing industries and the recession-induced decline in labor’s power facilitated the implementation of a tough adjustment program and liberal economic reforms.

While it may be true that there was a long term shift in the effective economic and political power of these different socio-economic groups, it is improbable that this alone could have resulted in such large differences in outcomes between the Alfonsin and Menem governments which were separated by only a short interval of time. On the basis of a purely social class explanation it is impossible to explain why organized labor paralyzed the Alfonsin government’s relatively mild stabilization policies and economic reforms with general strikes and protests while it reacted much more passively to the far more costly reforms launched by the Menem government. Similarly it is hard to understand why business group opposition was so intense and so effective in blocking key fiscal reforms during the Alfonsin government, but was not as formidable an obstacle during the Menem government.

The experience with hyperinflation certainly contributed to the change in the response and policy influence of business and labor groups. But, the close links between the Peronist party and the union movement meant that when Menem assumed office union leaders were faced with stronger incentives to cooperate with the government in respect to wage settlements and to refrain from launching major protests against proposed economic reforms. Menem’s command of a disciplined party with a practical majority in both houses of Congress and a substantial presence
in the provinces gave such groups less opportunity to exert influence. Menem’s stronger political position and the experience with hyperinflation enabled him to adopt an aggressive and consistent stance in respect to the fiscal deficit, economic deregulation, and privatization. In its decisions to center the tax system on the VAT and to temporarily maintain export taxes, the Menem government demonstrated its independence in respect to even its closest business allies and financial backers. Taking advantage of his political power base and constitutionally dubious decree powers, Menem was able, against the wishes of major business groups, to close tax loopholes, to implement more invasive techniques for collecting taxes, and to more aggressively punish tax evaders. The government’s consistent stance in respect to reducing the fiscal deficit and deregulating the economy, and the ultimately successful defeat of inflation, helped him to maintain the general support of business, despite the great harm caused to some by fiscal adjustment measures and free market reforms. By contrast, given its initial adventure in economic populism, its wavering commitment to fiscal, wage, and monetary discipline, and its limited efforts to reduce state interference in the market, the Alfonsin government never secured the trust of business groups. And, because of their allegiance to the Peronist opposition, the unions created a much greater impediment to the Alfonsin government’s stabilization and public sector reform efforts.

The intervening role played by political institutional factors is also evident when comparisons are made with the other three cases. The analysis of the experience of the Sarney, Collor, Franco, and Cardoso governments in Brazil shows recurring instances in which fiscal reforms were blocked by the congress due to strong pressures by business groups. Business group influence in the Brazilian Congress was enhanced by the highly fragmented nature of the party system and the extreme lack of party discipline. Since staying in office depends more on expanding one’s capacity to dole out financial and other benefits to constituents than on serving
the ideas or political goals of the party. Brazilian legislators are highly subject to the influence of lobbyists. By contrast, the more cohesive party system, the National Front’s legacy of inter-party cooperation and executive-centered decision-making, and the unitary system of government helped limit the influence of business and labor groups in the Colombian case. Similarly, the moderately polarized and relatively cohesive party system, and the strong powers of the executive in respect to the formulation of the budget, limited the influence of business groups in Uruguay.

Thus, I have argued that domestic economic circumstances, international economic and political pressures, and interest group pressures are best seen as environmental factors which affect the calculations of politicians about the political costs and benefits of supporting fiscal adjustment measures and reforms rather than as direct determinants of policies. Political institutional and other more contingent political factors play a critical mediating role by structuring the incentives faced by governing politicians and by affecting the chances for building and sustaining a pro-reform coalition.

One of the key institutional factors which was observed to affect the timing of significant efforts at fiscal adjustment and reform is the structure of party systems. The degree of fragmentation and polarization of party systems affects the capacity of the executive to build and sustain a coalition in Congress behind fiscal reform and the nature of the incentives flowing from inter-party electoral competition. But the impact of the party system structure on the executive’s ability to control the legislative agenda depends upon the extent of the president’s and the governing party’s electoral mandate and the security of the government’s tenure in office. The government’s sense of the security of its mandate is affected by the imminence of mid-term congressional elections, electoral defeats, or threats presented by the military or guerrilla forces.
In Argentina, the party system inherited by Alfonsin was fairly cohesive (two major parties at the national level) but polarized between the Radicals and the Peronists. The electoral success of the Peronists in the over-represented provinces prevented Alfonsin’s overall popular mandate from providing his party control of both houses of Congress or a large share of the regional governments. But, given the Alfonsin government’s lack of a majority in Congress, one of the key factors deterring a deeper fiscal adjustment was the relatively high level of polarization between the parties and the high level of party discipline. In this context not only was cooperation between the parties in regard to economic policy highly unlikely. The Peronist party’s forceful advocacy of a populist and nationalistic approach to the foreign debt and inflation raised the political stakes for Alfonsin and the Radicals of pursuing a tough fiscal adjustment.

The competitive bidding between the Peronists and the Radicals was that much more relevant to policy-making given the occurrence of midterm congressional and gubernatorial elections twice during Alfonsin’s six year term and the steady increase in civil-military tensions.

However, when Menem and the Peronists captured the presidency, a near majority in both houses of Congress, and the majority of the provincial governments, the cohesiveness of the party system and the internal discipline of the parties enhanced the possibilities for sustaining a coalition in favor of reform. Now there was a stronger guarantee that the government’s emphasis on fiscal austerity would be followed through and would deliver the expected economic and political payoffs. Instead of the sharply antagonistic opposition faced by Alfonsín, Menem confronted an opposition party that was divided and generally sympathetic toward the objective of economic stabilization and liberal economic reform. Given the hierarchical nature of the Peronist Party and the cohesive character of the party system, there was less opportunity for business groups and regional interests to influence the decision-making process. Menem’s
freedom for maneuver in managing the economic crisis was also enhanced by the settlement of the human rights issue and the defeat of the rebellious faction within the military.

In Uruguay the relatively cohesive and moderately polarized party system was seen to have facilitated fiscal adjustment under the Sanguinetti government but to have slowed the process of enacting more comprehensive fiscal reforms. The centrist and catch-all nature of the Colorado and the Blancos, which was reinforced by elections under the double simultaneous vote electoral system, contributed to the consensual style of policy-making in respect to budgetary and tax decisions. The disposition to compromise on the part of the two traditional parties was also encouraged by the negotiated nature of the democratic transition and the electoral competition from the Broad Front. At the same time, given the consensus among most politicians of the two traditional parties that there would not be prosecutions for human rights violations committed during the military government, the Sanguinetti government did not have to face serious threats from the military. However, the factionalized character of the two major parties and the moderate level of party system fragmentation hindered the process of enacting more fundamental public sector reforms, such as the reduction of the extremely large public administration, the rationalization of the costly pension system, and the privatization of state companies.

Similarly, the dominance of two long-standing and moderate political parties in Colombia allowed a smoother adaptation to its comparatively mild fiscal and external crisis. The absence of populist political forces meant that none of the Colombian governments faced strong electoral pressures to loosen control over the budget or to avoid tax increases. The tradition of coalition rule inherited from the National Front regime also encouraged a fairly technocratic and executive-centered process of economic policy-making. In both the Uruguayan and Colombian cases, the absence of mid-term congressional elections also lengthened the time horizons of
presidents and congressional politicians, thereby increasing the incentives for them to support reforms whose costs are experienced immediately and whose benefits come in the medium term.

By contrast, Brazil's highly fragmented and relatively polarized party system strongly undermined the prospects for readily solving the state's fiscal crisis. The large number of parties and the parties' lack of internal discipline provided multiple access points for socio-economic groups and regional political interests and made it very difficult for presidents to hold together coalitions in support of fiscal adjustment and reform. Strong electoral competition from the social democratic and populist left at times deterred more centrist politicians from supporting stronger controls over the budget. Of course, the occurrence of mid-term elections - including the November 1986 congressional and Constituent Assembly elections - narrowed the time horizon considered by presidents in making their policy choices.

But, the pace of fiscal adjustment was also affected by the extent of the president's constitutional powers and the degree of centralization of governmental authority. For instance, presidents in Uruguay and Colombia were bolstered by constitutional provisions which permitted them to autonomously determine key components of the budget, such as public sector salaries (in the Uruguayan case), and to overturn legislative spending initiatives. Alfonsin lacked this same degree of authority over budgetary matters in Argentina. The Brazilian and Colombian constitutions each explicitly permitted the president to enact legislation by decree, though these powers were more extensive, in practice, in the Brazilian case. In Uruguay the president could not make laws by decree but could exert control over the legislative agenda by tagging a bill as urgent. The Argentine constitution did not explicitly allow decrees under normal circumstances but its vagueness and the weakness of the Supreme Court, in practice, allowed presidents to use decree authority extensively.
What the examination of these cases shows, however, is that presidential decree power cannot fully substitute for power based in party and organizational support. Decree power gave Sarney and Collor initially the capacity to speed up the decision-making process and to exert greater control over the legislative agenda, but, in the end, the Congress effectively retracted this authority or rendered it ineffective. On the other hand, for a president with ample party support, such as Menem, decree power turned the Congress at times into an ancillary decision-making body.

Progress in balancing the accounts of the public sector and carrying out fiscal reforms was also significantly affected by the unitary or federal structure of the government and fiscal system. In the case of Uruguay and Colombia, which had more centralized governmental and fiscal systems, there were smaller pressures from subordinate levels of government for increased spending and the legislative process was less subject to fiscal demands from regional politicians. Given the highly fragmented nature of the Brazilian party system and the overrepresentation of less populous states, the federalist political structure resulted in the strong influence of regional politicians in the national congress, which greatly complicated the task of building coalitions in favor of fiscal reforms. In addition, the fiscal federal structure, in which local governments have considerable autonomy in making spending decisions but are reliant upon the central government for a large share of their revenues, gave subordinate governments little incentive to limit their spending and exacerbated the fiscal crisis. The similarly structured federalist system in Argentina also greatly weakened the control of the central government over a large fraction of the public sector accounts, especially during the Alfonsín government. With his party’s strong position in the Congress and the provinces and the enactment of a more explicit revenue sharing system prior to his assumption of power, Menem was able to gain some control over the spending by provincial governments and force them to initiate public sector reforms.
Institutional factors connected with the political system were not the only ones which affected the differences in the timing, pace, and scope of fiscal adjustment and reforms across the region. Another important factor was the organizational structure of the union movement and its ties to the party system. For example, in Colombia the unions were particularly weak, public sector workers were forbidden to strike, and the right to strike for other workers could be curtailed under a state of siege. Thus, Colombian governments had a freer hand in controlling the growth of wages and were less constrained by union pressures in carrying out public sector reforms. The Uruguayan union movement was stronger than that in Colombia but sharply divided between the more pragmatic and cautious communists and the more radical unionists and divided in terms of its affiliations to parties on the left. The Broad Front's focus on enhancing its electoral appeal led them to press for restraint by the unions. As argued above, the Argentine union movement's close historical ties with Peronism and great relative strength resulted in a large number of general strikes and constant factory-level strikes which seriously undermined the Alfonsin government's stabilization and public sector reform efforts. Despite imposing much tougher restrictions on wages and implementing much more profound public sector reforms, Menem did not encounter formidable union resistance because of the substantial leverage he enjoyed as the leader of the Peronist party. Though the Brazilian labor movement had become more independent and strong during the course of the long transition to democracy, it remained much weaker than its Argentine counterpart (in terms of membership and resources), and still faced highly restrictive labor legislation during the Sarney government. The labor movement's political clout was enhanced, however, by its representation in the political system through two political parties led by charismatic and popular labor leaders.

This study has shown that in accounting for governmental capacity to implement socially costly economic reforms more attention needs to be paid to the role of political party systems and
other factors affecting the relationship between the executive and the legislature. But, much more work needs to be done in terms of testing the impact of these factors on governmental abilities to control inflation, maintain balanced budgets, and implement economic policy reforms. Now that many Latin American democracies have survived their first decade or more the central hypotheses advanced here should be susceptible to more rigorous empirical analysis. along the lines of existing studies of OECD countries (e.g. Roubini and Sachs, 1989; Alesina and Perotti, 1995; Grilli, Masciandaro, and Tabellini, 1991). One cross-national empirical study of the entire region has been carried out which supports the idea that proportional representation electoral systems, fragmented party systems, and budgetary institutions (including, procedural rules governing the budget’s preparation in the executive, its approval in congress, and its execution) affect the level of fiscal deficits and the size of the public debt (Hausmann and Stein, 1996).

At the same time researchers should be cautious in interpreting and drawing implications from results which indicate a correlation between the structure of party systems and fiscal performance. Given the fact that most of the democracies in the region are so new and are still undergoing dramatic changes, including significant constitutional reforms, it is problematic to treat the party system structure and other political institutional factors as independent variables. Clearly, the processes of reforming the state and the economy are having important effects on the structure of party systems, which are changing otherwise as a consequence of the dynamics of electoral competition. The party system, therefore, is to some extent a product, as well as a cause, of these processes of reform. Thus, research cannot be limited to cross-national quantitative studies but also must necessarily involve more detailed studies which can trace the interactive relationships between the dual processes of democratic institutional change and consolidation and economic adjustment and reform.
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