

**Private Investment Response to Neoliberal Reforms:
Implications of the Argentine Case, 1989-1996**

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Introduction

Warren Christopher, then the U.S. Secretary of State, in visit to Buenos Aires in February 1996 declared that Menem and Cavallo "had done in Argentina one of the great economic successes of the century."¹ This is the official line in Argentina, echoed by fervent supporters of neoliberal economic reforms abroad.

If one only looked at some official statistics on economic growth and investment, one might conclude that economically Argentina is doing wonderfully. Budget deficits have been significantly reduced.² Since April 1991, after the Convertibility Plan, inflation has been kept at low levels. For the period 1990 to 1995, the annual average rate of GDP growth was 5 percent.³ Gross domestic investment grew at an average annual rate of 12 percent between 1990 and 1995.⁴

Yet a sober look at the data on the economic situation in Argentina raises serious doubts as to whether a solid foundation is being build in the country for sustainable economic growth.

The economic growth since 1991 is to a large extent due to the influx of dollars from abroad and to the utilization of idle productive capacity that firms had.⁵ Unemployment and

¹ Clarín, Edición Internacional, February 27 to March 14, 1996, p. 1.

² Budget deficits declined, as a percentage of GDP, from 1991 to 1995, but the estimate for 1996 indicates an increase in the deficit to 2.28 percent of GDP. Data are from table 24 of "Indicadores Macroeconomicos de la Argentina," July-September, 1996, Cepal office in Buenos Aires.

³ "Indicadores Macroeconomicos de la Argentina" July-September, 1996 and national accounts data from the Internet home-page of the Ministry of Economy, Argentina.

⁴ "Indicadores Macroeconomicos de la Argentina" July-September, 1996, table 1.bis.

⁵ Martín Ravazzani, "Cavallo se cura en salud," Clarín, 2 May 1993, International Edition, Economic Supplement, 12; Eduardo

subemployment have been steadily increasing since 1993. In 1996, unemployment was 17 percent and subemployment 12.7 percent.⁶ Moreover, while the domestic production of consumer goods, e.g., automobiles and home appliances, has increased, production of intermediate and capital goods has declined.⁷ With respect to imports, consumer goods exceed capital goods.⁸ Most of the imported capital goods are directed to the service sector, where privatization has taken place.⁹ Cepal found, in a study commissioned by the ministry of economy, that only 7 percent of imports by the industrial sector in 1992 were capital goods.¹⁰

Luis Bonelli, "El ahorro es la base de la fortuna, ¿no?" La Nación, 24 May 1993, International Edition, 6; Clarín, 22 August 1993, International Edition, Economic Supplement, 11. The influx of foreign capital since 1991 has increased the availability of consumer credit, contributing to greater demand.

⁶ Data from table 9 of "Indicadores Macroeconomicos de la Argentina," July-September, 1996.

⁷ Clarín, 22 August 1993, International Edition, Economic Supplement, 10-11; Clarín, 5 December 1993, International Edition, Economic Supplement, 2-3.

⁸ Clarín, 11 April 1993, International Edition, Economic Supplement, 6-7. The definition of "capital goods," used by the Argentine government includes items whose categorization are questionable at best, such as: VCRs, tape recorders, audio equipment, answering machines, and telephones. An analysis of government statistics of imported "capital goods" for the first four months of 1992 and of 1993 estimates that real capital goods were seventeen percent less than what the government reported, and half of the estimated capital goods imported, e.g., trucks, medical equipment, were not for the direct production of goods. Clarín, 28 December 1993, International Edition, Economic Supplement, 4-5.

⁹ Clarín, 5 December 1993, International Edition, Economic Supplement, 2-3.

¹⁰ Martín Ravazzani, "Un toque de realismo," Clarín, 11 July 1993, International Edition, Economic Supplement, 8.

The manufacturing industry share of GDP decreased from 1991 to 1995 while the share of services has increased. Between 1990 and 1995, the average annual growth in the manufacturing industry was 3.6 percent and in water, electricity and gas it was 7.5 percent.¹¹ Growth in the industrial sector since 1991 has been mainly due to the manufacture of automobiles and home appliances. Demand for automobiles and home appliances has significantly increased due to overvaluation of the peso and greater availability of consumer credit.¹²

Contributing to the increase in the service sector share of GDP are financial services and growth in service sectors like water, gas, transport and electricity (where privatization took place).¹³ The increase in financial services is an indication of the large inflow of capital from abroad, in large part repatriated Argentine money, after 1991, when the peso-dollar parity was established. The net movement of capital into Argentina for the period 1991 to 1995 was 34.1 billion dollars.¹⁴

A central question is how this inflow of capital is being used. This question is important because fixed investments is a key determinant of growth. Specially crucial are investments that will be oriented toward production for exports, given the trade deficits that Argentina has experienced after 1991. Between 1992 and 1994, the average annual trade deficit was \$ 4 billion. In

¹¹ Calculated from data in "Indicadores Macroeconomicos de la Argentina," July-September, 1996, table 4.

¹² Bernardo Kosacoff, "La industria argentina: un proceso de reestructuración desarticulada," work presented at the Latin American Studies Association meeting, Atlanta, GA, March 1994, 48-49. The same points are made by economists of business associations; see Clarín, 13 March, 1994, International Edition, Economic Supplement, 6-7.

¹³ From central bank data in Clarín, 2 May 1993, International Edition, Economic Supplement, 6.

¹⁴ "Indicadores Macroeconomicos de la Argentina," July-September 1996, table 22.

1995, there was a trade surplus due to a recession that year.¹⁵ Apparently, the incoming capital has been used primarily in connection with privatization (mostly in the service sector), for the consumption of durable goods and housing, and in financial speculation.

The influx of capital has been pushed into Argentina (as well as into other Latin American countries) by the drop in international interest rates and lured by attractive financial opportunities in Argentina.¹⁶ The amounts of deposits in interest-yielding accounts increased drastically since 1991. From April 1991 to April 1993, peso denominated deposits increased by 7.4 billion and dollar denominated deposits by 9 billion.¹⁷ Financial speculators switch from bank deposits, where interest rates have been comparatively high, to government bonds to dollars, depending on the evolution of yields.¹⁸ According to a study, of the 9.3 billion dollars that entered the country in 1992, 6.5 billion came attracted by high interest rates, 2.3 billion came due to privatization of public firms and only 500 million came as foreign direct investment.¹⁹ A large part of the incoming capital has not given up its exit option, indicating uncertainty about the future. Evidence suggests that financial investments are short-term. As of 1993, more than 90 percent of

¹⁵ National accounts data from the Internet home-page of the Ministry of Economy, Argentina.

¹⁶ For example, in 1992, interest rates in Argentina were about 1 percent a month higher than those for U.S. treasury bonds. Clarín, 23 January 1994, International Edition, Economic Supplement, 8-10. In 1995, the average monthly real interest rate for deposits was 1 percent (Central Bank of Argentina).

¹⁷ La Nación, 31 May 1993, International Edition, 6.

¹⁸ Clarín, 23 to 29 March 1993, International Edition, 9; Clarín, 28 March 1993, International Edition, Economic Supplement, 2-3 and 13; Clarín, 23 May 1993, International Edition, Economic Supplement, 5.

¹⁹ Martín Ravazzani, "El dólar también preocupa a los funcionarios," Clarín, 28 March 1993, International Edition, Economic Supplement, 16.

time deposits in the country were for less than 90 days, and most deposits were for 30 days.²⁰

The private investment response to neoliberal economic reforms during the Menem administrations has not been strong. Entrepreneurs have tended to be reluctant to make major fixed investments in areas where profits do not enjoy substantial guarantees, as in nontradable sectors in a domestic market characterized by a high degree of concentration of capital (i.e., under conditions where a significant degree of competition is absent). Given the importance of private investment for sustained economic growth, a central question for the long-term economic performance of Argentina is how to explain this deficient investment response to economic reforms.

Tarre Briceño argues that to overcome underdevelopment, it is necessary to establish "understandings" for the long-term. Where government control alternates between political parties, some policies must endure for several administrations. The implication is that each government should call upon the opposition to assist in the design of policies and not limit itself to presenting policies on a take it or leave it terms to the opposition.²¹ In a similar vein, Fajnzylber maintains that a necessary factor to attain sustainable economic growth is the establishment of an institutional climate that promotes cooperative relations between government, the business sector, and labor based on strategic agreements that give permanence to economic policies.²² Elster claims that constitutional guarantees of property rights are credible only when embedded in

²⁰ Martín Ravazzani, "Exportaciones sin salida," Clarín, 29 August 1993, International Edition, Economic Supplement, 16.

²¹ Gustavo Tarre Briceño, "Opposition in Times of Change," in Joseph S. Tulchin, ed. **Venezuela in the Wake of Radical Reform** (Boulder, CO: Lynne Rienner Publishers, 1993), 129.

²² Fernando Fajnzylber. **Unavoidable Industrial Restructuring in Latin America** (Durham, N.C.: Duke University Press, 1990), 188.

a system of checks and balances (in contrast to a system of concentration of power in the executive).²³

The Argentine experience provides evidence to support the assertions above. The concentration of power in the executive branch in Argentina hinders a participatory style of policy making in which opposition political parties as well as representatives of various business and labor associations play a meaningful role in policy formulation. The absence of an effective system of checks and balances in the realm of economic policies precludes the attainment of broad agreements on economic policies that would provide the necessary support for the sustainability of policies over the long-term.²⁴ The argument espoused here is contrary to the idea proposed by Lambert that underdeveloped countries need rapid, effective processing of decisions and that this is possible only with a dominant executive.²⁵

O'Donnell classifies Argentina as a case of delegative democracy.²⁶ In delegative democracies, executives (presidents

²³ Jon Elster. "The Impact of Constitutions on Economic Performance." **Proceedings of the World Bank. Annual Conference on Development Economics 1994** (Washington, D.C.: The World Bank, 1995), 222.

²⁴ This argument coincides with one made by Acuña. He claims that in Argentina participation in policy-making by organized actors who are affected by policies (and agreement among these actors with the policies made) continues to be necessary to guarantee enough support to sustain policies over time. Carlos H. Acuña, "Determinantes políticos sobre la relativa ausencia de exportaciones industriales en la Argentina (y sus consecuencias sobre la estabilidad y tipo de democracia esperables). Manuscript. Buenos Aires, 1991, p. 12.

²⁵ Jacques Lambert. **Latin America: Social Structure and Political Institutions** (Berkeley and Los Angeles: University of California Press, 1969), 257-365; cited by Scott Mainwaring, "Presidentialism in Latin America," **Latin American Research Review** vol. 25, no. 1 1990: 157-179, p. 161.

²⁶ Guillermo O'Donnell, "Delegative Democracy" **Journal of Democracy** vol. 5 no. 1 (January 1994): 55-69.

and their inner circle of advisors) have a strong tendency, in the process of policy making, to ignore courts, legislatures, parties, and interest groups. This is especially true regarding economic policies. There is virtually no accountability on the part of the president to other political institutions (e.g., congress, courts) that can question and punish improper behavior on the part of the executive.²⁷ This is not an institutional context propitious for attaining broad support for economic policies so that policies can be sustainable over the long-term. Moreover, O'Donnell argues that policy making in delegative democracies has a higher probability of producing gross mistakes by sidestepping a process of negotiations with legislators, parties, and organized interests and making policies swiftly.²⁸

Thus, two consequences of concentration of power in the executive are a higher likelihood of policy mistakes and a greater degree of uncertainty about the endurance of policies over time. Here, I focus on the latter result. I will address below the issue of policy mistakes only briefly.

My main argument is that an important determinant of the deficient private investment response to neoliberal economic reforms in Argentina is that there is a significant degree of degree of uncertainty about the sustainability of economic policies over the medium to long term. This uncertainty can be traced to an enduring authoritarian policy style that is a reflection of a high degree of concentration of power in the executive branch in a delegative democracy.

Policy mistakes

The neoliberal model, adopted by the Menem government with zeal, places too much faith in the efficiency of markets and not enough on the positive role that the state can play in the economy.²⁹ Theory and evidence indicate that the public sector

²⁷ Ibid., 59-61.

²⁸ Ibid., 62-64.

²⁹ For a an analysis of the neoliberal model see Adam Przeworski, "The Neoliberal Fallacy," **Journal of Democracy** vol. 3, no. 3 (July 1992): 45-59. For chronicles of reform policies

has a central and critical role in achieving sustainable economic growth, e.g., in infrastructural investment, in the improvement of education and health, and in measures to stimulate certain private investments.³⁰

The fervor to liberalize markets has hindered policy credibility. The fixed exchange rate has been used as an anchor to control inflation while at the same time liberalizing trade. The overvaluation of the peso and a reduction of tariffs have spurred large trade deficits.³¹ A highly overvalued exchange rate and large trade deficits are signs that policies will be

implemented since 1989 see Carlos H. Acuña, "Politics and Economics in the Argentina of the Nineties," in William C. Smith, Carlos H. Acuña, and Eduardo A. Gamarra, eds. **Democracy, Markets and Structural Reforms in Latin America** (Miami, FL: University of Miami, North-South Center, 1994); and William C. Smith, "Hyperinflation, macroeconomic instability and neoliberal restructuring in democratic Argentina," in Edward C. Epstein, ed. **The new democracy in Argentina** (New York: Praeger, 1992).

³⁰ Przeworski, "The Neoliberal Fallacy," 49-50; Albert Fishlow, "The Latin American State," **Journal of Economic Perspectives** vol. 4, No. 3 (Summer 1990): 61-74, p. 72; Joseph Ramos and Osvaldo Sunkel, "Toward a Neostructuralist Synthesis," in Osvaldo Sunkel, ed. **Development from Within: Toward a Neostructuralist Approach for Latin America** (Boulder, CO: Lynne Rienner Publishers, 1993), 7; and Dilmus D. James and James L. Dietz, "Trends in Development Theory in Latin America: From Prebisch to the Present," in James L. Dietz and Dilmus D. Janes, eds. **Progress Toward Development in Latin America** (Boulder, CO: Lynne Rienner Publishers, 1990), 8-10.

³¹ Canitrot indicates that the peso is increasingly overvalued (by more than 30 percent in the first year of the Convertibility Plan). Adolfo Canitrot, "Crisis and Transformation of the Argentine State (1978-1992)," in William C. Smith, Carlos H. Acuña, and Eduardo A. Gamarra, eds. **Democracy, Markets, and Structural Reform in Latin America: Argentina, Bolivia, Brazil, Chile, and Mexico** (Miami, FL: University of Miami, North-South Center, 1994), 89.

changed.³² Perceptions among investors that policy inconsistencies may lead to policy reversals are an important determinant of the investment response to economic reforms.³³ The trade deficits have been financed by income from the sale of public enterprises, foreign debt, and in a major way by the influx of speculative financial capital.³⁴ The government economic program is very vulnerable to increases in international interest rates. A significant shrinkage of the inflow of foreign capital would doom the exchange scheme. An outflow of capital could occur from economic growth in economically advanced countries or by an increase in U.S. interest rates.³⁵

Moreover, the overvaluation of the currency has hindered exports.³⁶ Argentina has recently tried to deal with the real appreciation by engineering a disguised devaluation through

³² Dani Rodrik, "Credibility of Trade Reforms: a Policy Maker's Guide," **The World Economy** 12, no. 1 (1989): 1-16; Dani Rodrik, "How Should Structural Adjustment Programs be Designed," **World Development** 18, no. 7 (1990): 933-947.

³³ Luis Servén and Andrés Solimano, "Private investment and Macroeconomic Adjustment: A Survey," **The World Bank Research Observer** 7, no. 1 (January 1992): 95-114, p. 108.

³⁴ Martín Ravazzani, "Exportaciones sin salida," Clarín, 29 August 1993, International Edition, Economic Supplement, 16.

³⁵ Sebastian Edwards, "Trade Policy, Exchange Rates, and Growth," in Rudiger Dornbusch and Sebastian Edwards, eds., **Reform, Recovery, and Growth: Latin America and the Middle East** (Chicago: The University of Chicago Press, 1995), 42.

³⁶ Clarín, 30 March to 5 April 1993, International Edition, 8; Martín Ravazzani, "El dólar también preocupa a los funcionarios," Clarín, 28 March 1993, International Edition, Economic Supplement, 16; Martín Ravazzani, "Exportaciones sin salida," Clarín, 29 August 1993, International Edition, Economic Supplement, 16; Ismael Bermúdez, "Mercosur en el pantano," Clarín, 2 May 1993, International Edition, Economic Supplement, 2-3. The observation is also made by Sebastian Edwards, "Trade Policy, Exchange Rates, and Growth," 40-41. This assessment of export performance is made despite a growth trend in exports since the 1980s.

increases in import tariffs, tax reductions, export subsidies, and attempts to lower labor costs, but apparently, the magnitude of the adjustment has been rather small.³⁷ The most dynamic growth sector between 1990 and 1995 has been domestic consumption.³⁸

Lessons from the economic reforms in Chile in the periods 1974-1979 and 1985-91 and in Mexico after 1985 indicate that a critical factor in the success of trade reforms is the avoidance of overvaluation of the currency in order to promote exports.³⁹ Experience in Latin American countries shows that overvalued exchange rates hinder exports while "competitive" exchange rates help export performance. Two basic factors that have led to overvaluation have been: (a) the use of exchange rates as an anchor to reduce inflation and (b) massive capital inflows.⁴⁰ A mechanism to prevent overvaluation of the currency is to control a strong influx of capital from abroad. But the drastic financial deregulation in Argentina precludes such controls. The simultaneous deregulation of domestic interest rates and international capital movements have promoted financial

³⁷ Sebastian Edwards, "Trade Policy, Exchange Rates, and Growth," 42-43; Sergio Serrichio, "Cómo devaluar sin ser visto," Clarín, 6 February 1994, International Edition, Economic Supplement, 2-3.

³⁸ "Cuentas Nacionales. Oferta y Demanda Globales, 1980-1995," Ministry of Economy, Argentine Republic, p. 13. In Dornbusch's view, sustained growth requires the export sector to quickly become the driving force of growth; if domestic demand is the source of growth, external constraints become binding. Rudiger Dornbusch, "Policies to Move from Stabilization to Growth," in **Proceedings of the World Bank Annual Conference on Development Economics**, 1990 (Philadelphia, PA: World Bank Publications, 1990), 42.

³⁹ According to Dornbusch, realistic exchange rates are the sine qua non of a successful open trade policy. Rudiger Dornbusch, "Strategies and Priorities for Reform," in Paul Marer and Salvatore Zecchini, eds. **The Transition to a Market Economy** (Paris: OECD, 1991), 178.

⁴⁰ Sebastian Edwards, "Trade Policy, Exchange Rates, and Growth," 36-37.

speculation by increasing domestic interest rates and creating a significant gap with current international interest rates.⁴¹

The Investment Response

Available evidence indicates that the private investment response has not been remarkable.⁴² Since 1991, the increase in investment has been mainly due to purchases of public firms.⁴³ In addition, sales of public enterprises have included obligations on the part of buyers to make fixed investments beyond the purchase of the companies.⁴⁴ According to studies from Cepal, the import of capital goods has been mainly due to fixed investments in non-tradable areas; such imports have not significantly increased the export capacity of the country.⁴⁵ Interviews with top executives of seven national conglomerates ("grupos económicos") in Argentina indicate that they have concentrated their fixed investment in sectors where privatization has taken place, i.e., oil, electricity, railroads,

⁴¹ Manuel R. Agostin and Ricardo Ffrench-Davis, "La Liberalización Comercial en América Latina: Una Evaluación," Paper presented at the Latin American Studies Association XVIII International Congress, March 10-12, 1994, Atlanta, Georgia, 3-5 and 22-28.

⁴² For journalistic analyzes of investment behavior under the Menem government see: Eduardo Luis Bonelli, "De aprensiones e incompatibilidades," La Nación, 7 June 1993, International Edition, 6, and Sergio Serrichio, "Las Señales del Modelo," Clarín, 28 November 1993, International Edition, Economic Supplement, 2-3.

⁴³ Eduardo Luis Bonelli, "Cuando la creciente va en contra del crecimiento," La Nación, 28 June 1993, International Edition, 6; Clarín, 28 November 1993, International Edition, 2-3.

⁴⁴ Clarín, 27 April 27 to 3 May 1993, International Edition, 9. The privatization of Aereolíneas Argentinas, for example, involved an obligation on the part of buyers for 684 million dollars of additional investment.

⁴⁵ See interview with Bernardo Kosacoff in Clarín, 27 March 1994, International Edition, Economic Supplement, 4.

telecommunication, and steel.⁴⁶ Also, interviews with Argentine economists show a consensus in thinking that the engine of economic growth for 1994 was in non-tradable sector.⁴⁷

The purchases of public firms is consistent with private investment behavior before the start of the Menem presidency in 1989, and do not portray a meaningful increase in business confidence. In an uncertain environment, capitalists are willing to make large investments in projects where rates of profits are quite secure due to market advantages.⁴⁸ Public firms have been monopolies or oligopolies. Data for 1973 and 1983 show that over 87 percent of the industrial production of public firms was in highly concentrated markets.⁴⁹

Faced with increased competition from imports, due to the overvaluation of the peso and the reduction of tariffs, industries have engaged mainly in "defensive" measures. For example, industrial firms have reduced operating costs, e.g., by decreasing the number of workers, and engaged in commercial activities (importing certain lines of products for retail). Also, industrial production is incorporating a larger amount of

⁴⁶ Of the seven conglomerates, only two, Bunge & Born and Socma (which includes Sevel, an automobile manufacturing firm) die not focus their current investment in areas where public enterprises were not sold. The other five conglomerates were: Astra, Pérez Companc, Benito Roggio e Hijos, Sociedad Comercial del Plata, and Techint. The latter bought Somisa, a large steel producer, from the government. Clarín, 16 January 1994, International Edition, Economic Supplement, 6-13.

⁴⁷ Clarín, 9 January 1994, International Edition, Economic Supplement, 4-10.

⁴⁸ See Juan J. López, "Social Conflict, Political Institutions and Economic Performance in Argentina," Ph.D. dissertation, Department of Political Science, University of Chicago, 1994, chapter 3.

⁴⁹ Daniel Azpiazu, Eduardo M. Basualdo, and Miguel Khavisse, **El Nuevo Poder Económico en la Argentina en los Años 80** (Buenos Aires: Editorial Legasa, 1986), 125.

imported components.⁵⁰ Making the large fixed investments needed to achieve a decisive increase in productivity and competitiveness seems to be mostly missing from the adaptive measures.⁵¹ Referring to the period when Martínez de Hoz was minister of economy, a time in which the currency was overvalued and tariffs were lowered as is the case after 1991, an executive of a foreign conglomerate who I interviewed in 1989 affirmed that, "although it was cheap to invest in productive activities, it was cheaper to import. The bias toward importing was clear. If you produced domestically and your competitor imported, you were dead. That was not a time to invest."

The lack of dynamism in investment behavior has been recognized by officials in the Menem administration. According to Antonio Erman González, minister of economy before Domingo Cavallo, the Convertibility Plan of Cavallo had failed to generate investment, i.e., led to a significant increase in the level of private investment.⁵² Juan José Llach, secretary of economic planning declared in January of 1993 that the objective for that year was to make 1993 the year of investment.⁵³ In 1996, José Luis Machinea, president of the central bank in the Alfonsín government, remarked that investment continues to be low. In Machinea's opinion, juridical insecurity and uncertainty about the continuity of economic policies is hindering private investment.⁵⁴

⁵⁰ Clarín, 13 March, 1994, International Edition, Economic Supplement, 2.

⁵¹ Clarín, 22 August 1993, International Edition, Economic Supplement, 11. Clarín, 28 November 1993, International Edition, Economic Supplement, 2-5. See also Bernardo Kosacoff, "La industria argentina: un proceso de reestructuración desarticulada," Cepal (Buenos Aires: Cepal, August 1993), 50-53.

⁵² Clarín, 1 to 7 June 1993, International Edition, 3. González also expressed doubts about the continuity of the exchange rate parity.

⁵³ La Nación, 11 January 1993, International Edition, 1.

⁵⁴ Interview with José Luis Machinea in **La Nación**, International Edition, 31 March, 1996, Economy & Business supplement, p. 7.

Executive Dominance

The dominance of the executive is a long-standing feature of the Argentine political system.⁵⁵ This dominance is evident in the relationships of the executive with Congress, with the judiciary, and with political parties. Under the Menem government, the degree of concentration of power in the executive has increased. Argentina under Menem has been a prime example of what O'Donnell has called delegative democracy.

Despite the Constitutional provision of life tenure for Supreme Court justices, traditionally the executive has arbitrarily removed justices and replaced them with others sympathetic to the current government. Since the tenure of justices has depended on the wishes of the executive, the Supreme Court does not have the ability to check the behavior of the executive branch without risking the tenure of its members. Consequently, legal constraints on abuses of power by the executive are weak. Given that the Court does not have the political power to adjudicate issues of separation of powers between the executive and the legislature, the Supreme Court has eluded ruling against the constitutionality of executive actions that challenge separation of powers. The Court declines to hear "political questions," and considers certain executive and legislative acts, e.g., those involving policy preferences, as immune to challenge under any circumstance.⁵⁶

Menem, from the outset of his administration, sought to gain sway over the Supreme Court in order to guard against possible

⁵⁵ See, for example, K. H. Silvert, "Liderazgo Político y Debilidad Institucional en la Argentina," **Desarrollo Económico** 3, no. 1 (October-December 1961): 160-161; Carlos Sánchez Viamonte, **Historia Institucional Argentina**, Segunda Edición (Buenos Aires: Fondo de Cultura Económica, 1957), 204-205.

⁵⁶ Germán J. Bidart Campos, **The Argentine Supreme Court: The Court of Constitutional Guarantees** (Buenos Aires: Allende & Brea, 1982), 16. Although the Constitution does not state that the Court has the power of judicial review, the Court has this power as a result of the Court's Sojo decision in 1887.

legal challenges to his acts.⁵⁷ In April of 1990, he attained congressional approval for an increase of the number of Supreme Court justices from five to nine, appointing judges sympathetic to his policies and securing a favorable majority in the Court.⁵⁸ Menem ended up appointing six of the nine judges. The increase in the number of justices prompted the resignation of the vice president of the Court, Jorge Antonio Bacqué; another justice also left the Court. In his letter of resignation, Bacqué stated that, "to suddenly increase the number of justices from five to nine engenders the risk of a sharp change in jurisprudence ... that risk conspires against juridical security."⁵⁹

In November 1993 in the "Pact of Olivos" between Menem and Alfonsín, leaders of the Radical Party demanded the replacement of three court judges with independent justices to guarantee an acceptable degree of impartiality of the Court. This was a demand by Radicals as part of their deal with President Menem and other members of his party for the Radicals to support the creation of a constitutional convention to modify the country's constitution (so that Menem could run for a second presidential term).

The Menem government and the other Peronist politicians exerted pressure to remove three judges from the Supreme Court. Peronist congressmen in the Impeachment Committee of the Chamber

⁵⁷ Delia Ferreira Rubio and Matteo Goretti, "Government by Decree in Argentina (1989-1993)," Paper presented at the Latin American Studies Association XVIII International Congress, March 10-12, 1994, Atlanta, Georgia, 6-7.

⁵⁸ Clarín, 2 to 8 April 1990, International Edition, 3. In another example of Menem's domination over the judiciary, he named an Attorney General by decree and made his dismissal also subject to decree. Previously, the appointment of the Attorney General required confirmation of the Senate and his removal was only possible by impeachment; Martín Carrasco Quintana, "Lo importante es la seguridad de lo constante," La Nación, 16 August 1993, International Edition, 3.

⁵⁹ La Nación, 23 April 1990, International Edition, 1 and 5. Another way in which Menem has interfered with the independence of the judiciary has been by repeatedly resorting to per saltum, taking cases away from their rightful judges.

of Deputies threatened with impeaching all the members of the Court unless the justices agreed among themselves what three judges would leave the Court.⁶⁰ At the end of 1993, two members of the Court resigned and one decided to retire, thus creating three vacancies.⁶¹ Soon afterwards, government officials and leaders of the Radical Party reached an agreement on who would fill the three vacant posts.⁶²

An example of the validation of executive abuse of power by the Supreme Court under the Menem government was the case of the Bonex plan. The Court ruled that the decree of "necesidad y urgencia" ("need and urgency") of 3 January 1990, the "Bonex Plan", was legal. This decree converted most private short-term saving deposits (about 1.5 billion dollars) into government bonds with a ten-year maturity. On 23 January the Senate ratified the decree, but the Chamber of Deputies did not sanction it. Yet the

⁶⁰ The justification for the impeachment was a recent scandal in the Supreme Court due to a change of a ruling adverse to the central bank. Allegedly, the change occurred under pressure from minister of economy Domingo Cavallo.

⁶¹ Another case of abuse of executive power in removing government officials who enjoy legal tenure in their posts was the dismissal of Martín Redrado by Menem at the end of March 1994. Mr. Redrado was the head of the Comisión Nacional de Valores, a watchdog agency to oversee the stock market. Redrado had legal tenure in his post until 1996, a measure that supposed to insulate him from political pressures. His criticism of unusually high commissions that Merrill Lynch and the First Bank of Boston wanted to charge for the sale of YPF stocks held by pensioners and disputes with Domingo Cavallo cost Redrado his job. Government officials close to Menem asked Redrado to resign, he refused and Menem fired him by decree. La Nación, 4 April 1994, International Edition, 6; Clarín, 22 to 28 March 1994, International Edition, 1; Clarín, 29 March to 4 April 1994, International Edition, 6-7.

⁶² La Nación, 22 November 1993, International Edition, 5; La Nación, 29 November 1993, International Edition, 1 and 5; Clarín, 23 to 29 November 1993, International Edition, 6-7. La Nación, 13 December 1993, International Edition, 1; Clarín 30 November to 6 December 1993, International Edition, 1.

Court argued that it could be inferred that Congress had approved a decree of need and urgency since Congress did not challenge it in a period of thirty days.⁶³

From July 1989 to December 1993, Menem has issued more than 12,000 decrees of all types and 308 decrees of necessity and urgency. By contrast, during his administration, Alfonsín issued only eight decrees of necessity and urgency.⁶⁴ By declaring need and urgency decrees, the president seized congressional legislative powers without the consent of congress. Until the constitution was modified in 1994, there was no law or constitutional provision granting presidents the authority to issue decrees of necessity and urgency.⁶⁵ The legality of this type of decree was defended by some on grounds that the executive could make them when congress was in recess or when decrees addressed serious national emergencies that could not wait for responses through the regular legislative process. Before 1994, legal experts agreed that for the decrees to be legal, the executive had to forward the decrees to congress for approval or rejection. Yet Menem issued the overwhelming majority of the decrees while congress was in session, and did not send Congress many of the decrees. In 1991, only 25 percent of the decrees were forwarded to Congress. In addition, these decrees have been used for matters that are obviously not emergencies.⁶⁶ The abuse by Menem of this type of decree is illustrated by Menem's use of it

⁶³ Clarín, 13 June 1993, International Edition, Economic Supplement, 7.

⁶⁴ Delia Ferreira Rubio and Matteo Goretti, "Government by Decree in Argentina (1989-1993)," 15.

⁶⁵ Among the constitutional changes in 1994, it was stipulated that decrees of necessity and urgency are prohibited in cases of penal, tax and electoral legislation, and they need to be ratified by congress without time limits. Liliana De Riz, "Argentina: Democracy in Turmoil," in Jorge I. Domínguez and Abraham F. Lowenthal, eds. **Constructing Democratic Governance: South America in the 1990s** (Baltimore, Maryland: The Johns Hopkins University Press, 1996), 158.

⁶⁶ Delia Ferreira Rubio and Matteo Goretti, "Government by Decree in Argentina (1989-1993)," 10-12 and 19-20.

to donate cement to build a road in Bolivia.⁶⁷ Of the 308 decrees of necessity and urgency that Menem had issued up to December 1993, 9 percent were ratified by Congress, 1 percent were repealed, and in 90 percent congress remained silent. Of the three decrees that congress repealed, in only one case the executive acquiesced. Menem vetoed the two other rejections and the decrees remained in force.⁶⁸

Among the legislation enacted by decrees of need and urgency under the Menem government, one finds creation of and changes in tax laws, modification of private contracts, suspension of public contracts and of payments to private firms supplying goods and services to the government, the establishment of rules related to export taxes and duties, and repeals of benefits and incentives to promote exports. According to the Argentine Constitution in force until 1994, only congress could impose taxes. Yet by 1993, the Menem government had issued more than sixty-nine decrees of necessity and urgency implementing taxation policies. At the end of August 1993, Cavallo argued that without Menem's decrees of necessity and urgency only 20 percent of the economic reform policies could have been implemented.⁶⁹

It is interesting that in a paper published by Cavallo in October 1991, he stated that, to pass bills is more difficult than to issue decrees of necessity and urgency. But he stated that,

ruling through laws produced greater legal stability because it created a sense of more permanent solutions that created the necessary conditions to foster investment and consequently economic growth.⁷⁰

A 1993 survey of opinion leaders found that 77 percent believed that there was no juridical security in the country. The

⁶⁷ Clarín, 13 June 1993, International Edition, Economic Supplement, 2-7.

⁶⁸ Delia Ferreira Rubio and Matteo Goretti, "Government by Decree in Argentina (1989-1993)," 20-21.

⁶⁹ *Ibid.*, 4, 6, 23 and 25.

⁷⁰ Cited in *Ibid.*, 6.

insecurity ensues from the fact that laws and policies can be arbitrarily and unexpectedly changed. Interviews with entrepreneurs, economists and legal experts reveals that the uncertainty is caused by the concentration of legal and de facto powers in the executive, a Congress that does not exercise its constitutional prerogatives, and a Supreme Court that is subservient to the executive.⁷¹

In addition to legislating by decree, the power of the executive in the policy making process is also shown by the ability of the executive to force legislation through congress. The general tendency has been for congress to have little or no participation in the formulation of economic policies.⁷² Economic plans have been secretly formulated, announced, and imposed by decree or rammed through Congress.⁷³ In the context of the negotiations between the Peronist Party and the Radical Party regarding reforms to the constitution, Menem declared that the economic policies of his government were not negotiable with anybody.⁷⁴

⁷¹ Clarín, 13 June 1993, International Edition, Economic Supplement, 2-7.

⁷² For evidence, based on interviews, of the subordination of congress to the executive concerning the legislative process see Luis Pássara, "El Rol del Parlamento: Argentina y Perú," **Desarrollo Económico** 32, No. 128 (January-March 1993): 603-624. Interview data presented by Pássara show that representatives of business associations could not remember of any key policy relevant to the agricultural and industrial sectors that had been considered in Congress. Ibid., 622.

⁷³ For example, see the historical descriptions of economic plans in: William C. Smith, "Hyperinflation, Macroeconomic Instability, and Neoliberal Restructuring in Democratic Argentina," 27 and 43-51; and Edward C. Epstein, "Labor-State Conflict in the New Argentine Democracy: Parties, Union Factions, and Power Maximizing," 135; both in **The New Argentine Democracy: The Search For a Successful Formula**, Edward C. Epstein, ed. (Westport, Connecticut: Praeger, 1992).

⁷⁴ La Nación, 22 November 1993, International Edition, 5.

On numerous occasions, Menem and members of his cabinet have publicly threatened legislators with implementing by decree bills introduced by the executive unless the proposals are not quickly approved by congress without modifications.⁷⁵ For example, Menem sent to the senate on 23 April 1990 a proposal of "Regulation of the Right to Strike in the Public Sector" and threatened that if congress did not pass the law quickly and without major changes he would enact it by decree. The law was finally imposed by decree on 17 October 1990.⁷⁶

The rapid approval in Congress of crucial pieces of legislation initiated by the executive is an indication of the minor role that congress has played in the formulations of these laws. On March 20, 1991, Cavallo announced by surprise the Convertibility Law. The law was implemented with Congressional approval on April 1, 1991. In only one week a major package of economic policies was presented and passed through Congress without modifications.⁷⁷

⁷⁵ Edward C. Epstein, "Labor-State Conflict in the New Argentine Democracy: Parties, Union Factions, and Power Maximizing," 146 and 148, and Delia Ferreira Rubio and Matteo Goretti, "Government by Decree in Argentina (1989-1993)," 5.

⁷⁶ In another example of pushing legislators to pass his laws under the threat of establishing laws by decree, Menem declared that he would implement the reform of the social security system by decree if the Chamber of Deputies failed to approve the reform within a given period of time; La Nación, 29 March 1993, International Edition, 1.

⁷⁷ The package included the end to the crawling peg exchange policy and the establishment of a fixed exchange rate to the U.S. dollar, authorization for the creation of a new currency, the requirement that the central bank maintain reserves in gold and foreign currencies equal to 100 percent of the monetary base (Argentine government bonds held by the central bank and payable in gold or foreign currencies are counted as part of the reserves), and the elimination of indexation clauses in all contracts, e.g., concerning wages; La Nación, 25 March 1991, International Edition, 1 and 5; La Nación, 1 April 1991, International Edition, 1 and 4.

To understand the subservience of congress in approving legislation introduced by the Menem government, one should take into account two factors. One is that Menem's party has had majorities in both houses of congress. The other is that it has been customary for incumbent presidents to dominate their parties, shaping their policy positions rather than been constrained by party platforms. Parties have not played a meaningful role in the policy making process.⁷⁸ A way presidents have controlled congressmen from the government party has been by threatening to expel them from the party unless they support the presidents's legislative proposals. The ability of presidents to discipline congressmen has been facilitated by the electoral rule of closed party lists. In October 1993, Eduardo Duhalde, former vice president in the Menem government, who was then president of the Justicialist Party (Menem's party) declared that Justicialists congressmen who did not vote in congress in favor of Menem's project of constitutional reform could be expelled from the party.⁷⁹

Investment uncertainty and executive dominance

Persistent uncertainty about the future evolution of government policies seems to be an important part of the explanation for why the level of private investment has not been higher under the Menem government.⁸⁰ Lack of business confidence on the sustainability of government policies is sufficient to thwart higher levels of investment.⁸¹ Reflecting the business mood in 1993, Juan Schiaretti, secretary of industry until June

⁷⁸ For example, see Luis Pássara, "El Rol del Parlamento: Argentina y Perú."

⁷⁹ La Nación, 11 October 1993, International Edition, 1.

⁸⁰ See the editorials in Clarín, 29 June to 5 July 1993, International Edition, 2, Clarín, 10 to 16 August 1993, International Edition, 2, and Clarín, 1 to 7 February 1994, International Edition, 2.

⁸¹ See, for example, Andrés Solimano, "Understanding the Investment Cycle in Adjustment Programs: Evidence from Reforming Economies," Policy Research Working Paper No. 912 (Washington, D.C.: Country Economics Department, The World Bank, May 1992), 1, 11 and 14-15.

1993, declared that there were sectors in Argentina that wanted to recover investments in six months.⁸²

The U.S. Ambassador to Argentina, James Cheek, declared on 10 August 1993 to the Argentine press that greater juridical security was necessary in Argentina. According to Cheek, there were many U.S. firms interested in seeing greater juridical security in Argentina in order to invest.⁸³ Foreign investors fear a legal system subordinated to the arbitrariness of the executive, since investments may engender litigations. Investors equate a change of government with a change of judges and a change of jurisprudence.⁸⁴

Rodolfo Terragno, president of the National Committee of the Radical Party, declared that it is necessary to generate confidence among businessmen for them to invest in productive activities with a long-term perspective in order to create employment. He pointed to juridical insecurity in "decrees and laws approved without consensus." According to him, juridical insecurity only generate short-term investments, e.g., financial investments.⁸⁵

Given the power of the executive, objections to Menem's economic policies on the part of major political actors causes misgivings about the sustainability of policies. Lack of consensus among key politicians on economic policies undermines business confidence in the continuity of economic policies. Businessmen fear that policies can be altered when governments change.

One line of cleavage over economic policies is between the policy orientations of the Menem government and the Radical

⁸² La Nación, 17 May 1993, International Edition, 6.

⁸³ La Nación, 16 August 1993, International Edition, 1; Clarín, 17 to 23 August 1993, International Edition, 7.

⁸⁴ Martín Carrasco Quintana, "Lo importante es la seguridad de lo constante," La Nación, 16 August 1993, International Edition, 3.

⁸⁵ La Nación, International Edition, March 26 to April 1, 1996, p. 4.

Party. Former President Alfonsín, in his speech upon being elected president of the Radical Party in November 1993, declared that it was necessary to reverse the current neoliberal economic model.⁸⁶ In December 1993, Raúl Alfonsín presided a meeting to analyze the critical situation of provincial economies. After the meeting, the Radical Party made public a document criticizing Menem's economic policies. The document stated that Menem's economic policies had extremely exacerbated tendencies of marginalization, and that it is impossible to have economic policies that do not take the people into account, pointing to the need to combine growth and social progress.⁸⁷ In January 1994, Eduardo Angeloz criticized the economic policies of minister of economy Domingo Cavallo. Angeloz argued that Cavallo's economic program lacked policies of growth that would generate employment and that apparently Cavallo did not understand the need to avoid increasing poverty.⁸⁸ At the end of March 1996, the Radical Party made public an economic and social program as an alternative to the economic program of the Menem government. The economic program of the Radical Party was presented as a "180 degree turn" (e.g., a gradual abandonment of the convertibility of the currency) from the actual economic policies of the Menem government.⁸⁹

Another line of conflict has been within the Peronist Party. In May 1993, there was an indirect, public interchange between politicians opposed to governmental economic policies and Domingo Cavallo. Antonio Cafiero, Senator from the Buenos Aires province, stated that Menem's policies were fragile, a fashion that would end because it was based on a coalition that did not represent the majority of Argentines.⁹⁰ Senator José Octavio Bordón, who at the time was a potential presidential candidate from the

⁸⁶ La Nación, 15 November 1993, International Edition, 3.

⁸⁷ Clarín, 28 December 1993 to 3 January 1994, International Edition, 3 and La Nación, 3 January 1993, International Edition, 1 and 3.

⁸⁸ La Nación, 10 January 1994, International Edition, 5.

⁸⁹ La Nación, International Edition, March 26 to April 1, 1996, p. 4.

⁹⁰ Clarín, 11 to 17 May 1993, International Edition, 5.

Peronist Party for the 1995 election, promised that, "from 1995 on, a new phase of peronism will begin, with new styles, methods, and proposals."⁹¹ Cavallo, attempting to calm businessmen after Bordón's remarks, argued that there was a possibility that the economic model would continue regardless of who occupied the presidency and the ministry of economy. According to government officials, Cavallo's declarations were necessary to project an image of the continuity of the economic model to prevent undermining the possibility of long-term investments.⁹²

In February 1994, there were public verbal fights between minister of economy Domingo Cavallo and several government officials. Rumors ensued that Cavallo would resign as minister of economy. The rumors encouraged a drop in the Stock Exchange (Bolsa de Comercio), and Menem launched a campaign of support for Cavallo.⁹³

In March of 1996, Domingo Cavallo revealed to a group of entrepreneurs in Argentina that there were divisions within the government concerning economic policies due to fear about the recession and the high levels of unemployment. Cavallo declared that a group of ministers, among whom was the minister of interior, Carlos Corach, wanted to implement interventionist policies that aimed to reverse the economic opening.⁹⁴

In a roundtable to discuss the achievements and pending issues of the first ten years of the current democratic regime in Argentina, Fernando de la Rúa, an influential national Senator from the Radical Party, indicated that currently there was a climate of political conflict and intense confrontation between the government and the opposition and called on politicians to

⁹¹ La Nación, 17 May 1993, International Edition, 4.

⁹² Clarín, 16 May 1993, International Edition, Economic Supplement, 16 and La Nación, 17 May 1993, International Edition, 6.

⁹³ Clarín, 22 to 28 February, 1994, International Edition, 1 and 6-9.

⁹⁴ Clarín, March 12 to 18, 1996, p. 6.

attain policy consensus to achieve continuity in government policies.⁹⁵

Conclusions

The arguments here go against the grain of much of the evaluations of the economic reforms under the Menem administration. Yet despite the extensive neoliberal economic reforms in Argentina since 1989 and their economic successes, like the maintenance of low levels of inflation, there are already grounds to question that the reforms have launched the country into a path of sustained economic growth. One problem seems to be that the private investment response has been inadequate for sustained growth. Apparently, there are significant similarities to patterns of investment behavior prior to the Menem period. Profitable financial businesses attract a lot of the capital, and firms are willing to make major investments mostly in projects where satisfactory rates of return are pretty much guaranteed.

The Argentine case points to the importance of political institutions for the success of economic reforms in generating sustained growth. An important degree of uncertainty among entrepreneurs concerning the policy environment continues to hinder the level of fixed investments. This uncertainty about the sustainability of economic policies is directly linked to the persistence of an authoritarian style of policy making by the executive branch, accentuated further under the Menem government. This authoritarian style is a consequence of the concentration of power in the executive.

Important disagreements among major political actors induce policy uncertainty among businessmen. Entrepreneurs fear arbitrariness in policy making and the possibility of policy changes with changes in governments and even with changes in ministers of economy. Although Menem and his men have so far been quite successful in winning elections, the electoral game under democracy is characterized by uncertainty of outcomes. Given the concentration of power in the executive, to believe that there cannot be significant alterations of economic policies is overly sanguine. The economic policies implemented since 1989 have been

⁹⁵ La Nación, 9 August 1993, International Edition, 3.

regressive in terms of income distribution. There are high levels of unemployment, and the economic situations of provinces is precarious.

Moreover, as O'Donnell has maintained, an authoritarian policy style seems to foster policy mistakes as policy makers implement their favorite policies. The implementation of policies that are not economically sustainable adds to the uncertainty among businessmen. One of the factors that businessmen look closely in evaluating the endurance of economic plans is their policy consistency.⁹⁶

The arguments here go against the current of thought that an authoritarian policy style is needed to carry out structural economic reforms. Although governments can in an authoritarian fashion implement deep economic reforms quickly and attain stabilization, they may destroy the long-term success of the reforms in terms of economic growth by generating policy uncertainty for investment. The observations I have made here about Argentina may well be applicable to other cases of delegative democracy in Latin America and Eastern Europe, e.g., Brazil, Peru, and Russia.

Domínguez and Lowenthal argue that effective democratic governance requires that executive authority be constrained and held accountable by an independent and autonomous judiciary and by additional countervailing powers.⁹⁷ If this is so, then there seems to be a congruence in requirements for effective democratic governance and for sustainable economic development under democracy.

⁹⁶ I learned this from my interviews of businessmen in Argentina.

⁹⁷ Jorge I. Domínguez and Abraham F. Lowenthal, "Introduction: Constructing Democratic Governance," in Jorge I. Domínguez and Abraham F. Lowenthal, eds. **Constructing Democratic Governance: South America in the 1990s** (Baltimore, Maryland: The Johns Hopkins University Press, 1996), p. 6.

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