

# Reflections on Argentina's Growth Performance and Dreams

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In starting these thoughts on why Argentina has not grown, it is important to keep in mind that Argentina is a fairly special case. Figure 1 shows that Argentina, which once scored with high income countries and took pride in considering itself European rather than Latin American, somehow migrated from one group to the other, and today is virtually indistinguishable of a middle income emerging economy.

However, in the case of Argentina, the particular feature that signals out is the fact that it has virtually not grown in the last three decades. Understanding this is important in itself (particularly for Argentines), but also important for other countries in the region that may be concerned about falling in the same trap.

## Sources of growth

Economists tend to think that the problem is in what we call the sources of growth: physical and human capital, technology, natural resources and infrastructure. And the recipe to revert stagnation is simple enough, just get these things going and growing for economic development to occur. "Structural reforms" or "reforms", whatever this means, are supposed to do the job. I do not contest this view, nor do I say it is wrong, but I think it ends being a bit tautological and does not provide useful clues for why Argentina, or the region, does not grow.

Let me give an example. We cannot be wrong if we say that we know a lot about how to finance, how to set up correct incentives and how to value investments in infrastructure. Neither are we wrong to point out that things have not been done how we would have done them in the past. Take for example investment in infrastructure in Argentina, which, at least till the 90s, was dismal. Central Piedrabuena, to name one such case, is a large thermoelectric project that cost about 2 billion US dollars to build (and be aware that these are dollars of the 1980s). When it was privatized it was sold for the paltry of 30 million US. Why? Because it had taken so long to build, that in the meantime the whole electricity system had been reformed and become so efficient that the plant had become obsolete! What could 2 billion US dollars have allowed if we would have used them to better our education, health, transportation, or communications? Or, worse still, consider the hydroelectric dam of Yacyreta that cost about 16 billion US dollars to build (over 35 years). When the electricity market was deregulated and reformed, the private sector came up with cheaper ways (in fact below 1 billion US) to add to the system capacity equivalent in size to that of Yacyreta. If the 2 billion of Piedrabuena were misspent, what could we say about the 15 billion of Yacyreta?

There is not much to discuss here. We agree that we need to better use the money we put in infrastructure, in education, health, etc. And I insist that we have a quite good idea of how these things should be done and I think they are being done better and better by the day. So, all this distracts from the real question which is why has it been the case that so far things have not been done "the way they should have been done".

What I am saying is that we should assume that policies are endogenous and then try to understand what they are endogenous to. Now, that is a difficult question. And we need to be sure that we don't end up just deflecting the point by thinking that everything is endogenous to everything, i.e. we need to find something that is exogenous. And then, in the unlikely case we do find that thing that we think is key, we need to trace back the story of how that ultimate exogenous thing explains the poor growth performance (here is where I believe I may be excessively influenced by the experience of Argentina).

One nice starting point is to think that politics and the behavior of politicians is endogenous to what society demands and believes. What politicians do is a response to what people ask from them and allows them to do. So to me, the source of the problem has to lie in the beliefs that society has about what it deserves and about what is feasible. If these beliefs are wrong, and stay wrong for a long time (a curious result, if it were to be true), then we may have the beginning of an explanation. So, what shapes the beliefs of a society? What shapes its aspirations? And can these desires and aspirations be at odds with reality?

At first glance our reaction is that it is clear that society must have aspirations at odds with reality. Just look at inconsistent fiscal and monetary policies, currency crises triggered by inconsistent behavior (for a self fulfilling run you need a Paul O'Neill but these do not come too often, thanks god), chronic inflation, and fiscal disequilibria, all of which have been an unending source of attention to scholars for years and of pain for Latin Americans.

### **Our standard explanation: build institutions**

Our traditional explanation for these sub-optimal policies, that embedded in the works of Velasco, Alesina, Drazen among many others, is that it *seems* that the views and policies are inconsistent, but they are not. What we see is suboptimal behavior that arises from the inability of resolving a policy coordination game. The lack of ability to solve this game puts society in a sort of prisoner's dilemma situation where you grab something, aware that this will take the whole society to a worse point, but you just do it because if not someone else will do it (and then you will pay the bill). So better if it is you. In a paper with Guillermo Mondino and Mariano Tommasi we used this story to explain chronic and cyclical inflation, but the model has been used many times and to address different issues, including the discussion of fiscal federalism, regional coordination, etc.

In fact, I believe this type of anomaly tends to spread largely into all types of human behavior (even though as economists we have focused on macro issues). Imagine yourself waiting in line at the bank. If there is a well-defined line everybody waits its turn. However if people are bunched at the teller's counter, be sure that after five minutes you will be punching people to make it to the counter (otherwise people will crowd you out indefinitely). I think this exercise is interesting because it shows that sometimes it takes very little management skills to move from a chaotic equilibrium to a normal and much better one.

Consistent with the above example, this literature has put a lot of emphasis on the building of institutions and rules. This emphasis is probably right, and I am sure it works wonders in situations where the overall level of risk is relatively low. But this is

an important caveat, because if shocks are too big, there are no institutions, anywhere, that can withstand unscathed. If not think of the dollarization of contracts upon the devaluation of the dollar (relative to gold) in 1933 in the US.

So we do have a framework to think about what has happened. But its policy recommendations have not worked (totally). If shocks are big, institutions do not hold. So we are really at square one. We do need to take a step back and go deeper into the roots of instability.

### **It's the beliefs, stupid!**

Notice that the interpretation I was pushing above is squarely different from our game theoretic explanation. In the story I am proposing the results are not a negative byproduct of a game where people understand perfectly what is good and what is bad. I am saying that people have a distorted view of reality, that they share this view, they keep thinking wrong, and therefore that they screw up. (Caution: before anybody even thinks I am trying to suggest that I do know what is good or bad, behold your thoughts! Neither do I think that nor do I want to suggest it. The perceptive biases I will describe below are universal and we are all subject to them. And there is no right or wrong, we are just describing how beliefs are shaped). So, in some sense, it's like I am back to a representative agent framework, except that this one is a bit stupid. Many of us make a lot of mistakes during our own lifetimes, so I am not outraged by this approach.

So let us think whether it is plausible that people may have difficulties in learning and reading reality and then show resistance to change their views. To that purpose let me mention two important empirical facts from the behavioral economic literature: confirmatory biases and attribution theory. Confirmatory bias refers to the fact that we read the evidence provided to us by reality the way we like. The typical experiment gathers people with evenly distributed beliefs on an issue (for example capital punishment). Give all of them one-sided literature (for example a bunch of articles explaining why capital punishment is good). When they come back the supporters will be even more supportive, but those who originally opposed the idea, will also do so more vehemently.<sup>1</sup> Thus the same information turns out to be processed very differently by each group according to its original beliefs, and people read the evidence to confirm their prior view of the world (by the way, what newspaper do you read?). So, put together the fact that we cannot read the information objectively, that we look for information that confirms your view of the world (hope it is clear now why I asked you about what newspaper you read), and that the reality we are trying to understand is so complex, and you have a story for why it may be difficult for societies to learn.

How about attribution theory? Attribution theory says, basically, that you blame external conditions for your failures but that you feel responsible for your successes. Apparently we are all subject to this sort of bias, in our reading of the world.<sup>2</sup>

So how do I combine these things to build a story for Argentina's underdevelopment? Remember, it has to be story where the "collective" gets it wrong and persists in its wrong ways.

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<sup>1</sup> See among many Lord, Ross and Lepper (1979).

<sup>2</sup> See Zuckerman (1979) and Pinker (2002).

Let me go back to Figure 1 and Argentina's chronic dismal performance. In a country that has stagnated for some time it is likely that most people have done poorly. In line with attribution theory people will believe that failure in economic performance is attributed to "external sources" where by external I do not necessarily mean foreign, but external to the individual. The result is an attitude that belittles the role of effort or the idea the individual effort determines incomes. On the contrary the belief will arise that corruption, connections or luck is the real thing. And once these beliefs are ingrained in people's mind it is difficult to get them out.<sup>3 4</sup>

So these societies develop a strong sense of unfairness. In the case of Argentina, this has derived in excessive claims on the government (accepted by the collective), which has led to inconsistent fiscal policies. While possible -be it through hyperinflation or debt accumulation- the policy maker tries to deliver. But one day, sooner or later, you do hit the budget constraint. And when you do the country experiences a crisis. Thus, in the excessive claims that argentines demand on their system, and not on the politician's incompetence, resides the inherent instability of Argentina's macroeconomics.

Let me note that Alesina and Angeletos (2003) use a similar story to explain the differences in taxation levels in Europe and the US. Their argument is that these two societies have different views about social competition and income inequality and that these beliefs feed into different tax policies (and thus, according to them on growth). Well, in the case of Argentina, and probably of Latin America, they feed into macroeconomic instability.

This instability, in turn, has an effect on growth fundamentals. Argentina's instability has led to massive redistributions of wealth (which locks in the beliefs that luck is the game in town), thus making the country unsuitable for investment. While the capital stock depends supposedly on the marginal product of capital, there is home bias. In the case of Argentina, that fact that Argentines save a lot abroad is not compensated by inflows from non-residents, leading to a lower stock of capital.

So, in a nutshell, we have beliefs that have evolved both from history and instability. These beliefs were at the root of macroeconomic instability, which weakened growth fundamentals. Why didn't society learn? Now you understand why I talked about confirmatory bias.

If someone thinks all this is nuts just think of what kind of view of the world is necessary to justify a law that states that whoever does not pay for a public service

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<sup>3</sup> You may be right to think that in my interpretation I need stagnation to explain stagnation. But the important thing for the story to go through is to reach a situation where people tend to support redistributive policies because they just think the system is too unfair. Even in the case of Argentina at the end of the XIXth century, that at the time was very rich, there was a strong sense of unfairness. I think this is more so in the case of other Latin American countries.

<sup>4</sup> The pervasiveness of this way of thinking becomes useful to understand the resilience of the "piquetero" movement in Argentina. Piqueteros are social protesters whose main weapon of persuasion is cutting off roads and streets. This is so, because only a society that believes that poverty is the result of forces external to the individual can accept that someone has the right to cut any street (an illegal act) in protest for this "unfair" state of affairs.

cannot be denied the service. This by the way, is exactly what the current Argentine government is proposing, with the acquiescence of the public opinion.

### **Can it be changed?**

So, if the culprit of underdevelopment is in the beliefs, can these be changed? I really have no clue. Leadership may be a part of the story, but I wonder to what extent individuals or “generations” can overturn deeply ingrained beliefs.

Are crisis enough? Crises are moments of reckoning and thought. They definitely have an impact on beliefs. And societies do change. I can confidently say that the last dictatorship changed Argentina’s beliefs regarding the alleged benefits of military rule. Likewise after every economic crises society allows for improvements in the budget (notice my expression: society allows). But these improvements appear to be short lived. If we look at Figure 2 we see that after the two recent crises fiscal numbers improve dramatically. So far these results have not been fully sustainable, but some learning seems to have taken place.

The external constraints may change as well, forcing a change of views. Spain, Ireland and Portugal, were all countries with extreme political views or extreme political violence. However, integration into the European Union tamed the extremes, and has shaped there a new view of the world. To see how much, compare the initial Almodovar pictures, where individuals were just toys of social forces (*Que he hecho yo para merecer esto?*) with the more recent celebration of self-determination and rehabilitation (*Carne Tremula*).

But Latin America does not have the equivalent of European Integration to lead beliefs. The US is too distant and too detached to do the job. So can we find a substitute?

Some scholars have emphasized the role of a collective dream.<sup>5</sup> In the US the constitution sold the idea of the government of the people, for the people and by the people and that all men were created equal. A funny principle considering that most signatories were slave owners. But the dream worked and set the mind frame of the “collective”.

Final, but not least, notice that our story builds the whole instability in economic policy as originating in a view of the world that arises from poor individual economic performance. So dealing with income distribution, ensuring equality of opportunities, and implementing progressive tax systems are key instruments to change these views. You may believe that these instruments as means to change beliefs only trace out a long and slow road ahead. Ok, fair enough. But, who told you it was going to be easy?

### **References**

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<sup>5</sup> See for example, for an application to Argentina, Shumway (1993).

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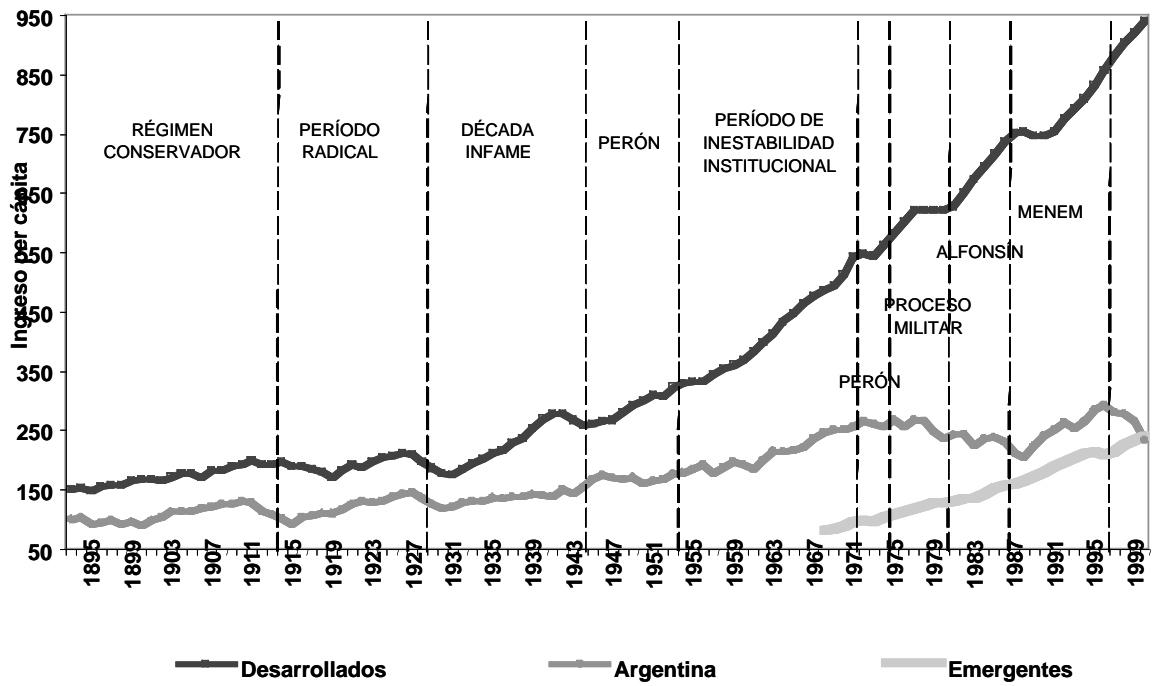
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# Figure 1

## Ingreso per capita 1895-2003



# Figure 2

