

# **The Argentine "productive model"**

## **Strengths and weaknesses of a heterodox economic model**

Julio Eduardo Fabris  
José Villadeamigo

### **INTRODUCTION**

Argentina is going through a period of high growth, driven by a dynamic aggregate demand in a context of expansion of employment and hence the wage bill, with a boost in the value of traditional exports (commodities and agricultural goods) and to a lesser extent, on industrial goods. It also experienced an increase in manufacturing output and a growth of import substitution, given the national currency devaluation after the default of 2001. Furthermore, it recovered the average level of gross domestic investment, greatly diminished after the recession and the crisis of the late 1990s, and there was an expansion of public expenditure, with the latter a mark on social spending.

This economic process<sup>1</sup> is referred to as the "productive model", rests essentially on the recovery of the activity level in good-producing sectors, specially manufacturing ones. During the last decade of the twentieth century, the output of this sector had been reduced very significantly, affecting in particular the existing branches of production goods and several intermediate goods. In those years financial and commercial liberalization and the effect of a low real exchange rate, led to the replacement of domestic production of manufactured goods with imported production.

Orthodox economists, and many analysts aligned with the political opposition, agree on the correlation between this economic boom and the commodities' international prices increase, thereby emphasizing the favorable external demand and underestimating the significance of domestic macroeconomic variables. They point out several weaknesses of the economic situation and the implemented policies, namely inflation, which has grown from 10% yearly, in the early years of the model, to 23% in 2010, according to private estimates; a shortfall in energy supply; the existence of subsidies that enlarge significantly public spending and price controls that discourage investment; persistence of a significant core of poverty and indigence and little improvements in personal income distribution.

However, despite the various criticisms the economic model<sup>2</sup>, received the achieved macroeconomic performance (economic growth, reducing indebtedness and unemployment, fiscal surplus, etc.) can be characterized as successful but without underestimating its weaknesses.

This paper analyzes the present Argentine "productive model" to identify its strengths and limitations. Special emphasis is conceded to rising inflation, one of the problems that received strong criticism from the detractors of the model. Very frequently they associate it with the expansion of public spending.

Regarding this problem, we consider the hypothesis of the existence of an average investment rate that is less dynamic than is necessary and with a composition that implies limitations to the increase in productivity. This behavior tends to perpetuate the existing bottlenecks and the creation of new ones, due to the inadequate composition of the investment in a growing global demand context.

Also, we assess the impact of distributional conflict hypothesis in the acceleration of inflation. This conflict was absent, until 2006, due to the adverse consequences of policies adopted in the 90's, exacerbated by the crisis that affected Argentina's economy until early this century.

Regarding the acceleration of public spending, we will try to demonstrate the inter-temporal inconsistency of the policies of lowering labor costs through subsidies on some goods and especially the consumption of certain services. This policy implies to allocate for this purpose a large amount of resources, which may be impossible to sustain due to its increasing dynamics.

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<sup>1</sup> It began in 2003 with the advent to power of Nestor Kirchner and continued with the presidency of his wife Cristina Fernandez de Kirchner.

<sup>2</sup> A portion of which is collected by the mass media, shaping the concept of "bad press" to the model.

Moreover, the possibility of carrying out a policy of incentives for production based largely on taxes on agriculture should not be considered sustainable over time. Given that tax deductions are not necessarily permanent, should be used, preferably, to implement a policy targeted to promote those sectors that can expand future exports. The appellant external constraint that in the past thwarted several incipient processes of growth, may, probably, reappear in the medium term if there is an adverse change in the external demand (expressed, for example, in unfavorable terms of trade).

It is this context that expresses one of the most important limitations of the model is the lack of a plan to promote diversification of production and industries with export potential, etc. To design and implement these policies would require questioning the desirable economic profile, the economic viability and political issues in the maelstrom of the moment are not being discussed with the breadth and seriousness that the issue requires.

The issues raised will be addressed from an analytical approach and trying to provide evidence from empirical data to support the conclusions of the analysis. Also, there will be a review of recent literature relating to the topics addressed.

## **THE RECENT DEVELOPMENTS OF ARGENTINA'S ECONOMY**

### **a) PRODUCTION**

The evolution of Argentina's economy from the severe economic crisis of 2001-2002 has features that we wish to emphasize.

The relatively rapid recovery of production, especially taking into account the long recession that preceded it and the very sharp fall in the level of production once the crisis erupted was triggered by a combination of: i) a balance-of- payment-crisis, a factor known for Argentina's economy and ii) a currency crisis that dragged down the financial sector, particularly linked to monetary and exchange rate regime sustained for a decade and very artificially in the last three years of the 90', iii) a fall in effective demand associated with a severe regressive redistribution of income. This was linked to changes due to the economic policies implemented in the process of openness of the economy during the last decade of the past century.

This recovery was based, especially in a strong dynamism in the goods production. This was related to the increase in the use of installed capacity followed by an expansion of productive capacity (increase in investment) in various areas of goods production as well as the adoption of improvements and technologies in other sectors (the primary one). There was a dramatic increase in aggregate demand, particularly in exports. Thus, foreign demand for some domestic production (food commodities and manufactures of agricultural origin) had a major influence in reviving the economy, at least at the beginning of the process.

Rising international prices of these goods was accompanied by a marked increase in the quantities produced in Argentina for several of these products (soybeans and derivatives, for example). This increase was related with a modification of the areas involved in the production of various agricultural goods. These changes however affected adversely the domestic supply of widely consumed foods such as beef.<sup>3</sup>

Such growth in the quantities produced of the agricultural sector was accompanied by two characteristics: one, the concentration of production on large estates<sup>4</sup>; the other, the introduction of technologies more intensive in capital and inputs. There was thus a sharp increase in the income of this

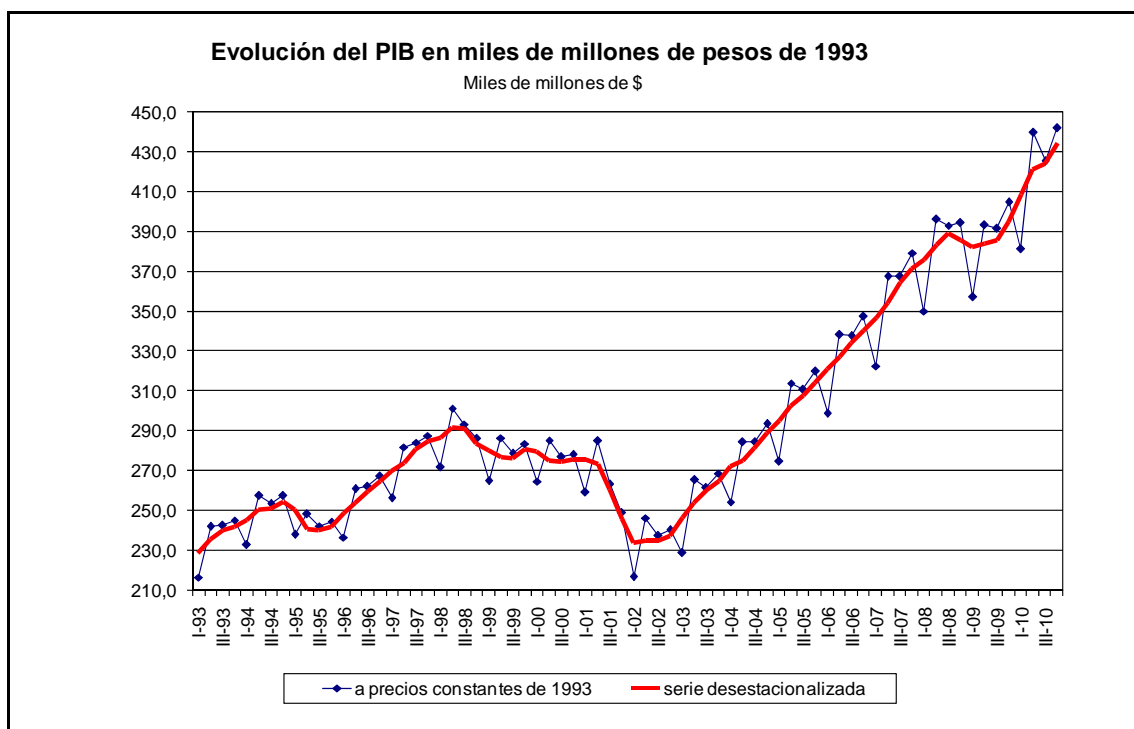
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<sup>3</sup> Beef supply was restricted, due in no small significance, by the shift of part of livestock production from prominent areas of the pampas to the margins of it. Then, the meat consume is reduced due to the high price achieved for this product.

<sup>4</sup> These were "extended" with types of leases and new forms of exploitation associated to some extent, to technological changes and the capitalization of the sector (the "pool" of planting, etc.). It is estimated that about 2,500 production units are responsible for 60% of soybean production. And adding the rest of the grains, it can be concluded that about 80% of cereal production is concentrated in less than 5,000 production units.

sectors which tended to focus on a relatively small proportion of proprietors<sup>5</sup>. This behavior contributed to the permanence of the regressive distributional pattern already established in the late twentieth century.

**FIGURE 1: GDP 1993-2010 – Thousands of million pesos of 1993**



Source: INDEC “National Accounts”

**Table 1: Variations of GDP and industrial production**  
Indexes. Year 1994 = 100

AÑO	INDEXES			
	GDP	Industrial GDP	GDP pc	Industrial GDP PC
1975	73	91	97	122
<b>1994</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
1997	111	108	107	100
2002	94	80	86	74
2007	143	131	125	115
2010	169	152	142	127

**Source:** Own elaboration on BCRA, INDEC and O. J. Ferreres

The other goods-producing sector that showed a sharp increase in production was the manufacturing industry. The output of the 2001-2002 crisis was swift due to the high idle productive capacity that allowed very high sectoral growth rates (14.3% on average considering five quarters from I-03 to I-04). In the following quarters achieved a lower average rate of increase than the previous one but

<sup>5</sup> Although a portion of medium and small landowners were also favored by leasing land contracts, it did not alter this picture.

also high (8% in IV-04 and IV-07) On the whole, manufacturing production increased by 64% between 2002 and 2007 and 16 percentage points between 2007 and 2010 (totaling 90% in eight years).

Then, the per capita industrial GDP (2010) stood somewhat above the average recorded in 1975<sup>6</sup>. Comparing the per capita industrial GDP in 1975 and 1997, leaving aside the values affected by the prolonged recession of the late 90's and the flattened figure of the 2001-2002 crisis, it appears that there was a fall of around 17.6%, reflecting the effect known as deindustrialization of the '90s.

At the end of 2007, the progress of re-industrialization process, as measured by increased production, faced certain limitations in the supply side of the upstream sectors and to some degree of expertise<sup>7</sup>, a slowdown in global demand in the domestic economy and a lower pace of investment, particularly in certain branches of industry output. This was coupled with the impact of the international crisis of 2007-2008 which accentuated the downward trend in demand and the investment weakness. The year 2010 brought a revival of manufacturing production (and the entire economy).

The re-industrialization process contains several notable aspects. On the one hand, it is possible to see the impact of industry in GDP; and secondly, is the composition of manufacturing output and its dynamics, focusing on various aspects, including its effect on the relative use of labor and capital; and then, the average labour's sectoral productivity and its evolution.

**TABLE 2: SECTORAL CONTRIBUTION TO GDP GROWTH**

GDP COMPOSITION	Million \$ 1993				Sectoral contribution to gdp Percentages of producer prices		
	2002	2007	2008	2009	02-07	07-08	08-09
<b>Actividad</b>	2002	2007	2008	2009	02-07	07-08	08-09
<b>Goods</b>	<b>71.486</b>	<b>116.198</b>	<b>119.603</b>	<b>115.422</b>	<b>40,63</b>	<b>16,39</b>	<b>-128,25</b>
Agriculture and livestock goods, Etc.	14370	19037	18523	15601	4,24	-2,47	-89,63
Fishing	433	465	484	427	0,03	0,09	-1,75
Mines and quarries	4916	5195	5250	5193	0,25	0,26	-1,75
Manufacturing	36176	59153	61842	61503	20,88	12,94	-10,40
Electricity Gas , Water	7182	9542	9863	9954	2,14	1,55	2,79
Construction	8410	22806	23641	22744	13,08	4,02	-27,52
<b>Services</b>	<b>154.498</b>	<b>219.014</b>	<b>236.874</b>	<b>244.560</b>	<b>58,63</b>	<b>85,97</b>	<b>235,76</b>
Commerce	27325	46219	49870,3	49751	17,17	17,57	-3,66
Hotels and Restaurants	6152	8745	9417	9486	2,36	3,23	2,12
Transport, Communications, Financial institutions	20664	37568	42129	44860	15,36	21,95	83,77
Real estate, etc.	12755	17280	20279	20436	4,11	14,43	4,82
Public Administ.	37238	46017,8	48902	50878	7,98	13,88	60,61
Education	14004	16133,8	16.758,0	17609	1,94	3,00	26,10
Other services	22.400	26.996	28.223,0	29.426	4,18	5,91	36,90
	13960	20054	21296,0	22114	5,54	5,98	25,09
<b>GDP Producer pr.</b>	<b>235.236</b>	<b>359.170</b>	<b>383.444</b>	<b>386.704</b>	<b>100,00</b>	<b>100,00</b>	<b>100,00</b>

**Source:** Own elaboration on INDEC, National Accounts.

<sup>6</sup> From this year there was a substantial change in economic and social reality of Argentina, and since then there would be a change in many ways was very significant, causing deterioration in welfare conditions of major population centers.

<sup>7</sup> Putting it briefly, there were shortcomings in the supply side, somehow linked to the country's structural economic deficiencies.

The manufacturing production sector showed the highest contribution to the GDP growth among the good's producing sectors (its production explained almost 21% of the increase in GDP between 2002 and 2007 and 13% in 2008). There was an increase of production activities closely related to the primary sector (MOA, Manufactures of agricultural origin), as well as an increase in the production of the MOI (Manufactures of industrial origin) branches that had survived the process of "structural reforms" implemented in the '90s and finally, the reappearance of sub-sectors of production that have not resisted the commercial opening of the economy during the 90's which decreased to a minimum their production, or proceeded to close their establishments.

Considering that the pace of growth of such clusters was different<sup>8</sup>, which would pose no significant peculiarities, it should be noted the existence of marked differences in the degree of development of such activities and the enlargement of the gap between the average values of productivity of each other with respect to the sector average.

**TABLE 3: INDUSTRY (MANUFACTURING)**

Indexes: hourly labour's productivity (IPHT) and employed workers (IOO)

Fecha	IPHT	IPHT	IOO	IOO
	Base I quarter 07=100	Annual Var. %	Base I quarter 07=100	Annual Var. %
I QUARTER 1990	57		126	
III QUARTER 1997	102,0		100	
I QUARTER 2003	116,4		71	
IV QUARTER 2007	139,1		97	
I Q 90/ IV Q 07		5,15		-1,44
I Q 03/IV Q 07		3,82		6,79

Source: CEP, Ministry of Industry

The expanding size of the manufacturing production wrapped both an augmentation of labor employment and an addition to capital and organizational improvements, which was more important in some of the industries. The variation of average labor productivity for the whole sector, as shown in Table 3, experienced significant growth not only compared to the low level of the first quarter of 2003 but also the numeral reached in 1997 (before the recession initiated in the third quarter of 1998).

This increase in productivity was achieved even with the increased employment of all manufacturing activities (Table 3). But the breakdown by major branches revealed marked differences in performance of labor. This indicates the existence of heterogeneity in the production conditions of the various branches of industry. This feature is not limited to the industrial sector but is also seen in all the productive activities of the economy, constituting one of the structural conditions in those countries of the lower level of economic development.

The second largest sector within the production of goods is Construction (contributed with 6.17% of GDP in 2008). Its growth was very high if we compare the gross value added in 2002 with the one of the year 2008 (increased by 181%). In 2007, it was the third sector considering its contribution to GDP growth, after the industry and the Transport, storage and communications activities. In the next year, 2008, yielded the third place to Trade, but continuing not too far away of this position (see Table 2).

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<sup>8</sup> "Initially, production sectors react more momentum were already clearly geared to foreign markets ... it was, in general, branches producing intermediate inputs of widespread use, in some cases also helped by good international prices (oil, base metals, fuels, leather). Given the possibility of placing their exportable surpluses abroad, these items that require the intense use of capital not only were the less likely fell during the recession, but also the ones that fastest recovered. Later in the same period, the most dynamic branches had some domestic market-oriented who had suffered intense competition from imports in recent years of convertibility, highlighting among others the textile and heavy engineering"; CEP, The industry in Argentina. Balance 2003/2007.

An important part of the GDP of the Construction sector complies with the Housing category. It should be noted that although there was some recovery in housing intended for low-income sectors, which unmet needs were increased significantly in the last three decades of the last century, the bulk of the homes built are dedicated to the middle-high and high income population.

In a more or less significant extent, these units are purchased with surplus revenue generated in the productive activities of the economy, constituting a form of deviation from the investment in other areas<sup>9</sup>. This behavior reaffirms traditional behavior of Argentina's economy, which has relatively large cumulative figures for the construction of so-called holiday-cities at home and abroad<sup>10</sup>.

**Table 4: Hourly Productivity \* Base 1993=100**

Description	2006	2007	2008	2009
<b>General Level</b>	<b>128,6</b>	<b>134,2</b>	<b>140,3</b>	<b>149,3</b>
Food and Beveridge 15	133,7	142,0	152,5	164,3
Products of snuff 16.-	79,6	98,0	124,5	128,0
Products textiles 17.-	83,1	87,0	82,1	81,9
Manufacture of wearing apparel; Termination and dyeing of fur 18.-	105,7	109,1	119,6	120,1
Tanning and leather finishing, Fab. Leather Products 19.-	169,7	191,3	205,0	225,1
Product. Wood and Fab. Wood Products and Cork 20.-	130,6	131,2	129,6	130,7
Paper and Paper Products 21.-	155,1	166,2	171,0	164,3
Publishing and Printing; Playing Recordings 22.-	136,5	148,7	169,8	161,6
Fab Coke, a product of oil refining 23.-	113,6	112,9	106,5	96,9
Chemicals and Chemical Products 24	118,5	119,0	126,3	140,6
Products Rubber and Plastics 25	145,8	146,9	147,6	161,0
Nonmetallic mineral products 26	141,2	143,5	149,0	158,6
Metals 27	130,3	130,7	143,1	141,4
Metal, Except Machinery and Equipment 28	114,9	114,2	111,5	113,7
Machinery and equipment nec 29	121,6	133,1	137,7	140,5
Machinery and apparatus nec 31	101,3	110,2	116,3	119,5
teams, radio, television and communication 32	95,1	98,8	106,8	144,7
Medical and Precision Instruments 33	111,1	139,5	144,4	146,7
motor vehicles, trailers and semitrailers 34	131,8	135,1	125,1	127,3
Equipment Transport NCP 35	82,3	82,8	71,4	71,3
Furniture & Mattresses, Ind. manufacturing nec 36	81,7	83,1	79,5	74,3

## b) THE EVOLUTION OF EMPLOYMENT

<sup>9</sup> It should be noted that the computation of gross domestic investment includes the construction along with the title Durable equipment (consisting of machinery and equipment and transport equipment).

<sup>10</sup> The south coast of Buenos Aires (Mar del Plata, Pinamar, etc.) and Punta del Este City –a luxurious Holiday city- in Uruguay.

The unemployment rate became higher during the 90's. In 1994 the unemployment rate amounted to 13,3%, rising to 19,8% due to shrinkage of the economy caused by the Tekila crisis. While there was a recovery in the next two years, the unemployment rate grew again from 1998 and reached a new record in 2002, with a rate of around 23%, which meant that at least 3,8 million people were unsuccessfully seeking for a job.

The recovery in employment levels is a hallmark of macroeconomics after the crisis. The unemployment rate declined substantially during the first decade of the century, so that in 2010 was estimated at 7.6% of the economically active population (EAP). It is noteworthy, then, the sharp difference between the last two decades regarding the incorporation of workers to production process: in the '90s, a GDP growth of around 49%, accounted for an increase of 19% staff employed and in the eight years of the first decade of the century, this last figure was 48%, while GDP increased 77%.

**Table 5: Change in GDP AND EMPLOYMENT**  
Between the ends of years indicated

Período	Change in GDP %	Change in Employment %
1990-1999 <sup>a</sup>	48,81	18,78
2003-2010 <sup>a</sup>	76,72	48,21

**Source:** Own elaboration on INDEC data.

The main sectors of the economy that contributed to job creation are registered or formal Manufacturing, Trade, Real estate and Construction, following them, although in much smaller proportions, Transport, storage and communications, Hotels and Restaurants and Financial activity.

The informal or unregistered employment also grew in the '90s. An important part of this type of employment is located in low productivity activities but also exists in other more developed activities. The sharp increase in labor informality was partly a result of the policies of labor market flexibility and also from the process of contraction of the production of goods and the resulting unemployment.

**Table 6: Unemployment and change of GDP rates**

Período	Unemployment rate	GDP rate Of change
1991	6,7	10,5
1992	7,8	10,3
1993	10,0	5,5
1994	13,3	5,8
1995	19,5	-2,8
1996	19,8	5,5
1997	15,5	8,1
1998	13,8	3,9
1999	14,3	-3,4
2000	15,7	-0,79
2001	16,8	-4,41
2002	22,7	-10,9
2007	8,8	8,65
2008	7,8	6,76
2009	8,8	0,85
2010	7,6	7,5

**Source:** Own elaboration on INDEC data.

Since 2003, although initially there was an increase in informality in absolute numbers, then began to decrease in its relative share in total employment as a result of economic recovery and the gradual abandonment of the so-called flexibility. However, still there is 33% of staff employed informally. The underemployment rate, meanwhile, now evidence a magnitude reduced from its levels during the late '90s.

It is possible to attribute the dynamic behavior of employment to several factors. On the one hand is the pace of economic growth and the type of activities involved in production growth (with the additional weight gained by the activities with more intensive use of labor). The revival of manufacturing industrialization had a positive impact on job creation, meanwhile in the 90's, an opposite process (the deindustrialization) had negatively impacted on overall employment of that period.<sup>11</sup>

Finally, it should be considered active employment policy that adopted the government since the outbreak of the crisis in 2001/2002<sup>12</sup>, what was described as a role of "employer of last resort"<sup>13</sup> played by the national government. It should be noted, however, that the last eight quarters evidenced signs of a slowdown in the addition of jobs to production process (a reduction in employment-output elasticity). This behavior does not make, yet, a clear trend. Since this is related to various aspects that influence the incorporation of labor in the production process, among which accounts the level of activity, the effect of international crisis may be an influential factor. Another one is the behavior of the level of investment and the magnitude of capital goods purchased or produced, in the economy. A third one is the composition of output<sup>14</sup>.

### **c) THE EVOLUTION OF INVESTMENT**

Another important aspect to consider is the investment process. Looking at the behavior of the investment rate of Argentina's economy in the second half of the last century (Figure 2) allows distinguishing two sub-periods, one, extending from 1950 to the late '70s and the other, spanning the last two decades of the century. In the first, we detected strongly increasing average rates of investment while the latter experienced a sharp decline on investment (during the 80's) and then a timid recovery in the '90s.

Thus, there are more years when the investment coefficient is below the average during the last decade of the century, when structural reforms were implemented. In the new century, the recession that began in the third quarter of 1998 and culminates in the profound crisis of 2001-2002, generated a very marked fall in the average investment rate (11,3% in 2002). Against this background, we find the sharp rise of investment since 2003, giving place to coefficients now above the long-term average.

It is interesting to make a comparison with Latin America and, specifically with Brazil and Chile (Table 7). It can be seen that in the second half of the '70s there was a rapprochement between the coefficients of Argentina and other Latin American countries, being Chile the case of an economy with a much lower rate of investment. In contrast, in the '80s has an equalization of average rates in the region, ranking below them Argentina. The crisis that affected overall LA in that decade, resulted in a decrease in average investment (except in Chile where there was an increase), but the favorable reaction during the '90s did not succeed in restoring the level of average investment of the '70s, with the exception of the Chilean case. Argentina was the economy that experienced the worst performance of investment since 1982; the reaction appeared only after the change in domestic and international macroeconomic environment since 2003.

The explanation for such behavior must be sought first, under the conditions of the international context (the stagflation of the '70s, the adjustment measures taken in the center of the world economy with the consequent reduction in prices of primary goods and rising interest rates and the bursting of the

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<sup>11</sup> It is estimated that the complete collapse of industrial employment accounted for 3.88 points of 5.86 for the total observed in the RMBA relevant between 1990 and 2001 (Damill and Frenkel, 2006).

<sup>12</sup> We refer here to the employment plans: workers, managers and heads of household, etc.

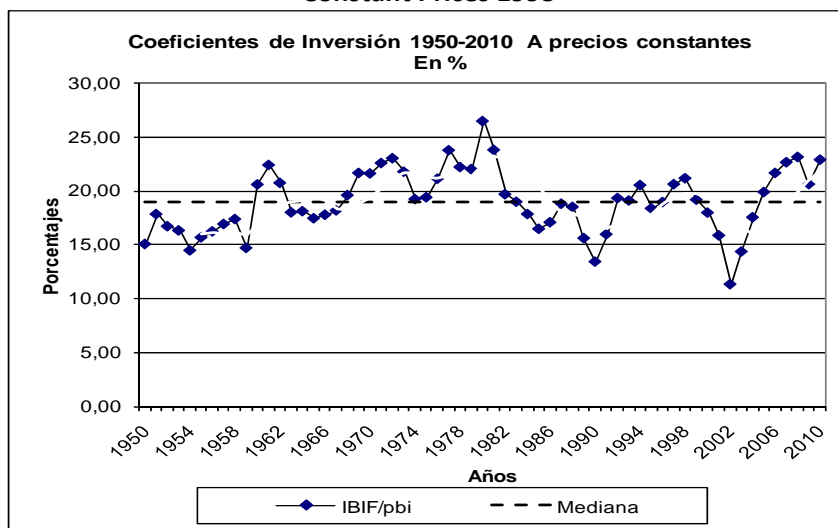
<sup>13</sup> Randall Ray, 2005, The Levy Institute of Bard College.

<sup>14</sup> We do not attach significance to the effect caused by changes in the relative price of labor since the substitution effect is not an important factor in the short term.



debt crisis that particularly affected developing economies) and secondly, the behavior of domestic variables. As well as other countries, Argentina also adopted restrictive policies to deal with external debt joined to other specific problems of the domestic economy.

**FIGURE 2: Investment rate 1950-2010  
Constant Prices 1993**



**Source:** Own elaboration on BCRA and INDEC data.

Those factors include a monetary and exchange rate policies that involved excessive revaluation of the currency (the famous "little board" of Martinez de Hoz between 1978 and 1982 and the dollar standard in force in the '90s) coupled with a significant reduction in tariffs (the commercial opening), financial reforms that ended up accentuating the difficulties of domestic financing of productive activities (the law of financial institutions in the late '70s, the separation of state and the closure of development banks) and strong fluctuation of the main macroeconomic variables (creating a situation of high volatility).

**Table 7: International Comparison: Investment rates (GDI/GDP)**

PERIOD	ARGENTINA	BRASIL	CHILE	Latin America
1974-82	23,80	24,18	16,90	23,85
1983-91	17,38	20,50	20,10	20,00
1992-01	18,91	21,25	24,90	21,40
2003-10	20,30	n.a.	n.a.	n.a.

SOURCE: Plan Fénix, Argentina

However, the latter aspect involves, to some extent, the problem of mutual influence between investment and income variables, ie, comes the need to establish the order of causality between them in tracing the origin of fluctuating production. Then, the volatility of the investment may be, if not a single and efficient cause, at least one factor that could be analyzed, in itself, when alluding to the change in income.

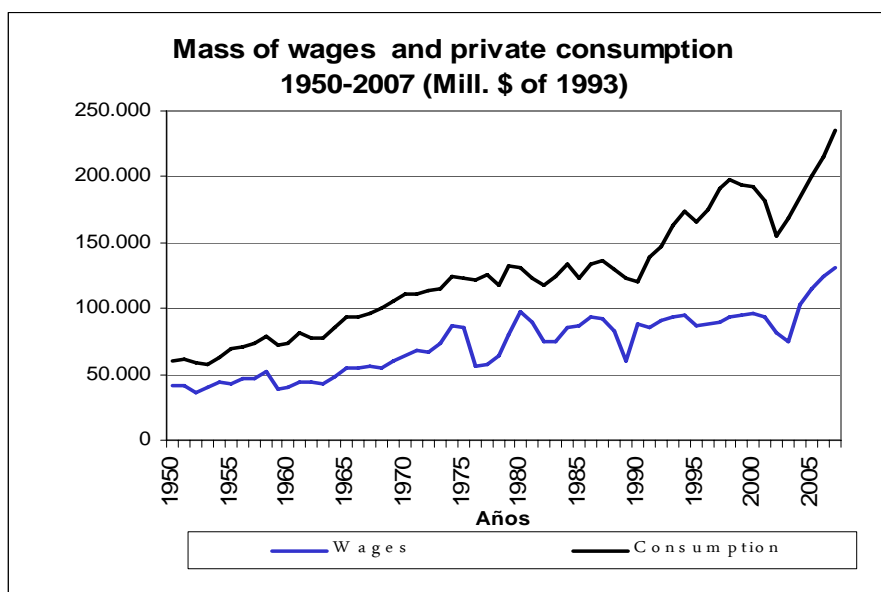
While the accelerator underlines the influence of income growth on investment, when the point falls within the sphere of economic cycle, can be better distinguished the need to focus on investment as a cause of it. In this case, the emphasis on corporate behavior in relation to investment seek to venture into

the reasons of the existence, or not, of sufficient magnitude of innovations to channel investment and therefore achieve growth or economic development<sup>15</sup>.

It is possible, however, to consider that certain contexts and macroeconomic policies, all together, can produce a kind of emphasis on the uncertainty, affecting more intensely investment decisions in a capitalist developing economy like Argentina.

It is also necessary to take special account of other important aspects when it comes to finding explanations for the explained investment behavior: a) the process of strong regressive redistribution of national income, experienced since the mid-70s, b) the creation of conditions for the development of an unblemished financial speculation<sup>16</sup> in several years from that decade; c) The purchase of foreign assets (and less significant hoarding currency), a typical feature in Argentina's economy<sup>17</sup>.

**Figure 3**  
**Mass of wages and private consume- 1950-2007**



Both the economic policies of the period 1976-82 as the reform period of the 90's led to a decline in real wages compared to 1974, decreasing also the wage bill, which affected the functional income distribution in a regressive way (See Figures 3 and 4). In turn, during the '90s, high unemployment, which is nourished in no small part by the dismissal of the restructured manufacturing and rural areas and towns of the interior of the country, joined the privatization of state monopolies with depressant effects on the level of employment and the policy of "flexible" labor (or labor market deregulation), influences shrinking wages. Poverty and indigence were thus present as a matter of quantitative significance, which was virtually absent in the ISI<sup>18</sup> model. All this caused the decline in income from work (and the weakening of aggregate

<sup>15</sup> The Schumpeterian theory of business cycle considers investment as closely associated with innovation. Therefore, Schumpeter's critique of Keynesian approach emphasizes the static nature of his theory on investment and suggests that this character becomes completely impossible to make a convincing treatment of it (J. E. King : 2009)

<sup>16</sup> It said that in the context of strong macroeconomic instability, several measures to promote productive activities escalated in the exploitation of "opportunities" that generated extraordinary incomes and also discouraged exports and industrial entanglement (Aspiazu, 1988)

<sup>17</sup> Capital flight is a longstanding fact in Argentina. In some periods are more acute, causing significant foreign exchange outflows.

<sup>18</sup> Import substitution industrialization.

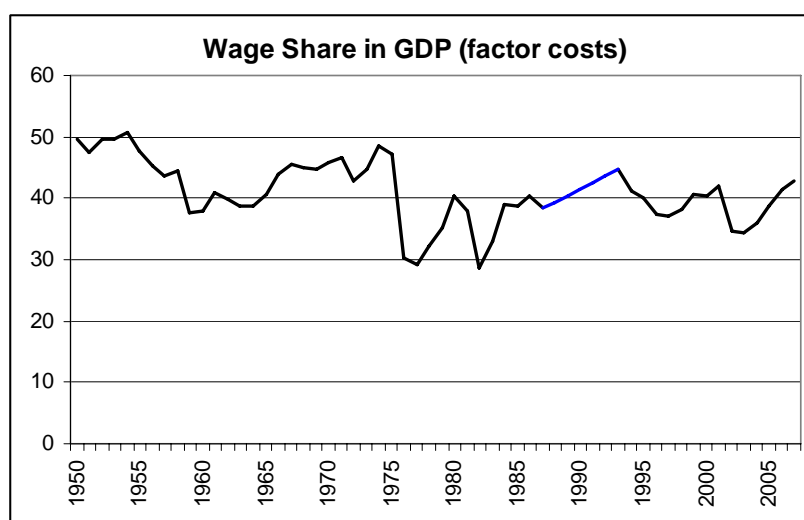
demand), a factor that once substantiated consumption and now recognizes in its root structural weaknesses.

### Correlation between mass of wages and private consumption

Periods	Correlation
1950-07	0,91808
1950-74	0,93546
1975-88	0,59703
1988-02	0,66959
2002-07	0,94935

Source: Prepared on BCRA data (1974, 1986) and INDEC National Accounts

Figure 4 . Wage Share in GDP (factor costs)



Source: Prepared on BCRA(1974-1987) data, INDEC, National Accounts (1993-2007)

It should be noted that the expansion of consumption in the '90s, relied on the demand of high income groups but also received, in a large extent, the effect of personal credit expansion based on the bank loans.<sup>19</sup> . So when the columns which supported the financial-monetary system of convertibility have been shaken, it was clear the impact of the credit crunch on consumption and became apparent the weakened base of it.

On the other hand, the promotion of indebtedness abroad between 1978 and 1982 and then in the second half of the 90s, collided with the generalized debt crisis of the early '80s and the closure of the sources of funds, afterwards. In both cases, finally, the process concluded with policies that limited public expenditure to sustain the payment of debt service.

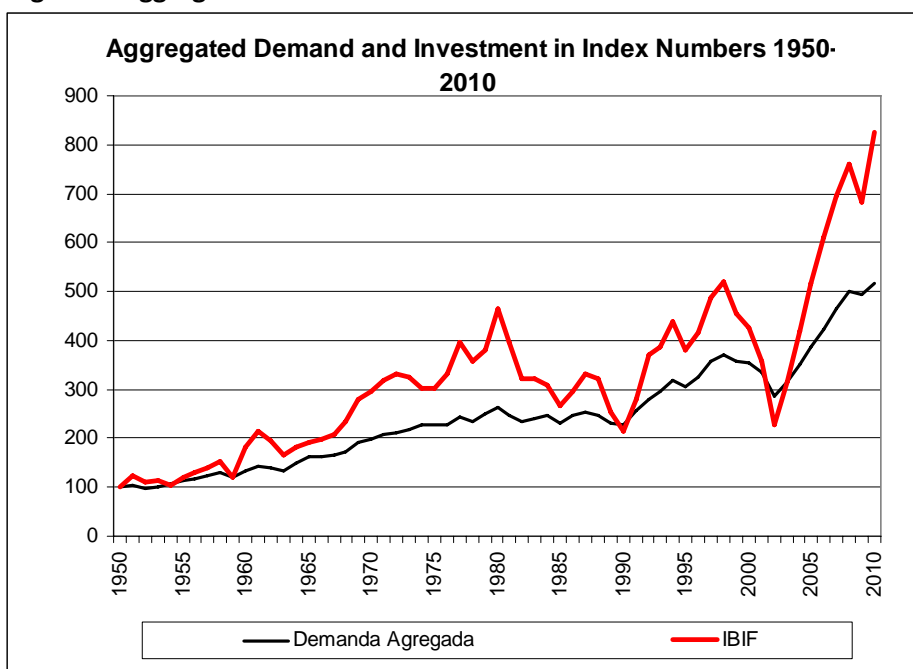
This process had led to stagnation if not shrinking and weakening of aggregate demand, which could not be offset by the growth of exports (Figure 5). This had an adverse impact on investment expectations by introducing a factor of downsizing of the domestic economy.

<sup>19</sup> The main part of this credit was profited by middle-income sectors.

Since the end of convertibility, the urgent need to address the crisis of 2001-2002 forced to implement policies to reverse the unemployment situation, to restore the conditions for wage change patterns, reduce the level of spending on public debt services, to increase social spending and to raise greatly the reduced public investment. All this added to the above mentioned modification of the monetary and exchange policies with the consequent rise in the nominal exchange rate. This, as noted above, pointed to a strengthening of domestic aggregate demand that came together with the dynamism of external demand directed towards traditional goods produced in Argentina. The rate of investment began to recover, rising quite rapidly and reaching, on average, 20.3% of GDP between 2003 and 2010.

Finally, we must approach the question of the composition of investment in capital goods. As can be seen in Tables 8 and 9, investment in construction has been the predominant portion of the whole investment while the durable equipment is the complement (in the 90's, the share of construction ranged between 56% and 66 % of total). The variations in the share of durable equipment are linked to the level of investment, so that when it grows it tends to be higher the segment devoted to this kind of goods. The share of construction decreased from 61% in the triennium 1993-95 to 57% in 2008-2010 (touching 54% in the last year)

**Figure 5: Aggregated Demand and Investment in Index Numbers 1950-2010**



**Source: Prepared on BCRA(1974-1986) data and INDEC, National Accounts (1993 basis)**

Durable equipment had an opposite behavior. The ratio of investment in machinery and equipment was in 1990-99, 5.36% of GDP and in 2007-2008, 6.42%. The increased amounts little more than a percentage point, being evident the need to increase this level, since it is the predominant mode of incorporating productive advance in the various sectors of national production and manufacturing in particular.

**Table 8 Composition of Fixed GDI: Construction and Durable Equipment**

YEAR	TOTAL Millions \$ 93	Construction Millions \$ 93	Durable Equipment Millions \$ 93	Construction %	Durable Equipment %
1993	45.069	27786,5	17283,0	61,7	38,3
1994	51.231	30529,6	20701,9	59,6	40,4
1995	44.528	27510,9	17017,3	61,8	38,2
1996	48.484	29222,5	19261,4	60,3	39,7
1997	57.047	33338,3	23709,2	58,4	41,6
1998	60.781	35270,4	25510,3	58,0	42,0
1999	53.116	31444,2	21672,1	59,2	40,8
2000	49.502	29772,7	19729,5	60,1	39,9
2001	41.750	26961,7	14787,9	64,6	35,4
2002	26.533	18283,0	8249,9	68,9	31,1
2003	36.659	24674,7	11984,8	67,3	32,7
2004	49.280	31037,2	18242,3	63,0	37,0
2005	60.458	37385,7	23072,8	61,8	38,2
2006	71.438	44288,6	27149,6	62,0	38,0
2007	81.187	47899,0	33288,0	59,0	41,0
2008	88.553	49853,0	38700,0	56,30	43,7
2009	79200,0	48081,0	31446,0	60,46	39,54
2010	96409,0	51000,0	44380,0	53,97	46,03

Source: Idem previous table

**Table 9****Fixed GDI: Durable Equipment and Machinery and equipment, domestic and imported**

YEAR	Durable Equipment			Machinery and Equipment		
	Total	Domestic	Imported	Total	Domestic	Imported
1993	100,0	64,33	35,67	100,0	60,89	39,11
1994	100,0	57,23	42,77	100,0	53,27	46,73
1995	100,0	58,92	41,08	100,0	57,20	42,80
1996	100,0	54,56	45,44	100,0	54,50	45,50
1997	100,0	47,99	52,01	100,0	47,01	52,99
1998	100,0	45,60	54,40	100,0	45,16	54,84
1999	100,0	47,60	52,40	100,0	44,84	55,16
2000	100,0	46,77	53,23	100,0	43,06	56,94
2001	100,0	48,59	51,41	100,0	48,10	51,90
2002	100,0	71,79	28,21	100,0	75,84	24,16
2003	100,0	60,67	39,33	100,0	62,90	37,10
2004	100,0	48,92	51,08	100,0	52,64	47,36
2005	100,0	45,27	54,73	100,0	48,46	51,54
2006	100,0	43,14	56,86	100,0	45,14	54,86
2007	100,0	39,70	60,30	100,0	41,24	58,76
2008	100,0	36,04	63,96	100,0	38,41	61,59
2009	100,0	41,36	58,64	100,0	43,89	56,11
2010	100,0	35,29	64,71		s. d.	s. d.

Source: Idem previous tables

The other remarkable feature of the process is the external acquisition of durable equipment and machinery and equipment. The rise of the investment rate was significantly correlated with the increase in expenditures on durable equipment (the correlation coefficient is 0.8995), reflecting an increase in imports of capital goods. This means that domestic production of such goods has a lower level and covers a narrower range than the respective domestic demand.

Another important aspect is the distribution of investment within sectors. Available figures indicate that there has been an increase in the utilization of installed capacity, and increased investment in various sectors of production. Although manufacturing activities have generated a significant proportion of imported capital goods, between 23% and 28% in the period 2003-2009, this concept seems to have reached a relative maximum or a roof level.

However, it should be emphasized that the absolute volume of capital goods imports by the manufacturing industry has greatly exceeded the values of 1998. To the extent that this item affects capital accumulation and incorporates technology to production processes is leading to productive progress. But also indicates that the rate of imports substitution in these goods -a significant factor with respect to progress towards the industrial transformation - does not show the desired progress towards diversification within sectors.

**Table 10**

**CAPITAL GOODS IMPORTS, total and by manufacturing (In million u\$s and percentages)**

<b>YEAR</b>	<b>Manufacturing Imports (1)</b>	<b>Total Imports of capital goods (2)</b>	<b>(1)/(2)</b>
	Millions u\$s	Millions u\$s	%
2003	712	2495	28,54
2004	1.240	5331	23,26
2005	1.591	7011	22,69
2006	1.889	8201	23,03
2007	2.583	10396	24,85
2008	3.103	12668	24,49
2009	2.016	8652	23,30
2010	2.820	11999	23,50

Source: CEP Ministry of Industry and INDEC

Another aspect of this progress, essential for reducing productivity gaps between the various branches of national production, is the aggregate expenditure on R & D (Table 11) Its relative size is small and the economic recovery experienced in Argentina since 2003 has not yet managed to increase it enough in order to expected to take the proper proportions.

**TABLE 11: Argentina: EXPENDITURES ON R&D**

<b>YEAR</b>	<b>% of GDP</b>
2003	0,39
2004	0,41
2005	0,44
2006	0,46
2007	0,49

Source: CEP Ministry of Industry and INDEC

**Table 12: EXPENDITURES ON R&D by manufacturing**

<b>Year</b>	<b>Index Numbers 1998=100</b>
1998	100
2001	121
2002	171
2003	210
2004	311

Source: Idem previous table.

#### **d) STRUCTURAL HETEROGENEITY OF ARGENTINA'S ECONOMY**

The Latin American structuralist thought created the concept of structural heterogeneity applied to the characterization of underdeveloped economies. The definition of the term refers to the production structure of the economy, emphasizing the differences between the economies of the Centre and the Periphery.

Also, it is possible to define the basis of the occupational structure. The production structure is said to be heterogeneous when the sectors, branches or activities in which job performance have reached levels characteristic of products with advanced technologies and, in general, incorporates heavy doses of capital, with others in which productivity is much lower. And noted also that this difference is much greater in the periphery than in the centres. (Aníbal Pinto, 1976).

Also, the production structure corresponds to some type of occupational structure, so that one is reflected in the other. It is, therefore, that in underdeveloped economies (of the periphery) the employed labor force is divided between those that obtain high wages and others that achieve only meager results of their efforts. Then it's possible to differentiate them based on their performance and determine the magnitude of labor working in conditions of high or normal productivity and the kind of labour with very low productivity (the mass of underemployed).

The other feature of these economies is the high magnitude of underemployment, much higher than that observed in developed countries (the Centre. And this feature appears through wide swathes of production, finding that the average performance of labor as a whole is relatively low. That is, the structural conformation of a typical developing economy (peripheral) explains their low productivity, in contrast with the structure and performance of labor of advanced economies (or central core).

Thus, some activities are identified as typical of developed capitalism, others of a developing capitalism and the ones with low productivity; far from the levels corresponding to the other two items (Coatz D., and F. Garcia Diaz, Woyecheszen S., 2010). It is estimated that in Argentina, by the year 2006, slightly less than half of those workers and decided to do so (PEA) were employed in low productivity occupations or had no job. And, taking into consideration the activities which they held a similar job performance or approximate to that of developed economies, a quarter of the *economically active population* was employed in more productive activities. If you add to this last group, the EAP employed in the public sector, this ratio would reach about 39% -40% of the total economically active population<sup>20</sup>

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<sup>20</sup> This total, called EAP Extended, includes the unemployed who have stopped looking for employment due to discouragement or other reasons around this, but such behavior doesn't indicate that they *have decided* to remain idle.

**Table 13 Argentina: Economically active population by strata (Second Half of 2006)**

<b>Whole Economy</b>	<b>People</b>	<b>%</b>
<u>I -Developed Capitalism</u>	<u>1.548.541</u>	<u>10,1</u>
Employees ENGE (>500) 2,9	445.980	2,9
Employees of large-medium enterprises (200-500)	545.087	3,6
Profesionales independientes	557.475	3,6
<u>II -Developing Capitalism</u>	<u>6.461.786</u>	<u>42,3</u>
Higher average productivity.	2.934.115	19,2
Lower average productivity	3.527.671	23,1
<u>III -Informal Sector</u>	<u>5.520.246</u>	<u>36,1</u>
Low – marginal productivity	1.932.086	12,6
Subsistence	2.539.313	16,6
SS Doméstico (Housekeeping ')	1.048.847	6,9
<u>IV -Hard Core Unemployment</u>	<u>1.763.507</u>	<u>11,5</u>
Extended EAP without public sector	15.294.080	100
Extended EAP Total	18.493.065	

Source: Coatz et alia

#### e) THE REINTRODUCTION OF INFLATION.

The inflation rate in Argentina's economy between 2002 and 2010, according to the official indexes, it is 9.33% per annum. Since 2007, there was a change in the methodology of collecting and processing data by the official agency which raised serious doubts about the credibility and validity of reported rates. For this reason alternative estimates are displayed by private entities. According to them the inflation rate is higher than that measured by the INDEC.

**TABLE 14: SELECTED ANNUAL PERFORMANCE INDICATORS**

**INDEX NUMBERS Base 2002=100 - PERIOD 2002-2010**

<b>Year</b>	<b>CPI</b>	<b>GDP mp</b>	<b>Exchange rate</b>	<b>IPM Non Agricultural (1)</b>	<b>Nominal Wage</b>	<b>Real Wage</b>	<b>Unemployment</b>
2002	100	100	100	100	100	100	24,3
2003	116,22	108,84	93,35	119,1	121,42	104,47	22,4
2004	121,1	118,67	93,35	127,91	136,67	112,86	18,1
2005	132,17	129,56	92,7	139,3	161,15	121,92	11,58 (13,18)
2006	146,58	140,52	97,28	151	194,57	132,74	10,18 (12,0)
2007	159,48 (176,63)	152,68	98,6	167,31	231,07	144,89 (130,8)	8,5 (9,7)
2008	170,96 (218,14)	163,0	108,1	192,53	280,18	163 (128,44)	7,9
2009	184,13 (250,86)	164,39	119,14	207,31	326,94	177,56 (130,32)	8,7
2010	204,196 (312,39)	179,45	125,06	237,8	413,05	202,28 (132,22)	7,5

Source: Prepared on INDEC data and private estimations for CPI. (1) WPI non-agricultural

#### Notes:

The Exchange rate was calculated comparing the last working day of December of each year.

The nominal wage, since 2008, corresponds to the general level (registered and no registered)

Values in parentheses correspond, in case of prices, to private estimates and for unemployment to values that include public employment schemes.



Both estimates are shown in Tables 14 and 14 Bis. Thus, the average consumer price increase in 2007-2010 becomes 15.3% annually. Thus the difference in estimations indicates a more pronounced acceleration of the average growth of prices in the economy since 2007. Then, the impact of international economic and financial crisis and the effects of a drought severe enough, coupled with the conflict over taxes on agriculture, resulted in a sharp slowdown in economic growth and a reduction in the average rise in domestic prices (2009). In 2010 it returned to growth of the economy and there was a further acceleration of price increases, yielding a higher rate (both in the official estimate and the private).

**Table 14 bis: Annual variation of different indicators. Percentages**

Year	CPI (1)	CPI (2)	GDP mp	Exchange rate	IPM Non Agricultural (1)	Nominal Wage	Real Wage (3)	Real Wage (4)	Unemployment
2002									24,3
2003	16,22	-	8,84	-6,65	19,10	21,42	4,47	4,47	22,4
2004	4,20	-	9,03	0,0	7,40	12,56	8,03	8,03	18,1
2005	9,14	-	9,18	-0,70	8,90	17,91	8,03	8,04	11,58 (13,18)
2006	10,90	-	8,46	4,94	8,40	20,74	8,87	8,87	10,18 (12,0)
2007	8,80	20,50	8,65	1,36	10,80	18,76	9,15	-1,46	8,5 (9,7)
2008	7,20	23,50	6,76	9,63	15,07	21,25	12,50	-1,80	7,9
2009	7,70	15,00	0,85	10,21	7,68	16,69	8,93	1,464	8,7
2010	10,90	24,53	9,16	4,97	14,71	26,34	13,92	1,458	7,5

Source: Previous table. (1) CPI INDEC (2) Private estimation (3) Indec (4) Using CPI (2)

The review of the situation in an analysis that includes other indicators (aggregate output, wages, retail prices and wholesale level, with and without commodities, exchange rate and level of employment and unemployment) can evidence the reasons that lead to consistent and coherent with the facts explanation.

The explanation of the Argentine inflationary process takes into account the following aspects:

**1 .- Increase in international prices of commodities (food and oil). The existence of supply constraints in some strategic sectors of the economy and the establishment of subsidies to users of key services.**

The rise in international prices of domestic primary production caused upward pressure from food prices. The international crisis provoked a fall in prices of 'commodities', but since the second half of 2009 there was a recovery in several goods prices, placing it on the levels of 2007. While the export taxes slowed the rise in domestic prices, there are other important effects that impact on wage goods.

One effect is the result of the spatial reallocation of livestock production and modification of the relative profitability between this activity and agriculture. Another effect is the process of concentration of land ownership, changes in the number of establishments and the relative yields of livestock in the context of various types of establishments engaged in such activities.

These events, which are not confined to the first decade of this century, led to the fall of the cattle stock and the resulting decrease in supply of beef. There is thus an upward pressure on beef prices quickly impacting on the closest substitutes goods (pork and poultry and fish) and then at various points in the food consumption (dairy products, flour, etc.).

In addition, it should be taken into account the relative narrowness of the productive capacity of items of fairly widespread use as energy inputs, petroleum, gas and electricity, and providing direct services

to the production and families (transport). This limited supply is a burden on business costs impacting more heavily on those cases that demand shows greater relative intensity<sup>21</sup>.

It is recalled that one of the measures applied to address the crisis in 2001-2002 was the introduction of subsidies to those sectors above mentioned (as the devaluation of the change had a significant impact on inflation, which is partially associated with the impoverishment suffered by a significant part of population, the increment of prices of indispensable services would have entailed an additional weight to that had already endured).

Although a portion of these grants was reduced (by excluding large users engaged in production, in the case of electricity and gas as well as certain groups of consumers whose consumption exceeds certain levels), they still represent a significant magnitude, especially when taking into account its weight on public accounts and on household spending. The latter effect is the virtually increase of their income, after payment of subsidized services compared with the amount they would receive if they were abolished.

An example to consider is that of those people whose spatial location requires them to make daily trips which are very costly given their low income levels (in general, families belonging to lower income groups, inhabitants of second and third strings of Buenos Aires Metropolitan Region).

## **2 .- Increase in production (and pari-passu in employment) were introduced without sufficient organizational improvements, technological adaptation and additional allocation of capital in various branches of production.**

As stated above, the strong recovery in industrial production and the restoration of discontinued operations and the productive heterogeneity meant increased costs of production. As wages were recovering, the unit cost increase was felt, especially in several branches of activity that are characterized by less use of capital and the use of less efficient technologies. This implied that the marginal cost increase is passed to prices when aggregate demand is increasing.

## **3 .- Oligopolistic structure of production**

The concentration in the production of goods and in various services, a phenomenon that has intensified since the second half of the 70's of last century and was very clearly outlined in the 90's, implied the existence of firms with strong market power. A trend of increasing costs (such as wage increases or price of imported inputs) will be moved to prices, if the business strategy adopted by enterprises is compatible with it. In general, corporate behavior is to transfer to prices the increments in variable costs, given the widespread mechanism of the "mark up".

## **4 .- Increase in demand for consumer goods and luxury real estate**

This increase is funded by surplus revenue or benefits not reinvested and that, therefore, not allocated in order to expand the productive capital stock of the economy. Those outlays generate, in general, an impact on prices of the respective purchased assets, at least in the short term.

## **5 .- Accentuation of the distributive struggle in a context of increasing price rises.**

The view of inflation as a distributive conflict appears as an interpretation that fits the behavior of the acceleration of inflation as indicated above. As Keynes pointed out, the sources of inflation may be

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<sup>21</sup> In the case of transport, the widespread use of tracking means a more expensive service given the rising cost of oil. Also, the passenger transport model, with a significant incidence of private cars, pose noticeable rising costs.

associated with non-cooperative behavior of social groups when they are facing conditions that threaten their positions in the income distribution<sup>22</sup>.

The analysis of the facts on which the vision of the dispute over the income is shown as a valid interpretation or more acceptable, appears especially when a strict interpretation rejects other approaches (for example, very often the root monetarist or more or less related versions of this theory). The recent versions of this approach have led to a more complete formalization and thus has facilitated the economic treatment of the problem<sup>23</sup>

In Argentina, the issue of wage-price spiral has a known tradition. It may be associated with those considered as "diffusion effects" of rising prices, according to the structural theory of inflation. This distinguishes them from the supply constraints that cause the "basic pressure" on prices.

The structural approach to inflation was frequently applied to explain the nature of Argentina's inflation. However, treatment of the price increase that emerged from that theoretical interpretation collided with several limitations, a number of them of not purely economic nature and therefore relevant anti-inflationary strategies do not achieved their goal. This limitation was placed on the theory itself, considering it ineffective rather than attributing it to the adopted instruments or the political difficulty of carrying it out.

The current Argentine inflation process can be well understood in accordance with the approach of distributive conflict. The wage-price spiral appears as a central element of inflation from 2007. The acceleration of price increase takes place in a macroeconomic context in which the following is true:

- a) The positive trade balance is maintained and can afford the Investments Revenue's deficit of the current account, leaving a net surplus currency. The Central Bank buys the surplus to build up reserves. Export of capital exists in the order of 3.1% -3.6% of GDP per year. The exchange rate reflects the relative abundance of foreign exchange and faces an accelerated inflation rate, so it tends to generate a certain appreciation of domestic currency;
- b) The national budget shows a primary surplus and the financial result is positive<sup>24</sup>,
- c) GDP increases at a sustained high pace, interrupted only in 2009, given the circumstances outlined above. The increase in exports, in physical terms closely associated to changes in the structure of commodity production<sup>25</sup>, maintains a negative influence on the supply of meat and other products causing upward pressure on its price and just as impacting on wage goods;
- d) The prices increase initiated in 2002 in a very high rate of unemployment environment. The recovery in employment took place within eight years, so that in 2010 the unemployment rate was 7,5%, diminishing about 15,5 percentage points (from 23% to 7,5%). Nominal wages increased and there was a recovery in average real wages;
- e) After the default announcement and debt restructuring, the economy hasn't experienced a rise of debt services and there was a debt reduction. Imports grew and the government increased the tax burden;
- f) There was an increased mass of credit provided by the financial system.

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<sup>22</sup> Keynes: 1940. The work of Holzman, Aujac and Smithies moved in the direction suggested by the interpretation of J. M. K. , posing in some detail the characteristics of a situation in which the dispute over the income and circumstances of relative power of relevant social groups, are joined in a process of widespread price increases.

<sup>23</sup> Given that the sociological aspect of the previous works were, according to reasonings of some people, a limitation of the theory.

<sup>24</sup> It has been noted by those inclined to root monetarist approach to foreign exchange purchases that fuel reserves are not funded in full by the budget surplus and that, instead, the Central Bank purchased with the monetary issue. But the central bank sterilized much of the increased liquidity by placing bonds in the square (and NOBAC, LEBAC). Apart from this, is the fundamental objection to the monetarist view of inflation (J. Robinson, N. Kaldor, Harcourt, among several others)

<sup>25</sup> The above-mentioned phenomenon of "soybean production 'and its impact on the supply of food (beef and other products)

The above facts can be framed within a more equitable distribution model in which rising prices (inflation) is a function of the real wages that workers aspire to obtain, gross margin desired by employers and labor productivity:

$$\pi = (\beta d \omega / a) - 1 \quad (1)$$

Where  $\pi = (p_t - p_{t-1}) / p_t$ : is the rate of price increase;  $\beta d = (1 + m)$ : gross margin desired by employers;  $\omega$ : the real wages which workers aspire to obtain;  $a$ : labor productivity.

If (1) is  $(a / \beta d) = z$ , then:

$$\pi = (\omega / z) - 1 \quad (2)$$

The expression (1) is known as gap aspirations (Rowthorn, 1977) in both (2) indicates that  $z$  is equivalent to the real wage that employers offer in terms of gross margins they want. And  $\omega$  is the goal sought by workers. The distance between the two is reflected in price increases as  $\pi = (p_t - p_{t-1}) / p_{t-1}$

If one takes into account the gross output of the economy after taxes and payments to the rest of the world, and is represented as the sum of the proportions received by workers and employers, we get the expression that indicates the identity of nominal gross income and adding the share of profits and wages (wage bill).

$$pY = B + WL \quad (3)$$

$$pY = rK + WL \quad (4)$$

Where  $r$  = rate of return,  $K$  = capital stock

Dividing (4) for  $pY$ :

$$1 = (rK / Y) + (W / p) (1 / a) \quad (5)$$

$$1 = b + w \quad (5 \text{ bis})$$

It follows that the profit share is equal to one minus the ratio of payments to workers:

$$b = 1 - w$$

And the rate of benefits is as follows:

$$r = (pY - WL) / K \quad (6)$$

Now, considering that enterprises have pricing power, that are not running policy of quantities only, alike in perfect competition, it holds that:

$$p = \beta d (L / Y) W_t = \beta d (W_t / a) \quad (7)$$

It is possible to replace  $p$  by the same as (7), which yields the following:

$$r = (Y / K) - (Y / \beta K) = Y (\beta - 1) / \beta K \quad (8)$$

That's why we can say that given certain level of the real product, the profit rate depends on the gross margin business. If the product is near of to full employment level, then, is clear that the aspirations gap may cause a rapid rise in prices, provided that there was parity of power between the two social groups. If the business group has a market power that would prevent the existence of a difference between the desired and the actual margin achieved, then the participation of employees in the rent would be set by the real effective wage level given the labor productivity in the economy. And if instead, was greater the relative power of employees, the opposite would happen.

In case  $r^d = r$  or  $\beta^d = \beta$ , it follows that:

$$(B^d - 1) / \beta^d = 1 - (W / p) (1 / a) \quad (9)$$

When enterprises succeed in imposing their market power (or the State intervenes in this regard)

If there is enough power to organize union actions to defend the real wage level and thus the revenue share of labor income, the following happens:

$$((B^d - 1) / \beta^d) + \omega / a = 1 \quad (10)$$

When employees can get into account the real wage target.

The evolution of income distribution in the case of the distributive struggle depends on the possibility of introducing a full indexation of nominal wages, that such indexing is performed at regular intervals of a fixed duration and that the real wage  $\omega$  keeps its level. Then, the distributional effect will depend on the wages offered by employers ( $z$ ) (since  $z = a / \beta = W / p$ ).

So when there is inflation, is essential to have the possibility of full indexation at regular intervals in order to hold a certain share of income.

An additional issue is the possibility of determining the target variables (target salary  $\omega$  and gross margin  $\beta$ d). It is interesting to establish the link between the latter and the behavior of real economic variables, specifically, levels of activity and employment.

It is a known fact that the situation in the labor market and unemployment are keys to the real wage level. Thus, the bargaining power of workers is closely related to the magnitude of unemployment, in addition to the existence of a sufficiently or substantial union's power. In addition, conditions affecting market goods are also important. In circumstances of a boom, companies are more inclined to bargain for higher wages against the claims of workers and vice versa in rather restrictive conditions. Then, one may consider a link between the situation in the market for goods and labor when wage bargaining takes place.

This link leads to employment levels, real wage target, effective salary and rate of inflation. It is achieved thereby establishing a relationship between inflation and the employment rate, the concept of balanced inflation rate, equality between the desired salary and the present or effective real wage to a certain level of employment.

Given this, it appears, then, the searched of the reason to establish a gross margin and modify it. One way to do this is to investigate the origin of the degree of market power. Certainly, economic concentration is a factor that exerts an undeniable influence (though not necessarily the only important thing.) Another reason is the causal link between the level of employment and gross margin. If it is chosen as the main factor determining the target range by employers,  $\beta^d = \beta^d (L / eap)$ , and are assumed to be, in the short term, a constant relationship between GDP and employment, real wages will equal the inverse of the margin:

$$W / p = 1 / \beta^d (e) \quad \text{where } e = L / EAP$$

It is possible to plot a Cartesian representation, where the vertical axis shows  $W/p$  and on the horizontal axis  $e$ , to display the functions of *desired real wage*, the *effective real wage* and the point of intersection of both functions. Faced with an incremented level of employment,  $e$ , there will be a lower effective real wage and a higher desired real wage, which widens the gap between them. The central question then is how to close this gap. Now that the gross margin is determined endogenously, there are more intense redistributive effects (thus shifting the function of the *desired real wage* right down which requires a greater decrease of the real salary and a redistribute effect consistent with it.) However, if it is chosen to move the effective real wage function, the redistribution would play against the companies. An intermediate solution would appear as an acceptable compromise, in order not to incur in a recessive adjustment to stop the ongoing process.

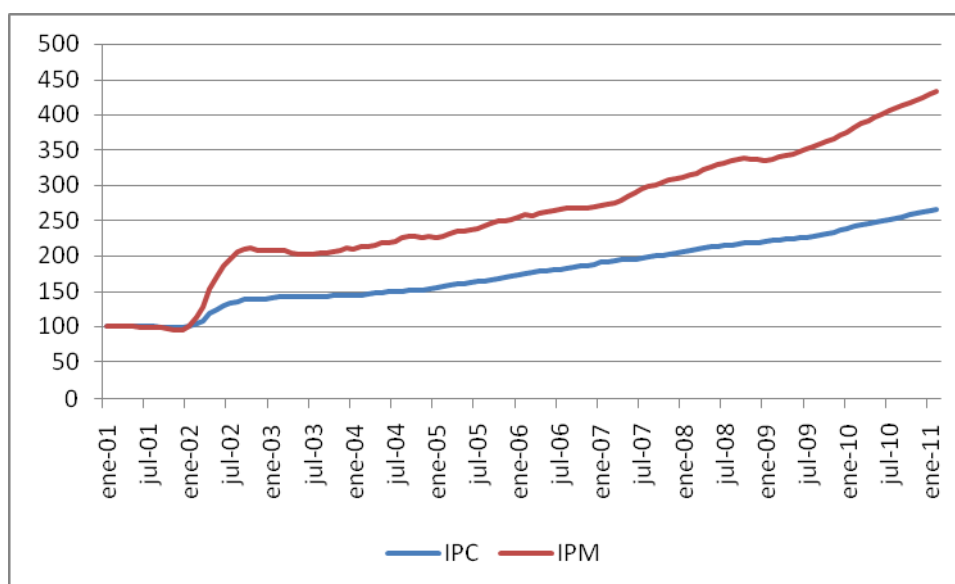
Finally, note that there is a possibility that the level of activity is not strictly relevant to the employment level. In this case, the gross margin would move independently of the demand for labor, but would be linked to the change in the degree of utilization of installed capacity. Or, if exists an increase in government revenue (taxes) or an augmented claim of the rest of the world (higher payments abroad). Then, the gap in expectations and the inflation rate would no longer relate mainly to increased demand and in this place, would be the so-called real shocks.

This approach to inflation due to distributive struggle corresponds well enough with the highlights for the case of Argentina in recent years. The significant increase in the level of employment and GDP growth, nominal wage growth and the restoration of salary discussions via collective labor agreements, the high concentration on the side of the business and the strengthening of trade unions, a situation of sustained economic boom and the expansion of credit associated with it, are elements of the explanation of inflation based on conflict. It must be added the effect of increasing the tax burden and the impact of the purchase of foreign assets by large holders of money. Moreover, it must be taken into account the investment behavior, detailed above, and the peculiarities of Argentina's economy as "developing economy."

In response, anti-inflationary policy should consider the nature of current inflation and the need to adapt it to a process of growth and development that requires state intervention.

## THE PROBLEM OF SUBSIDIES

As explained above the policy of subsidies to energy, transport and food production, has the rationale of a generalized subsidy to the industry by reducing (in a highly inflationary context, relative decline compared to the general price level of the economy) in real wages. This policy, which appears as a freezing of some prices in an inflationary environment, and whose magnitude can be verified by comparing the Wholesale Price Index vis a vis the Consumer Price Index, decrease the relative costs of labor, which in turn promotes employment and decrease the industrial's production costs<sup>26</sup>. It is a policy that might well be characterized as a compromise between the interests of national employers and labor union's demands.



WPI vs. CPI during Post-convertibility - Base 100: January 2001

As has been pointed out repeatedly<sup>27</sup> from various approaches, such policies are possible, as contrary to the most extreme views, that pose an irreducible contradiction between capital's and labor's interests<sup>28</sup>, but they are also transient in nature. In general, this kind of economic measure allows the redeployment of industry in the event that it is working with low utilization rates, and in a context of unemployment. As economic activity grow and incorporate workers into the production process, spending

<sup>26</sup> See Basualdo : 2008

<sup>27</sup> See Canitrot : 1975, Bhaduri and Marglin : 1990

<sup>28</sup> See Katz : 2010

on subsidized goods also grows, increasing the amount of subsidies provided. Furthermore, the existence of inflation make that the delayed rates generate an increase of the subsidy, since the frozen prices became more and more distant from the hypothetical market prices.

On the other hand, one might think that these price freezes, once established, could serve as an anchor for inflation. However, their current influence as containment of rising prices is clearly ineffective. The situation is even worse if we think that the release of price subsidies, would have a significant effect on the price level and in the purchasing power of wages, with consequent disruptive effects, namely, the slowdown demand, the accentuation of the distributive struggle and probably the weakening of trade union support to the "productive model". That's why the subsidy policy, if sometime an anti-recessionary weapon has gone on to become a swords of Damocles for the model and probably has to be replaced. To study alternatives to it, we will separate the effects of this measure and possibly, will be necessary not one but various policies to replace the subsidy policy.

On the one hand, subsidies lead to increased purchasing power of workers because they kept frozen the prices of several important consumer goods, and then the purchasing power of wage increases or, alternatively, is maintained, although wage increases do not go to the rhythm of the rise in other prices. In addition, subsidies have the effect of encouraging the industry via the relative cheapening of labor from the rest of the costs of the economy.

On the first effect of subsidies, their disappearance would mean a heavy blow to the power purchase of wages so that, if the annulment of the measure should be implemented in a phased manner. In addition, the question arises what policy could offset the loss of purchasing power that would come from canceling it.

Probably the only answer to this is a compensatory wage increase. We are talking about a wage increase above inflation, so as to restore the initial purchasing power, now with the prices without subsidies. However, it is very difficult that the employers do not translate the rise to prices, so the idea of a salary increase that exceeds inflation, leads to fear of an inflationary spiral that would express the distributive fight.

In the medium term, the only viable solution would be an increase in overall productivity of the economy that would allow a sustained rise in the purchasing power of wages. In the short term, fine-tuned economic and social policies and the stakes of the political ascendancy of the government are the only instruments that can allow the maintenance of a balance that allows the transition to the new scenarios.

For the second effect, the cancellation of subsidies would eliminate one of the factors that stimulate the industry. Given the traditional Argentine problem of unbalanced production structure and bottlenecks due to shortages of foreign currency, seems inappropriate to waste the opportunity provided by a favorable external environment for laying the groundwork for a change in the production profile. This issue has been raised by several economists from the political opposition<sup>29</sup>, while the more pro-government economists, that are overwhelmed by the current economic problems, have not taken it seriously until now<sup>30</sup>.

From an academic standpoint, there are studies focusing on economic development issues that express different views on the problem of productive development, more specifically, industrial development. We are interested in referring to the issue because in our view the implementation of a development plan is part of the solution of various problems in the economic "productive model" and

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<sup>29</sup> In fact the criticism is rhetorical, since none of the various opposition factions have had a pro-industrial policy when it came to power. It is used as a (right) signaling of the limitations of government policy, but did not result in constructive contributions

<sup>30</sup> After the resignation of Finance Minister Lavagna, the ideologist of the renegotiation of Argentina's debt, he was followed by Felisa Miceli. She announced in May 2007 the launch of a "National Production Plan". Soon (July 16, 2007) Miceli was forced to resign by an episode of alleged corruption, which led to a succession of finance ministers with rather ceremonial functions. The handling of the economy was concentrated in the hands of Nestor Kirchner until his death in October 2010. There was not to present any official launch of an industrial development plan, although many clues about the ideas that guide the economic action can be deduced from the policies implemented.

become also an alternative to the dependence on external demand for commodities with its current feature of high international prices.

## DEVELOPMENT'S PROPOSALS FOR POST-CRISIS ARGENTINA

We will begin by referring to some dilemmas, and the answers to them provided by economic development specialists. This will allow us to refer to the old debates, that are revisited in the present moment, and explain our approach about the issue.

To address the problem from the outset, it should be noted that the geographic and demographic features of the country, in addition to the ownership regime of land in Argentina, make it possible an economy based primarily on farming and livestock production<sup>31</sup>, commodity exporter and importer of industrial goods. In principle, from the point of view of macroeconomic balances, this production structure, highly specialized, would be sustainable<sup>32</sup>, with the exception of the important point that much of the population would be left over (especially the one devoted to branches of industrial production).

In 1910, Argentina was a country with 7 million inhabitants<sup>33</sup>, with a very important agricultural production for export and domestic consumption, especially meat and grains, an industry almost nonexistent, and a large concentration of wealth by large landowners (owning classes.) The problem of the initial shortage of population to perform work in agriculture and services was partly offset by the large influx of immigrants (especially Italian and Spanish) that between 1890 and 1910 left a positive immigration balance of more than 1 million and a half people.

The First World War, with its adverse effects on world trade, and the decline of England, Argentina's main trading partner, broke that pattern. Argentina emerged in the postwar period as a semi-industrialized country. De-industrialization in two separate periods 1976-1983 and 1992-2001 generated a change in Argentina's productive structure that evokes that exporter model.

This alternative production profile remains, apparently, in the memory of some sectors of the Argentine ruling class. Recently, when the 2nd centenary of national independence (May 2010) it had occasion to manifest. Personalities related with agriculture production and other sectors of the political opposition expressed, in a series of newspaper and other media, its strong nostalgia for the "centennial model".

But from the experience of the 90's of twentieth century, the whole population became convinced that this type of model would be accompanied by exclusion and unemployment, that's why this proposal of primary export model would not have political support. And from this traumatic experience the employment has become in Argentina one of the "fundamentals", at least in the field of political economy. That's why economic development theorists are inclined to an industrial profile accompanying agricultural and extractive industries.

Economists Porta and Bianco raised in a work called "The Views on the Development of Argentina. Consensus and Dissent "<sup>34</sup> the map of agreements and disagreements between those dedicated to the specialty. We will use your analysis to organize our discussion and point our views.

According to these authors there is agreement that the main problems of economic development of Argentine are:

- internal imbalances.

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<sup>31</sup> Recently also began to develop the mining industry, with the same characteristics, in this case mineral extraction and export almost without any elaboration.

<sup>32</sup> We refer here only to a sustainability from the point of view of macroeconomic variables. Possibly the social reaction to an attempt to establish such a model would be incompatible with the political system (democracy), as suggested for the emergence of combative social movements at the end of the 20th century.

<sup>33</sup> Today there are 40 million according to recent National Census.

<sup>34</sup> Porta and Bianco : 2004



- External imbalances
- unsustainable growth

in the first category they include income inequality, that deepened during periods of de-industrialization (1976-1983 and 1992-2001) and depriving the economic system of robust demand, the inequalities in access to public goods like health and education, worsened after the liberalization period of 90's due to the gradual privatization of those services, the aforementioned lack of employment and low sustainability of regional economies.

The second category lists the trade restrictions, which refer to the relative inability of the economy to generate, via exports, the foreign currency needed to afford the imports needed for production; the financial squeeze, which occurs when, because of the prospects for a balance of payments crisis in times of tougher trade restrictions, the country faces difficulties to access to refinancing funds; and finally, the spiraling foreign debt generated by the two above mentioned problems.

The third category refers to foreign exchange shortages, that historically were exacerbated by the emergence of a growth period that rendered the industry increasingly import demanding. Thus, the temporary solution of internal imbalance caused the external imbalance, while the resolution of the latter, usually through a devaluation compressing the domestic absorption, drove recessive and regressive impacts, and therefore reinstating problems of inequitable distribution. As a result of these processes, the economy historically assumed a dynamic of type "stop and go".

The structural causes of these problems mentioned are often attributed to: an unbalanced production structure (structural heterogeneity), in which the most dynamic elements appear as enclaves with little capacity to spill; serious lack of competitiveness at the level of firms and sectors, but also as a result of the type of international economic integration; and finally, a fragile macro-economic structure, highly vulnerable to external shocks. The latter would be responsible for a high uncertainty, structural rooted, which encourages short-term and conservative behavior of economic agents<sup>35</sup>.

Porta and Bianco analyzed in this context fifteen proposals for development and grouped it according to the following four areas:

- Sources of growth
- Production specialization
- Regulation and coordination
- Agents in the accumulation process

They grouped the proposals in four approaches. The first, which the authors called AUTARCHIC, is sustained by the CTA (Central de Trabajadores Argentinos), a dissident Trade Union Federation, and EDI (Economistas de Izquierda), a Marxist academic group. The second approach, that they call INDUSTRIALLY BASED NEO-DEVELOPMENTALIST is held, with different nuances, by the Union Industrial Argentina<sup>36</sup>(UIA), by members of the so-called Plan Fenix, a group of academics at the University of Buenos Aires with an economic vision related to Latin American Structuralism, Fundación de Investigaciones para el Desarrollo (FIDE), and by the authors Hugo Nochteff (Facultad Latinoamericana de Ciencias Sociales -FLACSO), Rubén Lo Vuolo (Centro Interdisciplinario para el Estudio de Políticas Públicas -CIEPP) and Andrés López (Centro de Investigaciones para la Transformación -CENIT).

The third approach is called AGRARIAN BASED NEO-DEVELOPMENTALIST neodevelopmentalist agrarian base and is expressed in the proposals of Consultants in Economics and Organization (CEO), Okita Foundation, and the authors Jorge Forteza (Booz, Allen & Hamilton) and Martin Redrado (Fundación Capital).

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<sup>35</sup> In other studies the poor vocation of leadership and the short-term vision of the Argentine business class has been explained by historical (Sabato: 1991) or political reasons (Peña, 1973).

<sup>36</sup> This is the larger Industrial Chamber in Argentina

In the last two mentioned approaches, the name “neo-developmental” refers to the development experience of Argentina led by President Arturo Frondizi, in the late fifties and the early sixties of the last century. This experience was based on the development of basic industries with the assistance of foreign investment, especially in the production of cars, oil and steel. While there were some important achievements, the expected development did not materialize. It was partly because the establishment of subsidiaries of transnational companies concentrated industrial activity in benefit of foreign capital and this led to disinvestment due to the shift of profits to the countries of origin. On the other hand foreign investors demanded to the government "security" for their investments, calling for the subordination of the labor force and trend monitoring militant unionism. This led to clashes between the government and the unions that weakened the Frondizi government , which was ousted by a military coup before the end of its mandate.

Their main differences with the original ideas of developmentalism, are the incorporation of open-economy standards and the prioritization of the development of value chains around final goods and services. Meanwhile, the basic difference between the two versions of "neo-developmentalism" is the sector that is chosen to lead the process of growth and development. For the first one the industry should be the driving force of economic growth. For the second, the development would be based on sectors where the country has natural advantages, especially in the agricultural sector through greater industrialization of primary products.

View	Proposal author	Sources of growth	Productive Specialization	Regulation y coordination	Agents of the accumulation process
Autarchic	CTA ; EDI	Domestic demand via re-distributive shock and re-design of regional integration	Labor intensive sectors and strong import substitution	The state as producer, strong public investment and high control over foreign direct investment	State, small and medium companies (SMC) and cooperatives
Industrial based neo-developmental	FENIX ; FIDE ; Nochteff ; Lo Vuolo ; UIA	Consumption and investment promotion. Domestic demand and projection to MERCOSUR	Development of industrial value chains, local systems of innovation and production of differentiated goods	State intervention through public policies on industrial promotion, competition and income	Supply networks, including small and medium companies (SMC) preferably. Technological transfer via foreign direct investment
Agrarian based neo-developmental	Forteza ; CEO ; Redrado ; OKITA	Global market orientation, export diversification and promotion of foreign direct investment	Agrarian-Industrial systems and regional value chains. Production of agriculture goods with more value added	State intervention through public policies on industrial promotion and competition	Value chains led by big companies (domestic or foreign). Supply networks, including small and medium companies
Neoliberal	FIEL ; IEERAL ; Arriazu	Global market opening for increase export and foreign direct investments	Products with static comparative advantages	Free market policies. De-regulation and competition	Market mechanism select the players

#### Views, Proposals and Axes of the debate - Porta and Bianco (2004)

Finally we mention the so-called NEOLIBERAL vision, expressed in the work of the Fundación de Investigaciones Económicas Latinoamericanas (FIEL), the Instituto de Estudios Económicos sobre la Realidad Argentina y Latinoamericana de la Fundación Mediterránea (IEERAL), and economist Ricardo Arriazu. This approach broadly shares the tenets of the "Washington Consensus" and proposes to open to the world economy, reduction of the public economic sphere, deregulation of product and factor markets and the deepening of the resources assignment functions by the market as the appropriate way to induce growth

and development. This is the approach that inspired the reforms of the nineties of last century in Argentina, which had a clearly negative result.

## A MARKET FOR DEVELOPMENT

The usefulness of Porta and Bianco work is that it provides a snapshot of the answers from different sectors to the questions that arise when the problem of development is brought to the discussion. On the one hand appears the question for the deployment space of the industries that are proposed, clearly highlighted by the limitations of the Latin American processes of "import substitution" of mid-twentieth century. One of the problems that emerged at that time was the small size of the market for the industries that were created.

Here the answers are varied, the neoliberal vision proposes the reintegration of the country in the framework of international division of labor, based on static comparative advantages, the agrarian based neo-developmental approach propose export to the world market agricultural and mining-based manufactured goods meanwhile industrial based neo-developmental reinforces the commitment to MERCOSUR<sup>37</sup> as an area of deployment of the industries that would be created.

For the industrial based neo-developmental approach, development must be based on the domestic market, that is not being purely exporter, which sets this vision apart from the two above approaches. The firm foundation in the domestic market has to be a base to project into MERCOSUR. The answers to this question expresses two different development styles commonly exemplified by opposing the cases of wealthier Western countries (Europe, USA, Canada, Australia) with the eastern countries (Japan, Korea, the Asian Tigers and now China). Although the examples of Korea, Japan and China seem to indicate that this is the currently feasible development path, it is also true that the inability of Japan to stimulate their domestic consumption appears to be on the basis of the prolonged stagnation that it suffers. On the other hand China will probably face this challenge in the near future, with results for now uncertain.

Is that in the rapidly changing conditions of the global economy, an export-led development may be frustrated by the increasing markets volatility. In fact the recent experiences of Ireland and Portugal with its export of services could be examples of the fragility of this pathway.

Recently there has been a reevaluation of the developments plans based on the creation of a strong domestic market, which would overcome the fluctuations in global demand. A development based on agricultural production and manufactures of agricultural origin (and obviously importing industrial goods due to their specialization and prevailing exchange rate equilibria) probably would not be able to cope with a return of commodity prices to the levels of the last century.

Finally, the approach known as autarchic also proposes the construction of a strong domestic market by promoting income distribution processes and also proposes the extension of the deployment space to a sort of Latin American Common Market. This last point relates to its critique of MERCOSUR, which is seen as a design tailored to the division of labor of multinational companies located in the region (the paradigmatic case is the automotive industry) and also challenged as a imposition of the powerful Brazilian industry to ensure semi-captive markets. The discussion includes the failed U.S. attempt to establish the ALCA<sup>38</sup> and the proposal of Venezuela's government Hugo Chavez for the expansion of the

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<sup>37</sup> Mercosur (Southern Common Market) is a regional union comprising Argentina, Brazil, Paraguay and Uruguay, Venezuela is in the process of incorporation. Bolivia, Chile, Colombia, Peru, Ecuador and Mexico are associated countries. It was created on March 26, 1991 with the signing of the Treaty of Asunción, establishing the free movement of goods, services and factors of production between countries, the establishment of a common external tariff and the adoption of a common trade policy, macroeconomic and sectoral policies coordination between participant states and the harmonization of laws in order to strengthen the integration process. These ambitious goals are met only partially.

<sup>38</sup> ALCA : Free Trade Area of the Americas, a U.S. initiative to expand the Free Trade in North America (United States, Mexico and Canada) to the rest of the states of the Americas excluding Cuba. Since the 2005 summit in Mar del Plata, ALCA was in crisis, to the point that many now consider it a dead Project-

ALBA<sup>39</sup>. The three areas treaties propose a unification of the Latin American markets but its geopolitical implications are clearly different.

MERCOSUR common market is created and managed by the governments of Brazil and Argentina, with strong influence of large industrial enterprises, and has effective operation, been key to the growth of the automotive industry in Argentina and for the protection of the region during the ongoing global economic crisis. The ALCA was a U.S. attempt to put the region under its trade protection, while the ALBA, that was created in opposition to the former is a tool for regional unification of the new nationalist governments that emerged in the last decade in rejection of neoliberalism. The autarchic approach questions the MERCOSUR by its limitations and its dependence on the pressure of big industry, and propose a reformulation of the regional market that reflects an economic alliance of the new Latin American governments<sup>40</sup>.

## PRODUCTIVE SPECIALIZATION

Turning to the second major topic of analysis, the productive specialization, we must consider several aspects. On the one hand, as a reflection of high unemployment that resulted from the neoliberal experience and that is not totally reabsorbed, the labor intensiveness of the activities is valued positively. That is the reason because agricultural production is questioned despite being highly profitable. In Argentina, it is very capital intensive activity, with use of machinery, chemicals products and genetically modified seeds. Thus economic outcomes are distributed among the landowners and the suppliers of agrochemicals and agricultural machinery, generally multinational corporations.

This scheme of remuneration of productive activity generates a pattern of low employment on the one hand and luxury consumption on the other, whose demand is for imported goods, given the availability of foreign currency resulting from exports. This particular configuration would create a kind of "Dutch disease", by removing the resources and the demand from industrial activity. In fact, as explained above, these consequences are moderated by the export taxes and the maintenance of a high exchange rate.

The above arguments question the productive specialization proposed by agrarian based neo-developmental approach and the neoliberal one too, since the market would select the inclusion of Argentina as a producer of raw materials.

The opposite pose, supported by the autarchic approach, place the emphasis on labor-intensive activities, but this emphasis carries the danger of replay the support and protection of industries with low production efficiency, another problem of the import substitution that was implemented in Argentina in the middle of last century. This problem, that was experienced in both, public enterprises and private protected enterprises, resulted in technological backwardness, especially since the seventies of the twentieth century, and proved to be a basis of consensus for the implementation of the economic reforms. Besides the low productivity of the industry would be non-compatible with an objective of increasing the purchasing power of wages.

However, the experience of the 50's and 60's of the twentieth century showed a different reality, with public and private enterprises growing, although with disparities, so it could be argued that the negative result was not be considered as a fatality. It is possible that a different management of promotion policies and public enterprises have led to a more favorable outcome.

Essentially the necessary behavior is to prevent the capitulation of government to the pressure from companies<sup>41</sup> and avoid the use of public business as a tool of political patronage. Without the

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<sup>39</sup> The Bolivarian Alternative for the Americas, ALBA, is a regional organization promoted by Cuba and Venezuela in reaction to ALCA. Currently include Cuba, Venezuela, Bolivia, Ecuador, Nicaragua, and the small Caribbean states of Antigua and Barbuda, Dominica and St. Vincent and the Grenadines as member states.

<sup>40</sup> Claudio Katz: 2008

<sup>41</sup> The concept of "rent seeking" used by neo-liberal economists to justify their proposals of privatization and liberalization of international trade and labor markets. See Anne Krueger : 1974

confidence that the perverse behaviors could be reversed it would not even be worth the debate about desirable development style. What is needed is not to underestimate the mentioned dangers, which seems to be one of the weaknesses of the autarchic approach.

In this sense, the proposal of the industrial based neo-developmentalism on industrial value chains, local systems of innovation and production of differentiated goods take a distance from the previous one in the sense of considering the increase in productivity through innovation, and by this remark pointing a way of reverting one of the problems encountered in previous industrialists' experiences.

Another dilemma that we face when try to identify products and sectors on which support a process of industrialization, is whether to promote sectors that are currently performing well or whether is necessary to define a set of sectors to promote based on more general considerations (productive linkages, labor absorption, positive externalities and synergies, etc.). The proposals discussed in the work of Porta and Bianco lack this issue because most of them were written shortly after the 2001 crisis, when not yet dynamic industrial sectors with export capacity were envisioned.

Today they exist (wine industry, production of agricultural machinery, vegetable oil, business services, etc.) and some analysts believe that a realistic development plan should rely on them for several reasons. On the one hand because they already exist, is no need to create them, on the other they have proved to be competitive and generate foreign currency, so the bet would be its further development<sup>42</sup>. Other analysts believe that progress in these sectors is due to the peculiar economic situation, therefore, as it vary, the current efficiency and export capacity would be damaged. On the other hand they say that letting to the market the production profile design would be to forego a planned development. In the present circumstances it would certainly be biased to a Ricardian development (based on static comparative advantages), rather than a Keynesian (market expansion) or Schumpeterian (based on innovation) ones, considered more desirables<sup>43</sup>.

Possibly a manufacturing based industrialization derived from primary products would be faster than any other, but not robust to the change in international conditions that determine the high price of commodities. By lowering their price, also would drop the manufactures based on them. Would also be an external market-oriented industrialization, with the already mentioned vulnerability to swings in global demand, which seem to be the norm in today's global economy.

If instead the government go ahead with development planning, it would possible to identify products and production chains that being viable or existing, might contribute to macroeconomic and social objectives for the medium term. One example of that kind is a recent study prepared by economists at the Centro de Estudios de la Unión Industrial Argentina (CEU-UIA)<sup>44</sup>.

In a work inspired in the theory of productive linkages of Hirschman, Rasmussen and others, the CEU performed an analysis based on an national input-output matrix updated by the team<sup>45</sup> production chains. The method, borrowed from Rasmussen, is to compare for each sector the intensity of its direct and indirect links with the average of the economy. The terminology used describe the characteristics of the chains<sup>46</sup>. A sector is a "high forward linkages" (AED) or "high backward linkages" (SAA) if its degree of articulation in these directions is greater than the average of the economy, "high national integration" (AIN) if both conditions are met, and "low national integration" (BIN) if not met any. The chart, reproduced

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<sup>42</sup> Kosakoff : 2009

<sup>43</sup> Yoguel : 2009 and Dosi : 1988

<sup>44</sup> Coatz et al : 2010

<sup>45</sup> The last published input-output matrix is dated on 2001 and contains data for 1997 Argentina's economy. Such statistical delay clearly points to the unwillingness of the current administration about the tools for economic planning.

<sup>46</sup> The concept of *chain* make reference to productive relationships that a given sector has with the rest of them. *Backward linkages* refers to relationship that established a sector as demander of inputs, while *forward linkages* include linkages that the sector establishes as supplier of goods or intermediate services.

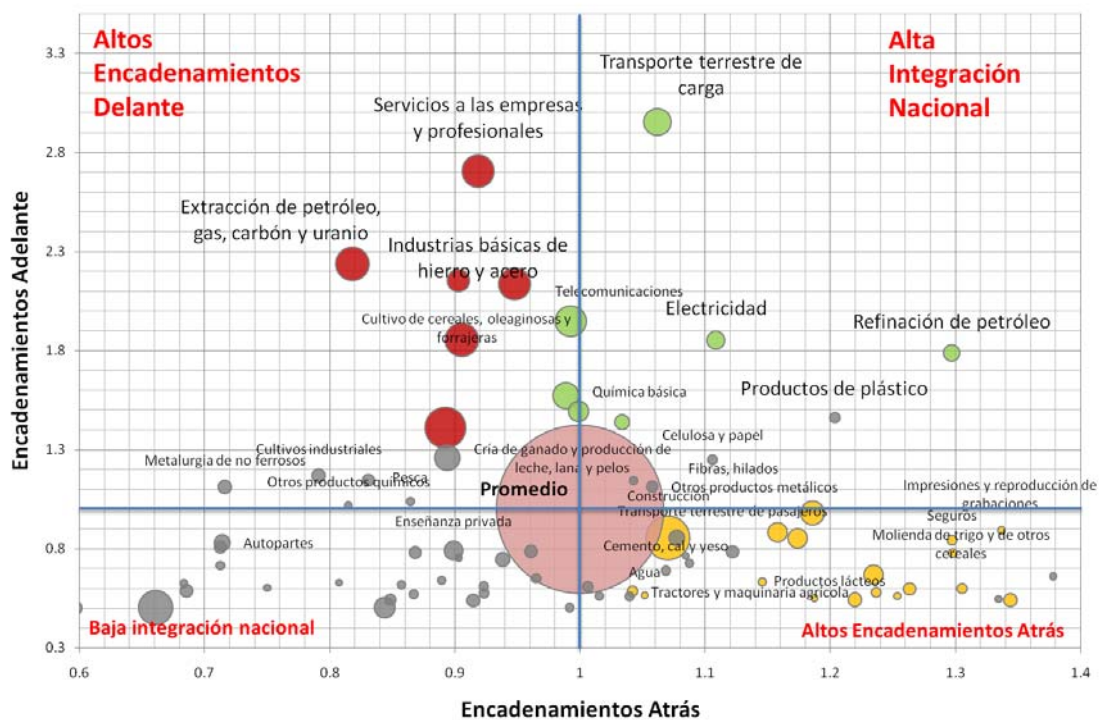
below, indicate the importance in generating value added, reflected in the size of the globe. The central circle indicates the total Gross Value Added of the economy<sup>47</sup>.

The planning of the economy has been underestimated due to the failures of the development process of the last century and even more by the collapse of the socialist bloc. However, we have not to forget that was his antithesis, the market guide, the cause of the frustrations of recent development efforts. We refer here to the experiences of Latin American economies during the opening of the nineties of the twentieth century and the recent experience of peripheral countries of Europe.

Perhaps the twenty-first century economic planning should be more flexible than the previous century one, have to include several aspects that were not taken explicitly into account, such as the induction of targeted activities, the influence of geopolitical variables, the possible reformulations in the light of the changing in global scenarios, and so on.

On the other hand, implementing development policies without a plan can be successful at first, when the objective consist of simple measures that should be held firmly<sup>48</sup>. But when the case is to carry a series of complex measures and political support for them is required, it seems more reasonable to develop a medium-term plan on which to base support and coincidences.

### The structure of manufacturing Productive chains in relation to the average of the economy



Source: CEU-UIA: 2011

Moreover, we have not to forget that a qualified staff must be recruited, clearly identified with the objectives mentioned in the plan, to carry forward the policies with firm steps, especially when these consist of requiring certain behaviors of the private sector (investment commitments, employment

<sup>47</sup> The average of the economy is at the origin of the axes, normalized on the point (1.1). At the right (left) of the x-axis are the sectors with higher to 1 backward linkages, ie higher (lower) the average of the economy. Above (below) from the y-axis are the sectors with higher (lower) than the average forward linkages.

<sup>48</sup> Maybe this was the case of the first stage of recovering after the crisis period in Argentina, where the central role was played by the policy of high real exchange rate. The limitations arising from the success of this policy, require a higher specification and analysis of the policies necessary to replace it.

formalization, tax compliance, etc.). Otherwise the success and coordination of actions will depend on political loyalties or the hyperactivity of the leaders<sup>49</sup>.

## THE ROLE OF THE STATE

The next qualifier axis on Porta and Bianco work, points to the role that should have the state in development, according to different authors analyzed. The views range from the disregard advocated by the neoliberal approach to strongly interventionism advocated by the autarchic vision. It is noteworthy that both views have a history in Argentina's economy. The liberal vision, which is actually a euphemism for a major state intervention but in a pro-business way, was implemented during the reforms of the 90's of the last century. The rationale justifying this role of the state lies in an apologetic vision of the market as an efficient allocator mechanism. The regression of the industry during those years and the subsequent bankruptcy of the state are questioning it as an appropriate mechanism for development. With state intervention, the situation is more complex. That is because the Argentine process of industrialization during the middle of the last century was led by the state, through the creation of large public enterprises in energy, steel, etc. Although after the Peronist period the subsequent governments also encouraged the establishment of subsidiaries of foreign companies, investment in infrastructure remained an state duty. This led to the existence of powerful state companies that initially led development<sup>50</sup>. However from the seventies, the lack of investment generated a great loss of efficiency of these enterprises. The political maneuvering and the labor union bureaucracy ended up with a public discredit of the companies to the extent that privatization was accepted by the population as the only way to improve services.

The privatization process had mixed results. In the case of telephone service, the provision has improved but at the expense of a huge increase in rates. In all other cases the balance is even more negative. Some companies went bankrupt and were re-nationalized, as in the case of Aerolíneas Argentinas, postal services and Sanitation. In other cases, rate regulation and the renegotiation of contracts after the 2001 crisis led to an disinvestment processes that led to sharp declines. The most serious cases are the railways and electricity supply and distribution.

Nevertheless, the deterioration of public enterprises before privatization was very deep and the privatizing government used this situation for propaganda purposes, to justify the sale of the enterprises. Therefore, in the public opinion remain some ideological opposition to the existence of public enterprises. That's why the current government is careful to go against this prejudice and promotes the progressive nationalization of enterprises in a hesitant way, still generating enormous criticism from the opposition. Recently, the political climate has changed and the government has been able to even begin to speak about the need of a Development Bank whose role came in quietly serving the ANSeS with funds from nationalized private pensions.

The autarchic approach propose to deepen this statist bias, exceeding even the field of public services, suggesting a production model in which large enterprises are state owned or, in the case of private companies, that have a strong state control over it, especially in the case of foreign firms.

In this scheme, the state action would promote the existence of small companies and self-managed cooperatives, that will act as suppliers of the big enterprises or will use the products made by them as inputs to small-scale produce of differentiated goods, goods with additional development or serving small markets demand. State control would not extend to these SMC<sup>51</sup>, instead they would be subject of policy

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<sup>49</sup> This description is not imaginary, but conforms with the management of Argentina's economy, which was from 2005, with the dismissal of Minister Lavagna and even more after the resignation of the Minister Miceli in 2007, an implementation directly dependent of president Kirchner and his wife.

<sup>50</sup> Among them: Ferrocarriles Argentinos, Yacimientos Petrolíferos Fiscales, Gas del Estado, Obras Sanitarias de la Nación, Aerolíneas Argentinas, Empresa Nacional de Telecomunicaciones, Empresa Nacional de Correos y Telégrafos, Vialidad Nacional, Servicios Eléctricos del Gran Buenos Aires, Empresa Líneas Marítimas Argentinas, Administración General de Puertos, Agua y Energía, etc.

<sup>51</sup> SMC : Small and median companies

promotion and creation of conditions conducive to its development. In this scheme, two important concepts are implicit from the point of view of political economy.

On the one hand the state would not be interested in promoting the existence of large enterprises, while not having the ability to control or influence their decisions. This stems from the recent experience of Argentina's industry, increasingly de-nationalized, where decisions taken in the headquarters (usually abroad) are sometimes detrimental to the country's needs. Shifting production to other countries, use of imported inputs rather than development of local suppliers, use of dividends to finance investments located abroad, etc. were recent conflicts between big business and government, who vacillates between interfering in such decisions or tolerate them <sup>52</sup>.

Moreover, especially for EDI, lies the idea that political power of the business class could be reduced to the extent that large private firms in the economy are tightly controlled, and the rest of the production system consists of a swarm SMCs whose influence is atomized. The political rationality of this economic proposal is understandable, especially in light of past experiences of industrialization (first Peronism government, developmentalism and Peronism government of the 70's) invariably thwarted by military coups that were supported by the more concentrated business sectors.

The vision of SMCs in the autarchic approach is partly idyllic, it would be companies with high labor absorption, with little political power because of their dispersion and that function as flexible subjects of state policy promotion. The reality of SMCs in Argentina is a bit more nuanced. Usually there is a strong polarization between companies operating with skilled formal work, incorporation of technology and adoption of international standards of quality and others that operate with low efficiency, sometimes informal almost enslaved work and low quality production. It is doubtful that an improvement in economic conditions produce a virtuous transformation into each other, in the absence of a directed state action.

An interesting possibility would be a state action by the formalization of employment, given that increased labor costs caused by this formalization will surely boost technological change and increased productivity. Arguably this should be implemented after the completion of the absorption of the unemployment due to the crisis.

Moreover it is worth to mention, although their treatment requires a separate work, that every economic proposal is implicitly associated with a political alliance that would implement it. Thus the opening of 90's was driven by international capital pushing through international agencies<sup>53</sup> and found in the Argentine business class decisive support <sup>54</sup>, while the first Peronism promoted the mass of existing small socialist trade unions and the creation of new ones in branches that were not unionized to be supportive of government action.

Between the extremes of statism, proposed by the autarchic approach, and market dominance as advocated by the neoliberal approach, are located neo-developmentalists visions. The state's role in these last visions is not of an employer, but of an sponsor.

## THE POLICY SUBJECT

Finally, in the work of Porta and Bianco, appears the analysis of the policy subject, that is the sector that would lead the development advocated. In the case of the autarchic proposal the players will be, according to EDI, the workers, grouped in public enterprises workers, SMCs and cooperatives, while the CTA identifies the private sector, especially small companies. For the neo-liberal approach should be the market who choose the subjects that will drive the process.

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<sup>52</sup> Recently a conflict arise due to the government decision of appoint directors in companies in which the state holds a stake. Siderar, one of the big companies of the holding Tenaris, reject the decisión and appealed to the courts against it.

<sup>53</sup> Essentially IMF (International Monetary Fund) and WB (World Bank)

<sup>54</sup> Although the proposal implies the closure of many companies. Before the launch of the plan, the Minister Cavallo spent several weeks visiting the chambers of commerce to seek support for it. Companies appeared to be hurt by the opening of the economy became importers of the same manufactured goods they produced before.



The neo-developmental vision bet to production networks composed of large and small companies, under the leadership of large business or more inclusive approaches depending on the authors.

## **CONCLUSIONS : THE NEED FOR A DEVELOPMENT PLAN**

In short, and returning to the considerations that led us to accompany the analysis of Porta and Bianco with our own concepts, the limitations of the current “productive model “ for sustaining a growing body of subsidies brings us to the analysis of the next stage of the development process. This arises from considering that only a systemic increase in productivity of the economy can sustainably increase the purchasing power of wages. This objective can be achieved to the extent that the productive system could consolidate and densify, generating the value chains required to get positive synergies.

Achieving this goal cannot be expected from the market action, rather, it is necessary to ensure that it does not encourages the consolidation of a pattern of growth based on primary exports and manufactures based on them. That's why there is room for state action to guide development based on the domestic market and deployed in the commercial space of Latin America. In this development the public and mixed enterprises should play a critical role, as they have had in the past, becoming engines of growth. Other government agencies such as universities and scientific and technological agencies would be promoting the use and dissemination of available technology, as well as promoting research and development.

In our view this stage should be guided by an explicit development plan, emerged from a broad debate promoted by the state and with the participation of all sectors of society (workers, entrepreneurs, academics, etc.).

It is also necessary the recovery of the statistics system, because we cannot think of an economic and social plan that excludes the use of them. In that sense there will be to backtrack a busy road during the economic liberalization, when we lost many public research centers due to privatization. But we also have to change the current failed approach of manipulation of statistics as a tool of politics.

Finally, we should work on critical recovery of development experiences of the second half of the twentieth century in both Argentina and Latin America, rejecting the conviction imposed by the liberal approach, but without closing our eyes to its obvious problems. Also we have to enrich this analysis with the most recent successful experiences of the BRIC and the failures of the European Tigers.

For once in many years we can say in Argentina that we are facing an opportunity. Will we meet this challenge?

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