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Volver: Argentina's tango between economic integration and isolation

Coordinatore: Ch.mo Prof. Paolo Colombo

Tesi di Dottorato di:

Davide Tentori

Matricola: 3810438

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INTRODUCTION

Tango is the traditional dance of Argentina: emotional and dynamic, it perfectly represents the features of a country which is a paradox between astonishing beauties and excellencies and disappointing performances. *Volver* is one of Carlos Gardel's most famous and emotional tangos: its melancholic notes suit the image of a country trapped within this paradox. "*Somos number one, como también lo peor, con la misma facilidad*": we are the best, as well as the worst, with the same readiness. These words, from the song "*La argentinidad al palo*" by the Argentine band Bersuit Vergarabat, well convey the idea of a country that does not know mediocrity, but can just perform either too well or too badly.

These features of the Argentine people involve not only the society but also the economy of the South American country. This is why this thesis aims at describing a country that has not taken advantage of its huge economic potential, and has often dissipated it implementing economic policies that prevented Argentina from becoming one of the most rich and developed countries in the world. This has happened several times over the course of the last decades (especially after World War II), and also in the last decade, after the harsh economic crisis suffered in 2002 following Argentina's default on its public debt. Since then Argentina has been ruled by the party "*Frente para la Victoria*" (Front for Victory), a peronist movement led by Néstor Kirchner (died in 2010) first and then by his widow Cristina. During this period the country has experienced an unprecedented economic growth and a remarkable social development, a process which allowed millions of citizens come out of poverty. However, despite these remarkable economic and social achievements, I argue that inappropriate economic policies implemented during this period did not help Argentina to grow further and were detrimental for the country's role as a relevant regional and global (as a member of the G20) member. Protectionism, an unfriendly attitude to foreign investors, ineffective industrial policies are leading Argentina to a position of self-isolation within the international economic community, with consequences that could be very negative for the country's future in the medium-long term.

The main research question of this thesis is aimed at exploring the relations between the internal dimensions of Argentine economic and political development and the external dimensions, in order to assess the country's potential in terms of regional (MERCOSUR – South American level) and global competitiveness. It is divided in three parts that adopt a variety of approaches (exploring economic institutions and policies, econometric analysis, international political economy and international relations) that have a clear common thread. Their purpose is to highlight how decisions and economic policies have affected the country's domestic growth, its external competitiveness, its role on the global economic stage, and the reputation it has within multilateral economic *fora* such as the International

Monetary Fund (IMF), the Group of 20 (G20) and the Common Market of the South (MERCOSUR). The first part of this research, entitled “Argentina: patterns of economic growth”, provides a comprehensive analysis of Argentina’s economic development model that has been implemented over the course of the last decade. In clear contrast with the neo-liberal policies of the 1990s, the Kirchner governments adopted policies characterized by a strong intervention of the State in the management of the economy and by protection of national industries. I will try to highlight the flaws of this model, which have prevented Argentina from moving towards the status of a fully developed country. I will argue that the export-led growth model, although it did not lead to a ‘re-primarization’ of the economy, relied too much on the agricultural exports in order to increase the government revenues and on a weak exchange rate as the main tool of industrial policy. Argentina would need different policies to achieve growth that might last even in the long run, which has to be pursued through structural reforms rather than only by periodical currency devaluations. The last chapter of this part will provide a comparison between three different development theoretical frameworks: structuralism, a theory elaborated by the Economic Commission for Latin America and the Caribbean (CEPAL) based on public intervention fostering the development of a national industry through the adoption of protectionist and inward-looking policies; neo-liberalism, characterized by privatizations and public disengagement from the management of the economy, which is entirely left to the rational actions of markets; new structural economics, a relatively recent paradigm that tries to be halfway between the first two theories, and tries to correct the excesses of neo-liberalism acknowledging the importance of the public action in order to address market failures.

The second part of the thesis is entitled “Argentina in the context of South American integration” and offers an empirical study of the trading flows in the region and in Argentina. Through the implementation of the Gravity equation, an econometric model particularly useful to explain the determinants of trading flows, I will try to assess how regional trade in Latin America is influenced by variables such as the membership to regional organizations for economic integration, like the Andean Community of Nations (CAN) and the Common Market of the South (MERCOSUR) and other macroeconomic determinants such as the bilateral real exchange rate. The following section will focus on a similar econometric analysis of Argentina’s trade patterns with some key partners (Brazil, Paraguay and Uruguay, as members of the MERCOSUR, and the European Union, China and the United States).

The third part of this work is dedicated to provide “A view from the outside: Argentina in the global context”. I will analyze Argentina’s behavior and role in three important international organizations: the International Monetary Fund (IMF), the Group of 20 (G20) and MERCOSUR. The aim is to assess, also from an historical perspective, whether the country’s relationship with these organizations has

been conducive to development within the global economic system or, on the contrary, Argentina has acted as an 'outlier' in international economic relations. This might drive the country towards a position of isolation which might constrain its potential as a main actor both in South America and in the current context of a changing multilateral system.

An appendix, containing three interviews, concludes this work. The interviews are the result of a short period of research conducted in Buenos Aires in August 2012. . The first and second interviews are mainly focused on Argentina's domestic economic performance and development with respect to its international competitiveness. Martín Schorr, researcher at the Latin American Faculty of Social Sciences (FLACSO), and José María Fanelli, Professor of Economics at the University of Buenos Aires, will provide two alternative views of the economic and industrial policies adopted by the Argentina's government during the last decade. The third interview was given by Verónica Moreno, a former advisor at the Foreign Relations of the Presidency of Argentina and offers a broad perspective of Argentina's role and position within the global system

A preliminary digression about the methodology is necessary. The thesis is heterogeneous in terms of the different research methods and approaches implemented: the potential drawbacks in terms of lack of consistency among the different parts are avoided by the fact that all the three parts contribute to provide a complete and detailed analysis of Argentina's economic performance from different angles and perspectives. The first part is intended to be a useful and necessary introduction that offers an analysis of the model of development followed in Argentina during the last decade. It then compares different theories of economic development in order to highlight strengths and weaknesses of each approach and to convey the message that economic policies should be designed ex-post, after a careful consideration of a country's situation in terms of resource endowments. The second part is empirical and offers a quantitative analysis of Argentina's trading flows in the context of South American integration. The Gravity model of international trade, through the Poisson Pseudo-Maximum Likelihood Estimation technique, was proved to be the most efficient econometric methodology to research on these issues. The main objective of this part is to assess the impact of economic organizations and of key macroeconomic variables (i.e. the bilateral real exchange rate and its variability) in promoting or depressing regional trade. This will be particularly useful with respect to the troubled economic relationship between Argentina and Brazil. Finally, the third part adopts a methodology typical of the International Political Economy (IPE) analysis. The three case studies on the IMF, G20 and MERCOSUR will be included into a theoretical framework of negotiating behavior adopted by emerging powers, and analyzed from the perspective of neo-liberal institutionalism which, in my view, is the approach that suits the current context of international economic relations best.

To conclude, the three parts are linked by a common thread which is aimed at assessing in which direction Argentina's "tango" is moving, from the domestic to the regional and global level. The country's economic experience has been characterized by swings between growth and recession, indebtedness and fiscal soundness, production diversification and technological upgrade and re-primarization, further pushes for integration with the rest of South American countries and the world and progressive isolation. Where is Argentina going, and where should it go? This thesis will try to offer an answer to these questions.

PART I – ARGENTINA: PATTERNS OF ECONOMIC GROWTH

1.1 South America and Argentina: an overview of the social and economic rising of the region in the last few years

1.1.1 Introduction and structure of the chapter

South America's economic history was historically characterized by underdevelopment, spread poverty and difficulty in catching up with developed countries. Argentina has partly been an exception, since it was one of the world's richest country until World War II, before being trapped in a deadlock of slow development and periodical recessions. However, over the course of the past decade the region has faced an unprecedented period of economic growth, social progress and political stability, favored both by internal and external circumstances and factors.

This chapter will analyze this dynamics, showing achievements, major strengths and future challenges for the region. It will set the scene before focusing more in detail on Argentina's case.

1.1.2 A picture of the evolution of economic and social development in LA throughout the 20th century

South America has been one of the regions with the highest potential in terms of economic growth, but it has also been one of the main disappointing cases in recent economic history. A region provided with a unique endowment of natural resources, its path of development had been characterized until a decade ago by slow economic growth, inequality and political instability. There are at least two long-term basic, structural explanations for this process:

- The political and social structures established by the Spanish colonizers, who based their power on an unequal distribution of land (the most common property institution was the land-tenure system, called "*latifundio*"). These structures led to inequality in the distribution of power even in contemporary times, with a high degree of concentration in industry and finance (Bulmer Thomas 2003), and to the establishment of political and economic élites that characterized the social structure of Latin American countries until very recent years;
- The distribution of the endowments of natural resources is not homogenous among the South American countries. It is possible to address this phenomenon as the "commodity lottery" (Bulmer Thomas 2003), in the sense that the agricultural products that need some processing before being exported provided stimulus for the development of an industrial sector in the countries well endowed with those resources. On the other hand, commodities with no forward linkages, in the sense that they do not require much processing, did not help the

formation of manufacturing industries, leaving certain economic systems at lower levels of the value chain. An example for the first case is meat in Argentina, while for the second case a clear example is guano in Peru.

These two explanations have to be considered as a whole, since political and economic stability and equality and richness in natural resources are both *necessary*, but not *sufficient* conditions to guarantee a stable development path in the South American region. Therefore, a country well-endowed with commodities could fall in the trap of the so-called “resource curse”¹ if this condition, potentially favorable, is not accompanied by a sound political and economic environment, and viceversa. Acemoglu, Johnson and Robinson (2005) showed that economic growth depends very much on how a society is organized in terms of institutions, since growth emerges when political institutions allocate power to groups with interests in broad-based property rights enforcement, when they create effective constraints on power-holders, and when there are relatively few rents to be captured by power-holders.

A simple variable to look at is the GDP per capita, which during the 20th century increased from a value of 223 current US\$ per capita in 1913 to a value of 804 current US\$ per capita in 2000 (World Bank). It is possible to obtain interesting information about the slow economic growth occurred in the region by looking at a comparison between Latin America and the Caribbean² (LAC) and the other most important regions in the world, in order to grasp an idea about the paths of economic and social development undertaken throughout the last decades. I chose South Asia, Sub-Saharan Africa and China as a representation of the developing countries, European Union, United States and Japan as a representation of the developed ones.

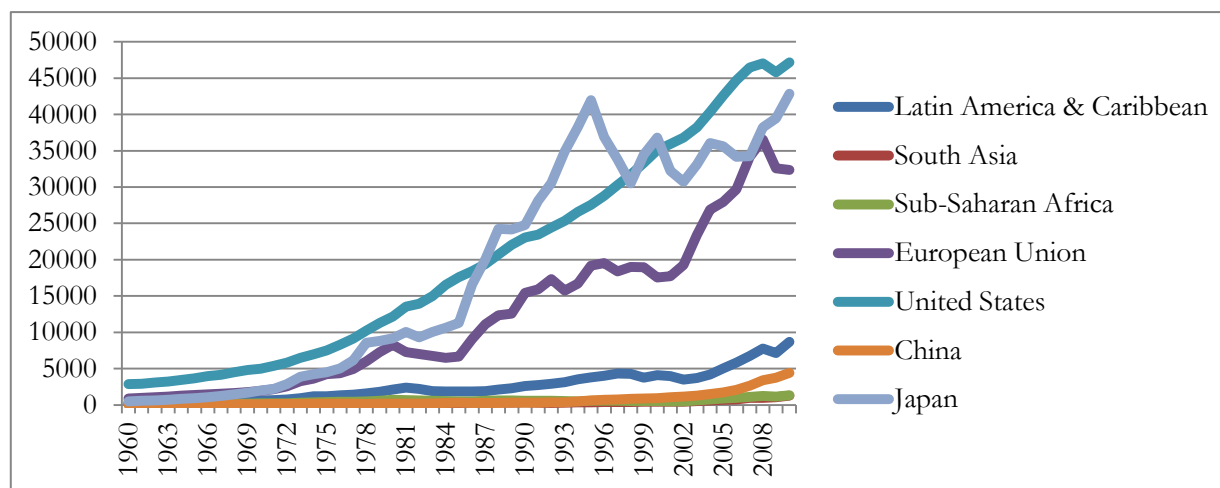
The first set of data refers to the level of GDP per capita, considered from 1960 to 2010. Figure 1 shows how strikingly different was the performance of LAC countries with respect to the more developed regions, even if the difference in the GDP per capita was not so impressive at the beginning of the period covered. On the other hand, it is also remarkable that LAC is the region that obtained the

¹ The “resource curse” is a paradox which links rich endowments of natural resources with poor levels of economic development, mainly due to a mismanagement of these resources and corruption by the ruling élites. South American countries suffered from this phenomenon, but today it might be the right moment to revert the direction (Radon 2013). However, recent empirical studies showed that a clear correlation between natural resource abundance and either a ‘blessing’ or a ‘curse’ in terms of economic development, but that the pre-condition for a good exploitation of those resources is the enforcement of a sound institutional and fiscal system (Canuto and Cavallari 2012).

² Even if the chapter is about South America for the elaboration of the data presented in this section I had to consider Latin America & Caribbean (LAC) as a whole, according to the type and availability of data. Nevertheless, it is important to underline that South America differs from LAC, in the sense that the former region only the countries from the channel of Panama southward.

best performance over time among the developing countries, achieving an average level of 8698 current US\$ per capita.

**Figure 1.1.1 - GDP per capita, LAC versus developed and developing regions
(current US\$, 1960-2010)**



Source: World Bank Databank

According to the growth in GDP per capita, I considered the same period of 50 years by computing the average value for each decade. In this case, the results show that LAC suffered from a heavy fall in the growth of GDP per capita during the '80s, obtaining a negative average. The trend of this variable follows that one of GDP growth: the dramatic slowdown during 1980 and 1990 is due to the economic crises (originated by debt and high inflation) that hit the region in that period.

**Table 1.1.1 - Average growth of GDP per capita, LAC versus developed and developing regions
(%, 1960-2010)**

| REGION | 1961-1970 | 1971-1980 | 1981-1990 | 1991-2000 | 2001-2010 |
|---------------------------|-----------|-----------|-----------|-----------|-----------|
| Latin America & Caribbean | 2.6 | 3.1 | -0.7 | 1.5 | 2.0 |
| South Asia | 3.7 | 0.6 | 3.0 | 3.1 | 5.4 |
| Sub-Saharan Africa | 2.3 | 0.9 | -0.9 | -0.3 | 2.2 |
| European Union | 4.0 | 2.6 | 2.1 | 2.0 | 1.0 |
| United States | 2.8 | 2.2 | 2.2 | 2.1 | 0.6 |
| China | 2.4 | 4.3 | 7.71 | 9.2 | 9.8 |
| Japan | 8.5 | 3.3 | 3.3 | 0.9 | 0.7 |

Source: elaboration of the author on World Bank Databank data

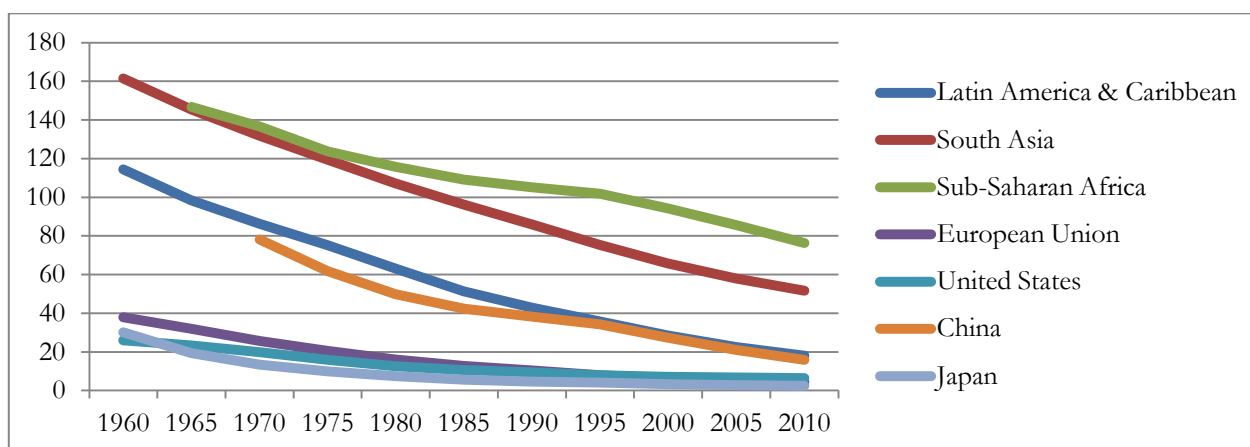
It is also interesting to give a look at a set of social variables, and to consider the improvements in the health conditions of people as a proxy to assess the social development occurred in these countries. I present the data regarding the evolution of life expectancy at birth and infant mortality rates, considered for the same period (1960-2010) and regions.

Table 1.1.2 - Life expectancy at birth, LAC versus developed and developing regions (1960-2010)

| Region | 1960 | 1970 | 1980 | 1990 | 2000 | 2010 |
|---------------------------|------|------|------|------|------|------|
| Latin America & Caribbean | 56.1 | 60.1 | 64.4 | 68.2 | 71.6 | 74.1 |
| South Asia | 43.2 | 48.6 | 55.3 | 58.5 | 61.8 | 65.2 |
| Sub-Saharan Africa | 40.5 | 44.4 | 48 | 49.5 | 49.8 | 54.2 |
| European Union | 69.4 | 71 | 72.9 | 74.8 | 77.1 | 79.6 |
| United States | 69.7 | 70.8 | 73.6 | 75.2 | 76.6 | 78.2 |
| China | 43.4 | 62.9 | 66.9 | 69.4 | 71.2 | 73.2 |
| Japan | 67.6 | 71.9 | 76 | 78.8 | 81 | 82 |

Source: World Bank Databank

Figure 1.1.2 - Infant mortality rate (deaths per 1000 inhabitants under 5 years), 1960-2010, LAC versus developed and developing regions



Source: World Bank Databank

The data show that there was a continuous improvement in life expectancy at birth and a steady decrease in infant mortality rate in each region, but LAC, together with China, recorded the best performance catching up with the most developed regions.

To summarize, it is possible to say that LAC countries improved a lot in terms of social and health conditions, ranking in the first position among the developing regions. The performance in the field of economic development was less impressive: GDP per capita has not increased so much as expected because of a general slow growth during the second half of the 20th century and because of a decade of recession in the '80s (the so-called 'lost decade' of Latin America).

Nevertheless, the first decade of the 21st century saw a break in the cycle of stagnation where the region was trapped and a strong economic recovery, which consisted not only in the increase of the general wealth of the region (in some countries GDP grew at really impressive rates, recording in some years double-digit growth percentages), but also in a more equal and comprehensive income distribution.

Next paragraph will shed light on the reasons why these performances were disappointing at first and impressive in the last years.

1.1.3 South America since the '50s: a series of ups and downs

As shown in the previous paragraph, South American countries experienced a quite disappointing economic performance since the second half of the 20th century. The path of development was not regular but it is described by periods of 'boom' and others of stagnation or recession. It is important to take into account that both internal and external factors are responsible for this volatile macroeconomic performance:

- Among the internal factors, the models of economic development experimented throughout different decades played an important role in determining the success, or the failure, in boosting growth;
- Among the external ones, macroeconomic events such as the oil shock in 1974 or the debt crisis of East-Asian countries in 1997-1998, but also the external influence of international organizations such as the International Monetary Fund (IMF) in determining the economic policies undertaken by the national governments.

In the period following World War II, South America experienced one of its fastest-growing periods, starting a transition towards the modernization of its economic structure. The acceleration was the result of the increase in the rate of capital accumulation and of factor productivity growth (Syrquin 1986). The prevailing model of growth at that time was based on the Import Substitution

Industrialization (ISI), which was aimed at supporting the creation of a modern national industrial sector through state intervention and protectionism in trade policy: therefore, it can be defined as an “inward-looking” approach (Bulmer Thomas 2003). This approach was promoted by Raúl Presbisch, first Secretary of the CEPAL (Economic Commission for Latin America), an organization created by the United Nations in order to foster economic growth in this region. The ISI was implemented to follow the indications of the infant industry strategy in all the nations where the first stages of industrialization had already been completed (Argentina, Brazil, Chile, Colombia and Uruguay). Nevertheless, if this strategy obtained success in East Asian countries, which started from an analogous level of development, in South America it was less effective. Two fundamental limits in the South American context prevented the ISI from being successful. The first one was the insufficient investment rate, determined by the difficulty of the domestic private sector in having access to the capital necessary to support large-scale investment in new industries. The second one was the small amount of manufactured exports. First of all, domestic markets were still too little to stimulate a fast growth in the productive capacity of the national industrial sectors. Secondly, the Effective Rate of Protection (ERP), which resulted as a combination of the nominal tariff on competing imports and also other forms of protection, was too high. Therefore, high costs (determined by the protection rate and by the oligopolistic structure of the internal markets) and inefficiencies (determined by ‘bottlenecks’ at the entrance of market) prevented the industrial products from penetrating the world market, differently from East Asian countries (Bulmer Thomas 2003). As Syrquin (1986) has also shown at the empirical level, the main difference in the transformation of the economic structure between South America and other semi-industrialized countries was represented by the continued relatively low participation in international trade.

The failure of this strategy led to a ‘u-turn’ of the choices in economic and foreign trade policies in some countries of the region (Argentina, Chile, Uruguay). The ISI was replaced in the ‘70s by the “export substitution strategy” which consisted essentially in trade liberalization. On one hand, exports were promoted through systematic currency devaluations aimed at depreciating the Real Exchange Rate (RER); on the other hand, imports were also encouraged by lowering tariffs and the other distortionary commercial policies that were used to protect national companies against foreign products (Bulmer Thomas 2003). These radical changes were promoted by the military dictatorships which took power during that period (Pinochet in Chile, Videla in Argentina and Bordaberry in Uruguay) and were considered as ‘shock therapies’ that would have helped the countries to gain a sustained level of economic growth. However, this strategy did not prove to be effective because it did not reflect an increase of productivity in the manufacturing industries of South American countries. Differently from East Asian countries, Latin American economies started producing items that did not match with

global demand for high value added products and got stuck in the so-called “middle income export trap”, consisting in a rise of the shares of global exports for certain products whose valued added was quite low. In other words, the region increased its global market share overall, but its improvement in the export competitiveness did not include many high-tech products, differently from the East Asian tigers (Palma 2011). This policy, that went on also in the 1990s after the implementation of the neo-liberal policies fostered by the Washington Consensus, was characterized by a chronic deficiency of effective demand for its non-tradable sector, as a consequence of undervalued labor and overvalued exchange rates (Palma 2011).

The second ‘pillar’ of this new set of policies was determined by the need of solving the lack of capital to finance investments. The opportunity was offered by two conditions that materialized during those years:

- The growth of the “Eurocurrency market”,³ which generated a huge pool of international liquidity controlled by international banks;
- The spread of branches and representative offices of international banks in South America (Bulmer Thomas 2003).

Loans offered to Governments by banks were considered much more convenient than loans offered by International Financial Institutions (IFI) like the IMF, because they had very few strings attached in terms of conditionality. That is why most of South American states shifted to this ‘debt-led growth’ strategy, by borrowing from banks at a growing pace. This made the level of public debt grow dramatically in a few years:

Table 1.1.3 - Banks’ share of public external debt, LAC countries (% , 1960-1982)

| Year | Share of public external debt |
|-------------|--------------------------------------|
| 1960 | 16.4% |
| 1970 | 19.5% |
| 1975 | 42.9% |
| 1979 | 56% |
| 1980 | 56.6% |
| 1981 | 57.6% |
| 1982 | 57.6% |

Source: CEPAL – IDB

³ The “Eurocurrency market” describes any currency holding outside the issuing country. It allowed for more convenient borrowings, thus leading to an improvement in the international flow of capital for trade between countries and companies.

The situation became unsustainable after the two oil crises, because the nominal rates of interest on the debt raised over the rate of growth of nominal exports. The debt-export ratio deteriorated rapidly by 1980, reaching the level of 200% in most South-American states. The implosion of this strategy led not only to severe economic recessions, but also to the fall of some authoritarian regimes, such as in Argentina (1983), where the severe defeat in the war of the Falkland/Malvinas islands suffered from the United Kingdom put the military dictatorship to an end.

It took quite a long time for South American countries to recover from the debt crises: during the 1980s GDP per capita grew by only 0.9% per year (Ocampo 2007) and the attempts made in economic policy in order to achieve macroeconomic stability failed. The main structural imbalance was represented by the combination of high financial exposure (indebtedness) and the relatively low trade dependence, differently from East Asian countries which were able to carry out the necessary adjustments thanks to a large external trade sector (Bulmer Thomas 2003). In order to improve the trade balance, a strategy based on import suppression and systematic currency devaluations was implemented. It worked in the short run, but as inflation started to skyrocket (in some countries it reached a three-digit level by the end of the '80s) and real incomes kept on falling, it became clear that stagflation⁴ could not be sustained for long. Therefore, the lost decade of Latin America ended with the awareness that, again, the economic policies implemented had not been effective in promoting sustained growth and development.

The 1990s were marked by another change of the economic policy paradigm characterized by a neoliberal approach. Under the supervision of the IMF, South American countries embraced the principles expressed in the so-called "Washington Consensus". Coined in 1989 by John Williamson, an economist from the Institute for International Economics, the term referred to a set of ten policy measures to be implemented in Latin American countries troubled by the debt crisis and the macroeconomic imbalances of the 1980s in order to obtain macroeconomic stability. These principles mainly advocated for privatizations and the opening of the economy to external trade and FDIs (Williamson 2004). High inflation (that in some cases and for certain periods turned into hyperinflation⁵) was finally put under control, in some cases thanks to the adoption of fixed exchange

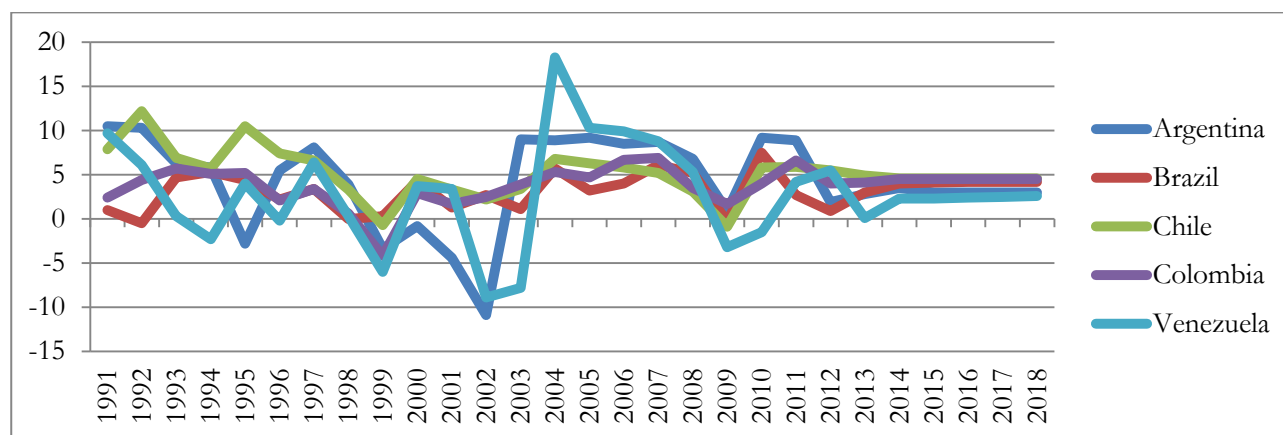
⁴ The term "stagflation" is referred to a macroeconomic situation where stagnation in the economic growth is accompanied by a rise in prices. South American countries experienced episodes of very high inflation (sometimes hyperinflation) in many cases, leading to a worsening of their macroeconomic balance.

⁵ The most commonly accepted definition of hyperinflation is from Phillip Cagan (1956), who wrote *The Monetary Dynamics of Hyperinflation*. He defined hyperinflation as starting in the month when the monthly inflation rate is above 50% and concluding in the month when the rate goes again below 50% and stays below this threshold for at least a year.

rate systems (as the convertibility regime in Argentina, see chapter 1.2), but the region’s vulnerability to external shocks was still high, as dramatically shown by another *tequila* crisis, a new debt crisis propagated from Mexico to the rest of the region that reversed for a period (1994-95) the capital flows into the region and led to a new temporary recession (Bulmer Thomas 2003). The openness of South American economies was part of the inclusion of the region in the new wave of globalization, although this process was not so successful during these years. As explained in the above, another detrimental effect of these new policies was the disappointing performance in terms of global trade, due to a widespread decrease of labor productivity. Moreover, the liberalization of capital controls allowed the region to establish their own bond markets and to borrow from the rest of the world. However, financial openness was not managed very well in countries like Argentina and Brazil, with the former obliged to default on its external debt at the end of 2001. This episode was the final example of a long-term economic pattern characterized by the constant failure to achieve stable and lasting economic growth.⁶

Then the 2000s came. An unprecedented decade of growth and stability marked a new era for the economy of South America. Figure 1.1.3 and Table 1.1.5 show the performances of five countries⁷, with Argentina being the fastest growing at an annual average rate of 5.5% between 2002 and 2012.

Figure 1.1.3 – Annual GDP growth (% , 1992-2018)*



Source: IMF * 2013-2018: forecasts

⁶ The definition of ‘stable economic growth’ should involve limited macroeconomic fluctuations in prices, employment and production. Limited and regular fluctuations around a country’s business cycle can increase the level of predictability and contribute to the creation of an appropriate environment for lasting economic growth.

⁷ I chose to represent data of Argentina, Brazil, Chile, Colombia and Venezuela since they are the biggest South American countries in terms of GDP.

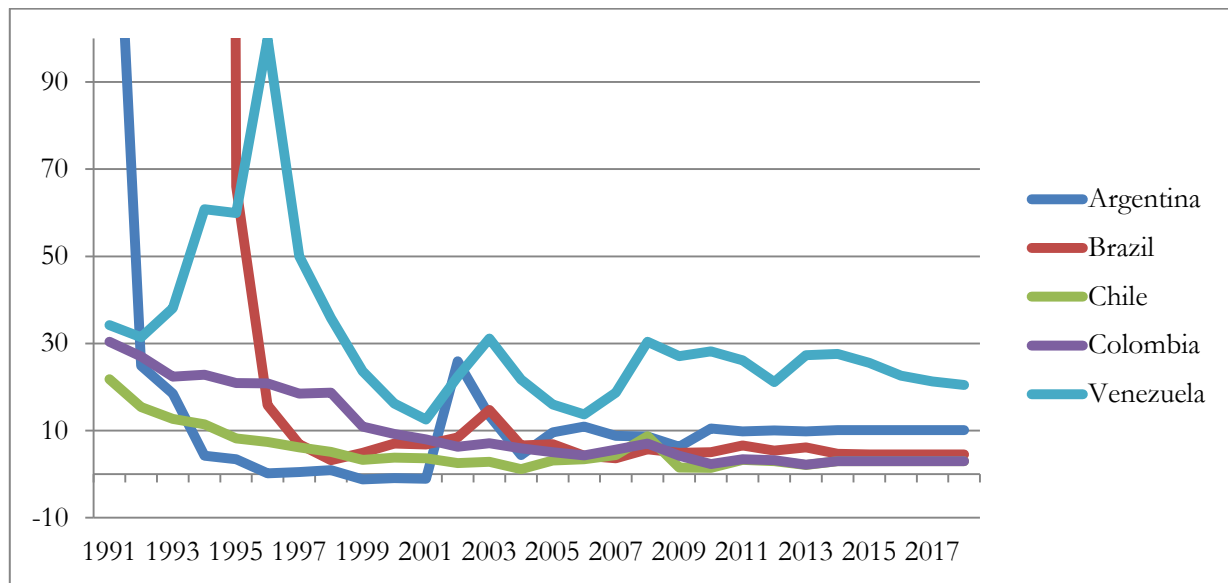
Table 1.1.4 – Average annual GDP growth (% , 2002-2012)

| Country | % Growth |
|-----------|----------|
| Argentina | 5.55 |
| Brazil | 3.53 |
| Chile | 4.46 |
| Colombia | 4.53 |
| Venezuela | 3.72 |

Source: personal elaboration on IMF data

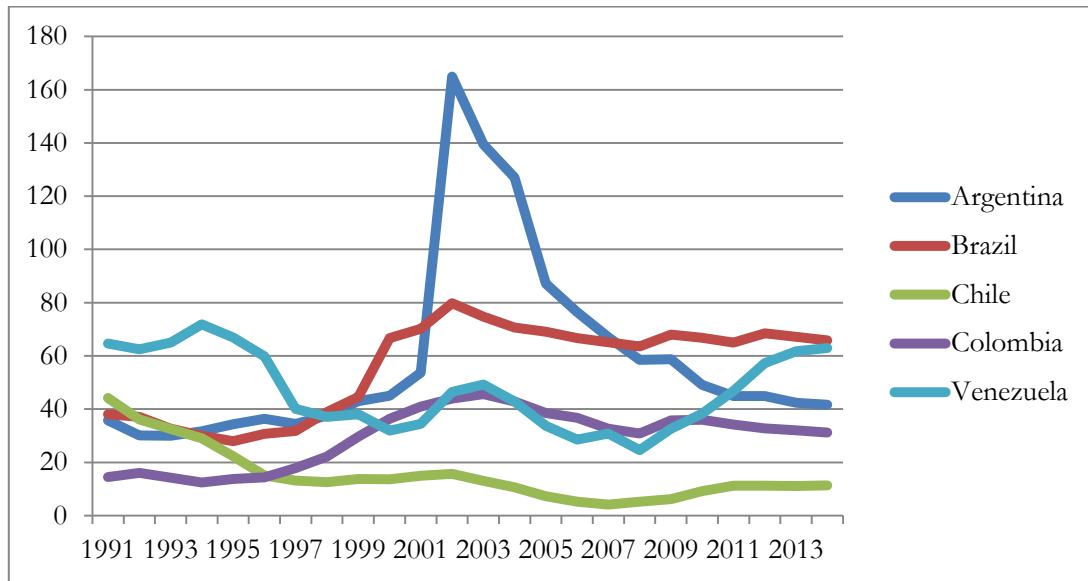
But it is not all about GDP growth. Tangible improvements have been observed also with respect to other macroeconomic variables, all indicating a shift towards stability. Inflation normalized around single-digit values (with the exception of Argentina and Venezuela, Figure 1.14), while no new debt crises seem at the horizon, as per the relatively low values of the public debt-to-GDP ratios observed during the last decade (the example of Chile is quite striking at this respect, with a level of 11.2% in 2012 – Figure 1.1.5).

Figure 1.1.4 – Inflation rate (% , 1992-2018)*



Source: IMF * 2013-2018: forecasts

Figure 1.1.5 – Public debt-to-GDP ratio (% , 1991-2014)



Source: IMF * 2013-2014: forecasts

The main reasons that help explain this season of growth and stability are two. The first one is external and is represented by the high prices of agricultural and mining commodities on international markets. The rise of exports, both in terms of volume (thanks to the increasing demand from big emerging markets, mainly China) and values also increased the fiscal revenues of South American states, providing them with sources of capital and preventing them from implementing once again debt-led growth strategies. The second one is internal and derives from the sustained domestic demand, thanks to the improved conditions of millions of people who finally came out of poverty conditions. The presence of a strong domestic demand is one of the main reasons why South America was much less affected by the global financial crisis of 2008-09 and the recovery was almost immediate and strong.

1.1.4 What's next?

Perspectives for the next years still look positive for South America's economy. According to the forecasts released by the IMF (Figure 1.1.3), GDP growth will remain positive, although not so high as in the previous decade, which looks normal as developing countries catch up with developed ones (Barro 1996). Real output growth moderated to 3% in 2012 after 4.5% in 2011 in the Latin American region overall and it seems it will stabilize around this level. The potential for sustained growth is still intact, since domestic demand is growing and many countries are still taking advantage of favorable conditions on the global markets for their exports of commodities.

However, some risks are likely to occur in the medium term. First of all, despite a generally favorable external environment, the region's growth rates are slowing down. It seems that production possibilities are being exhausted in a region where improvements in physical and technological infrastructures have not kept up with strong output performance. This resulted into "supply bottlenecks" that reduced growth in Latin American countries because of restrictions in some of the inputs of the production process that do not allow output to continue growing at previous rates, thus preventing the production possibility frontier from expanding further (Talvi and Munyo 2013). Moreover, a key risk for the region is a reversal of the tailwinds of easy financing conditions determined by high commodity prices. The slowdown of China's growth, which is a main buyer of South American agricultural and mining goods, might trigger a fall of their prices. Moreover, at the domestic level, current account surpluses have weakened in recent years and asset prices are on the rise. Therefore, a deterioration of the financial sector balance sheets might look likely to happen (IMF 2013a).

In conclusion, more reforms, most of them of a structural nature, are needed for South America to keep growing. Labor costs should be reduced in some countries (mainly in Brazil) and measures to enhance the human capital are needed (improvements of the education system, both in terms of quality of teaching and equal access), while product market reforms and infrastructural projects should be implemented in order to release the bottlenecks that prevent domestic economic systems from being fully competitive at the global level.

1.1.5 Conclusions: challenges ahead

This chapter focused on the long-term economic performance of South America. After World War II, the region struggled to find its way to undertake a pattern of stable and sustained growth, despite its huge potential thanks to a unique endowment of natural resources. Too conservative social structures, as a legacy of the Spanish colonial period, as well as a mismanagement of these resources (the so-called "resource curse") prevented South America from achieving a satisfactory performance in terms of growth, which remained volatile and very uneven among the different groups of the population.

Very different economic paradigms were adopted: the ISI strategy was suddenly replaced between the 1970s and the 1980s by an opening to free trade and external indebtedness, which led to macroeconomic crises and sluggish growth due to a lack of international competitiveness of South American manufacturing. The neo-liberal policies adopted in the 1990s were not effective in providing the region with stable and evenly spread growth, given its still high financial vulnerability to the rest of the world, as shown by the Argentine debt crisis of 2001.

The 2000s were finally a decade of sustained growth, thanks to high prices of commodities and the growing demand from major developing countries. It is now the moment for South America not to waste the big achievements obtained, not only in economic but also in social terms, and to grow up the ladder from a middle income region to a high income one. In order to be able to do so, the region has to remove its supply bottlenecks that prevent it from expanding its production frontier and taking full advantage of the favorable external conditions.

Argentina is the country that probably best summarizes the contradictions of the uneven and unstable development path in the region. In the following chapters I will focus on its economy, identify problems, compare strategies and suggest economic policy indications to overcome them.

1.2 An analysis of Argentina's economic policies (2003-2013)

1.2.1 Introduction

Argentina is South America's second biggest economy. A member of the G20, the country is considered a key player in the region and it has been able to strongly recover from the severe economic crisis of 2001-2002. The export-led growth of the last decade brought about an unprecedented period of economic boom, because of its stability and success in reducing poverty and income inequalities.

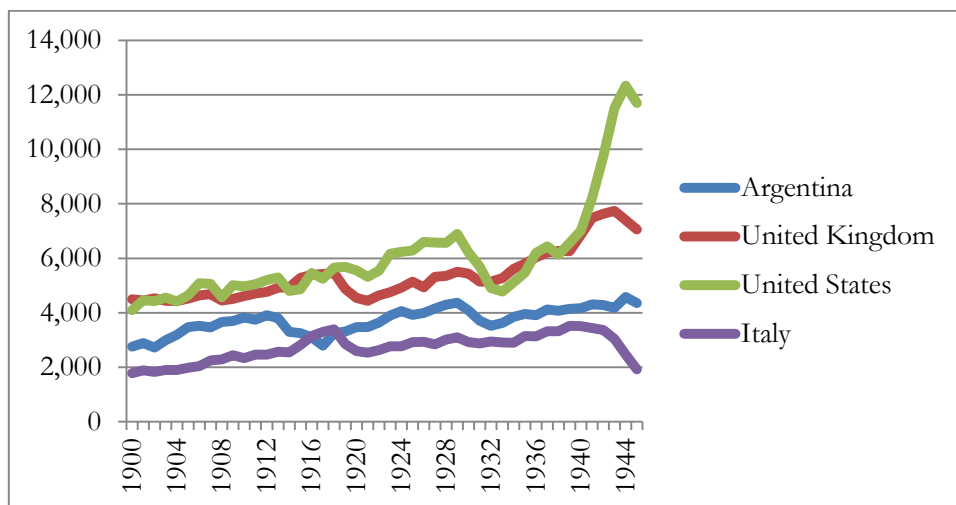
However, several problems seem to pose at risk the sustainability of the development model implemented by the Kirchner governments (Néstor from 2003 to 2007 and his wife Cristina Fernández since then). An excessive intervention of the State in the management of the economy, together with the typical features of a closed economic system, could limit the growth potential of Argentina, which is endowed of high quality resources both in terms of natural and human capital.

This chapter will analyze the economic policies implemented by the Argentine Governments in recent years and uncover the problems that can undermine the country's economic growth in the medium-long term. Before giving a brief summary of the economic policies adopted in the past decades, in order to highlight a story of an extremely high potential wasted because of wrong and inconsistent choices, I will focus on the industrial, investment, trade and financial policies enforced by the Kirchner governments. My hypothesis is that the increasing return to economic 'nationalism' will be detrimental to the long-term economic performance of the country, given the current situation of the global economy where integration with other countries is very important. In the next chapter I will then provide some policy indications that might help Argentina undertake a more stable path.

1.2.2. Setting the scene: Argentina's economic history since the 1950s

Describing the economic history of Argentina is not the main purpose of this thesis. However, it is useful to recall the main elements that characterized the period following World War II, in order to better understand the current situation. Argentina's economy is the story of a huge potential that has been partially wasted. In fact, although from a peripheral position not only in geographic terms but also in proportion to its economic power and influence, Argentina became one of the richest countries in the world by the middle of last century. If we look at its GDP per capita, it had been ranking well above Italy (used here as a term of comparison because of the similar demographic structure between the two countries) until and for some years after the end of World War II (Figure 1.2.1).

Figure 1.2.1 – Argentina vs. other countries, GDP per capita (million 1990 international Geary-Khamis dollars, 1900-1945)



Source: Maddison tables

A major agricultural exporter and also a manufacturing power with a considerable potential, Argentina could have easily become a developed country and followed the pattern of the United States and Western European countries. Nevertheless, the governments that ruled the country during the last decades were not able to undertake a coherent paradigm of economic development, but adopted strategies which proved to be unsuccessful and not consistent to each other. This is why the pattern of growth followed by Argentina was defined as an example of the “stop and go model”: economic cycles in Argentina during the period considered in this analysis were generally short and based on strong, devaluations and recoveries via expansive demand-driven policies (Della Paolera and Taylor 2003).

After Juan Domingo Perón took power in 1945, a new model based on political populism and economic nationalism was implemented. This model, defined “Peronism” not by chance, will be not doomed to disappear together with the President who first adopted it, but it will become, as I will explain in the next paragraph, the main reference for the present Government of Cristina Kirchner. A process of income redistribution from the agricultural, exporting sector to the urban industrial working class was put in place, together with a progressive expansion of the role of the State in managing the economy and in providing welfare assistance to the working classes. The increasing public deficit-to-GDP ratio, that reached the level of 13.4% in 1948, was being compensated by printing money, which brought about a rising inflation, always above the two digits (Silvestri 2004).

In 1958 the end of Peronism was marked by the radical (after the name of the *Unión Cívica Radical*, UCR, the main opponent party to the *Partido Justicialista*, PJ) government of Arturo Frondizi, who won

the general elections. His government decided to implement a “developmentalist” model in order to foster economic growth. Such framework considered the deterioration of terms of trade in agriculture and mining products as the main source of underdevelopment in countries that were primarily engaged in the export of commodities. Therefore, developmentalism advocated domestic industrialization and the expansion of energy and transportation infrastructure. This approach followed the ‘recipes’ suggested by the Economic Commission for Latin America and Caribbean (ECLAC), a regional agency of the United Nations, based on the Import Substitution Industrialization (ISI) strategy fostered by Raúl Prebisch, the first Secretary of the organization. Nevertheless, this model proved to be very inefficient since domestic industry was unable to be competitive vis-à-vis the rest of the world. Trouble occurred with this strategy and the urgent need for foreign capital flowing into the country convinced Frondizi of the necessity to ask for a loan from the IMF: receiving money from a multilateral institution, of which Argentina was a member itself, was in fact considered a more acceptable option rather than allowing foreign capital through the channel of Foreign Direct Investment (FDI), because the latter would have been considered as a form of intrusiveness and external control on the domestic economy (Kedar 2013).

Nevertheless, the need to find sources of financing drove Argentina to start increasing its external level of indebtedness: foreign capital was considered more convenient because the domestic interest rate was systematically higher than in the rest of the world (Basualdo 2006). The increasing external vulnerability of Argentina became manifest in 1982 when the debt crisis originated in Mexico propagated to the rest of the region and hit Argentina with a freeze of banking loans and a sudden lack of capital. In the meantime, the country had changed once again its model of development, because the military dictatorship that had been ruling brutally Argentina since 1976 abandoned the focus on industrialization and state interventionism in order to liberalize the economy with trade and financial openness (capital movements were allowed). However, the strategies aimed at containing inflation and consisting in a rigid control of the exchange rate were detrimental to the external competitiveness of Argentine goods. Therefore, exports were negatively affected (Silvestri 2004).

After Argentina was defeated by the United Kingdom in the war at the Falklands/Malvinas islands in 1982, the military dictatorship had no further cards to play and it was forced to resign, giving way again to democracy. Unfortunately, the newly elected radical government of Raúl Alfonsín was not able to bring Argentina back to the path of growth and stability. The 1980s, known as the “lost decade” of Latin America, were characterized by several cases of hyperinflation and a series of macroeconomic stabilization programs that proved to be ineffective. The “Plan Austral” and “Plan Primavera”, just to mention the biggest initiatives launched by Alfonsín in economic policy, aimed at contrasting inflation

and the long-lasting fiscal deficits, were not able to reach their target in the long run and had to be abandoned (Silvestri 2004).

Argentina's most important problem was structural and determined by its constant public fiscal deficits that the country started running since the Peronist period. This problem, accompanied with high inflation, had detrimental effects on Argentina's economy since it produced the so-called "Oliveira-Tanzi" effect. Named after the two economists who defined it, this effect shows the existence of a negative correlation between periods of high inflation and tax revenues: as prices rise too much, fiscal revenues decrease, even more if payments are delayed and there are lags in tax collection that make the value of taxes offset by the rising inflation (Bulmer Thomas 2003, Tanzi 2007). The heterodox policies applied by Alfonsín were based on the belief that the stabilization of prices would have been followed by an increase of tax collection, so that the fiscal deficit would be lower.

The only effective tool against inflation was a drastic intervention on the nominal exchange rate of the country: in 1991 Domingo Cavallo, the minister of the Economy of the new government led by Carlos Saul Menem, decided to peg the Argentine peso to the US dollar through a fixed convertibility of one peso to one dollar. This currency board regime helped lower the inflation from 2314% in 1990 to 0.2% in 1996 (IMF 2013). Together with price stabilization, the Menem government embraced the principles contained in the so-called "Washington Consensus" (see chapter 1.1.1) starting a process of liberalization and privatization and reducing the role of the State in the management of the economy. Argentina started growing again (at an average rate of 8.2% in real terms between 1991 and 1994, IMF 2013) and it was defined as a new emerging market, starting to attract foreign capital for new investments. However, also this new set of economic policies had its flaws and it was doomed to fail, as witnessed by the crisis of 1995, as a consequence of the new debt crisis originated in Mexico, which signaled the persistence of the country's external vulnerability.

The default on 107 billion US dollars external debt, in December 2011, was the unhappy ending of a growth model that could not be sustainable in the long run. The fixed exchange rate prevented Argentine government from using monetary policy as a tool to refinance its traditional high public deficit. This is why the country experienced a growing external debt that could not be paid back at an indefinite time horizon, as a Ponzi scheme.⁸ More in detail, Argentina used to suffer simultaneously from three sources of vulnerability:

⁸ The Ponzi scheme (after the name of Charles Ponzi, a fraudulent investor) usually entices new investors by offering higher returns than other investments, in the form of short-term returns that are either abnormally high or unusually

- the hard peg adopted against the theoretical arguments of an optimal currency area,⁹ in a context of wage and price inflexibility. Argentina suffered from a decline of its terms of trade after Brazil and the European Union depreciated their currencies in 1999 and from a rapid deterioration of its net foreign asset position. These negative effects were amplified by the fact that Argentina's exchange rate was pegged to the US dollar, but the United States was not a major trade partner, representing just 15% of its total trade;
- the fragile fiscal position resulting from an expansionary stance in the boom: the increase of public deficit and debt, made worse by pro-cyclical expansionary policies in years of growth;
- underlying vulnerabilities in the banking system: despite a façade of soundness (by 1998 Argentina ranked second in terms of quality of its banking regulatory environment, according to the World Bank), the domestic system presented three sources of vulnerabilities: the failure in recognizing the special risk of loans to debtors in the non tradable sector, in a context of an overvalued Real Exchange Rate; the failure to isolate the solvency of the banking system from the solvency of the government (direct exposure of banks to Government risk rose above 20% of total assets by 2000); thanks to its liquidity requirements, the Argentine banking system withstood a prolonged and severe process of deposit withdrawal during 2001 (Perry and Servén 2003).

Moreover, the existence of “twin deficits” , the fiscal one forcing the country to increase its external indebtedness, the current account one producing capital outflows originated by the fixed exchange rate (Silvestri 2004), surrounded Argentina in a deadly cage that made the default option unavoidable.

What would the alternatives to these problems have been? The authorities might either have attempted an earlier ‘pesification’ of the economy before devaluing, with the risk of a major deposit flight, or a full dollarization, but harming the external competitiveness of domestically produced goods (Perry and Servén 2003). However, it is by all means true that fiscal strengthening, stricter prudential regulations, a higher degree of flexibility in the labor market aimed at reducing unemployment, and an increased trade openness were necessary. The next paragraph will analyze the economic policies implemented in the last decade and will try to assess whether the Kirchner governments followed these policy indications.

consistent. Perpetuation of the high returns requires an ever-increasing flow of money from new investors to keep the scheme going, so there will be a time when the scheme cannot be perpetuated anymore.

⁹ The Optimal Currency Area theory (OCA) suggests that an irrevocable peg is more likely to be beneficial for the client country if it trades a lot with the anchor, and if client and anchor are not exposed to significant asymmetric shocks which would demand monetary policy responses of different sign in the two countries (Perry and Servén 2003).

1.2.3 Argentina and *Kirchnerismo*: an analysis ten years after

A “low quality” democracy

The new Presidential elections held in May 2003 showed an unexpected result. Carlos Menem, again candidate for the third time, had obtained the relative majority of the votes at the first round, but decided to withdraw from the second round, giving the way to the candidate who had got only 22.2 % of the popular preferences, Néstor Kirchner. Governor of the Santa Cruz province, Kirchner belonged to the left wing of the Partido Justicialista (the so-called *Frente para la Victoria*, Front for Victory, which was closer to the original Peronism) while, as I explained in the previous paragraph, Menem’s economic policies were far more liberal.

The new government was able to rapidly restore growth in the country, reducing the rates of unemployment and poverty at an historical low. Kirchner took advantage of an extremely favorable global conjuncture: high prices of agricultural commodities, together with a higher competitiveness of Argentina after the sharp devaluation of the peso vis-à-vis the dollar¹⁰ that allowed for a reduction of the real exchange rate, helped the economy to boom and to restore its fiscal position. The Kirchner Presidency was also marked by the unilateral decision to renegotiate the value of the country’s external debt with the issuance of new bonds with a much lower nominal value.

Néstor Kirchner decided not to run for a second Presidency term, but stepped down in favor of his wife, Cristina Fernández, who was elected in October 2007. The second term of the ‘Kirchnerist’ government was marked by increasing political and social tensions, as the economic growth started to slow down as a consequence of the global financial crisis. At the domestic level, the government had to face a period of turmoil because of the harsh confrontation with the agricultural exporters, who were charged a tax on their exports. Spring 2008 was characterized by high social and political polarization until the tax was removed. The resolute attitude of the *Presidenta* was clearly evident in episodes such as the decision to remove the former Central Bank governor, Martín Redrado, who was replaced in 2009 by Mercedes Marcó del Pont, an unorthodox economist close to the Government who accepted to use foreign currency reserves to finance an increase of public expenditure; or the discussed *Ley de Medios* (Law of Telecommunications), which harmed the most important media group in the country, *Clarín*; or, more recently, the conflict with the Constitutional Court to pass a law that would have put judges under the control of political parties.

¹⁰ The new nominal exchange rate was set at a floating level of 1 US dollar against 3 ARS.

On the other hand, foreign policy was characterized by the so-called “K-Style” (where “K” stands obviously for “Kirchner”): opposition to the neo-liberal policies promoted by the US, alignment with the other Latin American countries ruled by leftist governments and nationalist and populist rhetoric are the main features of this orientation (Correa da Silva 2012). In particular, Argentina strengthened its relationship with Venezuela, ruled since 1999 by the socialist government of Hugo Chávez: until 2010, it was the country Argentina had signed the highest number of bilateral treaties with (94, more than three times as with Brazil and Chile, 31 each, De Luca and Malamud 2010).

It is quite clear that Argentina is (and has been) a country full of contradictions. It is a society without ethnic or social conflicts, with a relatively advanced and diversified production structure and very good performances in terms of human development and quality of life (De Luca and Malamud 2010, López Belsué 2013)¹¹ but, on the other hand, it is affected by problems in terms of lack of transparency and corruption. The Corruption Perception Index elaborated by Transparency International sees Argentina at 102nd place in 2012, while according to the Index of Institutional Quality put together by the International Policy Network the country ranks 122nd in 2012. Argentina obtains similar disappointing results in other rankings, such as the Index of Economic Freedom released by the Heritage Foundation (160th in 2012, while only in 2007 it ranked 95th), and the Doing Business 2012 by the World Bank (113th in 2012 from the 65th position in 2007).

To sum up, from this general picture it seems that ten years of Kirchnerism helped improve living conditions of people, but an ‘authoritarian’ style of government, as well as a series of questionable policies, reduced the external credibility of the country in terms of institutional quality and ease of doing business. Democracy in Argentina is not at risk, but its functioning has many flaws (De Luca and Malamud 2010).

Ten years of growth: a macroeconomic overview

The crisis of 2001-2002 was shocking: in only one year GDP contracted by 10.9% and income per capita fell 22% below its level of 1998. The sharp devaluation of the peso vis-à-vis the US dollar (70% in a few months) strongly reduced the savings of households that held peso-denominated assets, both in real and absolute terms. Imported goods became more expensive because of the devaluation, while internal inflation (25.9% in 2002, IMF) increased the price of domestic goods. The combined effect

¹¹ Argentina ranks 45th according to the Human Development Index elaborated by the United Nations and 17th according to the quality of life index elaborated by International Living.

was that by June 2002 57.7% of the population was living in poverty conditions, while 23.8% was even in a condition of extreme poverty (World Bank 2002).

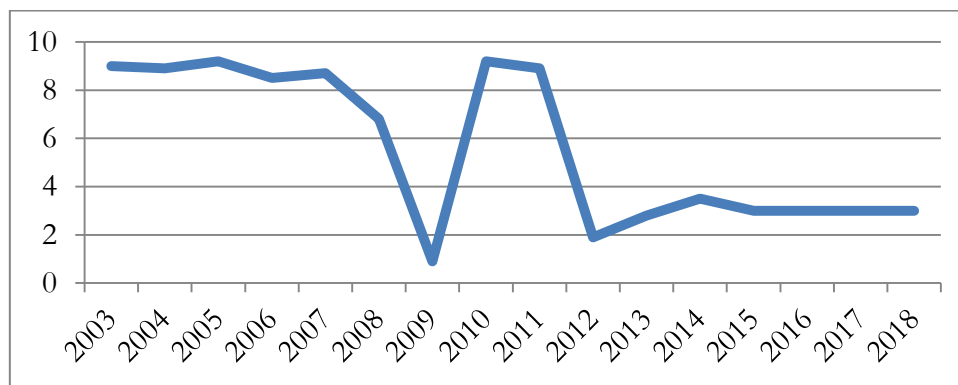
Argentina's economic and social situation was tragic. Néstor Kirchner, who took over Eduardo Duhalde, nominated President *ad interim* after the institutional chaos of December 2001 (during that month three different Presidents alternated), implemented a set of unorthodox economic policies that represented a clear rupture with the neo-liberal paradigm embraced during the 1990s. Fiscal expansion, together with enhanced competitiveness due to devaluation of the exchange rate and a large haircut on the defaulted debt, provided the macroeconomic basis for the recovery.

In particular, the most impressive years of boom were from 2003 to 2007, with an average GDP growth of 8.8% (IMF 2013 – see Figure 1.2.2). Economic growth was mainly driven by three factors:

- A favorable external environment and outlook, with a global rise in the price of agricultural commodities (Argentina became one of the main exporters of soy beans) and in the external demand, especially from China;
- A highly competitive exchange rate, which remained so also in real terms since inflation in these first years was not too high;
- The implementation of nationalization of foreign-owned businesses and the pursuit of import substitution and export tax policies (Zaza 2011).

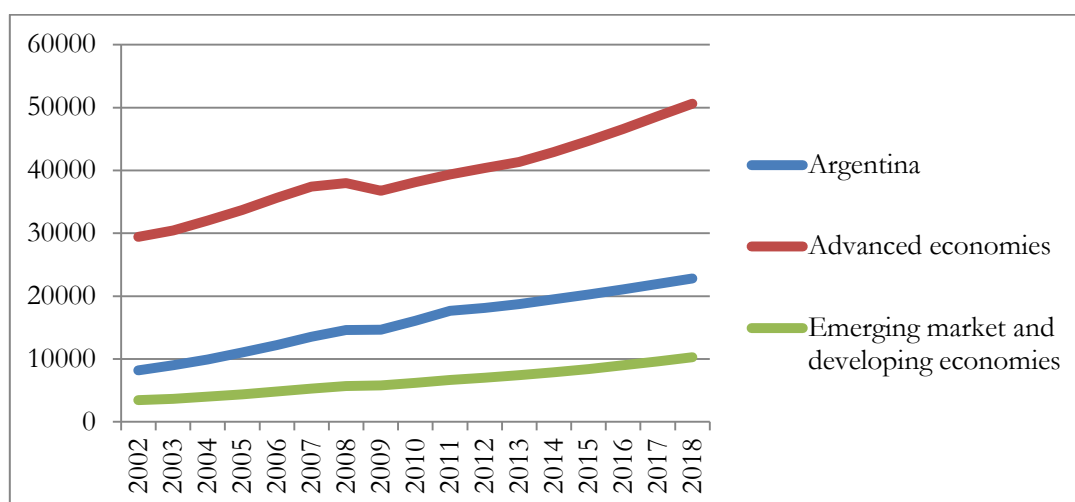
GDP increased both in absolute and per capita terms. Growth was more evenly spread than in the past, thanks also to the programs of conditional cash transfers promoted by the government in order to help the poorest households. GDP per capita is now higher than the average of emerging markets and developing countries and is expected to grow also in the next few years (Figure 1.2.3).

Figure 1.2.2 – Argentina, Real GDP growth (% , 2003-2018*)



Source: IMF *2013-2018: forecasts

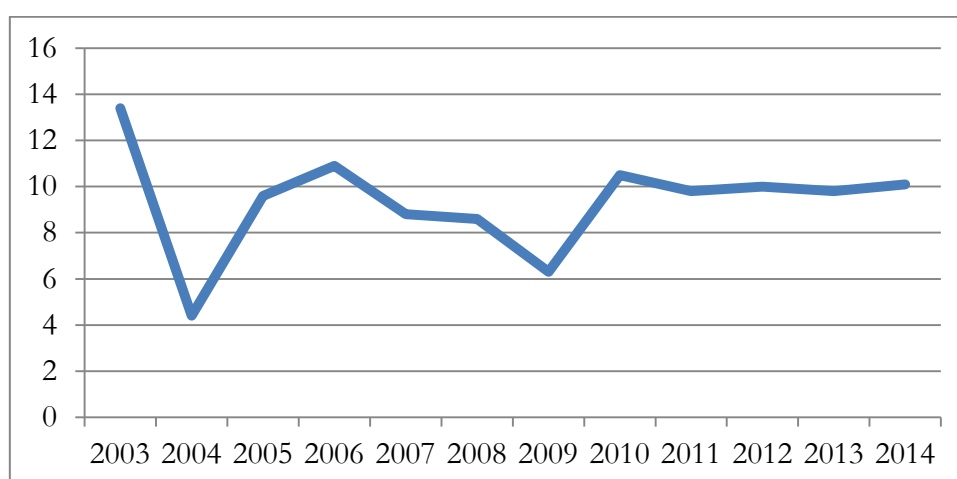
Figure 1.2.3 – Argentina, Real GDP per capita (US\$, 2003-2018*)



Source: IMF *2013-2018: forecasts

Inflation was not too high in the first years of the decade, and it did not offset the GDP growth in real terms. However, during the last 5 years prices started rising much more than expected, and officially declared by the statistics released by the National Institute of Statistics (INDEC). This is why the IMF stopped accepting the official data provided by the Argentine government. More reliable inflation estimates show that the real increase in prices has been well above the 8-10% declared on average, reaching up to almost 30% per year (Figure 1.2.4 and 1.2.5).¹²

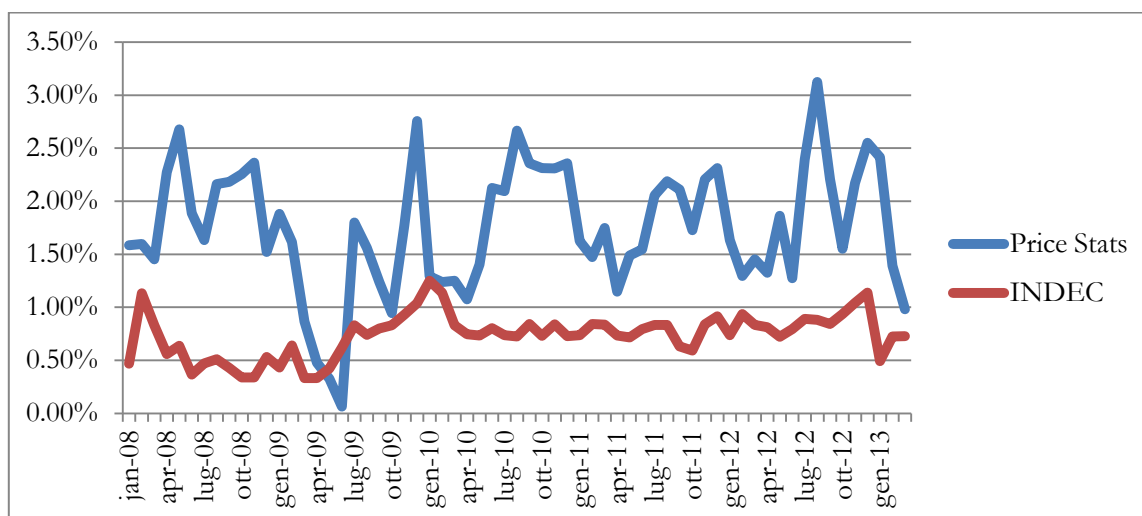
Figure 1.2.4 – Argentina, Consumer Price Index (%), 2003-2014*



Source: IMF *2013-2014: forecasts

¹² For a detailed explanation of the controversial debate on inflation in Argentina see chapter 3.1

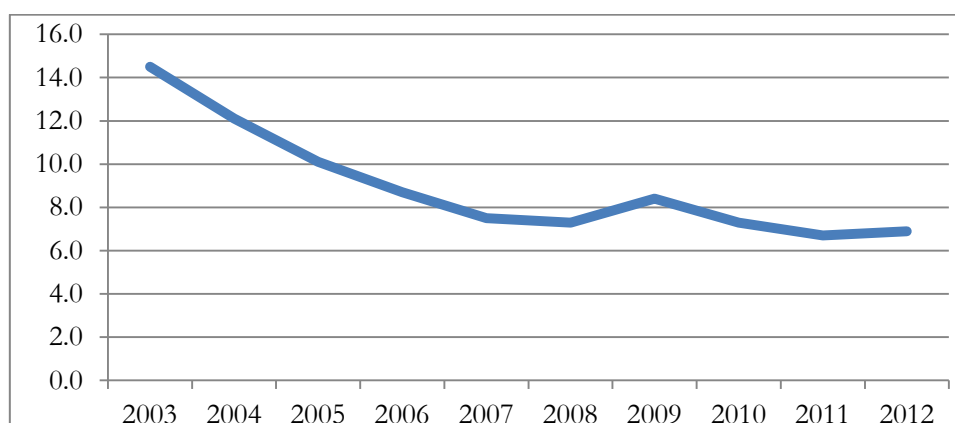
Figure 1.2.5 – Argentina, monthly CPI, INDEC vs. Price Stats
(% values, January 2008 – March 2013)



Source: elaboration of the author on INDEC, Price Stats data

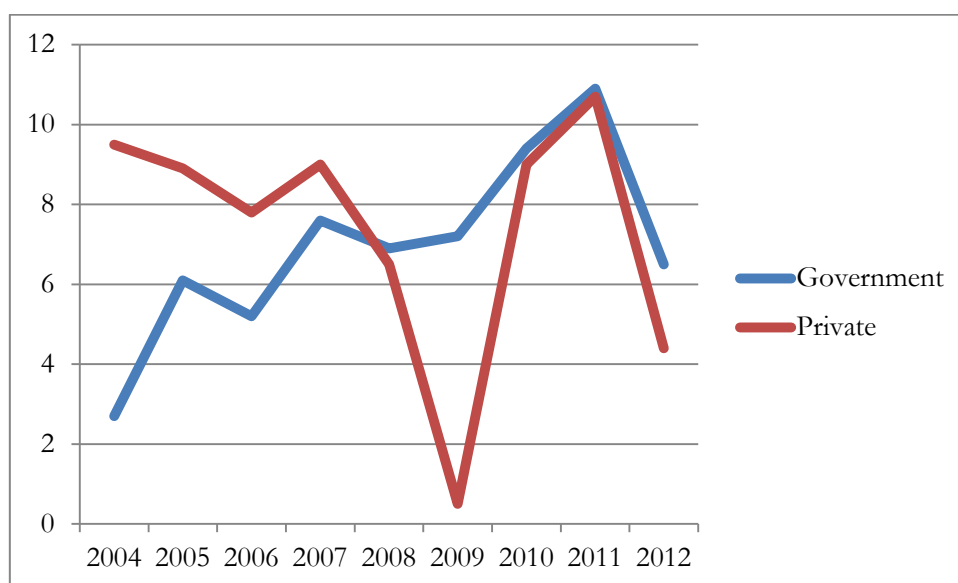
The situation of households has significantly improved. Unemployment has constantly decreased and is now below 10%, while private consumption has grown (Figures 1.2.6 and 1.2.7). On the other hand, also public consumption has constantly been on the rise, which might be worrisome for the central government public account (Figure 1.2.7). If we give a look at the current account balance, in fact, we see that the surplus accumulated until 2006 as a result of the boom in exports and of the increase in tax revenues has deteriorated and has now turned to a deficit (Figure 1.2.8). This is a quite significant result that should worry Argentine authorities since the surplus in the external sector has been one of the main assets of the country’s economic recovery.

Figure 1.2.6 – Argentina, Unemployment rate (% , 2003-2012)



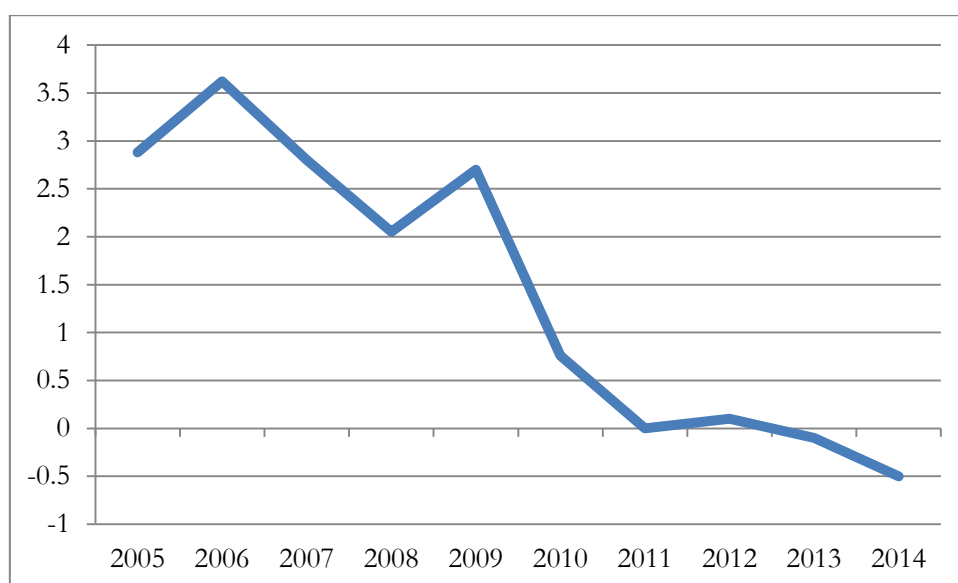
Source: INDEC

Figure 1.2.7 – Argentina, Public and private consumption (% annual increase, 2004-2012)



Source: ECLAC

Figure 1.2.8 – Argentina, Current account balance as a % of GDP (2005-2014)



Source: IMF

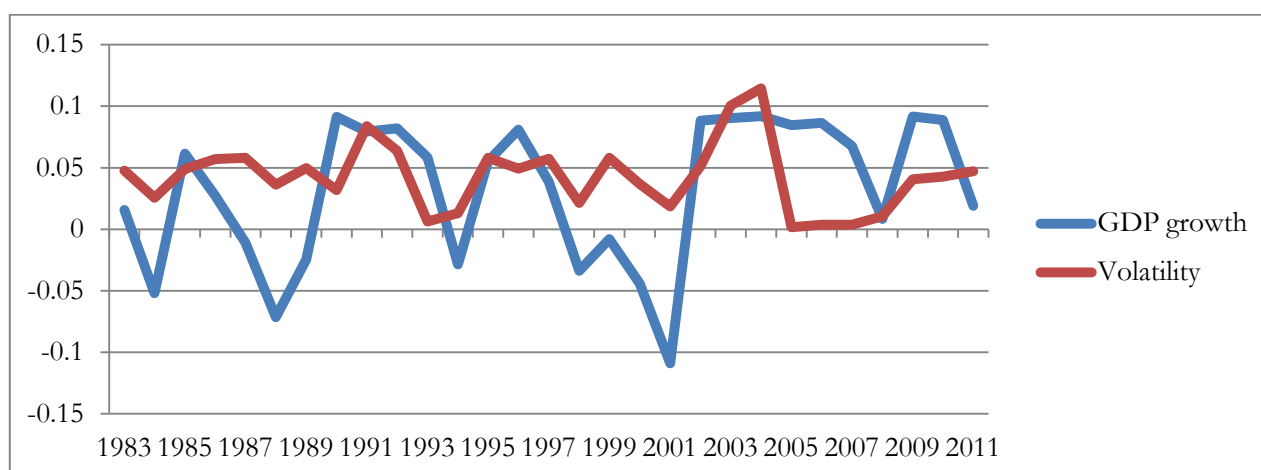
Forecasts for the near future still look positive. In 2013 GDP is expected to grow by 3.5% (ECLAC 2013): a good result, but much lower compared to the growth rates of the previous decade. In fact, the main determinant of the ‘sluggish’ growth expected in 2013 is the substantial increase of public

expenditure, risen by 26.6% on a yearly basis. This means that the public deficit-to-GDP ratio will rise up to 2.6%, compared to 1.7% in 2012 (ECLAC 2013)

There are several challenges that Argentina will have to face in the short run. The first priority should be to pursue macroeconomic stability. As the “stop and go” model shows, Argentina’s growth pattern has been affected by a high degree of volatility.¹³ As Fanelli and Abrieu (2011) show, Argentina’s growth historically presents a high level of volatility between 1960 and 2009, with an average level of the standard deviation of almost 6%: a much higher result than both the OECD countries (2.3%) and the rest of Latin America (4.2%). Empirical evidence shows the existence of a negative relationship between volatility and growth, with a negative influence of the former on the latter through three different channels: inflation and relative prices, financial stability (in terms of a good functioning of the banking system) and the fiscal position (with permanent effects of anti-cyclical fiscal policies) (Fanelli 2007). Does this apply also to Argentina? I computed volatility, measured by the standard deviation of economic growth with a three-year moving average, between 1983 and 2012. The results (Figure 1.2.9) seem to confirm the negative relationship between the two variables. During the 1980s volatility (red line) kept at high levels, while growth remained sluggish or even negative (these were the years of hyperinflation and the failure of the unorthodox policies implemented by the Alfonsín government, see previous paragraph). Despite the good performance of the first half of the 1990s, volatility was still high and increased during the last years of the decade, before and during the heavy recession of years 2000-2002. What we observe in the 2000s is different: volatility falls sharply while economic growth is strong and sustained. However, volatility rises again after the 2008/09 global financial crisis, but stays below the 5% ‘critical’ threshold. On one hand, this is good news for Argentina: for the first time in 30 years (at least for the period covered in my analysis) lower levels of volatility seem to have allowed the country to grow in a more stable way.

¹³ Volatility is considered as the standard deviation of GDP growth. It is considered as a proxy for the fluctuations of GDP.

Figure 1.2.9 – Argentina, Economic growth and volatility (1983-2012)



Source: elaboration of the author on INDEC data

Macroeconomic stability is the most important challenge that Argentina has to face in order to overcome the other ones. As shown, despite its successful performance and the still positive economic trend, growth risks to become sluggish and sustained mainly by fiscal stimulus. If we merge this factor with a deterioration of the current account balance, it is pretty obvious that such economic policies cannot be sustainable in the long run. Growth has to be supported by structural reforms aimed at enhancing the stock of capital, both in terms of technology and human skills (Mercado, Cicowiez and Coremberg 2011): positive effects of these measures are visible only in the medium-long run, but they are essential to enhance the country's competitiveness. This and other issues will be the object of the remainder of this chapter.

1.2.4 Argentina's economic structure: high potential and low competitiveness

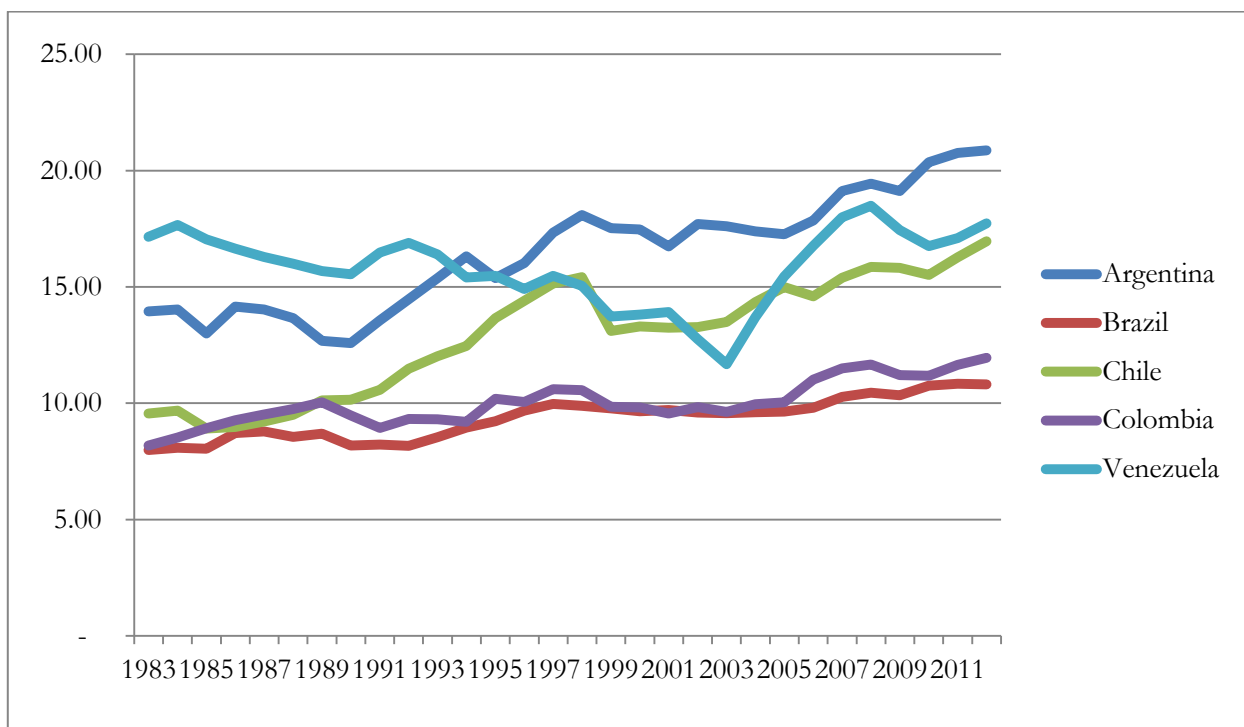
Lack of competitiveness and 'software': an overview

As shown in the first part of this chapter, Argentina's recovery has been based on a very simple set of economic policy tools: a devaluation which led to a more competitive exchange rate and a boost of the exports of agricultural commodities, drawing upon the exploitation of natural resources the country is relatively well endowed of. In order to be able to take full advantage of this situation, Argentina should establish and develop an economic and institutional system favorable to its inclusion in global markets.

An important indicator to evaluate a country's competitiveness is its labor productivity. Productivity can be roughly approximated as the ratio between a volume measure of output (GDP or gross value added) and a measure of input use (the total number of hours worked or total employment):

Let us look at Argentina’s performance over the course of the last three decades. Figure 1.2.10 shows the evolution of productivity in comparison with the other main South American countries included in my sample: it seems that Argentina is the best, with an hourly labor productivity of 20.86 US\$. However, as Fanelli (2012) explains, it is important to underline that during the last ten years the increase of per capita GDP was higher than labor productivity, which means that the overall growth is explained more by the increase of the labor force rather than the output produced by every single worker.

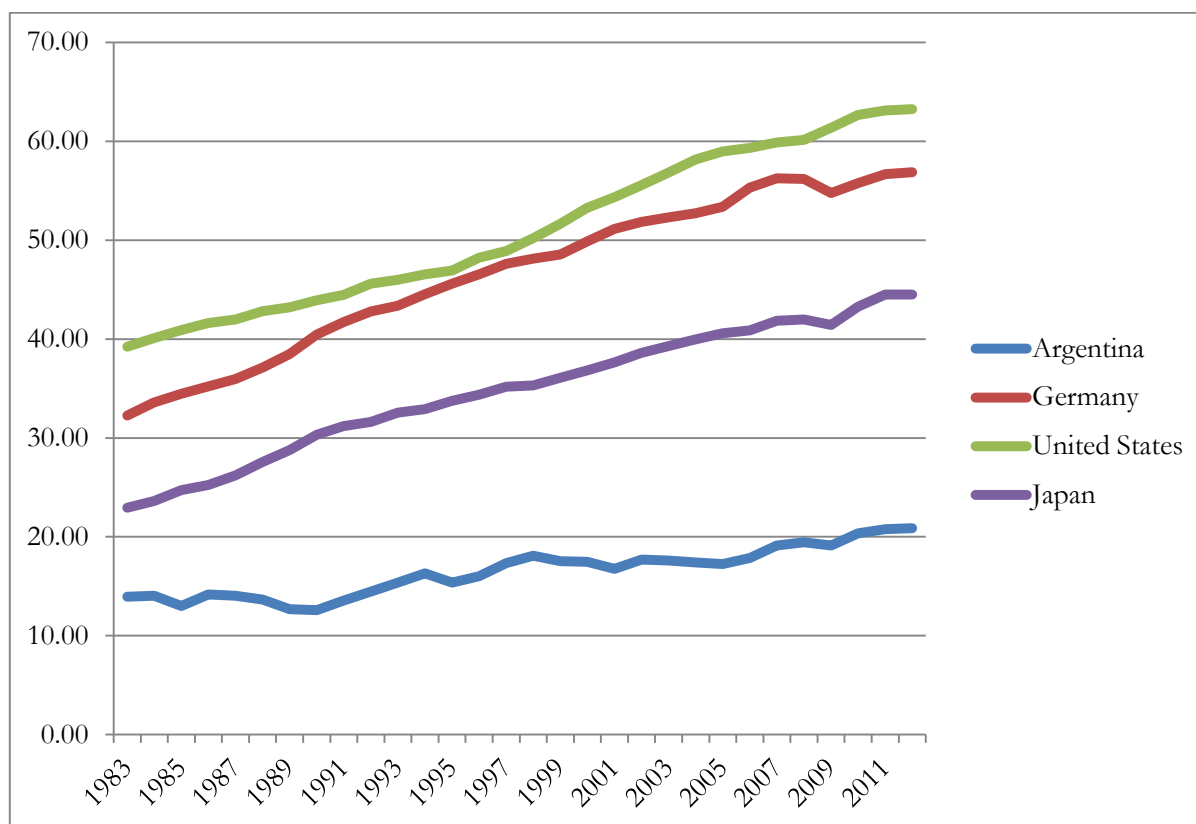
Figure 1.2.10 – Argentina vs. South America, GDP per hour worked, Argentina vs. South America (US 2012 PPP \$, 1983-2012)



Source: The Conference Board, Total Economy Database

If we go further and look at Argentina’s performance in comparison to some of the most developed economies in the world, we see that productivity is still much lower, despite a growth that, in relative terms, has been stronger than what was observed in the US, Germany and Japan during the last ten years (Figure 1.2.11). This means that, despite a process of catch-up with developed countries, Argentina is still far to close the gap with them in terms of productivity.

Figure 1.2.11 – Argentina vs. developed economies, GDP per hour worked,
(US 2012 PPP\$, 1983-2012)



Source: The Conference Board, Total Economy Database

There are other indicators that help look at a country's competitiveness also on a qualitative basis. The Global Competitiveness Index elaborated every year by the World Economic Forum (WEF) ranks Argentina in the 94th position out of 144 countries covered in its analysis (WEF 2013). This is not a good result, especially if compared to the other South American countries considered in my analysis: Chile stands 33rd, Brazil 48th, Colombia 69th and only Venezuela performs worse ranking 126th (WEF 2013). Argentina's overall standing is quite worrisome since the country lost ten positions in only a year, this being mainly due to a very negative assessment on its institutional environment (138th position according to this single indicator), and the inefficient functioning of its labor (140th) and financial markets (131st). The five most problematic factors for doing business, as perceived by a sample of interviews, are inflation, policy instability, corruption, foreign currency regulations and access to financing. The WEF report concludes its assessment on Argentina advocating structural reforms that might help its labor market become more flexible, in order to boost productivity, and its financial system deeper. Table 1.2.1 shows the overall performance of Argentina according to the WEF analysis.

Table 1.2.1 – Argentina, Global Competitiveness Index Assessment (2013)

| Indicator | Rank (out of 144) |
|----------------------------------------------|-------------------|
| Overall Index | 94 |
| Basic requirements | 96 |
| Institutions | 138 |
| Infrastructure | 86 |
| Macroeconomic environment | 94 |
| Health and primary education | 59 |
| Efficiency enhancers | 86 |
| Higher education and training | 53 |
| Goods market efficiency | 140 |
| Labor market efficiency | 140 |
| Financial market development | 131 |
| Technological readiness | 67 |
| Market size | 23 |
| Innovation and sophistication factors | 88 |
| Business sophistication | 89 |
| Innovation | 91 |

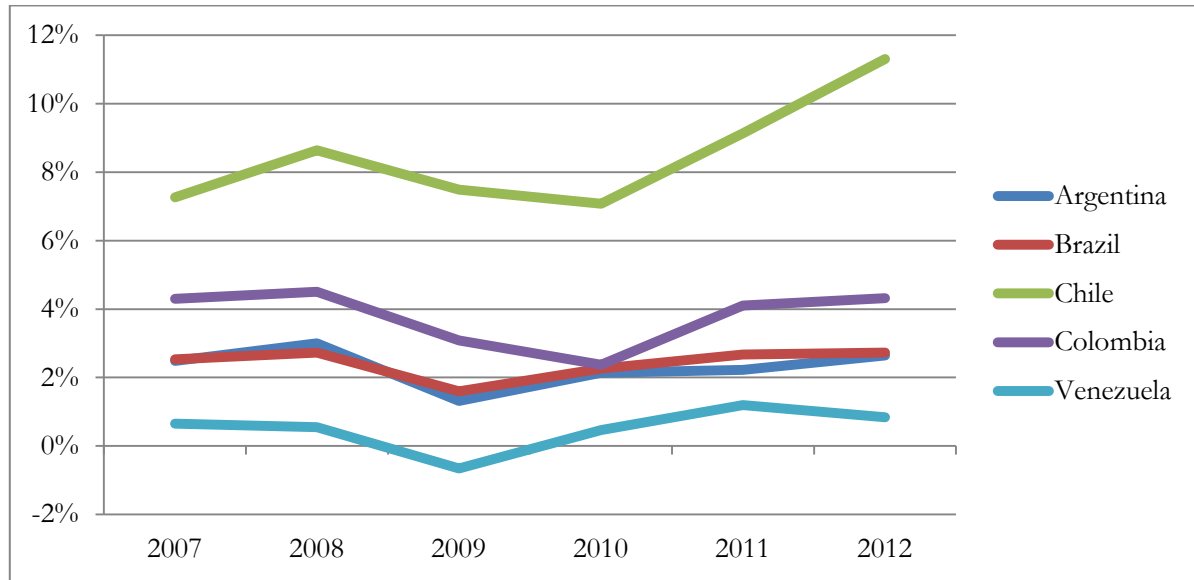
Source: World Economic Forum. The Global Competitiveness Report 2012-2013

Such a context does not seem the most appropriate to attract Foreign Direct Investments (FDI). Indeed, the scarcity of foreign capital is a problem for Argentina's economy, which looks much less dynamic than most of the other South American countries considered. The comparison with Chile is particularly brutal: in only a decade the latter has accumulated a stock of FDI which is almost twice as Argentina's stock (206.594 million US\$ versus 110.704 US\$), and it has achieved a share of foreign investment on GDP of almost 12%, while Argentina's share is less than 3%. By the same token, Argentina's position as a foreign investor is not very satisfactory, despite the presence in the country of some important Trans National Companies (TNCs):¹⁴ again, if we compare Argentina to Chile, the former's share of international investments is less than 1% of GDP, while the latter's amounts up to over 8% (see Figures 1.2.12 and 1.2.13). Among the main reasons of the overall disappointing performance of Argentina as an FDI recipient, the recent wave of nationalizations deployed by the government of Cristina Kirchner, especially in the field of the extractive industry (as witnessed by the expropriation of the 51% of shares of YPF, the most important oil&gas company operating in the country, from the Spanish company Repsol), helps explain the lack of new foreign capital flowing into the country. As the United Nations Committee for Trade and Development (UNCTAD) says,

¹⁴ Among the most important companies we mention Techint in the field of engineering and construction, and Arcor in the food industry.

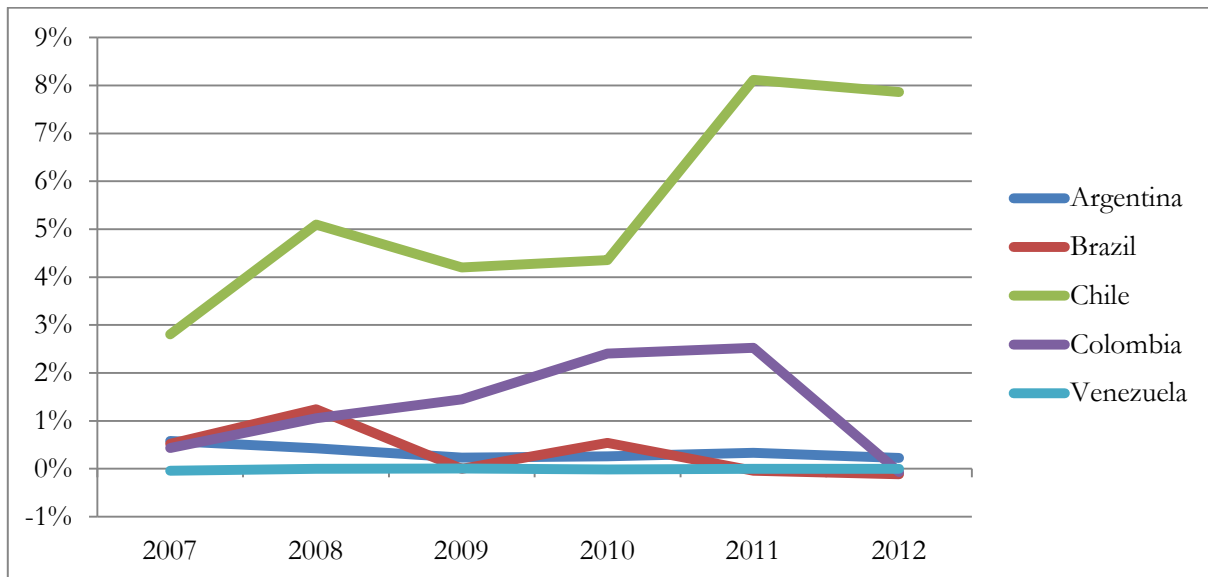
Argentina would need a shift to industrial policies aiming at developing domestic industries and improving technological capabilities. In order to do so, the country would also need a supply of capital available for investment, that cannot be provided only internally.

Figure 1.2.12 – Argentina vs. other countries, FDI inflows as a share of GDP (% , 2007-2012)



Source: elaboration of the author on UNCTAD data

Figure 1.2.13 – Argentina vs. other countries, FDI outflows as a share of GDP (% , 2007-2012)



Source: elaboration of the author on UNCTAD data

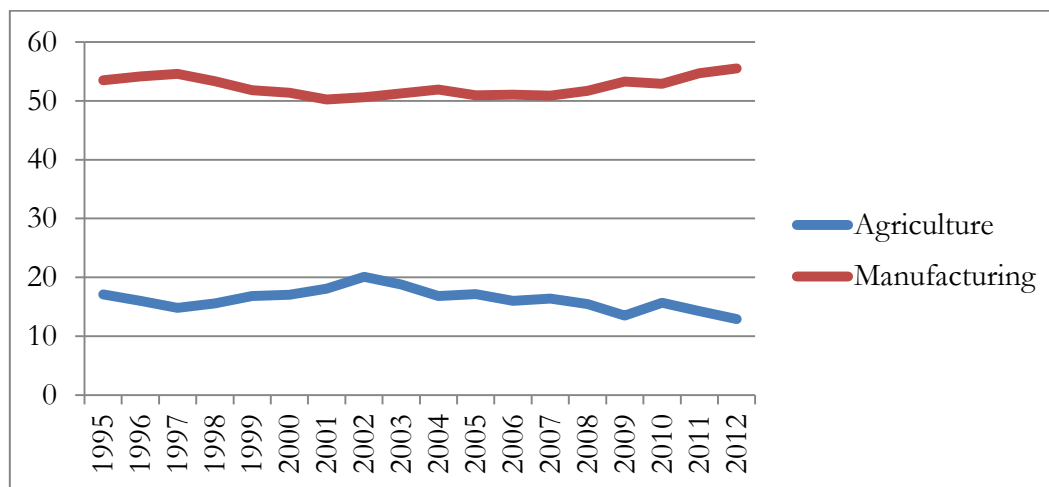
To sum up, Argentina’s economic system suffers from “software” deficiencies , where by software I mean the elements that contribute to form the institutional framework of the economy (Fanelli 2012).

It means that the legislative, financial and bureaucratic systems are not efficient and their flaws seriously damage the growth potential of the country. For instance, Argentina is affected by a lack of investment because the high inflation, the highly volatile macroeconomic environment, and the impossibility to rely on the official statistics and forecasts about price stability discourage capital holders from investing in long-term projects, therefore also damaging the domestic credit market. Moreover, the wave of nationalizations that took place in recent years increased the uncertainty about the respect of private property rights from the government. Finally, the lack of investment in higher education did not help human capital to develop further and to enhance productivity (Fanelli 2012). These are some of the reasons why Argentina, despite its huge potential, is still stuck in the situation of a middle-income country that is unable to take the necessary steps to become a fully developed economy.

Agriculture vs. manufacturing: an appropriate mix to be globally competitive?

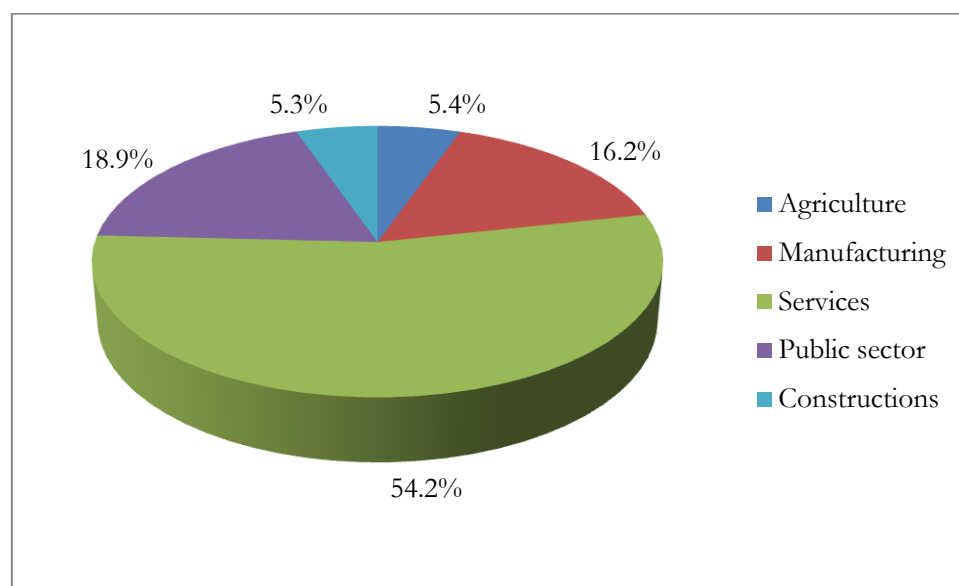
An important requirement for an economy to reach an advanced stage of development is that it presents a quite deep level of diversification among its sectors and also of technologic innovation. Final products should also contain a high component of value added. With respect to these considerations, where does Argentina stand? A significant part of the country's recent economic growth has been explained by the exploitation of agricultural resources, so that some analysts talked about a 're-primarization' of the economy. In order to assess whether this is true, I will analyze data regarding the evolution of Argentina's production structure. According to the data provided by the National Institute of Statistics (INDEC), we can have a look at the weight of the primary sector for the domestic economy. In terms of contribution to the GDP, agriculture's share among the sectors that produce goods is 12% and has slightly decreased over the course of the last 20 years. On the other hand, the share of manufacturing has remained pretty much the same, slightly over 50% (Figure 1.2.14). In absolute terms, agriculture does not seem to be such an important sector for the economy overall even if we look at the number of people employed: 5.4% of the labor force in 2011 worked in the primary sector, against 16% in the manufacturing and over 50% in the services sector (Figure 1.2.15).

Figure 1.2.14 – Argentina, Agriculture and manufacturing, share over goods produced (% , 1995-2012)



Source: elaboration of the author on INDEC data

Figure 1.2.15 – Argentina, Composition of the labor force across sectors (% , 2011)

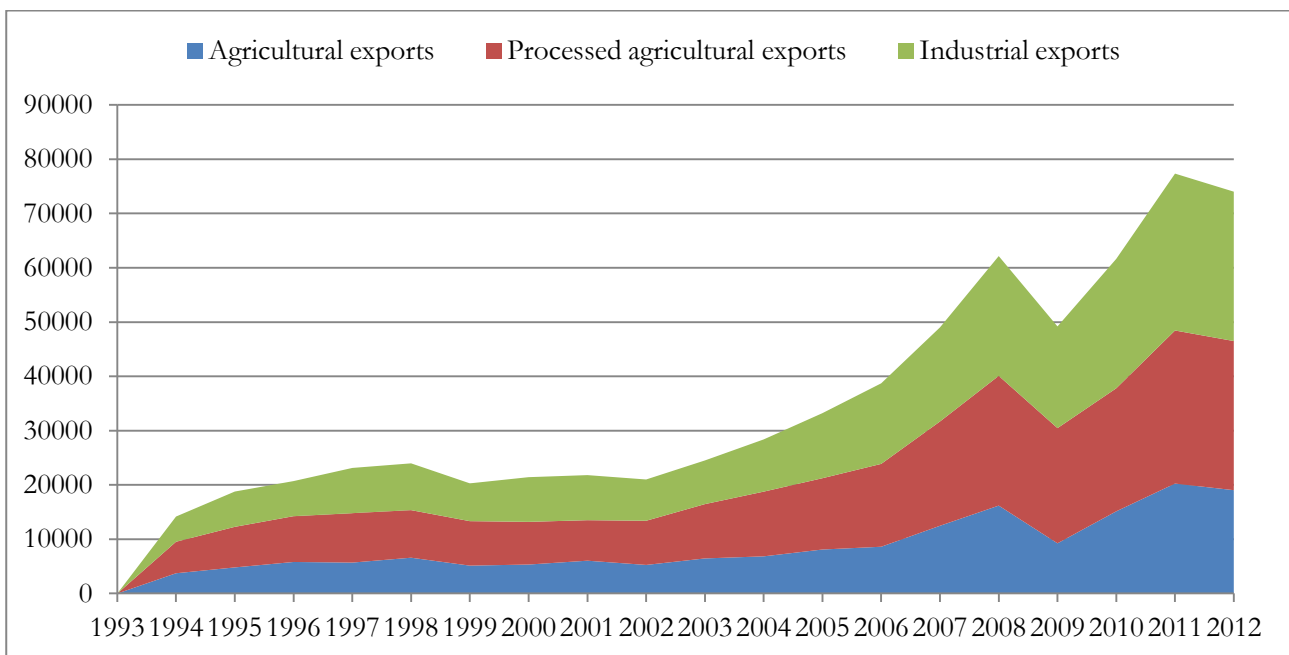


Source: INDEC

However, the agricultural sector plays a substantial role if we reason in terms of the value chain. The most important manufacturing sector is that one of processed food and beverages, which accounted for 33.2% of the industrial production and 43.4% of industrial exports in 2007 (Azpiazu and Schorr 2011). Moreover, exports of non-processed agricultural commodities account for 27% of total exports;

if we sum this to the share of agricultural manufactured exports, the total share goes up to about 60% (Figure 1.2.17). Therefore, even if it is not possible to say that Argentina’s economy was affected by a ‘re-primarization’, it is also clear that the primary sector takes on a vital importance for Argentina. However, the economic system and labor market is unbalanced, since very few workers are employed in this sector. Next paragraph will try to explain what this means for the country’s economy as a whole analyzing the role of industrial policies.

Figure 1.2.17 – Argentina, Composition of exports (million US\$, 1994-2012)



Source: INDEC

The role of industrial policies

There are several definition of “industrial policy”. A broader one defines it as the set of policies designed to support industry, including fiscal and monetary incentives for investment, direct public investment, incentives for investment in R&D, while a narrow one encompasses all those government activities aimed at supporting the development of certain industries in a national economy to maintain international competitiveness (Peres and Primi 2009). Within this continuum, it is clear that the concept of industrial policy assumes an active role of the State in supporting industrial production. As previously shown, in order to reach further stages of economic development a country has to evolve from a situation of ‘primarization’, where the exploitation of raw commodities is the most important source of income, and to achieve specialization through industrialization and the growth of a skill-intensive services sector.

The industrialization process in Argentina was initially led by the State that tried to develop a domestic industrial sector after the end of World War II by the implementation of developmentalist strategies based on the ISI and on inward-looking policies. However, it is quite evident that all the second half of the 20th century was characterized by a lack of coherence in national industrial policies. The forced industrialization that took place at the beginning of the period considered did not help Argentina gain global competitiveness: the kind of protectionism implemented in the country was not aimed at selecting the industrial sectors with the highest potential and at increasing investment and technological innovation, not complying to the principles of the so-called “infant-industry” theory.¹⁵ Moreover, the national industrial bourgeoisie was always unable to provide the amount of capital necessary for an endogenous development, so that Argentine industry soon became dependent on foreign capital (Azpiazu and Schorr 2011).

Since the middle of the 1970s a de-industrialization process took place. The military dictatorship suddenly broke up with the inward-looking strategy opening up the domestic economy and implementing a new model of capital accumulation based on financial speculation. Argentina’s industrial fabric became controlled by a restricted oligopoly of domestic and foreign groups, a tendency that could not be stopped even during the years of the Alfonsín Government. Capital available was diverted from productive investment in high value added, technology intensive sectors like machinery and equipment, to financial speculations (Azpiazu and Schorr 2011, Basualdo 2006). This strategy was then simply continued and deepened during the convertibility era of the Menem Governments in the 1990s: privatizations, de-industrialization, the establishment of a fixed, not competitive exchange rate vis-à-vis the rest of the world, further contributed to deteriorate the already fragile industrial fabric, leading to a rise of unemployment to unprecedented levels and of the people living in conditions of poverty (Azpiazu and Schorr 2011).

Have things changed under the Kirchner period? It is undeniable that after the 2001-2002 crisis the industrial sector gained new importance, with a 67% expansion from 2002 to 2007 (INDEC 2012) that has to be considered in the economic recovery of the country overall. In absolute terms, the most important manufacturing sector still remains that one of processed agricultural goods, but in relative

¹⁵ Infant-industry theorists argue that industries in developing sectors of the economy need to be protected to keep international competitors from damaging or destroying the domestic infant industry. In response to these arguments, governments may enact import duties, tariffs, quotas and exchange rate controls to prevent international competitors from matching or beating the prices of an infant industry, thereby giving the infant industry time to develop and stabilize. The strategy was successful in East Asian countries, where temporary protectionist trade policies were accompanied by investment in R&D, but it basically failed in South America.

terms the sectors that grew the most were machinery and equipment, mineral processing and textiles (Table 1.2.2).

Table 1.2.2 – Industrial GDP by main sectors (million ARS\$ and %, 2002-2007)

| | 2002 | 2005 | 2007 | % Growth 2002-2007 |
|--------------------------------|------------------|------------------|------------------|--------------------|
| Food & Beverage | 9683,8 | 12.090,70 | 13.665,40 | 41,1 |
| Textiles | 2.471,00 | 4.275,60 | 4.915,00 | 98,9 |
| Paper | 2.663,60 | 3.890,80 | 4.671,00 | 75,4 |
| Chemicals | 8.504,30 | 10.593,40 | 11.653,00 | 37 |
| Minerals | 871,5 | 1.570,90 | 1.902,90 | 118,3 |
| Basic metal industries | 1.493,20 | 2.045,20 | 2.357,00 | 57,8 |
| Machinery and equipment | 4.736,60 | 9.113,60 | 11.876,60 | 150,7 |
| Other manufacturing | 2.068,00 | 2.975,70 | 3.438,60 | 66,3 |
| TOTAL INDUSTRY | 32.492,00 | 46.555,90 | 54.479,50 | 67,7 |

Source: INDEC

Therefore, the processing of agricultural goods still remains the most important manufacturing sector, but it is now increasingly accompanied by other sectors that allow for a diversification of the domestic production. Moreover, an increase both of internal and external demand (industrial exports increased by 127% between 2002 and 2007), the latter thanks to reduced salaries and prices after the devaluation of 2002, helped Argentina's manufacturing recover.

Is this outcome due to a real and durable improvement of competitiveness and of a renewed general interest for the industrial sector? To answer this question, it is primarily important to define what we exactly mean by "competitiveness". In fact, this concept is not based just on price and cost issues, but it is more comprehensive and 'systemic' involving different dimensions: the micro level, referred to the innovation and efficiency of firms; the 'meso' level, referred to a country's infrastructural and educational endowment; the macro level, referred to the government's macroeconomic and fiscal policies; and a sort of 'target' level that points at the level of social cohesion and at the values a society uses to direct its development (Altenburg et al. 1998).

According to Couto (2010), the Kirchner Government decided to change priority in the orientation of its industrial policy, shifting from orthodox policies focused on macroeconomic stability (as witnessed

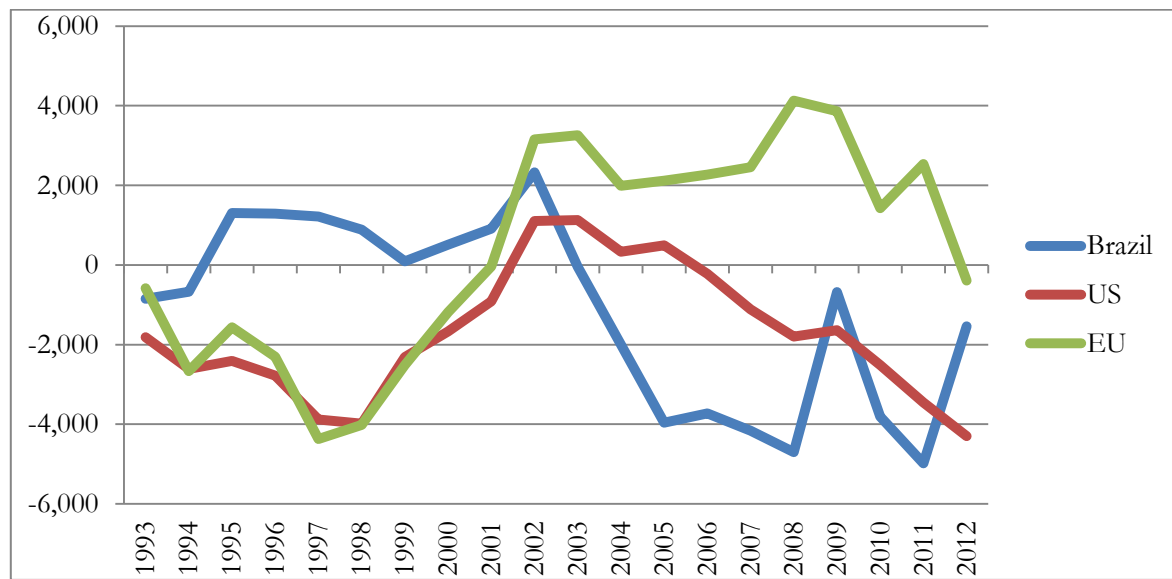
by the choice of pegging the currency to the US dollar) to unorthodox policies focused on boosting competitiveness. Apart from the fact that the target of stability was not met in the 1990s (see previous section), Azpiazu and Schorr (2011) are quite sharp in their assessment on what the Kirchner Government did to increase the level of competitiveness of national industry. They say that a deep and structured strategy was lacking and that the main axis of the new industrial policy was simply based on the strong devaluation of 2002 and on the pursuit of an “undervalued exchange rate” able to boost exports of Argentine products. In other words, keeping a competitive exchange rate, together with a favorable global conjuncture regarding the demand for commodities, created the favorable conditions for a ‘natural’ development of Argentina’s industry, especially in the sectors linked to the primary sector (as shown by the high percentage of industrial exports related to agriculture). As shown by Cimoli, Fleitas and Porcile (2011), there is a positive relationship between a depreciated real exchange rate and a higher technological intensity of the exported goods, and such an exchange rate is an incentive for the production of tradable goods. However, it is necessary that measures aiming at keeping the RER low are accompanied by measures promoting technological upgrading. Other measures implemented during the last years were mainly aimed at promoting investments in larger firms through several rounds of fiscal incentives offered to firms, such as more favorable conditions for the payment of the Value Added Tax or tax reductions for investments in capital goods and infrastructure (Law n. 25294, 2004 and Law n. 26360 of 2008). These mechanisms allow for bigger incentives to firms operating in export-oriented sectors and, in this respect, they work in a similar way to export subsidies. Encouraging exports is indeed one of the top priorities set by the Ministry of Industry in its “Strategic Industrial Plan 2020”, an agenda designed to increase and empower the national industrial sector. The main axes of this strategy are:

- Sustain internal demand through public investment in infrastructure, education and income redistribution;
- Defense of the domestic market and import substitution;
- Competitive exchange rate;
- Increase exports until 167 billion US\$ by 2020;
- Tools aimed at stimulating productive investments (Ministry of Industry 2013).

Therefore, this strategy seems to be based on protectionism and state interventionism, with further increase in public spending aimed at fostering private demand rather than creating the conditions for a competitive national industry in terms of skills and technology. The effectiveness of these policies cannot be defined as completely satisfactory so far: the devaluation was the main leverage to exports, but the net position of Argentina vis-à-vis its most important trade partners – Brazil, the United States

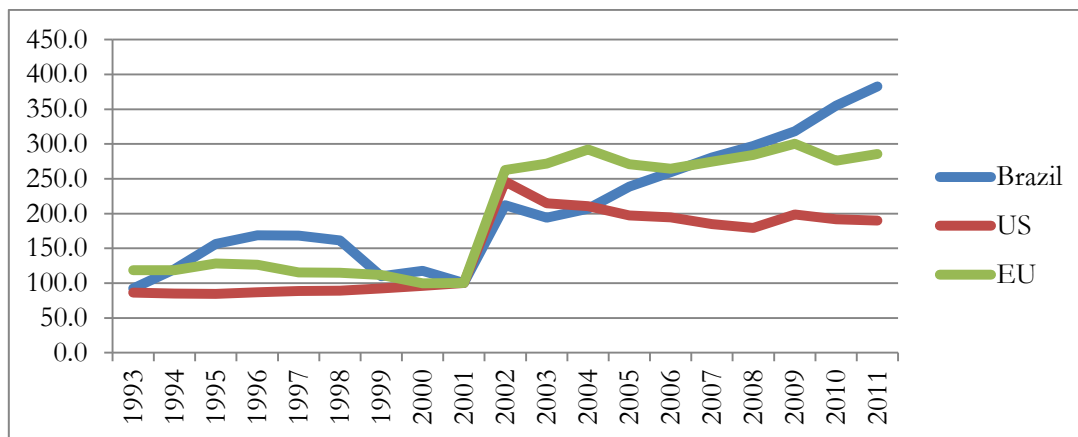
and the European Union – is getting worse and worse (apart from Brazil, against which Argentina has recently risen new protectionist measures) (Figure 1.2.18). This means that the exchange rate manipulation is not an effective tool in the long run: as Figure 1.2.19 shows, the real exchange rate between Argentina with the US and the EU has more or less stabilized. If we combine to this the growing trade deficit, the possible options at hand for Argentina in order to increase its competitiveness would be two. The second best, but easiest option, would be to manipulate again the exchange rate, devaluating the peso with the risk to trigger a further increase of inflation. This would be successful in the short run: industrial exports would rise, imports would become more expensive and therefore would decrease, and in general terms the Plan 2020 would have proven to be effective. On the other hand, the first best, but most difficult to implement strategy, would be to adopt structural reforms aimed at improving the functioning of the labor market, attracting new investments in technology and higher education, easing business conditions and access to market. Concerns about the ability of the Government to deliver such reforms will rise as the new Presidential elections, scheduled in 2015, approach.

Figure 1.2.18 – Argentina, Net trade position with Brazil, US, EU (million US\$, 1993-2013)



Source: Ministry of Industry of Argentina

Figure 1.2.19 – Argentina, Real exchange rate with Brazil, US, EU (million US\$, 1993-2013)



Source: Ministry of Industry of Argentina

A new wave of nationalizations

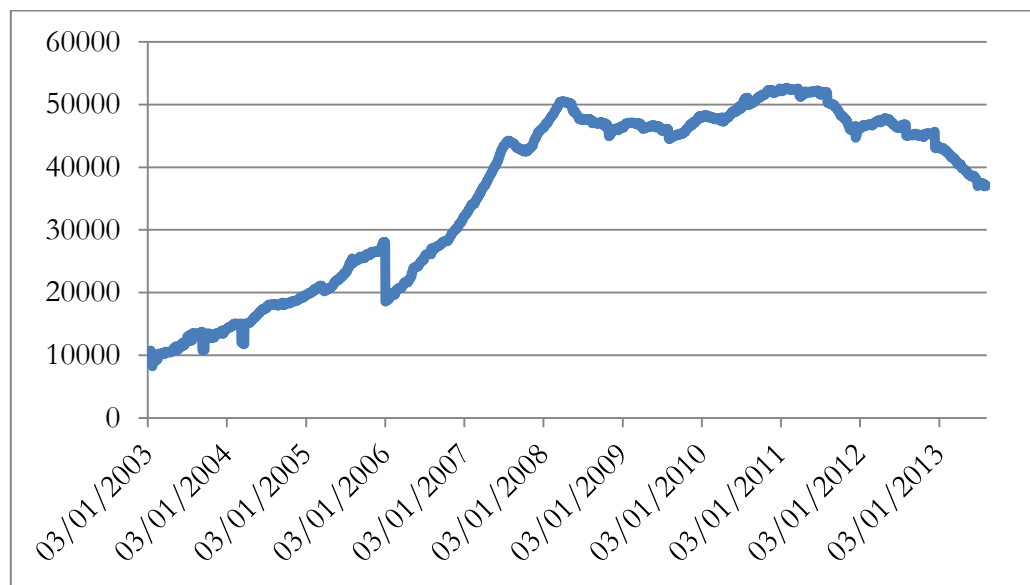
The renewed interventionism of the State in the management of the economy during the last decade was witnessed not only by protectionism and by industrial policies aimed at reducing imports in order to favor domestic companies. A new wave of nationalizations, in fact, followed the liberalizations and privatizations that took place in the 1990s during the Menem Governments.

The increasing role of the State in recent years can be mainly explained by the need of the Government to finance its expensive programs of social spending. The first important episode to recall is the nationalization of the private pension funds in late 2008. The private pension system was set up in 1994 and the scheme allowed workers to choose between staying with the state system or switching. By 2003 84% of workers with a pension scheme had chosen the new private funds. They have 9.5m accounts for total assets of 30 billion US\$ (The Economist 2008). This pot of money represented the largest group of private investors in Argentina's depleted capital markets after the financial default of 2001. Their demise would make it far harder for local firms to raise money. The re-nationalization of pension funds looked then like a way to fill the sudden lack of cash coming from the 44% fall of the world price of soy beans, that cut tax revenues by 2.7 billion US\$ that year.

The time to take control over foreign currency reserves then came. In this case one cannot technically define it as a 'nationalization', but the Constitution of Argentina clearly rules out the possibility that the Government can manage the country's foreign currency reserves, a norm aimed at respecting the Central Bank's independence. In December 2009 President Kirchner issued a decree transferring 6.6

billion US\$ of the reserves to a fund to service the public debt (The Economist 2010). As a ‘pariah’ in international financial markets, Argentina could not (and still cannot) borrow freely in international capital markets after the debt crisis. Following the Central Bank governor’s refusal to transfer the money, the President Cristina Kirchner replaced him with Mercedes Marcó del Pont, an unorthodox economist close to her positions. It could be considered more than a simple coincidence the fact that since January 2010 Argentina’s foreign currency reserves decreased by 23%, after a constant increase due to the considerable revenues coming from exports (Figure 1.2.20).

Figure 1.2.20 – Argentina, Foreign currency reserves (million US\$, 2003-2013)



Source: Banco Central de la Republica Argentina

The third and most recent episode took place in 2012 and is represented by the expropriation and nationalization of would expropriate and 51% of YPF (Yacimientos Petrolíferos Fiscales), the former state oil company, which had been sold to Repsol, a Spanish firm, in 1999. Of the confiscated portion, 51% went to the national government and 49% to Argentina's oil-producing provinces. President Kirchner explained the measure with the fact that Repsol was not investing enough in new explorations. The Spanish company replied to this accusation saying that in Argentina energy prices and tariffs are controlled and kept too low for an investment to be profitable (The Economist 2012). This act seemed to the global investors’ community as the ‘nail in the coffin’, since it is the final result of a series of actions taken by the Government determined by ideological faith rather than by any rational economic explanation (Erixon and Brandt 2013a). Argentina’s soil seems to be very rich of shale gas, but fresh capital is needed to invest in new explorations. There are serious concerns about the fact that the Government alone can provide the financial resources needed. Therefore, it has to look for new

private investors. This is why in July 2013 YPF signed an agreement with the American oil company Chevron for approximately 1.24 billion US\$ to enable the first phase of new drillings in the Loma La Lata Norte and Loma Campaña areas, where big amounts of resources are expected to be found. This issue can be also explained as an episode of ‘crony capitalism’,¹⁶ since most of the 3.5 billion US\$ of the dividends paid by Repsol had gone to pay the loans that Petersen, an Argentine company, took out to buy a share of the company with the support of the former President Néstor Kirchner. However, it seems there are some positive signals at the horizon: investment in the company has risen from 2 billion US\$ in 2012 to 5 billion US\$ this year and, in addition, YPF issued 150 million US\$ bonds in New York stock exchange market in September 2013, despite Argentina’s ongoing battle with international creditors (Financial Times 2013). Nevertheless, YPF needs to continue to attract foreign capital if it wants to deploy the high potential in terms of natural resources of Argentina’s soil.

1.2.5 Conclusion: impressive growth, insufficient competitiveness

This chapter provided an outlook on the economic performance of Argentina over the last decades, with a particular focus on the last ten years, as a result of the economic policies implemented over time. Macroeconomic problems (especially growth volatility and, in less recent years, long-lasting fiscal deficits and indebtedness) as well as lack of coherence in the development strategies adopted, harmed the growth potential of Argentina preventing it from achieving the status of a fully developed economy.

After the debt crisis of 2001-2002, that pushed millions of Argentine citizens below the poverty line, the new peronist governments led by Néstor and Cristina Kirchner were protagonist of an unprecedented period of economic boom. High and lasting growth was sustained by a strong increase of exports made possible by a sharp devaluation of the domestic currency, the Argentine peso, which restored competitiveness of domestic goods.

Exports mainly consisted of agricultural primary or processed products. This means that, despite a new phase of industrialization and economic diversification after three decades during which the national industry was progressively dismantled, industrial policies were not aimed at achieving a real global competitiveness of Argentine industrial products. A high exchange rate, subsidies to exports and protectionist measures against foreign goods (especially Brazilian) have been the main arrows in the bow of Kirchnerist industrial policy.

¹⁶ Crony capitalism can be defined as a description of capitalist society based on the close relationships between businessmen and the State. Instead of success being determined by a free market and the rule of law, the success of a business is dependent on the favoritism that is shown to it by the ruling government in the form of tax breaks, government grants and other incentives

However, those tools cannot be enough to provide Argentina's economic system with a real global competitiveness in the long run. As shown by the assessment of the World Economic Forum, Argentina is one of the worst countries in the world where to do business. Policies aimed at improving the 'software' of the economic system (in terms of transparency of institutions, effectiveness of bureaucracy, fight against corruption), as well as structural reforms to improve the labor market and the skills of workers in terms of higher education.

In the next chapter I will compare alternative patterns of economic development and give some policy indications that the country could follow to strengthen and better exploit its potential.

1.3 Argentina in front of the challenge of economic development

1.3.1 Structure of the chapter

In the previous chapter I analyzed the economic situation of Argentina. The historical perspective adopted at the beginning of the chapter showed that the macroeconomic volatility and the inconsistency between the heterogeneous models of economic development implemented over the course of the last decades produced a detrimental effect to stability and growth. During the last decade, the Kirchner governments were finally able to establish a new phase, characterized by sustained growth and a process of income redistribution that favored the poorest part of the population.

However, the ‘neo-developmental’ model embraced by Néstor and Cristina Kirchner has its flaws, as shown in chapter 1.2. The shift to a new industrialization and to a boom of exports thanks to an undervalued exchange rate did not coincide to a real increase of competitiveness in the long run. This chapter will analyze different economic development paradigms, starting from those followed in the past, either belonging to the ‘structuralist’ approach embraced by the economists of ECLAC (Economic Commission of Latin America and Caribbean) or to the ‘neo-liberal’ paradigm of the 1990s, and continuing with a more recent approach, labeled ‘new structural economics’, proposed and developed by Justin Yifu Lin, former Chief Economist at the World Bank. The approach appeals to common sense as a reasonable compromise between the ‘old’ structuralism and the ‘old’ neo-liberalism. I will then suggest some general policy indications drawing upon my analysis.

The last part of the chapter will also offer a focus on the potential of Small and Medium Enterprises (SMEs) as economic actors with an interesting potential for the growth of Argentine industry and economic development overall through their inclusion in global value chains.

1.3.2 Economic development: a brief review

Is it possible to design an efficient and successful approach to economic development? Too often the number of theoretical frameworks that have been designed and put into practice proved to be inadequate simply because, in most cases, they lacked the necessary degree of flexibility to adapt to the features of each specific situation. Economic development as a discipline was born right at the end of World War II intended as the mechanics of organizing a country’s resources and institutions to produce and distribute more goods and services, and to sustain regular social progress and rising prosperity (Lin

2011). The first theoretical frameworks were developed around the concept of ‘market failures’¹⁷ highlighted by the rise of Keynesian economics in the aftermath of the Great Depression. Differently from the *laissez-faire* theory based on the statement that the market can work properly by itself and does not need any external corrective mechanism, here the role of the State is important as a powerful supplementary means to accelerate the pace of economic development through an industrialization push. This was, basically, the Schumpeterian, Evolutionist and Structuralist (SES) approach that in Latin America became particularly popular thanks to the thesis developed by Raúl Prebisch, economist and first Secretary of the Economic Commission for Latin America and the Caribbean (ECLAC), a regional agency of the United Nations. Prebisch believed that the decline in terms of trade against the export of primary commodities from ‘peripheral’ countries (developing, Latin American nations) to ‘core’ countries (developed, Western countries) resulted in a transfer of income from resource-intensive to capital-intensive countries, therefore depriving the former of the financial resources necessary to develop their own industrial sector and to climb up the ladder of economic development (Prebisch 1950). This is why an industrialization process, driven by the State through policies aimed at protecting the domestic, infant industry, was the only means by which Latin America might have been able to fully obtain the advantages of technical progress (Prebisch 1950). Therefore, the element of technological upgrading lies at the basis of the development process in this theory, and this is why according to the SES public intervention is necessary in order to introduce asymmetries and to generate the incentives that make possible to explore technological opportunities (Peres and Primi 2009). However the Import Substitution Industrialization (ISI), although implemented in most of Latin American countries, failed because the governments of that period tried to defy the comparative advantages of their economies, simply given by their endowment structures, by establishing a national industry that was not going to be competitive externally because they gave priority to capital-intensive heavy industries when capital in their economies was scarce (Lin 2011). While Prebisch advocated for regional integration, which would have increased the opportunities to exploit economies of scale underlying capital goods industrial sectors, and for the formation of capital available for investment, none of these two conditions materialized. Therefore, these economies ended up with having overvalued exchange rates, too expensive goods and fragmented, inefficient markets, as they produced too small-scale goods (Bulmer-Thomas 2003). This is the main reason why this theory failed in Latin America while it was successful in other countries like South Korea: in this case, the approach adopted was aimed at prioritizing

¹⁷ Market failures encompass situations where, in any given market, the optimal quantity of a product demanded by consumers does not equate to the optimal quantity supplied by suppliers. This is a direct result of a lack of certain economically ideal factors, which prevents the equilibrium from being reached.

gradually certain sectors that were increasingly dynamic and knowledge and technology intensive, starting from textiles in the 1960s up to bio- and nano-technology in the 1990s and 2000s (Peres and Primi 2009).

After this quite unsatisfactory period, that culminated with the Latin American debt crisis of 1982, the region was involved in a new wave of liberal policies, fostered through the so-called “Washington Consensus”, a comprehensive set of reforms advocating for free market policies following the canons of rational expectations macroeconomics¹⁸ (Williamson 1990). Embraced by the United States and by the Bretton Woods institutions, the International Monetary Fund and the World Bank, this approach was largely promoted in developing countries, but its result in terms of growth and employment generation was controversial. Let us think again of the case of Argentina, where the neo-liberal ‘recipe’ was implemented at its full capacity: price stability and GDP growth was obtained at the increasingly unsustainable cost of rising unemployment and indebtedness (see chapter 1.2).

In recent years approaches based on the methodology of the so-called ‘hard-sciences’ were designed, such as the Growth Diagnostics or Decision Tree framework suggested by Hausmann, Rodrik and Velasco (2005), based on the importance to identify the “binding constraints” on growth in each country and, hence, to prioritize reforms in certain areas in order to remove those constraint, or the “randomization” approach based on the use of randomized control trials on social experiments used to assess poverty problems and to design appropriate policies based on the microeconomic evidence found (Banerjee and Duflo 2011).

1.3.3 New structural economics: original elements and links with ‘old’ theories

New structural economics is a relatively new approach to economic development designed by Justin Yifu Lin, former Chief Economist at the World Bank and Professor at the China Centre for Economic Research at the Peking University. It is based on two fundamental (and apparently antithetical) theoretical ‘platforms’: the neo-classical theory and the ‘old’ structuralism. It is neo-classical in the sense that it recognizes that differences in structure between developed and developing countries arise from differences in their endowment structures and that the economy is determined by market forces. On the other hand, it keeps some features of the structuralism *à-la*-Prebisch recognizing that in developing countries there are structural rigidities caused by political or economic distortions, for instance in price

¹⁸ The rational expectations approach proved that in market economies sustained periods of inflation lead to more expected inflation that is built on wages and other payments. Therefore, it refuses the structuralist foundation for the state’s role in using fiscal and monetary policy, since in the context of continuing nominal wage increases, restrictive monetary and fiscal policies mostly affect output and unemployment and have little effect on inflation (Lin 2011).

signaling due to oligopoly or monopoly. Therefore it recognizes for the State a role to play in establishing a fair environment for the economic transactions (Lin 2011).

New structural economics is based on three key pillars:

- Optimal economic structures are different at various stages of development: this happens because, at a given period t , the economy's factor endowments (defined as the relative abundance of natural resources, labor, human and physical capital) are different. The concept of comparative advantage then becomes crucial in determining the economic sectors that a country should exploit and develop in depth in order to gain the most;
- Economic development cannot be divided into rigid "stages" as suggested by Rostow (1990), so that a "big push" in terms of public investment is needed to allow the economy to make a transition from an agricultural-driven development to the industrial and services-driven stages. On the contrary, it should be seen as a *continuum* from a low-income agrarian economy to a high-income industrialized economy, where development takes place according to a gradual and incremental pace;
- The market is the fundamental mechanism for efficient resource allocation but, in order to face negative externalities produced by distortions in the transactions costs and price structures, the government should play a facilitating role in the industrial diversification, in the technological upgrading and in the provision of infrastructure, in terms both of 'hardware' (roads, ports, airports, telecommunications) and 'software' (legal framework, financial procedures, respect and enforcement of the rule of law) (Lin 2011).

How is it possible to translate these principles into practice? Lin identifies seven main areas:

- Fiscal policy: countercyclical policies are seen as the appropriate strategy, drawing upon the Keynesian framework. Investments in infrastructure are considered the best expansionary tool in periods of negative cycle and, thanks to the exploitation of the domestic comparative advantages, the country's fiscal position and external account are likely to be sound;
- Public revenue management policy: not all revenues coming from exports should be accumulated as foreign currency reserves in order to mitigate the risks of external vulnerability but an appropriate share of these should be used to invest in human, infrastructural and social capital so as to facilitate diversification, technological upgrading and a quicker catch-up process with high-income economies on the ladder of economic development;

- Monetary policy: interest rate policy in developing countries can be used as a counter-cyclical tool. Liquidity traps are less likely to be found in these countries, so that lowering interest rates in such contexts would encourage investment in infrastructure;
- Financial development: the optimal financial structure at a given stage of development is determined by the prevailing industrial structure and the average size of firms. It follows that low-income countries should choose small, local banks as the main axis of their financial system: this would better provide small scale firms with adequate financial services;
- Foreign capital: foreign direct investments (FDI) are seen as a favorable source of foreign capital since they are usually targeted towards industries consistent with a country's comparative advantage;
- Trade policy: trade liberalization should be seen as a further way to exploit domestic comparative advantages, but in order to foster industrial development and upgrading a gradualist approach to trade openness may be implemented in the earlier stages of development;
- Human development: since human capital is seen as part of a country's resource endowment, investment in education and training should be pursued, but it should be commensurable with the accumulation of physical capital, in order not to over or under supply the economic system with too low or high educated people, which may turn into a binding constraint in both cases (Lin 2011).

This approach does not come up with radically new ideas in economic thinking but, as it has been defined, is “old wine in new bottles” (Mc Culloch 2013). What is interesting of this approach is that it is not dogmatic and it has a certain degree of flexibility that allows to implement different instruments according to the specific economic structure of the country and its stage of development. It shares many elements both with the old structuralism and neo-liberalism, simply recognizing the need to adopt a comprehensive overview on economic situations and the fact that, in the past, top-down approaches that did not use to take into consideration the specific situations of the countries.

On the other hand, it is not an independent theoretical framework, and this is probably its major flaw since it does not add anything really innovative to economic development theory. The concept of comparative advantages, for instance, is a bit contradictory in Lin's theory, as he assumes that the public sector should intervene to address market failures, but in this case it would defy rather than support the notion of comparative advantages (Rodrik 2012). Therefore, this principle should be better interpreted in its dynamic meaning rather than in the static one. In order to guarantee a

sustained development and an effective transition from a low-income to a high-income situation, the exploitation of static comparative advantages, based only on the relative factor endowments at a given time t , is not enough, since this would lead in the long run to underdevelopment and weak productive structures (Ortiz and Schorr 2009). The Ricardian model of international trade, in its basic version, does not adopt an inter-temporal approach and is therefore based on a static view of comparative advantages. However, variations in the relative proportion of factors (depreciation of capital, technological upgrades, increase of skilled labor) lead to changes in the ranking of exportable goods at each time t according to the comparative advantage of each export activity E_t , implying that exporting the latter is only profitable at time t (Bruno 1970). In other words, a dynamic perspective is much more realistic, since within an economy productivity changes and growth factors come in and trade goods can no longer be ordered independently of time. For instance, as an economy moves towards more advanced development stages, the component of skilled labor tends to increase and a country that showed a comparative advantage in the intensive use of land or cheap labor can turn to a country whose comparative advantage is in the use of highly qualified labor.

Moreover, another questionable point of Lin's approach is that it is not always clear how to 'pick up winners', i.e. how to choose sectors provided with a "latent comparative advantage" on which most of private and public investment should converge (Krueger 2012). In other words, there is the risk that New Structural Economics will be used for political purposes as an excuse for governments to support specific industries, and therefore be as detrimental for development as the old theories were.

Table 1.3.1 compares the three theories highlighting points of convergence and divergence.

Table 1.3.1 – New structural economics vs. structuralism and neo-liberalism: a comparison

| POLICY | STRUCTURALISM | NEO-LIBERALISM | NEW STRUCTURAL ECONOMICS |
|----------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| FISCAL | Expansionary policies are desirable for their counter-cyclical effect (the fiscal multiplier is >1) | Expansionary policies are not desirable induce wrong expectations in firms and households | Counter-cyclical, expansionary policies are good in developing countries that export a lot thanks to their comparative advantages. In this way they can maintain a current account surplus |
| PUBLIC REVENUE MANAGEMENT | Creation of state-owned enterprises in strategic sectors generating large public revenue to be used for social investments | Accumulation of foreign currency reserves to maintain macroeconomic stability | A portion of the revenues should be used to finance domestic or regional projects that facilitate structural change |
| MONETARY | Central banks should be under the government's control and aimed at influencing interest rates and sector credit allocation | The main goal is price and macroeconomic stability. Central banks should be independent from governments | Interest rate policy can be used as a counter-cyclical tool and as an instrument to encourage infrastructure and industrial upgrading investments |
| FINANCIAL DEVELOPMENT | Governments have to correct potential market failures mobilizing savings and allocating credit to support the development of advanced capital-intensive industries | Financial liberalization, through a well defined system of property rights and a sound competition would guarantee the creation of a well functioning financial system | Size and structure of the financial system depends on the country's stage of development. For instance, it would be better for low income countries to choose small, local banks able to finance small firms |
| FOREIGN CAPITAL | Tight restrictions, both in terms of inflows and outflows, in order to prevent foreign governments or multinational corporations to take control of domestic strategic economic assets | Full capital mobility may allow a more efficient allocation of savings and increased opportunities for diversification of investment risk | FDIs are seen as an appropriate source of financing because they are usually targeted to companies in the sectors where the recipient country has a comparative advantage |
| TRADE | Gradual openness; focus on inward-looking strategies (ISI) | Complete openness to free trade and removal of tariff and non-tariff barriers | Gradualist openness with temporary protection of industries not consistent with static comparative advantages |

Source: elaboration of the author, based on Lin (2011)

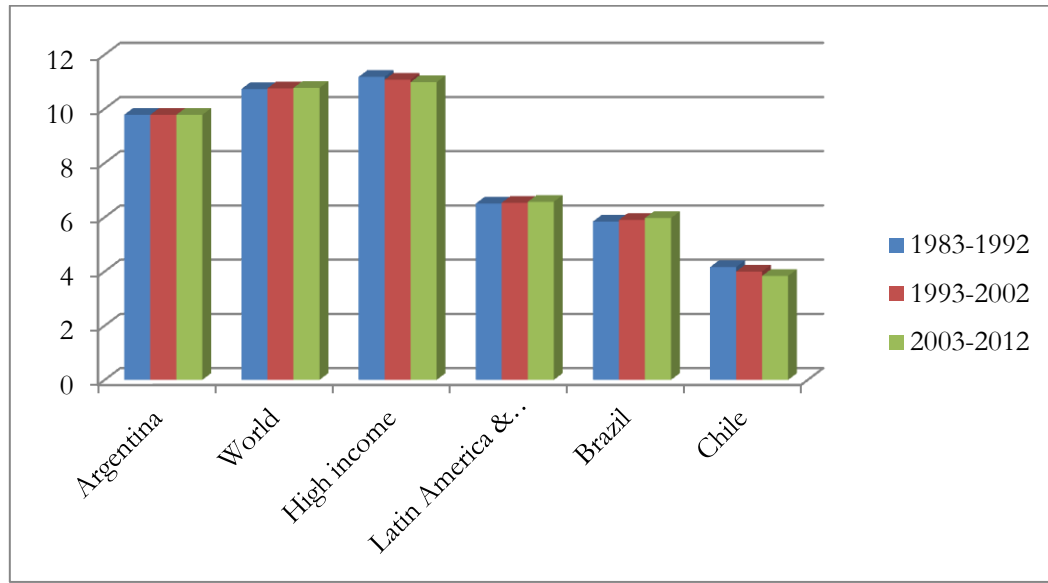
1.3.4 Back to 'old' theories? Factors endowments and comparative advantages

In this paragraph I will try to recall and assess the factor endowments of Argentina in terms of physical and human resources. Identifying these will help to have a clearer picture of the economic structure of the country and to elaborate some policy recommendations for the future economic development.

The following figures were elaborated using data from the World Bank Indicators. They compare Argentina over the course of the last three decades to the world, the rest of Latin America, the group of high-income countries, and Brazil and Chile. The former is the biggest country in South America and biggest Argentina's trading partner; the second is very similar to Argentina in terms of geographic, demographic and economic size and potential. This methodology of comparison was chosen in order to show whether and where Argentina has a different performance with respect to the other subjects included in the sample.

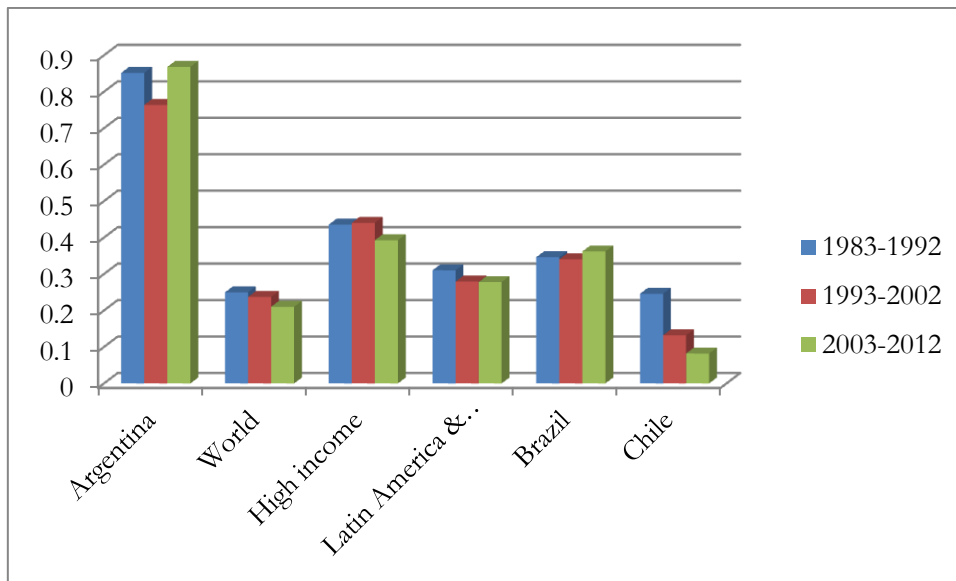
Is Argentina a natural-resource intensive country? It seems that agriculture is very important for the country's economy, both in absolute and relative terms. The share of arable land over the total land area is about 10%, much more than Brazil and Chile (even though the latter has particular geographical features) (Figure 1.3.1). Argentina shows also a very high ratio of agricultural land in terms of hectares per person, given by the fact that the country's surface is huge and the population is quite low (around 40 million people). This proportion is much higher than every other term of comparison included in my sample (Figure 1.3.2). The role of agriculture in terms of value added over GDP is also more prominent than in the rest of the world and even slightly more than in Brazil and Chile (9.7% during the last decade versus respectively 9.2% and 9%). What is interesting to note in this case is the sharp increase of agricultural value added in the 2000s compared to the 1990s, when the neo-liberal policies based on the stress given on financial speculation and on a fixed exchange rate that harmed exports reduced the role of the primary sector (Figure 1.3.3). Finally, how profitable is agriculture? The rent of natural resources in Argentina weighs almost 10% of GDP, again showing the same dynamics of value added with respect to the 1990s (Figure 1.3.4).

Figure 1.3.1 – Argentina vs. other countries, Arable land as % of land area (1983-2012)



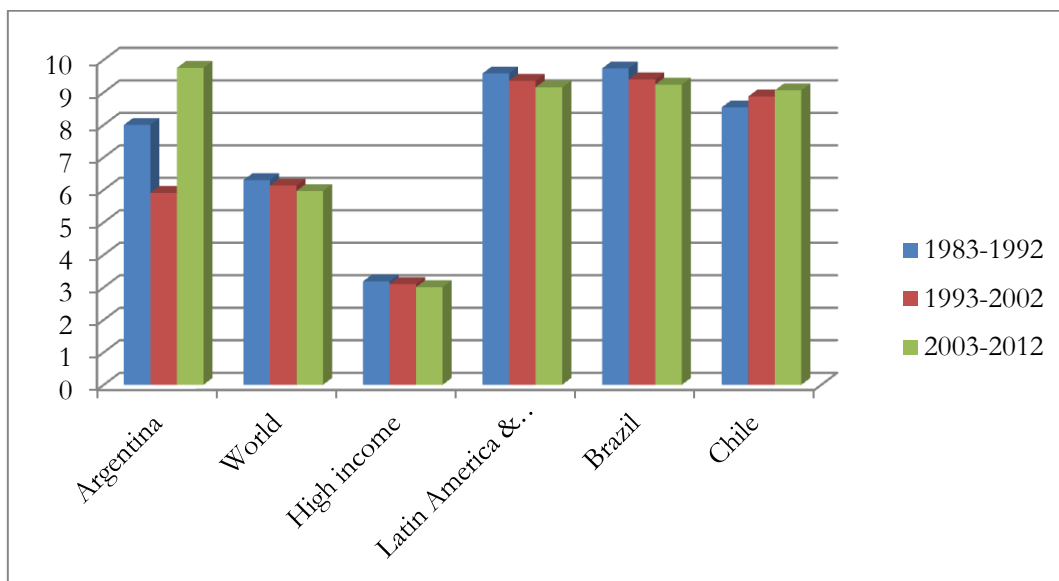
Source: elaboration of the author on World Bank data

Figure 1.3.2 – Argentina vs. other countries, Agricultural land, hectares per person (1983-2012)



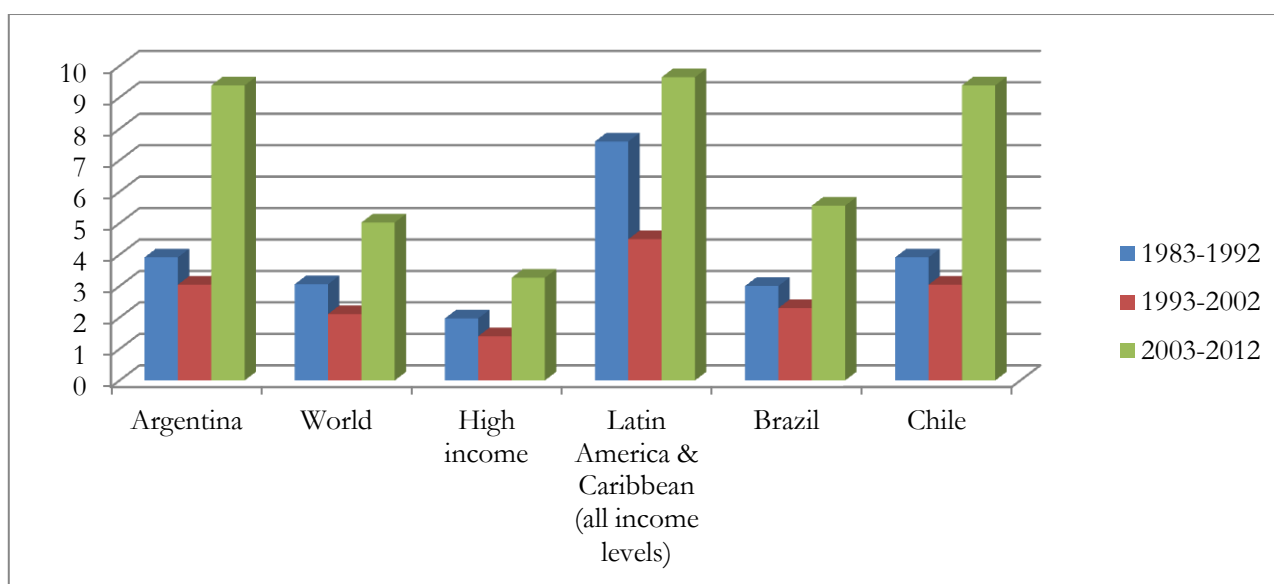
Source: elaboration of the author on World Bank data

Figure 1.3.3 – Argentina vs. other countries, Agricultural domestic value added, % of GDP (1983-2012)



Source: elaboration of the author on World Bank data

Figure 1.3.4 – Argentina vs. other countries, Total natural resources rent, % of GDP (1983-2012)



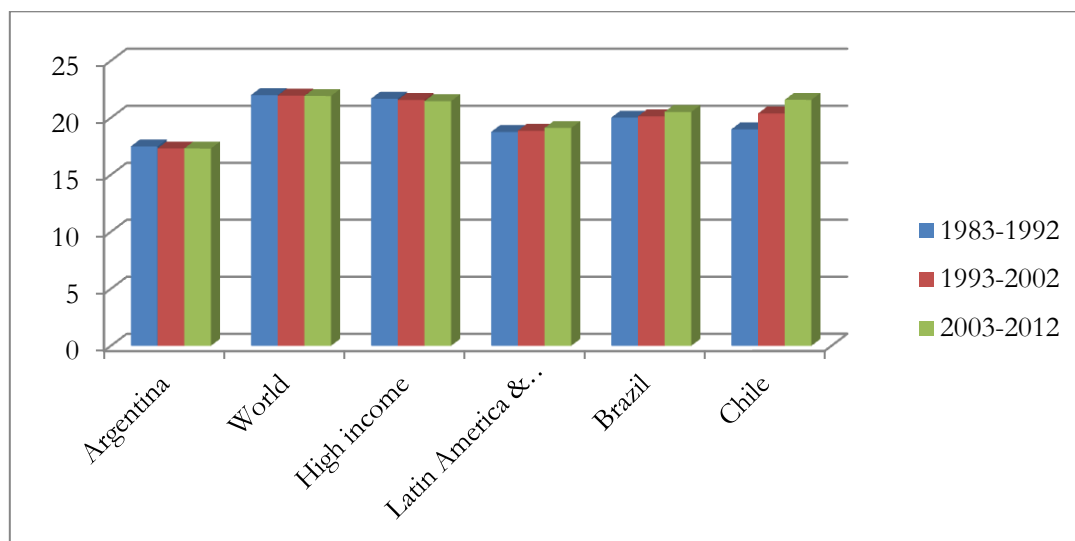
Source: elaboration of the author on World Bank data

With respect to capital intensity, Figure 1.3.5 shows Argentina’s position with respect to gross capital formation vis-à-vis the rest of the world. In this case the country has performed worse than the other subjects in the sample (17% of GDP on average in the last decade compared to 20% in Brazil and 21%

in Chile), denoting a substantial gap in capital availability that should be provided by an increase of investments, especially coming from abroad (see chapter 1.2).

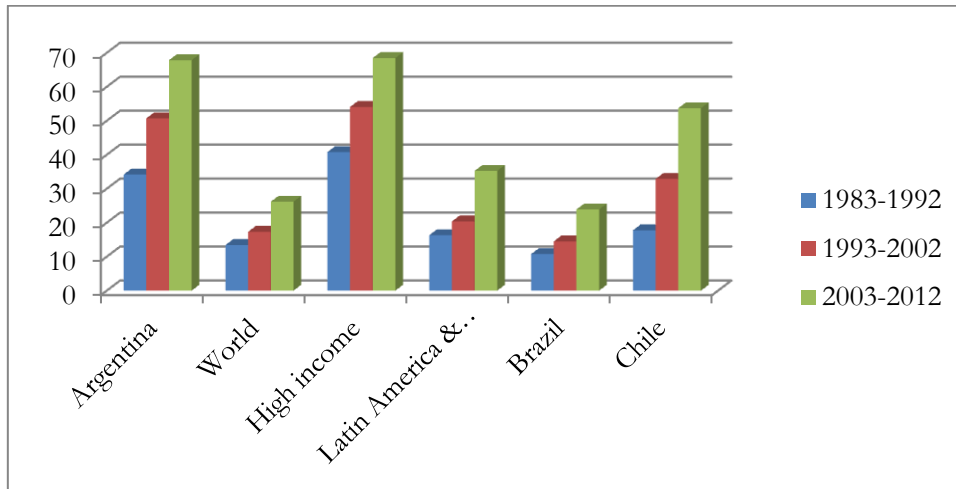
In terms of human capital, Argentina seems to perform well. The rate of enrollment to tertiary education (Figure 1.3.6) is very high and in line with the average of high-income countries (68%, much more than Brazil – 23% - and Chile – 57%). Moving ahead to the other sectors of the economy, value added in manufacturing and services show much higher values than agriculture (Figures 1.3.7 and 1.3.8). How advanced is manufacturing, in terms of technological upgrading? In this case, Argentina’s record is quite poor compared not only to high-income countries but even to Brazil: the share of high-tech exports over total manufacturing exports is only 8% against 12% in Brazil (Figure 1.3.9). This is quite evident also in terms of the domestic industrial production: the share of goods intensive in natural resources is still much higher (although it has slightly decreased over the course of the last twenty years) than that one of labor intensive and technology intensive goods (Figure 1.3.10).

Figure 1.3.5 – Argentina vs. other countries, Gross fixed capital formation, % of GDP (1983-2012)



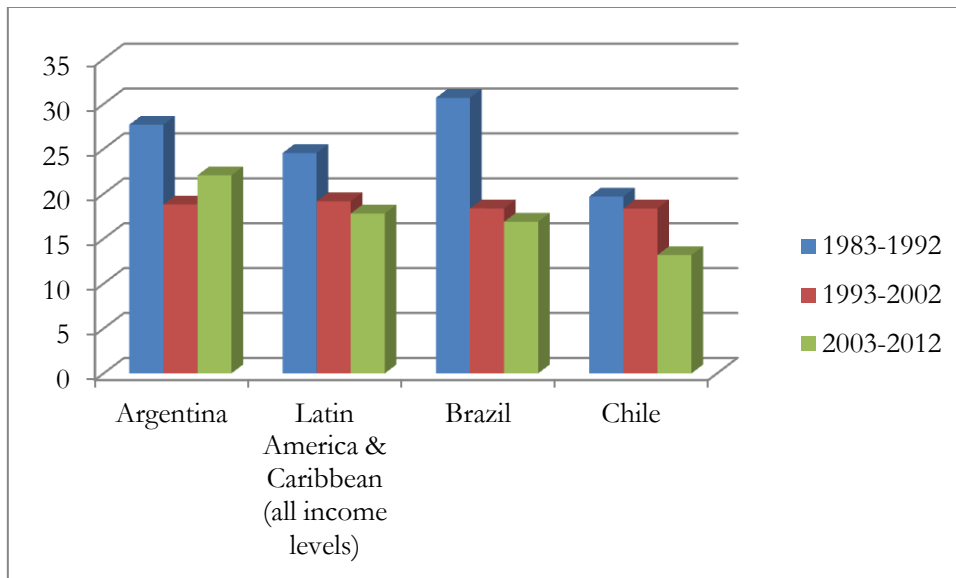
Source: elaboration of the author on World Bank data

Figure 1.3.6 – Argentina vs. other countries, Gross enrollment rate to tertiary education (1983-2012)



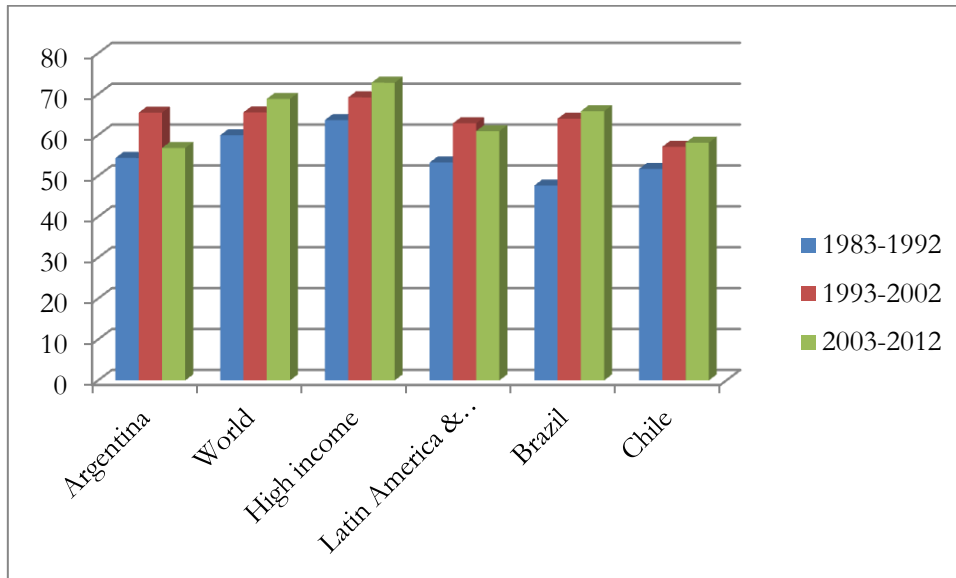
Source: elaboration of the author on World Bank data

Figure 1.3.7 – Argentina vs. other countries, Manufacturing domestic value added, % of GDP (1983-2012)



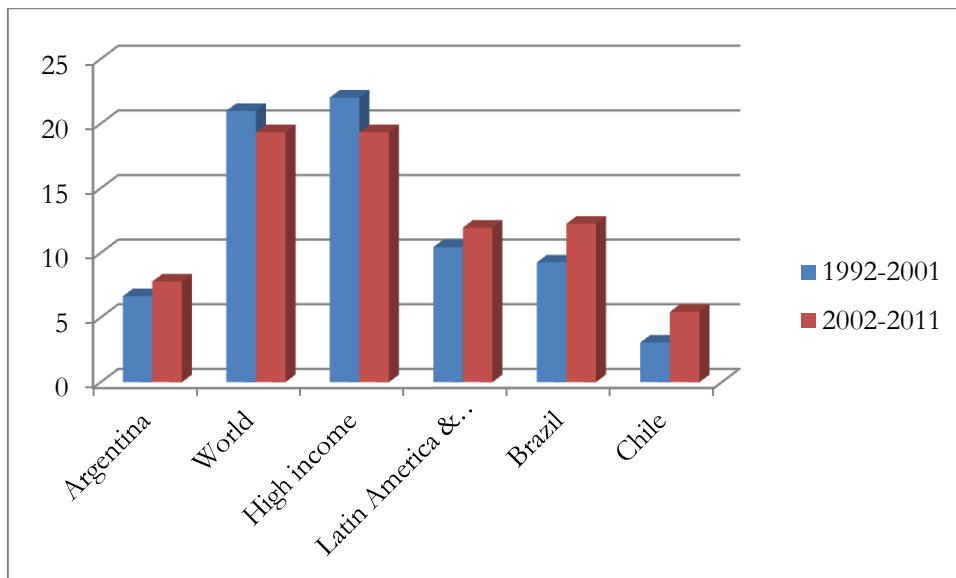
Source: elaboration of the author on World Bank data

Figure 1.3.8 – Argentina vs. other countries, Services domestic value added, % of GDP (1983-2012)



Source: elaboration of the author on World Bank data

Figure 1.3.9 – Argentina vs. other countries, Share of high-tech exports over manufacturing exports (1992-2011)



Source: elaboration of the author on World Bank data

To sum up, from the data shown in the above it seems that Argentina is a country well endowed of natural and agricultural resources, but with a diversified economy in terms of contribution to value

added of the manufacturing and services sector. However, the gap in capital availability seems to be a stumbling block for the development of a more competitive manufacturing in terms of technological intensity, despite the satisfactory presence of human capital.

Assessing the structure of the country's comparative advantages would go beyond the scope of this chapter, but the analysis shown in the above suggests that Argentina still has a relative better position in terms of the exploitation of its agricultural resources, so that the primary and the manufacturing sectors related to agricultural and food processing seem to be better positioned with respect to the other countries analyzed, given the relative abundance of these resources. Nevertheless, in a dynamic perspective Argentina should aim at improving its competitiveness upgrading the technological content of its exports if it wants to go up the ladder of economic development and reach the status of high income country. The gap in capital availability should be filled by policies aimed at attracting more FDIs, so that the abundance of human capital may be also exploited in a more efficient way and evolve the domestic structure of competitive advantage. Labor is already a relative cheap resource, since the undervalued exchange rate contributed to keep salaries low. In the next paragraph I will provide some suggestions at this respect.

1.3.5 Some policy recommendations for Argentina's development

After the failure of neo-liberalism, it seems that Argentina undertook a very different way. The peronist governments led by Néstor and Cristina Kirchner implemented a set of policies that were described in the previous chapter and that are based on maintaining an undervalued exchange rate in order to boost exports and to have cheaper production factors, a rigid control of the State on the economy through nationalizations, the direct management of foreign currency reserves and controls on capital flows, and expansionary fiscal policies, not only counter-cyclical but also pro-cyclical, as a fundamental tool to obtain political gains in terms of popular consensus. All this set of policies is inspired by the so-called "neo-developmentalism", that tries to reproduce the old developmentalist policies that were used to be implemented in the period after World War II in the framework of a capitalist model of society. However, in Argentina this process of structural change, based on a renewed State intervention, a different composition of the working classes, and a new model of capital accumulation, has been only partly successful so far. The dominant classes, mainly represented by commodity exporters, maintained their position of economic leadership in the country, and the biggest companies operating in Argentina still mainly belong to foreign capital: foreign-owned enterprises went from representing 32% of the top 500 firms in 1993 to more than 48% in 1998 and 66% in 2007 (Félicz 2012). In other words, the

Kirchnerist project has not been totally effective in readdressing Argentina's design of society, since the new model of capital accumulation reproduced the same structure of winners and losers.

Dynamic comparative advantages should be further exploited in sectors that show forward linkages and that are included in value chains. In the case of Argentina, this becomes pretty clear for those manufacturing sectors related to agriculture (food processing, production of high-quality wines, machinery for agriculture). Moreover, industries with dynamic comparative advantages will show a higher income elasticity, a faster technological progress and a fast-improving labor productivity. Therefore, as suggested by Ortiz and Schorr (2009), Argentina's development process could be based on a more equilibrated industrialization process, more vertically integrated and able to exploit economies of scale, through the empowerment of Small and Medium Enterprises (SMEs), an important element of Argentina's industrial fabric, and their inclusion in value chains. This strategy might lead to genuine competitiveness gains, not simply based on wage reductions determined by the undervalued exchange rate.

The analysis provided in the previous paragraph provides support to the following reasoning. In terms of resource endowments, Argentina is abundant with agricultural lands and a relatively highly-skilled human capital, although it is less endowed with capital than its Latin American neighbors and exports in relative terms a small share of high-tech goods. Moreover, the undervalued exchange rate allows to keep wages relatively low compared to the rest of the world. Argentina should therefore exploit its current comparative advantages in terms of the production of agricultural and food products and of manufactured goods or services that are more labor-intensive. Due to the fact that labor is cheap, on a dynamic perspective the country might shift its productive structure towards goods that use intensively skilled labor, and in the meantime focus to develop its manufacturing industry in sectors that are linked to agriculture, aiming at upgrading the technological content of the goods it produces.

It is fundamental for Argentina to become progressively more included in the global economy increasing its competitiveness and its degree of integration with the rest of the world. In order to do some reasoning about that, it is useful to adopt the approach of global value chains (GVCs). The Global Value Chain (GVC) approach provides useful tools to analyze the implications of international production fragmentation for economic development. A value chain is defined as the sequence of all activities involved from conception to marketing a product (Gereffi 1999). The chain becomes global if those activities are carried out in different countries. One important aspect is that some activities in the chain add more value and are more profitable than others, and that some actors in the chain have more power than others.

Argentina's insertion in GVCs is currently quite scarce (Fanelli 2012, González, Hallak, Schott, Soria Genta 2012). The OECD (2013) computes a country's participation in GVCs as the percentage of its exports contained in a GVC: this takes into account "upstream links" (looking back along the value chain and measuring foreign inputs or value added in a country's exports) and "downstream links" (domestic inputs or value added contained in other countries exports by looking forward along the value chain. It is then possible to assess and summarize Argentina's positioning inside GVCs as follows:

- Its participation is mainly driven by downstream links as other countries use Argentinean intermediates in their exports. In terms of upstream links, Argentina's main share is represented by its exports of natural resources;
- Agriculture, mining and transport and telecommunication services are the main sectors where Argentina's exports are mainly involved in GVCs through its intermediate exports;
- In terms of value added, the majority of the final demand for manufactured goods and market services in Argentina represents value added that has been created domestically (81% against 19% of foreign value added); the proportion becomes higher as the economy moves towards the services sector;
- Nevertheless, Argentina's share of global value added contained in exports is low (only 0.5%). Some sectors have a higher share on global trade in terms of value added than in gross exports, namely agriculture and food, reflecting the high proportion of domestic value added embodied in their production (OECD 2013).

It seems that Argentina's main problems in terms of insertion in GVCs are due to the facts that wages are too high for firms to enter segments of chains where low-skilled labor tasks are required and that firms do not generally possess the skills and market knowledge to perform more complex activities in the chain such as design and marketing (González, Hallak, Schott, Soria Genta 2012). Therefore, one might say that Argentina risks to get stuck in the so-called "middle-income trap"¹⁹ and to be unable to gain international competitiveness. Moving forward to the more advanced segments of those chains through technological upgrades and labor skills improvements might help the country to better exploit its comparative advantages in a dynamic fashion. For instance, the exploitation of agricultural

¹⁹ At middle levels of income, economic growth and structural upgrading become more arduous – the so-called Middle-Income Trap. Wages are too high and, at the same time, workers' skills are too low to be globally competitive either in low or high skilled sectors. The experience of Latin American with the Middle-Income Trap has been very different from that of the NICs. While the latter were able to surpass middle-income status in a relatively brief period of time, Latin American countries have remained in the middle-income zone for decades (Jankowska, Nagengast and Perea 2012).

commodities requires more and more effort in R&D activities (let us think of genetically modified beans or of the high quality wines sector) or the production of high-tech machinery, two things that might increase productivity in this sector. Or, another sector where Argentina has an interesting potential to develop is the high-end footwear industry, where Argentina could exploit wide availability of high quality raw leather, its long tradition in shoe manufacturing, and high-quality design which is in some cases linked to multinational luxury brands (González, Hallak, Schott, Soria Genta 2012).

But, first and foremost, Argentina's economy needs a clear and stable framework in order to grow fast and steady. As I showed in the previous chapter, the inconsistency between economic policies implemented over the course of the last decade and the serious deficiencies in the country's "software", i.e. the business and institutional environment, created a situation unfavorable for investment and productivity increases. It is then necessary for Argentina to adopt clear macroeconomic policies. Some personal recommendations follow:

- Fiscal policy: Argentina's government has been adopting too 'relaxed' fiscal policies during the last few years. Countercyclical, expansionary policies based on an increase of public spending were necessary in the aftermath of the 2001-2002 crisis in order to boost economic growth and to fight poverty, but nowadays the priority should be to adopt a longer-term perspective targeted on maintaining a surplus in the current account balance. As shown in the previous chapter, it has just turned negative and the trend is expected to get even worse (-0.5% in 2014). This situation would not help Argentina in case of regional or global economic crises that would expose the country to a fall in exports due to a crisis on the demand side. However, perspectives are more gloomy because of the proximity of the Presidential elections in 2015, that might induce the Government to increase social spending in order to raise consensus;
- Public revenue management: part of the revenues coming from exports should be used to recover the level of foreign currency reserves accumulated over the course of the last decade, so that the country might be able to face external shocks. Moreover, more investments in infrastructural projects and in R&D, aimed at enhancing Argentina's competitiveness in terms of 'hardware' (in physical and human capital terms) would be the most appropriate in this period, in order to allow the economy to move a step ahead;
- Monetary policy: the government had to face a difficult balance between the exchange rate and the interest rate, based on the trade-off between maintaining a devalued local currency to boost exports, and the risk of letting inflation rising out of control. During the last two years, the

Argentine currency lost again value vis-à-vis the dollar and, at the same time, the interest rate rose, reaching 13.25% in July 2013. This reflects the governments' attempts to calm down inflation and to sharply limit capital flows, which have been basically forbidden since the beginning of 2012. The increased demand for US dollars, traditionally a store of value for Argentine people given the fluctuations of the domestic currency and the periods of hyperinflation, led the government to impose strict limitations on capital flows in order to keep the amount of foreign currency reserves and to use them to pay public debt. This is why today in Argentina there is a sort of "multiple exchange rate" system (Burke 2012) that forces people to pay more to obtain dollars on the black market. The so-called "blue dollar" was sold at the end of August 2013 at 8.80 ARS against an official exchange rate of 1 US\$ against 5.66 ARS: a sharp depreciation with respect to one year ago, when the unofficial and official exchange rates were respectively 6.30 ARS and 4.66 ARS for 1 US\$. This system, with a black-market premium of 55.4% with respect to the official rate, is harming both domestic companies that have to deal with abroad and foreign businesses with the intention to invest in Argentina. This picture explains why a more clear framework of monetary policy would be needed. First of all, less attention should be paid in the medium-long run to keep a weak exchange rate but different strategies to increase competitiveness on a permanent basis should be pursued; secondly, controls on capital flows should be reduced, otherwise Argentina will not be able to fill the gap in capital availability (see Figure 1.3.5) needed to stimulate investment; thirdly, a progressive reduction of interest rates will be also useful to attract capitals and investments. Stabilizing the domestic monetary system will take time, but this sequence of policies is probably the only sustainable in a long-term perspective;

- Financial development: Argentina's banking sector suffers from serious problems of underdevelopment. Over the last 50 years its size increased only by 3% in terms of peso-denominated deposits (FOP 2013) and is today five times smaller than Chile's banking system. This seriously harms the performance of firms, especially the smallest ones that suffer the most from the lack of capital available for investments. Again, also in this case the system needs more stability: lower inflation and more certainty on the exchange rate would induce savers to hold more peso-denominated bank deposits and assets instead of holding US dollars, traditionally considered as a safer store of value;
- Foreign capital policies: similar considerations applied to the monetary policy can be also applied to the potential measures aiming at attracting more FDIs. The recent wave of

nationalizations, as well as the poor legislative and infrastructural system (see chapter 1.2.2), make Argentina one of the countries in the world where doing business is mostly difficult. Procedures to ease business, as well as a more stable monetary and financial environment are necessary to increase external confidence in the country and attract more capitals;

- Trade: more openness to international trade is required. In recent years, after that complete liberalization was implemented during the 1990s, Argentina's economic system was harmed by a too drastic opening and by a too rigid, non competitive exchange rate. After the 2001-2002 crisis, exports started booming again because of an undervalued exchange rate and renewed protectionist measures, such as tariff and non-tariff barriers (see chapter 3.3). Some degree of protection on certain goods might be helpful in the short run to allow industrial or services sectors connected by forward linkages with sectors that today present comparative advantages, but such measures should be lifted only temporarily because in the long run they would simply harm productivity and competitiveness, damaging customers that would not get access to cheap, good quality goods. Moreover, protectionism negatively affects Argentina's relationship with its neighbors, especially Brazil and the other members of MERCOSUR, Paraguay and Uruguay, not only in terms of trade exchanges but also in terms of the participation in regional and global value chains, especially in the agricultural industry (Stanley 2010). In an era of "hyperglobalization", characterized by an unprecedented increase of trade integration, not only in terms of gross trade flows but also in terms of value added (Subramanian and Kessler 2013), the advantages of more openness would be many: a deeper inclusion in GVCs; a full access to global markets; the opportunity to increase competitiveness through the channel of external competition.

1.3.6 Focus: Small and Medium Enterprises (SMEs)'s role in Argentina's economic structure

In this paragraph I want to focus on the role of Small and Medium Enterprises (SMEs) as a potential driver of economic growth in Argentina. It is important to take into account the weight of SMEs in Argentina's industries since they represent, as I will show below, a fundamental part of the domestic economic system.

First of all, it is necessary to define what SMEs are. There are several definitions according to the size in terms of employees or economic turnover. The European Commission defines enterprises according to their dimensions as follows:

- Less than 10 employees: micro enterprise

- Between 11 and 50 employees: small enterprise
- Between 51 and 250 employees: medium enterprise
- More than 250 employees: big enterprise

According to the turnover, this is the classification:

- Less than 2 million €: micro enterprise
- Up to 10 million €: small enterprise
- Up to 50 million €: medium enterprise
- More than 50 million €: big enterprise

However, Argentina adopts slightly different ranges to define SMEs. In terms of employees, the Observatory SMEs Foundation (*Fundación Observatorio PyMEs*, FOP) adopts the following classification:

- Less than 10 employees: micro enterprise
- Between 11 and 50 employees: small enterprise
- Between 51 and 200 employees: medium enterprise

Moreover, the Secretariat for SMEs and Regional Development (SEPYME), depending on the Ministry of Industry, adopts a further classification according to their turnover:

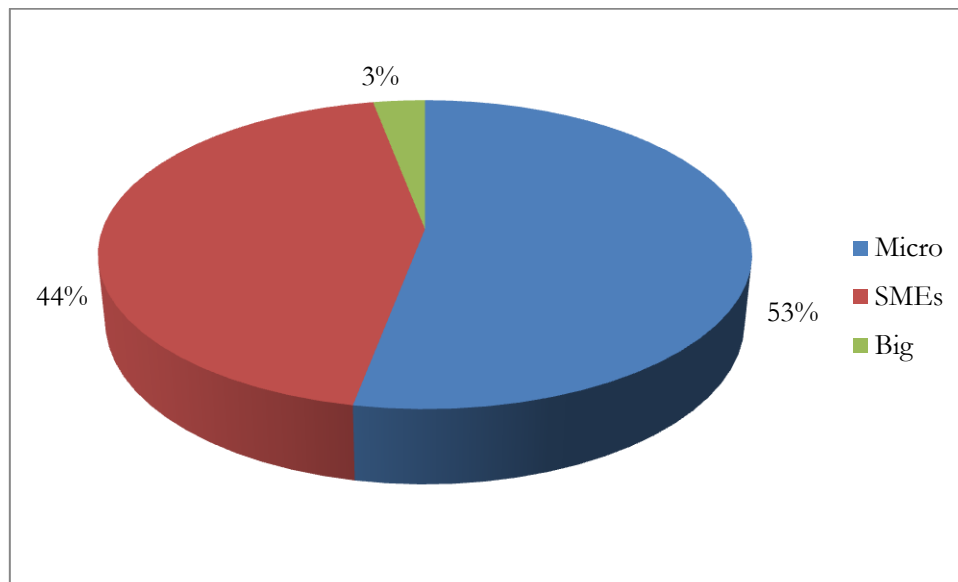
- Less than 1.8 million ARS (240.000 €): micro enterprise
- Between 1.8 million and 10.3 million ARS (1.37 million €): small enterprise
- Between 10.3 million and 183 million ARS (24.3 million €): medium enterprise
- More than 183 million ARS: big enterprise

Despite their limited size, SMEs are very important for economic growth both in developing and developed countries. As the World Bank shows, in middle income countries (between 1,000 and 11,500 US\$ per capita) they generate on average 39% of GDP, while in high income countries this share goes up to 51%. Moreover, they are considered a useful asset for developing industrial economies since they are labor-intensive providing more opportunities for low-skilled workers, they are correlated with lower distribution income inequality, they are an important part for the supply chain of Multi National Companies, they are important in the transition from agriculture-centered economies to industrial and services oriented, and they are important centres of technological innovation thanks to their flexibility and propension to risk taking (Newberry 2006).

What is the situation of SMEs in Argentina? According to the FOP (2013), they are very relevant for the industrial sector accounting for 44% of total enterprises and 42% of employees (Figures 1.3.10/a

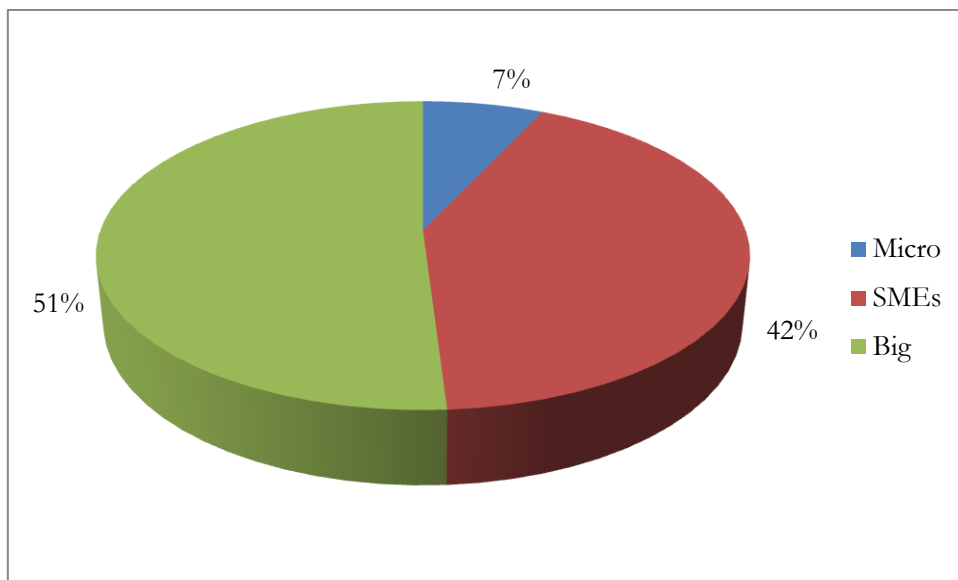
and /b). This proportion increases further if we take into account also micro enterprises, which in 2010 accounted for 54.1% of total firms. The proportion of Micro and SMEs increased over time, representing more than 96% of the total number of firms in Argentina (Figure 1.3.11). The most important sub-sectors are production of food and beverages (15.7%) and textiles and shoes (14.9%) (Figure 1.3.13). They also show a remarkable performance in terms of export and international competitiveness: 17.2% of industrial SMEs in 2011 exported at least 5% of their production, with an average exported share of 19%. The main destinations of their exports are Brazil (18.4%), Paraguay and Uruguay (38.4%), while Chile (14.6%), rest of Latin America (13%) and rest of the world (15.3%) account for much lower percentages. These are further evidences of the importance of such sectors for Argentina's economy: since almost half of the labor force in national industry works in SMEs, and 30% of them is active in sectors with comparative advantages (as shown in the previous sections of this chapter), then it becomes crucial to consider these firms as a main asset of the national industrial fabric. They are also important for the international performance of Argentina's economy, even though their potential seems to be limited to the regional dimension and in particular to their inclusion in MERCOSUR (Brazil + Paraguay and Uruguay account for more than 50% of their exports).

Figure 1.3.10/a – Argentina, Industrial firms, % of firms according to the number of employees (%), 2012)



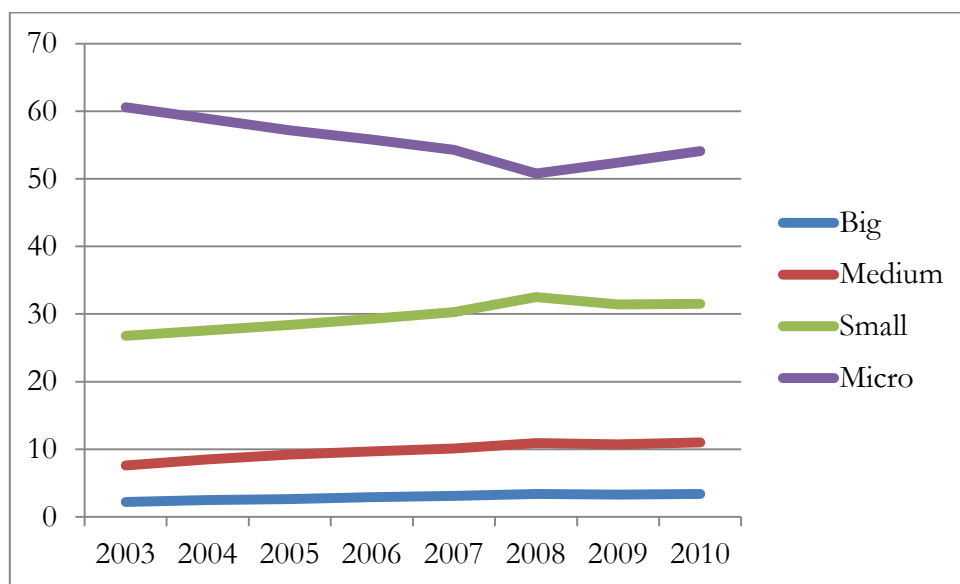
Source: FOP

Figure 1.3.10/b – Argentina, Industrial firms, distribution of employees according to the firms’ size (% , 2012)



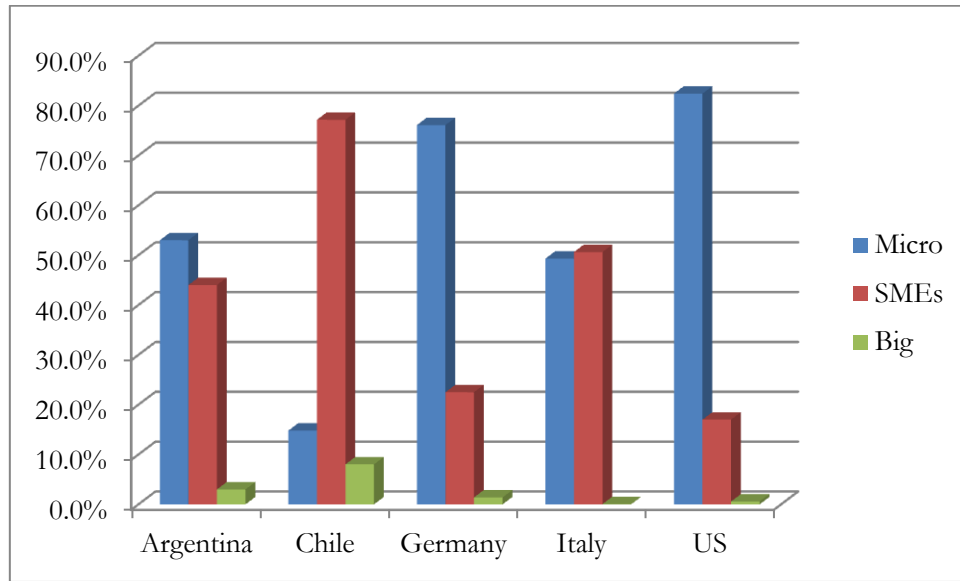
Source: FOP

Figure 1.3.11 – Argentina, distribution of firms according to the number of employees) (% , 2003-2010)



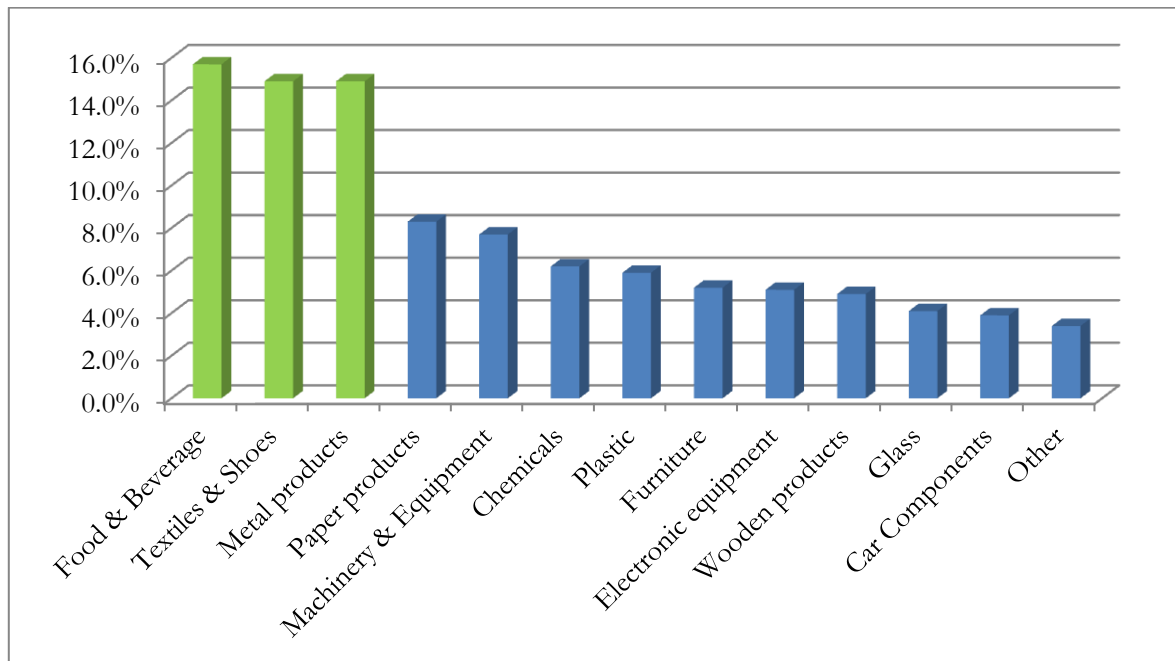
Source: CEPAL

Figure 1.3.12 – Argentina vs. other countries: industrial firms, distribution according to the number of employees (% , 2012)



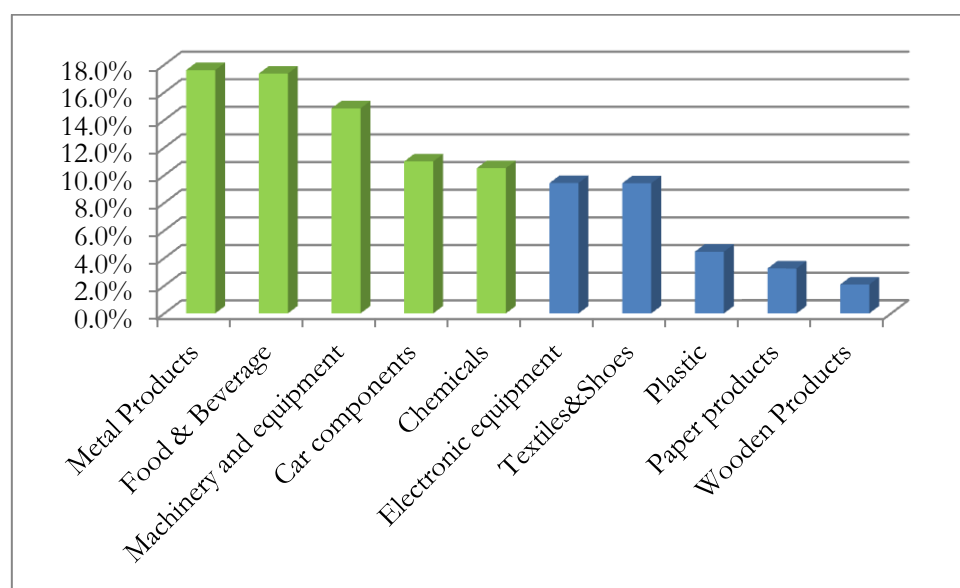
Source: elaboration of the author on OECD data

Figure 1.3.13 – Argentina, industrial firms according to their sector of activity (% , 2011)



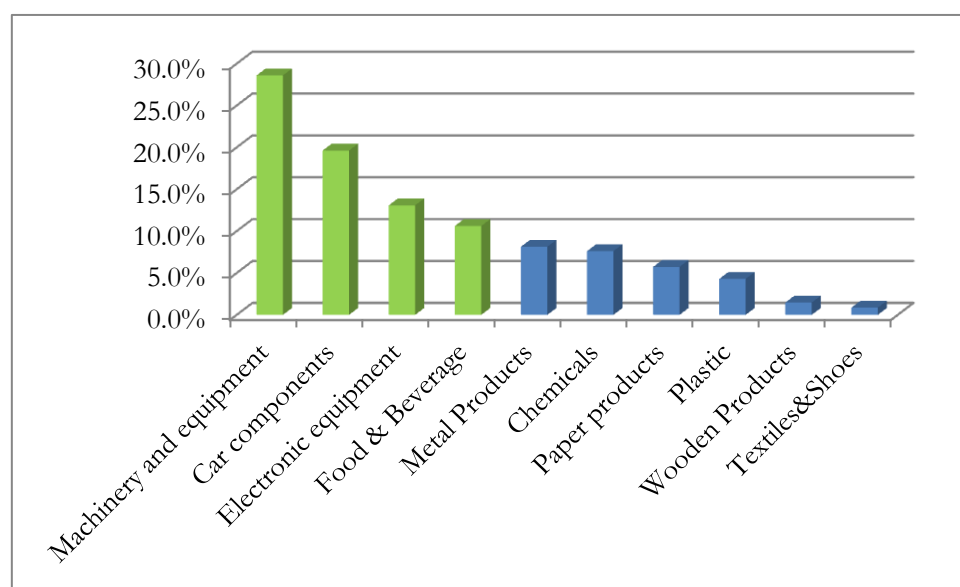
Source: FOP

Figure 1.3.15 - Italy, industrial firms according to their sector of activity (% , 2009)



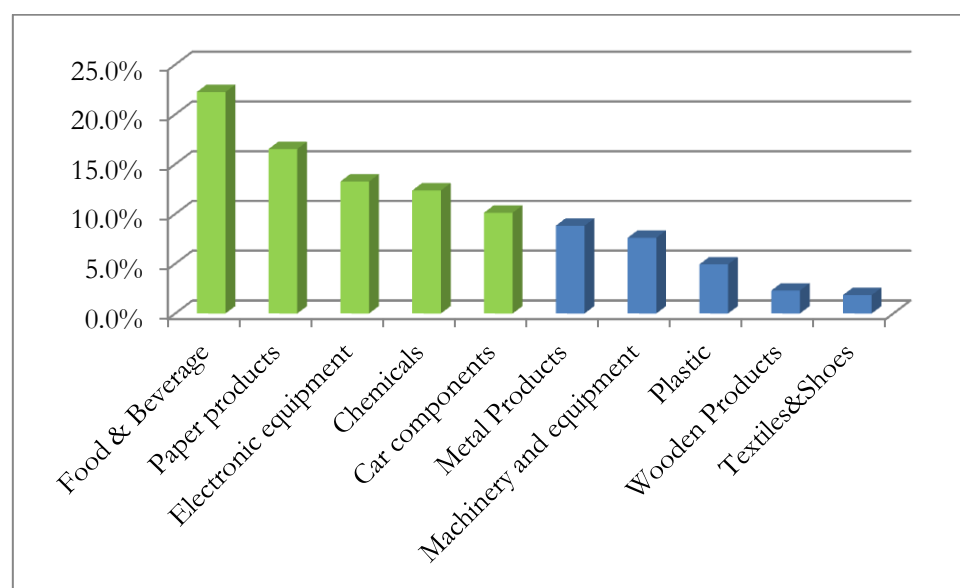
Source: OECD

Figure 1.3.16 – Germany, industrial firms according to their sector of activity (% , 2009)



Source: OECD

Figure 1.3.16 - US, industrial firms according to their sector of activity (% , 2009)



Source: OECD

A comparison with other countries suggests that the industrial structure is not much different from developed economies like Italy and Germany, where the proportion of MSMEs is also very high (Figures 1.3.12). In Chile, another South American country with a similar level of development, the proportion of micro firms on the total is much smaller, possibly because of a productive structure mainly focused on the exploitation of resources in the mining sector. Moreover, the comparison related to the distribution of firms across sectors²⁰ shows that Argentina shares with Italy a similar structure (Figure 1.3.15) especially in relation to textiles, food and beverage, and metal products). In particular, it seems that Argentina has a bigger proportion of firms in the sectors expected to have a comparative advantages. This can be considered a positive factor, and the presence of a high number of SMEs in these sectors can be also considered positive for their flexibility and their innovative and creative attitude. However, a high number of MSMEs can also present some drawbacks. They are more vulnerable in presence of shocks and they are more affected during a crisis or in presence of structural problems of the economy. While micro, small and medium-sized enterprises (SMEs) are more dynamic, flexible and able to specialize and organize in so-called industrial clusters than bigger firms, their size also hinders their ability to respond to the challenges posed by economic globalization. As the example of Italy, a developed country, shows, many firms are undercapitalized, often because of their size and this prevents them from investing on a regular basis, for example in R&D activities: in 2010 almost

²⁰ However, in this case only the sectoral distribution across all manufacturing firms (regardless for their size) was available.

40% of micro enterprises did not invest at all, according to the Bank of Italy (Subacchi and Tentori 2013). In Argentina, the structure of industrial SMEs is similar to that one of a developed country, in terms of number and sector distribution. However, in Argentina's context they are affected by structural problems, especially in terms of their ability to get access to credit and financing. Limited size of the banking sector (see previous paragraph) also contributed to negatively affect the performance of SMEs, so that 60% of them decided not to apply for banking loans for the difficulties in obtaining them (FOP 2013). Moreover, other problems that act as 'bottlenecks' against their development are:

- Small firms with limited infrastructure endowment
- Small firms with too low level of activity
- Medium firms with competitiveness problems
- Medium firms unable to increase their size (FOP 2013)

There is an unsatisfied demand for banking credit by SMEs that has not been filled yet, despite several governmental programs (FONAPYME, Credit of the Bicentennial initiative) implemented to improve their access to finance. Macroeconomic policies aimed at fighting inflation should be the key to solve the problem of credit, since this is the main problem limiting the size of the domestic banking sector, as most of deposits are denominated in US dollars. A substantial increase of deposits denominated in Peso would provide a stronger basis upon which it would be possible to build a more efficient credit system and guarantee resources for new investments to SMEs.

Another fact that needs to be stressed is that the propensity to export is higher as the average firm size increases (FOP 2013). However, despite the problems aforementioned there is a high potential for SMEs in Argentina to develop. Let us have a look at the structure of revealed comparative advantages (RCA) held by Argentina's industrial firms. The RCA index is used in international economics to calculate the relative advantages or disadvantages of a country in certain sectors of the economy, using trade flows as a proxy to define them. RCAs are equal to the proportion of the country's exports of the industry under consideration divided by the proportion of world exports of the same industry. If the ratio is >1 , then the country has a RCA in the production of the goods of that specific industry. Looking at Argentina, CEPAL found out that the country has RCA in vehicles and leather products, while the sector of agricultural machineries is approaching to 1 (Rivas and Stumpo 2013). The sector of leather products is one of the main industrial sectors in Argentina (this is also why it is heavily protected by the Government, as I will explain in part 3): it has a good potential but it is too labor intensive, so that all the improvements in this sector are captured by increases of employment. On the

other hand the sector of agricultural machinery presents a higher potential in terms of technological content and upgrade.

Another sector with a high development potential is the wine industry. Argentina is increasingly producing world-quality wines and is currently the 5th global producer of wine, the 7th largest exporter and the 7th largest domestic consumer (Prosperar - UNIDO 2010). Development of SMEs in this sector looks particularly profitable in the future because wine industry is a good example of a value chain that can be upgraded at the local (regional) or global level allowing Argentina to play a role of leadership in the most advanced segments of the production: there are new investment opportunities for the inputs required for production and packaging. From bottles, cardboard cases, corks, metal capsules and labels to specialty machinery, aluminum tanks and chemical inputs, the expanding wine industry is demanding more quantity and diverse supplies to meet world demand. There are more than 1300 wineries in the country, 85% of which are SMEs (Prosperar - UNIDO 2010). Wine industry is one of the sectors that received the highest amount of FDI in the recent past: between 1999 and 2004 750 million US\$ for greenfield projects flew into the industry, 62% of which coming from overseas investors (Prosperar - UNIDO 2010) contributing also to the technological upgrade of the sector. Wine industry represents today a niche of advanced development in the country and is a perfect example of how the country should grow following the simple prescriptions of the new structural economics.

Therefore, there are some sectors that would be able to further increase and become globally competitive, exploiting the dynamic comparative advantage mechanism explained in the previous sections. SMEs might be key players for the growth of these sectors, but difficulties in terms of access to credit and exploiting their export capacity prevent them from deploying all their potential. A further inclusion of SMEs in GVCs, as well as the implementation of strategies aimed at strengthening their complementarities (for example the creation of “clusters”) would help those firms and Argentina’s economy overall.

1.3.7 Conclusion: the need of coherent economic policies to enhance competitiveness and attract investments

In this chapter I provided some general policy indications for a potentially alternative model of growth and economic development in Argentina, keeping as a central point of the analysis the importance of becoming more competitive on an international basis.

A brief summary of the paradigms of development followed through the last decades was useful to show advantages and disadvantages of each approach, starting from structuralist policies and going

until new structural economics through the experience of neo-liberalism. The key element to bear in mind, made evident from the diachronic perspective that I adopted, is lack of coherence in economic policies: the Governments ruling the country over the course of the last decades have constantly changed the development paradigm they were referring to implement economic policies, in a quite different way from other States, for example Chile, that remained coherent to neo-liberal and monetarist policies since the 1970s, despite the change of different political regimes. As shown in the previous chapter, this uncertainty resulted in a “stop and go” pattern of growth and in a strong volatility of growth, which had a negative influence on inflation, the solidity of the financial sector and the soundness of the fiscal position. Therefore, what Argentina primarily needs is a clear and stable policy orientation, so that this can help to gain more confidence and trust from financial markets and attract capitals available for investment from within and without the country.

Fiscal policies should be less expansionary in periods of growth for the economic system to be sustainable in the long run, as well as monetary policies should be clearer (inflation should be stabilized and currency flows should be allowed) in order to promote internal and external investments. This would help firms, especially SMEs, to get better access to credit and to upgrade their global competitiveness. A further degree of openness of the economy in terms of trade and capital flows would complement these measures helping Argentina to be better inserted in GVCs.

To sum up, Argentina shows an enormous economic potential. The risk is to get caught, once again, in a situation of “middle income trap”, which usually affects growing economies that end up in stagnation, failing to upgrade to the level of high-income countries (Aiyar, Duval. Puy, Wu, Zhang 2013).²¹ If the country wants to move ahead and obtain at last the status of high income, developed economy, should change its direction and look for its place within the global economic system, accepting its rules and exploiting its own advantages vis-à-vis the rest of the world

²¹ The Middle Income Trap occurs when a country's growth stagnates after reaching middle income levels. The problem usually arises when developing economies reach the stage in which rising wages and declining cost competitiveness unable them to compete with advanced economies in high-skill innovations, or with low income, low wage economies in the cheap production of manufactured goods.

**PART II – ARGENTINA IN THE CONTEXT OF SOUTH
AMERICAN INTEGRATION: AN APPLICATION OF THE
GRAVITY MODEL**

2.1 Regional Trade and Economic Integration in South America: an Application of the Gravity Model

2.1.1 Research questions and structure of the chapter

Research questions and motivation

South American countries have experienced a strong and stable economic growth in the first decade of the 21st century, after the last regional crisis which took its origins from the default of Argentina on its external debt. The main reason of this 'boom' in the economic cycle of these countries can be found in the high prices and availability of commodities like soy (as in the case of Argentina and Brazil), copper (Chile), oil and gas (Venezuela and Bolivia). These favorable conditions have had a strong effect on exports, which rose according to their volume and to their value as well.

In the last decades, several projects for economic integration originated in the Latin American region. The two most advanced ones are the Andean Community (CAN), founded in 1969, and the Common Market of the South (MERCOSUR), established in 1991. Both organizations were born as free-trade areas and now they are custom unions: therefore, their principal purpose is to promote regional trade.

In this first chapter I apply the gravity model of bilateral trade, augmented with some variables of interest, in order to answer three main research questions.

The first one is to assess the impact of the different variables of interest included in the gravity model on regional trade in South America, and especially to assess whether and how the two most important regional integration organizations (CAN and MERCOSUR) promote trade. The second one is to analyze in detail the determinants of external trade of Argentina, with particular reference to the context of MERCOSUR and to the partnership with other important commercial partners such as the United States, the Euro Area and China. As Argentina is the core topic of my thesis, this issue will be analyzed in detail in the second chapter of this part, with a particular attention to the possible causes which may have prevented Argentina from achieving a better trade integration with its partners (e.g. the variability in the real exchange rate).

My objective is first of all to point out how the regional agreements influence trade in the different sectors. In fact, the production structure of the South American countries is not homogeneous. There are some middle-income countries with a high level of economic development (Argentina, Brazil and Chile) which production is quite differentiated among sectors and where manufacturing plays an important role; other countries characterized by a relatively high income but which economy completely relies on the exploitation of crude materials (Venezuela); some countries with a lower level of development (in some cases very low) which are still strictly dependent on the agricultural and

extractive sector (Bolivia, Paraguay, Peru). How are the patterns of trade in such an heterogeneous economic context? Can the gravity model explain trade flows in this scenario, where the levels of development are different and inter- industrial trade seems to prevail on intra- industrial trade, according to the hypotheses drawn by the literature on this topic? And, also, how do the regional agreements influence trade integration among countries so different in economic size (MERCOSUR includes huge States like Argentina and Brazil and small ones like Uruguay and Paraguay) and structure of production?

Furthermore, my other objective, with regard to the analysis of Argentina, is to assess how the country performs in terms of regional trade within the context described in the first empirical part of the chapter. How did the macroeconomic variables influence the external trade of Argentina? Was the trend in the GDP growth an important determinant for its exports? What about the exchange rate variability and the uncertainty derived from this factor?

Structure of the chapter

After a paragraph recalling the basic history of economic integration in South America and the attempts made by the Andean Community and the MERCOSUR, I will focus on the theory behind the gravity equation.

To test this equation for the South American context, I will use five different datasets: the first one contains data about total exports, the other four include data of exports in different productive sectors (food and live animals, manufacturing, commodities, crude materials). My aim is to point out how the regional preferential trade agreements affect the exchanges in these different sectors.

To do so, I run the gravity model using different regression techniques and compare the results obtained. I use a Poisson Pseudo-Maximum Likelihood Estimator (PPML), an OLS Fixed Effects and Random Effects estimator, and a Tobit estimator. Recent econometric literature has shown that the PPML regression is the most efficient to estimate the gravity equation. Therefore, I will focus more on the results obtained with this technique and I will apply some robustness checks. Comments on the results will follow.

The second chapter will be dedicated on the empirical analysis of trading flows of Argentina. The structure of this section will be similar to the first one: after a brief theoretical review about the variability in the real exchange rate and the different methodologies used to compute it, a quick recall of the macroeconomic recent history of Argentina will be provided (although a much deeper analysis was the object of part I). Then, results of the new regressions will be presented and commented.

2.1.2 The Andean Community (CAN) and the Common Market of the South (MERCOSUR): history, aims, functioning

First attempts of integration

Trade liberalization was considered one of the best ways to achieve cooperation among states and to promote economic development after the Second World War. These were the main reasons why different organizations promoting trade liberalization and economic integration were created: the most important were the General Agreement on Tariffs and Trade (GATT), founded in 1944 and turned into the World Trade Organization (WTO) in 1995, and the European Economic Community (EEC), risen in 1957 upon the basis of the European Community of Carbon and Steel, and then transformed into the European Union (EU) after the enforcement of the Treaty of Maastricht (1994).

The South American region showed at first an attitude of hostility towards these projects of liberalization and integration. In fact, after World War II, many governments in the area believed that the Import Substituting Industrialization (ISI) would have been the most appropriate strategy to help the South American countries to walk on the way of economic development, that had to be reached through the protection of the national infant industries and the push towards urbanization. This inward-looking strategy was followed by the majority of the States of the region, also those ones who were more endowed with natural resources and favored by the “commodity lottery” (Bulmer-Thomas, 2003).²² Therefore, the nominal and effective rates of commercial protection were kept extremely high, going in the opposite direction of the GATT, which rounds of negotiations concluded with strong tariff reductions (Bulmer-Thomas, 2003).

Nevertheless, the small size of national markets gave rise to the first projects of regional integration. In 1960 the Latin American Association for Free Trade (ALALC) was founded among Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay: the aim was to establish a free trade zone through a progressive reduction of tariffs according to the principle of the most favored nation.

The failure of the ALALC, principally due to a lack of commitment of its biggest members (Argentina, Brazil and Mexico) led to the constitution of another organization, the Latin American Association of Integration (ALADI), created in 1980. The mechanism of the ALADI should have opened the way

²² The commodity lottery is a definition intended to draw differences among commodities. Materials with forward linkages (i.e. that require further processing before export), like meat, can act as a stimulus to industrialization and urbanization, as in the case of Argentina. Otherwise, commodities that require only labor for their extraction (as the case of guano in Peru) did not pose the basis for the growth of a solid industrial sector. This is a strong explanation why South American countries followed different patterns of economic development.

towards the institution of a common market, but the economic crisis faced by Latin American countries during the '80s (the so-called "lost decade") prevented this organization from reaching its objective (Lara, 2011).

The Common Market of the South (MERCOSUR)

The Common Market of the South (MERCOSUR) represents the most ambitious project of economic integration in South America. Created in 1991 by the Treaty of Asunción among Argentina, Brazil, Paraguay and Uruguay (Bolivia and Chile became associate members, while the membership of Venezuela is still pending because of the negative pronouncement of Brazilian Parliament), MERCOSUR marked a further step on the integration process, since it created not only a free trade zone but also a custom union. The Protocol of Ouro Preto, signed in December 1994, determined the full enforcement of the organization through the establishment of the common external tariff and of its institutional structure. Since 1995 most of items traded faced zero duties, but a certain level of protection remained for categories of goods like automobiles, which represent a strategic asset for the manufacturing sector of both Argentina and Brazil.

In the intention of its founders, the organization was modeled upon the experience of the European Union, and the last step of this process should be the achievement of a 'common market' through the coordination of the national macroeconomic policies.

The effectiveness of MERCOSUR has been strictly dependent on the economic performance of its main members, Argentina and Brazil. Intra-regional trade increased during periods of boom, while it was negatively affected during periods of recessions. As it was shown by Bittencourt, Larson and Thompson (2005), the stability of the organization was in doubt due to the Brazilian crisis in 1998, which led to the devaluation of the national currency and to severe commercial disputes with Argentina (that during those years was pegged to the US dollar through a currency board regime), and to the fierce economic slowdown of the latter in 2002. The researchers attribute the troubles faced by MERCOSUR to a lack of policy coordination among the members, which could have helped to mitigate the issues arising among them. This lack of coordination has also been stressed by Baer, Cavalcanti and Peri (2002), who described how the divergence in monetary policy between Argentina and Brazil affected regional trade in a negative way. The deficits in the trade balance registered by Argentina in the first years of the MERCOSUR, and by Brazil afterwards, provoked a rise of the tariffs regarding sensitive goods as automobiles and the devaluation of the Brazilian currency in 1999, with the clear objective of gaining competitiveness in export. These factors led to an increase in the volatility of real exchange rate: since the theory suggests that an increase in the bilateral exchange rate translates

into a lower cost of producing tradable goods, exports should be positively correlated with the exchange rate. A high level of volatility in the exchange rate was shown having a negative impact on bilateral trade between the two countries (Baer, Cavalcanti, Peri 2002): which is exactly the effect a regional trade agreement should be aimed to avoid. Moreover, as it was pointed out by Busse, Hefeker and Koopmann (2004), the Argentine crisis is a proof of the fact that unilateral currency pegs have the risk to produce misalignments with the trade partners. Also Malamud (2005) underlines how the success of the organization strictly depends on the economic performance and on the political views of its two biggest members, but also recognizes that in its first seven years of life regional trade increased four times, this effect explained by trade creation rather than trade diversion. On the other hand, two main failures are attributed to the organization: the inability of promoting trade not only in goods but also in services, movements of capitals and people (recalling the famous ‘four liberties’ of the European Union) and the failure in expanding its membership (Malamud 2005).

In more recent years, commercial integration within the organization has faced other problems originated by different factors, not only economic (the global recession in 2008) but also political (disputes between Argentina and Uruguay).

The Andean Community (CAN)

Before MERCOSUR, which represents up to this moment the deepest attempt of trade integration in South America, another organization was created with the aim of promoting economic cooperation among its members. This institution was called Andean Community of Nations (CAN) (the agreement is also known as the Andean Pact – AP) and was created in 1969 by Bolivia, Chile, Colombia, Ecuador and Peru. The AP was set up as a reaction against the failure of the ALALC and had a more ambitious project: it had the aim of creating a custom union with a common external tariff. Venezuela joined in 1973 but Chile withdrew in 1976, as its neoliberal policies, adopted by the Pinochet regime and based on further tariff reductions and opening to Foreign Direct Investments (FDI), were considered incompatible with the purposes of the organization (Bulmer-Thomas 2003).

In 2005 the MERCOSUR States became associate members after signing an agreement of cooperation. Chile also became associate in 2006, while in the same year Venezuela withdrew.

A free-trade area was finally set up in 1993, thus leading to a strong increase in regional exchange.

In the first years after the implementation of the common tariff, trade among members of the CAN nearly doubled, even if after 1997 we see a slight decrease in multilateral exchange (UN Comtrade Statistics Division). The impact of the free-trade area was less important in comparison with the

implementation of MERCOSUR, which could count on a stronger institutional basis and on a much bigger economic size of its main members, Argentina and Brazil.

In conclusion, it is possible to say on one hand that the Andean Community seems having had a strong impact in promoting trade among its members. Moreover, this organization can potentially avoid the contrasts risen within MERCOSUR, since the members are more similar with each other according to the level of economic development and productive structure. In fact, the economy of Andean countries is mainly based on the exploitation of agricultural and extractive commodities.

2.1.3 The gravity model of international trade

The gravity model has become one of the most important theoretical frameworks to analyze the determinants of flows of bilateral trade at an empirical level. The first, and most simple, formulation of the gravity equation takes its origins from the works of Tinbergen (1962) and Linnemann (1966): it states that bilateral trade between two countries is directly proportional to their 'size' (measured in economic terms through the product of their Gross Domestic Product, GDPs) and inversely proportional to their geographic distance. The latter variable is used as a proxy for trading costs and barriers.

Therefore, here is the gravity equation in its basic form:

$$X_{ij} = \alpha_0 Y_i^{\alpha_1} Y_j^{\alpha_2} D_{ij}^{\alpha_3} \quad (1)$$

Where X_{ij} are exports from country i to country j , Y stands for the GDP and D for the distance.

Across the years, the equation has been applied to several case studies and the gravity model has been augmented with other variables. One important contribution comes from Krugman (1991a) who, going deeper from the concept of the comparative advantage, traditional in international trade theory, stressed the importance of increasing returns to scale in bilateral trade arising from concentration and proximity of production rather than from dispersed markets. The benefits arising from concentration translate not only in an increase of trade flows, but also in terms of efficiency (lower costs and bigger scale), specialization of labor (a concentration of higher-skilled workers is favored) and knowledge flows which are able to generate positive technological externalities (Krugman 1991b).

The gravity model is also used to explain intra-industrial trade: it means that two or more countries can specialize in producing different varieties of the same good and trade among each other if tastes are identical and homothetic. This is what has been suggested by Helpman (1987), and later by Debaere

(2002), who applied this version of the gravity model to a group of OECD countries, according to the fact that the similarity in the level of development (measured in terms of income per capita) should be a condition promoting intra-industrial (for instance manufacturing products) rather than inter-industrial trade (ex. manufacturing vs. agricultural products). This effect, considered not at a specific regional level but for a more general pair of countries, is known as the Linder Hypothesis (Linder 1961), according to which countries with similar levels of economic development (measured through per capita income) will have more similar tastes and then will exchange more between themselves.

Therefore, the theory suggests that the gravity equation succeeds in explaining multilateral trade if the countries in the sample are specialized in the production of differentiated goods, which is more likely in the case of manufacturing rather than agriculture: this is a reason why the gravity model would be more suitable for OECD countries. Nevertheless, the equation seems working well also for developing countries. Feenstra, Markusen and Rose (2000) showed that the gravity equation can arise from different types of models. Some in fact imply a “home market” effect, in the sense that an increase in the exporter’s income has a more than proportionate effect on exports, while others imply the opposite, called “reverse” home market effect. The first effect seems holding for differentiated goods, while the latter is more pronounced for homogeneous goods (Feenstra, Markusen and Rose 2000).

Attempts were also made in order to assess the impact of the so-called “multilateral resistance terms” (Anderson and Van Wincoop 2003), which represent a deeper contribution to catch the effect of trading costs and other variables affecting bilateral trade in a negative way.

Many empirical analyses were applied to measure the impact of these variables to bilateral trade flows. The South American region, object of this dissertation, has been already investigated in previous empirical works. Carrillo and Li (2004) applied the gravity model to a sample of South American countries to examine the effects on intra-regional and intra-industrial trade in the period 1980-1997. They also looked for the impact of regional trade agreements like MERCOSUR and the Andean Community (see previous paragraph). The researchers found that the AC had a significant effect on the reference products, while MERCOSUR had a stronger impact on capital intensive goods (Carrillo and Li, 2004). Another work by Bittencourt, Larson and Thompson (2005), applied on MERCOSUR countries, shed more light on the issue of trading barriers. After taking into account the macroeconomic internal problems of the main MERCOSUR members (Argentina and Brazil), they showed that an increase in exchange rate volatility contributes to affect regional trade in a negative way. Research on the South American area about the determinants of trade flows is still not very spread and deepened: nevertheless, the existing research pointed out some interesting results about the confirmation of the validity of the gravity model, the effectiveness of regional trade agreements and the importance of taking into consideration macroeconomic cycles in order to augment these gravity

models and to obtain a better goodness of fit. On the other hand, the datasets have to rely on relatively small samples, due to the restricted number of countries present in South America (ten Hispanic nations) and in organizations as MERCOSUR (only four). My research is aimed to go in the direction of giving another small contribution to the explanation of regional trade flows.

2.1.4 The estimation of the Gravity Equation: some econometric issues

Traditionally, the gravity equation is formalized as a log-linear regression: therefore, the coefficients of the different variables have to be interpreted in terms of elasticity.

$$\ln X_{ij} = \ln \alpha_0 + \alpha_1 \ln Y_i + \alpha_2 \ln Y_j + \alpha_3 \ln D_{ij} + \ln \eta_{ij} \quad (2)$$

One of the main econometric techniques used to estimate the gravity equation is the Tobit estimator. It is considered particularly suitable for this kind of regression, since real data show that, in many cases, trade between a pair of countries can be literally zero. As explained by Liu (2009), the standard censored Tobit model assumes that

$$X_{ij} = X\beta + u, u | X \sim \text{Normal} (0, \sigma^2) \quad (3)$$

Where X is a vector of covariates affecting bilateral trade. Such an estimator has been used in many estimates of the gravity model since it takes into account also the observations that take on a value of “0”. In fact, the Tobit estimation takes account of all the observations ($X_{ij} = 0$ and $X_{ij} > 0$ both) by using maximum likelihood to combine the probit and regression components of the log-likelihood function (Baum 2006). Nevertheless, as it has been pointed out by Santos Silva and Tenreyro (2006), the gravity equation was modeled on the basis of the Newtonian gravitational force which, by definition, cannot take on a value of zero. Therefore, the Tobit estimator could not fit the data very properly.

The second class of estimator is the Ordinary Least Squares (OLS). The regressions on the models of bilateral trade can be run using a Fixed-Effects (FE) or Random-Effects (RE) estimator. In particular, in panel data regressions on a gravity model, time varying country fixed effects could be used to absorb the “multilateral resistance effects” pointed out by Anderson and Van Wincoop (2003). For instance, if

the researcher is trying to assess the impact of being member of a particular trade-promoting organization, without time varying country FE there could be the risk of misattributing to the membership to that particular organization the effects on bilateral trade that should be actually attributed to other factors (Liu 2009).

Also this kind of technique presents some problems: as OLS estimators require in this case a log-linear regression, and the requirement for an estimation to be consistent is that the residuals are statistically independent from the covariates, the log of the residuals must be independent from the covariates as well. The expected value of the logarithm of a random variable depends both on its mean and on the higher moments of the distribution. Nevertheless, the classic log-linear gravity regressions only consider the first-order approximation and leaves the highest order moments in the residuals. Therefore, problems of heteroskedasticity arise affecting the efficiency of the estimator (not minimum variance anymore) and also its consistency, since it is estimating the log of the dependent variable, and not the variable expressed in levels (Santos Silva and Tenreyro 2006).

Also another class of estimator that could appear suitable for a gravity model presents some problems. The Non-linear Least Squares (NLS) estimator, in fact, provides inefficient results since more weight is given to the observations with a higher variance, therefore leading again to heteroskedasticity issues. Another drawback of this class of estimators, as pointed out by Santos Silva and Tenreyro (2006), is that they are not invariant to the scale of the dependent variable. Therefore, measuring trade in dollars rather in thousand dollars will lead to different estimations of the elasticities.

A possible solution to this series of problems is to estimate the gravity equation in a multiplicative form (without taking the logarithm of exports, the dependent variable) and allow for heteroskedasticity. As it has been shown by Santos Silva and Tenreyro (2006), the Poisson regression seems to be a good approach to do it. The Poisson Pseudo-Maximum Likelihood (PPML) estimator takes on the following form:

$$E (X_{ijt} | Z_{ijt}) = \exp(Z_{ijt} \beta) \quad (4)$$

It means that the conditional mean of the dependent variable (exports) is equal to the exponential of the mean of the covariates. Therefore, the coefficients obtained can be interpreted in terms of elasticity if the dependent variable is expressed in levels and the covariates are in logarithms (Liu 2009).

What are the benefits of using this estimator? As the PPML estimator gives the same weight to all observations, the risk of giving more weight to those ones with the higher variance (thus increasing the

'noise' present in the regression) is not present anymore. Therefore, the issue of heteroskedasticity can be controlled and reduced.

Moreover, in a subsequent paper Santos Silva and Tenreyro (2009) showed that the PPML estimator performs well also in the case when the dependent variable has a large proportion of zeros, thus replying to the doubts risen by some other researchers against this methodology (Mártinez Zarzoso, Nowak-Lehmann and Vollmer 2007). A simulation provided evidence of the fact that the PPML estimator is an advisable technique also in the case of a big proportion of zeros in the dependent variable, since the solutions used by estimators based on log-linearization are unreasonable, because they lead to inconsistent estimates (Santos Silva and Tenreyro 2009).

Empirical applications of the Poisson regression to the gravity equation have shown that this technique leads to more efficient estimates. Santos Silva and Tenreyro (2006) have tested it first in a cross-section regression, showing that OLS techniques generate over-estimations of some fundamental variables (as the GDP of exporter country) and exaggerate also the role of geographical distance and of trade organizations. On the other hand, the PPML estimator appears to be consistent and efficient since it passes the test of the Eicker-White's heteroskedastic robust standard errors.

I am also interested in results coming from a panel-data regression, since the empirical part of this dissertation is based on the analysis of a panel data set. Liu (2009) applied the Poisson estimator to a panel including all the members of GATT/WTO, in order to analyze the functioning of the gravity equation and the impact of preferential trade agreements. The Poisson regression showed that the agreements subscribed in the GATT/WTO system were effective in promoting trade not only at the intensive margin (deepening of the existing relationships) but also at the extensive margin (creation of new bilateral relationships).

Santos Silva and Tenreyro (2010) applied the PPML technique on a panel data estimation aimed to assess the impact of currency unions in promoting multilateral trade. To do so, they used a gravity model augmented with a dummy variable representing the sharing of a common currency. They found that the Euro did not have a remarkable impact in promoting regional trade, since the level of exchange was already very high before the introduction of the common currency.

The application of the PPML technique will be the core of the empirical part of this dissertation.

2.1.5 Data and estimation techniques

My sample consists of ten countries: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, Paraguay, Uruguay, Venezuela. They are all the Hispanic countries of South American area and they form part of the two integration organizations (Andean Community and MERCOSUR), with the exception of Chile, which is only an associate member to MERCOSUR, and of Venezuela, which

withdrew from the Andean Community in 2006 and was admitted in July 2012 in the membership of MERCOSUR. I decided not to exclude Chile since it is one of the main economic actors in the region and because I do not want to assess only the impact of being member of the CAN or of MERCOSUR, but I am considering other variables as well. Moreover, Chile is an associate member both to CAN and MERCOSUR.

Each countries is considered in pair with all the other ones, in order to form 90 pairs of commercial partners [$n * (n-1)$]. Each pair is considered over a period of 28 years, since 1985 to 2012.²³ Therefore, the dataset is a panel made up of 2520 observations.

The model to be estimated is the following:

$$\begin{aligned} \text{Log}X_{ij} = & \beta_1 \text{GDP}_i + \beta_2 \text{GDP}_j + \beta_3 \text{LogDist} + \beta_4 \text{LogDifgdp}_{ij} + \beta_5 \text{LogDifgdpsq}_{ij} \\ & + \beta_6 \text{LogRER} + \beta_7 \text{COB} + \beta_8 \text{MER} + \beta_9 \text{AC} + \beta_{10} \text{Dummy1985} + \dots \\ & + \beta_{34} \text{Dummy2009} + u_{it} \quad (5) \end{aligned}$$

While for the Poisson regression is:

$$\begin{aligned} X_{ij} = & \beta_1 \text{GDP}_i + \beta_2 \text{GDP}_j + \beta_3 \text{LogDist} + \beta_4 \text{LogDifgdp}_{ij} + \beta_5 \text{LogDifgdpsq}_{ij} + \\ & \beta_6 \text{LogRER} + \beta_7 \text{COB} + \beta_8 \text{MER} + \beta_9 \text{AC} + \beta_{10} \text{Dummy1985} + \dots + \\ & \beta_{34} \text{Dummy2011} + u_{it} \quad (6) \end{aligned}$$

The variables of interest are typical of a gravity model. As in the previous works by Carrillo and Li (2004) and Liu (2009), the dependent variable is represented by the exports of country i to country j (X_{ij}) while the main covariates are the Gross Domestic Product (GDP) of the exporter country (GDP_i), the GDP of the importer country (GDP_j) and the distance between the two countries. According to the theory predicted by the gravity model, GDPs of both countries should be positively correlated with the dependent variable (see previous paragraph). Exports and GDPs are measured in US current million dollars and the sources are, respectively, United Nations Comtrade Statistics Division (Standard International Trade Classification. Rev.4) and the World Bank Databank. The distance, measured in kilometers, was obtained by computing the great circle distance between the main economic cities of

²³ A time series from 1985 to 2012 was available only for total exports data. Disaggregated data regarding exports of every single commodity were available only until 2009. Therefore, the regressions on different sectors are based on a sample included between 1985 and 2009.

the countries in the sample: they do not coincide with the capital cities in the case of Brazil (São Paulo instead of Brasilia), Bolivia (Santa Cruz de las Sierras instead of La Paz), Ecuador (Guayaquil instead of Quito). The reason of this choice is the attempt to give a slightly better meaning to this variable, which is a quite rough proxy for trading costs. According to the predictions of the gravity model, the farther two countries are from each other (and then the more difficult is to trade), the lower the bilateral exchanges should be.

The variable $Dijgdpj$ measures the difference in the GDP per capita between the exporting and the importing country.²⁴ I introduced this variable to check if the Linder hypothesis holds. Linder (1961) gives a different explanation from the Heckscher-Ohlin theorem and he suggests that two countries trade more with each other as the domestic structure of preferences and the level of economic development are more similar. A way to approximate this effect is to include the difference in GDP per capita (Choi 2002, Carrillo and Li 2004). The variable was introduced also in its squared form in order to check for the right functional form. The data come from the World Bank Databank and they are measured in US current dollars. The expected sign is negative, since the lower is the difference in the level of incomes, the higher the amount of bilateral trade should be.

The variable $RERij$ measures the real exchange rate between each pair of countries. It has been obtained using this formula:

$$\left(\frac{GDP\ Deflator_j}{GDP\ Deflator_i}\right) * \left(\frac{NER_i}{NER_j}\right) \quad (7)$$

Where NER stands for the nominal exchange rate. The RER was computed according to the methodology proposed by Liu (2009) instead of the traditional way which uses the Consumer Price Index in place of the GDP deflator. In this case the latter was chosen since data about Consumer Price Index were not available for all countries in each of the years considered. The expected sign of this variable is positive: a higher real exchange rate could be interpreted as a proxy for competitiveness and therefore stimulate exports from one country to the other.

The variable MER is a dummy which takes on value “1” if both countries belong to MERCOSUR, “0” otherwise. The variable AC takes on value “1” if both countries belong to the Andean Community, “0” otherwise.

²⁴ In this case GDP is written in small capitals in order to distinguish between aggregate GDP, used for the first two variables, and per capita GDP.

The variable COB is another dummy which takes on value “1” if the two countries share a common border. It is another approximation for the trading costs and it should be positively correlated with the dependent variable.

The dummies from year 1985 to 2011 (2012 was excluded because it works as the base-year and therefore if included it would cause problems of multicollinearity) were chosen to capture the effect of macroeconomic events – or other variables not included in the model – on bilateral trade. In fact, along the period considered, there are several events that should be controlled. They are:

- 1989: hyperinflation crisis in Argentina after the failure of the project of the “*Peso Austral*”;
- 1995: full enforcement of MERCOSUR after the sign, in December 1994, of the Ouro Preto protocol (see previous paragraph);
- 1999: bilateral crisis between Argentina and Brazil due to the devaluation of the Brazilian currency in order to gain competitiveness;
- 2002: economic crisis in Argentina after the default on the external debt in December 2001;
- 2009: effects of the global financial crisis originated in 2008
- 2011: the economic recovery after a new rise of global demand.

For these reasons, the outputs of the regressions published in this chapter show only the coefficients of the dummies related to these six years.

Five different data sets were used in order to perform five regressions. The first dataset uses as dependent variable the value of total exports and it estimates the impact of the different variables on the export sector as a whole. The other four regressions use data related to the exports in different productive sectors, which are:

- Food and live animals;
- Manufactured goods;
- Commodities;
- Crude materials except fuels.

The data were obtained also in this case from the UN Comtrade Statistics Division. The regressions will be performed in order to answer two main questions. The first aims to assess if the gravity equation is able to explain regional trade in the South American context. The second is directed to point out how the regional preferential trade agreements (Andean Community and MERCOSUR) affect trade considered globally and in the different productive sectors.

Four different estimation techniques were used (see previous paragraph): the models were estimated with the Poisson Pseudo-Maximum Likelihood Estimator (PPML), an OLS Fixed Effects and an OLS

Random Effects and with the Tobit estimator. According to the literature review, we expect the Poisson estimation to be the most reliable among the four.

2.1.6 Results

The outputs of all the regression are shown in the tables at the end of this chapter. The tables compare the outputs obtained in each of the five regressions with the different techniques of estimation. The dependent variable is expressed in levels for the Poisson Pseudo-Maximum Likelihood estimation and in logarithmic form for the OLS Fixed and Random Effects and for the Tobit estimation, following the properties of the different estimators (see previous paragraph). The coefficients have to be interpreted in terms of elasticity. Since the PPML method of estimation is the most interesting and efficient, in order to facilitate the reading the results of those estimations will be included in the text.

The first table presents the outputs of the regressions using total exports as dependent variable. According to the PPML regression (table 2.1.1), the main variables of interest have the expected sign: the GDPs of the trading countries are positively correlated with exports and they are significant at the 1% level. The GDP of the exporter country seems to have a slightly stronger impact, correspondent to an increase of 0.28% in bilateral trade for a 1% increase in GDP.

Distance is, as expected, negatively correlated with exports but significant at the 10% level. This result can be compared also with the Common Border variable, which is significant at the 5% level and has a positive impact in the promotion of trade.

The Linder effect seems to play no substantial role in determining the trade patterns in the region. The coefficients are low, both in the linear and in the quadratic form, but strongly significant.

Also the real interest rate seems not to be an important determinant of bilateral trade. The sign is positive but its impact is negligible, even if strongly significant.

The dummies created in the attempt to capture the effect of the regional integration have a positive and significant impact. Belonging to the Andean Community seems to have a positive and strong impact on bilateral trade (0.348), while belonging to MERCOSUR seems to have a negative impact (-0.204). This result is quite striking, since the efforts for economic integration and the expectations for its positive consequences were bigger for MERCOSUR rather than for the Andean Community. A deeper reasoning will be the object of the next paragraph and chapters.

Regarding the effects of the macroeconomic and other external factors, we can see that all the year dummies are significant at the maximum level. The interpretation of these coefficients has to be considered in relation to the excluded dummy, related to the year 2012, which coefficient is coincident with the mean of exports in that year. The coefficients taken on by the other dummies have to be

interpreted as the differences between each year's mean and the base year, 2009. Therefore, an important improvement of bilateral commercial relations can be seen in the year 1995 (from -1.363 in 1994 to -1.085), possibly as a result of the full enforcement of MERCOSUR. In 1999, the coefficient turns out to be again more negative (from -0.984 in 1998 to -1.189), as formulated in our hypothesis. Another strong decrease of the coefficient can be seen in 2002 (from -1.062 in 2001 to -1.206), which could be partly explained by the economic crisis in Argentina. The variable starts to have lower and lower differences below the mean from that year on and assumes a positive difference in relation to the mean of the base year, possibly an evidence in favor of the strong economic growth which created a favorable climate for exports and regional trade. The more positive coefficients in relation to the year 2012 could be interpreted as a period of economic slowdown due to the global financial crisis broken out in the last quarter of 2008. The R^2 of the regression is equal to 0.299, therefore it seems that the model helps to explain nearly one-third of the determinants of exports. By the way, it is worth to point out that for log-likelihood regressions there is no measure of the R^2 : therefore, other measures of the goodness of fit are used to compute the so-called "pseudo- R^2 ", which cannot be interpreted in the same way. Therefore, the values of the R^2 obtained after PPML and Tobit regressions will be considered less reliable.

Table 2.1.1 – Total exports, PPML Estimation, results

| | | |
|-----------------------|---------------------------|----------------------|
| <i>X_{ij}</i> | <i>LogGDP_i</i> | 0.285 (0.000)*** |
| | <i>LogGDP_j</i> | 0.212 (0.000)*** |
| | <i>LogDist</i> | -0.039 (0.216) |
| | <i>LogDifgdpij</i> | 0.033 (0.000)*** |
| | <i>LogDifgdpsq</i> | 0.000 (0.000)*** |
| | <i>LogRER</i> | 0.016 (0.000)*** |
| | <i>COB</i> | 1.262 (0.276)*** |
| | <i>AC</i> | 0.348 (0.000)*** |
| | <i>MER</i> | -0.204 (0.000)*** |
| | <i>Dummy1989</i> | -2.318 (0.000)*** |
| | <i>Dummy1995</i> | -1.085 (0.000)*** |
| | <i>Dummy1999</i> | -1.189 (0.000)*** |
| | <i>Dummy2002</i> | -1.206 (0.000)*** |
| | <i>Dummy2008</i> | -0.034 (0.000)*** |
| | <i>Dummy2011</i> | 0.074 (0.000)*** |

| | |
|-----------|---------------------|
| cons | 7.115 (1.751)*** |
| R-squared | 0.299 |
| N | 2520 |

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: elaboration of the author

The second column of table 2.1.7 shows the results obtained by the OLS Fixed Effects regression. This estimator does not seem to be the best option to use, since it drops the variables that take on constant values (in this case, *LogDist* and COB), and the coefficients and reach too high levels of significance, although they take on the expected signs in most cases.

The third column shows the results of the regression using the OLS Random Effects estimator. The main variables still have the expected sign and they are significant, even if in this case the GDP of the recipient country seems to have a slightly bigger impact on bilateral trade (0.647 against 0.616). The difference in the income per capita and the real exchange rate again do not play any significant role. The impact of being member of the Andean Community is still bigger than belonging to MERCOSUR, even if in this case the variable MER does not reach the highest level of significance. Regarding the dummy year variables, they seem to follow the same pattern as in the PPML regression, and the principal years of interest confirm the hypothesis of this paper. The R^2 has a quite high value (0.642): as the sample size is reasonable, it can be considered as an evidence in favor of the goodness of fit of the model.

The last column of the table lists the coefficients obtained running the Tobit regression. The coefficients are very similar to those obtained with the OLS Random Effects. The ‘core’ variables of the gravity equation are strongly significant and take on the expected sign. The R^2 takes on a lower value but, since Tobit estimation provides only “pseudo- R^2 ”, as explained in the above.

Let us move to the regressions regarding the estimates for the different productive sectors, starting from food and live animals (Tables 2.1.2 and 2.1.8). Regarding the OLS estimates, as the Hausman test, run for all different datasets, showed that in all cases the Random Effects estimation provides consistent coefficients, for sake of simplicity I will comment only the results of the RE regression.

The results present the same, expected signs for the main variables of interest. In this case, the GDP of the exporter country seems to play a much bigger role in determining bilateral trade, as it is possible to realize looking at the coefficients of the regressions (0.969 for PPML, 0.537 for OLS RE, 0.463 for Tobit). The difference in GDP per capita presents now a bigger coefficient (-0.111) and is strongly significant in the Poisson regression, even if the sign is negative. The coefficients of the other regressions are slightly positive but not significant. The Linder effect seems not to take place in this case, and this could be explained by the fact that the products of this sector are primary goods which

respond less to the similarity in the levels of income: these results would suggest a lower elasticity of demand with respect to income for this category. See next section for further comment.

Apart from these considerations, the principal result of this second set of regressions is the negative sign taken on by the variables AC and MER. It seems that the regional integration did not play a positive role in promoting trade for this category of goods. A deeper reasoning on this result will be provided in the next paragraph.

Table 2.1.2 - Food and live animals exports, PPML estimation, results

| | | |
|-----------------------|---------------------------------|----------------------|
| <i>X_{ij}</i> | <i>LogGDP_i</i> | 0.969 (0.000)*** |
| | <i>LogGDP_j</i> | 0.179 (0.000)*** |
| | <i>LogDist</i> | -0.657 (0.340)* |
| | <i>LogDifgdp_{ij}</i> | -0.111 (0.000)*** |
| | <i>LogDifgdpsq_{ij}</i> | - |
| | <i>LogRER</i> | -0.017 (0.000)*** |
| | <i>COB</i> | 0.780 (0.387)** |
| | <i>AC</i> | -0.435 (0.000)*** |
| | <i>MER</i> | -0.038 (0.000)*** |
| | <i>Dummy1989</i> | -1.854 (0.000)*** |
| | <i>Dummy1995</i> | -0.440 (0.000)*** |
| | <i>Dummy1999</i> | -0.500 (0.000)*** |
| | <i>Dummy2002</i> | -0.674 (0.000)*** |
| | <i>Dummy2008</i> | 0.162 (0.000)*** |
| | Cons | 2.253 (2.743) |
| | N | 2,250 |

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: elaboration of the author

The results obtained for the category of manufactured goods (Tables 2.1.3 and 2.1.9) are not very different from the first category analyzed. The expected results for the main variables of interest still hold (therefore confirming the good specification of the basic gravity model), while the effects of the difference in GDP per capita seems to be again negligible. The impact of the Andean Community and MERCOSUR appears negative also in this case. In the PPML estimation, in fact, the signs of the coefficients are negative and strongly significant, while in the OLS Random Effects they are not significant, even if they are strongly positive. On the other hand, the results obtained by the Tobit

estimation look quite different regarding the MERCOSUR dummy: in this case the coefficient turns out to be positive (0.733) and significant at the 1% level.

Table 2.1.3 - Manufactured goods exports, PPML estimation, results

| | | |
|-----------------------|---------------------------------|----------------------|
| <i>X_{ij}</i> | <i>LogGDP_i</i> | 1.228 (0.000)*** |
| | <i>LogGDP_j</i> | 0.175 (0.000)*** |
| | <i>LogDist</i> | - |
| | <i>LogDijgdp_{ij}</i> | -0.093 (0.000)*** |
| | <i>LogDijgdp_{ij}sq</i> | - |
| | <i>LogRER</i> | 0.028 (0.000)*** |
| | <i>AC</i> | -0.570 (0.000)*** |
| | <i>MER</i> | -0.168 (0.000)*** |
| | <i>Dummy1989</i> | -1.078 (0.000)*** |
| | <i>Dummy1995</i> | -0.136 (0.000)*** |
| | <i>Dummy1999</i> | -0.343 (0.000)*** |
| | <i>Dummy2002</i> | -0.457 (0.000)*** |
| | <i>Dummy2008</i> | 0.376 (0.000)*** |
| | <i>cons</i> | -8.252 (0.198)*** |
| | R-squared | 0.48 |
| | N | 2,250 |

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: elaboration of the author

The fourth set of regressions is about the effects on exports in the sector of crude materials (except fuels, Tables 2.1.4 and 2.1.10). The coefficients obtained for the PPML estimation look quite puzzling, since for the first time the gravity equation seems not to work as expected: in fact, the correlation of the dependent variable with the trading countries' GDPs is negative. The effect of MERCOSUR is in this case positive and strongly significant, while the impact of Andean Community is negative.

The coefficients of trading countries' GDPs change sign after running the OLS RE regression: in this case they take on, as expected, the positive sign and they are strongly significant. The same effect can be seen with the Tobit estimation.

This set of regressions provides a different pattern of the dummies related to each year considered in the sample. Differently from the other categories of goods, the coefficients turn positively over the

mean of the base year much before (look at the value of 1995 for both OLS RE and Tobit) and then they stay over the value of the base year.

Table 2.1.4 - Crude materials exports, PPML estimation, results

| | | |
|-----------------------|---------------------------------|----------------------|
| <i>X_{ij}</i> | <i>LogGDP_i</i> | -0.405 (0.000)*** |
| | <i>LogGDP_j</i> | -0.237 (0.000)*** |
| | <i>LogDist</i> | 0.003 (0.557) |
| | <i>LogDifgdp_{ij}</i> | 0.021 (0.000)*** |
| | <i>Logdifgdp_{sqij}</i> | 0.000 (0.000)*** |
| | <i>LogRER</i> | 0.023 (0.000)*** |
| | <i>COB</i> | 0.655 (0.472) |
| | <i>AC</i> | -1.182 (0.000)*** |
| | <i>MER</i> | 0.541 (0.000)*** |
| | <i>Dummy1989</i> | -1.257 (0.000)*** |
| | <i>Dummy1995</i> | -0.479 (0.000)*** |
| | <i>Dummy1999</i> | -0.765 (0.000)*** |
| | <i>Dummy2002</i> | -0.769 (0.000)*** |
| | <i>Dummy2008</i> | 0.440 (0.000)*** |
| | Cons | 33.699 (4.408)*** |
| | R-squared | 0.014 |
| | N | 2,250 |

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: elaboration of the author

The fifth and final set of regressions uses as dependent variable the data referring to exports in the commodities sector (Tables 2.1.5 and 2.1.11). The PPML estimation says that the prediction of the gravity equation holds only for the importing country's GDP, which is strongly positive and highly significant (0.859). For the first time, the Linder effect and the real exchange rate seem playing some role, even if *LogDifgdp* does not take on the expected sign (0.441). The impact of AC and MER are both positive, strong and highly significant (5.732 and 1.664). The OLS RE regression, on the other hand, seems not to confirm the positive impact of the regional organizations in the exchange of commodities, as in the case of the Tobit regression, but shows a positive coefficient for the difference in GDP per capita. The Tobit estimator, differently from the PPML, attributes a stronger impact in promoting trade

to the exporting country (0.792 with the highest level of significance). The results regarding the year dummies show different coefficients according to the estimators used but, apart from the Tobit regression, show the same pattern: values above the average of 2009 which decrease strongly in 2008. The following paragraph will be dedicated to the interpretation of the results obtained.

Table 2.1.5 – Commodities exports, PPML estimation, results

| | | |
|-----------------------|-------------------------------|----------------------|
| <i>X_{ij}</i> | <i>LogGDP_i</i> | -0.060 (0.000)*** |
| | <i>LogGDP_j</i> | 0.859 (0.000)*** |
| | <i>LogDist</i> | -0.318 (0.610) |
| | <i>LogDifgdp_{ij}</i> | 0.441 (0.000)*** |
| | <i>LogDifgdp_{sq}</i> | -0.000 (0.000)*** |
| | <i>LogRER</i> | 0.118 (0.000)*** |
| | <i>COB</i> | 1.215 (0.712)* |
| | <i>AC</i> | 1.907 (0.000)*** |
| | <i>MER</i> | 0.980 (0.000)*** |
| | <i>Dummy1989</i> | 0.778 (0.000)*** |
| | <i>Dummy1995</i> | 0.791 (0.000)*** |
| | <i>Dummy1999</i> | 0.591 (0.000)*** |
| | <i>Dummy2002</i> | 1.137 (0.000)*** |
| | <i>Dummy2008</i> | 0.699 (0.000)*** |
| | <i>_cons</i> | -2.055 |
| | R-squared | 0.021 (4.934) |
| | N | 2250 |

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: elaboration of the author

2.1.7 Robustness checks

As the most recent literature has shown that the PPML technique is the most suitable to estimate the gravity equation (Santos Silva and Tenreyro 2006), I focused on this technique to check for the good specification of the model. A Ramsey's reset test was run on the total exports data set in order to assess if the functional form has been well specified and for the presence of omitted variables.

As the reset test performed for the panel regression did not reject the null hypothesis of bad

specification, a set of cross-section regressions was run for each year of the sample, and a reset test was run for each regression. I did this because the South American context is quite complex and many events took place in the economic field during the period of interest.

Table 2.1.12 reports the coefficients of the main variables of interest of the gravity equation and the result of the reset test. The coefficients of $LogGDP_i$ and $LogGDP_j$ are always positive as expected, while $LogDist$ is negative. The model passes the test until 1997 (with the exceptions of 1992, 1994 and 1996) and in 2002 and 2008 again, while in the remaining years the value of the reset test cannot reject the null hypothesis of misspecification. The evolution of trade in the two regional blocks shows that after 1997 there was a slowdown, and then a decrease, in regional trade, which sharply increases again in 2002. Therefore, I could suppose that the test fails because of the breakdown in the positive trend. A deeper analysis of this result will be object of future research.

A Hausman test was run to test if the Random Effects regression satisfies the requirement of consistency. The RE regressions passes the test for each of the five datasets and therefore it is consistent: I will refer to this regression for the comments of the next section.

2.1.8 Interpretation of the results

The main research questions formulated at the beginning of this chapter: were whether and what impact did the main regional organizations for trade and economic integration have in the promotion of multilateral exchange.

The regressions performed show that the gravity equation is effective in explaining regional trade, at least for its principal variables. $LogGDP_i$ and $LogGDP_j$ are positive and significant (often at the highest level) in most cases and they show an elasticity close to 1 in many cases. In the regressions using the data about exports of commodities, PPML and OLS RE regressions show a stronger impact of the importing country rather than the exporting. This could be consistent with the explanation provided by Feenstra, Markusen and Rose (2001), who suggest the existence of a “reverse market effect” in the case of homogeneous goods. Commodities generally do not need a lot of processing and they are not differentiated; therefore, this could be evidence in favor of the effectiveness of the gravity equation also in the case of developing economies that rely more on inter-industrial rather than on intra-industrial trade. The only exception is represented by the crude materials sector: in this case both $LogGDP_i$ and $LogGDP_j$ have a negative sign in the PPML regression. This could be explained with the fact that the main source of exports for the poorest countries in the South American region (Bolivia and Paraguay, for instance) come from crude materials that do not need a lot of processing, therefore they are more labor and natural resource intensive rather than capital intensive.

The geographic distance is the other main variable of the model. *LogDist* always takes on the expected negative sign, even if the highest level of significance is not reached in all cases. The coefficients of *LogDist* can be considered together with the results of the variable *COB*, which is another proxy for trading costs. These results could be interpreted with the fact that the countries in the sample form part of the same region and the distance among each other is not so high in terms of kilometers: therefore the variable is not significant at the highest level in some regressions. Nevertheless, the coefficients show a reasonably high level of elasticity and this could be the result of the difficulties in transportation due to the geographical barriers existing in South America (the Andean mountains and the Amazon forest) and to the lack of infrastructures (highways and railways).

No strong evidence was found in favor of the Linder effect, even after introducing the variable *Difgdp* in its squared form to check for the right functional form. The coefficients taken on in the different regressions are very low but often significant: as the theory predicts a negative correlation between the difference in the level of per capita income and bilateral trade (Choi 2002), the results obtained could be explained by the fact that South American countries are not homogenous according to the level of economic development and of the structure of preferences. The coefficient is positive and significant (0.441) only in the Poisson regression regarding exports in the commodities sector: the sign, which is opposite from what suggested by theory, conveys that a bigger difference in income per capita promotes more trade in this sector. As we have seen, a bigger effect is associated to the importing country: therefore, a stronger demand for imports could come from the poorest countries in the region, which have to rely on agricultural goods to satisfy the basic needs of low income people.

As in the case of the Linder effect, no strong results were found for the real exchange rate. *LogRER* takes on low values in all regressions except in the case of the commodities sector, where in the PPML regression it shows a coefficient of 0.118 (significant at the 1% level). A higher competitiveness in this sector, where the prices of the goods are strictly reliant on the stock markets, seems to stimulate exports more intensively than in other fields. A deeper reasoning on this could be the object of further research.

The preferential trade agreements of Andean Community and MERCOSUR are puzzling. If we look at total exports, the AC takes on a positive coefficient (0.727) while MERCOSUR is negative (-0.101) in the PPML regression, where they are both highly significant. I explain this with the fact that the Andean countries are more similar with each other, both in terms of economic size and productive structure, while the heterogeneity among MERCOSUR countries could have played as an obstacle towards a deeper integration. The effect of AC and MERCOSUR is negative in the food and live animals sector and in the manufacturing sector, while it is strongly positive in the commodity sector (1.907 and 0.980 respectively). I suggest that this happens because the goods that these countries

produce and export most are in the agricultural and mining sector. Moreover, the political and economic contrasts of Argentina with the other members (mainly Brazil) contributed to slow down the integration process. A more detailed analysis of this dynamics will be provided in the remainder of the thesis.

Finally, the year dummies confirm the hypothesis formulated at the beginning. The macroeconomic events, for which we could control only by including these dummy variables, have played an important role in affecting the patterns of regional trade. The economic crises of Argentina in 1989 and 2002 had a negative impact, as well as the devaluation of Brazilian currency in 1999 and the global financial crisis in 2008, while the full enforcement of MERCOSUR in 1995 had a positive effect. The strong coefficients and the high levels of significance of this variable suggest the importance of Argentina and Brazil in determining the trends of regional trade. This is evidence in favor of what suggested by Krugman (1991) about the concentration of production centers, but it also sheds light on the negative effect that political issues between countries can have on economic relationships.

2.1.9 Conclusions and indications for further research

Starting from the previous empirical research by Carrillo and Li (2004) and Liu (2009), and from the methodology suggested by Santos Silva and Tenreyro (2006), this chapter showed that the gravity equation performs well in describing the phenomena of trade creation in the South American region. The Poisson Pseudo-Maximum Likelihood Estimator, compared to the OLS Fixed and Random Effects techniques and to the Tobit estimation technique, provides the results most significant and coherent with the theory. GDPs of the trading countries do have a positive and strong impact on bilateral trade, while distance is negatively correlated. No strong evidence of the Linder effect was found, possibly because South American countries are heterogeneous according to their level of economic development and their structure of preferences.

The second research question did not have a complete positive answer: the organizations for economic integration present in the region (the Andean Community and the MERCOSUR) have played an important role in promoting trade among its members, but not in all sectors. The AC has been unexpectedly more effective in promoting exports, especially in the sector of commodities, while MERCOSUR had a bigger impact in the sector of crude materials, while if considered overall its impact was even negative. A higher level of similarity, according to the economic size and the structure of production, among the Andean countries, can provide an explanation to these results.

The macroeconomic events occurred in the region were decisive to draw the economic cycles and the trade patterns of the countries in the region. After controlling for particular events – the full

enforcement of MERCOSUR, the economic crises in Argentina and Brazil – I showed that the impact of these two countries had an influence over the trend of the whole region.

Commercial and other economic disputes between these two main actors, mostly via the channel of the volatility in the exchange rate, are likely to affect trade integration in the region and the development of MERCOSUR towards the creation of a common market, modeled upon the experience of the European Union. I leave to further research the exploration of these dynamics and the effects they can have on the economic integration in the region, while in the next chapter I will focus on the determinants of Argentina's trading flows

Table 2.1.6 - Descriptive Statistics

| Variable | Obs. | Mean | Standard Deviation | Min | Max |
|---------------------------|-------------|-------------|---------------------------|------------|------------|
| <i>X_{ij}</i> | 2520 | 376.4518 | 1119.077 | .001 | 17605.62 |
| <i>LogX_{ij}</i> | 2520 | 3.993782 | 2.405427 | -6.907755 | 9.775973 |
| <i>LogGDP_i</i> | 2520 | 10.76201 | 1.433914 | 8.496537 | 13.66216 |
| <i>LogGDP_j</i> | 2520 | 10.77852 | 1.440542 | 8.462107 | 13.66216 |
| <i>LogDist</i> | 2520 | 7.747351 | .6482529 | 5.313206 | 8.550628 |
| <i>LogDijgdp</i> | 2520 | 7.550762 | 1.010149 | 2.079442 | 9.073489 |
| <i>LogRER</i> | 2520 | -.3378967 | 5.212262 | -15.26929 | 15.26929 |

Note: X_{ij} measured in U.S current million \$

Table 2.1.7 - Total exports estimations

| | <u>PPML</u> | <u>OLS Fixed Effects</u> | <u>OLS Random Effects</u> | <u>Tobit</u> |
|-----------------------------------------|-------------------|--------------------------|---------------------------|-------------------|
| <i>X_{ij}/LogX_{ij}</i> | | | | |
| <i>LogGDP_i</i> | 0.285 (0.000)*** | 0.483 (0.210)** | 0.616 (0.165)*** | 0.574 (0.047)*** |
| <i>LogGDP_j</i> | 0.212 (0.000) *** | 0.586 (0.177)*** | 0.647 (0.148)*** | 0.628 (0.045)*** |
| <i>LogDist</i> | -0.039 (0.216) | - | -0.545 (0.244)*** | -0.512 (0.245)** |
| <i>LogDifgdp_{ij}</i> | 0.033 (0.000)*** | -0.026 (0.045) | -0.017 (0.045) | -0.020 (0.029)* |
| <i>LogDifgdp_{sqij}</i> | -0.000 (0.000) | -0.000 (0.000) | -0.000 (0.000) | -0.000 (0.000) |
| <i>LogRER</i> | 0.016 (0.000)*** | 0.025 (0.023) | 0.022 (0.022) | 0.023 (0.007)*** |
| <i>COB</i> | 1.262 (0.276)*** | - | 1.097 (0.313)*** | 1.156 (0.319)*** |
| <i>AC</i> | 0.348 (0.000)*** | 0.969 (0.357)** | 0.628 (0.287)*** | 0.727 (0.150)*** |
| <i>MER</i> | -0.204 (0.000)*** | -0.291 (0.268) | -0.015 (0.258) | -0.101 (0.170) |
| <i>Dummy1989</i> | -2.318 (0.000)*** | -2.333 (0.290)*** | -2.183 (0.281)*** | -1.947 (0.178)*** |
| <i>Dummy1995</i> | -1.085 (0.000)*** | -1.204 (0.275)*** | -1.122 (0.273)*** | -1.148 (0.159)*** |
| <i>Dummy1999</i> | -1.189 (0.000)*** | -1.297 (0.244)*** | -1.235 (0.246)*** | -1.255 (0.157)*** |
| <i>Dummy2002</i> | -1.206 (0.000)*** | -1.322 (0.253)*** | -1.262 (0.255)*** | -1.281 (0.157)*** |
| <i>Dummy2008</i> | -0.034 (5.02)*** | 0.280 (0.227) | 0.316 (0.233) | -0.305 (0.152)** |
| <i>Dummy2011</i> | 0.074 (0.000)*** | 0.275 (0.134)** | 0.251 (0.132)* | 0.258 (0.149)* |
| cons | 7.115 (1.751)*** | -7.896 (6.957) | -9.162 (5.248)*** | -7.844 (2.441)*** |
| R-squared | 0.299 | 0.54 | 0.642 | 0.199 |
| N | 2,520 | 2,520 | 2,520 | 2,520 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; standard errors for OLS regressions obtained using the Cluster option. *logdist* and *cob* constant, omitted by OLS FE

Table 2.1.8 - Food and Live animals sector estimations

| | <u>PPML</u> | <u>OLS Fixed Effects</u> | <u>OLS Random Effects</u> | <u>Tobit</u> |
|-----------------------------------------|-------------------|--------------------------|---------------------------|-------------------|
| <i>X_{ij}/LogX_{ij}</i> | | | | |
| <i>LogGDP_i</i> | 0.969 (0.000)*** | -0.819 (2.876) | 0.537 (0.154)*** | 0.463 (0.137)*** |
| <i>LogGDP_j</i> | 0.179 (0.000)*** | -3.795 (1.172)*** | 0.319 (0.148)*** | 0.205 (0.127) |
| <i>LogDist</i> | -0.657 (0.340)* | - | -0.859 (0.380)** | -0.773 (0.374)** |
| <i>LogDijgdp_{ij}</i> | -0.111 (0.000)*** | 0.366 (0.554) | 0.056 (0.127) | 0.039 (0.069) |
| <i>LogDijgdp_{sqij}</i> | - | -5.04 (2.630)* | -0.000 (0.000) | -0.000 (0.000)* |
| <i>LogRER</i> | -0.017 (0.000)*** | -0.090 (0.071) | -0.028 (0.027) | -0.031 (0.019)** |
| <i>COB</i> | 0.780 (0.387)** | - | 1.156 (0.514)** | 1.344 (0.310)*** |
| <i>AC</i> | -0.435 (0.000)*** | -1.789 (1.483) | -0.611 (0.301)** | -0.715 (0.234)*** |
| <i>MER</i> | -0.038 (0.000)*** | -3.136 (0.939)*** | -0.100 (0.421) | -0.167 (0.207) |
| <i>Dummy1989</i> | -1.854 (0.000)*** | -8.332 (2.726)*** | -2.397 (0.348)*** | -2.563 (0.256)*** |
| <i>Dummy1995</i> | -0.440 (0.000) | -3.385 (1.587)*** | -0.821 (0.260)*** | -0.908 (0.194)*** |
| <i>Dummy1999</i> | -0.500 (0.000)*** | -2.554 (1.110)*** | -0.528 (0.214)** | -0.598 (0.184)*** |
| <i>Dummy2002</i> | -0.674 (0.000)*** | -2.885 (1.188)*** | -0.744 (0.210)*** | -0.815 (0.188)*** |
| <i>Dummy2008</i> | 0.162 (0.000)*** | 0.321 (0.396) | 0.134 (0.108) | 0.133 (0.163) |
| cons | 2.253 (2.743) | 137.091 (85.365) | 8.531 (5.893) | 12.669 (5.132)** |
| R-squared | 0.144 | 0.19 | 0.4185 | 0.091 |
| N | 2,250 | 2,250 | 2,250 | 2,250 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; standard errors for OLS regressions obtained using the Cluster option. *logdist* and *cob* constant, omitted by OLS FE

Table 2.1.9 - Manufactured goods estimations

| | <u>PPML</u> | <u>OLS Fixed Effects</u> | <u>OLS Random Effects</u> | <u>Tobit</u> |
|-----------------------------------------|-------------------|--------------------------|---------------------------|-------------------|
| <i>X_{ij}/LogX_{ij}</i> | | | | |
| <i>LogGDP_i</i> | 1.228 (0.000)*** | 0.839 (0.476)* | 0.665 (0.135)*** | 0.655 (0.141)*** |
| <i>LogGDP_j</i> | 0.175 (0.000)*** | 0.262 (0.306) | 0.815 (0.145)*** | 0.512 (0.137)*** |
| <i>LogDist</i> | - | - | -0.755 (0.289)*** | -0.593 (0.422) |
| <i>LogDifgdp_{ij}</i> | -0.093 (0.000)*** | -0.035 (0.087) | 0.002 (0.079) | -0.16 (0.051) |
| <i>LogDifgdp_{sqij}</i> | - | -0.000 (0.000) | -0.000 (0.000) | -0.000 (0.000)*** |
| <i>LogRER</i> | 0.028 (0.000)*** | 0.046 (0.021)** | 0.044 (0.020)** | 0.046 (0.011)*** |
| <i>COB</i> | - | - | 1.178 (0.471)** | 1.499 (0.573)*** |
| <i>AC</i> | -0.570 (0.000)*** | -0.819 (0.348)** | -0.507 (0.318) | -0.671 (0.191)*** |
| <i>MER</i> | -0.168 (0.000)*** | 0.582 (0.484) | 0.733 (0.434) | 0.701 (0.160)*** |
| <i>Dummy1989</i> | -1.078 (0.000)*** | -1.828 (0.464)*** | -1.052 (0.275)*** | -1.308 (0.220)*** |
| <i>Dummy1995</i> | -0.136 (0.000)*** | -0.481 (0.265)* | -0.098 (0.162) | -0.228 (0.158)*** |
| <i>Dummy1999</i> | -0.343 (0.000)*** | -0.681 (0.225)*** | -0.358 (0.132)*** | -0.467 (0.148)*** |
| <i>Dummy2002</i> | -0.457 (0.000)*** | -0.802 (0.219)*** | -0.491 (0.146)*** | -0.594 (0.149)*** |
| <i>Dummy2008</i> | 0.376 (0.000)*** | 0.435 (0.084)*** | 0.441 (0.082) *** | 0.439 (0.123)*** |
| cons | -8.252 (0.198)*** | 9.664 (14.403) | -8.061 (5.382) | -1.413 (5.395) |
| R-squared | 0.206 | 0.48 | 0.571 | 0.263 |
| N | 2,250 | 2,250 | 2,250 | 2,250 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; standard errors for OLS regressions obtained using the Cluster option. *logdist* and *cob* constant, omitted by OLS FE

Table 2.1.10 - Crude materials estimations

| | | <u>PPML</u> | <u>OLS Fixed Effects</u> | <u>OLS Random Effects</u> | <u>Tobit</u> |
|-----------------------------------------|---------------------------------|-------------------|--------------------------|---------------------------|------------------|
| <i>X_{ij}/LogX_{ij}</i> | <i>LogGDP_i</i> | -0.405 (0.000)*** | -0.168 (0.660) | 0.858 (0.181)*** | 0.792 (0.146)*** |
| | <i>LogGDP_j</i> | -0.237 (0.000)*** | -0.216 (0.242) | 0.308 (0.140)*** | 0.246 (0.131)* |
| | <i>LogDist</i> | 0.003 (0.557) | - | -0.682 (0.394)* | -0.600 (0.368) |
| | <i>LogDifgdp_{ij}</i> | 0.021 (0.000)*** | -0.084 (0.093) | -0.083 (0.095) | -0.086 (0.048)* |
| | <i>LogDifgdp_{sqij}</i> | 0.000 (0.000)*** | 0.000 (0.000) | 0.000 (0.000) | 0.000 (0.000) |
| | <i>LogRER</i> | 0.023 (0.000)*** | 0.036 (0.026) | 0.029 (0.021) | 0.031 (0.015)** |
| | <i>COB</i> | 0.655 (0.472) | - | 1.747 (0.537)*** | 1.881 (0.499)*** |
| | <i>AC</i> | -1.182 (0.000)*** | -0.175 (0.367) | -0.495 (0.271)* | -0.423 (0.250)* |
| | <i>MER</i> | 0.541 (0.000)*** | -0.112 (0.359) | 0.108 (0.338) | 0.070 (0.224) |
| | <i>Dummy1989</i> | -1.257 (0.000)*** | -1.146 (0.510)** | -0.026 (0.370) | -0.131 (0.269) |
| | <i>Dummy1995</i> | -0.479 (0.000)*** | -0.06 (0.401) | 0.721 (0.310)** | 0.653 (0.217)*** |
| | <i>Dummy1999</i> | -0.765 (0.000)*** | -0.291 (0.383) | 0.270 (0.313) | 0.217 (0.203) |
| | <i>Dummy2002</i> | -0.769 (0.000)*** | -0.465 (0.344) | 0.077 (0.295) | 0.026 (0.204) |
| | <i>Dummy2008</i> | -0.440 (0.000)*** | 0.446 (0.172) * | 0.442 (0.174)*** | 0.443 (0.185)* |
| | cons | 33.669 (4.408)*** | 25.441 (16.369) | -10.253 (0.565) | -7.591 (5.307) |
| | R-squared | 0.014 | 0.13 | 0.4355 | 0.091 |
| | N | 2,250 | 2,250 | 2,250 | 2,250 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; standard errors for OLS regressions obtained using the Cluster option. *logdist* and *cob* constant, omitted by OLS FE

Table 2.1.11 - Commodities estimations

| | <u>PPML</u> | <u>OLS Fixed Effects</u> | <u>OLS Random Effects</u> | <u>Tobit</u> |
|-----------------------------------------|-------------------|--------------------------|---------------------------|------------------|
| <i>X_{ij}/LogX_{ij}</i> | | | | |
| <i>LogGDP_i</i> | -0.060 (0.000)*** | -0.148 (1.511) | 0.167 (0.156) | 0.792 (0.146)*** |
| <i>LogGDP_j</i> | 0.859 (0.000)*** | 2.595 (1.222)** | 0.728 (0.150)*** | 0.246 (0.131)* |
| <i>LogDist</i> | -0.318 (0.599) | 0.000 (0.000) | -0.822 (0.344)** | -0.600 (0.368) |
| <i>LogDijgd_{pj}</i> | 0.441 (0.000)*** | 0.216 (0.339) | 0.259 (0.277) | -0.086 (0.048)* |
| <i>LogDijgd_{psqj}</i> | -0.000 (0.000)*** | -0.000 (0.000) | -0.000 (0.000) | 0.000 (0.000) |
| <i>LogRER</i> | 0.118 (0.000)** | -0.059 (0.049) | -0.064 (0.033)* | 0.031 (0.015)** |
| <i>COB</i> | 1.215 (0.712)*** | 0.000 (0.000) | 0.725 (0.478) | 1.881 (0.499)*** |
| <i>AC</i> | 1.907 (0.000)*** | -0.062 (0.444) | -0.423 (0.298) | -0.423 (0.250)* |
| <i>MER</i> | 0.980 (0.000)*** | -0.433 (0.776) | -0.496 (0.532) | 0.070 (0.224) |
| <i>Dummy1989</i> | 0.778 (0.000)*** | 2.378 (1.725) | 1.306 (0.558)** | -0.131 (0.277) |
| <i>Dummy1995</i> | 0.791 (0.000)*** | 1.818 (1.063)* | 1.281 (0.430)*** | 0.653 (0.217)*** |
| <i>Dummy1999</i> | 0.591 (0.000)*** | 1.529 (0.855)* | 1.242 (0.423)*** | 0.217 (0.203) |
| <i>Dummy2002</i> | 1.137 (0.000)*** | 1.583 (0.878)* | 1.271 (0.468)*** | 0.026 (0.204) |
| <i>Dummy2008</i> | 0.699 (0.000)*** | 0.354 (0.365) | 0.414 (0.365) | 0.443 (0.185)** |
| cons | -2.055 (4.934) | -45.871 | -0.983 (5.760) | -7.591 (5.307) |
| R-squared | 0.021 | 0.09 | 0.228 | 0.032 |
| N | 2,250 | 2,250 | 2,250 | 2,250 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; standard errors for OLS regressions obtained using the Cluster option. *logdist* and *cob* constant, omitted by OLS FE

Table 2.1.12 - Cross Section PPML regressions results and Ramsey-Reset tests

| Year | Reset test | <i>LogGDP_i</i> | <i>LogGDP_j</i> | <i>LogDist</i> | (prob> χ^2) |
|------|------------|---------------------------|---------------------------|----------------|-------------------|
| 1985 | | 0.6289 | 1.060 | -0.2326 | 0.5273 |
| 1986 | | 0.7518 | 1.0344 | -0.3317 | 0.6230 |
| 1987 | | 0.7456 | 0.8098 | -0.6663 | 0.5365 |
| 1988 | | 0.8981 | 0.8932 | -0.3490 | 0.8586 |
| 1989 | | 0.6673 | 0.6847 | -0.2020 | 0.6630 |
| 1990 | | 0.8621 | 0.6957 | -0.4218 | 0.9801 |
| 1991 | | 0.7537 | 0.6215 | -0.5875 | 0.9144 |
| 1992 | | 0.9299 | 0.6914 | -0.7509 | 0.1367 |
| 1993 | | 0.9419 | 0.6998 | -0.7792 | 0.8654 |
| 1994 | | 0.8851 | 0.7331 | -0.7928 | 0.4680 |
| 1995 | | 0.7850 | 0.7104 | -0.6568 | 0.6479 |
| 1996 | | 0.8636 | 0.8330 | -0.7427 | 0.2399 |
| 1997 | | 1.0270 | 0.9495 | -0.9522 | 0.5439 |
| 1998 | | 0.9531 | 0.8727 | -0.8258 | 0.0612 |
| 1999 | | 1.0201 | 0.9559 | -0.9121 | 0.0017 |
| 2000 | | 1.0825 | 1.0428 | -0.9656 | 0.0055 |
| 2001 | | 0.8486 | 0.7635 | -0.8448 | 0.0005 |
| 2002 | | 0.7542 | 0.7891 | -0.9763 | 0.8189 |
| 2003 | | 0.9003 | 0.9110 | -0.9633 | 0.2354 |
| 2004 | | 0.9630 | 0.8734 | -0.8866 | 0.1967 |
| 2005 | | 1.0387 | 0.9297 | -0.9592 | 0.1036 |
| 2006 | | 1.0330 | 0.9479 | -0.9242 | 0.1473 |
| 2007 | | 1.1099 | 0.9937 | -1.0651 | 0.1826 |
| 2008 | | 0.6944 | 0.4162 | -0.2804 | 0.8203 |
| 2009 | | 0.9745 | 0.8743 | -0.8566 | 0.0631 |
| 2010 | | 0.5214 | 0.4285 | -0.0209 | 0.0259 |
| 2011 | | 0.5582 | 0.4672 | 0.0004 | 0.0020 |
| 2012 | | 0.4337 | 0.4324 | 0.0831 | 0.0481 |

2.2 Argentina in the context of regional and global trade

2.2.1 Research questions and structure of the chapter

In the second chapter of this part I will focus on the external trade of Argentina, in order to see, at an empirical level, which are the determinants on the exports and imports of this country. I will run several regressions which will be different from each other according to the variables included in the models and the number of observations, both from the point of view of the periods covered and from the point of view of the individuals considered (i.e. the trading partners of Argentina). In particular, the main goal of this chapter is to assess which is the behavior of Argentine external trade across the last 25 years by taking into consideration some crucial variables of interest, which are:

- The variability of the real exchange rate, which has been the object of several empirical analyses but was never applied to research about this country;
- The level of tariffs, which still constitute a high barrier of trade for Argentina, although it has been member of MERCOSUR, the most advanced regional economic organization, for 20 years.

In order to do so, a basic gravity model will be used as in the first part of the chapter, augmented with the variables described in the above and other regressors which will be presented in the following paragraphs. The next section will be dedicated to establish a theoretical framework about the exchange rate variability in order to provide some tools which will be at the basis of the next empirical part.

2.2.2 The role of exchange rate variability in international trade

Micro foundations of the implications of exchange rate variability in international trade

To approach the problem of the variability in the exchange rate, which is a macroeconomic variable, it can be useful to start from a microeconomic foundation of this issue. In fact, it is interesting to recall that the fluctuations in the exchange rate involve an important component of risk. The risk theory says that an increase in risk will lead risk-averse individuals to reduce their efforts (in terms of consumption or production, for example) in their risky activity and to shift their choices to less risky 'assets'. Therefore, the utility function of the 'risk averse' economic subject will be concave because of her decreasing marginal utility. On the other hand, a 'risk loving' individual will prefer to hold more risky 'assets' and her utility function will be convex, presenting an increasing marginal utility. According to

De Grauwe (1988) this microeconomic theory can be applied to international trade: if we look at a domestic producer of a generic country X, the risk is in the price he obtains for selling in the foreign market. The source of risk is given by the exchange rate. As we can see from the profit function:

$$\tilde{\pi} = (\tilde{p}_f q_f - w x_f) + (p_d q_d - w x_d) \quad (1)$$

the tilde indicates that the variable is a random one: in fact the price of the products sold in the foreign market is given by: $\tilde{p}_f = p^* \bar{e}$, where \bar{e} is the exchange rate and p^* is the foreign currency price (De Grauwe 1988). Therefore, the component of risk and uncertainty is given by the exchange rate determined at the international level.

The reasoning at the basis is the following: if an increase in the variability of the exchange rate increases the expected marginal utility of income from exports, then this increased variability will lead to more export activity. If producers are sufficiently risk averse ($R > 1^{25}$), an increase in exchange rate risk raises the expected marginal utility of export revenue and therefore induces them to increase their export activity. On the other hand, if $R < 1$, that means that producers are risk loving and therefore their marginal utility is increased by a higher exchange rate risk. (The third possible case is when $R=1$ and therefore the producers are indifferent between exporting or not, since they are risk neutral).

Why should I take into consideration all the three cases, even if the most reasonable seems the first one? Because an increase in risk involves both a substitution and an income effect:

- The substitution effect takes place when an increase in risk is seen to lower the attractiveness of an activity and leads people to shift their decisions of production;
- The income effect goes in the opposite direction and if the drop in the expected total utility of export revenue can be offset by increasing resources in the export sector (De Grauwe, 1988).

This is the reason why the total result can be uncertain. Nevertheless, in the reality the individuals are more likely to be risk averse: therefore, the macroeconomic reasoning which will be explained in the next paragraph will be based on the micro assumptions that the utility function of the producers are concave and separable, in order to exclude that the income effect may offset the substitution effect.

²⁵ "R" stands for the "coefficient of relative risk aversion".

How to measure and compute exchange rate variability

There are several empirical works which try to assess the impact of exchange rate variability on international trade. In this paragraph I will provide a short literature review of the main empirical tests and findings.

De Grauwe (1988) tries to study the importance of exchange rate (ER) variability in explaining the slowdown of international trade since the breakup of the fixed-exchange rate international regime (occurred in 1971) and the shock in oil prices (1973). He applies a gravity model to estimate bilateral trade flows among the ten major industrial countries in two periods (1960-69 and 1973-84). He uses a gravity model where the ER variability is defined as the variability of the yearly percentage changes of the bilateral ER between the currency of country *i* and the currency of country *j* around the mean changes observed during the sub period *t* (De Grauwe 1988). Therefore, it is the standard deviation of the yearly growth rates of the ERs around their mean. He considers both the *nominal* and the *real* ER, but he gets to the conclusion that the latter is a better measure because it takes into account inflation differentials. De Grauwe found that this variability has a negative impact on bilateral trade and that it accounts for 20% the reduction of the total decline in the growth of international trade (De Grauwe 1988). It is a long-run ER variability and it is a likely source of protectionist pressure, thus explaining this negative effect on international trade. That is why the researcher concludes that the ER variability produces a sort of “political economy” effect through the induction of more protectionist measures.

Another study by Dell’Ariccia (1998) examines the impact of the ER variability in the context of the European Union. According to the researcher, the gravity model of international trade is particularly suitable to the EU countries since they are relatively homogeneous in terms of technology, factors endowments and per capita income (Dell’Ariccia 1998). His sample consists of 14 EU countries (the members of the Union at those times) more Switzerland and covers a period of 20 years from 1975 to 1994. The researcher underlines that the main problem is to define a variable that captures the element of instability in the ER appropriately (Dell’Ariccia 1998). Therefore, he uses three different types of measure in order to be able to compare them. In particular, they are:

- The standard deviation of the first differences of the logarithmic ER, which has the property of being zero in case of a rate following a constant trend and of giving a bigger weight to the most extreme observations;
- The average absolute difference between the previous period forward rate and the current spot, which advantage should be to pick up the presence of a lack of credibility in case of semi-flexible exchange rates;

- The percentage difference between the maximum and the minimum of the nominal spot rate over the t years preceding the observation, which stresses the importance of medium run uncertainty (Dell’Ariccia 1998).

The results of the regressions confirm the hypothesis of the presence of a negative impact of the ER variability on regional trade. The coefficients are similar for the three methods used to compute the variable and for each regression a small but significant evidence of a negative effect is found.

The two researches described in the above take into account developed countries: does the same hypothesis hold for developing countries? If such an hypothesis should be confirmed, then also a test for middle income countries (as in the case of this chapter regarding Argentina and Latin American countries) can be performed and possibly give interesting results. A work by Arize, Osang and Slottje (2000) tries to verify this relationship by studying the issue of ER variability for a group of 13 Least Developed Countries (LDCs). They address the problem starting again by the consideration that an increase in variability increases risk in trade because the ER is agreed on at the time of the trade contract, but payment is not made until the future delivery actually takes place (Arize, Osang and Slottje, 2000) .

Regarding the methodology used to compute the variability of the ER, they apply the “moving sample standard deviation” of the bilateral real ER, which can be expressed as follows:

$$J_{t+m} = \left[\frac{1}{m} \sum_{i=1}^m (R_{t+i-2} - R_{t+i-1})^2 \right]^{\frac{1}{2}} \quad (2)$$

Where R is the natural logarithm of the real effective ER and $m=7$ is the order of the moving average.²⁶ They use a cointegration analysis to establish whether there is a long-run equilibrium between exports and the ER variability. The results suggest the existence of a negative and statistically significant long-run relationship between export flows and exchange rate volatility in each of the 13 LDCs (Arize, Osang and Slottje 2000).

Another example of the use of the moving average methodology regards an empirical work on Brazilian exports within the context of MERCOSUR (Larson, Bittencourt and Thompson 2005). Their

²⁶ The order of the moving average is generally arbitrarily chosen and it determines the kind of information I want to include in my sample. For example, in this case, the order “7” chosen means that in the sample data about the exchange rate over the previous 7 years will be included . Therefore, the measure of variability that will be obtained offers a long-run perspective.

study attempts to capture the lack of macroeconomic coordination among MERCOSUR countries in order to show that this factor prevented the four members (Argentina, Brazil, Paraguay and Uruguay) from achieving a closer integration. They used the real bilateral ER as a proxy to measure the impact of this lack in coordination, computed as the moving average standard deviation of the log differences of the bilateral real ER (S_{ijt}) given by:

$$S_{ijt} = \left(\frac{\sum_{l=1}^k (x_{ij,t-l} - \bar{x}_{ij,t})^2}{k-1} \right)^{\frac{1}{2}} \quad (3)$$

Where $X_{ij,t}$ is the bilateral real ER, $x_{ij,t} = \ln(X_{ij,t})$ and $k=2,4,6,8,9$ years.²⁷ The sample used for these regressions include Brazilian trade with the other three members of MERCOSUR and cover a period from 1989 to 2002. The authors analyze first the impact of ER variability on total trade first and then by disaggregating the analysis for different sectors of goods (agriculture, chemicals, livestock, mining and oil, manufacturing). The main results of this empirical research reveal that Brazil's trade is negatively affected not only by its own ER movements but also by the variability observed in its trading partners. The results suggest that the disharmonized policies within MERCOSUR cause substantial price and exchange rate variability, thus increasing risk and creating a negative environment for bilateral trade due to the risk aversion of the economic agents (Larson, Bittencourt and Thompson 2005).

Has this problem been addressed with regard to the case of Argentina? Sedano (2005) explains that misalignments in the value of national currencies of states belonging to the same regional trade organization can have negative effects on the integration process. This appears to be the case of MERCOSUR, in particular regarding the currency policy of Argentina and Brazil. In fact, currency devaluation is one of the most commonly used economic policies by a country to gain competitiveness and increase its exports when it faces trade balance of payments deficits (see also part I). That is why the collapse of the *Real Plan*²⁸ in January 1999, which led to a devaluation of the Brazilian currency, caused a shock in MERCOSUR stability by producing a trade surplus of Brazil with respect to Argentina: a gap which the latter was not able to fill even after the collapse of its currency board regime in January 2002. It is interesting to stress the fact that, in the first period subsequent to the Brazilian

²⁷ In this case different orders of the moving average were taken into account in order to check for the robustness of the results.

²⁸ The Real Plan is the name of a monetary policy implemented by Brazil in 1994 in order to stop inflation and obtain macroeconomic stability. The Plan was different from the Argentine currency board in the sense that it did not peg the "real" (the name of the new Brazilian currency) to the US Dollar, but it imposed that each Real should be backed exactly by one US Dollar in the Central Bank's foreign currency reserves.

devaluation, its trade balance deficit decreased not because of a rise in exports towards Argentina but because of a fall in imports (Argentine goods had become much more expensive, since the peso was still pegged to the dollar). In the second period, subsequent to the failure of the currency board, the trade balance became positive in favor of Brazil, which could increase its exports even more (+87% in 2003, +62% in 2004), while Argentine exports did not increase despite the devaluation. The author describes this process as an example of “trade diversion”: Argentina started to import more from Brazil than from other partners, such as the United States or the European Union because the devaluation of the Argentine peso contributed to depress the national income which approached the Brazilian level. This particular version of the “Linder Effect” (see chapter 2.1) established trade diversion within MERCOSUR favoring only one country, Brazil, also because it was the first to devalue. That choice in economic policy gave Brazil a sort of “first mover advantage”, which started to change irreversibly the direction of trading flows between the two countries (Sedano, 2005).

The issue of the variability of the exchange rate, considered as a proxy for the lack of macroeconomic coordination among the most important members of MERCOSUR, will be the object of the next paragraph, where it will be considered together with the other determinants of the international trade of Argentina through a set of regressions which constitute the second empirical ‘piece’ of this chapter.

2.2.3 The external trade of Argentina: empirical research

This paragraph will be dedicated to the description and the analysis of the empirical work done on Argentina. An econometric application of the gravity model of international trade will be applied on the bilateral trade of Argentina with several commercial partners in order to answer some fundamental questions. The main goal of this work is to look at the traditional variables of the gravity model and to see how Argentina has performed in the context of MERCOSUR across time and also in the global context: in fact, one of the regressions that were run includes in the sample not only the members of MERCOSUR, but also the most important global economic actors (the United States, the European Union and China). To do so, a specific econometric technique will be used. As I showed in the first empirical part of this part, the Poisson Pseudo Maximum Likelihood (PPML) estimation technique has proved to be the most efficient and suitable for the gravity model. Therefore, this research would like to add as elements of innovation the fact that for the first time an empirical analysis about trading flows of Argentina is done and that a new methodology is applied: in fact, the previous applications of the gravity model on the Latin American region are less efficient than the PPML technique, as elaborated by Santos Sylva and Tenreyro (2006).

The economic context

A much more detailed presentation of the economic context of Argentina was already provided in part I: for the purposes of this part of the thesis, it will be useful to recall just a few information about the main macroeconomic issues and challenges that the South American country faced in the last two decades.

After a period of deep recession and inflation (for some periods hyperinflation), occurred in the second part of the '80s after the collapse of the military regime and the restoration of democracy (1983), the newly elected Government of Carlos Saúl Menem, in the person of the Ministry of Finance Domingo Cavallo, decided to adopt in 1991 a 'shock therapy' on the monetary side in order to obtain price stability: it pegged its currency, the Argentine *peso*, to the US dollar, thus establishing a currency board regime.²⁹ The measure, called "Convertibility Law", established a perfect convertibility of the peso with the US dollar on the basis of a 1:1 parity, and reached the objective of defeating inflation. Nevertheless, due to an appreciation of the dollar that started in 1995, the Argentine currency resulted in being overvalued: this factor led to a deterioration of Argentine competitiveness and to an appreciation of its real effective exchange rate (REER, weighted for the external trade of the country), which rose by over 75% (Zaza 2011). Therefore, despite a perfect nominal stability in the exchange rate, in real terms this situation led to a new disequilibrium.

Nevertheless, the "Convertibility Law", together with the application of the neo-liberal principles and prescriptions contained in the so-called "Washington Consensus" (Williamson 1990), which consisted basically of massive privatizations and in the opening of the country to external trade and Foreign Direct Investments (FDI), Argentina's economy started to grow again. Nevertheless, the economic system still presented many problems: the level of unemployment remained extremely high (in the order of 20%) and the country was vulnerable to external financial shocks, as was shown by the Mexican financial crisis of 1995, which spread out in the Latin American region producing the so-called 'tequila effect', a sort of contagion which induced financial investors to run away from Argentine assets. The economy recovered again but it entered a period of new recession in 1999: in this occasion the

²⁹ "A currency board regime is one where the domestic currency is backed (usually 50% or more) with foreign reserve currency, and where the currency board is obligated to convert domestic currency into foreign currency on demand at a fixed price. With the exception of Argentina and Hong Kong, currency boards have typically been implemented by small developing economies" (M. Goldstein, "Managed Floating Plus – Policy Analyses in International Economics, Institute for International Economics, 2002).

main reason was due to the exchange rate, which was kept artificially overvalued, harming the competitiveness of Argentine goods. As seen in the previous paragraph, the decision taken by Brazil in order to devalue its currency and to shift from a fixed band to a completely floating exchange rate was a bad strike for Argentine exports. Recession, combined with the dramatic rise in external public debt (from 35% over GDP in 1995 to 151% in 2002³⁰), made the situation worse and worse. The series of emergency financial packages negotiated with the International Monetary Fund (IMF), consisting in a total amount of 23,8 billion US\$ in the form of conditional loans, had just the effect of worsening the crisis and delaying the moment of the collapse. By the end of 2001 the Government of President De la Rúa imposed a limit on cash withdrawals (the *corralito*) in a desperate attempt to keep the currency board alive, since the fear of a devaluation drove millions of Argentine people to withdraw all their savings in US dollars in order to keep the value of their money high. The Government was forced at last to declare the default on its external debt and to abandon the hard peg regime, devaluating the peso and establishing a new floating currency regime by fixing the value of peso to around 1:3 against the US dollar. This second deep shock in the exchange rate policy caused a ‘trade diversion’ effect, as we saw in the previous paragraph, contributing to the further deterioration in the trade balance of Argentina with Brazil. Nevertheless, the devaluation of peso contributed to boost Argentine exports to other destinations in the world, together with the boom in the world price of such agricultural commodities as soy beans. This ‘revival’ of the ‘export-led growth model’ (strongly supported by the new peronist Governments of Néstor Kirchner and Cristina Fernández de Kirchner) boosted the Argentina’s economy, whose GDP started to increase again since 2003 at impressive rates: the GDP increased by 8,8% in 2003, 9% in 2004, 9,2% in 2005, 8,5% in 2006 and 8,7% in 2007, with a slowdown in 2008 and 2009³¹ due to the global financial crisis that had also the effect of decreasing the world prices of agricultural commodities. However, an already well-known problem showed up again: in the first decade of the 2000s the high rate of inflation, (which has remained at a double-digit level) has contributed to increase the variability of the real exchange rate.

Data set and estimation technique

The empirical research consists of three different regressions: in each of these the aim is to apply the gravity model of international trade to the specific case of Argentina, but different countries were

³⁰ Source: Zaza,2011.

³¹ Source: Ministerio de la Economía Argentina (MECON)

included in the regressions and different periods covered. According to the methodology, all the three regressions were performed using a panel-data estimation. The regression technique involves the application of the Poisson Pseudo-Maximum Likelihood estimator in the formulation designed by Santos Silva and Tenreyro, since in the previous chapter the comparison among the different econometric techniques (PPML, OLS and Tobit) has shown that the first one is more efficient than the others.

Before starting to explain in detail the models performed, I will quickly recall the results obtained in the first part of the work. That empirical part is going to be useful as it provides a framework of regional trade in the Latin American context, where Argentina is located and operates. The gravity model took in consideration, besides the traditional variables of interest (GDPs of the two countries and the distance) also the difference in the GDP per capita (known as the “Linder effect”) among the different pairs of the countries in the sample (90 pairs for 10 countries), the real exchange rate, and a couple of dummy variables in order to isolate the effect of the Andean Community (AC) and the MERCOSUR in promoting regional trade among its members. Finally, a set of yearly dummy variables was included in order to capture other macroeconomic events that could not be taken into consideration in the other variables present in the model. The main results obtained were:

- The ‘classical’ variables of the gravity model work as expected (the signs of the GDPs are positive while the distance is negatively correlated with external trade)
- The “Linder effect” doesn’t take on a negative sign, according to the main economic theory, but it can be explained. In fact, the sign should be negative in case of intra-industrial trade, between countries which have a similar production structure and, then, similar tastes. That is why the GDP per capita is a good variable to have a proxy for this mechanism. Nevertheless, in South America the economic structures of the different countries are quite heterogeneous, so it is possible to explain regional trade at an inter-industrial level
- Regarding the dummy variables, belonging to the Andean Community seems to have been a more important factor in promoting the increase of trade among its members, more than happened within MERCOSUR, which has a negative impact overall (this slightly changes in the regressions disaggregated for different sectors). There are two possible explanations: the excessive asymmetries in the economic size and structure of the members of MERCOSUR and their cyclical coming back to protectionist measures
- The yearly dummies are effective in capturing the macroeconomic cycles which took place in the period covered (1985-2012)

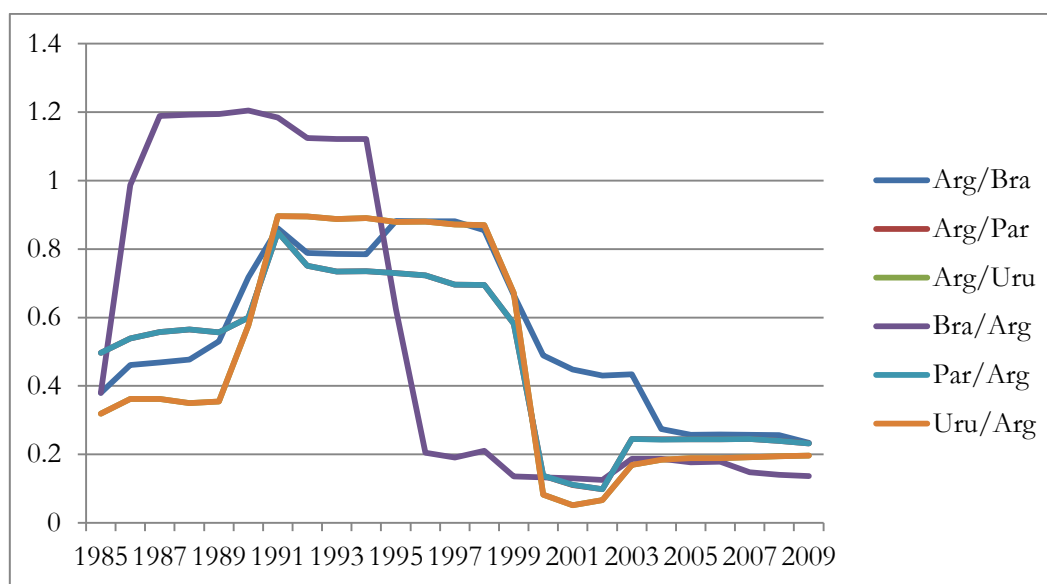
- The Reset test performed to verify the correctness of the functional form gave a negative response. Nevertheless, after repeating it for each year at a cross-sectional level, it gave a positive result at least for the first fifteen years in the sample: afterwards, the dramatic macroeconomic disequilibria provoked a change in the functional form.

The next three models are especially dedicated to analyze external trade of Argentina. The first one takes into account the trading flows of Argentina with the other members of MERCOSUR (Brazil, Paraguay and Uruguay) across a period of 25 years, from 1985 to 2009. It is important to say that, in this case and in the following, not all the pairs of countries will be included in the gravity model but only those ones where Argentina takes part. Moreover, the dependent variable is constituted by the total exports between the pair of countries considered, built up as the sum of the different goods classified in the databank of the United Nations Comtrade Statistics Division, according to the Standard International Trade Classification, revision 4. Therefore, the sample size consists of 6 pairs of countries x 25 years x 49 products, for a total of 7350 observations.³² The model is the following:

$$x_{ij} = \beta_1 \log GDP_{ij} + \beta_2 \log POP_{ij} + \beta_3 \log DIST_{ij} + \beta_4 \log RER_{ij} + \beta_5 VAR_{ij} \quad (4)$$

Where $\log GDP_{ij}$ is the log of the products of the gross domestic products of the two countries at time t, $\log POP_{ij}$ is the log of the products of the gross domestic products of the two countries at time t, $\log DIST_{ij}$ is the log of the distance between the two countries (measured with the method of the great circle distance and between the two main economic centers), $\log RER_{ij}$ is the log of the real exchange rate between the two countries at time t and VAR_{ij} is the variability in the real ER between the two countries at time t. The last one is the most important variable of the model and it was created using the “moving average standard deviation” (MASD) method described in the previous paragraph: it was computed on an yearly basis with a lag of ten years, therefore including data from 1975.

³² Unfortunately, it was not possible to have a more updated time series since data of disaggregated exports were available only until 2009.

Figure 2.2.1 – Real exchange rate variability in the MERCOSUR area, 1985-2009

Note: the variability was computed through the MASD methodology.

Source: elaboration of the author on IMF Data Bank

As it can be seen, the variability was higher in the first fifteen years considered. This can be explained with the high inflation typical in Argentina during the '80s and, even if at a lower extent, with the appreciation of the US dollar which kept a certain level of currency instability through an overvaluation of the Argentine peso.

The second model considers again the context of MERCOSUR, but it applies a different methodology to compute the ER variability. In fact, the MASD measure presents two main drawbacks:

- It was computed using yearly data of the real ER, but it is clear that changes in the RER are often determined by changes that take place in a much shorter period (months, weeks, even days)
- The lag is arbitrarily chosen but it can give too much 'noise' in the measure of variability if it is too close to the moment when the time series starts, or, on the other side, be not precise enough if it is too far.

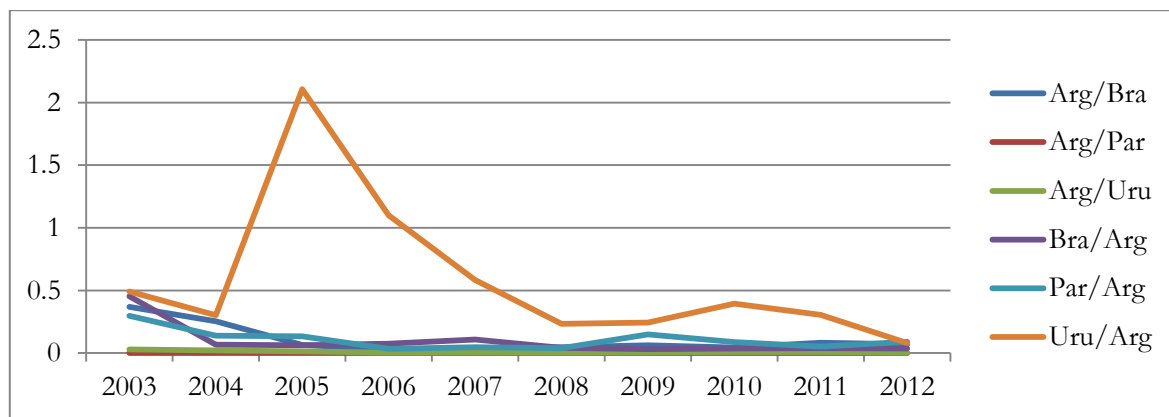
Therefore, a better measure should be found in order to capture and isolate properly the effect of the ER variability. Monthly data of the nominal ER and of the inflation rate were collected (again from the IMF Data Bank), and the variability of the RER was obtained by computing the standard error on a yearly basis, plus a lag of three months. This method should offer a more precise measurement and the use of a more 'reliable' lag (the RER in month 'x' is more likely to depend on the RER of a few months

before, instead of some years before). In this case the time series is shorter and covers a period from 2003 to 2009 (total size of the sample is of 2058 observations) in order to isolate the examination of the external trade of Argentina across the last decade, after the last economic crisis. Moreover, another variable was introduced in the model, as we can see from the equation below:

$$x_{ij} = \beta_1 \log GDP_{ij} + \beta_2 \log POP_{ij} + \beta_3 \log Difgdp_{ij} + \beta_4 VAR_{ij} + \beta_5 \log TARIFF_{ij} \quad (5)$$

The impact of tariff was considered important and a negative impact is expected on exports. In fact, during the last years a series of new protectionist measures was taken by the members of MERCOSUR and it was a factor that prevented these countries from achieving a deeper integration.

Figure 2.2.2 – Real exchange rate variability in the MERCOSUR area, 2003-2012



Source: elaboration of the author on IMF Data Bank using the SE methodology

As it is possible to see from the graph above, the main source of variability in the last decade was represented by the exchange rate of Argentina with Uruguay. A possible explanation of this can be seen at first in the effects of the devaluation of peso, and in the high inflation rate suffered by Argentina during these years. Nevertheless, with respect to the other countries variability seems it was much lower, as an evidence of a tangible improvement of the macroeconomic stability in the region. Therefore, the question whether RER variability has been an obstacle in the regional integration process is going to be asked.

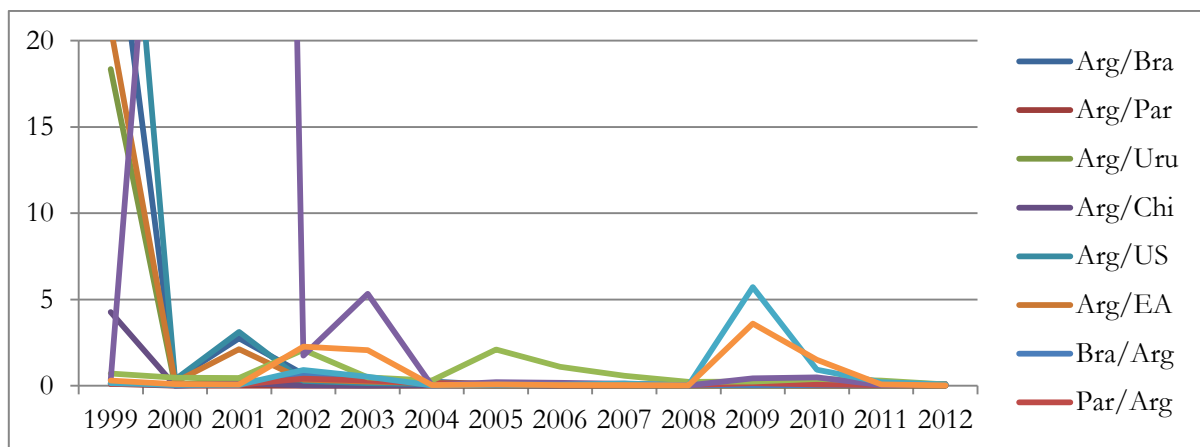
What about trade of Argentina with the rest of the world? In order to test also for this case the dataset has been expanded with the observations of trading flows with the United States, the Euro Area and China. In this case, the length of the time series was an obliged choice because the Euro, currency of the Eurozone, was officially enforced since January 1999: therefore this panel regression covers a

period from 1999 to 2009 and the sample size consists in $12 \times 11 \times 49 = 6468$ observations. The model is the following:

$$\begin{aligned}
 x_{ij} = & \beta_1 \log GDP_{ij} + \beta_2 \log POP_{ij} + \beta_3 \log DIST_{ij} + \beta_4 VAR_{ij} + \beta_5 dummy1999 \\
 & + \beta_6 dummy2000 + \beta_7 dummy2001 + \beta_8 dummy2002 \\
 & + \beta_9 dummy2003 + \beta_{10} dummy2004 + \beta_{11} dummy2005 \\
 & + \beta_{12} dummy2006 + \beta_{13} dummy2007 + \beta_{14} dummy2008 \\
 & + \beta_{15} dummy2009 \quad (6)
 \end{aligned}$$

In this case the variable “tariffs” could not be included since in the data base of the UN Comtrade Statistics Division data about all the pairs of countries were not available (for example, a single tariff towards European countries is not applied). Moreover, as the time series is reasonably long, the yearly dummy variables were included again in the model. Regarding the ER variability, the same method as in the previous regression was applied. This is the trend of the variability in the period covered for the pair of countries considered:

Figure 2.2.3 - Real Exchange Rate Variability, MERCOSUR + United States, Euro Area, China, 1999-2012



Source: elaboration of the author on IMF Data Bank using the SE methodology

The next paragraph will be dedicated to the analysis of the results obtained.

Results and interpretations

All the results are listed in the tables presented at the end of this chapter. Regarding the first regression (Table 2.2.1), which considers Argentina and the other MERCOSUR countries from 1985 to 2009, the main variables of the gravity model are significant and take on the expected value, are strongly significant (at the 1% level) and have a relevant impact on trade: GDP and population are positively

correlated with exports (with an elasticity respectively close and superior to 1) while distance has a negative effect (with an elasticity of -0,1, which is quite obvious since the distance is relatively small and, as a consequence, also the transportation costs). The real interest rate is slightly negative correlated and significant, while the variability of real ER takes on the expected sign (negative) but it does not reach a sufficient level of significance. The Reset test, performed to check for the correctness of the functional form, it is passed and gives a positive response.

The second regression (Table 2.2.2) covers a shorter time series (2003-2009) and the same group of countries (MERCOSUR area) but with a different methodology to compute the variability of the real ER. In this case, there are not relevant differences regarding the classical variables of interest (the elasticity effect on population is still more than proportionate), but the variability of RER now turns to be strongly significant but with a negligible effect on regional trade of Argentina. The variable *logTARIFF* is negative, as expected, strongly significant and with a reasonably large coefficient (-0.376). The Reset test in this case does not give a completely positive response, but the level observed is not much below the critical value of the χ^2 distribution.

The third and last regression (Table 2.2.3) covers the period 1999-2009 and includes a bigger number of countries which are trading partners of Argentina (MERCOSUR + United States, Euro Area and China). Population is positively and strongly correlated to external trade and distance takes on a negative and significant value (-1.356, much more than a proportionate effect in terms of elasticity); nevertheless, GDP this time is negatively and significantly correlated with exports, which is not quite straightforward to explain. Again, variability of the real ER is not significant and takes on a negligible impact, while the yearly dummy variables are significant at the maximum level and suggest to follow the correct path of the macroeconomic cycles. The Reset test is not passed, but again the value observed is quite close to the critical value of the distribution.

Therefore, the Gravity Model seems to perform well and to explain, at least in its main variables (GDP, population and distance), the external trade of Argentina. Moreover, the PPML estimator gives good responses, also in terms of the functional form and it appears to be an efficient estimator. The examination on the issue of variability of ER gives back as an answer the fact that the variability was not a decisive factor in preventing Argentina from trading more with its economic partners. The application of a more precise and reliable methodology, used in the second and third regression, suggests that this variable is not fundamental in explaining the partial failure of MERCOSUR. Other factors should be taken into account other elements that increased the volatility and uncertainty of the economic environment, such as the macroeconomic asymmetries among Argentina and the other three members in terms of size and productive structure and the commercial disputes which led to a revival

in protectionist measures. These measures regarded both tariff (as seen by the strong negative impact of the latter on regional trade) and non-tariff barriers, whose effect is more difficult to capture with an econometric variable.

2.2.4 Conclusions and implications for further research

This empirical part focused on Argentina and it tried to describe the behavior of the country in the field of external trade, with particular regard to its regional dimension as a member of MERCOSUR. The application of the Poisson Pseudo-Maximum Likelihood regression technique for the estimation of the Gravity Model showed its efficiency, due to the significance of the coefficients and the general correct specification of the functional forms of the models that were run. The issue of the variability of the real exchange rate does not seem to be a major constraint to Argentina's external trade, as it was shown by the methodology chosen in the two last regressions (standard error on yearly basis with a lag of three months). Nevertheless, some problems are pending and questions remain open. The low goodness of fit of the regressions suggests that there is much more to explain the external trade of Argentina with. Two channels are the macro and microeconomic asymmetries present among the members of MERCOSUR, and the revival of protectionist measures within the organization. According to this external economic environment, which role can Argentina play as a regional and global player? I will discuss and explore these questions in the next part.

Table 2.2.1 - Estimation of Argentina's trade with MERCOSUR countries, 1985-2009, PPML regression

| | X_{ij} |
|------------------|-----------------------|
| $\log GDP_{ij}$ | 0.930 (0.052)*** |
| $\log POP_{ij}$ | 1.494 (0.035)*** |
| $\log DIST_{ij}$ | -0.128 (0.042)*** |
| $\log RER_{ij}$ | -0.041 (0.011)*** |
| VAR_{ij} | -0.155 (0.120) |
| $_cons$ | -46.282 (3.586)*** |
| R^2 | 0.15 |
| N | 7,350 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; VAR_{ij} computed with the MASD methodology

Table 2.2.2 - Estimation of Argentina's trade with MERCOSUR countries. 2003-2009, PPML regression

| | X_{ij} |
|--------------------|----------------------|
| $\log GDP_{ij}$ | 0.434 (0.000)*** |
| $\log POP_{ij}$ | -0.776 (0.000)*** |
| $\log TARIFF_{ij}$ | -0.326 (0.000)*** |
| $\log Difgdp_{ij}$ | -0.008 (0.000)*** |
| VAR_{ij} | 0.004 (0.000)*** |
| $_cons$ | 25.239 (0.228)*** |
| R^2 | 0.07 |
| N | 2,058 |

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; VAR_{ij} computed with the SE methodology

Table 2.2.3 - Estimation of Argentina's trade with MERCOSUR countries + United States, Euro Area and China, 1999-2009, PPML estimation

| | X_{ij} |
|------------------|----------------------|
| $\log GDP_{ij}$ | -0.744 (0.020)*** |
| $\log POP_{ij}$ | 0.710 (0.048)*** |
| $\log DIST_{ij}$ | -1.356 (0.080)*** |
| VAR_{ij} | -0.000 (0.000) |
| $dummy_{1999}$ | -1.131 (0.216)*** |
| $dummy_{2000}$ | -0.952 (0.234)*** |
| $dummy_{2001}$ | -1.158 (0.217)*** |
| $dummy_{2002}$ | -2.293 (0.245)*** |
| $dummy_{2003}$ | -1.906 (0.238)*** |
| $dummy_{2004}$ | -1.536 (0.214)*** |
| $dummy_{2005}$ | -1.185 (0.207)*** |
| $dummy_{2006}$ | -0.755 (0.210)*** |
| $dummy_{2007}$ | -0.246 (0.211) |
| $dummy_{2008}$ | 0.293 (0.212) |
| $_cons$ | 40.006 (1.908)*** |
| R^2 | 0.19 |
| N | 6,468 |

* $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Notes: standard errors in parenthesis; * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$; VAR_{ij} computed with the SE methodology

Table 2.2.4 - Ramsey's RESET test performed for regressions on Argentina's trade

- Argentina + MERCOSUR, 1985-2009:

$$\begin{aligned} \text{chi2(1)} &= 0.00 \\ \text{Prob} > \text{chi2} &= 0.9628 \end{aligned}$$

- Argentina + MERCOSUR, 2003-2009:

$$\begin{aligned} \text{chi2(1)} &= 1.50 \\ \text{Prob} > \text{chi2} &= 0.2203 \end{aligned}$$

- Argentina + MERCOSUR, US, EA and China:

$$\begin{aligned} \text{chi2(1)} &= 1.47 \\ \text{Prob} > \text{chi2} &= 0.2258 \end{aligned}$$

PART III – A VIEW FROM THE OUTSIDE:
ARGENTINA IN THE GLOBAL CONTEXT

3.1 Argentina and the IMF: a problematic relationship

3.1.1 Structure of the chapter

This chapter will investigate the relationship between Argentina and the International Monetary Fund (IMF). Buenos Aires has had a problematic and swinging relationship with the IMF since the establishment of the organization. As I will show, the ambivalent ties of Argentina with the IMF are deeply rooted in the volatility of the economic policies adopted over the course of the second half of the 20th century, which were the result of a highly uncertain political scenario. That is why the “routine of dependency” (Kedar 2013) that took place between Argentina and the Fund ended up with deteriorating the macroeconomic situation of the country and making the debt crisis unsustainable, leading to the default on the external debt at the end of 2001. The tense relations that followed afterwards was characterized by the repayment of Argentina’s entire debt to the IMF in 2005 and culminated with the declaration of censure by the Fund’s Executive Board against Argentina for not providing reliable statistical data on its Consumer Price Index and GDP.³³ The progressive self-isolation of Argentina from the IMF, I argue, is the long-run result of mistakes made by both sides. On one hand, the inability to move on a coherent path towards economic growth and the frequent deployment of populism and economic nationalism by several Argentine governments (last but not least the recent experience with Néstor and Cristina Kirchner) progressively diverted the country from collaboration with the Fund. On the other hand, wrong policies and wrong timing of the loans granted by the IMF to Argentina made the economic situation even worse in some circumstances. The final outcome of this complicated relationship contributes to pose at risk the role of Argentina within global economic relations as a potential “pariah” (Brandt and Erixon 2013).

Therefore, the aim of this chapter is to show how the current behavior of Argentine policy makers towards the IMF, which can be considered irrational in view of the framework of International Political Economy developed at the end of this part (see chapter 3.4), is also the result of a long-run troubled relationship. The remainder is organized as follows: after a section recalling the history of the relationship between Argentina and the IMF, the chapter will focus on the current problems providing an analysis of the country’s behavior within the international macroeconomic context.

³³ The Statement of the Executive Board can be accessed at <http://www.imf.org/external/np/sec/pr/2013/pr1333.htm>

3.1.2 History: from triumph... to tragedy

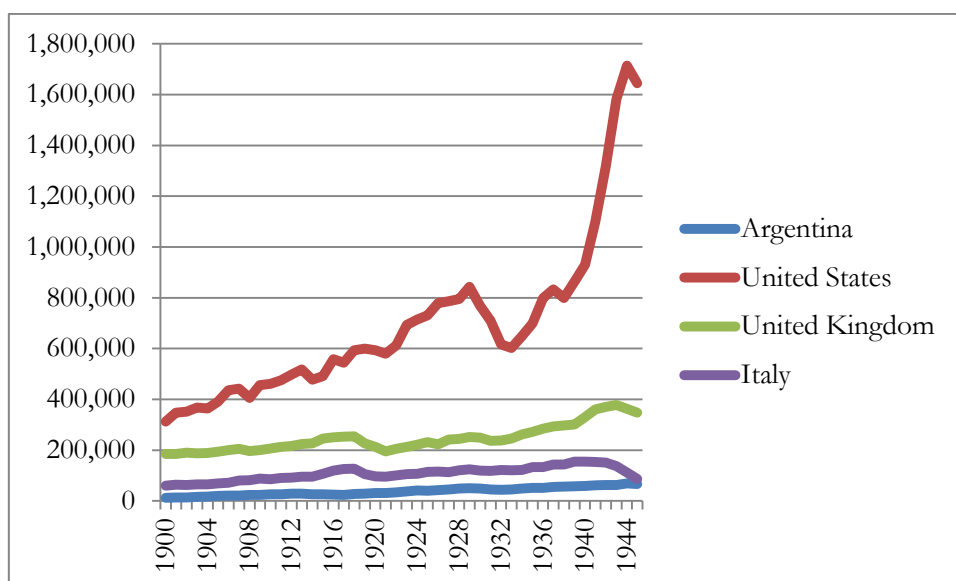
The Bretton Woods system and the inclusion of peripheral countries

World War II was such a dramatic event that not only produced a horrible cost in terms of human lives, but also changed drastically and irreversibly the distribution of political, military and economic power at the global level. Although the United States had been the first economy in the world in terms of real GDP already well before 1900 (Figure 3.1.1), the United Kingdom still retained the role of unique ‘super-power’ thanks to its colonial empire. The main center of global trade and financial transactions, London was keeping on enjoying its position of supremacy because the pound sterling was the reference currency as a means of payment and storage (Cassis 2009). On the other hand, the United States were pursuing a strategy of domestic growth and development and showing a low level of commitment in international economic affairs, apart from the interest in the hemispheric relationship with Latin American countries (Bulmer Thomas 2003).

Nevertheless, a slow process of redistribution of economic power was taking place and it was dramatically accelerated by the outburst of the world conflict. The economies of the European nations suffered from severe losses and were definitively overcome by the two new global super-powers: the US and the Union of Soviet Socialist Republics (USSR).

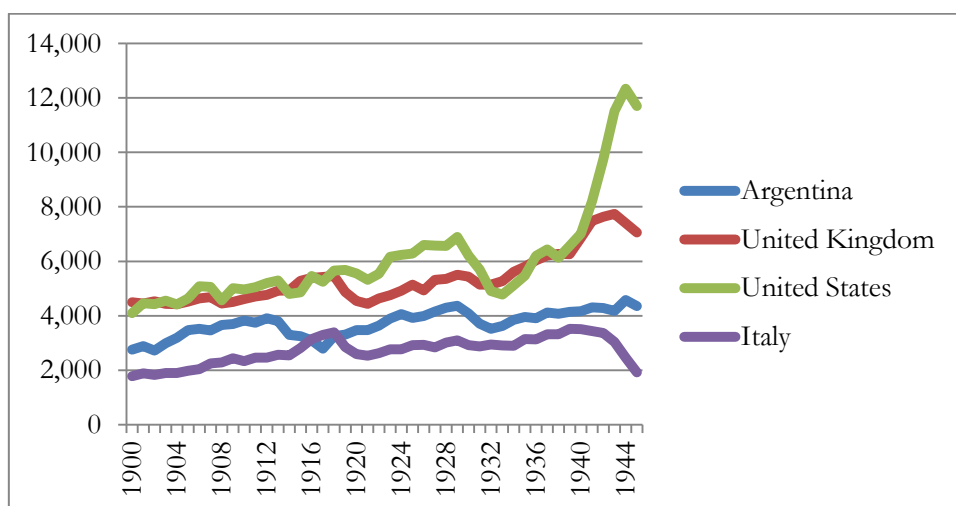
How was Argentina’s economy positioned during this period? Already a major exporter of agricultural commodities, the South American country had developed strong ties with the UK, being one of its biggest trading partners and providers of meat and other food products (Bulmer Thomas 2003). Therefore, although from a peripheral position not only in geographic terms but also proportional to its economic power and influence, Argentina became one of the richest countries in the world: if we look at its GDP per capita, it had been ranking well above Italy (used here as a term of comparison because of the similar demographic structure between the two countries) until the end of World War II and even for some years after (Figure 3.1.2). Partially immune by the economic consequences of the war (the heavy crisis produced by the conflict in Europe reduced the demand for domestic products), Argentina went out of the war as one of the most promising economies in the world. Then, what went wrong?

Figure 3.1.1 – Argentina vs. other countries, GDP (million 1990 international Geary-Khamis dollars, 1900-1945)



Source: Maddison tables

Figure 3.1.2 – Argentina vs. other countries, GDP per capita (million 1990 international Geary-Khamis dollars, 1900-1945)



Source: Maddison tables

The war was still going on in Europe and in the Pacific, but the future winners were already planning how to establish *ex novo* a new global monetary and financial system. Representatives of 45 countries gathered in Bretton Woods, a small village in New Hampshire (US), for a conference aimed at establishing two new organizations linked to each other: the International Monetary Fund and the

International Bank for Reconstruction and Development, better known as the World Bank (WB). How these two organizations should function, it was decided after a debate between two contrasting visions, embodied by the US and the UK, and in particular by the Deputy Treasury Harry Dexter White and the British economist John Maynard Keynes. The two men had had the task to draft alternative plans for the functioning of the organizations: aim of the conference was to analyze and discuss the two plans and find a combination of them (Kedar 2013). According to Keynes, the new institutions should have promoted international trade and act as a coordinating body among central banks. He also advocated the creation of a single currency, the so-called *Bancor*, which would have played the role of a universal means of payment. Harry Dexter White's project went even further and intended the two institutions not only as a means of macroeconomic and financial stabilization, but also as a vehicle for reconstruction after the war. This is why the World Bank became the institution specialized in the concession of grants and loans for the implementation of project enhancing economic and social development in poor countries, while the IMF retained the role of financial supervisor. In other words, they ended up with being the "stick" (the IMF) and the "carrot" of the new economic order (Kedar 2013).

At the meeting called for 1 July 1944, in addition to the US, the Soviet Union, the UK, Canada, China and European governments in exile, also allied countries in the Middle East, Africa and Asia were invited to attend. All Latin American countries took part, except for one: Argentina. Why was it left out of the initial membership of the Bretton Woods institutions? The main reason is provided by the tense relationships originated with the US during the war. Argentina was in fact the only Latin American country that decided to remain neutral almost until the end of the conflict (it would decide to declare war against Germany and Japan only in April 1945, one year after the Bretton Woods conference). Since European countries represented the most important market for Argentine exports, the institutions were worried that taking a position (no matter whether with or against Germany) would have harmed its external trade-oriented economy. Nevertheless, Argentina was unable to avoid suffering from negative consequences: on one hand the fall of demand from the European continent, devastated by the war, on the other hand the retaliation from the US for not joining the Allies and consisting of the stop in shipping weapons, heavy machinery and oil-drilling and the provision of credit and financial instruments (Kedar 2013), seriously damaged Argentina's economic performance.

The initial exclusion of Argentina from the membership of the IMF and the World Bank is a first example of the theory underlying this research. The definition of the new economic order, imposed by the US that surged on the global stage as the new hegemon, was based on the promotion of the US

dollar as the reference currency and the economic expansion of the ‘West’ fostering trade and foreign investment and establishing a system of fixed exchange rates in order to reduce uncertainty and facilitate economic transactions (Arceo 2011). A clear distinction between ‘center’ and periphery’ was established, with the former represented by the US and the former by developing countries which decided to adhere to the economic model proposed by Washington within this new liberal order. This mechanism of asymmetrical dependency was made explicit by the establishment of the ‘cornerstone’ of the IMF system: the so-called “Stand-By Arrangements” (SBAs). Created in 1952, they are the most important instrument to help countries in crisis solve their balance of payments problems. SBAs have a duration which can vary between 12 and 24 months and allow applicant countries to borrow an amount up to 200% of their quotas³⁴ for any 12-month period and to have cumulative access over the life of the program up to 600%. When the SBA is ongoing, the country has to comply a series of conditions which include quantitative criteria (mainly consisting in macroeconomic adjustment), structural reforms, regular reviews conducted by the IMF officials (IMF 2013a). The IMF was also based on the so-called “par-value system”, which consisted in an agreement signed by the member States to keep their currencies pegged to the US dollar, which was pegged to the gold itself.³⁵ Moreover, the Fund’s resources were decided to amount to 8.8 billion US\$, for which every member had to contribute in proportion to its economic size and power. Table 3.1.1 shows how the resources were allocated among the countries which adhered from the very beginning.

Table 3.1 .1 – IMF, Original distribution of Quotas (million US\$)

| Country | Quota |
|------------|-------|
| Australia | 200 |
| Belgium | 225 |
| Bolivia | 10 |
| Brazil | 150 |
| Canada | 300 |
| Chile | 50 |
| China | 550 |
| Colombia | 50 |
| Costa Rica | 5 |
| Cuba | 50 |

³⁴ Before the system was reviewed in 2009, member States were allowed to borrow up to 100% their quotas.

³⁵ Member countries were allowed to change their par value by 10% under the approval by the IMF that had to assess the existence of a “fundamental disequilibrium”.

| | |
|-------------------------|-------|
| Czechoslovakia | 125 |
| Denmark | n.a. |
| Dominican Republic | 5 |
| Ecuador | 5 |
| Egypt | 45 |
| El Salvador | 2.5 |
| Ethiopia | 6 |
| France | 450 |
| Greece | 40 |
| Guatemala | 5 |
| Haiti | 5 |
| Honduras | 2.5 |
| Iceland | 1 |
| India | 400 |
| Iran | 25 |
| Iraq | 8 |
| Liberia | 0.5 |
| Luxembourg | 10 |
| Mexico | 90 |
| The Netherlands | 275 |
| New Zealand | 50 |
| Nicaragua | 2 |
| Norway | 50 |
| Panama | 0.5 |
| Paraguay | 2 |
| Peru | 25 |
| Philippine Commonwealth | 15 |
| Poland | 125 |
| Union of South Africa | 100 |
| USSR | 1,200 |
| United Kingdom | 1,300 |
| United States | 2,750 |
| Uruguay | 15 |
| Venezuela | 15 |
| Yugoslavia | 60 |

Source: Kedar 2013

The accession of Argentina into the IMF and the evolution of the relationship

I argue that the initial delay of Argentina's admission within the IMF is the starting point of the relative isolation of the country inside global economy and imposed a negative 'bias' on the relationship of

Buenos Aires with multilateral institutions that has never faded away. Argentina joined the IMF and the World Bank twelve years after their creation, on 20 September 1956. Before it was admitted, the South American country was involved in long-lasting negotiation rounds with the Fund officials, which culminated with the final vote of the member countries that allowed Argentina in and with the official payment by Buenos Aires of a US\$ 150 million quota to each institution (IMF 2013).

Argentina was ruled in that period by General Juan Domingo Perón. Recalling the features of the so-called 'Peronism' is not the purpose of this chapter (see part I), but it is important to bear in mind the nationalist and populist approach lying at the basis of this regime, since this is very similar to today's attitude shown by the 'Kirchnerism'. After World War II in Argentina, but also in other countries of the region, the mainstream economic policy was based on "inward-looking" strategies, mainly relying on manufacturing and on the fostering of domestic industrialization as the key to develop the economy and to achieve sustained growth (Bulmer Thomas 2003). In order to do so, tariff and non-tariff barriers on trade were imposed and systems of multiple exchange rates were implemented to discourage imports of manufacturing products.

These policies were clearly against the prescriptions of the IMF, which advocated further openings of international trade and a system of fixed exchange rates. On the other hand, it must also be recognized that such policies, although targeting in the opposite direction to the indications of the Fund, forced Latin American countries to apply for SBAs with the IMF. Inward-looking models produced severe distortions in the current account balance of the countries implementing them: as they were designed to foster industrialization, they were bound to create a wedge between domestic and international prices damaging, in the case of Argentina and Uruguay, agriculture and exports (Bulmer Thomas 2003).

Therefore, in a sense it is possible to say that these economic policies were functional to the maintaining of a relationship of dependency between Latin American countries and the Fund, and Argentina provides a clear example. The need for financial assistance through the application to a SBA involved, as explained in the previous paragraph, the fulfillment of specific conditions and led to the establishment of a permanent network between Washington and Buenos Aires: IMF representatives were sent permanently to Argentina (as well as in other countries under SBAs programs) in order to provide technical assistance and to constantly monitor and report the evolution of the economic situation of the country to the headquarters in the US. This led to the creation of what Claudia Kedar calls the "routine of dependency" (2013): something that goes beyond the simple size of the loans and the debts accumulated by the borrowing states, but that consisted in a daily relationship between

Argentina and the Fund which was primarily functional and beneficial to the survival of the structure of global economic power and of the epistemic community of IMF and Central Bank's officials, more than to the economic stabilization and growth of Argentina in itself. This "routine of dependency" would last for almost 50 years before being suddenly broken by Néstor Kirchner in 2005.

Argentina and the IMF: a sequence of SBAs doomed to fail

Arturo Frondizi, who came to power after winning the elections in 1958, was the first President of Argentina applying for a SBA. A member of the *Unión Cívica Radical* (Civic Radical Union), the second main party in Argentina together with the peronist *Partido Justicialista* (Justicialist Party), he originally was a strong opponent to the entrance of his country into the IMF because of his nationalistic view of the economy. His government decided to implement a "developmentalist" model in order to foster economic growth. Such framework considered the deterioration of terms of trade in agriculture and mining products as the main source of underdevelopment in countries that were primarily engaged in the export of commodities. Therefore, developmentalism advocated domestic industrialization and the expansion of energy and transportation infrastructure. Nevertheless, this model proved to be very inefficient since domestic industry was unable to be competitive vis-à-vis the rest of the world. Trouble occurred with this strategy and the urgent need for foreign capital flowing into the country convinced Frondizi of the need to ask for a loan from the IMF: receiving money from a multilateral institution, of which Argentina was a member itself, was in fact considered a more acceptable option rather than allowing foreign capital through the channel of Foreign Direct Investment (FDI), because the latter would have been considered as a form of intrusiveness and external control on the domestic economy (Kedar 2013).

After this first scheme, a second SBA was signed by the government of General Juan Onganía in 1967, who was ruling the country on the basis of an authoritarian regime. He was followed by General Jorge R. Videla in 1977, during the years of the brutal military dictatorship, and then by Raúl Alfonsín, leader of the UCR and first President democratically elected after the regime, in 1984 and 1987. Then it was Carlos Saul Menem, an atypical peronist President, who further intensified the relationships of Argentina with the Fund by signing SBAs in 1989, 1991, 1992, 1993, 1995, 1996 and 1998. The increasing number of loans received by Buenos Aires was symptomatic of the deterioration of the financial and macroeconomic conditions of the country: the last SBA signed in 2000 by President Fernando de la Rúa could not prevent Argentina from facing its most severe debt crisis ever, but it

marked the point of no return showing that the “routine of dependency” had been winding around itself forming a vicious circle that ended up in a tremendous economic and social crisis.

The opening of this first credit line to Argentina implied the implementation of a stability program that was supposed to follow a different path from developmentalism and state interventionism, and to require decrease in public expenditure and further openness to external trade through the unification of exchange rates. Nevertheless, Argentina was never able to follow a coherent set of economic policies at least in a medium term view, mainly because of the political instability that dominated the country until the mid 1980s. On the other hand, it is also worth noting that the approach of the Fund was completely politically neutral, in the sense that it did not discriminate between different types of regimes, although they proved to be authoritarian, as in the case of the military dictatorship that ruled Argentina between 1976 and 1983. In this case, the government of General Jorge R. Videla decided to adopt ultra-liberal economic policies, following the monetarist experiment of the “Chicago Boys” tested in Chile, at that time ruled by the military dictator Augusto Pinochet. The military *Junta* appointed José Alfredo Martínez de Hoz as the Minister of Economy: having cultivated ties with the “Chicago Boys” who were operating in Chile, he implemented a massive liberalization of the economy, allowing foreign goods to enter the country. This led to the dismantling of the domestic industrial system, because the overprotection that characterized the inward-looking years and a disproportionately overvalued currency prevented it from achieving a good level of competitiveness. The SBA signed with the IMF increased the burden of Argentina’s foreign debt paving the way for the first debt crisis suffered by the country in the early 1980s (Bulmer Thomas 2003). After Mexico’s default on its external debt in 1982, the crisis spread out through the rest of Latin America, that had been relying on borrowings from banks in order to fill the gap in capital accumulation. Argentina adopted the same strategy in order to finance its domestic expenditure, and by the beginning of the 1980s it had become extremely dependent on loans from foreign banks (Kedar 2013). The Mexican default produced a freezing in the concession of loans, so that Argentina remained short of liquidity in a period where public spending dramatically increased because of the conflict against the United Kingdom for the control of the Falkland/Malvinas islands.

The devastating conclusion of the dictatorship led, together with the restoration of democracy and the election as President of Raúl Alfonsín, candidate of the UCR, to an attempt of detachment from the dependency on the IMF. In reality, the need for external capital was still high, so the Alfonsín administration continued to require financial assistance by the Fund (a new SBA was negotiated in 1984) without following its economic prescriptions. During his term, a new shift to unorthodox

policies was implemented: the Austral Plan of 1985 and the Plan Primavera in 1988 drastically tried to reduce inflation by cutting three zeros on the nominal value of the domestic currency, but none of them was effective in addressing hyperinflation and in preventing Argentina from asking again the Fund for financial assistance (de Beaufort Wijnholds 2007).

Another economic collapse in Argentina marked the end of the UCR in power leading to the return of a representative of Peronism, Carlos Saúl Menem. Winner of the Presidential elections in 1989, Menem had formerly been the governor of La Rioja province. He immediately proved to be a *sui generis* follower of Peronism, at least with regard to the management of the economy: despite adopting the traditional populist attitude, he imposed a dramatic ‘u-turn’ in economic policy embracing the principles of neo-liberalism. Menem appointed as Minister of the Economy Domingo Cavallo, who implemented a ‘shock therapy’ in order to put finally an end to the hyperinflation spiral that had been affecting the country for a decade. The launch of the “Convertibility Plan” in 1991, consisting of the establishment of a currency board that pegged the Argentine peso to the US dollar at a fixed exchange rate of 1:1, managed to reduce the inflation rate from above 3000% in 1989 to just 0.2% in 1996 (Figure 3.1.3). Then, the government started a wave of privatizations and deregulation of the economy which was fulfilling the principles contained in the so-called “Washington Consensus”³⁶ embraced by the IMF, the World Bank and the US Treasury Department. The strategy was successful in the short run since it allowed Argentina to obtain macroeconomic stability and to start growing again, although the adjustment proved to be painful for the labor force, since the level of unemployment increased from 8% in 1989 up to 19% in 1996 (IMF 2013). The adoption of these policy measures was necessary in order to maintain trust by the Fund and to continue receiving financial support and technical assistance. That is why in June 1991 the IMF approved a new SBA for 780 million Special Drawing Rights, replaced in 1992 by an Extended Fund Facility (EFF) of 2,438 million SDRs.³⁷ After the EFF signed in 1992 expired in 1996, a new SBA was granted until 1998, and upgraded to a new EFF until 2000 (Kedar 2013). Two main drawbacks of this strategy need to be stressed. First, once again Argentina

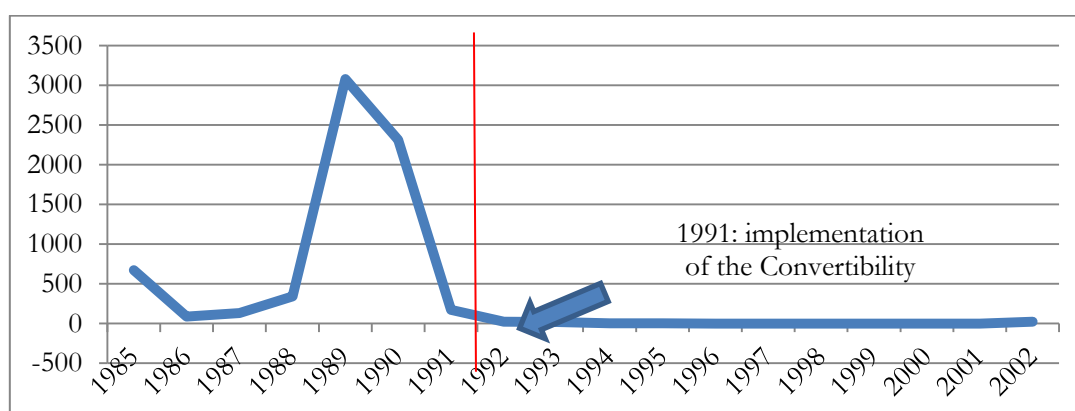
³⁶ Coined in 1989 by John Williamson, an economist from the Institute for International Economics, the term “Washington Consensus” referred to a set of ten policy measures to be implemented in Latin American countries troubled by the debt crisis and the macroeconomic imbalances of the 1980s in order to obtain macroeconomic stability. The ten principles were: 1) Fiscal policy discipline 2) Reordering public expenditure priorities from non-merit subsidies to basic health and education infrastructure (on a pro-growth and pro-poor basis) 3) A competitive exchange rate 4) Tax reform 5) Liberalizing interest rates 6) Trade liberalization 7) Liberalization of Inward FDI 8) Privatization 9) Deregulation 10) Enforcement and respect of property rights (Williamson 2004).

³⁷ EFFs were designed in 1974 to provide assistance to countries experiencing serious relatively long-term payments imbalances, thus providing a longer engagement than SBAs (IMF 2013d).

drastically changed the kind of economic model adopted: the complete opening to liberalization and foreign capital caused a disruption of the domestic production system, preventing the country once more from strengthening and safeguarding its main assets with a forward-looking strategy. Second, the dollarization of the economy proved to be ineffective and unsustainable in the medium run. Nevertheless, the “routine of dependency” between Argentina and the IMF reached during the 1990s its peak leading to the crisis of 2001 and to the current situation of isolation that will be analyzed in the next section.

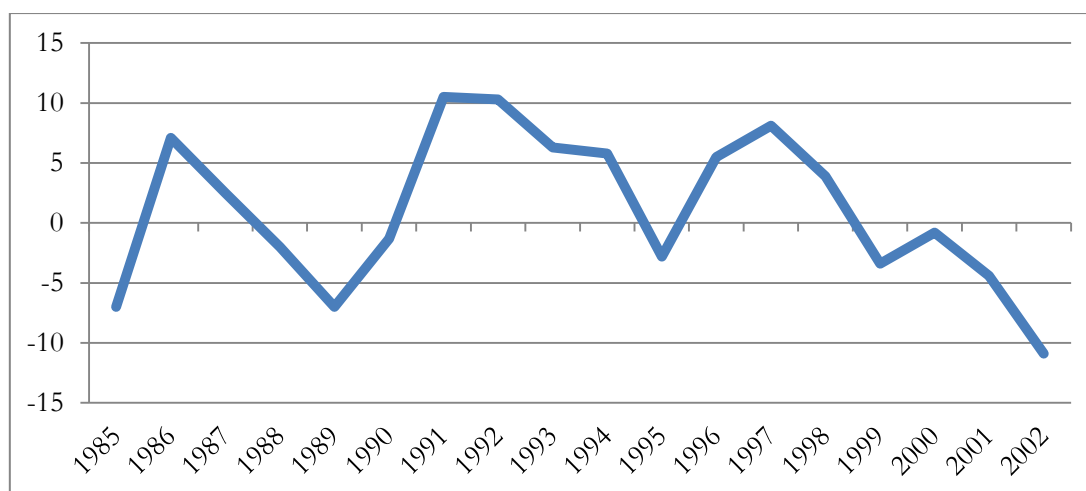
The irreversible convertibility with the US dollar, albeit helping Argentina freeze the unstoppable rise of prices at the beginning of the 1990s, seriously affected the international competitiveness of the country, leading soon to a new slowdown of growth and to external vulnerability with respect to the neighbor countries. Lack of coordination with other Latin American countries like Brazil, which devalued its currency in 1998 leading to a misalignment of the bilateral exchange rate (see chapter 2.2), provoked shocks consisting of a fall in Argentina’s terms of trade and a tightening of external credit markets. Moreover, the insufficient degree of international openness of Argentina, together with the constraints in the exploitation of its comparative advantages in agricultural goods (represented by the highly protective agricultural policies adopted in the US and the EU, Fanelli 2003), further damaged the economic performance of the country, which got stuck in a new recession by the end of the 1990s (Figure 3.1.4). In other words, the reduction of the demand for foreign exchange due to a fall of international competitiveness and the parallel mounting-demand for short-term financing triggered a ‘twin-crisis’ in Argentina (Fanelli 2007), contributing to garble more and more the dependency on the IMF.

Figure 3.1.3 – Argentina, Inflation rate (% average values, 1985-2002)



Source: IMF

Figure 3.1.4 – Argentina’s real GDP growth before and during the Convertibility era (% average values, 1985-2002)



Source: IMF

The legacy left by Carlos Menem to the new President elected in 1999, Fernando de la Rúa, was not very promising: sky-rocketing foreign debt and reduced access to financing were the most evident signs of a serious deterioration of Argentina’s external position, as well as a 7.2 billion US\$ fiscal deficit was warning that also the internal situation was turning really bad. Instead of concluding the experience of the Convertibility Plan, the new government kept on pursuing the same strategy trying to implement a plan of fiscal austerity made up by public expenditure cuts and tax increases (the so-called *impuestazo*). In order to cope with its increasing indebtedness, Argentina signed in March a new three-year SBA of 7.2 billion US\$, which had to be upgraded in January 2001 since it became clear that the county would not be able to meet its fiscal targets. A rescue package 39.7 billion US\$ worth, including also supplementary financing from the World Bank, the Inter-American Development Bank, Spain and other commercial banks, was signed, representing the largest effort ever made by the IMF (Kedar 2013). However, the perseverance of the IMF in providing assistance to Argentina can be compared to a doctor trying to reanimate a patient who is already dead and a last 7 billion US\$ upgrade to the SBA in September 2001 could not avoid de la Rúa’s resignation and prevent Argentina’s government from declaring the default on its external debt on 24 December 2001.

This epilogue represents the worst and least effective part of the troubled relationship of Argentina with the IMF described so far. Once again, mistakes from both sides were made revealing a quite surprising lack of any ‘learning-by-doing’ process both in Argentina’s and IMF’s officials. First of all,

the currency board should have been abandoned much earlier, once macroeconomic stabilization had been achieved. In order to keep such an exchange rate policy sustainable, a high degree of macroeconomic coordination with the country which currency is pegged to should be pursued in terms of inflation preferences and bilateral trade (de Beaufort Wijnholds 2003). The hard peg and the inflexible nominal wages and prices, together with a shock in the terms of trade, were the main source of severe macroeconomic imbalances (Perry and Servén 2003). Once confidence in a currency board regime wanes, the risk of a crisis is greater than under a floating exchange rate regime, leading to severe capital outflows and dramatic losses in foreign reserves in order to maintain the strict parity. Moreover, the IMF focused too much on central government's deficit, without paying enough attention to the general government deficit, given the fact that public spending was constantly increasing in Argentina's provinces (de Beaufort Wijnholds 2003).

Forty-five years of a discussed relationship culminated in a dramatic failure of the program of financial and technical assistance provided by the IMF to a developing country. Domestic and external factors have to be investigated among the reasons why this "routine of dependency" led to the creation of a vicious, rather than a virtuous, circle. Political instability is the main reason that helps explain why Argentina was never able to put in place economic policies durable and sustainable at least in the medium run. Alternative economic models were implemented almost interchangeably without giving the domestic production system the opportunity to structurally adapt to the changes imposed from above and to gain in efficiency and international competitiveness. On the external side, lack of flexibility from the Fund in putting its 'adjustment recipes' into practice inevitably led to the failure of its prescriptions in such a peculiar case like Argentina. Next section will analyze the evolution of the relationship between Buenos Aires and the IMF and what are the long-run results of the current situation, in light of the troubled story of the past 50 years.

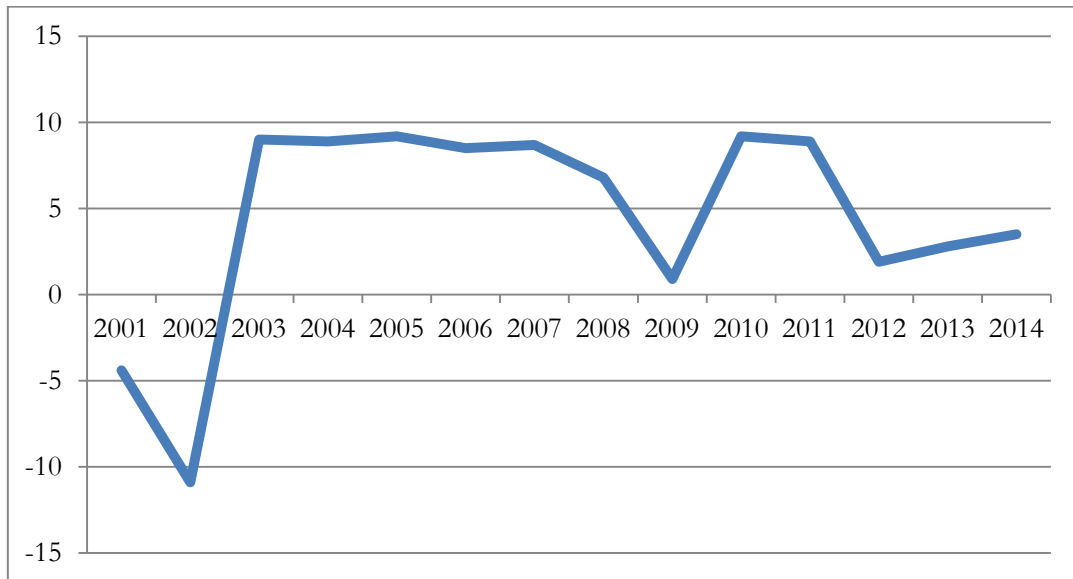
3.1.3 The Kirchner era and the 'divorce' with the IMF

The beginning of a new attitude

Eduardo Duhalde was appointed President of Argentina by the Parliament in January 2002 after one month of high political and social instability following the shock caused by the imposition of the *corralito* (the possibility to withdraw only a small amount of money from ATM machines in order to avoid a run on bank deposits). He had no other option but revoking the Convertibility Law, allowing the peso to float and to devaluate vis-à-vis the US dollar. In the short run, Duhalde could not prevent Argentina from suffering from the heaviest recession ever (-10.9% of GDP in 2002), but from 2003 the

country started growing again at an unprecedented pace (an average of 8.5% between 2003 and 2008, Figure 3.1.5). The internal devaluation, together with the favorable international situation in the financial markets represented by high prices of agricultural commodities, helped Argentina rapidly recover thanks to an impressive boost of exports and a consequent accumulation of foreign reserves.

Figure 3.1.5 - Argentina's real GDP growth after the Convertibility (% values, 2001-2014*)



Source: IMF *2013-2014: forecasts

The relationship with the Fund was not over yet. In January 2003 the IMF approved another SBA of 2.9 billion US\$ for a short period of 8 months, necessary to cover the forthcoming financial obligations. The new agreement did not provide new net financing but extended payment expectations, also unlocking further loans from other multilateral organizations dedicated to social programs (IMF Survey 2003). Things changed radically after the new elections in April 2003, unexpectedly won by an outsider of the Peronism, the former governor of the Santa Cruz province Néstor Kirchner. A very different personality from his opponent Carlos Menem (who withdrew his candidacy after winning the first round with a very short margin), Kirchner embodied many of the traditional features of Peronism: economic nationalism and political populism. This is why his political discourse was characterized for being strongly critical towards the multilateral financial institutions, that in his view had led not only Argentina but other Latin American countries to suffer from economic and social crises. Kirchner's government wanted to impress a radical change from the neo-liberal economic policies implemented by Menem under the supervision of the IMF and took advantage of the good economic situation in order to reaffirm Argentina's full sovereignty (Correa da Silva 2012). The new President was also helped and

backed by the renewed political environment of Latin America, characterized by a predominance of left-wing leaders who developed a strong critical debate towards multilateral institutions inasmuch ‘under the imperialist control of the US’. Tensions between the government of Buenos Aires and Washington increased as Kirchner used to criticize the IMF in multilateral *fora* (for instance at the United Nations) and the Fund expected Argentina to undertake measures to restructure its debt and embark on structural reforms (Kedar 2013). On 5 January 2006 Argentina unilaterally decided to fully repay its debt with the IMF for an amount of 8.98 million of Special Drawing Rights (9.8 billion US\$), thus putting an end to its financial dependency on the Fund. This allowed Argentina save 842 million US\$ in interest payments, but it represented at the same time a substantial detachment of Buenos Aires from Washington. The decision taken by the Kirchner government simply followed what Luis Inácio ‘Lula’ da Silva, President of Brazil, did a few days before repaying in full the last loan received by the IMF. Both repayments were welcomed by the Fund, as can be noted from the statement of the then Managing Director Rodrigo de Rato. “The decision made by Argentina’s authorities – he said – reflects their confidence that their external position is sufficiently strong to warrant early repayment. (...) We remain ready to assist the Argentine authorities in any way that would help them address the important challenges that lie ahead” (IMF Survey 2006). This statement diplomatically hid a certain amount of skepticism towards Argentina’s ability to ‘walk on its own legs’ and offered the country the opportunity to keep on receiving financial assistance. Nevertheless, Kirchner’s sudden decision clearly signaled that the “routine of dependency” was at its end, symbolizing the final outcome of a complicated relationship characterized by failures more than successes.

Argentina and the IMF in the present context: does detachment mean isolation?

Much has changed in the global economic environment during the past few years. Especially after the financial crisis in 2008, the process of redistribution of power has accelerated and, in parallel to this, also a redefinition of global economic governance and institutions is being implemented. The governance of the IMF has also been changing in a more ‘democratic’ and inclusive sense, with a sensible redistribution of quotas and voting powers in favor of developing countries.

How is Argentina positioned in this different and evolving scenario? As said in the previous paragraph, the country has stopped being a debtor to the Fund since the end of 2005. As of October 31, 2013, Argentina’s position in the Fund consists of a quota measured in 2,117 million SDRs. These holdings correspond to 0.89% of the total and account for a voting power measured in 21,908 votes (0.87% of

total votes).³⁸ The size of Argentina's quota can be compared to that one of a medium-sized European country (e.g. Austria and Denmark), while Brazil, a neighbor country which has a much bigger economic size, has a quota equal to 1.79 of total.³⁹

After repaying its debt with the IMF, Argentina's detachment from the multilateral financial institution started to increase. My purpose here is not to argue that the end of the financial dependency of Argentina on the Fund was negative; on the contrary, if considered *per se*, it is a clear example of the improved macroeconomic conditions of the country. Nevertheless, Kirchner's unilateral action also had a strong political meaning, in the sense that it showed Argentina's refusal to the system embodied by the Bretton Woods institutions. A second step taken from Argentina in the opposite direction of the IMF was the refusal to comply with the annual "Article IV consultations". This is a process of evaluation of any Fund's member account, through which the IMF tries to assess the economic health and to forestall future financial problems. It is a sort of a 'mutual vigilance' that all member States agree to when joining the Fund. According to Article VIII/Section 5 (General obligations of members – furnishing of information) of the Articles of Agreement of the IMF:

"The Fund may require members to furnish it with such information as it deems necessary for its activities, including, as the minimum necessary for the effective discharge of the Fund's duties, national data on the following matters:

- (i) official holdings at home and abroad of (1) gold, (2) foreign exchange;
- (ii) holdings at home and abroad by banking and financial agencies, other than official agencies, of (1) gold, (2) foreign exchange;
- (iii) production of gold;
- (iv) gold exports and imports according to countries of destination and origin;
- (v) total exports and imports of merchandise, in terms of local currency values, according to countries of destination and origin;

³⁸ The voting system within the IMF works as follows. Each member has a number of 'basic votes' (each member's number of basic votes equals 5.5% of total votes), plus one additional vote for each SDR of 100,000 of a member's country quota.

³⁹ Information available at http://www.imf.org/external/np/sec/pr/2011/pdfs/quota_tbl.pdf

(vi) international balance of payments, including (1) trade in goods and services, (2) gold transactions, (3) known capital transactions, and (4) other items;

(vii) international investment position, i.e., investments within the territories of the member owned abroad and investments abroad owned by persons in its territories so far as it is possible to furnish this information;

(viii) national income;

(ix) price indices, i.e., indices of commodity prices in wholesale and retail markets and of export and import prices;

(x) buying and selling rates for foreign currencies;

(xi) exchange controls, i.e., a comprehensive statement of exchange controls in effect at the time of assuming membership in the Fund and details of subsequent changes as they occur; and

(xii) where official clearing arrangements exist, details of amounts awaiting clearance in respect of commercial and financial transactions, and of the length of time during which such arrears have been outstanding.

(b) In requesting information the Fund shall take into consideration the varying ability of members to furnish the data requested. Members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed. Members undertake, however, to furnish the desired information in as detailed and accurate a manner as is practicable and, so far as possible, to avoid mere estimates.

(c) The Fund may arrange to obtain further information by agreement with members. It shall act as a centre for the collection and exchange of information on monetary and financial problems, thus facilitating the preparation of studies designed to assist members in developing policies which further the purposes of the Fund” (IMF 2011).

Argentina submitted the information required for the Article IV procedure for the last time in 2006, right after repaying its debt with the Fund. In the Public Information Notice (PIN) released by the institution after completing the monitoring procedure, it is possible to find some very positive remarks acknowledging the improvement of the economic conditions of the country. “Net private capital flows” it is contained in the PIN “turned in positive in 2005 for the first time since 1999. The post-

crisis fiscal adjustment is historically unprecedented. In 2005, the overall cash surplus of the consolidated government was 2.5% of GDP, underpinned by strong revenue performance (...) The exchange rate has remained stable amid sustained intervention by the Central Bank. Interest rates have risen gradually as bank lending has recovered and liquidity conditions have normalized. (...) There has been a demonstrable improvement in social conditions. By end-2005, the poverty rate has declined to 34% from the peak of 57% reached in 2002(...)" (IMF 2006). However, some potential elements of warning are mentioned, first of all the worrisome increase of inflation, that "(...) has risen steadily at 12.3%. (...) Provincial primary spending has been rising even more rapidly (around 19% in real terms in 2005) (...) (the provinces) moved into primary deficit in the second half of 2005" (IMF 2006). In conclusion, the Executive Board Assessment welcomed the strong growth performance recorded by Argentina, but at the same time urged the implementation of a "different policy mix and reforms to promote investment and supply, especially in areas where bottlenecks are of macroeconomic significance" (IMF 2006).

Nowadays, Argentina is the only G20 country that does not comply with the "Article IV" consultations and has been adopting the same behavior as Venezuela, although the latter is not part of the G20. Parallel to the failure to comply with the consultations, Argentina has also started disclosing official statistic information which has been considered unreliable and accusations to manipulate data on GDP and Consumer Price Index have been addressed by the IMF to Argentina's government. In particular, official figures released by the National Institute of Statistics (INDEC) would portray a better domestic economic situation than it actually is. Since 2007, doubts on the reliability of inflation data arose, because numbers provided by INDEC started to be considered well below the real values. In other words, political opportunity calculations would have pushed the government to the decision of 'cheating' on the data in order not to show that inflation was already rising above 'safety' levels and, instead of being stable on values between 10-13% per year (as officially reported), it was estimated skyrocketing up to 25-30%. Such data drastically change the picture of real economic growth in Argentina, since a sustained increase in prices, well above the growth of nominal GDP, implies a reduced growth per capita in real terms. The IMF repeatedly warned Argentina on the importance of providing reliable data, as can be seen in the statement released by the IMF Executive Board on 1 February 2012. In this document, the Fund regrets "the absence of progress in aligning the quality of the official data reported to the Fund for the Consumer Price Index for Greater Buenos Aires (CPI-GBA) and Gross Domestic Product (GDP) with international statistic guidelines". Therefore, the Board approved a decision calling on Argentina to "adopt specific measures within a period of 180 days" (IMF 2012a). In September

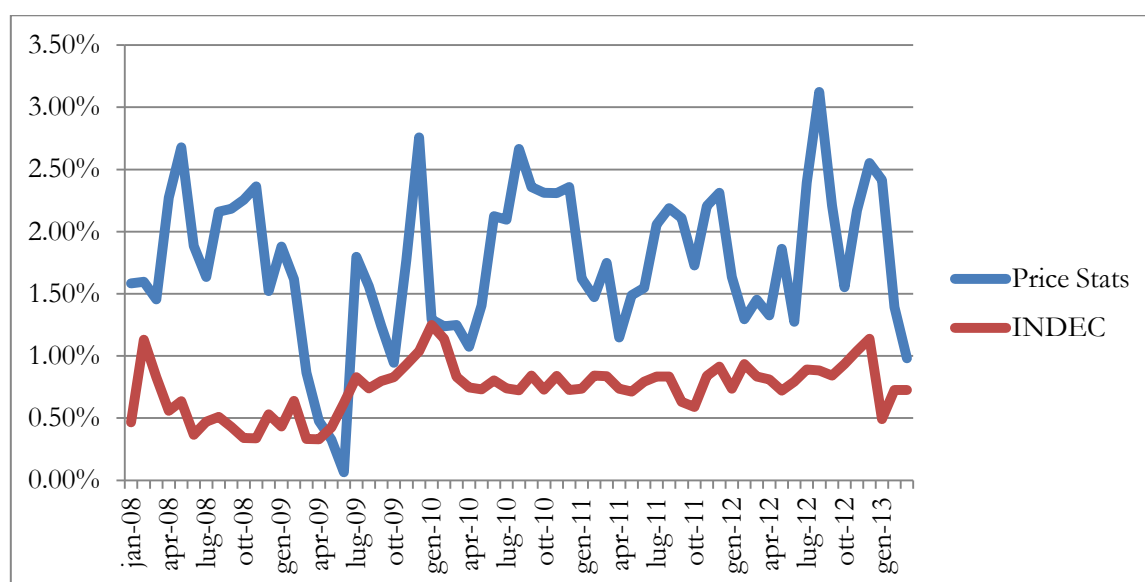
2012 a new statement by the Executive Board acknowledged that no substantial progress had been made in improving the quality of the information provided, threatening the possibility of undertaking further measures or negative sanctions against Argentina (IMF 2012b). In the meantime, at the IMF International Monetary and Financial Committee in April 2012, the then Argentina's Minister of Economy, Hernán Lorenzino mentioned the commitment of his country to work together with the IMF in order to build a better Consumer Price Index and, referring to his country's economic situation, criticized the Fund's decision of including Argentina within the list of "overheating economies" in the World Economic Outlook issued in spring 2012. "Overheating is not a risk that can be placed at the same level as high indebtedness, reluctant growth and high unemployment. Countries like Argentina, with 80 percent productive capacity utilization, 6.7 percent unemployment and high investment rates should not be considered as overheated" (IMF 2012c).⁴⁰ Again, it is useful to have a look at Minister Lorenzino's speech at the following International Monetary and Financial Committee, in October 2012. In this occasion, he mentions the CPI only once, saying that "(...) we (Argentina) benefit from technical assistance from the IMF to develop a new CPI index on a national basis (...)" (International Monetary and Financial Committee 2012). Despite this reconciliatory statement, Argentina's effort to provide better quality data was still considered too poor by the IMF, which decided to adopt a declaration of censure against the country on 1 February 2013 as "(...) the Executive Board found that Argentina's progress in implementing the remedial measures (...) has not been sufficient. (...) The Managing Director is required to report to the Executive Board by November 13, 2013 on the status of Argentina's implementation of the above remedial measures (...)" (IMF 2013c). What consequences could this decision imply? In theory, sanctions may be imposed, such as the loss of borrowing rights, the loss of voting rights, and culminate with the expulsion of Argentina from the organization (Webber 2013). Lack of trust in data provided by Argentina's government was shown also by independent economists and media. The example of a magazine like *The Economist* is clear at this respect: since February 2013, it stopped publishing data on inflation about Argentina from official sources, replacing them with CPI provided by an independent American society, Price Stats (*The Economist* 2013). Figure 3.1.6 shows the difference between inflation estimated on a monthly basis from 2008 to March 2013 by the INDEC and that one estimated by Price Stats. Figures provide by the latter reveal a much

⁴⁰ Overheating risk takes into account the excess in standard deviation for domestic variables as the output relative to trend, the output gap, unemployment, inflation, external variables as terms of trade, capital inflows, current account, and financial ones like credit growth, house prices and equity prices. According to the WEO issue of Spring 2012, Argentina's risk of overheating was mainly due to a too high variation in the output relative to trend, unemployment and inflation (IMF 2012c).

higher rise in consumer prices, which reflect, on a cumulative basis, on an annual average increase around 25%.

Figure 3.1.6 – Argentina, monthly CPI, INDEC vs Price Stats

(% values, January 2008 – March 2013)



Source: elaboration of the author on INDEC, Price Stats data

No official reactions from the Government followed this statement, although in previous occasions President Cristina Fernández de Kirchner had blamed the IMF for pushing faulty economic policies and treated the relationship with the organization as irrelevant (Webber 2013a). Also, in a vigorous speech at the United Nations General Assembly in September 2012, Kirchner attacked the IMF Managing Director Christine Lagarde claiming full sovereignty and independence of Argentina from the Fund (Mercopress 2012). Nevertheless, Argentina’s embarrassment in front of this issue is quite evident, given country officials’ discomfort in addressing domestic inflation in public, as evident from the difficulty shown by Minister Lorenzino in answering to a Greek journalist about CPI in Argentina (Webber 2013b).

3.1.4 Conclusion: from the “routine of dependency” to... a “routine of detachment”?

In this chapter I took the evolution of the relationship between Argentina and the IMF as an example of how the country is positioning itself within the framework of global economy. I argue it is quite interesting and useful to analyze this pattern because linkages between Buenos Aires and the financial

institution trace back in the 1940s, so that it is possible to have a long-term period of Argentina's inclusion in the international economic context.

Initially excluded from the membership in the Bretton Woods institutions, Argentina then established a "routine of dependency" (Kedar 2013) with the IMF, having to apply - on a quite regular basis - for Stand-By Agreements in order to solve its macroeconomic imbalances. Both internal problems, represented by political instability which reflected into the cyclical implementation and dismissal of incoherent economic policies, and external ones, as the Fund's inability to adopt flexibility in its financial assistance and to anticipate that such policies as the "Convertibility Plan" in the 1990s were unsustainable in the long run, are the sources of the final outcome, represented by the drastic detachment of Argentina from the IMF.

Despite the huge progress made by Argentina over the course of the last decade, in terms of economic growth, reduction of macroeconomic imbalances, social inclusion and fight against poverty, the progressive isolation the country is adopting within the Fund can be a strategic mistake for the role and leadership can play in the redefinition of global economic governance. In the current period, characterized by a transition from an asymmetric world dominated by the US economic supremacy to a multipolar scheme where regional powers can have their say (Tentori and Zandonini 2013), being 'part of the game' should be an imperative for a country like Argentina that is also member of the G20. However, while Brazil is playing a much more active role in the IMF, being a promoter of the quota-scheme reform, Argentina has preferred to adopt a critical position, aligning itself to the position of Venezuela.

The relatively small economic power of Argentina (compared to Brazil and Mexico in the rest of the Latin American region) should rather induce the local government to play a more active part in these institutions in order to be able to exert a stronger influence and to be involved in addressing global economic governance. Nevertheless, internal political calculations, represented by the need to maintain consensus of the population against political opponents in view of the forthcoming parliamentary elections, are more likely to increase this new "routine of detachment", as I shall define it. Potential new economic troubles (commodity prices expected to fall down, inflation rising, foreign currency reserves deteriorating) might put Argentina in the position to ask for external financial assistance again. Should Buenos Aires find itself in the position of a "pariah in the world economy" (Brandt and Erixon 2013a), it might prove very difficult to 'keep on track' in the forthcoming years.

3.2. Argentina and the G20: the risk of isolation and irrelevance

3.2.1 Structure of the chapter

Among the global multilateral organizations, the Group of 20, better known as the G20, is the most recent. Since its inception as a ‘leaders-forum’ in 2008, in the aftermath of the global financial crisis, the G20 has shown a reasonable degree of effectiveness in addressing the severe macroeconomic imbalances unveiled by the crisis. Characterized by a low level of bureaucracy and institutionalization, it takes place with an annual summit of the leaders of the 20 members (19 States from all the continents plus the European Union). However, the annual meeting is just the tip of the iceberg of an intense preparatory work developed by the so-called “*sherpas*”, which meet regularly over the course of the year.

Argentina is a member of the G20 together with Brazil and Mexico among Latin American countries. Being part of such a new and important forum should have made Argentina willing to play an active and collaborative role, but the attitude the country has adopted during these years reveals at least a problematic approach towards the decisions taken within the organization. A low rate of compliance with the decisions approved, together with lack of collaboration with other financial institutions (especially the International Monetary Fund, as I showed in the previous chapter), resulted in a progressive detachment of Argentina from the organization, up to the point that proposals for its expulsion have been pushed forward by some States. The vacant seat might be filled by Chile that, on the contrary, has been recently admitted in the Organization for Economic Cooperation and Development (OECD) and is considered a ‘model’ for complying to the economic policies of the current global order.

What can the consequences of this ‘irrational’ attitude be for Argentina? Isolation in the redefinition of global economic governance can be detrimental for the country’s economic performance but also for the role it can potentially play on the global stage. This chapter will provide an introductory section on the G20, recalling the main stages of its still recent history, the internal functioning and the outcomes achieved so far. It will then offer a case study on the role of Argentina, in order to show the disappointing contribution of the country to the progress of the organization. Literature sources, as well as official documents, will be used in order to support the hypothesis formulated in the above.


3.2.2 The G20: an organization searching for legitimacy and effectiveness

A bit of history – From the G20 Finance to the G20 “2.0”

Global economic multilateralism had been negatively affected over the course of the past decade by several factors. On one hand, the standstill in the negotiation process of the Doha Round within the World Trade Organization (WTO) stopped the multilateral liberalization of international trade. This was mainly due to disagreements between ‘Western’ and developing countries on agricultural issues. On the other hand, the increasing use of bilateral and regional Free Trade Agreements (FTAs) helped increase trade liberalization, but at the same time complicated economic relationships at the global level leading to a situation defined as a “spaghetti bowl” (Bhagwati 1995). Moreover, when the financial crisis broke out in 2008 with the collapse of Lehman Brothers spreading all over the world, severe macroeconomic imbalances among countries, in terms of current account imbalances and misalignments in the exchange rates, determined by a lack of coordination became evident.

In other words, it was clear that an improvement in global economic governance was needed. Nevertheless, ‘traditional’ International Financial Institutions (IFIs) and other multilateral organizations had proved to be inefficient and in need for reform. The existence of a trade-off between ‘universalism’ and efficiency was quite evident: the broader the membership becomes, the higher the probability that an organization’s internal governance is doomed to be little effective (Table 3.2.1).

Table 3.2.1 – Universalism vs. efficiency in international organizations

| | |
|-----------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>UNIVERSAL</p>  <p>EFFICIENT</p> | <ul style="list-style-type: none"> • UN General Assembly • WTO • IMF and World Bank • G20 • UN Security Council • G8 • “G1” (i.e. unilateralism) |
|-----------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

Source: Chatham House 2013

Organizations characterized by a limited and selected number of members and by a lower degree of bureaucratization and institutionalization can react more quickly to external stimulus and take decisions in a more rapid and effective way. This helps explain why the WTO and the IMF went through a phase of internal paralysis: their governance framework was not able anymore to respond to the deep and fast changes that the global economy was experiencing.

In response to these problems and challenges unveiled by the global crisis of 2008, the Group of 20 (G20) was meant to be the new key multilateral economic and financial forum and a sort of a ‘new club’ at the heart of the process of reform in global governance (Subacchi and Pickford 2011). In reality, the G20 was created in the occasion of the East Asian financial crisis in 1997-98 as a meeting between Finance Ministers of the member States. The idea, pushed forward by Paul Martin of Canada and Larry Summers of the United States, was to establish a forum for exchanging views between Finance Ministers and Central Bank Governors of advanced and emerging markets, thus extending the membership of the G7 meetings between the financial representatives of the seven most industrialized nations (Pickford 2013). The inaugural meeting took place in Berlin in December 1999. Criteria adopted to choose the members do not necessarily include the economic size, in terms of the country’s GDP, but also the geographic position (in order to have a balanced representation among the different regions) and the notion of “systemically important countries”. This is why countries with a potentially relevant economic and financial impact on other countries were invited at the table, also countries that could be defined as potentially “problematic” for the global economic system, namely Argentina and Turkey (Cooper and Thakur 2013). Table 3.2.2 shows the list of the 19 member States plus the European Union.

Table 3.2.2 – The G20 members

| Region | Country |
|---------------|----------------|
| Africa | South Africa |
| North America | United States |
| | Canada |
| | Mexico |
| South America | Brazil |
| | Argentina |
| Asia | China |
| | Japan |
| | Indonesia |
| | India |
| | South Korea |
| Eurasia | Russia |
| | Turkey |
| | European Union |
| | France |
| | Germany |
| | Italy |
| | United Kingdom |
| Middle East | Saudi Arabia |
| Oceania | Australia |

The need for innovative policy responses was made urgent by the worse than expected outcome obtained by the coordinated action between the IMF, the World Bank and the Asian Development Bank. The macroeconomic conditions advocated in response to the financial bubble burst in East Asia after a strong speculative attack against the Thai baht included higher interest rates and low inflation targets, but the net effect of these ‘austerity’ measures was deflationary, thus leading to a recessionary cycle in those economies (Cooper and Thakur 2013). This is another case that shows how responses coordinated by the IMF proved to be ineffective in addressing macroeconomic crises: as described in the previous chapter, in the occasion of the crisis in Argentina, the same solutions were applied to cope with a different problem (an overvalued currency and public spending running out of control). This led to a failure.

One important step forward made by the newly-established G20 was the creation of the Financial Stability Forum (FSF), which took shape in April 1999. The purpose of the FSF was to enhance cooperation among the various national and international supervisory bodies and international financial institutions so as to promote stability in the international financial system, in accordance with the Bank for International Settlements (BIS).⁴¹ Nevertheless, the actions undertaken to shape this body were still quite ‘conservative’ and ‘orthodox’, since membership was reserved to the G7 finance ministers and central bank governors.

Another element that might have prevented the G20 Finance from achieving a satisfactory degree level of effectiveness is its dependency on the United States. The purpose of this chapter is far from criticizing the role of Washington as a global economic leader, but as some scholars pointed out, the US was the real and only force behind the scenes of this process. In other words, the US wanted to deliver the outcome of reform without the impression of unilateralism: “The dominant state takes care to secure the acquiescence of other states according to a hierarchy of powers within the inter-state structure of hegemony. Some second-rank countries are consulted first and their support is secured. The consent or at least some of the more peripheral countries is solicited” (Cox 1993). This is why, despite a more ‘democratic’ decision-making procedure (according to the principle ‘one head one vote’ and differently from the IMF quota system) and the establishment of a hosting function on a rotating basis, depth and effectiveness of the G20 Finance was limited.

⁴¹ Information on the FSF available at <http://www.financialstabilityboard.org/about/history.htm>

The crisis that broke out in the US in September 2008, after the collapse of the Lehman Brothers bank, and that rapidly spread all over the world revealing the failure of the financial globalization, made clear that new ways to address the challenges posed by the global economy with coordinated responses were needed. Hence, the idea of upgrading the G20 finance to a sort of ‘G20 2.0’, where the member States would have been represented by their leaders. The idea was proposed for the first time in 2004 at the Davos Forum jointly by Canada’s Prime Minister Paul Martin who, together the US Treasury Secretary Lawrence Summers, contributed in 1999 to the launch of the G20 Finance (Cooper and Thakur 2013).

The first G20 meeting where the countries’ leaders took part was in Washington DC in November 2008. In 2009 and 2010 summits were held twice a year because of the emergency situation of the global economy; after the recovery started to take place at the world level, annual meetings have been held. Table 3.2.3 summarizes the summits that have taken place so far and explains what countries will host the future summits that have already been scheduled. It is worth to remember that meetings are now chaired on a rotational basis.

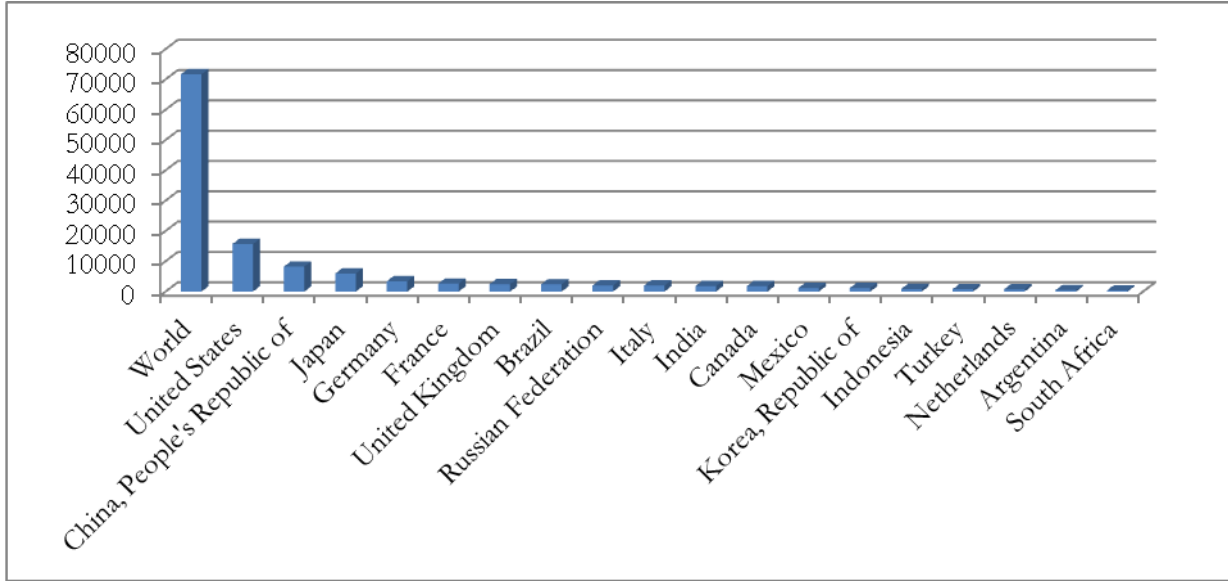
Table 3.2.3 – The G20 summits (2008-2015)

| Date | Venue |
|----------------|------------------------|
| November 2008 | Washington DC, US |
| April 2009 | London, UK |
| September 2009 | Pittsburgh, US |
| June 2010 | Toronto, Canada |
| November 2010 | Seul, Korea |
| November 2011 | Cannes, France |
| June 2012 | Los Cabos, Mexico |
| June 2013 | St. Petersburg, Russia |
| 2014 | Australia |
| 2015 | Turkey |

Source: www.g20.org

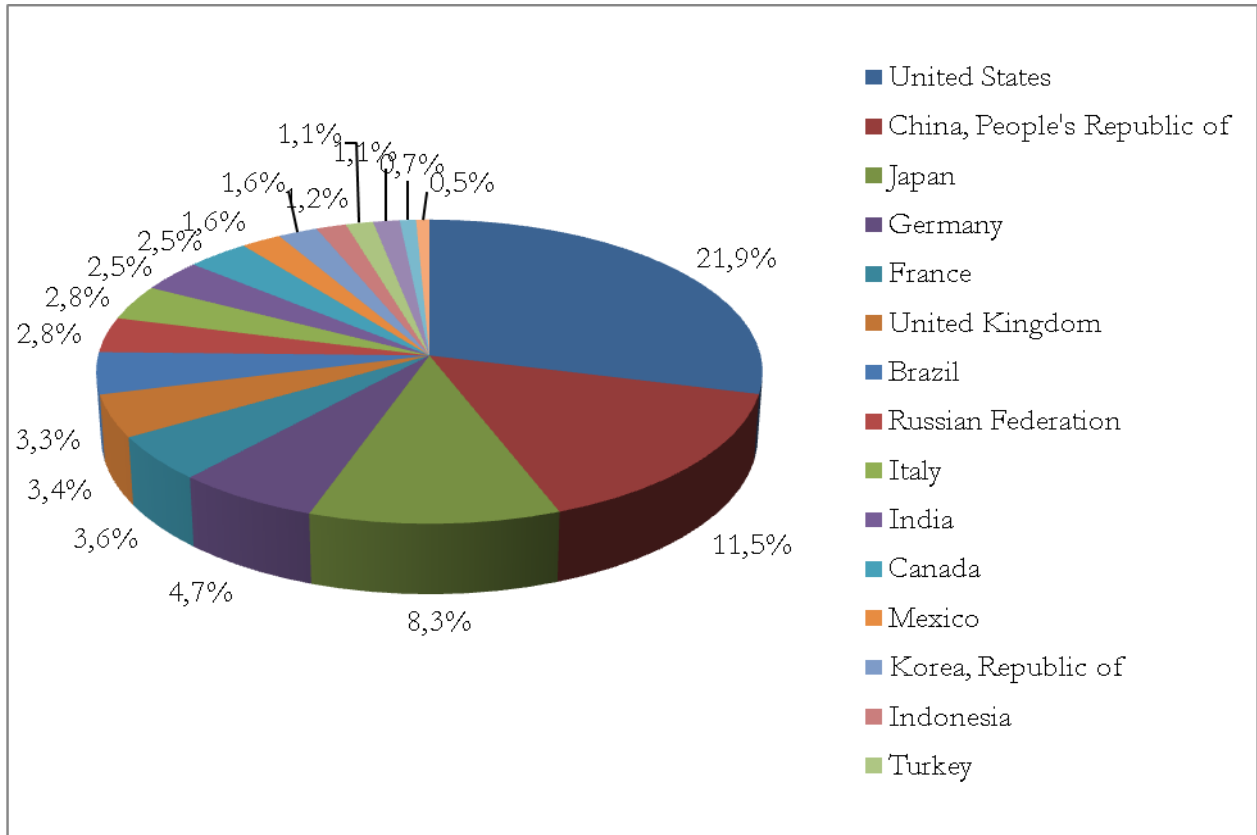
Considered all together, these countries accounted in 2012 for 75.4% of world GDP (personal elaboration on IMF data). They represent indeed most of the global economy, although the shares and weights of this economic power are held quite disproportionately among them: on one hand the US and China account respectively by 21.9% and 11.5% of world GDP, on the other hand 7 countries represent less than 2% of world GDP (Figure 3.2.1 and 3.2.2).

Figure 3.2.1 – The GDP of G20 members (billion US\$, 2012)



Source: IMF

Figure 3.2.2 – G20 member countries' shares of World GDP (% values, 2012)



Source: IMF

At the meetings several issues were addressed. The agenda of the G20 started becoming broader and broader, tackling also environmental issues such as the climate change or energy issues. The risk of a trade-off between effectiveness and comprehensiveness is therefore evident. Nevertheless, the ‘core’ economic issues can be listed as follows: macro actions, financial stability and reforms, International Financial Institutions finance and firewalls, IFI reform, growth, jobs and structural reforms, development, trade (Pickford 2013). According to this taxonomy, the most important results were achieved at Washington, London, Pittsburgh and Cannes.

The first summit in Washington led to a commitment towards “closer cooperation on fiscal, monetary and financial stabilization” (G20 Washington Final Declaration 2008). An action plan on financial regulation and supervision was adopted, leading to a regulatory cooperation, and an expansion of the Financial Stability Facility was agreed, paving the way towards a cooperation of the latter with the IMF. With respect to international trade, a general commitment to “an open and global economy” was re-launched, together with the promise to revive the WTO Doha Round, at that time at a standstill.

The main achievement of the London summit was the establishment of the Financial Stability Board (FSB). Born as an upgrade of the Financial Stability Facility, the FSB has been created to “coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies”.⁴² National central banks, Finance Ministries and banking regulatory committees are represented within the Board, whose mandate mainly consists in the assessment of vulnerabilities for the global financial system, promotion of coordination and information exchange among authorities responsible for financial stability, collaboration with the IMF.

The Pittsburgh summit was characterized by the collective commitment on achieving “strong, sustained and balanced growth”, which has become the ‘motto’ of the G20 since then (Zandonini 2013). The G20 was also designated as “the premier forum for our international economic cooperation”, as can be read in the Final Declaration. In order to implement and achieve sustained growth through cooperation a new tool was created, the so-called Mutual Assessment Process (MAP). The MAP is carried on in collaboration with the IMF, which provides technical analysis to evaluate key imbalances and how members’ policies fit together (IMF 2013e). Through the MAP, the member States agree to share

⁴² See <http://www.financialstabilityboard.org/about/overview.htm>

information with each other and the Fund about their policy plans and expected performance over the next 3-5 years, while the IMF has to assess the potential global implications (IMF 2013e). The latest Umbrella Report, released by the IMF in 2012, warned about the risks of a new recessionary phase in many countries of the European Union (which eventually took place) and underlined the importance of enhancing coordination among all members, especially in terms of current account balance: in order to facilitate the process of fiscal consolidation in deficit economies, more action was required to surplus economies to facilitate demand rebalancing by addressing domestic distortions (IMF 2012d).

More emphasis on growth was put at the G20 summit in Cannes, in October 2011. The “Action Plan for Growth and Jobs” was launched, on the basis of the new difficult economic situation that the Euro Area was going to face, given that some of its most important countries were going to be affected by a double-dipped recession (especially Italy and Spain). It was agreed that medium term foundations for growth had to be based on an enduring commitment to fiscal consolidation, the boost of private demand in countries with a current account surplus, structural reforms to raise job creation, strengthen reform of national financial systems, measures to promote free trade and development (G20 Cannes 2011). This strategy was upgraded during the G20 summit in Las Cabos, Mexico, hosted for the first time by an emerging country. The countries agreed on assessing progress made on the Action Plan on the basis of a framework consisting of three pillars: consistency and fairness of the review process; a peer review process; annual reports to the leaders summarizing the outcomes of the assessments (G20 Los Cabos 2012a).

A new set of priorities has been decided for the G20 in St. Petersburg, Russia. The summit took place in September 2013 and it was based on growth through quality jobs and investment, trust and transparency, effective regulation. The emphasis on growth seems to be the common thread of the last meetings, but another element that deserves to be mentioned is the stronger link to the G8. In fact, the 2013 meeting that took place in Lough Erne, Northern Ireland, focused on the importance of restoring growth through an environment based on transparency. A comparison and an analysis of the potential interactions between the two fora goes beyond the scope of this chapter, but bridging the gap between the G8 and the G20 might help increase further the coordination between advanced and developing economies (Zandonini 2013). However, at the G20 leaders meeting in St. Petersburg the economic issues were overshadowed by the debate between the US and Russia on the opportunity and legitimacy of a military action against the Syrian regime of Bashar al-Assad: something that goes much beyond the scopes for which the G20 had been originally created. The final declaration, approved at the end of the summit, contains a joint commitment to foster economic growth through the channels of

macroeconomic and financial stability (the fight against financial fragmentation with the full enforcement of the Banking Union in the EU is the most important example with respect to this), fiscal transparency, and the promotion of a new round of multilateralism in international trade. In this sense, the forthcoming Ministerial Conference of the WTO, that will take place in December 2013 in Bali, is considered as a potential turning point to restore multilateral talks that take into account also the importance of Regional Trade Agreements (RTAs) (G20 St. Petersburg 2013).

A successful history?

Originally established as a forum for national Finance Ministers and Central Bank governors, the G20 was elevated to a leaders-level organization in November 2008. After initial successes in addressing and coordinating a global response to the economic and financial crisis, its effectiveness seems to be waning for different reasons: a reduced sense of urgency, a ‘nationalization’ of the problems, which are not perceived as strictly global anymore, and flaws in the decision-making process, that often tend to result in ‘lowest common denominator’ agreements (Pickford 2013).

In the current situation, characterized by rapid changes in the structure and the distribution of global economic power, an organization like the G20 is necessary to address these changes and foster the implementation of new global governance based on inclusiveness, ownership shared by members and coordinated actions. Nevertheless, improvements to its working methods are needed: the continued broadening of the agenda prevented the organization from achieving tangible and deep results in all of the issues covered during the meetings. Therefore, it would be better to limit the scope of the G20 to macroeconomic and financial coordination (Angeloni and Pisani-Ferry 2012).

Also, the trade-off between legitimacy and effectiveness should be addressed as soon as possible. G20 members, as systemically important countries, should be more proactive in pushing for further reforms to the governance of IFIs, which would help make the IMF and the WB more representative and act as a counterbalance to the G20’s limited membership (Subacchi and Pickford 2011).

Last but not least, strategies to bridge the gap between the G8 and the G20 should be pursued. Areas of overlapping and complementarity exist between the two fora, so that a coordinated action between the two of them might increase the degree of effectiveness (Kirton 2013).

The G20 represents a unique opportunity to address the changes in global economic relations through coordination and cooperation instead of conflict. But its structure and functioning have to be strengthened to deploy all its potential. Whether the G20 will lose efficiency is one of its main future

risks. An excessive enlargement of its agenda, as recently witnessed by the summit in Russia, might upgrade it further to the status of a new multilateral forum for the resolution of global disputes, but it might reduce its effectiveness in addressing economic issues.

3.2.3 Argentina and the G20

History of its membership

Argentina forms part of the G20 for different reasons other than its mere economic size. In terms of GDP, it does not rank among the first 20 countries in the world,⁴³ but it was included among the G20 members for different reasons. Geopolitical considerations imposed that Latin America would be represented by the biggest Central American country, Mexico, and by the most representative of South America: Brazil and, of course, Argentina. Secondly, the latter was originally preferred to Chile because during the 1990s it had regained economic credibility thanks to the policies implemented by the Minister of the Economy Domingo Cavallo (see previous chapter) (Cooper and Thakur 2013). Moreover, the unprecedented friendship established with the United States and the adoption of the neo-liberal policies contained in the so-called “Washington Consensus” (see previous chapter) played an important role in determining this decision (Abeles and Kiper 2010). Nevertheless, as we briefly explained in the previous section, Argentina was considered important also because of its latent financial and macroeconomic vulnerability and for the potential to spread its economic ‘diseases’ to other countries. Despite the fact that Argentina was a member of the G20 Finance since its inception in 1999, this is exactly what happened in occasion of the 2001 crisis, after which the default on Buenos Aires’ external debt had to be borne by private savers all around the world.

The last criterion was reiterated when the Bush administration took the decision of upgrading the summit to the leaders’ level: Argentina, together with Turkey, was confirmed among the participants around the table of the discussions since they might be part of future financial crises (Cooper and Thakur 2013).

Argentina had the opportunity to play an active and important role within the G20. Although the size of its economy is not so big and its systemic relevance cannot be compared to that one of Brazil, its importance as a fast-growing emerging market and as a benchmark of past mismanagement of financial

⁴³ According to the latest IMF data, Argentina’s nominal GDP stood at 474,954 million US\$ in 2012, ranking 27th at the global level (IMF).

crises would have allowed the country to get more and more involved in the process towards the definition of a new global economic and financial governance.

Firstly, it is useful to recall that in the G20, because of its improved inclusiveness and the formal equality of all its members, a plurality of policy models were suggested and followed. The collapse of the neo-liberal policies, represented by its misinterpreted exacerbation of the financial crisis, led to a reshuffle in the global order and to the elaboration of three different responses to the crisis. The 'anglosaxon' model, led by the United States and the United Kingdom, advocated for countercyclical macroeconomic policies, both in fiscal and monetary terms, and it had a more reticent approach towards stricter financial regulation. The 'European' block, represented by the European Union and led by Germany, was more conservative and pushed for policies based on fiscal adjustment and consolidation and a more advanced financial regulation. The last approach, represented by the BRICS countries, was positioned in the middle view with favor to countercyclical, growth friendly policies, asking at the same time a deeper regulation in financial issues (Abeles and Kiper 2010). Argentina's approach was closer to the last group of countries.

The first two years, characterized by four rounds of meetings, saw a quite active participation of Argentina which generally tended to adopt positions closer to the BRICS countries. According to the Argentine government, global economy was facing a systemic crisis rooted in an excessive financial deregulation and a possible response from developing countries was to build up a series of 'safety nets' through the accumulation of foreign reserves and the pursuit of current account surpluses (Abeles and Kiper 2010). According to this main policy framework, Argentina's action within the G20 revolved around the following issues:

- a) Counter-cyclical policies: Argentina agreed on the proposals for fiscal stimulus plans fostered by the US and kept on implementing expansionary measures (conditional cash transfers programs, public investment plans). It must be recalled that the country had been facing a period of sustained and unstopped growth since 2003 and that only in 2009 it slowed down because of the external consequences of the global crisis;
- b) Financial regulation: Argentina was particularly active in the issue related to the improvements of the risk assessment mechanisms implemented by rating agencies. Not only they were blamed for not being able to foresee the mortgage bubble expanding from the US, but they were also keeping on considering Argentina as a country not ready to be included again inside the global financial markets;

- c) Reform of IFIs: Argentina supported all the proposals made with respect to an increased and more flexible liquidity provision to emerging markets, often characterized by domestic shortages of liquidity, and to a more inclusive reshape of their governance structures. The IMF quota reform, as well as the proposal to increase the capitalization of the Inter-American Development Bank (IDB), were supported by Buenos Aires;
- d) Labor standards and conditions: Argentina promoted, together with Brazil, the idea of getting the International Labor Organization (ILO) involved in the G20 discussions. The emphasis on decent jobs and on the rise in salaries did not match with the attitude of developed countries, which advocated for more flexible labor markets and wage moderations (Abeles and Kiper 2010).

At the same time, however, some objections were moved by the IMF to Argentina for manipulating its exchange rate, accumulating an excessive quantity of foreign reserves and over regulating controls on capital movements. Despite these diverging views, Argentina had the opportunity and the potential to vie for an important role within the G20, given the innovative ‘rules of the game’, its relevance as a systemic important country, and the human skills and expertise it is well endowed of. An issue-by-issue approach, based on technical arguments rather than ideological, should have been adopted in order not only to protect and safeguard its own interests but also to give an active contribution to the redefinition of global and regional governance coordinating its action with other developing countries (Gutierrez Girault, ed., 2010). Brazil, not only the biggest economic power in South America, but already a strategic partner within the MERCOSUR free trade area, would have been the natural partner Argentina had to pursue its strategy with, a strategy based on the rejection of protectionism (in order to second the country’s export-led growth) and the stabilization of monetary and exchange rate policies. The opportunity of a new multilateral forum, characterized by a higher degree of ownership and equal power between members, offered optimal conditions for a “medium-sized power” like Argentina to play a more active role from the periphery on the global scenario, developing for this purpose a deeper and more intense cooperation with the other developing countries sitting around the table (Deciancio 2010). Then, why after a promising start, Argentina started to isolate itself from the rest of the G20 member States?

In order to assess current Argentina’s situation in the G20, it is very useful to look at what the country is really doing to comply with the decisions taken at the summits. The G8/G20 Research Group at the University of Toronto elaborated a ‘scorecard’ that keeps track of the measures implemented in each

member States after they have been agreed on at the meetings. First of all, let us have a look at the commitments undertaken by Argentina at the Los Cabos summit in 2012. They revolve around different areas that are: fiscal policy, financial sector policy, structural reforms, and they embrace a broad range of policy measures. Table 3.2.4 provides a detailed list of the commitments.

Table 3.2.4 – The commitments taken by Argentina at the Los Cabos G20 summit, 2012

| Fiscal Policy | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Commitment/Timeframe | Objectives | Update on Progress |
| Primary fiscal result compatible with a decreasing debt-to-GDP ratio | Keep increasing public sector solvency | 2011 finished with a primary surplus of 0.3% of GDP. National Public Debt reached 42.7% of GDP in 3rd quarter 2011, 1.4 p.p. below the previous quarter and 4.4 p.p. below the same quarter of 2010. The Provincial Debt Relief Program (created in 2010) has been extended until 2013. This plan allows the most indebted provinces to refinance their debt with the National State in favourable conditions. |
| Reduce subsidies on household energy consumption and public transportation by means of a focused approach with the aim of protecting lower-income families. | To reduce the fiscal cost of subsidies and free resources for infrastructure investment, as well as to improve the distribution of income by channelling subsidies exclusively to lower-income households. | This policy has begun to be implemented, starting with the elimination of subsidies for higher-income households. |
| To apply countercyclical fiscal policies in case the international economic situation deteriorates further. | To offset the negative impact of extremely adverse international conditions. | The National Government has a solid fiscal position, as evidenced by its primary surplus and a declining debt/GDP ratio. This fiscal strength would allow it to use fiscal tools in order to preserve employment and production, if necessary. |
| Financial Sector Policy | | |
| Commitment/Timeframe | Objectives | Update on Progress |
| Provide central bank funding to banks for long-term | To increase the financing of both infrastructure and | In 2011 ARS 4bn were disbursed (representing 5% of total |

| | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| investment projects by attenuating maturity mismatch. Up to ARS8bn will be allocated (10% of total corporate loans of the banking system). /2011-2013 | private sector real investment in order to augment the rate of growth of potential output. | corporate loans). |
| Increase Financial depth and equality through the diffusion of free savings accounts for low-income households and instant electronic transfers./2012- 2015 | Increase the private credit to GDP ratio from 11,7% of GDP in 2011 to 16-18% in 2015 and promote a more widespread access to financial services. | <p>In December 2011, the Credit to GDP ratio reached 14.4%, increasing 2.7 pp. on a year-over-year basis. The BCRA has been promoting the use of electronic means of payment through the implementation of a universal free bank account with an associated debit card, and the reduction of inter-bank transfer costs. There was an expansion of 35% of money transfers of small amounts in the last year. 101.400 Universal Free Accounts were created since the implementation of this program in the end of 2010.</p> <p>Under a new regulation that promotes a wider geographical coverage of the financial system, 84 branches were opened through 2011. Most of them (67 branches) were placed in areas where the financial infrastructure is less developed.</p> <p>As an alternative of using cash in transactions for large amounts the BCRA relaunched the so called “Cheque Cancelatorio”. In 2011 2.184 transactions were made totalizing ARS154 millions and 4.244 transactions totalizing USD 241 millions.</p> |
| Complete the adoption of (Basel II, Basell II.5 and Basel | To increase banking sector soundness and resilience by | The project for the adoption of Basel II is being |

| | | |
|------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>III) the three Pillars in Basel II and the new elements in Basel III.</p> | <p>upgrading the regulatory framework to the best international risk management practices.</p> | <p>implemented as from may 2011. The rules on capital requirements for operational risk have been put forward through Com."A"5272 as from January 2012. As regards capital requirements for credit risk an advanced proposal including Basel 2.5 and Basel III modifications is being considered by BCRA Directors and impact studies are well ahead. As regards the provisions of Pillar 3 these will be implemented in 2012 and Pillar 2 will be put into effect in the first half of 2013.</p> <p><i>As from January 2012 financial institutions must have in place a comprehensive risk management process based on the guidelines established by the Central Bank (Com."A"5203). This comprehensive risk management process must contemplate credit, liquidity, market, interest rate and operational risk.</i></p> <p>In line with Basel II and III, the Central Bank of Argentina implemented further steps to strengthen bank solvency standards. A new regulation set by the Central Bank (com."A"5273), established that banks posting profits (after applying the existing regulatory filters) may only pay dividends if their regulatory capital, following the corresponding allocation, is at least 75% above the minimum regulatory requirement. The purpose of this measure is to reduce the financial system's pro-cyclicality, by having a capital buffer to face potential financial and/ or macroeconomic volatility episodes.</p> |
|------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

| | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Expand the regulatory scope to include other institutions that directly or indirectly are involved in financial intermediation. | Strengthen financial stability. | The Central Bank Charter was modified in March 2012 by Law 26.739 extending the regulatory scope to the payments system, including clearing houses, and other institutions that directly or indirectly are involved in financial intermediation. |
| Design incentives in order to channel credit towards productive purposes and certain economic sectors, especially the SMEs, or less developed regions./ 2012-2016 | Bolster economic development. | The Central Bank Charter was modified in March 2012 by Law 26.739. |
| Give authority (power) to the Central Bank to ensure a fair relationship between the financial institutions and consumers. | Protect consumers of financial services and foster competition in the banking system. | The Central Bank Charter was modified in March 2012 by Law 26.739. |
| Structural Reforms | | |
| Commitment/Timeframe | Objectives | Update on Progress |
| Increase food and agricultural output and diversify production and exports, as established in the Agricultural and Food Strategic Plan. | To increase the world's food supply, improve Argentina's external sustainability and allow for higher imports of capital goods. | Grain production did not grow in 2011 as a result of unfavourable climatic conditions. In spite of that, total land sown with cereals grew by 770.000 has (2.2%). There was an increase of 440.000 has. (10%) in the area planted with corn and an increase of 405.000 has (54%) in the area sown with barley. |
| Add 3227 mw of new power by 2013, with emphasis on technologies such as hydroelectric, nuclear and gas power stations. | To augment energy supply and increase the share of green technologies in electricity generation. | In 2011 and the first quarter of 2012 ten energy projects have been completed, representing a total added capacity of 1223mw. Moreover, the Yaciretá dam height was raised, allowing for a gradual increase in capacity of up to 1000 mw. The new additions include both hydroelectric and |

| | | |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | | <p>olic plants.</p> <p>In 2012 the energy supply is expected to augment by 1630 mw, 700 of which correspond to the Nuclear Central Atucha II, and 30 mw to wind energy.</p> |
| <p>Continue increasing the coverage and the per capita allocation of social programs.</p> <p>Reduce unemployment to 6% by 2015.</p> <p>Increase drinkable water and sewage coverage to 90% and 75%, respectively, by 2015.</p> | <p>To reduce absolute poverty and improve the distribution of income.</p> | <p>The main income transfer program, the “Asignación Universal por hijo”, which is directed to children under the age of 18, has achieved an 85% coverage rate for children in a vulnerable situation. In May 2011 the program was extended to pregnant women.</p> <p>During 2011, pensioners of the Argentine Integrated Retirement System increased their income by 37% and the minimum pension was raised by the same percentage.</p> <p>Pensions were further raised by 17.6% in March.</p> <p>The unemployment rate fell from 7.8% in 2010 to 7,2% in 2011. Besides, the rate of informal employment has been reduced in 1 p.p. between 2010 and 2011, to 34.2%.</p> <p>The water and sanitation company (AySA) launched the Strategic Plan 2011-2015. National transfers to this public enterprise reached USD 540 million in 2011, which represents an increase of 229% compared to 2010.</p> <p>Moreover, the “Water and Sanitation Program for Urban and Suburban Centers” is being implemented, with a total cost of USD 250 million.</p> <p>A long-term project to clean up the Matanza- Riachuelo</p> |

| | | |
|--|--|-----------------------------------|
| | | river basin is being implemented. |
|--|--|-----------------------------------|

Source: G20 Los Cabos

As it can be seen by the table, the set of policies Argentina was asked to implement are quite broad and go from fiscal policy to food and energy security. Some of them, especially in fiscal policy, would have requested not too much of an effort to the Government, since sound public account deriving from a decade of current account surpluses and massive revenues from agricultural exports helped Argentina to be already on the 'right track'. However, excess in public spending and slowness in adjusting to new regulations in the financial and the banking sector represented a serious risk that the country deviated from this 'right track'.

Which is what actually happened: if we look at the scores individually obtained by the G20 member countries as per the rate of full implementation of the decisions taken at the summits, we discover that Argentina is the country with the lowest score. Normalized on a scale that goes from +1 (full implementation) to -1 (no implementation at all), Argentina obtained an average score of -0.29, with the lowest score recorded in the "protectionism" area (-1) (G20 Research Group 2012). Even in the area of fiscal consolidation, despite not too bad statistics (a general government balance of -1.6% and a debt-to-GDP ratio of 49.1% in 2010, IMF), the rate of improvement and compliance with the G20 decisions was absolutely insufficient (a miserable 0). In the field of International Financial Institutions, Argentina obtained a negative score for not ratifying the Board Reform amendment of the IMF, which would pave the way to the reform of the quota sharing and the system of vote. As already said before, adjustments to reform in the banking regulation were very poor, and no implementation at all of the Basel III agreement has been recorded so far (-1). Finally, Argentina is the country that has raised the highest number of new protectionist measures (10 for food and agricultural goods, 66 for manufactured goods, 6 for fuel and minerals, 4 for other categories of goods). Even with respect to developing countries Argentina (which can be hardly be considered a developing country tout-court itself) has adopted the highest number of trade-distorting measures. The country obtained positive scores only in relation to food security and internal social development. Table 3.2.5 shows the ranking of the G20 member States according to their implementation rate.

Table 3.2.5 – G20 decisions implementation: individual scores

| | Fiscal Consolidation | Structural Reforms | IFIs reforms | Financial Regulation | Protectionism | Development | Average |
|--------------------|----------------------|--------------------|--------------|----------------------|---------------|-------------|--------------|
| Canada | 1 | 0.17 | 0.5 | 0.42 | 1 | 1 | 0.68 |
| Korea | 1 | 0.43 | 0.67 | 0.17 | 1 | 0.53 | 0.63 |
| Saudi Arabia | - | n/a | 0.67 | 0.42 | 1 | 0.51 | 0.65 |
| Japan | 0 | 0.17 | 1 | 1 | 1 | 0.43 | 0.6 |
| Australia | 1 | 0.29 | 1 | -0.08 | 0 | 0.89 | 0.52 |
| Mexico | - | 0.33 | 1 | -0.25 | 1 | 0.5 | 0.52 |
| Germany | 1 | 0.5 | 1 | 0.42 | -1 | 1 | 0.49 |
| UK | 1 | 0.5 | 1 | 0.42 | -1 | 0.84 | 0.46 |
| France | 1 | 0.4 | 1 | 0.42 | -1 | 0.78 | 0.43 |
| EU | 1 | 0.4 | 1 | 0.33 | -1 | 0.85 | 0.43 |
| Italy | 1 | 0.38 | 0.67 | 0.42 | -1 | 0.49 | 0.33 |
| South Africa | - | 0.2 | 0.67 | 0.42 | 1 | 0.51 | 0.23 |
| Brazil | - | 0.2 | 1 | 0.17 | -1 | 0.74 | 0.22 |
| China | - | 0 | 1 | 0.33 | -1 | 0.57 | 0.18 |
| Russia | - | 0.6 | 0.83 | -0.25 | -1 | 0.62 | 0.16 |
| India | - | 0 | 0.17 | 1 | -1 | 0.51 | 0.14 |
| Turkey | - | -0.2 | 0.83 | -0.42 | 0 | 0.48 | 0.14 |
| US | 0 | 0 | 0.17 | 0.5 | -1 | 0.85 | 0.43 |
| Indonesia | - | -0.2 | 0.33 | 0.17 | -1 | -0.18 | -0.18 |
| Argentina | - | n/a | -0.17 | -0.17 | -1 | 0.17 | -0.29 |
| G20 average | 0.8 | 0.24 | 0.71 | 0.23 | -0.35 | 0.62 | 0.34 |

Source: G20 Research Centre

What are the reasons of such a disappointing performance? Simply bad will or bottlenecks in the domestic bureaucracy and administration that could have prevented Argentina from reaching a higher level of implementation? Although the latter is surely part of the explanation, the former is probably the most important and worrisome. The next section will explore this issue.

Still a G20 member?

Argentina had been criticized by different countries all over the world during the past few years for the economic policies implemented, not exactly friendly towards Foreign Direct Investment and the promotion of international free trade (see part I). In April 2012, the re-nationalization of the Spanish oil company Repsol triggered harsh controversies, not only by the Spanish government but also by other countries. The forthcoming G20 summit at Los Cabos provoked a debate around the issue whether Argentina were still deserving a chair at the organization. Official measures were proposed against the country's participation in the forum, for instance the Resolution submitted to the Senate of the United States by Senator Richard Lugar, the most senior Republican member of the US Senate foreign relations committee, claiming that: "Whereas the Republic of Argentina has consistently violated the spirit and letter of these and other G20 declarations through its policy of expropriating the property of foreign investors, evading the judgments of United States courts, ignoring decisions of international arbitral forums, refusing to comply with International Monetary Fund requirements and failing to implement anti-money laundering and terrorist financing measures; Whereas the President Cristina Fernández de Kirchner has flouted international norms and agreements by proposing legislation to nationalize Argentina's largest oil and gas producer, YPF SA, effectively expropriating the assets of foreign investors; Whereas Argentina has persistently ignored claims brought by United States and other countries before the International Center for Settlement of Investment Disputes (ICSID), administered by the World Bank, despite receiving billions of dollars in loans from the World Bank; Whereas Argentina remains one of only four countries, and the only G20 member, that refuse to submit to an International Monetary Fund review in violation of Article IV of the IMF Charter; (...) Resolved, that the Senate (1) finds that the Republic of Argentina has failed to meet the responsibilities inherent to membership in the G20, (2) calls upon the President and the Secretary of the Treasury to work with the governments of the G20 to suspend the participation of the Republic of Argentina in the G20 until the Government of Argentina has fully demonstrated its intent to adhere to international norms of economic relations and to commit to the rule of law (...)" (Lugar 2012). Although the Bill was not passed, possibly because of a sentiment of antipathy against Repsol for oil-drilling in Cuba spread among US Senators (Rachman 2012), it helped foster the debate around Argentina's membership. If

the then President of Mexico Felipe Calderón, host of the G20 summit, described the nationalization of YPF as “very regrettable”, it can be said that both Argentina adopted a non-cooperative attitude within the G20 and that at the same time a strategy to marginalize Argentina at the Los Cabos meeting was being put in place (Cooper 2012). Moreover, tense relationships with the United Kingdom because of the revived controversy around the sovereignty issue on the Falkland/Malvinas islands induced Prime Minister David Cameron to publicly attack Cristina Kirchner for undertaking protectionist measures aimed at harming the global economy. Aside to the official proposals to kick the country out of the organization, other countries were invited as external observers: among them, Chile and Colombia, that, thanks to their successful economic policies, are the two best candidates to replace Argentina, were its expulsion ever decided. There is still an on-going debate about how the membership of the G20 should actually be, and Argentina is often excluded by the ‘ideal’ group of States. A research by Brill and Glassman (2012) showed that, according to criteria of economic size and global economic importance, country’s adherence to the rule of law and principles consistent with market-based economies, and the size of a country’s financial services sector, Argentina (together with Mexico, Indonesia and Russia) does not fully qualify to be a G20 member.⁴⁴

As shown, at the G20 Los Cabos summit the position of Argentina inside the G20 reached its lowest peak ever. Even at the last summit in St. Petersburg the attitude of the country doesn’t seem to have changed much. President Cristina Kirchner advocated for a new wave of multilateralism and rejected the accusations of protectionism, saying that developed countries are those which impose the highest trade barriers⁴⁵ and are mostly responsible for the lack of dialogue and economic coordination. Argentina also proposed to establish a committee within the WTO to deal with international health and sanitary standards, so as to have a set of global common rules and to avoid non-tariff barriers of this kind (La Nación 2013).

However, a combination of factors resulted into the progressive detachment of Buenos Aires from the rest of the members: a poor record in the implementation of the decisions taken, hostile actions towards foreign investors and international trade, tense relationships in foreign policy deriving from the long-lasting, unresolved issue of the Falkland-Malvinas islands. Together with the broadening fracture with the IMF, the international role of Argentina is being harmed and marginalized.

⁴⁴ The empirical test attributed a score to each different criterion. According to their results, the four countries should be replaced by Norway, Malaysia, Switzerland and Singapore.

⁴⁵ However, Argentina is one of the most protectionist countries in the world (see chapters 3.3 and 3.4).

3.2.4 Conclusion: the risk of becoming an ‘outlier’ in the global economy

The G20 is a relatively new organization in the framework of global multilateral institutions. Born in 1999 as an annual meeting between Finance Ministers of the 19 (plus the European Union) most “systemically important countries”, in 2008 it was upgraded as a leaders’ summit and it was defined as “the world’s steering committee”. Very active especially in the areas of fiscal policy, financial and banking regulation, it was quite successful in addressing the worst consequences of the global financial crisis and in helping developed and developing economies find coordinate responses in order to retake the path of growth relatively soon. The novelty in its internal governance, based on informal procedures where each member has the same weight, helped increase the sense of ownership between the States and favored the active participation of developing countries.

According to this framework, Argentina had the big opportunity to start playing again an important role on the global economic stage. Its membership in the G20 was chosen because its relevance in Latin America and its recent past characterized by a systemic debt crisis. As one of the fastest growing countries in the 2000s, Argentina could have seized the opportunity to undertake an active role within the forum aligning itself with the position of the BRICS countries and establishing networks with the other developing countries. This would have allowed it to have an increasingly reliable and respected weight and to be considered a full member of the international economic and financial community.

Nevertheless, despite a promising start limited to progress in fiscal consolidation, Argentina became more and more isolated among the G20 countries. It ranks last according to the implementation of the measures agreed at the summits and this is due not only to inefficiencies and bottlenecks in its bureaucratic sector, but also to a hostile attitude developed over the course of the past few years. The nationalization of the oil company YPF, as well as the renewed hostility against the UK for the control on the islands Falkland/Malvinas and the increase in protectionism are the clearest examples of the process that is driving Argentina to be a “pariah” or an ‘outlier’ in the world economy, as shown in the previous chapter dedicated to the IMF. Isolation is likely to prevent Argentina from being inside networks of cooperation and from receiving foreign capital that should be necessary to sustain domestic investments and to allow the country to be part again of global financial markets. In a world that is rapidly changing its shape and moving towards a multipolar distribution of the economic power, it seems that Argentina is going to miss a unique opportunity.

3.3. Argentina and the MERCOSUR: a promise not fulfilled

3.3.1 Structure of the chapter

The history of economic integration in South America is characterized by several attempts that trace back in a not too recent past. The examples of the Latin American Association for Free Trade, set up by Argentina, Brazil, Chile, Mexico, Paraguay, Peru and Uruguay in 1960, the Association of Latin American Integration (ALADI), established in 1980 between 13 Latin American nations, and of the Andean Community of Nations (CAN), created in 1969 between Bolivia, Colombia, Ecuador and Peru, represent the oldest organizations aimed at building up the integration process, in terms of trade and macroeconomic coordination, in the region.⁴⁶

The main focus of this chapter is the Common Market of the South (MERCOSUR), created in 1991 between Argentina, Brazil, Paraguay and Uruguay. Started as a free trade area, it then became a custom union in 1995 after the enforcement of the Ouro Preto protocol. As the most ambitious economic integration project ever launched in South America, in the intentions of its member States MERCOSUR should have followed the same pattern of the European Union, in order to progressively become a fully fledged, integrated common market. The project had been working well during its first six years of life and helped increase intra-regional trade by more than four times (BID – INTAL 2012) with a further boost during the last decade.

Nevertheless, economic and political contrasts between its two main members, Argentina and Brazil, led the integration process to a standstill because of the lack of a sufficient degree of macroeconomic coordination and a progressive return to protectionist measures raised intra-bloc. MERCOSUR's current situation is disappointing and its institutional paralysis ended up with the organization being overtaken by other trade and economic integration projects developed by other dynamic South American countries (for example Chile which is involved in the negotiations towards the Trans Pacific Partnership, TPP).

What is the role of Argentina in this process? In this chapter I show that the country has adopted during the last two decade inappropriate economic policies which led to an insufficient degree of integration, especially with its most important neighbor, Brazil. The 'irrational' behavior adopted at the global level, shown in the two previous chapters dedicated to the analysis of the role of the country within the IMF and the G20, has been reflected by a similar attitude at the regional level, because of a

⁴⁶ See Chapter 2.1 for further information.

never extinguished protectionist trend which is leading Argentina to a progressive isolation. Therefore, I argue that the economic policies implemented at its borders within the regional integration context have negative spillovers also at the global level, undermining Argentina's international position and its economic relevance in South America and worldwide.

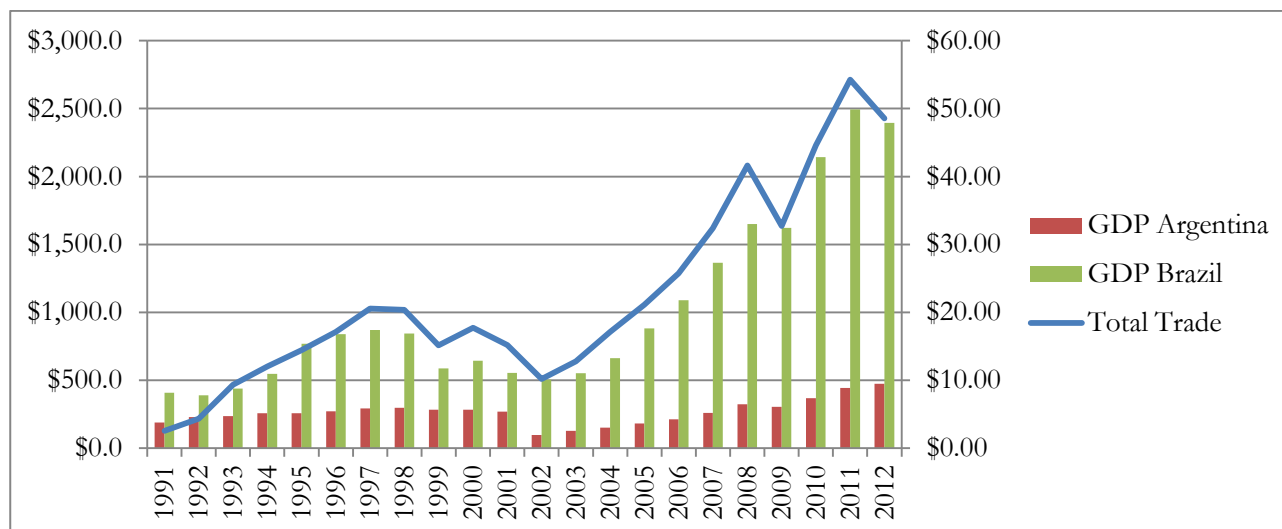
3.3.2 MERCOSUR: history and achievements

The Common Market of the South (MERCOSUR) represents the most ambitious project of economic integration in South America. Created in 1991 by the Treaty of Asunción among Argentina, Brazil, Paraguay and Uruguay (Bolivia and Chile became associate members, while the membership of Venezuela is still pending because of the negative pronouncement of Brazilian Parliament), MERCOSUR marked a further step on the integration process, since it created not only a free trade zone but also a custom union. The Protocol of Ouro Preto, signed in December 1994, determined the full enforcement of the organization through the establishment of the common external tariff and of its institutional structure. Four concrete goals were targeted: free circulation of goods, services and factors of production; coordinating macroeconomic and sectoral policies; harmonizing domestic legislation (Malamud 2005). Since 1995 most of items traded faced zero duties, but a certain level of protection remained for categories of goods like automobiles, which represent a strategic asset for the manufacturing sector of both Argentina and Brazil.

In the intention of its founders, the organization was modeled upon the experience of the European Union, and the last step of this process should be the achievement of a "common market" through the coordination of the national macroeconomic policies.

The effectiveness of MERCOSUR has been strictly dependent on the economic performance of its main members, Argentina and Brazil. Intra-regional trade increased during periods of boom, while it was negatively affected during periods of recessions. Malamud (2005) underlines how the success of the organization strictly depends on the economic performance and on the political views of its two biggest members, but also recognizes that in its first seven years of life regional trade increased four times, this effect explained by trade creation rather than trade diversion. On the other hand, it is also possible to argue that the increase in regional trade can be interpreted as the natural outcome of periods of economic 'booms'. Figure 3.3.1 shows that intra-regional exchanges were on the rise in the periods 1991-1996 and 2003-2008, when Argentina and Brazil had the highest and most stable rates of growth of GDP (respectively 5.9% and 2.85% during the first period, 8.5% and 4.2% during the second - IMF 2013).

Figure 3.3.1 – Trade and economic growth in MERCOSUR (billion US\$, % values, 1991-2012)



Source: Elaboration of the author on UN Comtrade and IMF data

Internal demand, as a reflection of economic growth in Argentina and Brazil (we do not consider in this analysis Uruguay and Paraguay because of their negligible economic size), has therefore been a main determinant in the increase of intra-trade zone. External demand (i.e. coming from the rest of the world) has also promoted the increase of exports extra-region for the four countries, since during the last decade the proportion of intra-regional has grown little from 11% in 2002 to 15.7% in 2010 (BID Intal 2012).

Despite the constant increase of intra-regional trade flows, MERCOSUR has been affected during the last years by a return of protectionism. Following an opposite trend from the rest of the world, in 2010 new 62 protectionist measures were raised by the four countries, while at the global level trade defensive measures decreased by almost half (Evenett 2012). The main recipients of the protectionist barriers were other Latin American countries, the European Union and Asia particularly in the sectors of textiles, raw metals, paper and cardboard (BID Intal 2012).

Another important area to assess the degree of economic integration is that one related to the promotion of Foreign Direct Investment (FDI). The “Protocol of Colonia for the Promotion and the Reciprocal Protection of Investment”, signed in 1993, states that the four members guarantee the same treatment to external investors according to the Most Favored Nation principle. In particular, this refers to the limits imposed to expropriations and nationalizations, which can occur only in cases where the public interest clearly prevails over private ones (Lara 2011). Investment flows increased particularly during the 1990s thanks to the liberalization and privatization process implemented in Argentina under

the two terms of President Carlos Menem and also to an effective action of integration and harmonization of some important markets such as car manufacturing (Lara 2011). A second important wave of FDI coming into the region took place after the 2001-2002 crisis, but the total proportion of FDI on the overall GDP of the bloc is still quite low (2.3% in 2010, BID Intal 2012). Argentina used to be the first recipient of FDI until the middle of the 1990s, but it was overtaken by Brazil and its participation in the incoming flows into the region was only 12.1% in 2010 (BID Intal 2012).

Finally, macroeconomic coordination is a third important area to assess the degree and the effectiveness of integration in MERCOSUR. In 1995 the MERCOSUR Action Plan had stressed the importance of having coordinated macroeconomic policies in order to strengthen the economic integration and to let the custom union work effectively. Therefore, the Plan suggested to establish a periodical exchange of information among the Member states and to set up common regional economic indicators so as to design and implement a coherent framework of macroeconomic policies. In 1999 a High Level Working Group was created and asked to provide MERCOSUR with the appropriate tools in order to comply with these needs, and in 2000 the group was upgraded to the status of Macroeconomic Monitoring Group (*Grupo de Monitoreo Macroeconómico*, GMM), dedicated to the elaboration of harmonized fiscal and public debt policies. After this intense preparatory work, the leaders of the four countries agreed with the Florianopolis Declaration in December 2000 to address the following targets:

- Deficit-to-GDP ratio: up to 3% of GDP from 2002
- Debt-to-GDP ratio: up to 40% of GDP from 2010, with a convergence process starting in 2005
- Inflation rate: up to 5% between 2002 and 2005, then 4% (BID Intal 2012).

How have the four countries performed so far with respect to these targets? Table 3.3.1, 3.3.2 and 3.3.3 show the data recorded in the last decade and highlight whether the maximum level allowed has been respected (green color), or not (red color). In the case of public debt, a yellow color underlines whether a process of convergence was taking place.

Table 3.3.1 – MERCOSUR countries, Deficit-to-GDP ratio (% values, 2002-2011)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----------|--------|-------|-------|-------|-------|-------|-------|-------|-------|--------|
| Argentina | 0.93% | 3.38% | 5.45% | 4.65% | 4.18% | 2.47% | 2.76% | 0.21% | 1.68% | -0.11% |
| Brazil | 3.22% | 3.27% | 3.72% | 3.79% | 3.23% | 3.36% | 4.01% | 2.12% | 2.44% | 3.09% |
| Uruguay | -1.38% | 1.87% | 2.99% | 2.08% | 1.96% | 2.38% | 3.57% | 1.16% | 1.36% | 1.09% |
| Paraguay | 0.23% | 3.03% | 3.83% | 4.03% | 3.64% | 3.52% | 1.34% | 1.08% | 1.74% | 1.99% |

Source: IMF

Table 3.3.2 – MERCOSUR countries, Public debt-to-GDP ratio (% values, 2002-2011)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|-----------|---------|---------|---------|--------|--------|--------|--------|--------|--------|--------|
| Argentina | 164.97% | 139.46% | 127.03% | 87.13% | 76.46% | 67.10% | 58.52% | 58.70% | 49.10% | 44.94% |
| Brazil | 79.80% | 74.69% | 70.63% | 69.15% | 66.66% | 65.18% | 63.55% | 68.06% | 66.84% | 64.94% |
| Paraguay | 72.61% | 53.10% | 45.49% | 38.00% | 27.87% | 21.92% | 19.07% | 18.04% | 15.43% | 12.04% |
| Uruguay | 94.71% | 99.27% | 90.14% | 77.62% | 70.35% | 63.17% | 61.65% | 61.02% | 57.06% | 55.07% |

Source: IMF

Table 3.3.3 – MERCOSUR countries, Annual Inflation rate (% values, 2002-2012)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|-----------|-------|-------|------|------|-------|------|-------|------|-------|------|-------|
| Argentina | 25.9% | 13.4% | 4.4% | 9.6% | 10.9% | 8.8% | 8.6% | 6.3% | 10.8% | 9.5% | 10.0% |
| Brazil | 8.5% | 14.7% | 6.6% | 6.9% | 4.2% | 3.6% | 5.7% | 4.9% | 5.0% | 6.6% | 5.4% |
| Paraguay | 10.5% | 14.2% | 4.3% | 6.8% | 9.6% | 8.1% | 10.2% | 2.6% | 4.7% | 8.3% | 3.7% |
| Uruguay | 14.0% | 19.4% | 9.2% | 4.7% | 6.4% | 8.1% | 7.9% | 7.1% | 6.7% | 8.1% | 8.1% |

Source: IMF

It is possible to say that the performance with respect to the public account has been quite successful in all four countries. In particular, Argentina managed to obtain a substantial haircut on its external debt after the unilateral decision of restructuring it down to 30% of its original level. The real problem seems to be the inflation rate, that remains particularly high in Argentina (as I showed in chapters 1.2 and 3.1, official data on inflation are considered to be much lower than they actually are).

Another big problem of macroeconomic misalignment has been due in the past to too different bilateral exchange rates. It seems then that internal asymmetries between the four members have represented the biggest stumbling blocks to achieve further integration. As shown by Bittencourt, Larson and Thompson (2005), the stability of the organization was in doubt due to the Brazilian crisis in 1998, which led to the devaluation of the national currency and to severe commercial disputes with Argentina (that during those years was pegged to the US dollar through a currency board regime) , and to the fierce economic slowdown of the latter in 2002. The researchers attribute the troubles faced by MERCOSUR to a lack in policy coordination among the members, which could have helped to mitigate the issues arising among them. This lack of coordination has also been stressed by Baer, Cavalcanti and Peri (2002), who described how the divergence in monetary policy between Argentina and Brazil affected regional trade in a negative way. The deficits in the trade balance registered by Argentina in the first years of the MERCOSUR, and by Brazil afterwards, provoked a rise of the tariffs regarding sensitive goods as automobiles and the devaluation of the Brazilian currency in 1999, with the clear objective of gaining competitiveness in export. A high level of variability of the exchange rate was shown having a negative impact on bilateral trade between the two countries (Baer, Cavalcanti, Peri, 2002): which is exactly the effect a regional trade agreement should avoid. An analysis of the macroeconomic cycles in MERCOSUR showed that lack of synchronization has marked the last twenty years especially between Argentina and Brazil, the former being characterized by a much higher degree of volatility (Builes Vásquez 2010).

In 2010 the last step ahead was characterized by a long-awaited agreement on a common customs code, but in the more recent years, the integration process has faced other problems originated by different factors, not only economic but also political. The most interesting example is provided by the admission of Venezuela into the membership of the organization. The country, which shares its borders only with Brazil among the other members of MERCOSUR, applied to be admitted in the organization after withdrawing from the CAN in 2006 in opposition to the forthcoming of Free Trade Agreements with the United States. The admission process took several years and it was prolonged by the refusal by the Parliament of Paraguay to ratify the act that would allow Venezuela in. Finally, at the MERCOSUR summit in Brasilia on 31 July 2012 Venezuela was admitted, simply because Paraguay's membership had been previously suspended following a *coup d'état* that had removed the former President Fernando Lugo. Serious juridical concerns were expressed about the fairness of this process (the simple 'freezing' of the membership status does not mean that other members can be admitted without the consent of the former) but also about the real implications of Venezuela's admission,

determined not by a concrete willingness of economic liberalization and integration, but by the geopolitical ambitions of the former President of Venezuela Hugo Chávez to establish a new south American bloc of power (Stefanini 2012). However, the potential gains for Venezuela, as a country increasingly dependent on imports from other MERCOSUR countries after the conversion of the domestic production system to the exclusive exploitation of oil resources, should not be underestimated (Arellano 2013).

To conclude, it seems today that MERCOSUR ran out of the integrating push that had animated the first years of its life. To use Malamud's words (2008), the organization lacks the fundamental characteristics that are needed for a regional integration process to be successful. First of all, demand conditions that arise because of further needs of lowering transaction costs are low in MERCOSUR, since we showed that the proportion of intra-regional trade compared to total trade is not so high. Secondly, the organization has also a deficit of supply conditions, in the sense that there is not a clear leader willing to act as a 'paymaster', i.e. willing to pay most of the integration costs. The role of 'paymaster' should be played by Brazil, for its relevant economic size, but its reluctance as a regional leader prevented MERCOSUR from achieving a deeper level of integration. Finally, inertial conditions, represented by the degree of institutionalization, are also too weak. MERCOSUR is endowed with an institutional framework, but the questionable status of MERCOSUR community law, given the absence of direct effect and mutual recognition, prevents regional regulation from having primacy over domestic law (Malamud 2008).

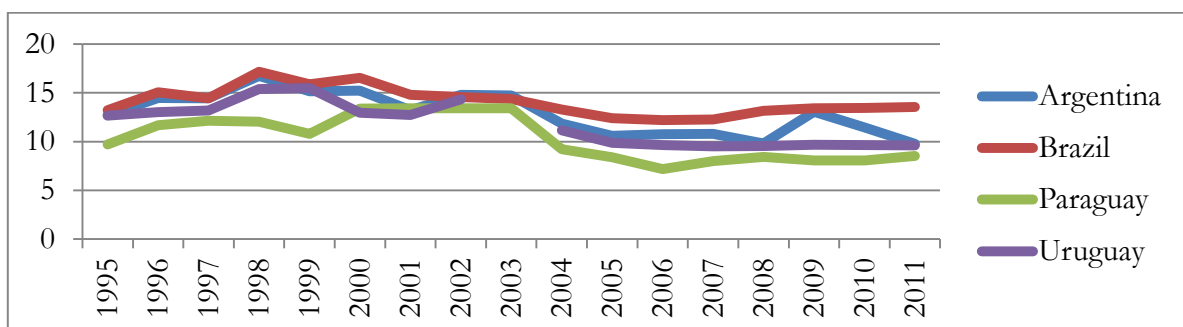
3.3.3 Argentina: from integration to ...isolation

Argentina was originally a strong promoter of MERCOSUR as a project that, in the intentions of its founders, would have followed and replicated the integration process of the European Union in South America. As shown in the previous section, the first steps moved by the organization seemed to stay on the right track, but after some years the integration process was at a standstill. This happened mainly because of the responsibility of its two biggest members, Argentina and Brazil. There are at least three factors that prevented MERCOSUR from being successful. First of all, macroeconomic imbalances between Argentina and Brazil: in part II it was shown how the devaluation of the Real implemented by Brazil in 1999 led to a sudden loss of competitiveness from Argentina, from which it had never been able to completely recover, even after abandoning the currency board with the US dollar in 2002. This provoked a misalignment between the two countries and an enduring lack of coordination in terms of bilateral exchange rate. Secondly, the unwillingness of both countries to take on the role of a leader

deprived MERCOSUR from the “supply conditions” to properly nurture the integration process. Brazil always looked with reluctance at the role of regional leader, while Argentina’s return to political and economic nationalism after the 2001-02 crisis help explain why MERCOSUR remained without an integrating push.

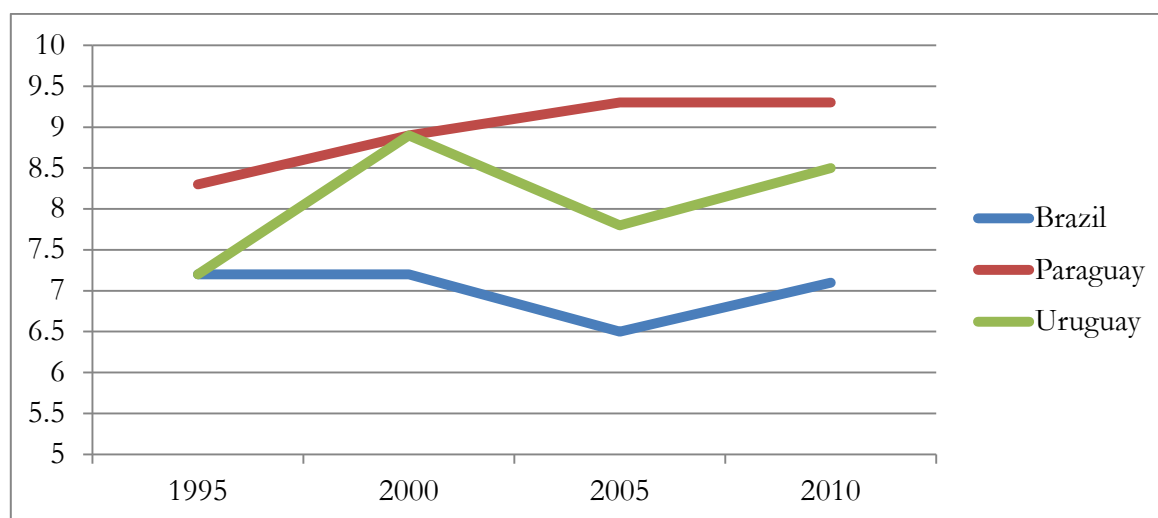
Third, and a consequence of both the previous two factors, is Argentina’s return to protectionism. It is important to make a distinction between tariff and non tariff barriers (NTBs). If we look at the simple mean of tariffs applied for all products traded, Argentina and the other members of MERCOSUR have reduced them over the course of the last 15 years (Figure 3.3.2). However, they are still at an average level of 10.3%. A further focus on Argentina suggests that, with respect to its MERCOSUR partners, it has kept the level of tariffs low, as shown by the average levels computed for all products in 1995, 2000, 2005 and 2010 (Figure 3.3.3). The econometric regressions performed in part II revealed that belonging to MERCOSUR had a negative impact overall on the exports of the four countries. I argue that this is not due to the level of tariffs, which are relatively low between the MERCOSUR countries, but a reason for this is a sharp rise of Non Tariff Barriers erected especially by Argentina in the last five years. Argentina ranks third in the world as per the number of new protectionist measures (in the sense that they are considered discriminatory against goods produced abroad) implemented since 2008 (185), behind only the European Union and the Russian Federation (Table 3.3.4). Argentina is also the third most protectionist country as per number of sectors affected by protectionist measures (73, behind the European Union and Italy). Such a dramatic increase of discriminatory measures can be partly explained as a consequence of the global financial crisis of 2007-08, which induced many countries to reduce its openness towards the rest of the world in the attempt to preserve their domestic economic system (Bianchi 2013).

Figure 3.3.2 – MERCOSUR countries, Tariff rate applied, simple mean, all products (1995-2011)



Source: World Development Indicators, World Bank

Figure 3.3.3 – Argentina, tariff rate applied to MERCOSUR partners, simple mean, all products (1995-2000-2005-2010)



Source: United Nations Comtrade Statistics Division

Table 3.3.4 – The world's most protectionist countries (2008-2013)

| Number of protectionist measures imposed | Number of sectors affected by protectionist measures |
|------------------------------------------|------------------------------------------------------|
| EU 27 (372) | EU 27 (78) |
| Russian Federation (231) | Italy (78) |
| Argentina (185) | Argentina (73) |
| India (113) | Germany (66) |
| Belarus (101) | Algeria (58) |
| Germany (99) | Russian Federation (54) |
| United Kingdom (98) | China (52) |
| Italy (94) | Kazakhstan (50) |
| France (91) | USA (47) |
| Brazil (80) | Nigeria (45) |

Source: Global Trade Alert 2012

At present, Argentina is implementing a total number of 234 protectionist measures and is responsible for 48% of the 335 discriminatory measures adopted by Latin American countries since March 2008.

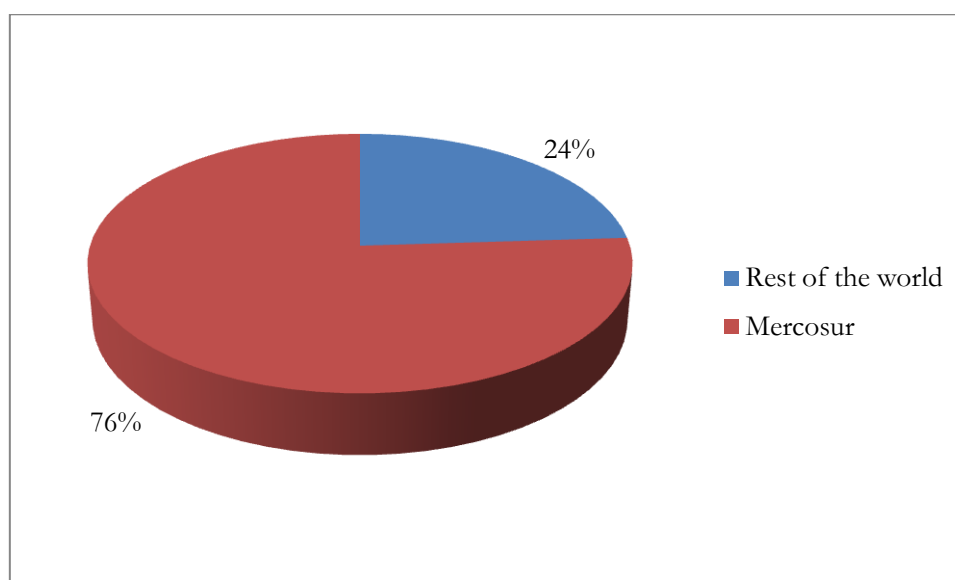
Most of them are directed against MERCOSUR partners (179, equal to the 76%), and in particular 103 of them are aimed at affecting Brazilian exports (Table 3.3.5 and Figure 3.3.4).⁴⁷

Table 3.3.5 – Argentina’s protectionist measures against MERCOSUR partners (2013)

| Country | Number of protectionist measures |
|-------------------------------|----------------------------------|
| Brazil | 103 |
| Paraguay | 29 |
| Uruguay | 47 |
| TOTAL against MERCOSUR | 179 |

Source: Global Trade Alert

Figure 3.3.4 – Argentina’s protectionist measures (World and MERCOSUR partners, 2013)



Source: Global Trade Alert

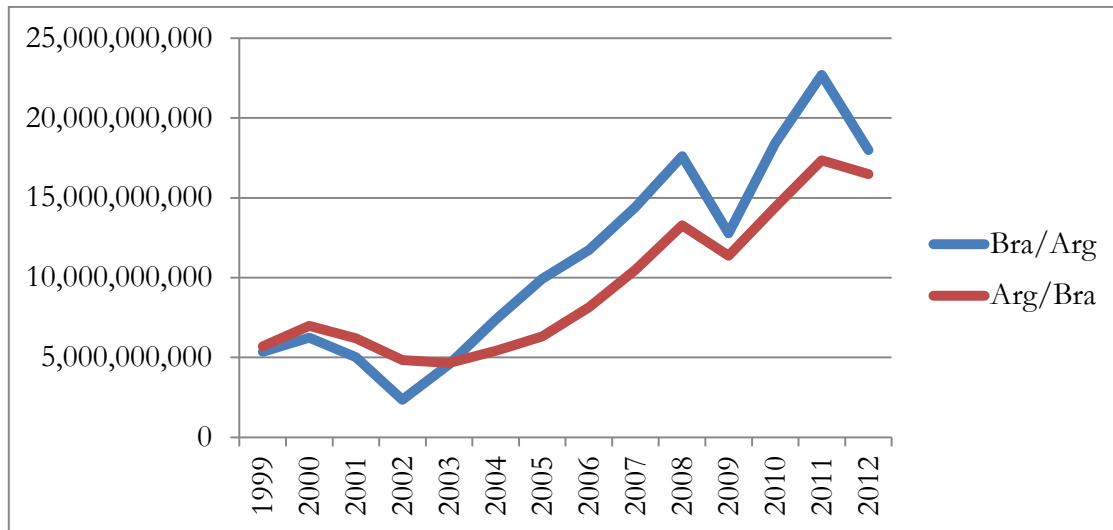
A closer look at Argentina’s trade policy helps to understand what kind of instruments the country uses in order to protect its domestic products. Argentina’s NTBs mainly revolve around the following policy tools:

⁴⁷ It must be noted that some of these measures apply simultaneously to more countries at the same time, so it can be the case that some of the measures aimed at affecting Brazil are affecting at the same time Paraguay and/or Uruguay.

- Capital goods regime (national producers of capital goods competing with imported goods are compensated with a tax benefit of 14%. Moreover, in 2012 an import duty of 14% was established for capital goods that can be provided by domestic manufacturers);
- Bicentenary Productive Financing Programme (a programme launched in 2010 aimed at providing cheap credit to domestic firms, mainly in sectors like autoparts, food and medicament.);
- Programme for the Recovery of Production (subsidies preventing firms from firing their employees Subsidies increased by 450% between 2009 and 2010 up to amount of 130 million US\$);
- Reference prices (currently 86 tariff lines are covered by these measures, mainly textiles and plastic products, that impose higher prices than the actual market prices and generate extra protection for domestic producers);
- Antidumping measures (mainly for textiles and machinery equipment, which are labor intensive and characterized by a high proportion of Small and Medium Enterprises, and especially directed against Brazil);
- Non-automatic import licenses (see below for a more detailed explanation) (Szapak and Tussie 2013)

The main reasons why Argentina started imposing so many new barriers are essentially two: on one hand, the increasing trade deficit vis-à-vis Brazil (Figure 3.3.5), on the other hand the return to economic nationalism especially during the first and second Presidency term of Cristina Kirchner. Since 2003 Argentina started running a trade deficit with Brazil, which rose up to the maximum level of 5.3 billion US\$ in 2011. This sharply fell down to only 1.5 billion US\$ in 2012, with a 20% reduction of imports from Brazil over the previous year and also of a 4% drop of exports from Argentina to Brazil (UN Comtrade). This happened because between 2011 and 2012 Argentina started raising many new Non-Tariff Barriers (NTBs), as shown in the above. Among the NTBs, the most implemented by Argentina were non-automatic import licenses,⁴⁸ which were applied to additional 172 products imported from Brazil, adding up to a total of 584 products (Resolution 45/11).

⁴⁸ The WTO defines import licensing as administrative procedures requiring the submission of an application or other documentation (other than those required for customs purposes) to the relevant administrative body as a prior condition for importation of goods. Automatic import licensing (licensing maintained to collect statistical and other factual information on imports) is defined as import licensing where the approval of the application is granted in all cases. Therefore, non-automatic import licensing is defined as licensing not falling within the definition of automatic import licensing. Non-automatic licensing is used to administer trade restrictions such as quantitative restrictions

Figure 3.3.5 – The bilateral trade relationship between Argentina and Brazil (1999-2012, US\$)

Source: UN Comtrade Statistic Division

Brazil is by far the country most affected by non-automatic import licensing: in 2011, 36.5% of these measures from Argentina were applied against MERCOSUR, 95.7% of which were aimed at affecting Brazilian exports (BID Intal 2012). Sectors most affected by these measures were car manufacturing, electric equipment, ICT devices, metals and chemical products, which corresponded to the sectors that suffered the most from the rising trade deficit vis-à-vis Brazil (BID Intal 2012).

The new barriers erected by Argentina triggered a new ‘trade conflict’ with Brazil, that engaged in further restrictions against exports from its neighbor country imposing non-automatic import licenses on cars in May 2012. Buenos Aires’ first move triggered a conflictive ‘tit-for-tat’ strategy based on continuing retaliation between the two players,⁴⁹ which ended up with damaging the domestic economy, since 70% of Argentine exports to Brazil come from the car manufacturing sector. A bilateral agreement signed in June 2012 tried to prevent the two countries from adding new import licenses, but the consequence so far has been a serious deterioration in the trade relationship between the two countries, as shown in Figure 3.3.5. Although the official reasons used to explain this return to

which are justified within the WTO legal framework. But they should not have restrictive or distortive effects on imports additional to those caused by the imposition of the restriction, and is to correspond in scope and duration to the measure it is used to implement (WTO 2013).

⁴⁹ ‘Tit-for-tat’ means ‘equivalent retaliation’. The strategy was first introduced in game theory by Robert Axelrod. It can lead to cooperation if the move of the first agent is cooperative, so that the second player replicates the former’s action. Otherwise, if the first player is not cooperative, the second will not as well. This will lead to a sub-optimal equilibrium.

protectionism were that the Government needed to protect strategic sectors for the national industry and to safeguard jobs in the country (Webber 2011), these measures did not have any positive effect on the domestic economy, with consequences both in the short and the medium-long run. Short term consequences imply a further increase in internal prices, since imports from Brazil became more expensive, so that they affected consumers. On the other hand, in the long term protectionist measures do not provide any incentive to national producers to increase their productivity, damaging their competitiveness at the global level. Moreover, negative spillover effects propagated to the other MERCOSUR countries, affecting also 6.2% of Paraguay's imports and 24.2% of Uruguay's, countries that rely very much on intra-regional trade (BID Intal 2012). This further contributed to lead the integration process at a standstill.

At the regional level, Argentina has not only implemented non-automatic import licenses, but also countervailing (or anti-subsidy) and anti-dumping duties and safeguards.⁵⁰ Nevertheless, these measures represent a very small part of the trade barriers deployed by the country, since they affect only 20 Brazilian products (0.3% of the total and a value of 28 US\$ million) (BID Intal 2012).

Sectors most affected by the measures described are those ones where Argentina's economy is more sensitive. Non-tariff barriers mainly revolve around car manufacturing (the deficit with Brazil shrank, but mainly because of an overall reduction of bilateral trade rather than because of a strong increase of Argentine exports), textiles, shoes and dairies.

⁵⁰ Anti-dumping duties (ADD) are imposed in addition to any normal customs duty for which the goods being imported are liable. It enables the country to take action against goods sold at considerably less than their 'normal value'. This is defined as a price that is lower than the price of similar goods in the country from which they originate. Countervailing, or anti-subsidy duties, Countervailing duties (CVDs), also known as anti-subsidy duties, are trade import duties imposed under World Trade Organization (WTO) Rules to neutralize the negative effects of subsidies. They are imposed after an investigation finds that a foreign country subsidizes its exports, injuring domestic producers in the importing country. According to World Trade Organization rules, a country can launch its own investigation and decide to charge extra duties, provided such additional duties are in accordance with the GATT Article VI and the GATT Agreement on Subsidies and Countervailing Measures. Finally, WTO member may restrict imports of a product temporarily (take "safeguard" actions) if its domestic industry is injured or threatened with injury caused by a surge in imports. Here, the injury has to be serious. Safeguard measures were always available under GATT (Article 19). However, they were infrequently used, some governments preferring to protect their domestic industries through "grey area" measures — using bilateral negotiations outside GATT's auspices, they persuaded exporting countries to restrain exports "voluntarily" or to agree to other means of sharing markets. Agreements of this kind were reached for a wide range of products: automobiles, steel, and semiconductors, for example.

To conclude, it is possible to infer that the integration process in MERCOSUR has been armed both in terms of trade relationships by an increasingly damaging retaliation strategy implemented by Argentina and Brazil and in terms of macroeconomic integration by an insufficient coordination among the four member countries.

3.3.4 Conclusion: regional integration at a standstill

This chapter described the pattern followed by MERCOSUR since its foundation, in 1991, until the present day. At its inception the most ambitious attempt of regional integration in South America by replicating the process implemented by the European Union, it is now at a standstill and the current situation can be defined disappointing.

As it was shown, MERCOSUR helped without any doubt to promote intra-regional trade, especially during the first years of its existence, but this remarkable increase was mainly explained by the economic growth of its members, and especially of the two biggest, Argentina and Brazil. In other words, the increase of intra-regional exchanges was also accompanied by an increase of extra-regional trade.

Several problems have undermined the deepening of the integration process especially over the course of the last fourteen years. They are due both to political and economic reasons. Political reasons imply the lack of “supply”, as described by Malamud (2008), in terms of integration force by its two main members. Argentina, under the governments of Néstor and Cristina Kirchner, turned to adopt a nationalist foreign policy which led the country to have diplomatic argues with its neighbors, while Brazil did not accept to undertake the role of regional leader preferring to look outside the continent.

However, economic reasons are way more important. Lack of macroeconomic coordination between Argentina and Brazil, mainly represented by misalignments of the exchange rates, affected the trade relationships not only at a bilateral, but also at a regional level. The Macroeconomic Coordination Group, established within the MERCOSUR, has not been effective enough in promoting harmonization among the four States and in achieving the targets set in terms of debt and deficit reduction and inflation control.

Moreover, Argentina’s recent return to protectionism and economic nationalism triggered a ‘tit-for-tat’ conflictive relationship with Brazil. The imposition of many NTBs, among which non-automatic import licenses to hundreds of products coming from Brazil played a major role, justified as a means to

protect domestic industries and workers, contributed to further increase prices in Argentina and undermine its global competitiveness in the medium term.

In conclusion, it is possible to say that Argentina has adopted an 'irrational' behavior also at the regional level. Instead of promoting the full realization of an effective custom union and of an integrated, economic area, the country's nationalist strategies are detrimental to its economic development and to the role of leadership it could play at a regional level. For its economic size, Argentina could be a big regional power in South America and a medium-sized power at the global level, but the economic policies implemented during the last years are leading the country to a progressive isolation. Next chapter will be dedicated to analyze the framework of the international relations where Argentina operates and what strategies the country could adopt to become a more active and integrated player .

3.4. Argentina in the neo-liberal order: is there any way to play a role?

3.4.1 Structure of the chapter

In the previous chapters of this part I analyzed Argentina's behavior in the economic international context, through a series of case studies covering different dimensions of multilateral institutions (from the global to the regional level) and different time periods. I showed that Argentina has adopted for most of the time since the end of World War II economic policies and political attitudes not compatible with the rules at the basis of the liberal order established after the conference of Bretton Woods. Internal political instability was reflected into uncertain and wavering economic policies and relationships with the main global institutions, as described in the case of the International Monetary Fund (IMF). This dynamics has intensified during the last decade, dominated by the "*Kirchnerismo*", a new political movement embodied by Néstor and his widow Cristina Fernández de Kirchner, whose populist and economic nationalist roots are based in the early Peronism.

Nowadays, the economic global framework is quickly changing. From a unipolar scheme, dominated by the United States as the only superpower remained on Earth, we are moving towards a new situation where economic power is distributed more evenly across the world. How is Argentina positioned in this context? Can the country play a decisive role in multilateral economic affairs and influence other countries' behavior? If things stay as they are, I argue that Argentina is doomed to become marginalized in the global arena and to have negligible relevance. A way out of this *cul-de-sac* would consist of accepting the rules of the current neo-liberal order, based on an increasing participation of developing countries in the process of economic global governance, and play an active role inside of it, instead of breaking off relationships with institutions and implementing protectionist policies that are detrimental for the development of Argentina itself.

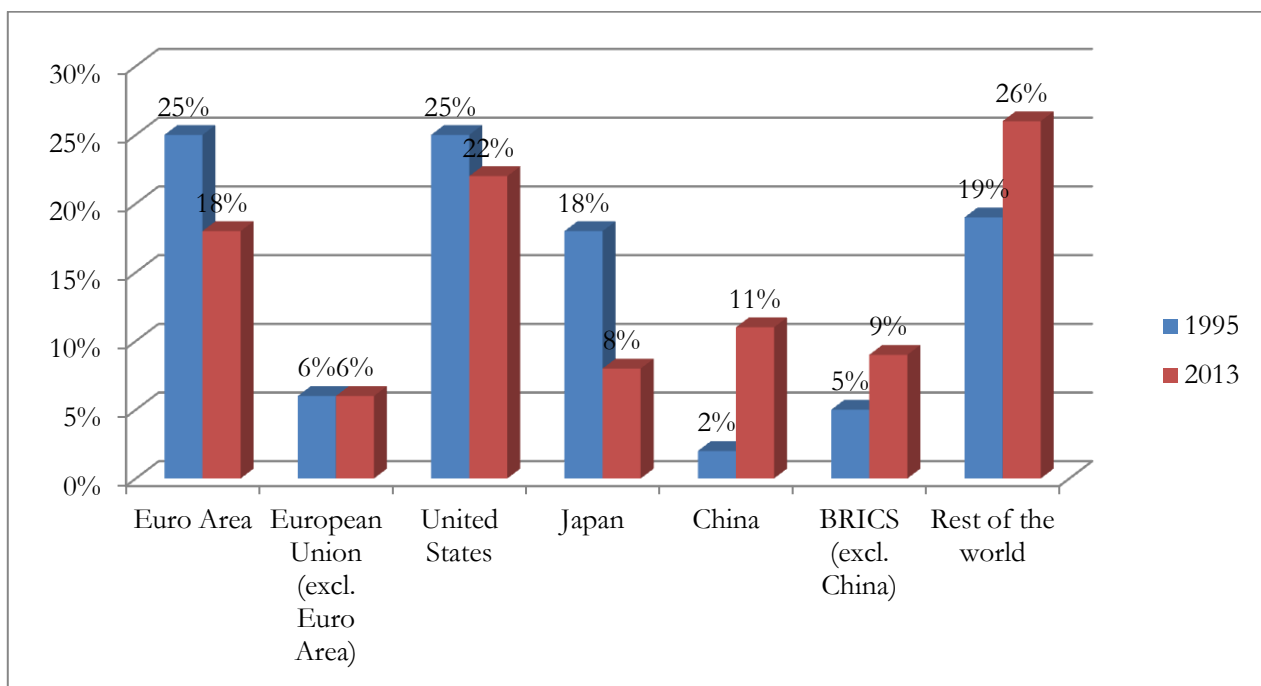
This chapter is structured as follows. After a theoretical digression aimed at defining what economic power is and how it can be interpreted in the current global context, an assessment of Argentina's power will be provided. A negotiation behavior framework for rising powers will then be applied to the case of Argentina in order to stress the main drawbacks of its strategy. Finally, an analysis of the role the country can play and a series of policy recommendations to improve its relevance at the global and regional level will be provided.

3.4.2 Economic power in a changing global environment

Economic power and its global diffusion

The size and complexity of the world economy has expanded massively in the last two decades. The US and the EU remain economically dominant but, unlike twenty years ago, theirs is relative rather than absolute dominance (Tentori and Zandonini 2013). Figure 3.4.1 shows they still account for almost half of the world's GDP, although their share has gone down by almost ten percentage points in the last fifteen years and China's share has grown more than fivefold in the same period, which has made it the second largest world economy. This redistribution process has been accelerated by the economic crisis, which has affected developed economies the most.

Figure 3.4.1 – Share of World GDP (% , 1995 and 2013 at market exchange rates)



Source: IMF

It is uncertain whether this process is leading to a tripolar framework, with China as the third pivotal actor on the global stage, or rather towards a multipolar distribution of economic power, where the BRICS (other than China) and other developing countries will be rapidly able to play a determinant role at a global level.

It is useful to recall the notion of economic power. It derives from the broadly accepted definition of “power” given by Robert Dahl as “the ability to induce another party to do something it would not otherwise do” (Dahl 1957) and therefore implies the concept of “influence”. Therefore, in economic terms it can be defined as the ability to induce someone else’s actions by deploying economic instruments (Cooper 2004) and it is something different than economic ‘dominance’. For instance, let

us think of the United Kingdom: far from being a ‘dominant’ country anymore, it is by all means very powerful because of its strategic position as a global financial centre. The last wave of economic globalization process, started at the end of the 1980s, brought about increasing levels of integration and interdependence, in terms of trade and financial flows. This resulted into a process of diffusion of economic power, which enabled to provide new players with economic power (Subacchi 2008). Such players involve not only States like the BRICS or other emerging markets, but also non-state actors like Multinational Corporations, financial institutions, Non-Governmental Organizations, leading to a complex network of relations which flow in both directions, differently from the unidirectional flows typical of earlier economic phases.

Therefore, it is clear that GDP cannot be considered a sufficient indicator to assess a country’s economic power. Other factors and variables must be taken into account. For example, capital accumulation in developing countries can be considered as a good proxy for rising power in emerging markets (Subacchi 2008), for example in the Gulf states, where massive oil revenues were accumulated into the so-called Sovereign Wealth Funds which are an increasingly important leverage for these small countries to reach the rest of the world via FDI flows.

It is not easy to provide a quantitative assessment of economic power, but some attempts were made in order to provide a parsimonious, and at the same time comprehensive, representation of the power a national government can deploy in the global arena. Basu et al. (2011) elaborated an “index of government economic power” based on a weighted average of four indicators: government revenues, foreign currency reserves, export of goods and services, and human capital, taken as the product of population and the average years of schooling. The analysis covered a period of 9 years, between 2000 and 2009: the US ranks first in each year, while China took over Japan in the second place and Brazil, the Russian Federation and South Africa entered the top 10. Argentina’s performance dramatically fell at the beginning of the period covered, clearly because of the debt crisis of 2001-2002, from the 21st position in 2000 to the 32nd in 2002, and then partially recovered occupying the 26th position in 2009 (Table 3.4.1).

Table 3.4.1 – Index of government economic power (2000 and 2009)

| <u>Ranking 2000</u> | <u>Country</u> | <u>Ranking 2005</u> | <u>Country</u> | <u>Ranking 2009</u> | <u>Country</u> |
|---------------------|------------------|---------------------|--------------------|---------------------|--------------------|
| 1 | United States | 1 | United States | 1 | United States |
| 2 | Japan | 2 | China | 2 | China |
| 3 | China | 3 | Japan | 3 | Japan |
| 4 | Germany | 4 | Germany | 4 | Germany |
| 5 | France | 5 | France | 5 | India |
| 6 | United Kingdom | 6 | India | 6 | Russian Federation |
| 7 | Italy | 7 | Russian Federation | 7 | France |
| 8 | India | 8 | United Kingdom | 8 | Brazil |
| 9 | Canada | 9 | Italy | 9 | South Africa |
| 10 | Brazil | 10 | South Africa | 10 | Italy |
| <u>21</u> | <u>Argentina</u> | <u>29</u> | <u>Argentina</u> | <u>26</u> | <u>Argentina</u> |

Source: Basu et al. 2011

This is why new theoretical frameworks are probably needed to explain increasing global complexity. For example, the traditional distinction centre versus periphery does not seem to fit the current context anymore. The ‘centre’ issues the reserve currency, while countries in the periphery are willing to peg their currency to that one issued by the center in order to gain stability in terms of exchange rate and external trade (Subacchi 2008). The centre is embodied by a “hegemonic State” which imposes a capital accumulation model and a global division of labor, managing world capital flows at its own convenience (Arceo 2011). The United Kingdom and pound sterling between the 19th and 20th century, the United States and the dollar since the end of World War II, are the two main examples of this theory, which was broken at the empirical level by the global financial crisis of 2008. The rebalancing of economic power and the increasing interdependence suggest that a multipolar framework would better explain today’s situation (Subacchi 2008).

Can International Political Economy explain the ongoing changes?

As we saw, the current global economic environment is characterized by a high level of transformation. From a unipolar distribution of power, the scheme is gradually changing towards a multipolar distribution where the US is losing their economic hegemony.

The question I formulate in this paragraph is whether the available theoretical frameworks of the International Political Economy (IPE) can properly address and explain today's situation. IPE is about the interplay of economics and politics in global affairs and it became a discipline of social sciences only in the 1970s, since before then the role of economics in international affairs had been almost neglected. The collapse of the Bretton Woods system, symbolized by the end of the convertibility of the US dollar to gold, which put an end to an era of stable exchange rates, and the economic crisis determined by the oil shock triggered by the OPEC countries urged scholars to focus on the linkages between economic and international affairs. In particular, the increasing importance of interdependence between States was highlighted and analyzed under different perspectives.

One of the main theoretical approaches is neo-liberal institutionalism, which assumptions are based on two works by Keohane and Nye (1977) and Keohane (1984). Interdependence between States in economic affairs is increasing but it is asymmetric: this is why States are more powerful and less vulnerable than others. The United States clearly represents the most powerful actor, but after the collapse of the Bretton Woods regime its hegemony is slowly decreasing. Therefore, it is necessary to rely on new patterns of cooperation where multilateral institutions can play a decisive role in addressing issues between States and leading to a positive sum game. Keohane's theories are in favor of maintaining the existing order through the development of more cooperation and coordination among states.

The other main schools of thought in IPE are the mercantilist and the Marxian view. The first one derives from the realist theory of international relations, which is based on the assumption that States are driven by self-interested actions; therefore, the aim of every state is maximizing its wealth and independence, even at the expenses of other States. This is why stability will be possible only with the presence of a hegemon. On the other hand, the Marxian tradition is based on the dichotomy between centre and periphery, represented by the relationship of exploitation of the centre (industrialized countries) on the periphery (developing ones) (Woods 2001).

The theoretical frameworks aforementioned put the nation State at the centre of international relations as the main actor (although neo-liberal institutionalism highlights the importance of multilateral organizations and center-periphery theories stress the role of classes (workers vs. capitalists) and social groups. However, over the course of the last three decades an increasing number of new types of actors have played an increasingly important role in the global arena, given the most recent wave of the economic globalization process. On one hand, interdependence between States has increased (see

previous paragraph) and this process led to growing asymmetries among them in terms of the ability to deploy their power, so that the effective incapability of some of them of exercising control over their destinies does not add up to a zero-sum game (Strange 1994a). On the other hand, authority of nation States has diminished and has been progressively accompanied by new economic players, such as firms, Multi National Corporations (MNCs) and multilateral organizations. In other words, the power of markets is now comparable to that one of States (if not even more important in some cases) (Strange 1994a and Strange 1994b). Susan Strange (1994a) pointed out that in this changing global governance the absence of an opposition was one of the main problems to address. This is why new theoretical frameworks and ways to address these shifts in the distribution of power should be found, in order to guarantee more stability to the global and economic financial system. According to these systemic factors of change, in particular the realist/mercantilist and the Marxist theories do not seem the most appropriate to explain the current situation. We are living in an evolving world where economic relations are characterized by increasing interdependence and interconnectedness. The recent global financial crisis, amplified in Europe by a double-dip recession in the Euro area, changed the situation so that today the world is well described by the image conveyed by Christine Lagarde, Managing Director of the IMF, of a “three-speed global economy” (IMF 2013a). Therefore, macroeconomic coordination and cooperation is needed in order to avoid the imbalances which led to the crisis and to restore a global environment able to enhance stability and growth. As explained in the previous chapters of this part, the G20 looks like a particularly suitable organization, because of its informal structure and ability to admit rising powers in the decision making process.

Neo-liberal institutionalism is the most suitable approach to provide this context with an appropriate theoretical framework. It depicts the world economy as an arena of inter-state cooperation, where the core actors are the States (like in the realist approach), but they delegate power to international organizations. It does share some features with realism, since it recognizes that States are self-interested. But they are also rational actors, and that is why they agree on delegating some of their powers to the supranational level. Therefore, cooperation is achieved thanks to the rational decision by States, which understand that multilateralism through international institutions is functional to the pursuit of their own interests (Woods 2001). The advantages from cooperating are clearly explained by two examples drawn from game theory: the prisoner’s dilemma and multiple games with the adoption of tit-for-tat strategies. Especially in the latter case, after the first round the players understand that it becomes rational to cooperate, otherwise both will stay in a sub-optimal situation. Hence, the rational

acknowledgement that it is good for States to institutionalize their cooperation in the long run, in order to gain mutual benefits (Keohane and Martin 1995).

In the next paragraph I will focus on the case of Argentina, and show, through a neo-liberal institutionalism approach, how the country has refused to adopt rationality in its choices, at the expenses of its economic stability and its international role.

3.4.3 Argentina and its role as an emerging actor

A disappointing negotiating behavior

As shown in the previous paragraph and chapters, Argentina is today one of the most important countries in Latin America from an economic point of view. Should we try to assess its economic power, we could define it as a ‘medium-sized’ country, not only in terms of GDP but also of government revenues, foreign currency reserves, export of goods and services, and human capital, according to the empirical methodology followed by Basu et al. (2011). Therefore, Argentina’s economic size and potential of projecting its power abroad would provide a sufficient explanation to its inclusion into the G20 membership as a regional pivot and according to the country’s ranking among the top-30 classification of economic power.

Nevertheless, when it comes to observe and analyze the country’s behavior, the story is quite different. In this paragraph I will analyze Argentina’s strategy in the international economic arena and provide policy indications drawing upon a theoretical framework based on the negotiation strategy of emerging powers and including it within the neo-liberal institutional approach described in the previous paragraph.

The increasing interconnectedness and interdependence between States, and between them with non-State actors, means that power relations have to be analyzed under the negotiating behavior deployed by such actors. Developing and rising powers are characterized for adopting particular strategies at this respect, since they are defined as States that have established themselves as “veto-players” in the international system, but have still not acquired agenda-setting power (Narlikar 2013a). It is important to note that the concept of “veto player” has to be considered in a flexible way, meaning that veto-players are actors whose agreement is required in order to change the status-quo (Narlikar 2003, Tsebelis 1995) Among them the BRICS (Brazil, China, India, Russia and South Africa) are the main examples, but there is an increasing number of “outbreak nations” (Sharma 2012) that can be compared to the former ones because of similar features and potential, although maybe at a more

reduced scale (regional rather than global). I include Argentina within this category and will use the following framework to explain its behavior. I argue that Argentina can be considered a veto player, with respect to the following taxonomy, especially as member of the G20 and of the MERCOSUR. Of course, given its smaller size in comparison to Brazil, Argentina's role as a veto player is more evident and effective at the regional level, and the MERCOSUR offers a useful example at this respect. Narlikar (2013a) elaborates a taxonomy that highlights three particular aspects of negotiating behavior:

- Negotiation strategy: it comprehends a *continuum* from distributive strategies, which include tactics based on refusals to make any concessions, issuing threats and penalties and threatening other players, to integrative strategies that comprise attempts to explore common solutions, which means strategies aimed at "expanding the pie". In other words, these strategies involve a spectrum between conflictive and cooperative solutions;
- Coalitions:⁵¹ two sets of oppositions can be listed. The first one is between bloc-type versus issue-based coalitions: the first ones usually include like-minded states willing to share common values and beliefs in view of a broad range of targets to jointly achieve; issue-based coalitions are characterized by a higher degree of pragmatism and they are formed in order to address a specific problem. This is the main reason why the latter generally tend to last for shorter periods. The second set of coalitions is a polarization between balancing and bandwagoning. Balanced coalitions are generally formed by actors that share a similar amount of power, while bandwagoning strategies are generally applied by weaker states that align with stronger ones in order to enjoy some of the benefits the latter would gain anyway.
- Framing: this category refers more to the area of ideas and how different actors view their objectives. This has to do with hierarchy and political cultures, but also with the international context and the particular institution where the negotiation is taking place. Framing tactics are likely to vary not only with the position of particular actors in the international hierarchy and their political cultures, but also with the international context and the particular institution where the negotiation is taking place.

The negotiating behavior can be deployed with established powers (i.e. the US, the EU, Japan), or with other emerging powers, within the context of multilateral and international organizations, and also with private actors.

⁵¹ By coalition we mean "a group of states that comes together in pursuit of a common end" (Narlikar 2003)

According to this taxonomy, that is quite parsimonious but helpful, it is possible to define the behavior of an emerging power in the global context. For example, the analysis of Brazil suggests that the country tends to establish bloc-based coalitions (the so-called “South-South” cooperation) with low ideological content but determined by *real-politik* motivations (Burgess 2013). The case study of India suggests also that this country shows a tendency to form balancing rather than bandwagoning coalitions and some degree of distributive bargaining (Narlikar 2013b).

Therefore, it is possible to apply this methodology to analyze Argentina’s action in the three multilateral organizations used as a case study in the three previous chapters.

Table 3.4.2 – Argentina’s behavior in the IMF

| Negotiating behavior | | |
|-----------------------------|---------------------|------------------------|
| Strategy | <i>Distributive</i> | <i>Integrative</i> |
| | X | |
| Coalitions | <i>Bloc-Type</i> | <i>Issue-based</i> |
| | | X |
| | <i>Balanced</i> | <i>Bandwagoning</i> |
| | | X |
| Framing | <i>Ideological</i> | <i>Non-ideological</i> |
| | X | |

Source: elaboration of the author

Table 3.4.3 – Argentina’s behavior in the G20

| | | |
|-----------------------------|---------------------|------------------------|
| Negotiating behavior | | |
| Strategy | <i>Distributive</i> | <i>Integrative</i> |
| | X | |
| Coalitions | <i>Bloc-Type</i> | <i>Issue-based</i> |
| | | X |
| | <i>Balanced</i> | <i>Bandwagoning</i> |
| | | X |
| Framing | <i>Ideological</i> | <i>Non-ideological</i> |
| | X | |

Source: elaboration of the author

Table 3.4.4 – Argentina’s behavior in the MERCOSUR

| | | |
|-----------------------------|---------------------|------------------------|
| Negotiating behavior | | |
| Strategy | <i>Distributive</i> | <i>Integrative</i> |
| | X | |
| Coalitions | <i>Bloc-Type</i> | <i>Issue-based</i> |
| | X | |
| | <i>Balanced</i> | <i>Bandwagoning</i> |
| | X | |
| Framing | <i>Ideological</i> | <i>Non-ideological</i> |
| | X | |

Source: elaboration of the author

Chapters 3.1, 3.2 and 3.3 were dedicated to the analysis of Argentina’s behavior within some of the most important economic multilateral organizations, two at the global level (the IMF and the G20), one at the regional level. The discontinuity between global and local organizations was adopted in order to identify similarities or differences in the type of action deployed by Argentina.

Tables 3.4.2, 3.4.3 and 3.4.4 briefly show my findings, summarized through the negotiating framework explained in the above. It seems that Argentina has adopted a similar strategy in all the three organizations object of the analysis, with some remarkable differences between the global and the regional level. Argentina’s strategy has been relatively more distributive both in the IMF and the G20,

as well as in MERCOSUR, and the type of coalitions where the country took part have been relatively more issue-based and characterized by bandwagoning in the IMF and G20, while the coalition scheme adopted in MERCOSUR is relatively more bloc-type and balanced. These results are particularly evident in the case of the troubled and long-lasting relationship with the IMF: the asymmetric bargaining power of Argentina with the Fund, and in particular with the United States, resulted into a distributive strategy implemented mainly towards unilateral actions like the repayment of the debt towards the Fund in a single instalment or in the refusal to comply with the Article IV Consultations. The implementation of these choices progressively put Argentina in a position of isolation, from where it is difficult even to implement bandwagoning in coalitions. A similar attitude has been observed in the G20, where Argentina has the lowest compliance rate to the decisions taken at a collective level during the summits. A partial different behavior was observed with respect to MERCOSUR, where the attempts to establish a stronger and more stable cooperation were made, at least during the first decade of the organization. In this case, the strategy has been more integrative and the coalition more of a 'bloc-type' and balanced, although especially in the last years the rise of tit-for-tat retaliations with Brazil changed the direction of Argentina's behavior in a more distributive way.

Therefore, the country's behavior can be defined 'irrational' especially because it lacks of coordination between the other developing countries members of the forum, so that it is not able to take part in stable and comprehensive coalitions. In this respect, Argentina is much less involved in the so-called "South-South" cooperation, differently from Brazil, where since Lula's presidency economic foreign policy was based on the promotion of strong relationships with other developing countries (especially in Africa), so that today Brazil is seen by many States as a potential source of political support, developmental assistance and commercial opportunity (Burgess 2013). In other words, for its growing economic importance as a major commodity exporter, Argentina could have nurtured the ambition, as its bigger neighbor, to become a 'bridge' between the North and the South of the world, so as to gain in 'immaterial' terms (international reputation and consideration) but also in terms of external trade and attraction of new investments into the country.

The Kirchner governments were not able to do so because of the wrong 'framing' adopted in their negotiating behavior. In all my case studies, it appears that Argentina's framing, i.e. its view of the world, has been characterized by ideological assumptions and considerations, which led to an exaggeration of populism and economic protectionism. This ended up with narrowing the space for capital inflows, while the country would need much more foreign investment, and undermining the global competitiveness of its firms. Argentina's closure towards the rest of the world also negatively

affected the regional integration process, since the trade disputes with Brazil (but also with Uruguay, although at a lesser extent) led MERCOSUR to a standstill (see chapter 3.3).

As already shown, the final outcome of this underperforming negotiating behavior is leading Argentina to be a 'pariah' in international relations. How this can be avoided, it will be the object of the next paragraph where a neo-liberal institutional approach will be adopted.

The thin line between relevance and irrelevance on the global stage

In the previous chapters it was shown how Argentina managed to recover successfully from the severe economic crisis of 2001/2002. Growth has been impressive during the last decade, as well as the improvements of living conditions of Argentine people. Nevertheless, it cannot be said that the country's economic power, intended in the terms explained in the above, has increased. As a rising nation, Argentina cannot use properly its veto power because the policies implemented so far, as well as its reduced economic size, are confining it to a position of irrelevance in the global system. This is why I argue that Argentina's behavior in the international arena is 'irrational' in the sense that distributive negotiating strategies, based on retaliation, and bandwagoning coalitions, are detrimental to its economic welfare.

The global and the regional level have to be considered in parallel. At the global level, Argentina is progressively isolating itself from the rest of the international economic community, while at the regional level the country is unable to push forward the integration process through an effective development of the MERCOSUR.

What can Argentina do in order to gain a more important role and to increase its economic power? First of all, the assessment of the country's power showed that its capacity of projection is and will be limited, given its reduced population, productive capacity and also considering its peripheral geographical position in relation to the rest of the world. This condition should be the preliminary assessment by Argentine authorities in order to develop a pragmatic foreign economic policy that takes into account strengths but also structural weaknesses that limit the country's international role.

This means that Argentina can aspire to a role as a medium power, able to exert power and influence only at the regional level. In order to gain importance at an upper stage, it should not act alone, but in coalition with other emerging economies. According to the negotiation scheme proposed in the previous paragraph, Argentina should reverse its strategies from distributive to integrative and form

balanced coalitions with developing countries from other regions. This would be the only way for the country to play an international role, given its negligible veto power for the reasons already explained.

This can be achieved inside the existing multilateral institutions. The G20 provides a unique platform where it is possible, at least in principles, to develop a new global economic governance that fosters macroeconomic coordination and international trade, and where all players have the same weight. The IMF, on the other hand, is also going through a reform process in the sense of an extended participation for developing countries. These organizations are clear examples of an evolving situation, which should be seen as an opportunity for Argentina to be part of this process where new rules are defined and more space for new actors is allowed. The neo-liberal institutional perspective is the most suitable to describe the current situation and also to interpret the window of opportunity that Argentina is facing, but that is narrowing day after day. The country should still pursue its national economic interest, but in a different way, playing an active role inside the global institutions. In pragmatic terms, Argentina should make a 'u-turn' in its economic policies giving up to its economic nationalism and opening its economy to imports (as a way to stimulate domestic productivity and competitiveness) and to foreign capitals, in order to foster investments which are extremely needed to propel its economic growth.

However, Argentina has to be relevant in its region before being relevant at the world level. This can be achieved only by adopting a different attitude within MERCOSUR and in particular with its main economic partner and neighbor, Brazil. Born in the neo-liberal context of the Washington Consensus), MERCOSUR was designed as a strategic response to the imperatives generated by the globalization processes aimed at enhancing markets, trade and investment (Riggirozzi 2011). In order to work properly as a custom union and a future common market, it should have followed the following stages: trade creation; an increasing competition intra-bloc; the exploitation of economies of scale; intra-bloc cooperation in projects related to technological innovation; a more rational production obtained through a regional 'division of labor'; economic complementarity (Balassa 1961). Especially the latter stages were not properly implemented, so that MERCOSUR is currently at a standstill and it is also taking some steps backwards in terms of trade liberalization (see chapter 3.3).

This happened for two main reasons. The first one is a change in the ideological 'framing' of MERCOSUR, which in the 2000s was seen more as in opposition to the neo-liberal project of the Free Trade Area of the Americas (FTAA), that led to a more 'political' rather than economic conception of the regional organization (Bernal-Meza 2008). Argentina and Brazil shared this common view, but soon

after that divergences between the two States became evident. While Brazil shaped its foreign policy on the basis of a realist perspective, but also of the recognition that a favorable international institutional framework was necessary to support its ambitions to play a global role, Argentina behaved in the opposite way (as already shown) and did not support Brazil's ambitions, as made clear, for instance, by its opposition to Brazil's claim to gain a permanent seat in the United Nations Security Council. These contrasting views in terms of foreign policy were amplified by the trade disputes that led to a new rise in protectionism (see chapter 3.3).

Therefore, it seems that Argentina is following an inappropriate path also at the regional level. Given its limited size, it should exert effort in two directions in order to strengthen its role as a regional power. First of all, it should foster a real economic integration, enhancing specialization among the different MERCOSUR members and integration in the regional value chains (see part I). On the other hand, it should establish a balanced coalition with Brazil, in order to contribute and take advantage of its strategic position at the global level. For example, Brazil has been listed among the strategic partners of the European Union since 2007 and a joint action plan has been established for the years 2012-2014, which includes a deepening of economic relations, especially in terms of FDI (the EU is the main foreign investor in Brazil) (European Commission 2013). Negotiations for a Free Trade Agreement with the MERCOSUR were stalling but a new round of talks was held in October 2012; however, a positive final outcome still seems far to be achieved. There are indeed some trade disputes and there are even proposals for economic sanctions and retaliations by the EU in response to Argentina's protectionist measures (Brandt and Erixon 2013a).

In conclusion, if Argentina changed its negotiation strategy, aiming at establishing balanced and deeper coalitions with Brazil and other developing countries, and at opening up its economic policies, it might take advantage of the favorable global framework. This would help Argentina come out of the current international isolation and also contribute to its economic growth and development.

3.4.4 Conclusion: Argentina's wasted potential to become a regional power

In this chapter it was shown how the world economic environment is rapidly changing; from a unipolar structure, dominated by the United States, the distribution of economic power (which definition takes into account several dimensions and not only a nation's GDP) is becoming more and more equal among emerging powers. The BRICS are the most important emerging nations from a geopolitical and geoeconomic point of view and Argentina cannot aspire to play a decisive role at the global level. Nevertheless, given its growing and developing economy and its resources, it is a medium

power and it could be a leader at least in the South American region, at least in the MERCOSUR integration organization.

However, given the ‘irrational’ policies adopted particularly during the last decade, Argentina is not exploiting its advantages and assets that would allow it to be more important on the global stage. The analysis of the three case studies (Argentina and the IMF, the G20 and MERCOSUR) was made applying a theoretical framework from the International Political Economy. The neo-liberal institutionalism, compared to realist and marxist theories, was considered as the most appropriate to explain today’s context, where a new wave of multilateralism in the management of global economy is being fostered through the G20, an organization characterized by a low level of formalization where developing countries have the same weight as developed ones. Moreover, a negotiating behavior scheme was adopted in order to describe Argentina’s action within these three organizations.

My findings show that the country is not negotiating its position in the global economy properly, since it is implementing strategies based on retaliation and bandwagoning without having tools powerful enough in order to deploy its veto power in an effective way. The outcomes, a progressive isolation at the global level, and a standstill in the regional integration process, are detrimental to Argentina’s economic development.

Therefore, a change in Argentina’s ‘framing’ of its economic foreign policy. The example of Brazil, less inspired by ideological principles, suggests what the country should do in order to increase its power and become a pivotal actor at least in South America. Wider and broader coalitions with other emerging markets should be pursued, as well as more open economic policies should be adopted in order to increase international trade, attract foreign capitals and raise internal competitiveness.

There is a clear way ahead for Argentina, and this should be included within the current evolving international economic system. Otherwise, the country is probably doomed to stay in the ‘limbo’ of “frontier nations” for the years coming.⁵²

⁵² The Wall Street Stock Exchange Market removed Argentina from the list of “emerging markets” downgrading it to the lower class of “frontier markets”, where the rule of law is thin and enforcement of the existing rules even thinner (Sharma 2012).

APPENDIX – INTERVIEWS TO ARGENTINE EXPERTS

Interview to Martin Schorr, Researcher, FLACSO Argentina (Latin American Faculty of Social Sciences)

Ten years after the Kirchner – Néstor and Cristina – took power, what is your evaluation of the economic policy framework implemented by their governments?

The roots of the ‘Kirchnerist’ policies trace back to the context of deep recession in 2002, after the default determined by the failure of the neo-liberal model implemented during the 1990s. The first important step was the devaluation of the Peso, which had very negative effects in the short run reducing salaries by 30% and making the recession even worse. In this context the new Government of Néstor Kirchner, elected in 2003, put an end to the model of financial speculation as the core element of the process of capital accumulation, introducing a “neo-developmental” model based on a growth pattern relying on productive sectors.

In this framework, the industrial growth of the last decade can be divided in two stages. The first one, from 2002 to 2007/2008, was entirely focused on keeping a weak exchange rate as basically the only instrument of industrial policy. The second stage is parallel to the end of the period of the strong US dollar and the break out of the global financial crisis: since then the Government has implemented new measures such as import restrictions, more tariffs, interventions to direct investments to specific productive sectors). However, both stages were characterized by a general absence of a precise strategy and a plan of industrial development.

Is it true that Argentina is running the risk of coming back to a ‘re-primarization’ of its economy?

I would not agree with statement. It is true that a big part of Argentina’s recent growth can be explained by the remarkable performance of its agricultural exports and by the Government revenues collected by the taxes imposed on these exports, but the real data about the composition of the Gross Domestic Product actually show that there was not a return to the primary sector in terms of production and a dismantling of the industrial sector. On the contrary, the intention was to support industrial growth and this has been partly achieved thanks to the policy instruments that I mentioned before. Some sectors, like agricultural machinery and the automotive, received quite a lot of attention and managed to grow. However, the Government was unable to use those instruments in the most efficient way, failing to support the smaller and more vulnerable firms, as well as the peripheral regions that would need to grow the most.

So, why do you say that the industrial policy implemented by the Kirchner did not help Argentina's economy to exploit all its potential?

There have been a lot of new measures aimed at supporting industrial firms. This at least was a positive attempt to rebuild the industrial fabric of the country, after the neo-liberal wave of the 1990s. The main problem is that those Government programs were unable to target and prioritize companies, sectors and geographical areas that needed this support more. For example, there are different schemes which offer financial support repaying up to 40% of the investment undertaken by a firm; but very few firms manage to get access to this support, since they are not able to meet the conditions set by the banks in order to obtain credit. The underdevelopment of the domestic banking sector is a structural problem of Argentina, which affects the most vulnerable firms: smaller, operating in more isolated geographical areas (for example in the North-West) and in sectors which are not 'strategic', not linked with agriculture or the automotive industry. Therefore, it is not true that there is no support for the industrial sector: the problem is that policies wrongly designed prevent Small and Medium Enterprises (SMEs), which constitute the backbone of Argentina's industrial system, from developing further. Also, in my view it is not true that Argentina is affected by a lack of capital, especially from abroad, for investments. We do not need more FDIs, there is a good availability of domestic capital: the problem is that the transmission channels do not work properly and money is not allocated where it should be more necessary. For instance, much more investments in R&D would be needed in order to exploit better the high quality of Argentina's human capital. Let us look at the episode of the nationalization of YPF. Foreign extracting companies used to exploit our natural resources for short-term gains. On the contrary, before YPF was sold to Repsol, it acted as a territorial mechanism of economic and social development, with its demand to local suppliers and the schools located in rural areas. When the company was privatized, all this disappeared. This is why I say that a company like YPF does not need more foreign capital, it just needs to be managed well in order to be a useful tool for local economic development rather than a speculative opportunity for foreign capital.

Let us look outside of the country: can Argentina be globally competitive with this economic system and policies? What about the challenges posed by China and Brazil?

First of all, I would like to highlight once again that international competitiveness cannot be pursued only by manipulating the exchange rate, something which can be effective in the short-term but that is not able to enhance a country's competitiveness in the long-term because it creates high inflation. Moreover, this kind of policies are becoming more and more ineffective because global competitors

like China are not competing any longer only on prices and cheap labor costs, but they are upgrading more and more the quality of their exports: 17% of the capital goods imported by Argentina come from China, they are products with a higher technological content and value added.

Regarding Brazil, I would say that opening Argentina's trade to it can be both an opportunity and a threat. It is an opportunity for companies operating in sectors like the agro-food and the automotive industry, because of the huge Brazilian domestic market. On the contrary, it is a threat for other sectors that are more vulnerable to Brazilian imports and because there is little scope in my opinion for production integration between the two countries. In the current situation, I think that MERCOSUR is only a platform for companies operating in tradable sectors, but the disadvantages for the non tradable ones are quite high. This is why I think that more longer-term policies, such as projects to support R&D at the firm level, should be prioritized in order to strengthen Argentina's industrial sector as a whole and to guarantee an evenly spread development to all the sectors and regions.

Interview to José Maria Fanelli, Senior Researcher at Study Centre of State and Society (CEDES), Buenos Aires, and Professor of Economics at the University of San Andrés, Buenos Aires

What is your general evaluation after ten years of Kirchnerism? Do you think the economic model implemented over the course of the last decade is about to run out of effectiveness?

To be more precise, there has not been only one model during this decade. There is a big difference between the policies implemented between 2003 and 2007 and from 2008 onwards. Policies in the first period were consistent and the country grew showing twin surpluses, both in fiscal and current account terms. Moreover, the economy was competitive and the government was paying its debt back. The turning point is represented by the intervention of the National Institute of Statistics (INDEC): price statistics started to be manipulated in January 2007. That was followed by a wave of violation of property rights (see chapter 1..2) and of bad public policies, consisting of a rise of public expenditure, utilization of the currency reserves held by the Central Bank (with inflationary consequences), undervaluation of the exchange rate and increase of the cost of US dollars. Actually, it is even possible to identify a third stage, started at the end of 2011 with the imposition of rigid currency exchange controls and the exacerbation of the Government's interventionism. The economy stalled and investments started to flow out of the country. This kind of regime is exhausted because the restriction of currency flows is more and more harsh given the disequilibrium of the energy balance and the fiscal deficit becomes larger because of the burden of energy subsidies and the lack of bureaucratic control. There is no future to this kind of situation. The question is not whether this economic system will last, but how this is going to change and what the political consequences of this change will be. Therefore, it is not very useful to talk about a 'K-model'.

The domestic industrial policies are based on the establishment of an undervalued exchange rate. Is this still an instrument sufficient to sustain the international competitiveness of Argentine products?

The exchange rate is not so undervalued anymore. Of course, it was necessary to impose a strong control on the exchange rates and of the imports because of the rise in the cost of US dollars. The

Government did not adopt a consistent industrial policy, using at most some instruments from the 1950s (like the import substitution strategy) that nobody still implements today. Industrial policies, as they are today conceived in a modern fashion by authors such as Rodrik, were never taken in consideration.

What evolution do you foresee for national energy policies? The potential of the so-called ‘shale gas’ seems to be very high, but massive investments are necessary to exploit it. Can the recent partnership between YPF and Chevron be considered within a new context of openness to foreign capital?

Argentina has a high potential for the exploitation of shale-gas resources but needs very big investments, especially in terms of technology that it does not currently have. Such investments could be partly financed by repatriating capitals that flew out of the country (Argentina is today a net creditor vis-à-vis the rest of the world) and by attracting FDIs. In order to do so, the pre-condition is to generate credibility and predictability in the public policies and to reach a better enforcement of the rule of law. This is why the partnership with Chevron does not mean much: the amount of money is limited and the juridical framework is very uncertain. For instance, at present multinational corporations operating in Argentina cannot distribute dividends. So, who would invest at such conditions?

The World Economic Forum ranked Argentina in 96th position out of 144 countries in its latest “Global Competitiveness Report”. What does Argentina need to improve its ‘software’ conditions?

I am not surprised by the fact we are so badly positioned in the competitiveness ranking. Argentina’s limitations are not in the lack of viable investment projects, but in its software endowment, i.e. the rules of the game, institutions and policies. I think that this aspect can only improve, starting with a government change in 2015. It would be very hard for the current Government to obtain credibility back.

Nowadays, what is Argentina’s potential in the international economic environment? Is there a risk of isolation and, if this is the case, what could the consequences be?

I don’t think Argentina will isolate itself from the rest of the world. It is not in the DNA of the country, that was built on the exploitation of international trade and immigration during the first wave

of globalization. It was the current government that isolated itself from the rest of the world, and the consequences are really negative. For example, given the fact that Argentina is a net creditor and has a low public debt, how to explain that the country does not have access to the international capital markets and that the country risk is much higher than Brazil's, which has a much higher public debt and a current account deficit? The only possible explanation is that the policies implemented by this administration since 2007 are unreasonable: Argentina has political and economic disputes with its neighbors (Chile, Brazil), with the international investors, with the Paris Club, with Spain, and so on and so forth. However, in order not to be wrong about the country's future, it would be better to talk of 'Argentina' instead of the 'current Government'. The next one will surely have a lot of work to do in order to recompose the relationship with the rest of the world, but it will be also able to gain a lot of benefit from the exploitation of all the promising projects that the Government is not taking advantage of because of its irrationality. Vaca Muerta is only an example.

Interview to Verónica Moreno, Former advisor at the Foreign Relations of the Presidency of Argentina

Despite the economic and social progress obtained by Argentina over the course of the last decade, what are the biggest challenges the country will have to face in the next few years? Can the progressive isolation of Argentina with respect to the global economy decrease its external vulnerability or, on the contrary, be detrimental?

It's true that Argentina remained for a period relatively isolated from the international financial instability, mostly thanks to the nationalization of the private pension funds in 2008, which represented a high proportion of the public debt. The nationalization of those funds and their conversion into public assets made possible to re-finance the debt at inferior interest rates to the market, thus reducing the financial cost of the consequences of the crisis. At the same time, the utilization of the foreign currency reserves of the Central Bank in order to service the debt with private holders and multilateral organizations allowed Argentina to remain partially immune to the global financial turbulences.

In this context, there have not been significant private capital inflows to the domestic financial sector (the total of credits circulating is just equal to 15% of GDP), in a moment when FDIs to Argentina were quite scarce. Therefore domestic financial stability was not significantly harmed by sudden movements in the capital flows.

The crisis produced a more visible shock on the side of international trade shown in 2009, when there was a 12% decrease of the price of Argentine exports, made even worse by the drought that led to a 35% contraction of the volume of agricultural exports. Despite this slow down, since 2010 there was a strong upward rebound of prices, with a moderation in the second half of 2011. Therefore, the economy started again to grow strongly, with a 8% GDP growth in 2010 and 2011, thanks to the anti-cyclical macroeconomic policies implemented in 2009 as well as to the recover from the drought in 2010 and the rise of commodity prices in 2010-2011. This process was accompanied by an expansion of imports in response to the expansion of aggregate demand and the undervalued exchange rate. The pressure on external liquidity that came from the acceleration of imports was amplified in 2011 by the rapid outflows of private capital, that put an obstacle to the strategy of the Government aimed at reducing Argentina's exposure to the international financial risk. These developments led the Government to impose restrictions on trade and international capital movements at the end of 2011, which was successful in the short run by putting a brake on the fall of the trade surplus and by avoiding excessive capital outflows.

A key point is that Argentina's GDP growth during the last years was mainly driven by internal investments and by an intensive use of production factors, and not by an increase of total factor productivity. This process is not sustainable in the context of a global crisis, because an intensive use of these factors leads to their scarcity, affecting internal competitiveness in the long run. At the same time, an increase of productivity is necessary to maintain growth in the long run and keeping the debt sustainable, reducing pressure on the external liquidity, which will allow to reduce the need to impose trade barriers and capital movements.

In accordance to what happened at the global level, Argentina increased its degree of protectionism, but at a much stronger rate than other countries. Argentina is among the top-ten countries which impose the highest number of trade restrictions.

In this framework, Argentina's economic outlook starts to deteriorate affecting negatively the population: distrust is further deepened by the fact that 2013 is an electoral year. The slowdown in growth, as well as the steady increase of public expenditure, might lead the country to the necessity of a fiscal adjustment. Although the Government ensures that the economy grew at a 2.8% in the first two months of the year, some private consultancies have lower estimates. For instance, Elypsis, whose leader is the former Chief Economist of the Central Bank, Eduardo Levy Yeyati, foresees a 2% growth in 2013, lower than the rest of Latin America.

The annual inflation rate should be between around 22% and 25%, according to the provincial statistical agencies that realize the measurements, since the National Institute of Statistics (INDEC) is accused, even by the IMF (see chapter 3.1) of data manipulating. Not even the price control policy, based on an agreement between the Government and the supermarkets, is able to put an end to the price rise since the wholesalers keep the branded products included in the price-freezing off sale.

Social unrest increased in the last months forcing the Government to move salaries up of a 24.4% in the first quarter of 2013, according to the inflation, and to increase the minimum free-tax amount applied to salaries, after the Government lost the primary elections.

Tax collection increased in the first four months by a 28.5%, more than the inflation rate. Tax imposition is also rising and Argentina is the Latin American country with the highest tax rate, equal to 40% of GDP.

According to the external trade, exports decreased by a 3% in the first quarter, especially for the reduction of wheat, oil, soy oil and bio-fuel exports. On the contrary, imports increased by a 5% in the same period, given that Argentina had to increase by 57% its energy purchase. The energy deficit provided a sort of justification for the nationalization of YPF in 2012: despite the intention to reduce external dependency, it is difficult for the Government to attract the necessary investments to exploit

the basin of non conventional gas that has been recently discovered at Vaca Muerta, Patagonia, and that has only attracted a limited interest of Chevron so far.

In the currency black market, the US dollar is 70% more expensive than in the legal market. The Government is considering what measures to undertake at this respect. At the moment is discarding the hypothesis of a devaluation or a liberalization of currency flows because it fears that this might end up with a higher inflation and because this is an electoral year.

At the same time, the systematic depreciation of the Argentine peso negatively affects the real estate sector and is starting to hit the firms, some of which engage in financial speculation by illegally buying US dollars instead of investing or satisfying debts taken abroad. Multinational corporations, having to bear the effects of internal devaluation, also increase prices of their goods and services in order to better compensate their shareholders.

On the other hand, the support given to energy consumption through subsidies over the course of the last decade has been one of the main reasons why Argentina lost its twin surpluses (fiscal and current account). In fiscal issues, increasing subsidies, as a result of the insufficient update of energy tariffs, strongly contributed to the public deficit. The 'autarchy' principle undertaken by the Government, together with the difficulty to get access to the foreign credit market after the 2001 default, resulted into an increasing dependency on resources drained from the Central Bank to fill the deficit, both by printing money (thus causing inflation) and by using foreign currency reserves. By the same token, the need to import hydrocarbons has been rising, up to the point that since 2011 Argentina has been a net energy importer, for the first time after twenty years.

To sum up, the economic statistics do not look very promising at the moment. The deterioration of the public account has been financed by printing money, which boosts inflation. The latter weakens savings in domestic currency and pushes the demand for US dollars and the rising gap between the value of the currency on the legal market and on the black market. Lack of trust turned also into a massive run on foreign currency denominated deposits, which harms the reserves of the Central Bank. All of this has to be included in a context of low growth, if compared to the regional average.

However, Argentina's points of strength lie in its comparative advantages in sectors like the food and the mining industry, its low public indebtedness and the low vulnerability of the external sector, and the low levels of leverage, both public and private.

The items that weigh the most in Argentine exports (which include agricultural and mineral commodities as well as cars) have been very dynamic during the last five years. The potential price volatility of commodity prices exported by Argentina and the slowing down of emerging economies

might weaken this strength: for that reason I would suggest a wider diversification of products and destinations of exports.

Argentina starts from a quite good position in terms of public debt. The debt-to-GDP ratio was 44.9% at the end of 2012. This condition reduces the country's vulnerability to global financial shocks. The low interest rate on the debt stock associated to the restructuring of the debt realized in 2005, together with rates inferior to the market, allow to keep the debt-to-GDP ratio at the current level even with a relatively low long-run GDP growth, without having to generate big primary fiscal surpluses. In the same way, the Government chose not to enter the market to satisfy its financing needs, using the reserves of the Central Bank to service its debt with private creditors and multilateral organizations. In this way it is possible to keep an interest rate inferior to the market, strengthening debt sustainability. At present, the Government is waiting for the decision in the Supreme Court of the United States with respect to the holders of Argentine debt, which might force to change its strategy.

It is worth to highlight that, although this strategy can bring about macroeconomic strength in the short run, propensity to financial autarky does not offer any positive contribution to the long-run growth, as clearly seen in the Argentine experience during the post-war era.

In a framework where global liquidity is going to be abundant for a long period, choosing financial autarky can lead to miss opportunities to sustain long-run growth without jeopardizing the sustainability of public debt. If Argentina came at a negotiation table with the Club of Paris, it would be good that future debt emissions, both public and private, have a long maturity and rates consistent to the growth rates of Argentina, and that be preferably aimed at financing high productivity investments. But, if the country insists on the autarky option, it might worsen its fiscal deficit.

Every crisis offers challenges and opportunities, and in this case there is no exception to this rule. On the side of challenges, it is worth mentioning the need to avert the fiscal deficit (in 2012 the first deficit since 1996 was recorded) and also the current account deficit in order to avoid distortions that reduce productivity and competitiveness.

Many rich countries with problems of indebtedness and in their external sector choose to introduce competitive devaluations. In this framework, policies promoting competitiveness are necessary. The move to exports of goods and services characterized by higher sophistication is key to accelerate the growth rate through a deeper action of learning by doing. But at this respect Argentina has problems to face the challenge to generate an accelerated productivity growth, which is the most important element to converge to the levels of income of developed countries.

The Inter-American Development Bank (IDB) in 2010 assessed that the factors that mostly push growth down in different Latin American countries, including Argentina, are:

- a) A disproportionate market share captured by low-productivity firms, especially in the services sector but also in the manufacturing, because of market failures and policies that introduce distortions in favor of firms characterized by a lower productivity;
- b) The low intensity of technological innovation, especially in the private sector;
- c) The high transportation costs, intern and international, that reduce international competitiveness and investments in new export activities;
- d) The low financial development, that prevents most productive firms from expanding further and less productive firms from technological upgrade.

It should be added to those factors the lack of the rule of law, which is unfortunately commonly spread in the country. Argentina is one of the country with the highest number of pending trials at the International Center for Settlement of Investment Disputes (ICSID) of the World Bank, and at other international courts. Other fast-growing Latin American countries, such as Peru, Chile, Colombia, despite they changed political majorities several times, have clear that part of their economic systems cannot be modified if they want to keep attracting investments. One of the most important flaws of Argentina is the permanent modification of the ‘rules of the game’, which might seriously affect the generation of trust in a context where FDIs are absolutely necessary.

Argentina is member of the G20, an important organization for the definition of the multilateral economic governance, but its contribution has been quite scarce and is the country with the lowest rate of implementation of the decisions taken at the G20 summits. What are the reasons of this behavior and what should Argentina do to play a more relevant role?

According to the political actors taking part in its formation, Argentina was included in the G20 in 1999 because of its alignment to the US and for the adoption of neo-liberal policies become popular during the 1990s under the name of “Washington Consensus”; in such a context Argentina was considered as the example to follow, since it strictly followed the doctrine spread through the recommendations of the IMF and the WB.

With the change of political orientation and the economic policies that became common in Latin America since the beginning of the 2000s, Argentina broke its automatic alignment and turned its international inclusion towards a deepening of its relationships with the other countries of the region, and with other ‘emerging’ countries like China, India and Russia.

Therefore, within the G20 we saw the formation of ‘blocs’, among which there is the ‘Anglosaxon’, which holds the biggest capacity of action and proposition, followed by the ‘European’ and then by the

‘BRICS’. In this framework, Argentina remained closer to the BRICS, but it kept a degree of freedom in function of its national interests and priorities.

The opportunities to intervene, propose or veto the countries that do not belong to any of these groups like Argentina, are quite scarce. This is why the strategy of those countries, characterized by a small political and economic weight consisted in joining ‘critical mass’ from the periphery and take advantages of the spaces when opinions between principal actors are contradictory, sustain converging positions, discarding the inappropriate or not favorable ones and at the time to make proposals, explore alliances with the most relevant partners.

Nevertheless, the Argentine experience regarding economic and financial crisis might offer a relevant contribution to the group. It is worth to mention that in the framework of the current Argentine government the main topics presented at the summits were: countercyclical policies, financial regulation, international financial institutions, labor conditions and more recently money laundering and debt conversion.

Let us talk about regional integration: the trade disputes with Brazil harmed the integration process in MERCOSUR. This could have negative consequences not only at the regional level, but also at the global level, since the project of a free-trade area with the EU is at a standstill and Brazil would like to start negotiations with Bruxelles alone. What are the perspectives for Argentina in this context?

Since the second half of the 1980s the bilateral relations moved from the traditional competitiveness in political and strategic issues to focus on promoting a common economic agenda on the basis of cooperation and complementarity. The creation of MERCOSUR in the 1990s was the corollary of this convergence pushing on the intensification of the economic bindings.

Despite these good intentions, the bilateral agenda was always focused on the management of bilateral economic disputes leaving the strategic orientation aside. In this context the Brazilian financial sector grew a lot while the same did not happen in Argentina, so that the relations between the two Governments became stagnating.

The growth of private business in Brazil was accompanied by a fragmented vision on the desirable kind of relationships with Argentina: while the Government and some business sectors having interests in Argentina or showing political sensitivity to the importance of the bilateral relationship adopted a sort of ‘strategic patience’, other influent sectors asked for bigger autonomy for Brazilian initiatives in the

international field and for a firmer answer against the protectionist measures adopted by Argentina. As a consequence, the stimulus to expand the bilateral relationship became less intense.

These changes in the dominant perceptions were influenced by different factors. Among those which had a positive impact it is possible to mention three: the expectation that the political bilateral relationship might contribute to increase the 'capital' of Brazil vis-à-vis the rest of the world, the vision that Argentina could contribute to Brazil's target to become included in the global economy, and the increase of the interdependence due to the rise of trading flows and investments. However, in parallel to these positive factors it is necessary to mention some negative ones: the asymmetries in terms of economic size and the opposition to accept restrictions to the internal policies of industrial development and investments attraction or to the Brazilian strategies in different international fora. While the origin and the dynamics of the positive factors is relatively autonomous (especially the political incentives), the negative ones were highly articulated: in particular, there was a direct relationship between the perception of growing asymmetry and the lower availability from Brazil to accept restrictions in the management of internal and external policies. The result was a relationship concentrated in the administration of ordinary disputes within a complete lack of a strategic agenda.

On its side, in Argentina the perception is expanding that Brazil is more and more increasing its strategic importance as economic partner. During the last few years, Brazil became a more relevant economic partner and is gaining importance not only in the region, but globally.

There is no consensus on the specific content the relationship with Brazil should have and, even if in the debate the references to a strategic partnership are quite common, the bilateral economic relationships are managed with a short-term view in the framework of a mutually defensive interaction. This situation is mainly the consequence of bilateral asymmetries with respect to: the size, the participation in the respective markets, the standards of specialization and the regulatory disputes. These divergences come from conceptual and ideological differences, asymmetries in the institutional framework and in resource endowments in the public organization and policies.

The development of Brazil in the last decades, the diversification of its production structure and the weight gained on the global stage are sufficient reasons why Argentina might reconsider the costs and benefits of the economic relationship with Brazil and, in this framework of growing asymmetries, find ways to stimulate the strategic interest of its neighbor.

Against this objective there is a strong internal unrest originated by the adoption of inconsistent and short-sighted policies. Among those, the most criticized by Brazil were the import restrictions and the currency controls on the US dollar. Another issue that deeply worries Brazil is the reduction of opportunities to get access to credit by the Argentine government, which directly affects Brazilian firms

and, more broadly, the MERCOSUR as a whole. All this situation goes against the deepening of the capital market, and reduced the possibility for the local economic agents to plan, favoring activities able to provide immediate returns.

The sectors dominated by the presence of MNCs show heterogeneous perspectives. Their future obviously depends on the public policies and the coordinated actions both Governments will eventually undertake. Despite the principal global MNCs act simultaneously in both countries, evidence about complementarity and specialization in global value chains (GVCs) is scarce. After the experience of the late 1990s, the risk of a competition policy for the attraction of investments through incentives is still there and its effects potentially negative for Argentina deepened as the bilateral asymmetries broadened. Therefore, in this area it is difficult to develop cooperative strategies without a leadership of public policies which include an effective commitment from Brazil.

Moreover, there is a complex of activities with a potential of complementarity that could push for a bigger cooperation and integration, like agro-industrial chains (both countries are facing similar challenges in moving up the value chains), firms specialized in providing mechanical components (oil industry, automotive industry), tourism and other services. In this context, the free trade negotiations between the MERCOSUR and the European Union, that have been ongoing since 1999, reflected once again, in August 2013, the persistence of intra-bloc divergences.

In practice, the deputy Minister of Development and Industry of Brazil, Ricardo Schaefer, said that technical alternatives are being considered, in case a common agreement on the future of MERCOSUR is reached. These options would consist in the negotiation of ‘different-speed’ agreements for every country, although the Brazilian Foreign Ministry ensured that any decision will be agreed upon by all the partners.

According to the *Itamaraty* (the name used for Brazil’s Ministry of Foreign Affairs) Brazil will not negotiate a separate agreement with the EU, as long as the opening to third markets that involve most of the goods and services is defined as a single bloc. Moreover, it was said that any position taken by the Brazilian Government has to be previously debated and supported by the Chamber of External Trade, an inter-ministerial body.

The only exception will be Venezuela which, in order to fully join MERCOSUR, is still going through a joining process to the Common External Tariff that defines the openness of MERCOSUR as a whole with respect to the external countries or blocs.

Nevertheless, as the Argentine economic context keeps on deteriorating it should not be discarded that Brazil decides to open direct negotiations with the EU, as already done by Colombia and Chile, as long as it relaxes its trade restrictions, according to the critics contained in the last report of the European

Commission (September 2013) in which both Argentina and Brazil are listed among the countries that most restrictive regulations to trade applied, together with Russia, India, Indonesia, Ukraine and South Africa.

Fredrik Erixon of the European Centre for International Political Economy (ECIPE) defined Argentina as “a pariah in global economy”, should it continue with this attitude, especially in trade and FDI issues. Do you think this risk is real? What could the consequences be?

I have to make a strong effort to answer this question without feeling personally involved. I have been told for all my life that, in occasion of each crisis, that is going to be the last one in Argentina. And every time the country is able to rise back again from its ashes. Argentina is a country that has been deeply analyzed because it went through all the possible economic circumstances. Argentina experienced almost everything over the course of the last 30 years. In 1989 and 1990, years with an annual inflation rate of 4000% and 1300%; afterwards, between 1999 and 2001, a 25% fall of GDP. This is why is almost compulsory for an economist to pay a visit to Argentina.

Today, the main problem of the country is the lack of trust not only in the foreigners but in the Argentine people themselves: social unrest is rising. The most dynamic countries of Latin America have been devoted in the last decade to put a brake to the inflow of US dollars, so that their national currencies do not appreciate too much and lose competitiveness. In Argentina, the opposite happened: controls on currency movements were applied, as well as restrictions to imports and measures to stop the outflow of dollars. We had a default in 2001 and we then experienced a decade of growth, due to the rising prices of commodities that resulted in a 30% annual inflation, but now the tailwind is off and we are going to face a stagflation. Not even the global economic situation is good. Uncertainty is not only centered in Argentina, since the emerging countries are growing slowly while the developed ones are going through a crisis.

The years 2014 and 2015 will be crucial to our future, considering that we are in an international context of transition where Argentina has two directions to choose: to keep on isolating from the international context, committing a political and economic suicide, or taking advantage of this context and looking for opportunities outside.

CONCLUSIONS

This thesis offered a comprehensive analysis of Argentina's position and role within the global economy, adopting different methodologies of the economic analysis.

The focus of the research started from the analysis of the domestic economic dimension of the country. It was then broadened to the study of the determinants of Argentina's trading flows with its regional partners, and finally to the analysis of Argentina's global inclusion in the management of the global economy.

The first part was a study of Argentina's economic structure and of the development models adopted over the course of the last decade and tried to suggest some policy options for the future in order to guarantee more economic stability and less volatility in the long run. This would help Argentina become more competitive vis-à-vis the rest of the world (and especially with its neighboring country in South America). During the period covered by my analysis, industrial policies were mainly based on the manipulation of the exchange rate, a strategy which can be helpful in the short run but not very effective in the long-term also because its main drawback is rising inflation. A better institutional framework and business environment, as well as more investments in technological upgrade and R&D, would be necessary for Argentina's sectors with the highest potential (especially those linked to agricultural and food processing and those ones that require a higher intensity of human capital) to move further on global value chains. The protectionist barriers erected during the last few years were not helpful, differently from the experience of South-East Asian countries, to enhance Argentina's competitiveness because these measures were not accompanied by policies targeted at improving the strength of domestic firms, especially Small and Medium Enterprises (SMEs), which represent the biggest part of Argentina's industrial sector but suffer from structural problems like a chronically underdeveloped banking system which seriously affects their performance.

The second part was an empirical analysis of the variables determining Argentina's trading flows. The econometric application of the Gravity model of international trade, and of the Poisson Pseudo-Maximum Likelihood estimator (which was shown to be the most efficient estimator after a comparison with other regression techniques), gave some important results. The first one is that MERCOSUR's effectiveness in promoting regional trade is questionable: the coefficient obtained from the regression says the impact was negative if we consider all the goods involved in the bilateral transactions, while sign changes according to the category of goods (it turns positive only for commodities and crude materials). The second one is that macroeconomic instability, mainly

represented by a particular measure of exchange rate variability I computed, do not seem to have affected in a significant way Argentina's trade pattern with its main partners. Both of these main results could be explained by factors that mainly revolve around the troubled economic relations between Argentina and Brazil, and I suggest that future research on this topic should follow this direction.

In the third part of my research I adopted a methodology taken from International Political Economy. The case study of Argentina's behavior in three international organizations (IMF, G20 and MERCOSUR) reveals how this has been characterized by progressive hostility towards the current global economic system and failure in the implementation of the decisions taken at a collegial level (the example of the G20 is striking at this respect, showing that Argentina is the country with the lowest implementation rate of the decisions taken during the G20 summits that took place since the global financial crisis broke out in 2008). The taxonomy of negotiating behavior of rising powers suggested by Narlikar (2013) helped order the findings obtained in the analysis, showing that Argentina mainly implements distributive strategies, promoting issue-based coalitions with a high degree of ideological content. The neo-liberal institutional framework, which suggests that States are rational actors and therefore they accept to delegate a portion of their sovereignty, looks like the most suitable to describe the current global environment, which is shifting from a unipolar framework to a multipolar distribution of the economic power. In such a context, it seems rational to use multilateral organizations like the IMF and the G20 to address these changes and to create a new global governance through the coordination of macroeconomic, monetary and financial policies. My conclusion, therefore, is that Argentina's behavior seems irrational: the current situation could be quite favorable for rising economic powers to play a more active role in redefining global economic governance.

The aforementioned findings represent the most important results obtained in each of the three parts of the thesis. After this long research, it is possible now to analyze them in light of the research questions formulated at the beginning of this work. In the introduction I had explained that the main goal of this thesis was to explore the relations between the internal and the external dimension of Argentina's economic and political development, in order to assess the country's potential in terms of regional (MERCOSUR – South America) and global competitiveness. In fact, the structure of the thesis explicitly wanted to expand the focus of the analysis from the domestic level (part I) to the regional (part II) to the global one (part III). From the research, it emerged how economic policies implemented by Argentina were incoherent. The lack of coherence is evident both at the domestic and the global level. In the first sense, this has been a common feature over the last decades: economic policies and strategies were periodically replaced by opposite ones (for instance the recurrent shifts from public

interventionism to liberal policies), with the result of creating uncertainty and instability and slowing growth down. From the external point of view, Argentina moved from periods of openness towards the rest of the global economies to others, as the current one, characterized by higher degree of isolation. From another point of view, Argentina's policies proved also to be inappropriate at all levels. They harmed the country's potential to play an influential role in the global arena. If we consider the domestic dimension, for instance, the recent policies based on high public intervention, protectionism and capital controls, not only reduced the country's growth potential, but also had a negative impact on the external attractiveness of the country for new investments. In a similar way, lack of collaboration and engagement of Argentina in the main international economic organizations damaged its external reputation and credibility, leading to the same consequence. The overall result is a country which economic policies can be effectively described by a 'tango' between economic integration and isolation, as suggested by the title of this thesis. The current framework (monetary, fiscal, industrial and trade policies) is not consistent and compatible with the international 'rules of the game' which, as I argued in part III, would be actually appropriate to nurture Argentina's economic growth.

What is the innovative contribution given by the results of this research? The methodological approach, based on three different analytical frameworks, offered a comprehensive analysis of Argentina's recent economic history starting from different angles and perspectives. This helped build a multi-dimensional image of the country's economic role within the global economy, something which would have not been possible with the adoption of a single methodology. For instance, a pure econometric analysis of Argentina's performance would not have allowed a more analytical study of the reasons and implications underlying the results obtained with the regressions. By the same token, an investigation based only on IPE analytical frameworks would not have made possible to analyze economic phenomena in detail.

Moreover, another innovative contribution comes from the fact that the different parts apply analytical frameworks and tools that had not been tested to the Argentine case before. The first part compares three different economic development theories to show strengths and weaknesses, and combines these elements to provide policy recommendations. The second part adopts the recently defined PPML estimation technique to analyze the variables of Argentina's trading flows, showing interesting results especially in terms of the disappointing effects of regional integration (the case of MERCOSUR). Finally, the third part focuses on a case study of three different examples which are then classified according to a new taxonomy of negotiating behavior.

Therefore, the overall result of this innovative methodological approach can be compared to the pieces of a ‘jigsaw’ that contribute to form a clear and detailed picture of the subject. Such a ‘jigsaw’ could be expanded by further research that could follow these directions:

- a more detailed analysis of monetary policy and of the potential scenarios arising from a future shift (for instance towards a full openness of capital flows and the dismissal of strategies pursuing competitiveness through currency devaluations);
- an investigation on Argentina’s potential reinsertion into global financial markets, starting from the strategies it should adopt to strengthen its domestic banking sector;
- further specifications of the econometric analysis of Argentina’s trading flows, aiming at defining better the implications of monetary policy and protectionist measures on the country’s trading patterns and on regional integration.

In conclusion, how is it possible to summarize the findings of this research? Argentina’s recent – and less recent – history is the case of a country endowed of a huge potential, both in terms of natural and human capital resources, which has been partly wasted mainly because of macroeconomic instability and lack of coherence in the models of development adopted over the course of the last decades. The thesis showed there is a link to the external dimension, since these domestic economic policies resulted also into a lack of global competitiveness which affected in the long run the economic performance of Argentina, preventing it from achieving the status of a completely developed country. This situation has partially changed during the last ten years: the Kirchner governments managed to promote stable and sustained growth, but their industrial policies were not effective in fostering competitiveness in terms of creating a favorable business environment able to attract capitals from within the country and from abroad. Moreover, populism and economic nationalism are isolating Argentina from the rest of the region and the world, driving the country to the status of ‘pariah’ in international relations.

Therefore, this research would like to suggest some policy recommendations. Argentina would need to implement different policies at all levels. At the domestic one, economic policies should be aimed at fostering innovation in sectors provided with comparative advantage and at promoting more private investment. At the regional level, the integration process of MERCOSUR could be revived through a solution of the commercial disputes with Brazil and with a commitment to harmonize the macroeconomic imbalances with the other members. Finally, at the international level Argentina should play a more collaborative role in order to gain reputation and credibility from other key global partners.

The recent mid-term parliamentary elections, held in Argentina at the end of October 2013, saw the most negative performance for the Kirchner's *Frente para la Victoria*, which still remains the strongest party in the country but which has significantly reduced its share of votes, losing in the biggest cities (Buenos Aires, Córdoba, Rosario). This will prevent President Cristina Kirchner from managing to obtain a constitutional modification (requiring more than the absolute majority of votes in Parliament) which would allow her to run for a third term.. Cristina Kirchner reshuffled her cabinet by replacing the key economic figures (Minister of Economy, Secretary of Trade relations, President of the Central Bank) with other experts. Hernán Lorenzino was replaced by Alex Kicillof as Minister of the Economy, while Guillermo Moreno was removed from his appointment as Trade Secretary (he was considered the main responsible for manipulating the data on inflation) and Juan Carlos Fábrega replaced Mercedes Marcó del Pont at the head of the Central Bank. However, despite this effort to provide more reliable and credible figures, it seems unlikely to expect a substantial shift of economic policies in the short-medium run. Therefore, the presidential elections in 2015 might be a real turning point for Argentina's political and economic future although, as the country's history shows, a new change at the government will not necessarily mean a better future for the country. It is crucial that Argentina's emotional and unpredictable tango is finally driven in the right direction.

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