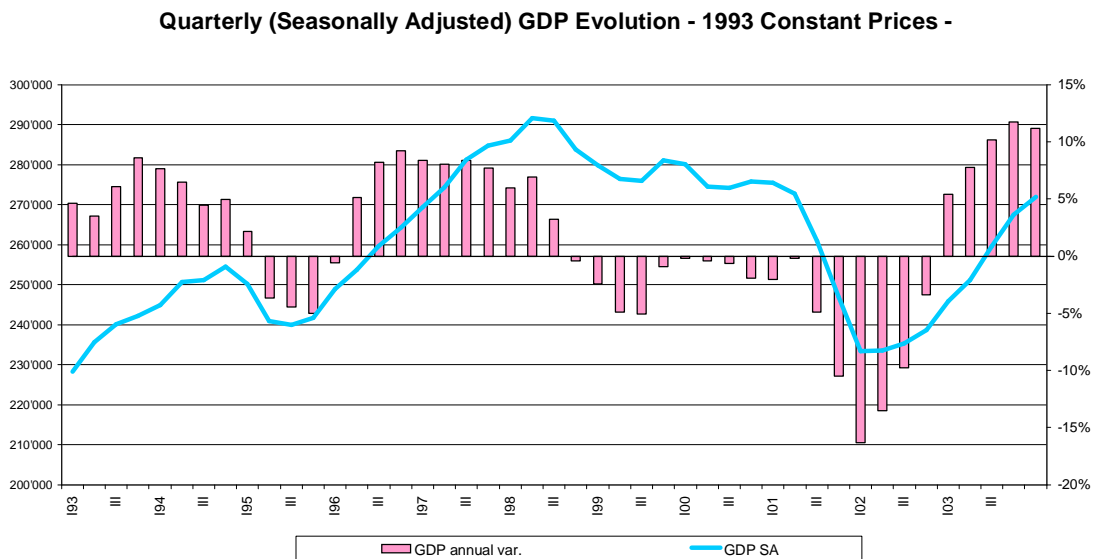


IMPACT OF GLOBALIZATION – ARGENTINA

Until 1999 Globalization was a success story in Argentina. Real GDP growth rate reached 8.1 percent in 1997. The turning point came at the end of the 1990s. Argentina's economy has gone through three years of deep recession. A rebound took place in 2002, after a strong fall in the level of activity.



Source: FIEL

Argentina came a long way since the restoration of democracy in 1983, but the record has been decidedly mixed. People in Argentina endured a significant drop in their standard of living and their life prospects.

In the early nineties, after a severe hyperinflation in 1989, several market-oriented reforms were implemented. Though they spurred economic growth, they were insufficient and the economy remained not competitive. Argentina never fully opened its markets and when Brazil devalued its currency in January 1999, Argentina's economy was heavily affected. At the end of the 1990s the country was constrained by a total external debt of 50 percent of GDP, a high fiscal deficit and 14 percent unemployment. Since

then, the debt burden in Argentina increased. Hundreds of local and foreign firms have gone bankrupt, output and tax revenue have contracted, and unemployment has reached more than 20 percent. At the end of 2001 Argentina defaulted his public external debt, causing the biggest default in history. The decision to freeze bank deposits in late 2001 was exacerbated by the country's dysfunctional judicial system, its pervasive culture of corruption and the oversized bureaucracy.¹

Meanwhile, thanks to devaluation of the Argentine currency, the country's trade balance (half of it represented by agricultural exports) has improved. The Argentine government ended the freeze on bank savings accounts, releasing roughly US\$ 5.5 billion to Argentine households – a sign that the four-year recession is ending. But there is still a long way to go. Real GDP is now around 10 percent lower than in 1998, unemployment is about 18 percent, poverty rates remain extremely high, and signs of price stabilization partly reflect continued controls on utility prices. Despite this, according to IMF, the worst may be over. Since mid-2002, there has been a strong recovery in real GDP and strong growth in industrial production and construction. Consumer confidence is rising and unemployment has fallen, which partly reflects the growth of beneficiaries under employment support programs.

¹ The Heritage Foundation (2002), p. 93; The Heritage Foundation (2003), p. 81.

A. 1 Effects on Income Levels and Living Standards

Since 2002, there has been a noticeable recovery in real GDP. But real GDP is still almost 10 percent lower than in 1998. The huge drop in GDP since 1998 ensured good growth rates in 2003–04.

	1981–91	1991–01	2000	2001	2002	2003	2004	2005
GDP	-0.1	2.9	-0.8	-4.4	-11.3	8.8	9.0	9,2
GDP p.c.	-1.5	1.6	-2.0	-5.6	-10.1	7.9	8.2	

Source: World Bank; IMF. *FIEL forecast **: own estimates

Argentina had the highest US dollar income per head in the region. In 1998 an Argentine earned about US\$ 12'992 on the average. In 2000 real GDP p.c. was still US\$ 11'800. In local currency terms, average incomes have been further decimated by inflation and are forecast to recover only slowly. For a lack of data regarding poverty and income distribution, only limited statements can be made. Gini index in 2005 (0.524) was lower than in 1999 (0.542)²

² ECLAC, 2006.

Looking at urban households you can find that the gap between really poor and very rich people increased. Compared to 1994, less people are member of the middle-income class, but more people are among the poorest 20 percent. The share of the richest 10 percent increased from 34.2 percent in 1994 to 36.7 percent in 1999.

DISTRIBUTION OF INCOME IN URBAN HOUSEHOLDS IN ARGENTINA, BY QUINTILES (IN %)

	1980*	1990*	1994**	1999***	2006***
Poorest 10%	2.8	2.3	2.1	2.3	1
Poorest 20%	4.0	3.9	2.9	3.7	3.3
II quintile	10.6	8.7	8.8	9.8	7.9
III quintile	15.7	14.2	14.1	13.3	13.3
IV quintile	21.7	20.9	21.0	19.2	21.5
Richest 20%	45.3	50	51.1	51.6	53.8
Richest 10%	30.9	34.8	34.2	36.7	37.1

Source: ECLAC, INDEC (*Encuesta Permanente de Hogares*).

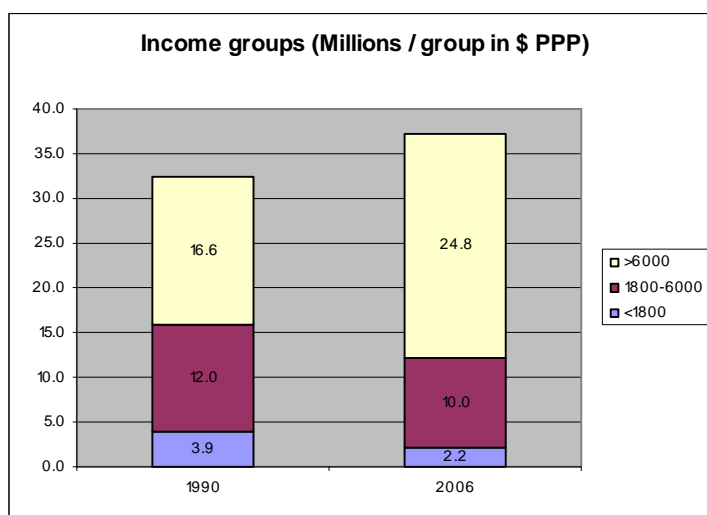
* refers to the metropolitan area

** refers to 20 agglomerations

*** refers to 28 urban agglomerations

According to the Argentinean statistical office, inequality in income distribution increased in 2006. Following a tradition in Argentinean politics, a controversy between the government and the INDEC started. The Argentinean government has often accused the INDEC's survey method of neglecting welfare policies by computing monetary income only. This quarrel might lead to a reform of the methodology, which would bring forward more favourable results in 2007.

As you can see in the chart below, the income level in Argentina is relatively high. In 1999, about one million people earned less than 1'800 US\$ per year. Despite the fact that still too many people live in poverty, the share is quite small compared to the share of rich(er) people.



Source: World Bank

There is an increasing trend of the human development Indicator as measured by the UNDP. From 1990 to 2003 The indicator improved from 0.81 to 0.86, placing Argentina in the midfield of the countries with high human development.³

HUMAN DEVELOPMENT INDEX TRENDS, 1985 – 2004

	1985	1990	1995	2000	2001	2002	2003	2004
World	--	--	0.772	--	0.72	0.729	0.741	0.741
DC*	--	--	0.586	--	0.65	0.663	0.694	0.679
Argentina (36/175⁺)	0.805	0.808	0.830	0.844	0.849	0.853	0.863	0.863
LAC**	--	--	--	--	0.777	0.777	0.797	0.795

Source: Human Development Report 2006.

* Developing countries, ** Latin America and the Caribbean, + HDI Rank 2004

³ UNDP (2003), p. 237–238.

Argentina improved its performance in three basic dimensions of the indicator.

SOCIAL STATISTICS FOR ARGENTINA, 1970 – 2000												
Literacy rate (percent)				Life expectancy (years)				Infant mortality (per 1000 live births)				
	1970	1980	1990	2000	1970	1980	1990	2000	1970	1980	1990	2000
Argentina	93	94	96	97	67	70	72	74	52	35	25	17
LAC*	74	80	85	88	61	65	68	70	84	61	41	29
DC**	53	62	69	75	55	60	63	64	108	88	67	59

Source: World Bank, *World Development Indicators*.

* Latin America and the Caribbean, ** Developing countries

To show how widespread human poverty is in a country, you can use the Human Poverty Index (HPI). The HPI–1 measures deprivations in the same three basic dimensions of human development captured in the HDI⁴. The HPI–1 value is expressed in percentages and indicates the proportion of the population affected by the three key deprivations in their lives. In 2004 the index was calculated for the first time for Argentina with a value of 4.3 and the country ranked 3rd.

⁴ HPI–1 measures deprivations for *developing* countries, whereas HPI–2 captures also social exclusion and measures deprivations for selected OECD countries.

A. 2 Effects on Employment

In the majority of the Latin American countries the employment rate increased slightly or remained relatively flat until 1998. Since then it has fallen in several countries⁵. In the case of Argentina total employment increased by 1.415.000 jobs in five years, from 1996 to 2001⁶.

Absolute values have limited significance. Therefore we consult the employment-to-population ratio as a further indicator. It provides information on the ability of an economy to create jobs. Argentina's ability to create jobs improved or remained stable until 2000, but it deteriorated significantly the last two years. In 2001 the ratio was 35.15% and in 2002 just about 34.1%.

Total employment in Argentina (in Million / percent)		1996	1997	1998	1999	2000	2001	2002
Population	Total	35.75	36.20	36.64	37.07	37.50	37.92	38.33
Persons aged 10 years and over	10+	--	--	--	18.9	--	--	--
Employment	Total*	10.3	10.8	11.4	11.5	11.5	11.7	11.0
Employment for Manufacturing and Services**	Total	7.3	7.8	8.2	8.3	8.3	8.1	8
Employment-to-Population Ratio	Total	34.3	34.95	36.76	36.53	36.2	35.15	34.1
Unemployment	Total*	2.1	2.0	1.7	1.9	2.0	2.2	3.0
Unemployment for Manufacturing and Services**	Total*	1.5	1.4	1.2	1.3	1.5	1.7	2.0

Sources: LABORSTA, INDEC, US Census Bureau

*:Employment figures refer to urban centers

⁵ Compare also to chapter 6, p. 73–74.

⁶ Refers to urban employment (see chart).

A. 3 The Costs of Institutional Constraints and the Benefit of Opening

Global foreign direct investment (FDI) inflows, down by 41 percent in 2001, fell by another fifth in 2002 – to US\$ 651 billion, or just half the peak in 2000. In 2002 inflows into the developed world declined by 22 percent. The decline in the developing world was steepest in Africa (41%), followed by Latin America and the Caribbean (33%). Both manufacturing and services were hit hard, while FDI flows to the primary sector rose.⁷

Inflows into and outflows from Latin America and the Caribbean rose in 2005 for the second consecutive year, thus recovering from a steady decline in FDI inflows between 1999 and 2003. FDI inflows into Latin America and the Caribbean declined in 2002 for the third consecutive year, falling by a third to US\$ 56 billion – the lowest since 1996. The decline in FDI was concentrated in Argentina, Brazil, and Chile, where FDI into services was more important. FDI inflows into Argentina in 2002 were only 10 percent of the average received during 1992–2001, when Argentina received 13 percent of the region's inflows. Despite the impact of the debt default crisis on transnational corporations (TNC) in Argentina, very few of them left the country. However, there were large negative flows in the reinvested-earnings and intra-company loan components of FDI, revealing that established TNCs have been reducing their investments.

To sum up, there is considerable uncertainty, affecting FDI in Argentina at present, as regards both economic factors and policy with respect to inward FDI and the large public service industries that have been privatized with TNC participation. Argentina's economy is now recovering after three years of deep recession. How these developments will affect FDI inflows and of operations transnational corporations in the medium and long term will depend on a number of factors. However, should Argentina's economic situation continue to improve, foreign investors may well be induced to

⁷ UNCTAD (2003), pp. 3–4.

invest again in this country that is rich in natural resources and human capital.⁸

FDI played an important role in Argentina's economy in the 1990s. The ratio of FDI to gross fixed capital formation rose, and its level in the period 1998–2000 was comparable to that of Brazil and Mexico. Flows rose steadily, peaking in 1999. Then, the country began to slide into recession and to suffer from high levels of country risk and growing uncertainty about the future of the currency convertibility scheme that had been in place since 1991. The deepening crisis finally affected FDI inflows in 2001 and they fell to the level of the early 1990s⁹. Total investment in foreign affiliates declined by 30 percent in 2001, reaching its lowest level since 1996. That compares with a fall in total domestic investment of 16 percent in 2001. The peso depreciation also increases the attractiveness of the country for export-oriented FDI. Some firms with significant investment in the 1990s have announced that they will not make more investments in Argentina in the near future.¹⁰ See Appendix for an explanation of Argentina's FDI figures.

FDI flows in Argentina

		1997	1998	1999	2000	2001	2002	2003	2004	2005
Inward	mi US\$	9161	7292	23986	10418	2166	2149	1652	4274	4662
	% of GDP	3.0%	2.0%	8.0%	4.0%	1.0%	0.0%	0.0%	2.8%	2.5%
Outward	mi US\$	3653	2325	1730	901	161	-627	774	442	1157
	% of GDP	1.0%	1.0%	1.0%	0.0%	0.0%	0.0%	0.00%	0.3%	0.6%

Source: UNCTD

⁸ UNCTAD (2002), p. 65.

⁹ See Appendix

¹⁰ UNCTAD (2002), pp. 63–64.

FDI Stocks

		1980	1990	2000	2004	2005
Inward	mi US\$	5 344	8 778	67 601	50583	55245
	% of GDP		6%	24%	33%	30%
Outward	mi US\$	5 970	6 057	21 141	21 476	22633
	% of GDP		4%	7%	14%	12%

Source. UNCTD

The Inward FDI Performance Index benchmarks success in attracting FDI. It is the ratio of a country's share in global FDI flows to its share in global GDP. Countries with an index value of one receive FDI exactly in line with their relative economic size. Countries with an index value >1 attract more FDI than may be expected on the basis of relative GDP. Countries with index values <1 may suffer from instability, poor policy design and implementation or competitive weaknesses in their economies.¹¹ In 1988–1990¹² Argentina was ranked 48 (of a total of 140 countries) with an index value of 1.2. Despite the difficult years the country had to go through, Argentina improved its ranking (place 37) in 1999–2001, with an index value of 1.3.¹³ ¹⁴ In 2005 Argentina ranked 83, and was still suffering from the lack of confidence from international investors.

¹¹ UNCTAD (2002a), p. 23.

¹² The Index is shown for three-year periods to offset annual fluctuations in the data.

¹³ UNCTAD (2002b), p. 26.

¹⁴ See Appendix

To evaluate a country's development in economic performance it is helpful to consult the data for its trade activities, too. Compared to 1991 Argentina intensified its trade activities.

TRADE OF GOODS AND SERVICES IN ARGENTINA (IN %)

	1981–91	1991–01	2001	2005	2006
Imports (% of GDP)	7.4%*	6.1%	10.2%	24.6%	23.3%
Imports (average annual growth)	-1.3%	9.1%	-14.0%	-14.0%	-14.0%
Exports (average annual growth)	4.2%	8.8%	2.9%	2.9%	2.9%

Source: World Bank. * referring only to the year 1981.

Looking more closely to the structure of trade you can find that food and manufactures still are the most important trade domain for Argentina. In the past two years Argentina significantly intensified (sextupled) its exports of fuels. But the country also exports four times as much ores and metals than ten years before.

TRADE IN ARGENTINA 1991 – 2001 (US\$ MILLIONS)

	1981	1991	2000	2001
Total exports	9 143	11 978	26 409	26 655
Food	6 111	7 193	11 511	11 833
Agricultural raw materials	454	452	456	431
Fuels	620	749	4 708	4 566
Ores and metals	160	204	873	817
Manufactures	1 796	3 376	8 516	8 681
Total imports	9 143	11 978	26 409	26 655
Food	471	446	1 228	1 162
Agricultural raw materials	321	233	368	306
Fuels	1 022	461	933	816
Ores and metals	247	287	514	456
Manufactures	7 365	6 823	22 074	17 517

Source: World Bank.

A. 4 Current and potential growth

It has been pointed out in chapter 6 that economic performance of most Latin American countries is worse under current conditions than it would be with stability and additional reforms. One possibility to measure how efficiently a country taps its potential is the Index of Economic Freedom (IEF)¹⁵. The key to prosperity is open markets and a fair and just system, that is sound institutions, particularly a strong rule of law¹⁶. Property rights, regulations, and black market factors were found to have the highest significance in explaining the variation in per capita income across countries. This indicates that people invest, work, and consume where regulatory barriers are lowest and, most important, where property rights are well protected. Without the rule of law, societies have no mechanism to stop private abuses and public mismanagement¹⁷.

The IEF measures a total of ten different factors. For each factor, a country receives a score from 1 to 100 – where 100 is freest and 1 most repressed. In 2003 Argentina was categorized "mostly free" for the first time instead of "free". According to the IEF Argentina appears to be reverting to the closed society that characterized the end of the 1980s with price controls, financial restrictions, inflation, and rampant violation of property rights. The country significantly dropped back in the ranking and is placed now 68. Argentina continually improved its scores until 1999, when it was ranked 14 with an average score of 2.10, but then a rapidly and continuing deterioration took place. Particularly five factors were affected: Capital flows and FDI as well as banking and finance. Furthermore property rights, regulations and black market.

¹⁵ Economic freedom is defined as "the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself". The Heritage Foundation (2000), p. 71.

¹⁶ Eiras (2003), p. 1. Compare also to pages 71 et sqq.

¹⁷ Roll/ Talbott (2002), in: Eiras (2003), p. 3.

THE 10 FACTORS MEASURED BY THE IEF FOR ARGENTINA

Year	1997	1999	2001	2003	2005	2007
IEF Rank	30	38	14	29	--	68
Overall Score	74.1	76.9	70.5	55.5	54	57.5
Business Freedom	70	70	70	50	50	65.5
Trade Freedom	60	81.2	65	54	56.2	61.4
Fiscal Freedom	86.8	85.1	81.6	81.4	81.8	82.3
Freedom from Government	88.3	86.5	82.7	80.8	91.1	89.6
Monetary Freedom	82	89.7	95.5	88.5	65.3	71.3
Investment Freedom	70	70	70	50	50	50
Financial Freedom	70	70	70	30	30	40
Property Rights	70	70	50	30	30	30
Freedom from Corruption	70	70	50	35	25	28
Labour Freedom					60.8	56.2

Source: The Heritage Foundation.

Score from 1 to 5 – where 1 is freest and 5 most repressed.

82 percent of people living in Argentina do not trust the legal system. Based on the increasing evidence of insufficient protection of property rights, Argentina's property rights score is 1 point worse in 2003. Regarding businesses in Argentina, they still face problems involving inconsistent application of regulations, fraud and corruption. The labor market remains rigid despite the passage of a labor flexibility law in April 2000. Such rigidity is reflected, in part, in rising unemployment. Compared to 2002 the score in regulations remained stable, but it worsened one point compared to 2001.

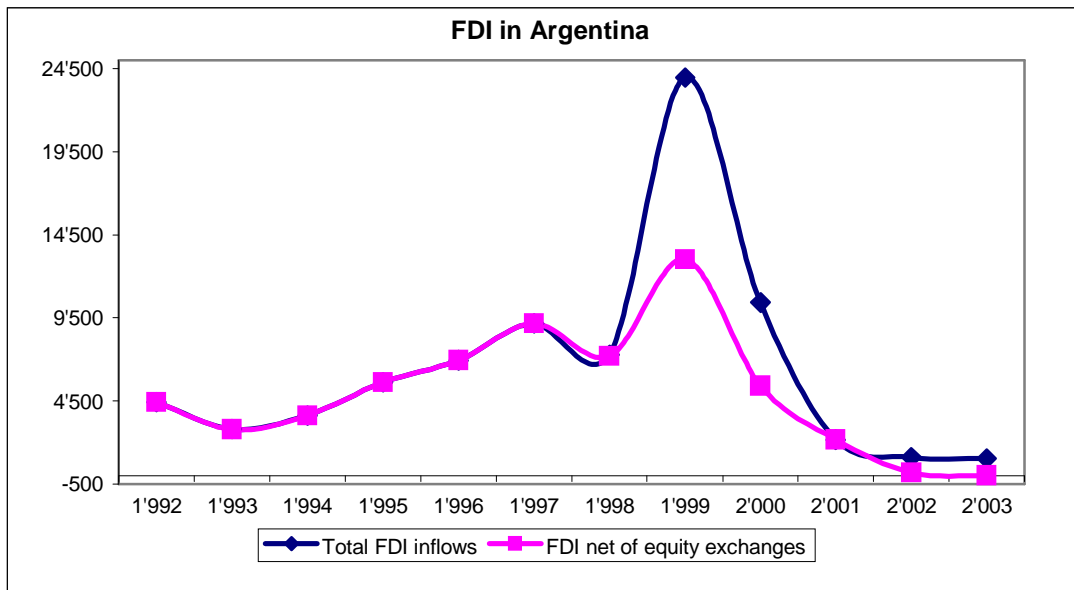
Appendix: A Technical Note on FDI in Argentina

FDI played a major role in contributing to Argentina's good economic performance during the nineties. Official figures show an increasing trend over the decade, with averages of - in US\$ millions - 4.000 for 1992-1995, of 8.000 for 1996-1998 and a peak of 24.000 in 1999. That year the tendency reversed and flows decreased ever since.

There is however, a note of caution regarding the values for 1999 and 2000. As other forms of capital flows, FDI flows are included in the financial account of the Balance of Payments (BOP). The BOP registers all transactions relating residents of an economy with non-residents. To have a clear idea of what is going on, one should look at both inflows and outflows (i.e. net flows) in a given period.

In 1999, Repsol, an Spanish Oil Company, offered to buy the stocks of YPF, an Argentinean oil company, whose equity were mainly floating in the NY Stock Exchange (after the firm's privatization in 1993). The result of that operation was an inflow of FDI, and due to the double entry nature of the BOP, an equivalent outflow in Portfolio investment (due to the fall in Argentine assets in hands of non-residents). Therefore if one calculates the value of FDI inflows net of portfolio outflows for that year, one finds that it is substantially lower than the value of total FDI inflows. Similar operations took place in the year 2000.

The graph below shows the evolution of FDI total inflows and that of the FDI inflows when equity changes are subtracted.



Source: Instituto Nacional de Estadística y Censos (INDEC)

FDI in Argentina (u\$s millions)

	1'992	1'993	1'994	1'995	1'996	1'997	1'998	1'999	2'000	2'001	2'002	2'003
Total FDI inflows	4'432	2'793	3'637	5'610	6'951	9'161	7'292	23'986	10'418	2'166	1'093	1'020
FDI net of equity exchanges	4'432	2'793	3'637	5'610	6'951	9'161	7'193	13'037	5'402	2'169	180	n/a
Portfolio investment: Equity Securities	1'120	4'979	3'116	1'090	990	1'391	-210	-10'773	-3'227	31	-116	65

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Acronyms and Abbreviations

bn	Billion (1 bn = 1000 millions)
ECLAC	UN Economic Commission for Latin America
EIU	Economists Intelligence Unit
et sqq	and the following
Δ	change
DC	Developing Country
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFCF	Gross fixed capital formation
HDI	Human Development Index
HPI-1	Human Poverty Index for Developing Countries
ICSE	International Classification of Status in Employment
IEF	Index of Economic Freedom
ILO	International Labor Organization
LAC	Latin America and the Caribbean
KILM	Key Indicators of the Labour Market (of ILO)
mio	million(s)
p.c.	per capita
PPP	Purchasing Power Parity
TNC	Transnational corporations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
US\$	US Dollar
WBG	World Bank Group

WDR World Development Report (of World Bank)

WIR World Investment Report (of UNCTAD)