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THE EVOLUTION OF MULTINATIONAL CORPORATE INVESTMENT IN ARGENTINA

Christine J. Massey

Introduction

In 1989, under the leadership of President Carlos Menem, Argentina began a miraculous recovery which completely transformed the country. Instead of continuing to discourage foreign investment by means of heavy government regulation, Argentina became one of the most open economies for foreign investment in the world. Multinational corporations in particular have found numerous benefits from investing in the Argentine economy. Equal treatment for foreign corporations and deregulation have spurred a huge influx of foreign businesses to the country. In addition to looser restrictions, multinational corporations have found more opportunities awaiting them as the economic climate within Argentina constantly improves.

In this essay I first provide a historical background of Argentine foreign investment policies before the reforms. Next I address the changes that have occurred and the reasoning behind the shifts in attitude towards foreign investment. I follow with a description of some of the characteristics of the Argentine economy which have made multinational corporate investment in Argentina so appealing. To demonstrate by example the benefits of investment in Argentina, I analyze the success of two major corporations, Whirlpool and Nabisco. Finally, I address the future of the multinational corporation in Argentina and the question of whether this growth and deregulation can be expected to last.

Investment History before the Reforms

The import substitution model, which is based upon the idea of strengthening one's own industries to replace the dependency on imports to achieve industrialization, became a popular model for many Latin American countries, including Argentina, after WWII. The 1930s and 1940s were a trying time for these countries because of the decrease in foreign demand that
occurred during these periods. By 1940 shipments to and from Argentina had dropped to less than half the volume of a year earlier. Blockades that resulted from WWII generally limited the access that ships had to countries.

In addition to the reduction in exports that resulted from blocked entry and lowered demand due to the war, imports also decreased. Countries like England, for example, were shifting their resources to arms production and could no longer ship valuable resources to other countries. As a result, Argentina found itself in a difficult situation. Both imports and exports were at their lowest levels in years, and the country needed to find ways to decrease its reliance on foreign markets. Argentina, as well as the other Latin American countries, felt that it could use its rich resources and skilled labor to produce the same items that it was importing, helping to put it on a more equal level with other industrialized countries. The import substitution model can be said to be the beginning of an anti-foreign sentiment that would continue in various degrees throughout Argentine history.

Why Import Substitution?

As demand for its products decreased abroad, Argentine companies needed to find new markets for their goods at home. In addition, as imports of manufactured goods increased, Argentina needed to find a way to produce the needed items at home. The country saw a need to become more self-reliant. One of the leading Argentine economists at the time, Raúl Prebisch, thought the way to achieve this goal of self-reliance was through the promotion of industrialization. Most Argentine exports were raw materials, such as grains, while its imports consisted mostly of manufactured goods. By erecting high barriers for foreign goods, Argentine companies could grow and learn to compete without the pressure of foreign competitors. The country would no longer need to rely on imports from other countries, as it would now have the capabilities to produce the needed items at home.

Perón Economics

Juan Perón was one of the first presidents to discourage foreign investment and utilize the methods of import substitution. By 1955 under his nationalistic leadership private foreign investment declined to only three-fifths of what it was nine years earlier. (Rock, p. 263) Perón interpreted this drastic decline as signifying an end to the foreign control of Argentina's economy. He felt growth could be led inward: that Argentine companies could profit by manufacturing and selling goods for their own economy instead of relying on foreign demand. In addition to decreasing the economy's dependence on foreigners, Perón felt that industries would become naturally self-sufficient and productive.

To further limit the excessive influence that Perón believed foreign countries had on Argentina's economy, Perón nationalized most of the foreign investments within the country. In the 1950s, Argentina had a substantial foreign exchange reserves surplus which was in the form of credits and essentially frozen as a result of the depressed economies that many countries suffered from as a result of the war. Fearing that Argentina would never see the money again, Perón sought to buy back many foreign investments with these credits. The majority of the investments which were repatriated were British, including the railroad system which the Argentine government took over. Under Perón, virtually all foreign investments, with the exception of U.S. properties, were transferred to the ownership of the Argentine government. (Alexander, p. 67)

Perón's methods to improve the economy were quite unsuccessful, however. Inflation was pervasive throughout the Perón administration. The annual inflation rate increased steadily from a 12.2 percent rise in 1947, to 13 percent in 1948, to 32.7 percent in 1949. (Rock, p. 299). Stagnation was present throughout the economy. In 1955 the per capita gross national product was only 16 percent higher than it was in 1943. Argentina no longer had the highest per capita income in Latin America, falling behind Venezuela in the early 1950s. Thus, while prices were rising, real wages fell approximately 20 percent between 1948 and 1952. (Rock, p. 301)

Perón tried to cover up the country's problems by using state spending as a way to absorb the needed investment activities. For example, to make the economy seem as if it
were growing, Perón increased the number of state employees. In fact, by 1955 10 percent of the working population was employed by the state. (Rock, p. 266) By increasing investment through state spending, Perón could mask the fact that industries were not growing and that the import substitution model was not successful in expanding the economy.

The government realized that access to new technologies, available mostly from multinational corporations, was a necessity if it wanted the country to become more industrialized. Between 1959 and 1973, lulled by inducements from the state, multinationals expanded into Argentina. (Rock, p. 328) However, many Argentines were wary of the actual benefits that the multinationals were perceived to provide for the country. Critics contended that multinationals were expanding at a rate double that of the national companies, thus taking away market share from national companies. Furthermore, they alleged that much of the investment from multinationals came, in fact, from domestic savings, while only a quarter of actual investment came from abroad. (Rock, p. 329) These companies were then also blamed for repatriating most of their profits to their home country, ignoring the investment needs of the Argentine economy. All of these factors helped to contribute to a growing feeling of discontent with the multinational corporations.

The Foreign Investment Law of 1973

The Foreign Investment Law of 1973 gives the best picture as to the extent of the protectionist sentiments. This law placed heavy restrictions on foreigners and generally made Argentina an undesirable country for foreign investment. The law forbade foreigners from purchasing more than fifty percent of any enterprise doing business in Argentina. In areas vital to national security, no foreign investment was allowed. To further augment the barriers against foreigners, the country placed heavy taxes on the foreigners and then limited profit remittances to 14 percent of net returns. (Lewis, p. 421)

If a company still was not deterred by these considerable restrictions and decided to enter the Argentine market, it would have several other obstacles to overcome. Access to local banks was severely limited, so obtaining any needed funds would be quite difficult. In addition, all projects for new investment and expansion had to go through about 100 minor and mid-level functionaries before they passed to the cabinet for final review, resulting in about two years of red tape. (Lewis, p. 316) To keep companies from bringing in their own people, the Foreign Investment Law required 85 percent of managerial and technical personnel to be Argentine.

All of the rules and regulations made it quite difficult for any foreign company to be successful in Argentina. In fact, the Foreign Investment Law of 1973 created disadvantages deemed so insurmountable that there was no foreign investment for the next three years following the enactment of the law. (Lewis, p. 421)

Changes in Attitude toward the International Investor

During the late 1980s, the Argentine government began to realize that years of import substitution and barriers to foreign investment did little to help the economy grow. While it can be argued that import substitution did indeed help to encourage growth in the manufacturing sector, it is important to note that the ultimate goal for such growth was a desire to encourage the economic development of the country. In this sense, these policies were not successful. Argentina never came close to catching up with any of the developing countries. Per capita income was stagnant, inflation rates were enormous, and the manufacturing sector never became competitive with those of other countries. In fact, between 1977 and 1987 industrial output declined 12.6 percent (Doggart, p. 49)

The problem with heavily regulating foreign companies to give domestic firms an advantage is that the domestic advantage only lasts as long as the barriers are up. If the companies lack the necessities for competitive manufacturing, such as technological infrastructure, managerial know-how and an entrepreneurial attitude, they will not be able to succeed once the barriers are lifted. To allow the barriers to remain and to rely solely on
domestic manufacturing only hurts the economy since consumers will receive poorer quality goods at higher prices. For example, high tariffs for foreign countries allowed manufacturing industries to exist in Argentina even though the cost of production for domestic companies was three to four times that of their foreign counterparts. (Krugman and Obstfeld, p. 262)

Another problem with import substitution is that the domestic market usually is not large enough to support the development of its industries. Economies of scale often cannot be realized when producing for just one country. Because Argentina was so restrictive towards foreign investments, exporting to other countries was an impossibility since most countries would employ similar high tariff policies towards Argentine companies. As a result, manufacturing companies could not grow since their markets were limited.

Thus, Argentina finally realized that it needed more than restrictive foreign policies to expand its economy. As the Argentines saw other countries developing at a faster rate and with better technologies, they saw a need to allow foreigners to come in and bring their ideas and experience from abroad. Most Argentine companies do not invest in research and development, and instead rely on the knowledge and expertise of foreign companies. (Bunge y Borne) It has been less costly to learn from foreigners by opening up the economy than to spend millions of dollars trying to create methods which are already in use abroad. In fact, Argentine companies such as Molinas, a well known foodstuffs company, say they look forward to the entry of foreign companies such as Nabisco International, because they can learn from Nabisco new methods for their own manufacturing processes. (Bunge y Borne)

The Opening of the Argentine Economy

Under the leadership of President Carlos Menem, the government initiated moves in 1989 to make Argentina one of the world’s most open economies. Most of the regulations of the past were eliminated. In its place were instituted policies which encouraged foreigners to enter the Argentine markets. One of these changes involved the reduction of tariffs on imports. Until 1988 the average tariff rate for imports was 39 percent, with some rates as high as 65 percent. These rates were lowered to an average of 20 percent, and the highest rates were pushed down to 30 percent. In addition, all export taxes were eliminated. Furthermore, Deregulation Decree 2284/91 abolished all quantitative restrictions on imports and exports. Before these changes, private capital flows were negative, with a deficit of $4.3 billion in 1989 and $769 million in 1990. After these changes, Argentina experienced positive capital inflows which amounted to $2.3 billion in 1991, $7.8 billion in 1992 and $5.1 billion in 1993. (Republica Argentina..., 1994, p. 45)

Foreign corporations also no longer suffered from regulations which unfairly favored domestic corporations. The Economic Emergency Law of 1989 placed foreign corporations on an equal footing with domestic companies. This law stated that there would be equal treatment for domestic and foreign capital invested in the country’s productive processes as well as equal treatment towards the remittance of profits. Equal treatment meant that corporations enjoyed the benefits of not being taxed on dividends and having to pay a corporate income tax of only 30 percent. (Republica Argentina..., 1994, p. 36) Furthermore, the government abolished a measure which permitted foreign exchange repatriation only in the form of a Bonex, a 10 year government bond. Companies were now permitted full repatriation of capital and profits through dividends and royalty investments. (Doggart, p. 22) Much of the red tape was also eliminated by abolishing the requirement that capital investments had to be approved by government officials.

While the opening up of the economy did help to bring some foreign investment into Argentina, it has not been until the last few years that investment has shown a significant increase. This recent growth can be attributed to certain characteristics of the Argentine economy itself that have made Argentina an extremely profitable business opportunity. This will be covered in the next section.
Favorable Conditions for the Multinational Corporation

The greatest single contributor to the recent surge in foreign investment is simply the restoration of confidence in foreign investors that the Argentine economy will remain stable. The country risk rate, which is used to measure the extra risk inherent in investing in a particular country, has decreased significantly over the last few years. In particular, the risk rate measures the political and economic stability of a country. Investors pay close attention to these rankings because they serve as an indicator of whether or not financial transactions and investments will be affected. (Gunter, p. 506)

There are two rankings which are widely accepted by investors: the *Euromoney* Country Risk Rankings and the *Institutional Investor* Credit Rankings. In September 1991, Argentina scored only 34.9 of 100 possible points in the *Euromoney* analysis, placing it 78th in country rank. This ranking placed it just slightly ahead of such countries as Guatemala and Egypt. However, in September 1994 Argentina jumped to 49th place with a score of 56.18 points. Argentina’s status also improved with the *Institutional Investor* rankings, jumping from 78th place with only 20.2 points in 1991 to 58th place with 30.5 points. (Institutional Investor... 1991 and 1994) Improvements in its ranking can be attributed to a decrease in the country’s debt in default, and an increase in access to capital markets and financing. These ratings show an increase in faith in economic and political stability in Argentina.

Argentina can also attribute part of its decrease in risk ranking to investors’ optimistic views of the country’s new democracy. Before Menem the average term in office of government officials had been 29 months for the president and only 13 months for the minister of economy. (Arthur Andersen, p. 8) Investors were also enthusiastic that the main thrust of the Menem administration leaned towards privatization. Realizing that in the past the government had been wasteful and had extended control over too many industries, Menem sought to sell government owned corporations to the public to help balance the budget and spur private investment. In this way, the new government was able to turn a continual budget deficit into a $175 million budget surplus after only its first year. (Doggart, p. 32)

Another factor which has added to Argentina’s newly perceived economic stability is the Convertibility Plan. In essence the Convertibility Plan is a set of legal measures which the government instituted in 1991 to help bring the country’s hyperinflation under control. The exchange rate was fixed at parity with the U.S. dollar, and the country’s monetary base was tied directly to gold or hard currency. Hence it became impossible for the government to finance its deficits through seignorage, the printing of money. Because the Convertibility Plan has helped to stabilize the money supply, the inflation rate, which peaked at 4,900 percent in 1989, has dropped to around 3 percent per year. This rate compares favorably with inflation rates in many developed countries. As a result of improvements such as these, significant amounts of capital have been returning to Argentina to take advantage of the investment opportunities that now abound.

Argentina also possesses a competitive advantage in certain areas which makes it worthwhile for corporations to enter into its markets. It has an abundance of natural resources, ranging from the fertile pampas region, to mining fields, forests, fish, and hydraulic resources. With twenty-five years of reserves, the country is completely self-sufficient in the gas sector. The country is also near self-sufficiency in oil, with nine years of reserves available. (Arthur Andersen, p. 3) Thus a company which moves to Argentina will find that it does not have to face shortages of necessary resources.

Demographic factors and the economy in general also contribute to the desirability of entering the Argentine markets. At an estimated $6,494 per person, Argentina now has the highest per capita gross domestic product in Latin America. (Whirlpool) Between 1990 and 1993, the economy grew at an incredible rate, making it the third fastest growing country for that time period. (“Open Market Changes...,” p. 6A) As a result of this increase in income, there is a greater demand for goods. In addition, Argentina has a large middle class. It is this group that most companies target, and a large middle class means more profit opportunities for a corporation. (Whirlpool)
All in all, foreign corporations have come to feel quite welcome in Argentina. The Foreign Investment Law of 1993 put foreign companies on equal footing with Argentine firms by allowing them to invest in the country without prior government approval. They have been permitted to enter the markets through the most convenient vehicle available, be it a merger, takeover, greenfield or joint venture. Companies are also no longer forced to disclose their profits, and no records need be kept. This lack of regulation makes it easy for a company to bring money back and forth from abroad. In addition, not having to pay any taxes on dividends provides another strong incentive to invest in the country.

Although there are opportunities for all types of corporations in Argentina, there are two industries in particular which seem to be striving in the new economic environment: the durable goods and the foodstuffs industries. Two successful multinational corporations, Whirlpool and Nabisco, are examples of companies from each industry which have benefited from expansion into Argentina.

**Whirlpool**

The durable goods industry, and in particular the appliance (white goods) sector, has experienced unparalleled growth in recent years. In 1991 production levels were at an unprecedented high, and expansion has continued. (Republica Argentina..., 1993, p. 43) One of the reasons for the growth in this industry is the increase in Argentine living standards. As the middle class has increased, the desire for housing has also grown. As the demand for housing increases, the demand for appliances also increases. Installment and credit plans have also made the purchase of durable goods more affordable. The Whirlpool Corporation is an excellent example of the large gains in profit that multinational corporations have experienced with the new Argentine economy.

Worldwide, Whirlpool earns a two percent annual net return. Yet, in Argentina the corporation enjoys a ten to fifteen percent return. Why is Whirlpool so much more successful in Argentina than in other parts of the world? Whirlpool executives attribute the region's higher returns to a lack of competition in the market. The company has also been an established player in the market for quite some time and has been able to command higher profit margins on its products due to high consumer demand. Overall, the investment climate is quite ripe for corporate growth and for new players to be introduced on the market. In fact, General Electric, another well-known appliance company, is getting ready to enter the market and reap the rewards of the region.

**Nabisco**

The foodstuffs sector of Argentina is another industry which is poised for growth. Demand for its products has also been spurred by an increasing population and growth of the middle class. Nabisco International, a popular foodstuffs corporation, recently made a $250 million investment in Argentina by purchasing the large Argentine biscuit company, Terrabusi. According to Kirk Elliotte, the director of strategic planning for Nabisco International, "With the opening of the economy and the Convertibility Plan, the Argentine economy became more attractive to international investors including Nabisco." He also cited the improved economy and higher standard of living as other factors which he felt would prove beneficial to Nabisco's presence in the Argentine market.

**MERCOSUR**

In addition to all of the factors previously discussed, businesses are optimistic about MERCOSUR, a common market which began in January 1995. The participating countries of this agreement are Argentina, Paraguay, Brazil, and Uruguay. The MERCOSUR treaty has three major provisions. The first is a trade liberalization program which has eliminated many duties and tariff restrictions among the member countries. The second provision, the countries must coordinate their macroeconomic policies to add some stability among their economies. Finally, the MERCOSUR countries have established agreements among their regions which will accelerate the integration process and optimize the use of production factors.
MERCOSUR is expected to create a market of 200 million inhabitants and an economic region with a GDP of close to one trillion dollars. (Republica Argentina..., 1994, p. 103) This agreement will be especially beneficial to Argentina because a large percentage of its trade is directed towards the other MERCOSUR countries. In fact, the percentage composition of interregional trade between Argentina and MERCOSUR members has increased from 17 percent in 1990 to 26 percent in 1993. (Arthur Andersen, p. 27) Companies that move into Argentina will find that the span of their markets will be even greater, leading to larger profit opportunities.

Future Stability

There is no doubt that Argentina is an excellent country for foreign investment and the multinational corporation. However, one must wonder whether the growth of the economy will be sustainable and if the regulations pertaining to foreign companies will continue to be as relaxed once enough capital is drawn into the country. Thanks to the Convertibility Plan, which has pegged the peso at a one-for-one exchange rate with the dollar and limits the government’s control over seignorage, faith in the stability of the economy has remained quite strong. GDP is expected to continue growing at a rate of 4.5 to 6.5 percent per year. The government has also demonstrated a commitment to a stable economy by running a budget surplus for the past two years. (“The Foundations...,” p. 5) In addition, the growing popularity of payment plans and installment loans reflects the belief that inflation rates will continue to remain in check.

The equal treatment of foreign corporations will continue to remain in effect because of the Argentine economy’s reliance on foreign investment. The country has seen what restrictive policies can do and also knows the benefits that can be gained from an open economy. Closing its economy did nothing to increase production or give a competitive advantage to any of its industries. It only allowed the country to fall further behind the rest of the world. However, increasing accessibility to its markets has aided the economy. The growth in multinational corporate investment has added jobs and has helped to increase technology transfer to Argentine companies.

The recent currency and debt problems in Mexico have seriously dampened short-term growth prospects and investor confidence in many Latin American countries, including Argentina. Amidst speculation that the peso was overvalued and would soon be devalued, Finance Minister Jaime Serra Pouche went on record in December 1994 stating that there would be no change in peso policy. A few days later, however, he reversed the country’s policy and widened the peso band, increasing the devaluation limit to 13.25 percent. Increasing the devaluation limit meant that the peso would be permitted to fluctuate to higher and lower values without the government interfering to support its value. The result was an immediate fall of 12.7 percent in the value of the Mexican peso. The devaluation was allowed because Mexico wanted to correct its large trade deficit which amounted to $17 billion for 1994. (Torres, “Headed South....,” p. A1) By devaluing the peso, it was believed that exports would rise significantly as prices for Mexican goods abroad would decrease while imports at home would slow as the peso price increased.

The Mexican devaluation was a severe blow to all the Latin American economies. Two days after the devaluation, the Argentine stock market fell 8 percent, and the Brazil market dropped 6 percent. Investors, fearing that what happened in Mexico could occur elsewhere, pulled a lot of their money out of these markets.

Why did this devaluation affect the rest of the Latin American economies, including Argentina, which had recently been praised for its economic stability and reforms? According to Argentina’s Finance Minister, Domingo Cavallo, investors tend to view Latin American countries as one group rather than individual countries, because of their attempts at similar economic reforms. (Sims, p. D6) Argentina especially is often linked with Mexico since both have opened their economies to foreign investment and have aggressively privatized state industries. The two countries also have large current account deficits, making them reliant on outside capital flows. To attract the foreign capital needed, both countries have drawn
investors to their markets with promises of stable exchange rates and economic growth.

Still, there are several key factors which differentiate Argentina from Mexico. Argentina’s current account deficit is about half that of Mexico, while her international reserves are double those of Mexico. (Sims, p. D6) In addition, the Currency Board of the Convertibility Plan ensures that the domestic money supply is completely backed by dollars. Mexico has no such system. As long as Argentina follows the dictates of the Convertibility Plan, it is unlikely that it will experience the same troubles as Mexico. The question is, will the country continue to stand by its Currency Board? Thus far, it appears that Argentina will not back down. Mr. Cavallo has stated that he would rather “dollarise” the economy (allow every peso to be converted into dollars) than devalue the peso. Additionally, 85 percent of the country is in agreement with Mr. Cavallo. (“The Foundations...,” p. 5)

While the Mexican debacle at the end of 1994 has raised questions regarding the future stability of Argentina, most people feel confident that Argentina will remain a safe place for investments. Although most companies have scaled back their investments in Mexico, they are showing their confidence in Argentina by continuing with their investment plans. For example, Walmart continued with its plans to open six more stores in 1995, while cutting the number of new Mexican stores from thirty to six. Fiat has invested $600 million to open its own Argentine factory. Other car companies such as Chrysler, General Motors, Toyota, and Renault have also expressed their optimism by announcing future investments in the country. (Friedland, p. A17) MERCOSUR has been said to be a strong motive in most corporations’ investment decisions.

Such investor optimism can be attributed to Argentina’s apparent commitment to its Convertibility Plan. In a bold move to keep its currency stable, the government announced in mid-March of 1995 that it would choose to deflate its economy instead of devaluing the peso. Even the people agree that the country has too much to lose by devaluing. A March Economist poll showed that 85 percent of Argentines were against the devaluation of the peso. Because of the country’s commitment to the Convertibility Plan, analysts expect the level of new foreign investment in 1995 in Argentina to equal that of 1994, about $1.5 billion. (Friedland, p. A17)

Investors also attribute their willingness to keep their money in Argentina to MERCOSUR and the optimism of soaring trade growth with Brazil and the rest of Latin America. Thus, despite the uneasiness that has come about as a result of the Mexican crisis, investors still have faith that Argentina will ride out its problems and remain an excellent investment for the long term.
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