

POL. 337

Economic Policy under Kirchner: Repeating the Cycle?

Simon Fraser University

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Hayley Jones

I. INTRODUCTION.

Following the devaluation of the Brazilian Real in 1999, Argentina began a downward spiral into one of the worst economic crises in the country's history. Between 1998 and 2002, real GDP fell 28% , the peso, pegged to the US dollar, was devalued and depreciated to 4 pesos to the US dollar, inflation rose to 41%, unemployment rose from 12.4% to 23.6%, the poverty rate increased from 25.9% to 57.5%, and real wages fell by 23.7%ⁱ. The crisis was largely seen as a result of the implementation of neoliberal reforms under the Menem administration. Current President Néstor Kirchner took power in 2003, a year after the economic collapse and the ensuing political turmoil, and has attempted to implement a series of heterodox economic policies with the aim of rehabilitating the Argentine economy. Thus, several questions arise: Which interest groups within Argentine society have benefited from Kirchner's economic policies and what stance have they taken vis-à-vis these policies? How will this impact his prospects for re-election later this year?

This paper will first examine Kirchner's term in office and the implementation of his heterodox economic policies, specifically focusing on inflation and exchange rate policies, through the lens of David Erro's Tragic Cycle framework of analysis. It will also analyze the different stances taken by major interest groups vis-à-vis these policies, focusing on the Confederación General de Trabajo, the Confederación General Económica, the Unión Industrial Argentina, and the Sociedad Rural Argentina. Lastly, on the basis of Erro's cycle framework and corporatist theory, it will assess the sustainability of Kirchner's economic policies and his possibilities for re-election in October 2007.

II. THE TRAGIC CYCLE THEORY.

While Kirchner's term in office as Argentine President cannot be fully explained by David Erro's Tragic Cycle Theory, it does provide a framework of analysis through which many of Kirchner's policies can be understood.

A. The First Phase: Sense of Crisis.

While Kirchner's predecessor, Eduardo Duhalde, managed to implement some economic reforms to ease the effects of the economic crisis, the country remained in mired in one of the worst economic crises in Argentine history when Kirchner took office only a year after the height of the crisis. GDP per capita had dropped from \$US 7410.39 in 2001 to \$US 2666.90 in 2002ⁱⁱ, real wages dropped by almost 24% between 2001 and 2002ⁱⁱⁱ, and unemployment jumped to almost 18%^{iv}. There was a broad consensus in Argentine society that the neoliberal economic reforms implemented during the Menem era were widely responsible for the 2001 economic collapse and that the neoliberal development model had completely failed in Argentina.

Nevertheless, it cannot be said that most interest groups, or even a significant portion of the population congregated behind Kirchner in his bid for power. In fact, Kirchner assumed the presidency in May 2003 with only 22% of the vote, when Menem withdrew from the presidential race. Thus, although there appeared to be a broad societal consensus for political and economic change, this consensus did not congregate around Kirchner as their chosen power broker for taking control of government nor did he take office with a clear mandate to govern or to effect significant policy changes.

B. The Second Phase: Mandate for Change.

While Kirchner ascended to the presidency through democratic elections, it can be argued that this was somewhat of an unconventional and noninstitutionalized procedure. Argentina had endured considerable political turmoil with the resignation of President Fernando de la Rúa followed by a series of interim presidents that were unable to deal with the economic crisis that the country faced. Moreover, Kirchner succeeded Duhalde in the presidency who was not democratically elected, but appointed to complete de la Rúa's term after his resignation. Thus, while the democratic elections that brought Kirchner to power did not follow a prolonged divergence from the conventional and institutionalized procedure through which power brokers ascended to the presidency, that is, through democratic elections, his ascendancy to power did represent a divergence from the transfers of power under several preceding administrations.

In accordance with the second phase of Erro's cycle theory, Kirchner's initial policies included measures aimed at satisfying all major interest groups through an expansionary economic policy. In an effort to rebuild the Argentine economy following the financial crisis in 2001, Kirchner applied a series of heterodox economic policies emphasizing increases in exports combined with import substitution, control of inflation through price agreements with the private sector and price freezes on public utilities, and debt-restructuring with international financial institutions and foreign investors.

The devaluation of the peso stimulated import substitution as many imports suddenly became prohibitively expensive for many Argentines, while also stimulating export-oriented sectors as Argentine exports became more competitive on world markets. The trend towards import substitution was viewed favourably by both the *Confederación General de Trabajo* (CGT) and the *Confederación General Económica* (CGE) due to the

increased demand within the domestic market (CGE) as well as the increased jobs that such industries create (CGT). At the same time, the devaluation of the peso and the lower exchange rate increased the competitiveness of Argentine exports on world markets to the benefited of the *Unión Industrial Argentina* (UIA) and the *Sociedad Rural Argentina* (SRA).

Kirchner's task over the past four years has been to balance the agendas of the various interest groups whose support is essential to his administration. His government has attempted to stabilize the economy, regulate inflation and avoid further default with international financial institutions and foreign investors by increasing tax revenues through the introduction of export taxes, ranging from 5 to 10% on manufactures to 20% on certain agricultural products and crude petroleum^v. While the implementation of such export taxes accounted for 93% of the total increases in tax revenues and have enabled the government to maintain a fiscal surplus, they have caused some tensions with the business and agricultural sectors. The SRA is particularly opposed to these export taxes as some of the highest rates apply to some of Argentina's most important agricultural exports, including meat, soya and dairy. Historically, such taxes have been used to subsidize benefits for other interest groups. Moreover, although the SRA and UIA oppose the introduction of such export taxes, the CGT and CGE stand to benefit from the increased government revenues accrued by these taxes, through active government intervention in other parts of the economy or through increased social spending.

The government has also sought to maintain a competitive exchange rate through intervention by the Central Bank in order to maximize revenues from export taxes and to keep exports competitive on world markets. While the SRA and UIA are traditionally

opposed to government intervention, in this case, such intervention benefits these two interest groups by increasing the profitability of their exports. On the other hand, a low exchange rate for the peso does not benefit the CGE and thus the CGT as a result of the increased costs of imports on which the CGE is dependent.

The Kirchner administration has further increased government revenues by holding down public-sector wages. While private-sector real wages have increased by 22.3%, public-sector real wages have declined by 37.9% since December 2001^{vi}. In 2006, the government announced guidelines under which wages increases should not exceed 19%^{vii}. Government intervention to hold down wages is opposed by the CGT which stands to benefit directly from increased wages, and the SRA which maintains that such measures do not stimulate internal market demand. On the other hand, low wages are supported by the CGE and the UIA as this decreases their labour costs.

Kirchner has also relied on negotiating price agreements with the private sector and maintaining price freezes on public utilities in order to regulate inflation. The CGT has benefited from these price agreements and the price freeze on public utilities in that they seek to regulate prices for basic commodities in relation to consumer price inflation rates; moreover, given that the government has sought to hold down wages, these measures are key in maintaining an acceptable standard of living for members of the CGT. These price agreements and price freezes can be seen as subsidizing labour costs and thus are beneficial to the CGE. While the UIA may not oppose price agreements for the same reasons as the CGE, it is likely opposed to the price freezes on public utilities given that many utilities providers are foreign-owned multinationals that stand to benefit from increased utilities prices. The SRA, traditionally opposed to government

intervention in the economy, would likely oppose these price agreements as they affect basic commodities such as agricultural products, and thus the SRA stands to gain from increases in prices. In March 2006, the government announced a 180-day ban on 80% of beef exports in order to curb rising inflation. Although the ban was responsible for 70% of the slow-down in consumer price inflation in 2006^{viii}, it sparked strong opposition from the SRA while it benefited consumers in other interest groups, including the CGT, CGE and UIA.

Thus, Kirchner's economic policies sought to satisfy diverse interests across the four main interest groups through increased government intervention, at times in favour of labour interests, domestic industry, international industry and the agricultural sector, at the same time as maintaining an open, export-oriented economy.

C. The Third Phase: New Conflicts.

While Kirchner has attempted to satisfy all major interest groups through expansionary economic policy, the economic trade-offs required to accomplish this have led to increased inflationary pressures. Inflation rates stood at 9.6% in 2005, 12.3% in 2006 and are expected to remain double digits through 2008^{ix}. While the president's reliance on price agreements with the private sector and the maintenance of price freezes on public utilities established by emergency decree in 2002 have proved popular with the CGT and the CGE, these measures have led to increased tensions with the business and agricultural sectors. In early 2006, the government attempted to negotiate price agreements on key agricultural products with the SRA; however, when the SRA refused to agree to such price restrictions, the Kirchner administration threatened to impose increased taxes on meat exports^x. Using export taxes as a means of punishment, which

the government has threatened to do, will further antagonize the SRA, leading to increased conflict, instability and inflation.

Furthermore, the Kirchner administration has become increasingly antagonistic towards the international bourgeoisie and the UIA. The president has pressured large consumer goods multinationals and supermarkets to agree to price agreements. When oil giant Shell refused to agree to price freezes, Kirchner called for a boycott of the company. Finally, the government rescinded its contract with French utility giant Suez over a similar price freeze disagreement, driving it out of the country^{xi}. While these measures have proved popular with consumers, namely the CGT and CGE, they have served to deter foreign investment in Argentina. Moreover, Kirchner's refusal to lift price freezes on public utilities has resulted in very little investment in the utilities and energy sectors, leading to the current energy crisis that the country faces^{xii}.

In sum, currently the Kirchner administration can be understood within the third phase of Erro's cycle framework. Signs of economic problems, such as rising inflation, and distributional conflicts between the main interest groups have begun to emerge. While increased GNP growth and reduced inflation have been key goals of the Kirchner administration since taking office in 2003, these have been achieved through increased government intervention which has led to artificially low market prices and exchange rates. These policies hold the potential for economic slowdown and increased inflation once they are abandoned. Measures such as price agreements and increased export taxes may be effective in curbing inflation in the short term; however, they can ultimately lead to a misalignment of relative prices and can cause increases in inflation once they are abandoned. In addition, the export taxes introduced by the Kirchner administration may

prove to be unsustainable should international commodity prices decline, thus decreasing government revenues. Kirchner's economic policies, although attempting to satisfy the interests of various economic actors, as is typical in phase two, have begun to antagonize the SRA and the UIA. Kirchner's use of export taxes to increase government revenues and his refusal to lift price freezes on public utilities remain key issues for these two interest groups. Yet, there has been little change in the direction of Kirchner's economic policies with the aim of effecting higher growth and investment and lower inflation while ameliorating relations with the UIA and the SRA.

III. ECONOMIC FORECAST AND PROSPECTS FOR RE-ELECTION.

After growing at a rate between 8 and 9 percent for several consecutive years, the GDP growth rate is expected to slow to 7% in 2007 and 4.7% in 2008^{xiii}. Consumer price inflation was held down to 9.8% in 2006; however, this was a result of price agreements covering 70% of goods in the consumer price index basket^{xiv}. Further, despite the price agreements covering the majority of goods in the CPI basket, prices on these products have increased by 8.6% since October 2006^{xv}. The consumer price inflation rate is expected to increase through 2008 reaching 13.0% by the end of that year^{xvi}. Moreover, the exchange rate for the peso has held at approximately 3.06 pesos to the US dollar; nevertheless, this is a direct result of intervention by the Central Bank^{xvii}. The peso is expected to appreciate slightly through 2008, reaching 3.17 pesos to the US dollar^{xviii}.

With the upcoming October 2007 elections, the Kirchner administration is expected to continue with its current economic policies, maintaining price agreements with the private sector and price freezes on public utilities in an effort to combat inflation, as well as intervening in the currency market in order to sustain a low exchange rate for

the peso^{xix}. The government is unlikely to make significant progress on the contract renegotiations of foreign investors in the utilities sector^{xx}, which could ultimately deter the investment required to sustain long term economic growth once government interventionist policies are abandoned.

It is unlikely that the Kirchner government will effect the necessary structural reforms in the tax revenue system that would ensure future economic growth. The introduction of export taxes has significantly bolstered government revenues, enabling the Kirchner administration to maintain social spending and interventionist economic policies to the benefit of certain interest groups, including the CGT and CGE. In order to avoid continuing Erro's Tragic Cycle and progressing to phase four, the next government will need to reduce government intervention in the economy that leads to distortions in market prices, inflation rates and exchange rates and address structural reforms, including the revenue-sharing system between the federal and provincial governments and the tax revenue system. To sustain long term economic growth through the promotion of investment and to avoid creating further tensions with the UIA and SRA, the government will need to reform distortionary taxes such as export taxes on commodities and the financial transaction taxes^{xxi}. Yet, this will have to be balanced with CGE and CGT demands for regulation of consumer price inflation, and CGT demands for higher wages as many public-sector contracts come up for negotiation this year^{xxii} if these two interest groups are to continue backing Kirchner and his *Frente para la Victoria* coalition.

Although Kirchner's heterodox economic policies have shown signs of antagonizing the UIA and the SRA, they have paid off in opinion polls. Kirchner enjoys an approval rating of 78%^{xxiii} and appears to be well positioned to win a second term in

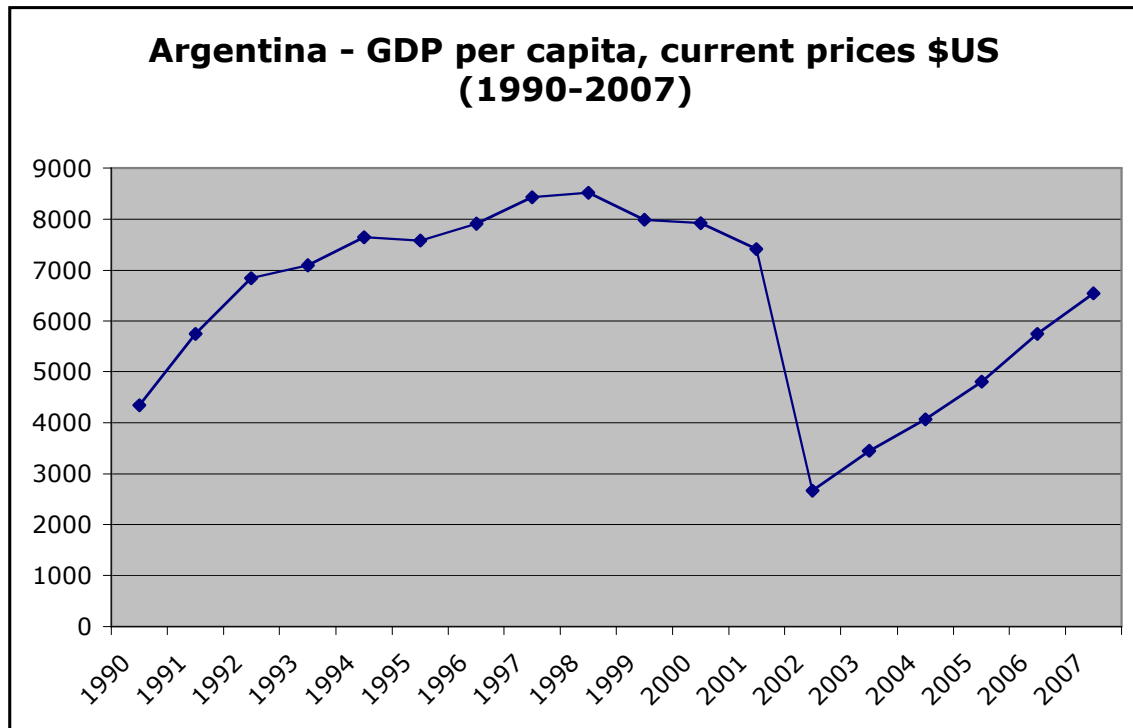
office in October 2007. If Kirchner is to maintain this broad approval, he will need to address the weakness within his economic policies, including reducing government intervention in the economy that causes distortions in inflation rates, market prices and exchange rates which are unsustainable in the long term, while encouraging increased investment needed for continued economic growth. He will have to balance these policy reforms with structural reforms to the tax revenue system, that satisfy the interests of the UIA and SRA by reforming export taxes, while also maintaining current levels of government revenues in order to satisfy the interests of the CGT and CGE by easing the pressures of an upsurge in inflation.

IV. CONCLUSION.

In sum, Erro's Tragic Cycle framework provides a basis for understanding Kirchner's ascendancy to power and the implementation of his economic policies. His ascendancy to the presidency can be viewed in the context of a broad societal consensus for political and economic change following the 2001 financial crisis and the ensuing political turmoil that saw some five interim presidents within the expanse of ten days. Nevertheless, this consensus did not congregate behind Kirchner as the chosen power broker to take control of government. Further, it can be argued that Kirchner's ascendancy to power represented an unconventional and noninstitutionalized procedure in that he followed several interim presidents appointed by Congress rather than democratically elected. Finally, his expansionary economic policy can be viewed as attempting to satisfy all major interest groups. Yet, recently, there have been signs that economic trade-offs have led to inflationary pressures and distributional conflicts, antagonizing the UIA and SRA. He will need to address the economic weaknesses

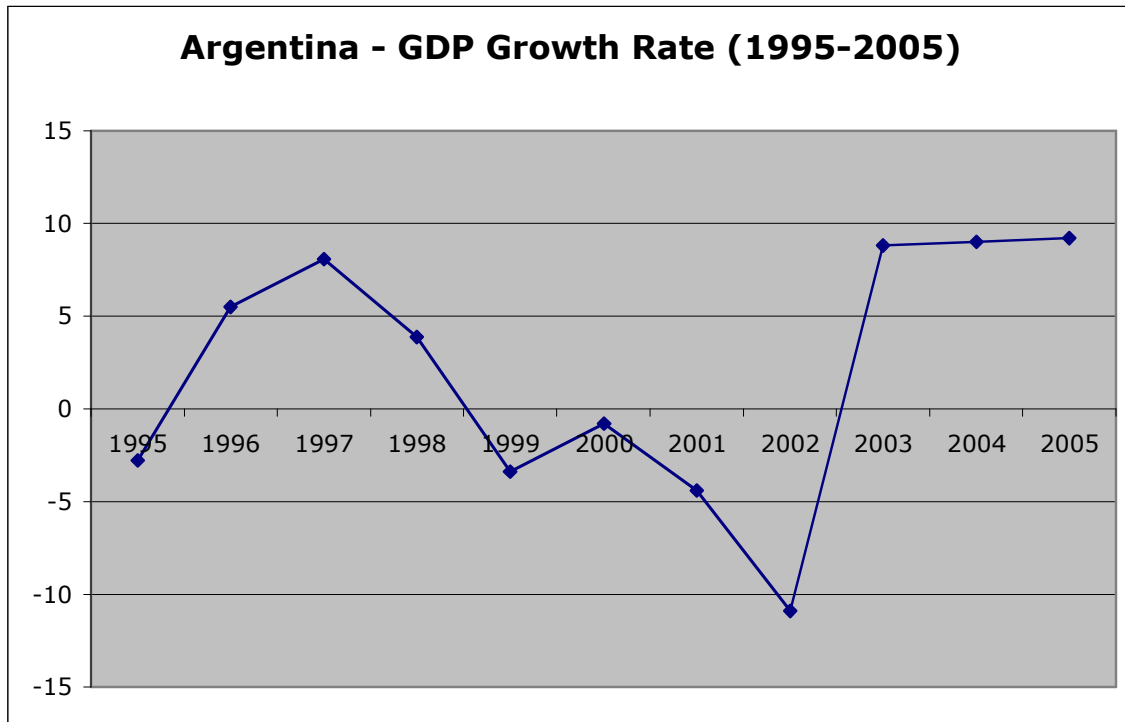
within and the tensions caused by his economic policies if he is to maintain his high approval rating and obtain a broad mandate to govern in the upcoming October elections.

Appendix A:



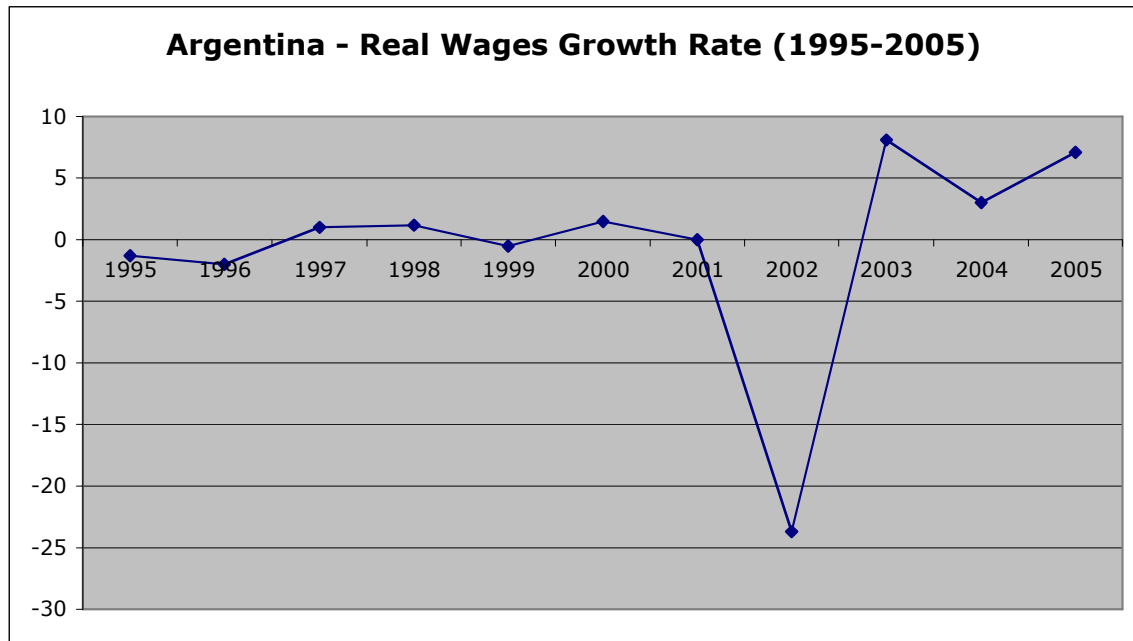
Source: IMF Database

Appendix B:



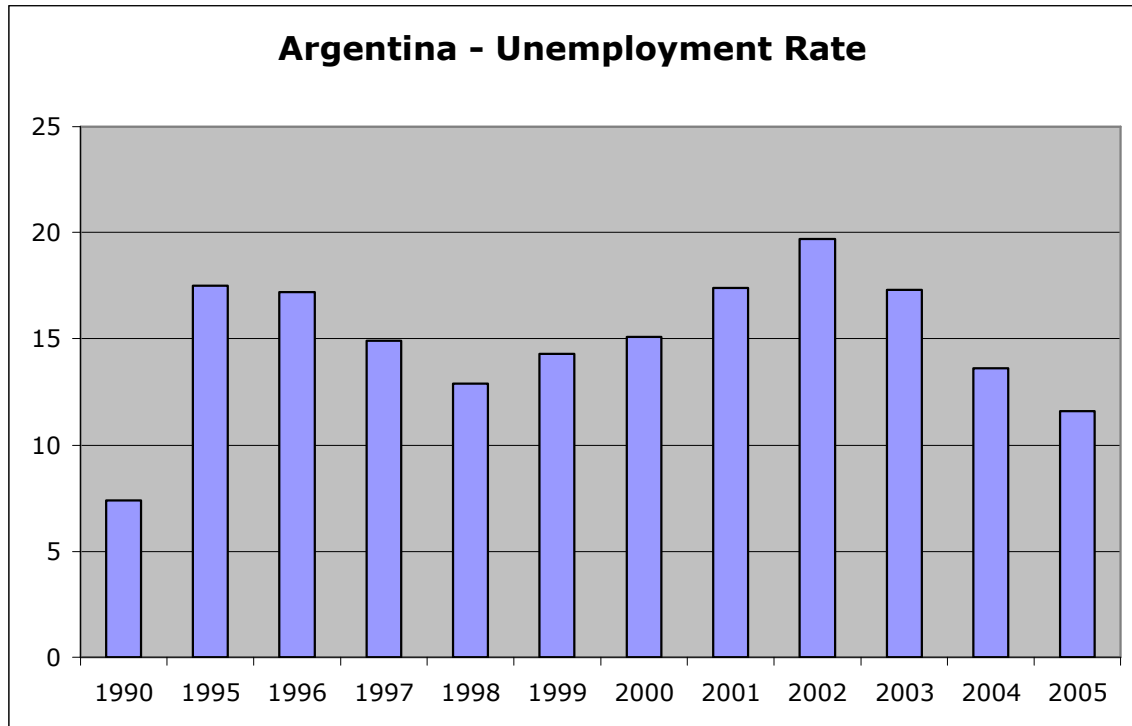
Source: Ministry of Economy and Production, Government of Argentina

Appendix C:



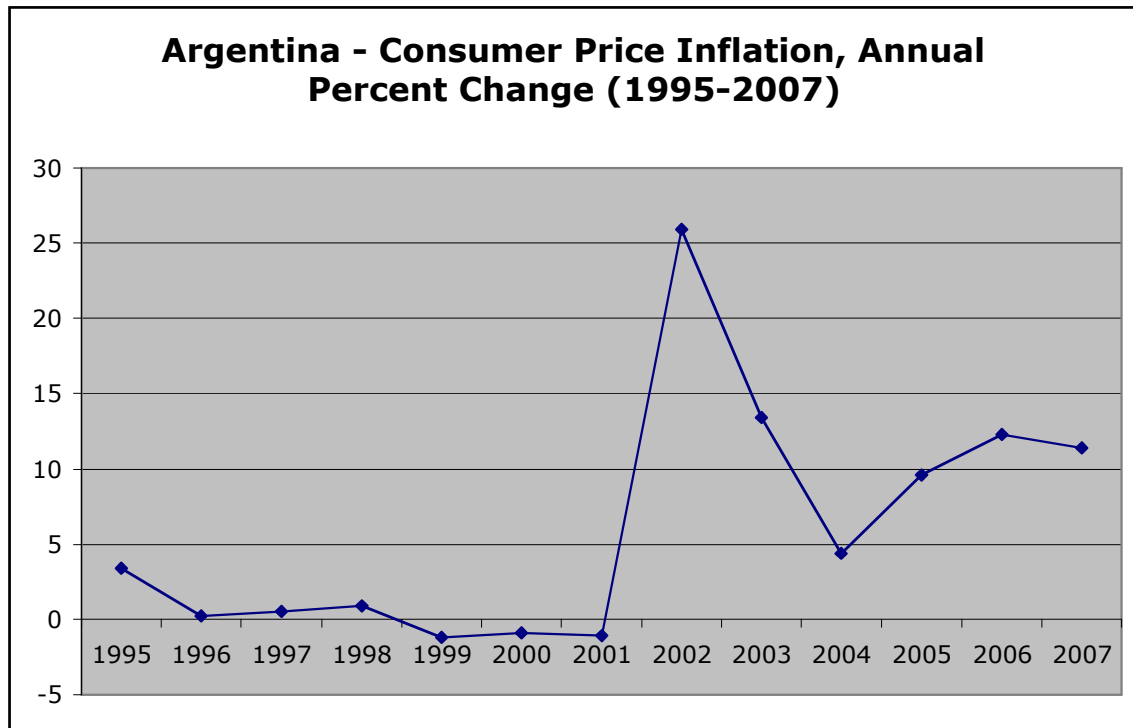
Source: Ministry of Economy and Production, Government of Argentina

Appendix D:



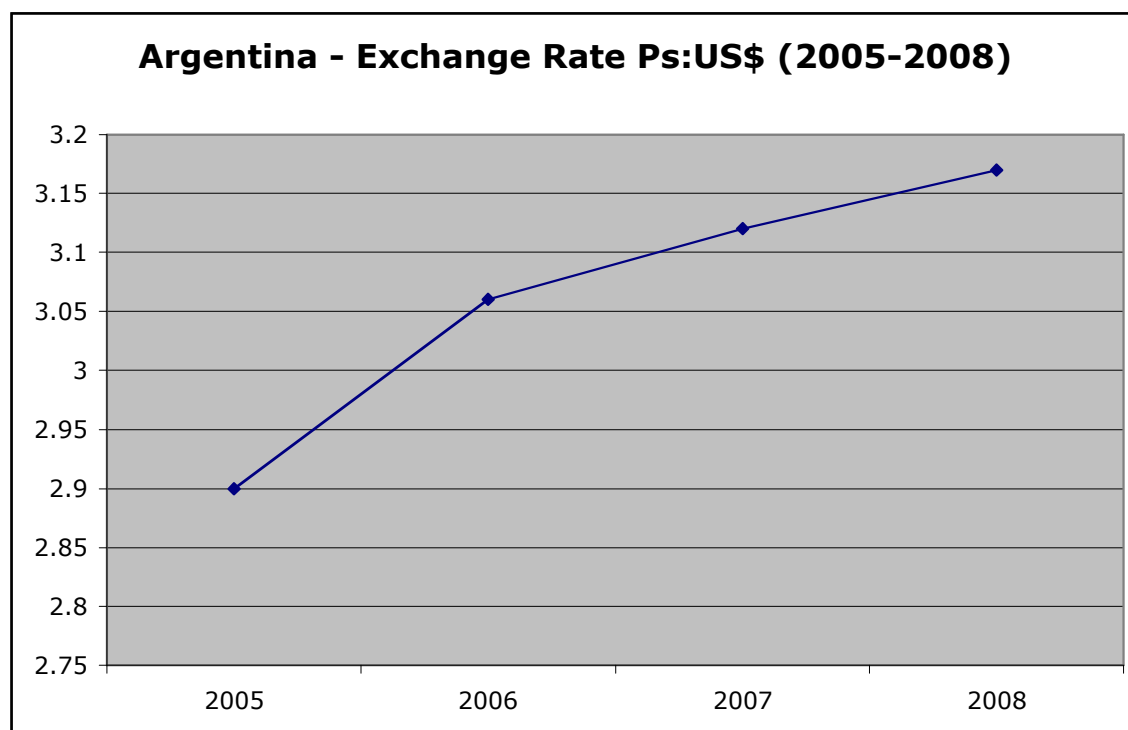
Source: CEPAL, Statistical Yearbook for Latin America and the Caribbean 2005

Appendix E:



Source: IMF Database

Appendix F:



Source: Economist Intelligence Unit, Country Report January 2007

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Endnotes:

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- ⁱ Jim Saxton, "Argentina's Economic Crisis: Causes and Cures." Joint Economic Committee United States Congress. <http://www.house.gov/jec/>
- ⁱⁱ International Monetary Fund. "Report for Selected Countries and Subjects." Data & Statistics, <http://www.imf.org/external/pubs/ft/weo/2006/02/data/weorept.aspx>
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- ^v The Economist Intelligence Unit. "Country Profile 2006: Argentina." 47.
- ^{vi} Ibid, 38.
- ^{vii} Comisión Económica para América Latina y el Caribe. "Statistical Yearbook for Latin America and the Caribbean 2005." 127.
- ^{viii} The Economist Intelligence Unit. "Country Profile 2006: Argentina." 36.
- ^{ix} The Economist Intelligence Unit. "Country Report Update: Argentina." January 2007, 6.
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- ^{xvii} Ibid.
- ^{xviii} Ibid.
- ^{xix} Ibid, 2.
- ^{xx} Ibid.
- ^{xxi} Ibid, 3.
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