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Argentina and Import Substitution Industrialization

Lorenzo Vasquali

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Δ/νση: Φίλωνος 35, 18531 Πειραιάς
Τηλ. : 211-7201886
web site: www.kedisa.gr
E-mail: info@kedisa.gr

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Argentina and Import Substitution Industrialization

Path Dependence and Institutional Failures rooted in post-Colonial Power Allocation

Abstract

This study examines the divergence between Argentina and the Western developed nations during the twentieth century. The research compares Argentina with Australia, similar countries that followed policies of "Import Substitution Industrialization" (ISI) until the mid-1970s, long after other Western nations had veered away from autarchy. The study investigates various reports on the implementation of these policies and traces back in time to identify the critical differences between Argentina and Australia that led to divergent economic paths. One important answer lies with the interest groups that prevailed in the post-independence power struggle. In Argentina, the landowning elites of the Pampas shaped the economy in a tributary relationship with "core countries" because their interests were low wages and a weak currency. Conversely, merchants in Australia built reciprocal relations with the world economy; they demanded growth of the consumer market, capitalization of land, and kept a firm balance between import and export. The extractive setup of the Argentine economy made it ill-equipped to navigate the shocks of the twentieth century.

Keywords

Import Substitution Industrialization, underdevelopment, peripheral economy, tributary relationship.

Introduction

At the turn of the twentieth century Argentina was among the richest countries in the world. This paper investigates its divergence from the club of "developed nations" in the following decades when policies of "Import Substitution Industrialization" (ISI) tightened their grip on the Rio de la Plata.[1] The theory of ISI subscribes to the idea that protectionism will shelter infant domestic industries from the interference of more competitive substitute goods imported from the global market and subsidies will stimulate the development of such industries to fully developed sectors. As a result, Argentina would reduce its dependence on developed countries and transition from an agricultural exporter into an industrialized nation.

After 1945, though it ostensibly fit with developed countries better than it did with developing ones, the former rapidly integrated trade through GATT and EEC while Argentina, much like the latter, stood apart from this process and remained strongly protectionist.[2] This paper presents the results of a comparative analysis, evaluating Argentina's failure and Australia's successes. The literature on the topic canonically takes Australia as such comparison given the likeness of the two: both countries are regions of recent settlement located in the temperate latitude of the Southern Hemisphere, both encompass large open grassland and are inhabited by populations of Europeans who overwhelmed the natives and pushed them to the margin or the bottom, both countries were prime examples of capitalistic societies, exporting primary products to Europe in vast quantities and achieving high per capita income for the settlers. Notably, the two not only share a similar history of early modern economic development but they also both followed import substitution industrialization policies until the mid-1970s. Their striking similarities make explanations of the differences between them all the more revealing.[3]

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[1] Alan M. Taylor, *The Argentina Paradox: microexplanations and macropuzzles*, pp. 4-5
[2] Taylor, *The Argentina Paradox*, pp. 4-5
[3] Barrie Dyster, *Argentine and Australian Development Compared*, p. 91

Argentina's fall from grace serves as a cautionary tale for countries who wish to preserve their prosperity by understanding which key elements could spoil it. It also offers valuable insight to those who recognize themselves in the deep determinants that influenced Argentine politics and caused its GDP *per capita* to plummet from 85% of Australia's in 1930 to roughly 30% nowadays.[4] The line of inquiry is to follow the unfolding of import substitution industrialization back to the point where Argentina went astray. Motives are then presented as to what made autarchy stick on the Rio de la Plata and, finally, reasons are excavated further back. The objective is to explain why such motives arose in Buenos Aires but did not in Sydney. This paper aims to present a comprehensive body of work connecting the existing literature on ISI in Argentina with comparative research about the economic development of a virtually identical country: Australia. The goal is to present the underlying differences that account for divergent paths taken during the twentieth century. Such deeper determinants were a crucial, if not the first, domino tile in the country's decline and downfall.

Theoretical Framework

Path Dependency

"Path dependency" is the first theoretical concept that lends itself to the writing of this paper. It describes the continued use of a product or a practice based on historical preference. This resistance to change pertains here to the policies of import substitution industrialization: even when more efficient alternatives became available, Argentine institutions and organizations did not display the capability to gently adjust to the changing environment as Australia did. Protectionist measures exhibit path dependency because manufacturers have a vested interest in less competition and more subsidies. As protectionism strengthens manufacturers and makes them wealthier it also expands their influence, giving them an edge in furthering their interests, which lie with more protectionism. In this instance, the stronger the distributional conflict between different interest groups, e.g. manufacturers and landed elite, the stronger democratic institutions need to be to enforce intertemporal agreements between them.[5]

Underdevelopment

If "path dependency" explains a portion of what happened in both countries under scrutiny, it does not account for the difference in outcome. It is then interesting to look at both of them through a further lens of analysis, weighing the possibility of Argentina being one of the "peripheral countries", while Australia would belong to the "core" ones. In this model, countries in the periphery are exporters of natural resources and primary goods, while they need manufactured goods which they import from countries in the core of the economy. In so doing, they provide cheap labour, a destination for obsolete technology and markets for developed core nations to take advantage of, all the while experiencing eroding terms of trade, as the real price of their exports declines compared to manufactured goods. [6] However, though Australia might fit with core nations now, it certainly did not back then, since it was primarily an exporter of natural resources, it definitely was located at the periphery of the world economy, yet it presented a relatively high *per capita* income, aligned with those of the economies at the centre.[7]

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[4] Elias Baracat et al., *Trade Reform and Institution Building: Peru and Argentina under the WTO*, pp. 592-593

[5] Sebastián Galiani, Paulo Somaini, *Path-dependent import-substitution policies: the case of Argentina in the twentieth century*, pp. 32-37

[6] José Antonio Ocampo*, Raúl Prebisch and the Development Agenda at the Dawn of the Twenty-First Century*

[7] Dyster, *Argentine and Australian Development Compared*, p. 94

We then consider "Dependency Theory" in the interpretation of André Gunder Frank: accepting the centre-periphery antithesis but considering underdevelopment as a dynamic process rather than a position within a global system. Here underdevelopment is understood as the consequence of the deformation and subordination of one economy to another, more aggressively capitalist, economy.[8] Argentina fits these specifics perfectly: its innermost provinces had a functioning, though grounded, economy which was sustained by the mining activity in the *Andes*, i.e. agricultural products were exchanged for silver. However, in 1776 Buenos Aires was allowed to participate in the Atlantic Trade by the Spanish Crown. Inner Argentine provinces were now months closer to international markets and they were invaded by competing exports which sapped their domestic production. Merchants looked for payment in silver, but the traditional market of the *Andean* mines could no longer be relied on. Therefore, local production eroded over time and the once-functioning economy of these provinces was slowly dismantled: underdevelopment.[9]

Extractive and Inclusive Institutions

Finally, the approach to this paper is mainly derived from the theoretical perspective offered by Daron Acemoglu and James Robinson, in that deep determinants regarding the distribution of power within the country (institutions) are questioned as to how they influenced its development and, most importantly, its positioning relatively to the global economy. In the literature of their making, "extractive institutions" are juxtaposed with "inclusive institutions", both articulate in the economic realm as well as the political one. The former are characterized by siphoning of wealth and centralization of political power in the hands of restricted elites, versus the latter, which exhibit inclusive markets where a levelled playing field of opportunities is offered to everyone, as well as the opportunity to participate in a functioning democracy. Extractive institutions become a means of exploitation by the *de facto* ruling oligarchy, while inclusive institutions are democratic and distributive.[10]

Empirical Section

Perón and ISI

In 1976 a coup d'etat diverted Argentina's trajectory from the policies of import substitution industrialization that the country had followed in the previous decades. Profound changes were deemed necessary by the military *Junta* to eliminate the structural stop-and-go cycles that had characterized the economy: rapid growth spurred by fiscal stimuli ("go") and periods of contraction aimed at controlling inflation, managing unemployment and keeping the economy stable ("stop"). By then the country had already fallen back significantly compared to the rich Western World, which had experimented with autarchy in the '20s and '30s, but then started liberalizing and opening to trade as early as the end of World War II.[11] Argentina, on the other hand, had followed the path of most other developing countries and, starting in 1945, it had intensified its protectionist policies under President Juan Domingo Perón.[12]

The government of President Perón had implemented a series of measures intended to expand the industrial base of the country. Import quotas and foreign exchange rationing granted a level of protection against foreign competition and speculation, while soft financing, import privileges for machinery, and higher levels of remittance allowance subsidized local manufacturers and aimed to expand existing activities through the enlargement of the internal market. Resources were reallocated from the agricultural to the manufacturing sector by means of taxation and differential exchange rates. As a result, the manufacturing share of GDP had grown from 21.6% in the 1930-1939 period to 24.2% between 1940 and 1949, while the agricultural sector, traditionally the engine of the economy, had fallen roughly 20% over the same period.

[8] Dyster, *Argentine and Australian Development Compared*, p. 95
[9] *Ibid.*, pp. 97-98
[10] Daron Acemoglu, James Robinson, *Why Nations Fail*, pp. 81-86
[11] Gabriel Casaburi, *Trade and Industrial policies in Argentina since the 1960s*, pp. 9-10
[12] Casaburi, *Trade and Industrial policies in Argentina since the 1960s*, p. 4

This forced the country to import to satisfy local demand and even eroded agricultural exports, thereby contributing to generating balance of payment problems.[13]

By the late 1950s the economy had entered the second phase of ISI with policies geared towards the promotion of key industrial sectors: petrochemical, steel, machinery and automobile. However, these policies were adopted in the midst of macroeconomic instability: high and variable inflation rates, high fiscal deficits, frequent crises in the balance-of-payment and large fluctuations in the real exchange rate. Still, industrial production had grown by 7% annually between 1964 and 1974, though this was more the result of generous government incentives than the fixing of low competitiveness and low levels of technology that had always plagued the industry.[14] At this point the structural failures of the ISI model had become apparent: the internal market had become over-protected and it lacked competitiveness in the manufacturing sector, while tariffs were generating distorting effects with great dispersion. Socio-political turbulence became more and more frequent, although it is impossible to establish a clear causal relationship.[15] In this context, the *Junta* found fertile ground to overthrow the government.

Industrializing amidst dying Globalization

Argentine history with ISI, though, began further back and as early as World War I. At the time imports had obviously become scarce; this created gaps in the economy that were filled by the domestic entrepreneurial spirit of manufacturers who started producing consumer goods. Following the war, discussions on import tariffs ensued, as items were still taxed based on fixed values established by the 1906 legislation. By 1919 the value assigned to imports averaged only 35% of their invoiced value, hence the tariff was affording much less protection than it had been designed to do.[16] Furthermore, Argentine exports entered a crisis stage when the post-war world market overflooded with cattle and agricultural goods, which made Argentine meat plummet. Total earnings of all exports declined nearly 25% between 1920 and 1921, and did not recover 1920 levels until 1924. As a result, the peso fell in value and, with declining exchange rates, imports became more expensive, pushing consumers to purchase more national goods. Things changed in 1924 when exports, which had regained traction, paired with foreign capital inflow caused the peso to appreciate against the dollar and the pound, making imports cheaper until the Alvear (*UCR*) government made a return to the gold standard in 1927. By the time this happened tariff protection for new industries had already seeped into the political landscape and they had become a major political issue.[17]

When the Great Depression struck in 1929 the Yrigoyen (*UCR*) administration quickly pulled out of the Gold Standard once again. Under threat of Imperial Protection, the president also agreed to deeply unfavourable trade terms proposed by Viscount D'Abernon, actively promising to buy £9'000'000 worth of railway equipment in exchange for the undertaking to buy "a very small fraction of what we inevitably buy". Losing the British Empire would have closed off the most important market for Argentine exports, which had already lost Spain, France and Italy after they had raised tariffs. Shortly thereafter a military coup d'etat led by Lieutenant General José Félix Uriburu overthrew Yrigoyen's presidency, manifesting the disillusion that had built up towards *Radicals* policy-making and the urge for economic nationalism that had enthralled military elites as well as the industrial and urban segments of the population, who felt that the time to favour land-owning and agrarian exporting elites needed to come to a halt.[18] The 1930 coup was the first military overthrowing of a democratically elected government in the Argentine Republic, and one that would set Argentina on a downward path of erosion of democratic institutions, impacting its expected projections of GDP-per-capita over the following decades significantly.[19]

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[13] Casaburi, *Trade and Industrial policies in Argentina since the 1960s*, p. 4
[14] *Ibid.*, pp. 5-7
[15] *Ibid.*, pp. 9-10
[16] Carl Solberg, *The Tariff and Politics in Argentina 1916-1930*, pp. 261-263
[17] Solberg, *The Tariff and Politics in Argentina 1916-1930*, pp. 281-282
[18] *Ibid.*, pp. 283-284
[19] Rok Spruk, *The Rise and Fall of Argentina*, p. 2

Growth under Extractive Institutions

Despite the discouraging picture of economic history presented so far, Argentina looked much better at the beginning of the twentieth century. At the time it sat in the ranks of the 10 wealthiest countries in the world.[20] No other country had advanced quite as far as Argentina did before 1914: Buenos Aires had developed adequately functioning market institutions, some semblance of democratic politics and the rule of law as a foundation. Furthermore, Argentina was gaining massively from trade and it relied heavily on foreigners for local capital stock and labour supply. One explanation as to why it is that Argentina diverted from the rich countries (a club to which it ostensibly belonged at that point) is then found in the fact that it had more to lose than any other developing country when the end of the first era of Globalization came around. While adjusting to changing times was bothersome for many countries with smaller trade shares and smaller financial inflows, it entailed a radical and painful reorientation on the Rio de la Plata. Such reorientation was at first delayed in the '20s and the '30s, hoping that the pre-1914 liberal order would be restored, but, with the Great Depression first and World War II then discrediting the outward-looking order of global trade further and further, new interests arose, with more autarkic goals.[21]

The case of the prosperity that Argentina experienced during the *Belle Époque* seems then akin to the (flimsy) growth under extractive institutions, and consequent richness, of the Caribbean Islands between the sixteenth and eighteenth century. At the time a small minority controlled sugar plantations in Barbados, Cuba, Haiti and Jamaica and, though the majority of the population was savagely exploited, the decision by the planter elite to directly allocate resources to high-productivity assets that they controlled put these islands among the richest places in the world.[22] Argentina's situation, though not quite as draconian, was that of a very well-established landed elite situated in the *Pampas* around Buenos Aires, who made their fortune through the export of agricultural goods.[23] These *estancieros* were ultimately the ones to gain the most from the transition to the Republic and the expansion of the frontier, by gathering more and more land at their disposal, as well as profiting from the severe devaluation that hit the *peso* as early as 1826.[24] Ultimately, by 1930 inequality was quite high in the country, and the distributive tension between manufacturers and landowners was so stark that the weak Argentine democratic institutions were disrupted by it.[25]

The Australian Comparison

The rule of the *estancieros* affirmed itself as early as the first half of the eighteenth century. By then terms of trade had shifted in Argentina so as to accommodate landholding and production for export. Whereas the balance in Australia between import and export, between consumption and production held firm throughout.[26]

When independence was proclaimed in 1810, it became apparent that three interest groups would vie for dominance in the Rio de la Plata. First the merchants, who wanted to open trade with the whole world, free of tariff on the coast and unencumbered by tariffs between provinces. Second, the graziers of the *Pampas* who would benefit from free movement of cargo through the port in both directions, yet would not welcome competition from the long-established pastures inland, therefore demanded tariffs between provinces. Third, the inland provinces, long dominated by families who would have been harmed (as they were) by the unhampered flow of goods into and therefore demanded for tariffs. The interests of these three groups clashed over three distinct wars: one between the provinces and Buenos Aires, one against Brazil and one for the expansion of the frontier against the Indians. With every truce and the compromising arrangements that came with them the steady state of things came, quite logically, closest to that

[20] Rok Spruk, *The Rise and Fall of Argentina*, p. 1

[21] Taylor, *The Argentina Paradox*, pp. 15-16

[22] Acemoglu, Robinson, *Why Nations Fail*, pp. 87-90

[23] Eric C. Edwards et al., *Property Rights to Land and Agricultural Organization*

[24] Dyster, *Argentine and Australian Development Compared*, p. 101

[25] Facundo Alvaredo et al., *A short episodic history of income distribution in Argentina*

[26] Dyster, *Argentine and Australian Development Compared*, p. 95

intermediate position of the grazier of the *Pampas*.[27] With the cost of the wars, unpaid loans, trade blockades and the depreciation of the *peso* that started occurring more and more often since 1826, wealth was redistributed more and more towards the *estancieros*, who found inflated international prices for their exports, paid lower real prices on the instalments of the plot of land that they had bought and paid (at least temporarily) lower real wages to their employees. Capital gravitated more and more towards pastoralism, and so did imports from merchants, who tended to neglect everyday customers who presented unstable pesos instead of earnings form exports.[28]

Australia on the other hand, was not particularly burdened by any major conflict. It was, however, dominated by the Commissariat of the British government on the demand side, and by private traders on the side of supply. This impelled many of the colonists to seek out as much of the Commissariat's business as possible by standing as middlemen between it and the ships which brought overseas cargo, by standing as middlemen by the government and, eventually, by becoming domestic producers and raising produce themselves. The early entrepreneurs here were doubly interested in the domestic market, as they did not only expand the demand for imports but also gave them the chance to acquire *store receipts* later convertible into treasury bills. It was then recognized that local production must persist to increase the amount of foreign exchange ultimately accruing to traders. This not only generated domestic activity but it established a vigorous two-way flow of goods and it made spectacular failures of other merchants unappealing, as they would make finance or credit for the Australian trade harder to find in Britain, and raise the rate of interest.[29]

Conclusion

At the beginning of the twentieth century, both Argentina and Australia experienced the natural emergence of manufacturing sectors in response to the intrinsic protection provided by exogenous international conditions. This gave rise to urban manufacturing interests and to the demand for protectionism, which was granted. Eventually, these policies were blamed for their relatively poor performance and, though it encountered opposition, the government of Canberra was able to enact a gradual, steady and predictable process of liberalization. Buenos Aires, on the other hand, was torn between leftist groups trying to expropriate the holdings of the oligarchic landlords and the military who overthrew the government and forcefully opened the economy in 1976. Therefore, trade liberalization was not based on consensus, rather, it was the result of a unilateral decision that aligned with the landlords and the capitalists who alone could survive integration with the world economy. Trade reform was abrupt and did not provide any way to smooth out losses.[30]

Ultimately, by the beginning of the twentieth century, the Australian labour movement was already mature and consolidated without being a hegemonic party: it had to make compromises with the Free Trade Party, which represented the interests of the agricultural sector. In Argentina, the ruling elite had vested interests in the agricultural sector and did not need to compromise with antagonistic interest groups.[31] An explanation as to why this happened is found by looking at the conflictual unfolding of interests that brought the landed elite of the *Pampas* to power, versus the smoother and more inclusive transition that favored merchants in Australia. Going forward, it would be interesting to investigate whether trader's interests always play out more inclusively.

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[27] Dyster, *Argentine and Australian Development Compared*, p. 99
[28] *Ibid.*, p. 101
[29] *Ibid.*, pp. 104-110
[30] Galiani, Somaini, *Path-dependent import-substitution policies*, pp. 32-37
[31] *Ibid.*, p. 33

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