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## **Institutional Gaps: The Argentine Restriction on Agricultural Production**

### **Industry Speaks**

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### **Abstract**

This article aims to explain the implications of weak institutions on agribusiness investment in Argentina. Weak institutions lead to policy development and enforcement grounded in the moment, rather than based on precedent and deliberative processes over time. Political exigencies and election cycles challenge policymakers to yield to legal precedent, rule of law, international standards in an environment of weak institutions. We suggest, and welcome critique, that the weak institutional environment in Argentina allows for capricious tax, trade, pricing, and investment policies by government to the point of creating undo business uncertainty. This uncertainty results in an inferior agribusiness investment environment, which in turn reduces the potential economic impact a robust agribusiness complex could provide to the nation.

**Keywords:** Argentina, agribusiness, institutions, business environment

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## **Introduction**

This article aims to explain the implications of weak institutions on agribusiness investment in Argentina.

Institutions are sets of rules, regulations, guidelines, codes and implied and express traditions which prevail in a society, which govern the relations among citizens, and also the relationship between the citizens with the government. Institutions are the backbone of the social, economic, and political organization (Aquinas 2005). Following the financial crisis of 2001, the last two administrations have broken the implicit contract between the agricultural sector and Argentina's government. It seems that the old adage is true, that those countries that don't need the agribusiness sector for economic growth provide subsidies, and those (like Argentina) that depend on agribusiness for hard currency and revenue, tax it.

Institutional failure occurs within regulatory, normative, and cognitive pillars (Scott 2003). The regulatory pillar comprises regulatory institutions; the set of rules and laws that guarantee stability and order in any given society). The normative pillar consists of the values and rules that govern people's behavior. The cognitive pillar consists of a set of cognitive rules that constitute the very nature of reality and the framework within which meaning is acquired.

Agribusinesses must honor on a daily basis government's laws, regulations and policies. Normative institutions set in a framework of business practices, policies and ethical standards. Cognitive institutions reflect the way people interpret the world around them, and how they manage to make sense of such world, on the basis of rules and schemata.

Following the crisis of 2001, the Argentinean Peso was de-pegged from the dollar and quickly devalued. The cost of borrowing dramatically rose overnight as all bank deposits and wages dropped 2/3rds in value. Argentina was cut off from international capital markets, both in terms of credit and investment. The country was a financial island. The government faced two immediate problems, how to raise revenue, and how to stay in power. Raising revenue was a taxation problem, while staying in power meant controlling inflation.

Argentina's political structure centers legislative power in the strongest and most populous region of the country, Buenos Aires. A relatively strong presidency and weak congress and judiciary too contribute to a concentration of power in the capital. A historically weak regulatory system governing investment, commerce and taxation are not anchored by strong or definable normative or cognitive belief system. Thus the strong central government not only has great impact on the business environment, but create uncertainty for investors and managers.

The weak institution-strong central government situation in 1990's created a pro-business environment and low levels of inflation in Argentina. In the 2000's inflation once again threatened the economy and a devalued Peso hurt the poor and middle class who held very few real assets or US dollars overseas. The government responded with strong anti-inflation policies that assured a strong voter base among the lower and middle classes. The strategy was to keep prices low for staple goods and services (electricity and public transportation). The policies came at a cost.

Outside faith in the integrity of the financial and political institutions of the country was shaken to the point of isolating the country from foreign investment.

Argentina has always had a comparative advantage in many areas of agricultural production, beef, soybeans, maize, wheat, soybean meal and oil, and most recently biodiesel. Beef and wheat reflect high domestic utilization, as well as strong exports, while soybeans, maize, soybean meal and oil, and biodiesel are principally exported. Exports are notoriously easy targets for tax collection, especially large volume/low value exports, such as are common in agriculture. Serendipitously there has been a boom in global agriculture, so demand for Argentinean exports soared, resulting in a windfall of government tax revenue.

Government's task was now to implement agricultural policies that minimized domestic inflation while maximizing export tax revenues. That meant controlling prices for domestic staples such as beef, dairy and wheat products, and providing incentives for greater economic activity in the export oriented soybean sector. Export bans caused beef and wheat products to remain in country, driving down domestic prices. High, but not too high, taxes on soybean product exports raised over \$10B USD in tax revenue, while not adversely affecting lower and middle class voters. Argentina only domestically uses 10% of the soybeans it produces (Goldsmith et al. 2011; Puig.2011). So pro soybean meal, oil, biodiesel, and grain export policies do not adversely affect domestic consumer price levels, in a direct way.

The strategy in place for the last eight years has worked as the government was once again elected by a wide margin in the Fall of 2011. For the long term though, the damage may be severe. Uncertainty and capriciousness by government create a very poor investment environment for business (Ledesma 2008). For example, the laws, regulations, and policies recently passed by the government have done significant damage to the beef value chain. This once global leader of high quality inexpensive pasture-raised beef has been forced to shutter many of its export facilities and lay off thousands of workers.

Strong institutions provide balance to weak political systems overly affected by election cycles. Strong normative and cognitive institutions imbedded in entrepreneurship, private sector investment, strong public sector infrastructure, and equitable tax policies, and transparent regulatory systems not only take time to develop, but require nurturing by visionary leaders. Historically Latin America has not had that kind of leadership. Recently though a number of countries have made great strides improving the strength and viability of their institutions resulting in significant economic growth and poverty reduction. So there are good examples in Latin America of strengthening institutions, active investment, and growing economies.

There certainly are challenges and tradeoffs when a country emerges from a crisis like occurred in Argentina in 2001. What have we missed? Have we overstated the impacts to the agribusiness environment? Have we over simplified the state of institutional development. We would love to hear you thoughts and opinions. This is golden era for the leading agricultural producers of the world, such as Argentina. It is a wonderful time to be in the food, feed, fiber, energy, and industrial inputs business as so much of the world desires what agriculture produces.

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