

**FOREIGN DIRECT INVESTMENT, DISTRIBUTIVE CONCERNS, AND DOMESTIC
POLITICS – LABOR AND BUSINESS INFLUENCE, INVESTMENT REGIMES AND
FOREIGN INVESTMENT IN ARGENTINA**

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ABSTRACT: In this paper I analyze how domestic cleavages and politics to affect foreign investment in Argentina. Foreign Direct Investment (FDI) can increase or decrease the returns to domestic actors in line with their ownership of factors of production. I analyze how domestic actors would organize politically to curb or intensify the effects of FDI on their income. In response to the demands of their core constituents, governments would adopt policies that encourage or limit foreign investment. Based on simple assumptions on the effect of factor movements on the rate of return to domestic factors of production, this paper introduces a model that explains why governments that cater to labor would welcome foreign investment, while those that cater to domestic business interests would oppose. Thus, the type of investment regime adopted depends on who is in power or, to put it differently, on the nature of domestic political coalitions. I examine whether those regulatory regimes ultimately affect the level of foreign investment flowing into the country.

INTRODUCTION:

This paper explores the link between foreign investment and domestic politics in Argentina. To the extent that foreign direct investment (FDI) implies an inflow of capital to the host country, it may increase or decrease the returns to domestic actors in line with their ownership of factors of production. I argue that these domestic actors will organize politically to curb or intensify the income effect of FDI. Government will respond to the demands of their core political constituents and adopt measures that would encourage or limit the inflow of FDI. The content of the policies adopted will depend on who is in power, i.e.: on the incumbent domestic coalition in the host country. Eventually those regulatory decisions affect the level of foreign investment inflows.

A simple formal model introduced in the first section of the paper supports the logic of the argument. Next I conduct a series of tests on the main predictions of this model using data from Argentina for the 1970-2002 period. A short narrative of the relationship between politics and foreign investment in Argentina in the post-war era closes the empirical part of the paper. Argentina has experienced changes in political regimes and in the composition of ruling coalitions that resulted in changes in the relative influence of labor and capital. The choice of this case allows for within country variation in terms of political regimes and institutional design, and degree of labor and capital influence.

In the 47 years since Perón's inauguration in 1946, politics has moved back and forth from authoritarian to democratic, development strategies have varied from import substitution through liberalization, and policy orientation from populist to conservative, and back. I map these changes to the different policies adopted vis-à-vis foreign capital.

In 1952, for instance, Perón put an end to the wave of nationalization started by the Ramirez-Farrell military regime and deepened during his early years in office. The collapse of the coalition of labor and capital that had supported Perón in the mid 1940s was the precursor of Perón's about-face in his policy towards foreign investors. This controversial change in policy is reflected in the Parliamentary debates of the time where opposition forces condemned Perón's plan to lure investors in Argentina's oil sector.

During the tenure of the military government that overthrew Perón in 1955, FDI inflows dropped. This is unsurprising given that the regime had its core support in domestic business interests. The military government had also removed Peronist loyalists from the national leadership board of trade unions, confiscated unions' property, and repressed labor activity. FDI resumed during the early years of the reformist administration led by Frondizi, to fall again in the 1960s remaining flat for the following two decades. In the 1990s, another Peronist administration with strong support from organized labor -especially in manufacturing – adopted an open regime towards foreign investment. Counter to these trends, the orthodox policies of trade and current account liberalization measures adopted by Martínez de Hoz during in 1976 failed to lure inflows of FDI. On the contrary, several of the most prominent MNCs left the country in the 1970s, which is also predictable based on the constituency base of the military in power.

THEORY

It has been argued that an optimal tax system should place the tax burden on those factors that are least elastic to taxes.¹ Hence mobile capital –which is usually more elastic to taxes– should be taxed more lightly. These prescriptions are likely to run into problems

¹ An ex-ante optimal tax policy is one that maximizes consumer welfare subject to government and private-sector budget constraints. See (Eichengreen 1990).

when applied to conditions that approximate those in the real world. Provided that capital income is more concentrated than labor income –i.e.: mean and median factor endowments differ– a majority of the population would gain from shifting part of the tax burden to capital despite efficiency losses (Persson and Tabellini 1994). Persson and Tabellini (1994) show that the interactive effect between this distributive conflict and the credibility problem associated with sequential determination of policy makes it difficult for governments to commit to optimal tax schedules. Delegating policy-making authority to right-leaning politicians is the prescribed recipe to mitigate this problem (Persson and Tabellini 1994). Right-leaning leaders would reduce the tax burden and attract mobile capital.

I argue that the inflow of foreign investment also has distributive consequences. Hence a different equilibrium is possible, one where left-leaning governments are gentler and kinder to foreign investors, and right-leaning governments are hostile. This chapter introduces a simple model that supports the logic of this partisan government thesis.

The model looks at the interaction between host governments and investors. Foreign capital owners care about the net rate of return to investing in a host country, which is affected by the conditions offered to them by host governments, and the likelihood that those conditions will be enforced.² The host government, on the other hand, would like to lure investors in and extract as much revenue from them as they can. However, domestic actors organize around their endowments of labor or capital to promote their preferred policies, and governments tend to be responsive to the demands of these groups: right-leaning governments' are usually more receptive to the demands of

² After economic shocks investors would also prefer a policy schedule that automatically adjusted to their advantage, i.e.: that the contract offered to them would change when the state of the world changes in an unfavorable manner to them, but not otherwise.

domestic capital, while left-leaning governments tend to cater to labor. Hence governments would offer foreign investors (and adhere to) a contract that maximizes revenue (government utility) but minimizes domestic political backlash according to their type.

By choosing a Cobb-Douglas/constant returns to scale production function and a simple assumption about factor returns I model inflows of capital as having distributive consequences on the returns received by domestic labor and domestic capital.³ The prediction from the model is that governments that cater to a domestic coalition built around labor will offer conditions that are more favorable to foreign investors, while governments who draw their support mostly from capital owners will be less favorable. As a result, inflows of foreign direct investment will be larger under pro-labor governments, than under pro-capital governments, all else equal.

Contrary to the old dependency claim, I argue that given limited assumptions – that will become apparent below – labor is the most likely candidate to align with foreign investors.⁴ Still, why would labor align with foreign investors? The answer is really simple: inflows of capital change the marginal product of labor and capital, hence affecting relative return to owners of domestic factors of production. The effect on capital, whose marginal product is likely to decrease with an inflow of capital that changes the relative labor to capital ratio, is predicted to be negative, while the effect on labor is likely to be positive.⁵

³ In order to have this effect, investment inflows should have the potential to affect the stock of capital in the host country.

⁴ On dependency and multinational activity see (Evans 1979; Evans and Gereffi 1982; Gereffi 1983), among others. For a critique on the triple alliance argument see (Dominguez 1982).

⁵ There is abundant evidence of instances when labor opposed the outflows capital (Caves 1996). Moreover, newspapers and magazine articles give testimony of management and capital owners complaining against investment of foreign firms in the unified Europe. See, for example, Anthony Rowley,

FOREIGN INVESTMENT AND DISTRIBUTIVE CONCERNS:

The model starts with two actors: a *host government*, and a *foreign investor*. These actors receive a payoff from their interaction that takes the form of tax revenue (τ), in the case of *government*, and return to investment in the host country to the *foreign investor*. The foreign investor has two options: she can invest at *home* (rest of the world), action for which she would receive a return r (net of home taxes), or she can invest abroad, receiving a return to her investment, which we will call R . Let K^F be the amount invested by foreign investors in the host country, while K^D is the amount invested in this market by domestic capital. The total amount invested in the host country by foreign and domestic investors is K , where:

$$K = K^F + K^D$$

The indirect utility function of the host government is:

$$U^G = \tau(K) \tag{0.1}$$

Assume, for simplicity, that domestic capital is (relatively) inelastic to taxes:

$$K^D = \bar{K}$$

Output (y) is produced according to a standard constant returns to scale Cobb-Douglas production function, where:

$$y = f(K, L) = A K^\alpha L^{1-\alpha}$$

Assume, for simplicity, that $A=1$, $L=1$ (or $k=K/L$) and $\alpha \in (0,1)$. Also assume

competitive factor markets, i.e.: factors are paid according to their marginal contribution to output. The marginal product of capital is:

Onto the drawbridge; Japanese and South Korean firms lay siege to ‘fortress’ Europe, *Far Eastern Economic Review*, May 18, 1989 v144 n20 p68(3). Or even the American public protesting against Japanese interests investing in the US in the early 1990s. Financial Times, October 4, 1989, Chief of Sony tells why it bought a part of America's soul.

$$f_k(K) = \alpha(K^F + \bar{K})^{\alpha-1} \quad (0.2)$$

The return (R) to a foreign investor in the host country would be:

$$R \equiv f_k(K) - t$$

Where t is a tax raised on foreign investment. R must be at least equal to r , for I to invest in the host country:

$$R \equiv f_k(K) - t = r \Rightarrow f_k(\bar{K} + K^F) - t = r \quad (0.3)$$

Then, equation (0.3) becomes:

$$\alpha(K^F + \bar{K})^{\alpha-1} - t = r \quad (0.4)$$

From equation (0.4) we can derive the amount of foreign investment (K^F) that flows into the host country:

$$K^F = \left(\frac{r+t}{\alpha} \right)^{1/(\alpha-1)} - \bar{K} \quad (0.5)$$

Then, from (0.5) we can see how t affects investment:

$$K^F(t), \text{ or } K(t) = K^F(t) + K^D = K^F(t) + \bar{K}$$

$$\text{Note that: } \frac{dK}{dt} = \frac{dK^F}{dt}$$

Hence, from (0.3) we obtain:

$$f_{kk} \frac{dK^F}{dt} dt - dt = 0 \Rightarrow \frac{dK^F}{dt} = \frac{1}{f_{kk}}$$

By assumption (concavity of f_k), we know that $f_{kk} < 0 \Rightarrow$

$$\Rightarrow \frac{dK^F}{dt} = \frac{1}{f_{kk}} < 0 \Rightarrow \frac{dK^F}{dt} < 0 \quad (0.6)$$

Next, assume that $\tau(K)$ takes the following functional form:

$$\tau(K) = t K(t)$$

Next I model a political support function –following Hillman (1982)– where the host government not only cares about revenue but looks after the fate of two groups of domestic actors: workers and owners of capital.⁶ The government’s objective function contains an indirect utility derived from the weighted average of the welfare of domestic labor and capital, and a direct utility derived from increased revenue through taxes levied on foreign capital.⁷

Political support in the case of capital flows results from the value domestic actors place on the distributive effects associated with factor flows.⁸ Utility of domestic actors is affected by the investment decision of the foreign investor (K^F). An inflow of capital changes the relative endowment of labor and capital in the host country, hence affecting the marginal productivity of these factors of production. Assuming that factor markets are competitive, the entry of capital affects the return to labor positively and that of capital negatively.

There are two actors that have the potential to affect government: labor (L) and capital (K), whose utility functions are (respectively):

$$U^L = U(x)$$

$$U^K = U(z)$$

Where:

$$x = w = f(K) - f_k(K) K$$

⁶ The political support function model used by Hillman to assess the effects of protectionism is derived from the Stigler-Peltzman model of regulation. (Stigler 1971; Peltzman 1976; Hillman 1982; Hillman 1989).

⁷ Grossman & Helpman adopt a broader form of this political support function originally developed by Hillman, where government’s selection of policy outputs result from a trade-off of domestic welfare for political contributions (Grossman and Helpman 1994; Grossman and Helpman 2001). It also differs from the function used by Dutt & Mitra (Dutt, Mitra et al. 2002).

⁸ As derived from the Mundell equivalence proposition and the Stolper-Samuelson theorem. (Mundell 1957).

Host governments are partisan; they weigh the support of labor and capital differently:

$$U^G = \tau(K) + \beta U^L + (1-\beta) U^K \quad (0.7)$$

This is captured by the parameter $\beta \in [0,1]$ in (0.7). A higher value of β reflects a government that values the support of domestic labor, while a lower value implies that the government is right-leaning, one that pays more attention to the preferences of domestic capital. Replacing x and z from above, the host government's utility function is:

$$\begin{aligned} U^G &= t K^F + \beta U(x) + (1-\beta) U(z) \\ U^G &= t K^F(t) + \beta U(x) + (1-\beta) U(f_k(K) K^D) \\ U^G &= t K^F(t) + \beta U(f(K(t)) - f_k(K(t))K(t)) + (1-\beta) U(f_k(K) K^D) \end{aligned} \quad (0.8)$$

The maximization problem becomes:

$$\max_t t K^F(t) + \beta U[f(K(t)) - f_k(K(t))K(t)] + (1-\beta) f_k(K(t)) \bar{K}$$

First Order condition (FOC):

$$\tau' = 0$$

$$t : K^F + t \frac{dK^F}{dt} + \beta U_x \left[f_k \frac{dK^F}{dt} - f_{kk} \frac{dK^F}{dt} K - f_k \frac{dK^F}{dt} \right] + (1-\beta) f_{kk} \frac{dK^F}{dt} \bar{K} = 0 \Rightarrow$$

$$K^F + t \frac{dK^F}{dt} + \beta U_x \left[f_{kk} \frac{dK^F}{dt} K \right] + (1-\beta) f_{kk} \frac{dK^F}{dt} \bar{K} = 0$$

Second Order Conditions (SOC):

$$\tau'' < 0$$

$$\frac{dK^F}{dt} + \frac{dK^F}{dt} + t \frac{d^2 K^F}{dt^2} - \beta \left[U_{xx} \left(-f_{kk} \frac{dK}{dt} K \right) \left(f_{kk} \frac{dK}{dt} \right) + U_x \left(f_{kkk} \frac{dK}{dt} \frac{dK}{dt} + f_{kk} \frac{d^2 K^F}{dt^2} \right) \right] +$$

$$+(1-\beta)\bar{K}\left(f_{kkk}\frac{dK}{dt}+f_{kk}\frac{d^2K^F}{dt^2}\right)<0$$

This gives a solution (as long as the SOC are satisfied) and other parameters of the model:

$$t^p = -\frac{K^F}{\frac{dK^F}{dt}} - \beta \frac{U_x \left(-f_{kk} \frac{dK^F}{dt} - K \right)}{\frac{dK^F}{dt}} - (1-\beta) \frac{f_{kk} \frac{dK^F}{dt} \bar{K}}{\frac{dK^F}{dt}}$$

Which can be further simplified to:

$$t^p = -\frac{K^F}{\frac{dK^F}{dt}} - \beta [U_x (-f_{kk} K)] - (1-\beta) f_{kk} \bar{K} \quad (0.9)$$

It becomes apparent that the level of t^p varies with β .⁹ The first term on the right hand side of equation (0.9) has a positive sign. The level of t^p is thus contingent upon the signs and levels of the terms that follow β and $(1-\beta)$.

We know that K , \bar{K} , U_x are positive, while f_{kk} and dK^F/dt are both negative.¹⁰

Through a comparative statics exercise we can assess the effect of a change in pro-labor orientation of government (β). From (0.9) it we know that: $dt/d\beta < 0$.¹¹

Consider the two extreme cases:

a) When $\beta=1$, the first term in (0.9) is positive, while the second term is negative:

$$-U_x (-f_{kk} K) < 0$$

We label this case as t_L^p .

⁹ In reduced form: $t^p = \tau(\beta)$

¹⁰ U_x is positive by definition: labor's utility is an increasing function of x .

¹¹ Based on the functional form of the production function, all these terms could be expressed in terms of $f(K)$, and its different order derivatives. For now finding the direction of the likely effect of changes in β suffices.

b) When $\beta=0$, the first term in (0.9) the second term is positive: $-(f_{kk}\bar{K}) > 0$

Labeling this case as t_K^p , to distinguish it from t_L^p we may infer that $t_L^p < t_K^p$

It is fair to state that the tax schedule decreases in β . From this we may conclude that a government that places more weight on the support of labor would choose a tax on foreign capital that is lower than the tax structure chosen by a government who places more weight on the support of owners of capital.

The behavior by government affects domestic constituents in different ways, in line with the effects that FDI has on different types of individuals in the host country. This section shows that as investment inflows change the relative endowment of labor and capital, owners of capital will be hurt, while labor should benefit. Translating the previous comparative statics exercise into words allows me to derive the following proposition:

Proposition 1: *the larger the value that government agents place on the political support of labor, the lower the tax schedule offered to foreign investors, all else equal.*

From $dt/d\beta$, recently discussed, and dK^F/dt , which we know from (0.6), we may derive the following proposition:

Proposition 2: *the larger the value that government agents place on the political support of labor the higher the level of foreign investment, all else equal.*

Under this scenario, a potential loss of support from pivotal domestic actors may help solve the time consistency problem. Government must now tradeoff the additional tax revenue levied when acting opportunistically with loss of political support from domestic actors resulting from the expected effect of taxes on inflows of capital.

PARTISAN GOVERNMENT, TAXES AND INVESTMENT

The previous framework can be trivially modified to incorporate alternative conditions, usually associated with partisan variation in the assessment of higher taxes, as a proxy for government intervention in the economy. For example, domestic actors may accrue benefits (losses) not only from the effect of the inflow of capital on their returns, but from revenue as well: they may receive a share of g .¹²

The model described above assumed that labor and capital valued the income they obtained from participation in the market. But labor is also likely to prefer reducing income volatility and demand for social insurance that would, resulting in higher taxes, all else equal. Higher (lower) taxes lead to lower (higher) foreign (and overall) investment, which reduces (increases) labor's income from the market. I extend the model to account for labor's preference in this dimension. Labor now faces a tradeoff between the utility of income obtained from participation in the market, with the utility obtained from goods produced with the extra taxes collected.

Government raises taxes but can only keep to himself proportion δ of the revenue obtained, where $\delta \in [0,1]$, and uses the rest to provide a good g .¹³ Assume, also, that only labor values a higher level of government expenditure, g , while capital is indifferent. The utility functions of labor (L) and domestic capital (K) are:

$$U^L = U(x, g)$$

$$U^K = U(z)$$

where $g = (1-\delta) t K^F$

¹² An alternative would be to change weights on the objective function, making revenue more valuable to government than the indirect utility of the government's constituents.

¹³ $1-\delta$ captures the weight placed on g by different types of government. A decrease in δ would reflect the fact that an extra \$ in revenue is valued more heavily by a left government. When $\delta = 1$ we are back in the model discussed in the previous section.

Government has the following utility function:

$$U^G = \delta t K + \beta U^L + (1-\beta) U^K$$

$$U^G = \delta t K^F + \beta U(x, g) + (1-\beta) U(z)$$

$$U^G = \delta t K^F(t) + \beta U(x, (1-\delta)g) + (1-\beta) U(f_k(K) K^D)$$

$$U^G = \delta t K^F(t) + \beta U[f(K(t)) - f_k(K(t))K(t), (1-\delta) t K^F(t)] + (1-\beta) U(f_k(K) K^D) \quad (0.10)$$

Government's maximization problem becomes:

$$\max_t \delta t K^F(t) + \beta U[f(K(t)) - f_k(K(t))K(t), (1-\delta)t K^F(t)] + (1-\beta) f_k(K(t)) \bar{K}$$

The first order condition (FOC)¹⁴ to this maximization problem is:

FOC: $\tau' = 0$

$$\begin{aligned} t : \delta K^F + \delta t \frac{dK^F}{dt} + \beta U_x \left[f_k \frac{dK^F}{dt} - f_{kk} \frac{dK^F}{dt} K - f_k \frac{dK^F}{dt} \right] + \beta U_g \left[(1-\delta) K^F + (1-\delta) t \frac{dK^F}{dt} \right] \\ + (1-\beta) f_{kk} \frac{dK^F}{dt} \bar{K} = 0 \Rightarrow \\ \Rightarrow \delta \left[K^F + t \frac{dK^F}{dt} \right] + \beta U_x \left[-f_{kk} \frac{dK^F}{dt} K \right] + \beta U_g (1-\delta) \left[K^F + t \frac{dK^F}{dt} \right] + (1-\beta) f_{kk} \frac{dK^F}{dt} \bar{K} = 0 \end{aligned}$$

The solution is a function of β, δ :¹⁵

$$\begin{aligned} t^* &= \frac{-\beta U_x \left(-f_{kk} \frac{dK^F}{dt} K \right) - (1-\beta) f_{kk} \frac{dK^F}{dt} \bar{K}}{(\delta + \beta U_g (1-\delta)) \frac{dK^F}{dt}} - \frac{K^F}{\frac{dK^F}{dt}} \\ t^* &= -\frac{\beta U_x (-f_{kk} K)}{(\delta + \beta U_g (1-\delta))} - \frac{(1-\beta) f_{kk} \bar{K}}{(\delta + \beta U_g (1-\delta))} - \frac{K^F}{\frac{dK^F}{dt}} \quad (0.11) \end{aligned}$$

¹⁴ In order to save space the second order condition ($\tau'' < 0$) is not reproduced here.

¹⁵ And the other relevant parameters.

When $\delta=1$, the solution is identical to the one discussed in the previous model, where the level of t^* depends on the values of β . We know that the first argument in the right hand side of equation (0.11) is negative while the second and third are positive. Most action occurs when δ approaches zero, i.e.: when government values less the direct impact of additional revenue, taxes on foreign investment will be lower under when β increases. Under these conditions, when $\beta=0$ and δ approaches zero, the loss of utility resulting from the reduction in the return to domestic capital's income due to the inflow of capital is magnified, while the weight that government places on taxes becomes smaller and smaller. When $\beta=1$ and δ approaches zero the optimal tax converges to the t_L^p case.¹⁶

INTUITION:

The model discussed in the previous sections is based on very simple assumptions about the production function, and interactions between governments and investors.¹⁷ It also relies on very simple assumptions about actors' preferences. All these simplifications combined result in a rather basic objective function. However, the model allows us to make predictions about the expected sign of the investment regime that host governments would offer to foreign investors, and ultimately the level of investment in the host country.

The main assumption is that labor interests converge with those of foreign investors, while those of domestic businesses would diverge. Yet is also possible that

¹⁶ To simplify this prediction we could even assume a different functional form for $U(x, g)$; it could be: $x = w + g$ if g is an in-cash transfer.

¹⁷ Of these assumptions the constant returns to scale production function is perhaps the most problematic when dealing with multinational activities, especially under the Horstmann & Markusen (1992), and Brainard (1993) model where the decision to invest abroad is driven by the proximity/economies of scale trade-off. (Horstmann and Markusen 1992; Brainard and National Bureau of Economic Research 1993).

preferences of labor and foreign capital do not fully converge. This divergence of interests between domestic labor and foreign capital has been captured in the last of the models discussed. Labor preferences are mapped onto a two-dimensional space: one dimension results from the value placed on income from participation in the market, and follows straight from the trade theoretic literature: changes in relative endowment competing wages up. The other dimension is related to the value labor places on government spending, which acts as a form of social insurance against the potential hardship associated with downturns in economic activity that is beyond the control of labor (See Cameron among others Cameron) and Rodrik (1997). Social insurance implies higher taxation, which affects the return to investors. Foreign capital compares the return at Home, net of taxes and subsidies, with the potential return in the host country. Return in the host country is affected by the level of social spending, which implies higher taxes. Increasing labor (capital) influence has a negative (positive) effect on the return on investment in the Host country through increasing (decreasing) welfare taxes and transfers, all else equal. Yet increasing labor (capital) influence has a positive (negative) effect on the return to investment in the Host country through reducing uncertainty about the policy environment.¹⁸

The model suggests that even when labor values higher taxes or government spending, the level of taxes offered to foreign investors will be lower than when capital owners are more influential on government, even though the latter, by assumption, do not place any value on the extra revenue obtained from taxing foreign capital.

¹⁸ It could even have a positive (negative) effect on changing the policy environment in the direction preferred (disliked) by the investor other types of shocks, if the domestic actor whose interests are congruent to those of the foreign investor internalizes these preferences.

A government needs not tie his hands when facing foreign investors who worry about the perspective of being taken advantage of. The commitment mechanism to the conditions offered to investors at the time when investment decisions are made is enforced by the ability of labor to sanction government for foregone income –or employment if frictional factors are large– that results from FDI flight. Hence, even though investors may react negatively to higher welfare taxes, they know that the risks they face are higher when governments cater to domestic business interests.

TESTABLE HYPOTHESIS

I argued earlier that responsiveness of government to foreign investors is a function of the relative power of labor –its potential to influence on the policy-making process– and the receptiveness of politicians to labor’s demand. It is possible that labor would prefer an overall higher level of taxes on capital, which would make investors more likely to shun these countries. Yet taxes on foreign capital are likely to be lower than those under a government where domestic business interests are central. If these predictions are right we should expect to find higher levels of foreign direct investment in countries where governments are more responsive to labor.

The main testable hypothesis is the following:

Partisan Hypothesis: *foreign direct investment inflows in Argentina will be larger under Peronist (pro-labor) administrations.*

An alternative hypothesis is derived from the institutional constraints literature:

Veto-Gates Hypothesis: *foreign direct investment flows will be larger when the government is institutionally constrained.*

EVIDENCE

Next, I test whether change in government orientation within a country affects the average level of FDI inflows received. I will compare the amount of FDI inflows in one year under pro-labor administrations to the average level of inflows in years with administrations leaning towards capital owners. The observations used for this test are from Argentina for the period 1970-2002.

EQUALITY OF MEANS TEST

The first set of statistical evidence is from data on Argentina for the period 1970-2002. The difference in performance of pro-labor and pro-capital governments can be seen in a simple comparison of means. Tables 1.1 through 1.4 reproduce these results. Table 1.1 shows that there appears to be a systematic difference in the average net FDI inflows in years under pro-labor governments (Cámpora-Perón-Isabel Perón, 1973-1975; Menem, 1990-1998; Duhalde, 2002) compared to years with military rule (1970-1972; 1976-1983) and those with UCR presidents (Alfonsín, 1984-1989; De la Rúa 2000-2001).

The mean under pro-labor governments is US\$4.39 billions (an average 1.93% of GDP), while under other regimes is US\$1.15 billion (or 0.75% of GDP). The differences are statistically significant as shown by the results of the t-statistics and the confidence intervals reproduced in the tables.¹⁹ There is also a systematic difference between the annual amount of FDI received under democratic rule: the average is US\$4 billion (1.65% of GDP), compared with US\$0.28 billion under military governments (0.53% of GDP).²⁰ Figure 1 conveys this information in graphic format.

¹⁹ In alternative tests I have used different transformations of the dependent variable, such as natural log (Tables 2.1), as a ratio of GDP (Table 3.1), or as a ratio of world flows (Table 4.1), with similar results. In all cases the tests show that the means remain statistically different beyond conventional levels of confidence.

²⁰ The tests also show that the difference is more remarkable for the Menem administration. Also note that there is a remarkable and statistically significant difference between the two Menem administrations when

But FDI net flows, without sufficient controls might not be the relevant measure to compare FDI inflows across periods. Economic performance, GDP growth, macroeconomic management, trade liberalization, or simply international capital mobility –higher global FDI flows in the 1990s, coinciding with Menem’s tenure– may drive the difference in performance over the different administrations. To control for those conditions I conduct alternative tests.

REGRESSION ANALYSIS

There is a lack of consensus about the factors that should be considered as determinants of foreign investment, and/or the sign attributed to these factors.²¹ Empirical approaches that analyze the flow of investment capital have adopted different methodologies.

Findings are difficult to compare due to lack of correspondence in the universe of cases, sample size, model specification and choice of controls.²²

From this extensive and diverse literature the main variables that appear to be consistently related with FDI flows are factor endowment, market size and trade orientation. Market size usually returns a positive result, which probably reflects the presence of economies of scale (Wheeler and Mody 1992).

Regarding the relationship between investment and trade, the results are contested. The theoretical debate is whether trade and investment are complements or substitutes. While Mundell (1957) assumes that they are substitutes, recent work by

compared to any of the other governments in the sample, democratic and authoritarian alike. See tables 1.3, 2.3, 3.3 and 4.3.

²¹ See (Chakrabarti 1998; Chakrabarti 2001).

²² The most ‘successful’ empirical approaches are probably those based on gravity specifications. See (Blonigen, Davies et al. 2000). But gravity techniques, which are good at capturing vertical and horizontal models of FDI, cannot account for the knowledge-capital model of multinational activity. (Markusen, Maskus et al. 1999; Markusen, Maskus et al. 1999; Carr, Markusen et al. 2001).

²³ Lucas (1993) conducts an econometric analysis of a single-equation model based on Cobb-Douglas technology using aggregate data on 7 South-East Asian economies over the period 1961-87 (Lucas 1993).

O'Rourke and Williamson (1999) challenge this hypothesis (O'Rourke and Williamson 1999). In particular they reject the hypothesis that trade and factor flows are substitutes, at least for the pre-WWI period. There is also work done at the firm level. Using cross-sectional data on the activity of affiliates of US multinational, Brainard (1993) found that the share of affiliate sales exports and sales is positively related to trade barriers (Brainard 1993). Blonigen and Feenstra (1996) confirm the relationship between the threat of protection and investment, using data of Japanese FDI into the U.S. during 1980-1987 (Blonigen, Feenstra et al. 1996). On the other hand, Wheeler and Mody (1992) find no significant relationship between openness and FDI (Wheeler and Mody 1992).

In the statistical tests that follow I include variables that proxy for market size (GDP), relative endowment of capital (GDP per capita or GDP per worker), trade orientation (openness as a percentage of GDP), to control for those determinants that stand out in the literature. One of the main assumptions in the model is foreign capital is a substitute of domestic capital. To control for this substitution effect I add savings in the host country as one of the regressors.²⁴

DATA AND METHODOLOGY:

I conduct a series of regression analysis on the time series data for Argentina. Due to data availability on the FDI Net inflows data, I am limited to a 33-year span, which is short for a time-series analysis. An additional problem, frequently present when dealing with economic data, is that the series are likely to be non-stationary. Non-stationarity renders the estimates inefficient, and underestimates the standard errors. Diagnostic tests suggest

²⁴ Other variables used in the empirical literature include competitiveness, domestic investment, growth, government intervention, infrastructure, privatization, and trade balance (Wheeler and Mody 1992).

that that we cannot reject the null hypothesis that FDI Net inflows (Million US\$) in levels, natural log form, and as a ratio of GDP are indeed non-stationary. First-differencing the variables in natural log format and as a ratio of GDP makes both series stationary, indicating that they are integrated of the first order. The independent variables of interest are also integrated of the same order.²⁵ Data availability for the independent variables, first differencing variables and introducing lags in the different model specifications further reduces the number of observations available to conduct the tests. Modeling the dependent and independent variables in differences also makes it more difficult interpreting the substantive effect of the coefficients. Bearing these caveats in mind, I proceed to describe the results, which by no means can be considered conclusive.

The results are reproduced in Table 8 (FDI/GDP). Model 1 suggests that the ratio of FDI/GDP is positively related to trade the dummy variable for the years with a pro-labor government. The coefficient is statistically different from zero beyond the 95% level of confidence.²⁶ Models 2, 3 and 4 include additional control variables that may affect the inflow of FDI. The first of these controls is a variable that tries to capture the effect that an increase in international capital mobility may have on the inflows received by Argentina, irrespective of any internal conditions in the country.²⁷ The coefficient on this variable is positive and significant beyond the 99% level of confidence. Another

²⁵ Post-diagnostic tests suggest that the relationship between the variables is not likely to be spurious. Note that two series are co-integrated if both alone are integrated, but their linear combination is stationary (Greene 1997). Additionally the series appear to be stationary with a trend. Once we control for international capital mobility, the series appears to become stationary (similar results using year to control for the trend component).

²⁶ In alternative specifications not reproduced here but available upon request, I have included a dummy for the two years of the Isabel Perón administration (July 1974 to March 1976). Including this dummy makes the coefficient on Peronist larger and significant beyond the 99% level. The coefficient on Isabel dummy is, on the contrary, always negative while its significance varies according to variables included in the different specifications. In the qualitative section I will explain these results.

²⁷ I proxy international capital mobility by the total amount of world FDI outflows in that year. The variable World FDI and Ln World FDI appear to be I(1); their first differences are stationary: $Z(t)=-5.358$ and $Z(t)=-4.368$ respectively, with MacKinnon approximate p-value for $Z(t)=0.00$ in both cases.

control is trade openness. This variable returns a positive coefficient but is not significant in any specification.

Savings enters negatively into the equation, while endowment of capital (proxied for by GDP per worker) is negative; yet none of these variables are significant at conventional levels of confidence, which is unsurprising based on the limited number of observations available and the short time-series structure of the data.²⁸

Next I include an index of *political constraints* (proxy for institutional and partisan veto gates) constructed by Henisz (2002). Polconv is an index of how constrained the chief executive is in her choice of policies derived from a spatial model of political interactions. It is a measure of the likelihood of change in policy given the structure of political institutions (the number of veto points) and the preferences of the actors that hold each of these points (the partisan alignment of various veto points and the heterogeneity or homogeneity of the preferences within each branch). Model 4 also includes an interactive term of this variable with the pro-labor dummy. When the interactive term is included on the right-hand side of the equation, the pro-labor dummy remains positive. Both the index of political constraints and the interaction between pro-labor orientation of government and political constraints are negative, but neither is significantly different from zero.²⁹

These findings suggest that there appears to be a systematic relationship between government pro-labor orientation in Argentina, and the inflow of FDI to the country,

²⁸ The ratio of government consumption to GDP is negative in model 3 and flips sign in model 4; and does not seem to belong in the model.

²⁹ Similar results are obtained when using the natural log of FDI and Argentina's share of World FDI as the dependent variables.

rendering the hypothesis derived from the theory plausible.³⁰ These results show support the labor influence hypothesis, but seem to refute the veto gates approach. The negative sign on the proxy for veto gates may indicate that once we control for partisan orientation of government, political constraints do indeed affect the probability that policy will change. Inflows of FDI are larger in years under pro-labor administrations, but when pro-labor executives are constrained by the presence of veto players inflows tend to be lower.

The results are of substantive impact: a change towards a pro-labor government results in a change of close to one standard deviation of the dependent variable in first difference form. The aggregate level of the data does not allow to fully test the potential of the theory, which as developed above is more likely to be at play at the sectoral level. In Argentina the change of relative endowment of capital may have a more immediate effect at the industry level. In addition, unions and business associations are organized at the industry level.

QUALITATIVE EVIDENCE: LABOR INFLUENCE IN ARGENTINA

The tests on Argentina cover the past three decades of the country's history. During this period FDI has increased dramatically under Menem's administration but has otherwise remained flat throughout the rest of the governments and years (Figure 1).³¹ Larger inflows in the 1990s could be attributed to either push or pull factors (Calvo, Leiderman et al. 1993), (Fernandez-Arias 1996). The main push factor leading to higher inflows is the increase in international capital mobility that resulted from changes in the strategies

³⁰ Tests using quarterly data available for the period 1977-2003 yield similar results (not reproduced here). These results also make apparent that not only Peronist governments but also all democratic regimes performed better than the military in government.

³¹ FDI inflows to Argentina appear to be extremely volatile. Figure 1 shows that the ratio of FDI/GDP peaked in two other instances that can be attributed to domestic politics: under Frondizi and under Onganía, though limited data is available for the latter period. The upward trend in the 1980s predating and post-dating the debt crisis, are probably better explained away by external factors, social unrest and economic and political instability.

of MNCs and in the liberalization of trade and investment regimes.³² Pull factors that could have led to higher levels of inflows in the 1990s are structural reform, including privatization of utilities and SOEs, price and exchange rate stability and balancing of fiscal accounts all leading towards higher creditworthiness of the Argentine government; trade liberalization and the formation of MERCOSUR; and an overall improvement in economic performance. Then, it could be argued that it was not labor support that brought about the dramatic increase in foreign investment, but Menem's alleged departure from the policy stances traditionally associated with the Peronist party. In this section, I will try to show that there is no such departure: there is continuity between the policies adopted by Perón in the 1950s and Menem in the 1990s. Both Menem's close relationship to the Confederacion General del Trabajo (CGT) and organized labor, and Perón's relationship to capital have been usually understated in extant accounts of Argentina's political economy in the postwar era. I will also show that partisan orientation of government plays a significant role in explaining foreign investment inflows. Once we control for the pull and push factors described earlier it becomes apparent that the bulk of FDI has flown into Argentina under governments that had a special link to labor.

There are alternative explanations to the trend in FDI inflows observed in this period. One explanation is completely unrelated to politics and domestic coalitions: ISI and economic performance have created a disincentive to invest in the country. An alternative explanation emphasizes on politics and makes the opposite prediction to the theory discussed above: it is precisely labor influence what deterred foreign.

³² A fall in interest rates in capital exporting countries may "push" capital to emerging markets; "pull" factors are associated with domestic developments in the recipient economies, in which case larger inflows would be associated with changes in the macroeconomic performance and creditworthiness of the recipient economy. In the extant literature on international capital flows it is contested whether pull factors dominate push factors or conversely international factors dominate.

Post-war economic performance in Argentina was characterized by stop-go cycles. Under a strategy of import substitution industrialization the economic authority had to balance the needs of these two sectors –an exporting sector based on agriculture on one hand, and an import-competing sector in manufacturing– but would usually yield to the needs of the politically influential industrial cluster. A combination of poorly designed policy instruments that comprised tariffs and tax incentives, differential exchange rates, price freezes and financial repression created allocation mechanisms divorced from price incentives (Taylor 1998).³³

The import competing sector was dependent on intermediate inputs and capital goods that could only be procured overseas. Increasing domestic demand for agriculture products from a burgeoning urban population, disincentives to invest and produce in the exporting sector due to policy discrimination against agriculture and declining international prices for the country's exports, would lead to cyclical foreign exchange crises. The corrective package adopted by different administrations would always include devaluation of the peso to correct for the distortions in relative prices, to boost exports and discourage imports. But devaluations usually caused inflation, had recessive consequences on output, and ultimately affected income distribution. Cycles of expansion and contraction of the economy and price distortions created by the ISI strategy deters all forms of investment; and FDI is more elastic to these disincentives and becomes more

³³ According to Taylor this phenomenon, which persisted till the aftermath of the debt crisis, was not privy to Argentina: "...only recently have economic reforms began to undo the price distortions that have been built into the Latin American economies since the generalized interwar autarky and specific policy reactions of the 1930s. Prior to those reforms the region remained unattractive to foreign investors not only because of its low levels of technology (low productivity) but also because unfortunate price twists lowered the realizable rate of return on capital." (Taylor and National Bureau of Economic Research 2003, pp. 28); see also (Taylor and National Bureau of Economic Research. 1994).

volatile. FDI would increase more rapidly when the economic authority tries to correct those distortions.

The second explanation should find a negative correlation between FDI inflows and labor influence. The surge in flows under Menem is explained by Menem's ability to weaken unions. A first look at union density data seems to support this argument (Table 7); yet even in the 1990s foreign investment flow into the formal sector where unions remained strong, and remarkably so when compared to other countries (see Table 8).

In sum, it is true that throughout the postwar era poorly designed policy instruments and recurring economic crises may have affected the incentives to invest. The different responses by successive administrations to these events suggest that politics might have played an important role in determining the level of foreign investment as well. In the following sections I will produce evidence that suggest that the predictions from the model are plausible. I will review patterns of labor influence in Argentine politics, try to map those changes to the regulation of foreign direct investment.

LABOR ORGANIZATION AND INFLUENCE

A series of social, cultural, political and economic conditions have made Argentina a propitious environment for the emergence of a strong labor movement.³⁴ In the post-war era unionization in Argentina has been among the highest among developing countries and compares to the rates found in industrialized societies. See Tables 7 and 8.³⁵ Reforms to labor market rules introduced by Perón in the late 1940s that strengthened the position of organized labor helped shape one of the strongest labor movements in Latin America

³⁴ Among these conditions we find a high rate of urbanization; immigration from industrial nations in the late 19th and early 20th Centuries; a large internal market; a relatively small and highly skilled labor force; and the virtual absence of surplus-labor (Ranis 1994).

³⁵ In the early 1990s close to 50 percent of Argentine workers were unionized. Within the industrial sector the figure reached 65 percent of the workers (Ranis 1994, 56; International Labour Office 1997).

(Collier and Collier 1991).³⁶ These institutions outlived Perón, and made labor one of the central actors in Argentine politics. Organized labor has, since, become a central political player in the country.³⁷ Blue-collar workers have maintained their loyalty to unions and the Peronist party. Under non-Peronist democratic governments –Frondizi, Illia, Alfonsín and De la Rúa– the CGT leadership faced internal pressure from the rank-and-file, and they have usually responded by a militant behavior against the government, forcing their internal opposition to take a stance. Military regimes have been blatantly anti-labor.³⁸ Under the 1976-1983 regime, for instance, direct repression and disappearance of labor activists had an obvious effect on union activity, which remained low until late 1981.

Democratization in the last two decades of the 20th Century brought about changes in union behavior. In the past, union militancy against weak democratic governments at times paved the way for military intervention, or led to an authoritarian regime with the decisive support from organized labor, as in the case of the fall of Illia in 1966. During Alfonsín's tenure unions seemed to be more conscientious about the need to strike a balance between opposing government policies to advance the Peronist partisan agenda without debilitating democratic life. In the years of structural reform under Menem unions were forced to go beyond income redistribution and pursue a broader range of policy issues that, such as investment policies and restructuring of the

³⁶ In the 1946-1954 period union membership in Argentina increased fivefold: from 500,000 to 3,000,000.

³⁷ During the first years in office, Perón succeeded in placing the union movement under government control using tactics such as political favoritism, bribery and the imprisonment of union leaders that opposed government initiatives. Jose L. Figuerola –one of Perón's closest aides who had a central position in drafting the five-year plan, labor reforms and initiatives to hold sway over the labor movement– had helped Primo Rivera to map control over unions in Spain. In terms of ideology the Argentine labor movement under Perón has been characterized as fascist. Latin America labor unions had opposed to the Argentine unions participation in ILO conferences until September 1946 (29th Conference), when they decided to court the Argentineans. The pro-Peron General Confederation of Workers (CGT) has systematically clashed with the continental labor organization (ORIT) affiliated with the International Confederation of Free Trade Unions. Perón created his own Latin American grouping of unions (ATLAS) to oppose ORIT.

³⁸ The *Onganiato* is a special case, and will be discussed in more detail in the following sections.

state, or even union leaders' personal and political agendas.³⁹ Resorting to general strikes and belligerency became ineffectual in pursue of those objectives, which would only be used as a strategy of last resort.

The internal organization of trade unions and their activity in Argentina is regulated under the Professional Associations Act (*Ley de Asociaciones Profesionales*, henceforth LAP). The first LAP was passed in 1945 during Perón's tenure in the Ministry of Labor and Social Welfare.⁴⁰ The exclusive right to represent workers granted to the government recognized union and their right to bargain collectively were instituted in October 1953 (*Ley 14,250 Convenciones Colectivas de Trabajo*).⁴¹ Collective bargaining was suspended not only under military regimes but under democratic governments as well.⁴² The legal framework was formally revised in four occasions, none of which have had a substantial effect on the overall outlook of the system.⁴³ However, the direction of these amendments to labor union regulations may indicate of labor's relative political strength and influence.

A simple comparison of the main provisions shows that the original regime and the amendments introduced by Perón in 1973 had tended to strengthen union vis-à-vis

³⁹ On union behavior at times of structural adjustment see (Murillo 2001).

⁴⁰ Decreto-Ley 23,852, October 2, 1945.

⁴¹ Similar rights were granted to employer associations. These associations were regulated by the *Ley 14295 de Asociaciones Profesionales de Empleadores* (Employers' Associations Act), passed in 1953. This regime was abrogated in 1955. Hereafter there has been no attempt at regulating the organization of employers' association.

⁴² During Perón's second government, a social pact suspended collective bargaining until 1975; under Alfonsín collective bargaining was banned because they would disrupt the Plan Austral (stabilization plan passed in 1985) until 1988, when they was formally reinstated under a new regulatory regime (*Ley 23,545 de Convenciones Colectivas de Trabajo*)

⁴³ The first reform took place in 1958 under Frondizi (*Ley 14,455*, August 8, 1958), basically reinstating the provisions of the 1945 law which had been suspended by the military regime of 1955-1958. The next reform to the system came under Perón in 1973 (*Ley 20,615*, November 20, 1973), followed by the 1979 reform by the military junta (*Ley 22,105*, November 15, 1979). Last under Alfonsín in 1988 (*Ley 23,551*, March 3, 1988), resulting from a compromise between the Radical President and a Peronist in Congress. (See Krotoschin 1972; Vázquez Vialard 1981; Krotoschin and Ratti 1983; Fernández Madrid and Caubet 1994; Brumat Decker 2001)

employers, and the position of union leaders vis-à-vis rank and file workers. Frondizi yielded to most of labor demands, in fulfillment of his agreement with Perón that launched him to office. But he was concerned about the overwhelming political clout of union leaders and their limited accountability to workers.⁴⁴ His administration restored the 1945 LAP regime that had been suspended by the Revolución Libertadora, but introduced several amendments that have been less favorable to union leaders. The 1958 LAP reduced their terms of appointment, promoted electoral competition within unions, sanctioned the right of rank-and-file workers to call for a congress, and amended the system of grievances upon which the contract of a union leader could be terminated. But all these amendments were sugarcoated with a major concession that Frondizi made to labor: the creation of the welfare fund system (*obras sociales*) administered by the government accredited union in each sector.⁴⁵ The 1979 LAP sanctioned by the military government removed these contributions from union control, following the practice started by the 1966-1973 authoritarian regime.

Alfonsín adopted a confrontational stance towards the Peronist unions: he believed that in a democratic society it was political parties, not interest groups, who should be responsible for political intermediation. Soon after his inauguration in 1983 Alfonsín tried to impose a new LAP regime on unions that would decentralize union power. The main objective of this regime was to democratize unions and forcing their atomization to reduce union influence in politics. Ultimately the Mucci initiative was stalled in Congress by the opposition, but the relationship between Alfonsín and

⁴⁴ A concern that was shared by all democratic Presidents not elected under the Peronist Party ticket.

⁴⁵ The reforms to the LPA under Frondizi in 1958 created the system of social welfare funds (*obras sociales*), which mandated employer contributions for welfare and retirement purposes; these earmarked funds were managed by unions.

organized labor never healed despite his conciliatory moves in successive years, which even led to the appointment of Carlos Alderete –a prominent union leader– to the Ministry of Labor Affairs in 1987. In 1988 the Alfonsín administration caved in to union pressure and Congress passed a new LAP, which was identical in substance to the 1973 legislation.⁴⁶ Under Alfonsín unions regained the monopoly of representation of workers in their sector, and control of social welfare organizations, but were deprived of the right of collective bargaining on wage related issues, particularly during the years of the Plan Austral which had frozen prices and wages to control inflation.

Another indication of the link between the party in office and interest groups is the fate of legislation aimed reforming labor contracts. Labor market institutions had been criticized by businesses for allegedly stifling their ability to create jobs. Wage bargaining in Argentina is conducted at the industry level, with low levels of coordination when compared to other countries in with similar labor market institutions. In the early 1990s roughly 40 percent of Argentine workers belonged to a labor union, and close to 90 percent of the workers were covered by an industry-wide union negotiated agreements signed over two decades earlier, given that from 1976 through 1988 collective bargaining was outlawed for different circumstances. Labor's political influence during the Menem administration is undoubtedly reflected in its ability to block labor reform in Congress.⁴⁷ It also shows in Menem's reluctance to force these reforms through legislative decree powers, which he used (and probably abused) in other policy areas. Reform to labor market institutions was finally introduced in 1995 amidst a recessionary economy and

⁴⁶ The 1988 reform decreed that the government would grant this right to a union only if at least 20 percent of the workers in the sector favored collective bargaining. Lists of delegates needed to get support by 3 percent of the union's members to be acknowledged by the Ministry of Labor.

⁴⁷ See (Etchemendy and Palermo 1998; Etchemendy 2001).

facing the spillover effects of the Tequila crisis. Congress passed a labor reform act – which had been negotiated by the recently appointed Minister of Labor Armando Mera Figueroa on behalf of government, the UIA in representation of business groups and organized labor represented by the CGT. Yet two years after this piece of legislation introducing more flexible labor contract conditions the law was passed, 46 percent of the labor agreements in force had been signed before 1975 (Etchemendy 2001, 10).

In 1998 the government, with the conspicuous support of labor, backpedaled on the temporary and fixed term contracts as well as several of the limited reforms introduced earlier. It is worth noting that while organized labor lobbied Menem and Congress to keep the labor reform legislation from passing, unions in different sectors negotiated flexible conditions to encourage foreign investment.

Major changes to labor market institutions were introduced under the De la Rúa administration by the notorious Labor Reform Act of 2000. This legislation eliminated the ultra-activity clause of labor agreements, under which the conditions negotiated in a pre-existing agreement become the reversionary point. It also reduced labor taxes, instituted a longer probation period and made labor contracts more flexible. This was presented to the public as a major piece of legislation, a stepping stone for the De la Rúa administration upon which the government would claim that it was capable of advancing a reform package that Menem had failed to deliver. However, the legislative process that led to the passage of this law was smeared with accusations that the government had bribed Senators to change their vote. The labor reform act became De la Rúa's worst nightmare: the allegations of corruption by De la Rúa and his Cabinet led to the disintegration of the coalition of parties that had brought him to power to eliminate from

politics the corruptive practices that were rampant under Menem. Vice-President Alvarez resigned in disapproval of the events.

In conclusion, the analysis of the changes introduced to the legislation that regulate labor unions and labor market institutions suggests that: “Peronist-sponsored governments tended to be most generous in their defense of trade unions’ organizational and bargaining strengths vis-à-vis employers.” (Ranis 1994, 45).

LABOR INFLUENCE AND FOREIGN INVESTMENT

Governments’ reliance on the support from labor or business described in the previous sections could be mapped onto investment policies and investment outcomes in the postwar era. Appendix 2 presents a summary of the different statutes that regulate foreign investment in Argentina since 1946. Some of these statutes appear to have had a direct effect in the amount of foreign investment received by the country ensuing their approval, while others appear to be inconsequential. There are two reasons why we find this dissimilar effect of the basic statutes on foreign investment outcomes. The first reason, which will become apparent in the discussion below is that all of these statutes have delegated into a government agency or office the ultimate decision on which investors will receive preferential treatment and which investors will be discriminated against. The choice to delegate this authority is political and more often than not those agencies are permeable to the pressure of interest group lobbies. Governments are more likely to respond to those lobbies around which their support base is built. The second reason is that there are multiple other policy instruments that affect the decision of foreign

investors or the form of entry of capital, which I have discussed earlier.⁴⁸ It is the combination of these multiple policy instruments what will characterize how friendly or hostile to foreign investors the investment climate is likely to be.

Until the end of World War II, Argentina enjoyed a privileged relation with the UK. Britain was the country's main investor and trade partner through 1947, year of declaration of inconvertibility of the pound. Gloomy conditions in the US and Europe in the 1930s affected trade and restricted availability of capital to developing countries. Smoot-Hawley Act in the US, and the preference system for the British Commonwealth adopted in the Ottawa Convention in 1932 negatively affected Argentina's trade. The Argentine government adopted an economic stance that has been characterized as *reactive*, with capital controls and multiple exchange regimes, and so did many other countries in Latin America and elsewhere.⁴⁹ The government represented a conservative coalition of the landed aristocracy of exporters of high quality chilled-beef who had secured access to the British market under the 1933 Roca-Runciman agreement, represented by the Sociedad Rural Argentina (SRA), and a burgeoning industrial bourgeoisie, represented by the Union Industrial Argentina (UIA). The rural elite of beef exporters that had been a prominent component of the military regime that toppled Hipólito Yrigoyen in 1930, tolerated a limited form of industrialization through import substitution and selective government intervention, to preserve the level of economic activity enjoyed by the country in the pre-depression era. Substituting for imports was virtually a necessity at a time when global trade had been restricted as a consequence of

⁴⁸ Among these policy instruments we find protection of property rights; tax schedules and taxation system; regulatory regimes on the activity and market structure; trade policy; nationality requirements; monetary regimes and exchange rate policy; etc..

⁴⁹ Most of the controls on capital in Argentina were placed between 1931 and 1936.

the protectionist stance adopted by the rest of the world. The other sector of lower quality meat producers who had been left out of the trade agreement and promoted free trade lined up with the opposition led by the Radical party (Murmis and Portantiero 1971), (Halperín Donghi 1964).

Argentina was among a handful of countries that did not default in the 1930s, and was duly rewarded. However, policy innovations introduced to fight the consequences of the Great Depression became crystallized in Latin American countries, whose governments adopted economic dirigisme and a larger role for the public sector as their developmental strategy (Taylor and National Bureau of Economic Research 2003). The result was high black market premium, distortions in relative capital prices, and periodical depreciation of the exchange rate in competitive bids. These distortions explain the low investment rates in Argentina –as in the rest of Latin America– leading to slow economic growth (Taylor 1998). The explanation of the fall in foreign investment inflows ensues. While in the prewar era foreign capital filled the gap between domestic savings and investment⁵⁰ the artificially higher costs of capital depressed the demand for investment in these countries, reducing the need to borrow abroad.⁵¹

The onset of World War II and the U.S. restrictions on Argentine imports of military technology increased the interest of the military in domestic industrialization. With the military coup of 1943 the coalition of beef and industrialists that had ruled in the 30s started falling apart. What had been conceived as a reactive effort by the elites to

⁵⁰ Taylor and Williamson (1994) argue that two conditions led to these inter-generational transfers from the core to the New World: immigration and frontier expansion (Taylor and Williamson 1994; Taylor and National Bureau of Economic Research 2003).

⁵¹ The effect of price of capital on the differential marginal incentive to invest in two economies is $(MPK1 / MPK2) = (y1 / p1 k1) / (y2 / p2 k2)$, where p is the relative price of capital and k the capital per person. This is different from Lucas (1990) where prices do not enter the equation. See (Lucas 1990).

industrialize the country as a response to the external crisis eventually backfired: industrialization brought forth a class that would become highly influential in Argentine politics: organized labor (Escudé 1983; Escudé 1988). An opportunist member of the military regime that took over office in 1943 –a colonel named Juan Perón– was the first figure who made a clear attempt at incorporating this rising social actor into politics, in a coalition with urban capital.⁵²

Perón's support base changed over time. During his second term in office he represented two different regionally based coalitions: in central and urban areas his appeal was class-based and by 1954 Perón came to represent labor almost exclusively.⁵³ After his re-election in 1952 opposition to Perón came from the Catholic Church – probably a straw-man hand-picked by Perón to divert attention from excruciating economic hardship, a fraction of the armed forces, intellectuals, and university students. By the end of his term disparate groups of nationalist and capitalists –businessmen, bankers and landowners– joined the opposition rank. The *descamisados* was the only group that remained loyal to Perón till his fall in September 1955.⁵⁴

Perón's government from 1946 to 1955 seems like a “hard case” due to its reputation for nationalism, populism and anti-business discourse; but on closer inspection it seems to fit the theory about the link between labor support and foreign investment. Initially Perón's administration regulated foreign investment through a series of Central

⁵² In 1945, before being elected to the Presidency of Argentina, Peron made promises to business interests and wood labor. The losing side of the Union Democrática ticket received the support from an ideologically diverse spectrum ranging from landowners, stock-breeders and the upper classes close to Jose Tamborini –formerly Interior Minister of President Marcelo T. de Alvear- on the Right, to the Communist and Socialist parties in the political Left.

⁵³ In rural and peripheral areas Perón's party incorporated conservative leaders and his appeal was broader (*populist* in Mora y Araujo's words). See also Smith, Llorente, etc..

⁵⁴ To curb the imminent threat from disgruntled army officials, in a massive rally held on August 31, 1955 Perón publicly threatened to arm the *descamisados* in defense of his government.

Bank resolutions that restricted the amount of dividends that could be repatriated. But even before the turn of the decade the urban coalition of industrialists and workers that brought him to office showed signs of stress. Perón turned away from capital and to openly favor labor.⁵⁵ Perón reformed the foreign investment regime in 1952, reversing the wave of nationalization started by the previous military regime -of which Perón himself was a visible member

In 1948 an executive decree (3347/48) signed by Perón established a regulatory framework for foreign investment and created a government agency, the Comisión Nacional de Radicación de Industrias (CNRI), to oversee foreign investment initiatives. The regime, and consequently the agency, would promote selective location of foreign investment projects especially in the manufacturing sector. In 1951, Perón unveiled a new plan for the economy. One of the key elements of this plan was deepening import substitution and encouraging export promotion by courting foreign investors. By 1953 the government had already realized the importance of creating an environment conducive to better investment conditions that would boost economic performance (Altamir, Santamaría et al. 1967). For the first time in Argentine history the government adopted a comprehensive regime that would unambiguously regulate foreign investment in Argentina. The regime –established by Congress under Law 14,222– created a National Registry of Foreign Investment (Registro Nacional de Inversiones Extranjeras) and granted certain privileges –in the form of tax breaks and preferential access to foreign

⁵⁵ In 1955 the Confederation General Económica (CGE), an association of business created by Perón to counterbalance the influence of the Union Industrial Argentina (UIA), made a final attempt to bring the multiclass coalition back together by summoning a Productivity Congress. This came at a time when, according to Juan Carlos Torre, foreign exchange shortages affected domestic businesses that could no longer import supplies and raw materials to keep their factories running. Measures that business opposed: negotiation of oil contracts, the establishment of Kaiser in Cordoba, the change in domestic prices in favor of agriculture, application of anti-inflationary policies and the demands of international credit institutions. (Torre 1974).

exchange– to foreign investment projects that received government’s approval, but limited annual remittances to an 8 percent of the total investment in the country (Altamir, Santamaría et al. 1967, 371).

After his re-election in 1952 opposition to Perón came from the Catholic Church – probably a straw-man hand-picked by Perón to divert attention from excruciating economic hardship, a fraction of the armed forces, intellectuals, and university students. By the end of his term disparate groups of nationalist and capitalists –businessmen, bankers and landowners– joined the opposition rank. The *descamisados* was the only group that remained loyal to Perón till his fall in September 1955.⁵⁶ Together with the announcement of the new regime to promote foreign investment, Perón’s government placed higher controls on imports by domestic companies, and threatened to expropriate their equipment, machinery and inputs that the government deemed had not been imported for production. This rhetoric by a leader who had earlier nationalized public utilities and a reputation for lack of restraint made the prospect of investing in the country hardly appealing at all. Yet foreign investment position in the country remained stable, and by 1953 there was a net inflow of FDI, reversing the negative trend of disinvestment and expropriations that had characterized the previous two decades.

While since 1934 net flows of investment had been negative, following nationalization of railways, public utilities and services, by the early 1950s foreign investment inflows turned positive again, rising to US\$58 millions in 1953 (Altamir, Santamaría et al. 1967). (See Table 5). Note that the sharp decrease in foreign capital stock between 1945 and 1949 maps almost directly to the amounts paid by the Argentine

⁵⁶ To curb the imminent threat from disgruntled army officials, in a massive rally held on August 31 1955 Perón publicly threatened to arm the *descamisados* in defense of his government.

government for the formerly British owned railways, a solution that the British had been lobbying for since the early 1940s.⁵⁷ All other forms of investment in the country increased in the same period, which is puzzling to alternative explanations.

After Perón's fall Argentina's political arena became unstable with groups fighting for influence in the absence of any form of political intermediation. Over a quarter of a century of import substitution, economic groups had become more heterogeneous and so did their interests. An emerging industrialist class fought for political influence with the formerly insurmountable landed aristocracy. And they both had to face labor. But even within the industrialists a wedge started to open between big and small business. Coalitions became transient and policies changed as political leaders, authoritarian and democratic alike, search for support in their quest for survival.

In the 1955-1958 tenure of the *Revolución Libertadora* there was little prospect that the government would induce foreign investment. The government appointed Raul Prebisch as its main economic advisor. Prebisch elevated an economic program that would reduce trade deficit by promoting traditional exports. The currency was devalued and the multiple exchange rate system eliminated: the official rate went from \$5, \$7.5 and \$15 to \$18, and the market rate reached \$36. Trade barriers were reduced, and capital controls eliminated. The Central Bank was given independence. In 1956 the country joined the Bretton Woods institutions, and soon after that successfully renegotiated the country's foreign debt with the Western European economies. Trade liberalization had a

⁵⁷ In seizing foreign assets Perón made use of the expropriation provisions in the Argentine Constitution. In most cases he made sure that the settlement was equitable, and in many circumstances –such as railways, telephone and shipping interests– the outcome was overtly favorable to the previous owners of the expropriated assets. Expropriation of assets that belonged to German nationals after the late declaration of war with the Axis was an exception. These expropriations are probably better characterized as targets of opportunity.

negative impact on the manufacturing sector, which was not competitive by international standards.⁵⁸ Devaluation had an impact on domestic prices, affecting the real income of wage earners in particular. The program resulted in transfers that contrasted sharply to those under Perón: from the city to the countryside, and from labor to capital (Rapoport 2000, 541). The government removed union leaders from office and banned all forms of union activity. In September 1956 a series of strikes virtually brought economic activity to a standstill. Despite labor repression, the liberal outlook of the economic program, and the repeal of the restrictions to repatriate capital and dividends, the government of the *Revolución Libertadora* failed to attract foreign capital (Rapoport 2000, 544). Several of the policies adopted by the government of the *Revolución Libertadora* signal the regime's negative disposition towards foreign investors: not only did the government annul the oil contracts and stalled negotiations with oil producers initiated by Perón, but it also modified the investment statute issued by Peron in 1953. The new conditions established by a 1955 Central Bank resolution required that investment projects obtained government approval prior to starting their activity. Among the conditions for approval investors had to persuade the government that their project did not hurt domestic businesses; that they would establish in "convenient" locations; that the project was intended at reducing foreign exchange and increasing exports; and that the project was compatible with the developmental priorities set by the government. The vagueness of the faculties granted to

⁵⁸ One of the sectors where the impacts were starker was the auto industry: car imports doubled between 1955 and 1957, while the import of auto parts and chassis increased threefold and eightfold respectively (Rapoport 2000, 454).

the regulatory authority ultimately this led to a restricted inflow of investment capital: approximately US\$17 million for the period.⁵⁹

Arturo Frondizi, took office on May 1 1958; the proscription of the Peronist Party allowed the UCRI –Frondizi’s party– to control both houses of Congress. President Frondizi, who had been characterized as one of the most prominent nationalists in Argentine politics before taking office, was probably the most fervent opponents to Perón’s opening to foreign capital. The call for a congress to reform the Constitution in 1957 under the military government finally led to a split among the radical party along the lines of its main factions: the left-leaning group of the party led by Frondizi clashed with party leader Balbín’s stance towards the Revolución Libertadora. As much as this division was based on their different attitude towards the military regime, Balbín and Frondizi dissented on their view of Perón and his economic program. These differences became insurmountable with Frondizi’s about face⁶⁰: he recruited Frigerio, a businessman and editor of *Que* –an influential magazine used by Rogelio Frigerio to propagate his *desarrollista* (developmentalist) program. Frigerio was a key advisor to Frondizi in economic and labor issues a decisive figure in preparing the program to attract foreign investment, and liaison with the Peronist labor unions. Frondizi also joined forces with a

⁵⁹ In 1957, the auto manufacturer Kaiser Industries Corp launched production in Córdoba under conditions negotiated in the previous administration. A Cabinet crisis in March 1958, two months before inauguration of President elect Arturo Frondizi (elections were held in February 23, 1958), may reflect the government’s position regarding foreign investment: Julio Cesar Cueto Rua, Minister of Industry and Commerce in Aramburu’s Cabinet made public an initiative to allow foreign investment in the oil industry, which was forbidden by legislation of the time. The debate led to the resignation of the Minister of the Interior, Carlos Alconada Aramburu, and the Minister of Education, Acdeel Salas, both figures affiliated with Balbín’s UCR del Pueblo, which lost to Frondizi in the presidential elections.

⁶⁰ “Se dice que la política petrolera del presidente era todo lo contrario de lo que había sostenido el ciudadano Frondizi en su libro *Petróleo y Política*. Me complace recoger este cargo. No vacilo en reconocer que la doctrina de dicho libro no corresponde enteramente a la política practicada por mi gobierno.” (*It has been said that the policy for the oil sector of the President was the opposite to that which Frondizi upheld as a citizen in his book Oil and Politics. I am pleased to respond to this charge. I do not hesitate in acknowledging that the doctrine in the book does not exactly correspond to the one enacted by my government*), Arturo Frondizi, public address of February 15, 1962 (Clarín, February 16, 1962).

group of intellectuals from the left –including socialists, such as Merchensky and Strobino; Real and his communist followers; Jauretche and Scalabrini Ortiz, from FORJA; Odena and Prieto, formerly Peronists, among the most prominent ones– and a group of nationalists imbued in the catholic church’s values like Camilion and Musich (Rapoport 2000, 546). Frondizi and his followers left the party and founded the UCRI. The new party soon reversed policy position that had led Frondizi to oppose vehemently against Perón’s opening to foreign capital in 1952.

While exiled in Venezuela Perón asked his followers to support Frondizi’s bid for the Presidency; allegedly the two leaders signed a secret agreement that would grant Frondizi the votes of the core Peronist constituency, organized labor, in exchange for a package of measures related to labor market regulations, normalization of unions and several economic initiatives. Soon after his inauguration Frondizi began fulfilling his side of the deal: in August 8 1958 the Senate gave final approval to a law initiated by the President that regulate the activity of labor unions (Ley de Asociaciones Profesionales), which Frondizi soon signed. The new regime reinstated Peronist loyalists –who had been banned from participating in union elections by the military government of Aramburu and Lonardi– at the head of the CGT, restored the monopoly of representation to a single union per sector certified by the Ministry of Labor, and returned union assets and facilities seized in 1955 by the Revolución Libertadora. The union certified by the Labor Ministry would also control the compulsory union members’ dues collected by employers.

There is a link between Frondizi’s policy towards foreign investment and his quest to secure the support of labor. Campaigning for the Presidency in 1958 Frondizi

affirmed that the main hindrance to Argentina's development was the dependence on the export of agricultural products at a time when agriculture faced ever declining international prices (i.e.: a systematic decline in the country's terms of trade). The previous attempts at industrial development under ISI failed due to its emphasis on light industry, which put additional strain in the country's external balance. Hence, the *desarrollistas* would promote the development of basic sectors such as oil and energy, steel, chemical, machinery, mechanic, transportation and autos. They proposed a program that would deepen ISI with selective opening, especially towards foreign direct investment in these sectors. Business and conservative interests opposed Frondizi and his economic program. The success of the *desarrollista* program depended on the government's ability to channel investment towards priority sectors. Frondizi and his allies believed that there were two alternative ways of doing this: encourage the development and consolidation of domestic capital or promoting the inflow of foreign investment. The latter would be preferred over the former because it was deemed to have a less negative effect on income distribution and would expose the country to new technologies needed to break the development gap (Rapoport 2000).

Frondizi proposed a major overhaul of the country's foreign investment regime. The key legislation was the foreign investment act of 1958 (Ley 14,780 de inversiones extranjeras), which granted national treatment to foreign investors. This legislation was complemented by a series of regimes to promote industrial and regional development, an investment insurance scheme, tariff exemptions for the import of capital goods, and selective trade protection.⁶¹ However, investment licenses were granted by the Executive

⁶¹ See (ECLAC/UNCTAD 2002).

branch on selective basis, following the recommendation of the Advisory Commission on Foreign Investment created by executive decree in 1958 (Decreto 1594/58).

FDI increased dramatically in the first half of Frondizi's tenure; most of it flew into the manufacturing and concentrated in a handful of activities: chemical and petrochemical, autos and auto-parts, steel and machinery received 90% of the inflows (Azpiazu and United Nations. Economic Commission for Latin America and the Caribbean. 1995). Frondizi hoped that foreign investment would result in higher levels economic activity and employment that would help him draw support from the Peronists. Organized labor did not reciprocate the UCRI's effort to court workers; union cooperation soon dwindled and transformed into utter conflict. Frondizi was closely checked by the Armed Forces, and soon realized that under current political conditions he could only expect to secure support from the military, which would ultimately force him to revise his economic plan.

In mid-1959 the administration faced an economic crisis completely devoid of any form of popular support. Domestic businessmen did neither trust the President nor share his views; the Conservative Party, which began reorganizing at the national level, better represented them. Peronist union leaders fought back to regain control of the country's politics and felt betrayed by Frondizi who responding to pressure from the military kept the party outlawed, violating the pre-electoral agreement that brought Frondizi to the Presidency. Perón made public the 1958 agreement with Frondizi, and ordered union leaders to cease any form of collaboration with the government. By the time that Congress voted the removal of Cordoba governor Alfredo Zanichelli in June 1960 –under allegations that he was overprotective of terrorists in order to gain the support of Peronist

leaders— it was clear that the Frondizi administration was fully accountable to the military.

Frondizi was forced to resign in March 28, 1962. Jose Maria Guido became interim President and called for elections held in July 1963, in which the Peronists could not participate. Arturo Illia, representing the Union Cívica Radical del Pueblo (UCRP), who obtained 25 percent of the votes was elected in the Electoral College and inaugurated in October 12, 1963.⁶² Illia adopted a clearly anti-foreign investor stance: he annulled the oil contracts signed by Frondizi; adopted restrictive rules for licensing investors and imposed foreign currency controls. But policy was not the only determinant of the low levels of FDI inflows in the Illia administration. There were also economic conditions: the excess demand that had drawn FDI in under Frondizi had virtually disappeared when the subsidiaries of the MNCs had reached full production capacity. The position of the radical government matches that of the party's support base: white-collar middle class workers and professionals, who systematically appear to despise all things foreign in general, but foreign investment in particular. Why this group would hate foreign investment is a puzzle to this theory that is based on preferences rooted on material rather than ideological preferences of actors.

The *Onganiato* –military regime led by Onganía– appears to disprove the theory: a conservative regime supported by domestic capital that receives larger inflows than its democratic predecessor. On closer scrutiny, however, we find that the junta's erratic relationship with labor might have played a role in shaping the conditions offered to investors and in investors' behavior. Unions had played a major role in debilitating Illia,

⁶² In the 1963 election 22 percent of blank votes were cast in protest for the proscription of the formula Solano Lima-Berni, supported by Perón from the exile.

welcomed the military coup, and threw their support behind Onganía. The appointment of Adalbert Krieger Vasena to the Ministry of Finance in December 1966 deepened the rift between two groups within organized labor.⁶³ Eventually organized labor split in 1968 along the lines of this schism: one of these groups aligned behind Vandor, a neo-Peronist leader, head of the UOM (union of steel industry workers), who had political ambitions of his own⁶⁴; the other group formed the combative CGT de los Argentinos.⁶⁵ The Vandor group adopted a conciliatory approach towards Onganía and his economic policies. Krieger Vasena, adopted a series of economic measures to control inflation which included a sharp devaluation of the currency (the peso lost 40 percent of its value), reduction of public employment, abrogation of labor contract conditions agreed upon under collective bargaining, and salary and price freezes, though the former were left at their pre-crisis levels with prices were adjusted upwards before the freeze. Any form of protest was harshly repressed. After all this was the *economic time* that Revolución Argentina envisioned in its three-tiered program to bring Argentina back to normalcy; all sectoral demands should wait to their right timing. Once economic conditions improved, the *social time* would follow, while the *political time* should wait. Under Krieger Vasena macroeconomic conditions improved, and so did the investment climate. By 1968 the economy was operating at close to full capacity, and after a drastic fall in wages in the first two years, real salaries recovered. Catering to public sector contractors the

⁶³ In 1957 a group of sixty-two unions united into the so-called “62 organizaciones Peronistas” that would coordinate the political activity of those unions that remained loyal to Perón. The group broke up in 1966 into the “62 Organizaciones de pie junto a Perón” led by José Alonso on one side, and the “62 organizaciones leales a Perón” headed by Augusto Vandor.

⁶⁴ Augusto Vandor, leader of the UOM, was the most prominent representative of a group of Peronist unionists who decided to part ways with their leader in the exile, and took political initiative in their own hands following a strategy that came to be known as “Peronism without Perón.”

⁶⁵ The CGT formally split after its general congress elected Raimundo Ongaro as Secretary General in 1968. Ongaro became the head of the CGT de los Argentinos.

government adopted a massive public works. During Onganía's tenure FDI inflows are larger than those in the years under Illia (see table 6). The type of inflows received did not pose a big threat on labor, but were resisted by capital, domestic and foreign alike. The latter, whose projects financed by inflows that had taken place under Frondizi were already up and running, also wanted to keep competition out. Yet another economic crisis forced Onganía to revise his economic program. During this crisis the more combative group of organized labor, the CGT de los Argentinos headed by Raimundo Ongaro, took a more prominent political role. In May 1969 university students and workers converge in a massive protest in Cordoba, which was brutally repressed by the military. This protest, which came to be known as the *Cordobazo*, soon became an symbol of the combative fraction of the labor movement. Onganía is deposed in July 8 1970, amidst widespread violence; he was succeeded by Roberto M. Levingston. Levingston appointed Aldo Ferrer to the Ministry of Finance, and adopted a more nationalist economic policy. This administration made conditions for investing in Argentina more restrictive: foreign investors were encouraged to establish joint-ventures with domestic capital, could only buy non-voting shares in national companies, and had limited access to credit. In due course licenses were granted by executive decree, which determined the amounts and conditions for profit and capital repatriation. Prior to obtaining an investment license projects had to be approved by a government office. Levingston's tenure was short lived: in March 1971 he is replaced by another military leader, General Alejandro A. Lanusse who oversaw the transition to democracy.

The 1973-1976 Peronist government is a peculiar case. Perón could not participate in the March 11, 1973 presidential elections: Lanusse had set a residency

requirement for candidates, which Perón did not satisfy due to his 18 years in exile. After C ampora’s inauguration Per on returned to Argentina; political pressure mounted and ultimately forced C ampora to resign in June 1973. Raul Lastiri – President of the House of Representatives and C ampora’s son-in-law– became interim government and looked over the September 23, 1973 elections that the Per on-Per on formula won by a large margin. After Per on returned to power in 1973 he aimed at representing a broader political coalition than that he helped build in 1946, and even broader than the one that supported him at the time he was overthrown by the Revoluci n Libertadora. Per on appointed Jose Ber Gelbard, a businessman and chairperson of the CGE in Per on’s previous government, as his Minister of Finance. He forsook his ubiquitous anti-establishment, populist and nationalistic stance of the mid-1940s, and adopted a more conciliatory position aimed at consolidating a moderate form of welfare capitalism with larger union participation. The key instrument of the new economic policy was a broad social contract (Gran Paritaria Nacional) between government, business and labor.⁶⁶ The CGT and other Peronist leaders succeeded at removing from government the leftist factions that supported C ampora. But these groups failed to stay together after Per on’s death and the coalition collapsed from within, amidst escalating political violence in an

⁶⁶ The ambivalent position towards foreign investment adopted by Per on in 1973 is inscribed in his effort to appeal to labor and business. His discourse to the National Congress of the Peronist Party held in May 24, 1974 is more than eloquent: “... hay algunos que quieren expulsar a todas las compa n as que hasta ahora han sido multinacionales. Mientras tanto, en otro sector vecino se sostiene que no hacemos inversiones y que los extranjeros no invierten aqu . Entonces, pregunto:  a cu al de estos dos les hacemos caso? Creo que a ninguno de los dos, m axime que en lo que se refiere a esas compa n as extranjeras, nosotros tenemos el poder de decisi n. Vale decir, si ellas est n de acuerdo con las leyes que ya se han dictado, deben hacer lo que decimos nosotros. Para ello, no necesitamos expropiarlas ni echarlas del pa s, en virtud de que constituyen factores de desarrollo indispensables.” (*There are people who would like to drive multinational firms out of the country. But the neighboring sector that we should not expect foreigners to invest here if we ourselves are not willing to do it. Then, I ask myself, whom should we listen to? I think we should listen to none, especially regarding foreign companies, where we have the power to decide. That is, they should do what we tell them to do if they are willing to comply with domestic regulations. And because they are essential to our development, we need not expropriate their assets or to force them out of the country*).

institutional environment characterized by a lack of political leadership. See (Godio 1981; Di Tella 1983; Ranis 1994).

In only one year under Cámpora and Perón wages had recovered and industrial employment grew by 10 percent (Ranis 1994, 34). Under the Isabel Perón government the social pact agreed upon under Perón fell apart: unions became more militant as a reaction the government's determination to contain inflation at the expense of wages. The government devalued the currency in June 1975, leading to a sharp outburst of inflation: the consumer price index rose by a staggering 350 percent in 1975. Soon after that the government announced that collective bargaining –which was to resume by mid-1975 under the social pact agreed upon under Perón– was suspended until further notice. On July 7 and 8, 1975 the CGT called a general strike, the first one against a Peronist government:

“For the first time in over thirty years of Peronist history, labor was pitted against Peronist political leadership” (Ranis 1994, 35).

In 1973 Congress passed a restrictive foreign investment regime and adopted measures that discriminated against firms where foreign investors had a controlling interest (above 50 percent of the shares) limiting their access to industrial promotion regimes; FDI falls slightly in 1974 and remains low throughout the period. This result can be attributed to the change in policy, as much as it is a consequence of the strategies adopted by MNCs to respond to the uncertainty created by the oil crisis, and on a domestic environment characterized by political and economic instability.⁶⁷ The

⁶⁷ Cámpora and Perón's presidencies were short lived. Cámpora's support came from the left-wing base in the Peronist party, formed mostly by intellectuals and university activists who had turned militant and belligerent while fighting the repression of the previous military regime. But as soon as Perón placed foot on Argentine soil Cámpora was forced to step down. Perón proved ready to distance himself from the left

restrictions imposed on foreign investment towards foreign investors is probably also the result of a nationalist reaction against MNCs who had become a major player in manufacturing at the expense of domestic business, and did not hesitate in taking advantage of their market power.

Under the guidance of a Chicago trained group of economists and lawyers led by the Minister of Finance Jose Alfredo Martinez de Hoz. Martinez de Hoz had extensive links with Argentina's business elite: he was a member of a wealthy landowning family, and had been active in business and government positions. The economic program of the military government aimed at controlling inflation, and restructuring the Argentine economy in favor of the most internationally competitive business groups.⁶⁸ For that purpose the government reformed the financial sector, reduced tariffs to trade and eliminated subsidies. They did not, however, privatize public utilities or state owned enterprises, which became an important political resource to keep domestic business content. The program had a drastic effect in the manufacturing sector reducing output and employment; the adoption of this program was possible due to overt repression of labor and any other groups that might have otherwise opposed. To ease balance of payments constraints the government relied heavily on foreign borrowing. (Haslam 2002, 109-122).

and tried to put together the old urban coalition. He raised taxes on exports and tariffs on imports; raise wages and increased employment especially public sector employment. These policies and increased government intervention in the economy distorted prices and created once again a strong incentive towards consumption at the expense of savings and investment (Taylor 1996). After Perón's death, the administration led by his wife Isabel shifted policies and demanded more sacrifices from labor (wage controls were reinstated), while courting capital. See (Monteon 1987). Yet, Isabel Perón could hardly control the government: his right-wing lieutenant Jose Lopez Rega, who was appointed to the Ministry of Welfare, was the one in charge. The year and a half under Isabel was a period characterized by economic chaos, political and social unrest resulting in high level of labor conflict and all-out violence between the left and right wings of the Peronist party.

⁶⁸ One of the key elements in the price strategy was restricting money supply, liberalizing trade, and adjusting wages below inflation levels. Between 1976-1978 export taxes are cut: taxes on wheat fall from 64 percent to 13 percent; those on meat exports fall from 36% to 22% (Krueger 1992, 94). Import tariffs in manufacturing fall 40 percentage points on average (from 90% to 50%). (Kosacoff 1994, 7).

At first glance the investment regime adopted in 1976 looks liberal and permissive. However, the government relied little in foreign direct investment and made sure it remained low.⁶⁹ On the contrary, the program led to the departure of several of the most emblematic MNCs of the ISI era: General Motors, Citroen, Fiat and Renault are a few of the most prominent cases. The decision to leave the country made economic sense: trade liberalization made it easier to supply the Argentine market from abroad. Additionally, though foreign investors were not discriminated against on paper, they were in practice: the main beneficiaries of the investment promotion regimes were domestic business groups (Azpiazu and Basualdo 1989). The foreign investment regime also forced MNCs to associate with domestic firms.

The military left Alfonsín an overwhelming legacy: the country was in deep recession, inflation was rampant –over 400 percent–, unemployment was rising, the Central Bank had no reserves left in its coffers, and the external accounted for 70 percent of the domestic product and five times the amount of the country’s exports (Rapoport 2000, 905). The government faced the threat of capital flight and had to steer a heavily indebted Argentine economy through the rough years of the debt crisis with limited domestic support: the UCR administration did not have control over Congress, and periodically clashed with the organizations representing labor –discussed earlier- and capital in agriculture and manufacturing alike. Political conflict and erratic economic policies helped worsen economic conditions, and had a negative impact on overall FDI

⁶⁹ The final version of the foreign investment statute (Ley de Inversiones Extranjeras 21,382) passed by the Military Junta in 1976, was more restrictive the original version prepared by the Ministry of Finance under the supervision of Minister Jose Alfredo Martinez de Hoz. In practice a government agency had the discretionary right to approve which projects would be admitted and granted preferential treatment. Hardly any of the foreign investment projects approved under this regime received investment promotion benefits.

flows.⁷⁰ Alfonsín's government did not change the investment regime setup by the military, but through Central Bank regulations used the prerogative to restrict repatriation of dividends. Despite the negative outlook of the economy and political instability and conflict, inflows of FDI reversed the negative trend of the previous three years and in 1995 were already larger than those of the 1981 (the highest level under the military regime). FDI falls in 1986 and 1987, to regain momentum in 1988 and 1989 mostly inscribed under debt swap schemes devised to reduce the public sector's exposure to rising international interest rates (Azpiazu and United Nations. Economic Commission for Latin America and the Caribbean. 1995).

The government systematically clashed with labor unions, which was playing out the political strategy of the Peronist Party to regain control of the executive, and with the agricultural lobby, which resented the preferential treatment that was given to manufacturing. Devoid of political support from other interest groups, the Alfonsín government leaned towards a grouping of industrialists and government contractors, which was known as the Grupo Maria. This group demanded protection for the domestic market in general and manufacturing in particular, and favored the expansion of government activities that would grant them access to government contracts. The adoption of policies catering towards this group may also explain why the level of inflows under Alfonsín was slightly higher, but overall close to the level received under the military once we control for international trends and domestic conditions.

The Menem administration was responsible for the major transformation that the Argentine economy experienced in the 1990s. Pressed by hyperinflation and a collapsed

⁷⁰ The Alfonsín administration failed systematically in its attempts to pass legislation that would authorize several investment projects by foreign manufacturing firms. The most prominent of these initiatives was one by Honda which had plans to build an assembly factory in Cordoba.

public sector Menem had to take immediate action to reform Argentina's economy. Menem's early reform package aimed at reining in inflation, for which purpose it put special emphasis on reforming the state through retrenchment and balancing government accounts, privatizing inefficient state enterprises and utilities, reducing subsidies to businesses and linking wage increases to productivity. The State Reform Law and the Law of Economic Emergency were the key pieces of legislation that enabled Menem to implement his reform plan. Another important tool was the Convertibility Law of March 1991, which instituted the currency board that would peg the national currency to the dollar for over a decade. As a whole reform was multidimensional; Menem was undeniably clever at keeping together a broad coalition of diverse interests that would make reform possible.

According to received wisdom market reform was possible due to the relative autonomy of the executive vis-à-vis interest groups. This autonomy allowed Menem to unilaterally put in practice an orthodox economic plan that would have been impossible under his politically weak predecessor, beholden to the Peronist majority in Congress, to the pressure of labor and business interests, and the demands of the military. (Smith and Acuña 1994). An alternative explanation states that reform resulted from the pressure exerted by the most highly concentrated and internationalized part of the capitalist class (Azpiazu and Nochteff 1994; Margheritis 1999). Yet again an alternative explanation that challenges these two views seems more plausible: Support for economic reform resulted from a series of formal and informal bargains by a broad coalition of interests groups that were anchored in the old ISI model. Among those interests these explanations pinpoint to labor and business in manufacturing (Etchemendy 2001). As in Japan those who received

compensation were not necessarily the more competitive sectors but the politically stronger actors (Beason and Weinstein 1996). Menem was able to pick the pieces of the puzzle that better allowed him to secure political support. See (Gibson 1997; Murillo 1997; Schamis 1999; Etchemendy 2001).

Menem and Alfonsín shared a view of what a viable economic program demanded: macroeconomic stability, including price stability, fiscal balance and debt rescheduling; export orientation and exchange rate stability, and higher savings and investment rates to increase output. While most of Alfonsín's attempts failed, political alignment of labor with Menem played a major role in making some of those changes possible. In times of Alfonsín organized labor opposed; under Menem they had no chance but to acquiesce: domestic and international conditions had changed significantly.

Moreover, Menem is usually depicted as having established a liberal foreign investment regime in 1991. Yet there were no major changes in the investment regime that had been passed by the military in 1976. His major point of departure was closing the National Registry of Foreign Investment in 1993, hence abolishing the licensing requirement to conduct business in Argentina, and eliminating the tax on "excessive profits" regulated under the previous regime. This regime granted investors the right to remit dividends and repatriate the principal without restrictions.⁷¹ Earlier legal instruments used by the Menem administration to reform the public sector, such as the Reform of the State Act and the Economic Emergency Act of 1989 had provisions

⁷¹ An administrative decree issued by the Menem administration in 1993 (Decreto Reglamentario 1,853/93) ordered the text of the 1976 investment law. The main amendment introduced by this decree was the elimination of the licensing process prior to entry, i.e.: they would be on similar grounds to their domestic counterparts. However, many activities still require a license/government approval. Investors were also granted exemptions on import tariffs and value added taxes for the import of capital goods and turnkey plans.

regarding the participation of foreign investors in the privatization process. Foreign firms associated with banks and domestic capital participated extensively in the privatization process.

While most incentives to foreign investors were granted were at the sectoral level (the auto industry is the most prominent example), the Menem administration did not open all sectors to foreign investors; in fact, several policies tended to protect entrenched domestic business interests at the expense of international capital: the most notable examples are the oil (especially in the earlier years of his administration) and steel industries, among other sectors.

The sectoral pattern of protection and investment promotion observed in Argentina seems to replicate the economy's pattern of factor mobility. Factor mobility, the ease that factors find in moving to a different use in the economy, may affect the pattern of adjustment to increasing exposure to trade. When sectoral mobility is limited, the effect of rising imports will be felt at the industry level. Similarly, when there are such costs associated with moving to a different industry –in the form of specific assets, training and qualifications– we may also expect that the inflow of investment capital, for instance, will primarily affect the return to factors in that industry, increasing the return to labor but hurting capital. However, those effects will also be felt by capital in other sectors of the economy as well. An inflow of capital may release capital from the industry, or compete for labor from other sectors. Restrictions to mobility usually lead labor and capital in the sector to organize and become politically vocal.

In the auto industry, for example, union leaders lobbied the government into promoting foreign investment into the sector, and tried to lure foreign investors in by

offering them a better labor contract to the one they would grant to the domestic firms operating in the sector under the license of foreign producers. Unions and representatives of foreign businesses called in the government to sign sectoral agreements that included provisions on wages, training, employment, strikes, automobile taxes and tariffs, and so forth (Catalano and Novick 1998; Tuman and Morris 1998).

This is compatible with Etchemendy's findings that that event though unions had been key in shaping the form that reform took, not all unions got their preferred policies. Unions were a central constituency in the coalition that supported Menem's reformist program. Organized labor pressed for initiatives that would shield them from some of the negative effects of the structural reform program adopted. In many policy dimensions unions got their way. But in many other instances it was strong business that received the benefits, and labor was duly compensated.

Wrapping up, in both circumstances, under Menem and under Perón, scholars and pundits alike tend to conclude that in courting foreign capital these leaders betrayed labor, trumped their followers or simply bought off their leaders. See Fuchs (1981), (Monteon 1987; Murillo 2001). Yet both Menem and Perón retained a substantial level of support from workers, especially those in the industries where investment flowed in, and counted the unions as one of their most important political organizations.⁷² Moreover, under the foreign investment regime established by the military in 1976 led to lower levels of FDI inflows, and encouraged MNCs to leave the country. The evidence, hence,

⁷² "The Menem multiclass appeal rests easily within the ideological framework of the early and mature Peronism, each obeying the pragmatic dictates of the time. But the Menem coalition is broader even than the Perón coalitions of 1945 and 1973, subsuming as it does almost every societal sector and interest. In 1945, Perón initiated an anti-oligarchic, national sectoral alliance, in 1973 an anti-military, multiclass alliance. In the 1990s Menem has mounted another multiclass alliance against public and private bureaucracies and a corporate-protectionist economy." (Ranis 1994, xii).

seems to support an alternative explanation, one where attaining labor support and courting foreign investors are congruent. In fact, one of the main challenges of the CGT leadership was to understand the liberal-democratic disposition of the Argentine working class, which an intuitive Menem was apt at capturing (Ranis 1994, xxi).⁷³ The causal link becomes apparent at the micro level, where most explanations have failed to look.

CONCLUSION:

In this paper I explore the link between domestic politics and foreign direct investment flows. I argued that FDI flows are larger when labor is more influential, and smaller when capital owners are. Simple assumptions about actors' preferences that parallel those in the trade-theoretic literature allow me to derive the conditions under which labor will take a position that is pro-foreign capital, while domestic capital would oppose.

In the empirical section of the paper I try to assess whether the conditions described in the model are plausible. I conduct a series of simple statistical tests on the hypothesis that in Argentina those administrations that cater to labor are more likely to attract higher levels of FDI, finding preliminary evidence that supports the core hypothesis.

The findings in the sample of the past three decades of Argentina's history are consistent with the predictions derived from proposition 2 in the formal model, namely that pro-labor/Peronist governments attract more FDI. These results cannot be taken as conclusive evidence. The theory is about preferences of domestic actors derived from their position in the economy and policy outcomes that are assumed rather than tested. I use measures of variables that are but poor proxies that do not fully map onto the main

⁷³ "What has not been significantly emphasized, however, is that the Argentine working class... has been predisposed to many of the Menem initiatives, certainly since the onset of democracy, and they have clearly committed to a democratic capitalist culture, even though their union leaders were at first much more ambivalent." (Ranis 1994, x).

concepts in the theory, while several of the relevant political and economic variables are only measured indirectly. However, the fact that they capture a direct relationship between partisan orientation of government and foreign investment using aggregate data, where the ratio of signal to noise is likely to be low, and a coarse measure of the main explanatory variable is quite noteworthy.

Caveats notwithstanding, the results presented suggest that the theory advanced in this paper is plausible. To the extent that they are partisan governments need not be institutionally constrained to attract foreign direct investment. This solution brings forth the ‘mutual exchange of hostages’ analogy. Investment will be secure when government’s attempts to target investors hurt domestic actors that the government cannot afford to ignore; i.e.: when investors can take a pivotal domestic actor hostage. Preferential treatment to foreign investors is a ransom that political leaders are usually willing to pay to prevent pivotal domestic actors from being harmed. What kind of hostages do investors take? It is likely that they will choose those actors that have motive and opportunity to affect government behavior. They must be influential, and they must potentially benefit from FDI inflows. To the extent that domestic and foreign capital are substitutes, labor interests become congruent to those of foreign capital.

The results from the statistical tests seemed to be supported by anecdotal evidence from postwar Argentina. The theory helps explain Perón’s changing behavior towards foreign investment precisely at a time when he seemingly moves away from domestic capital while still capturing the overwhelming support of labor. Inflows of FDI in the last stretch of his government reversed a trend of FDI outflows that had been the rule in the

previous years. It is precisely the link between Peronist administrations and organized labor what helps explain these changes.

The relevant counterfactual here is what would have happened had capital been more influential. The closest example to this counterfactual is, probably, South Korea, which I explore elsewhere. Facing similar external constraints to those of Argentina under Perón, in the form of balance-of-payment problems, in South Korea where labor was repressed and politics dominated by a ruling coalition centered around domestic capital interests, policy towards foreign investment was restrictive. The outcome was hardly any foreign investment at all, especially when compared to other Asian NIEs (Haggard and Harvard University. Center for International Affairs. 1990). More recently, South Korea started to open up to foreign investment, especially after the exchange rate crisis of 1997. See Yun (2003). It is likely that democratization and the collapse of the *chaebols* opened the door to this liberalization.

Table 1: Argentina FDI Net Inflows (US\$ million)**Table 1.1. Pro-Labor vs. Other**

Group	Obs	Mean	Std. Err.	95% Conf. Interval	
Combined	33	2755.38	839.13	1046.13 4464.63	
Peronist	14	4934.29	1660.71	1346.54 8522.03	
Other	19	1149.87	607.42	-126.26 2426.01	
Difference		3784.41	1585.48	550.81 7018.01	
Degrees of freedom: 31		t = 2.3869			
H ₀ : Mean FDI Net _(Peronist) – Mean FDI Net _(Other) = Difference = 0					
H _a : Difference ≠ 0		P > t =	0.02		
H _a : Difference > 0		P > t =	0.01		
H _a : Difference < 0		P < t =	0.99		

Table 1.2. Democracy vs. Autocracy

Group	Obs	Mean	Std. Err.	95% Conf. Interval	
Combined	33	2755.38	839.13	1046.13 4464.63	
Military	11	278.08	74.46	112.17 444.00	
Democracy	22	3994.03	1178.54	1543.12 6444.95	
Difference		-3715.95	1680.90	-7144.16 -287.74	
Degrees of freedom: 31		t = 2.2107			
H ₀ : Mean FDI Net _(Military) – Mean FDI Net _(Democracy) = Difference = 0					
H _a : Difference ≠ 0		P > t =	0.03		
H _a : Difference > 0		P > t =	0.98		
H _a : Difference < 0		P < t =	0.02		

Table 1.3. Menem vs. Other

Group	Obs	Mean	Std. Err.	95% Conf. Interval	
Combined	33	2755.38	839.13	1046.13 4464.63	
Menem	10	6813.12	2049.41	2177.03 11449.21	
Other	23	991.15	505.55	-57.30 2039.59	
Difference		5821.97	1532.35	2696.72 8947.22	
Degrees of freedom: 31		t = 3.7994			
H ₀ : Mean FDI Net _(Menem) – Mean FDI Net _(Other) = Difference = 0					
H _a : Difference ≠ 0		P > t =	0.00		
H _a : Difference > 0		P > t =	0.00		
H _a : Difference < 0		P < t =	1.00		

Table 2: Argentina Ln FDI Net Inflows⁷⁴

Table 1.4. Pro-Labor vs. Other

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	32	6.64	0.32	5.99 7.30
Peronist	14	7.40	0.57	6.18 8.62
Other	18	6.06	0.31	5.41 6.70
Difference		1.34	0.61	0.10 2.58

Degrees of freedom: 30 $t = 2.2123$
 H_0 : Mean Ln FDI Net_(Peronist) – Mean Ln FDI Net_(Other) = Difference = 0
 H_a : Difference $\neq 0$ $P > |t| = 0.03$
 H_a : Difference > 0 $P > t = 0.02$
 H_a : Difference < 0 $P < t = 0.98$

Table 1.5. Democracy vs. Autocracy

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	32	6.64	0.32	5.99 7.30
Military	11	5.35	0.23	4.84 5.85
Democracy	21	7.32	0.40	6.49 8.16
Difference		-1.98	0.58	-3.16 -0.79

Degrees of freedom: 30 $t = -3.3990$
 H_0 : Mean Ln FDI Net_(Military) – Mean Ln FDI Net_(Democracy) = Difference = 0
 H_a : Difference $\neq 0$ $P > |t| = 0.00$
 H_a : Difference > 0 $P > t = 1.00$
 H_a : Difference < 0 $P < t = 0.00$

Table 1.6. Menem vs. Other

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	32	6.64	0.32	5.99 7.30
Menem	10	8.54	0.24	8.01 9.08
Other	22	5.78	0.31	5.14 6.42
Difference		2.76	0.49	1.77 3.76

Degrees of freedom: 30 $t = 5.6737$
 H_0 : Mean Ln FDI Net_(Menem) – Mean Ln FDI Net_(Other) = Difference = 0
 H_a : Difference $\neq 0$ $P > |t| = 0.00$
 H_a : Difference > 0 $P > t = 0.00$
 H_a : Difference < 0 $P < t = 1.00$

⁷⁴ One missing observation due to negative net inflows in 1987.

Table 2: Argentina FDI/GDP (%)**Table 2.1. Pro-Labor vs. Other**

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	33	1.25	0.28	0.67 1.82
Peronist	14	1.93	0.56	0.71 3.14
Other	19	0.75	0.21	0.31 1.18
Difference		1.18	0.54	0.08 2.28

Degrees of freedom: 31 $t = 2.1909$

H_0 : Mean FDI/GDP_(Peronist) – Mean FDI/GDP_(Other) = Difference = 0

H_a : Difference $\neq 0$ $P > |t| = 0.04$

H_a : Difference > 0 $P > t = 0.02$

H_a : Difference < 0 $P < t = 0.98$

Table 2.2. Military vs. Democracy

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	33	1.25	0.28	0.67 1.82
Military	11	0.43	0.09	0.24 0.62
Democracy	22	1.65	0.39	0.83 2.47
Difference		-1.23	0.57	-2.38 -0.07

Degrees of freedom: 31 $t = -2.1688$

H_0 : Mean FDI/GDP_(Military) – Mean FDI/GDP_(Democracy) = Difference = 0

H_a : Difference $\neq 0$ $P > |t| = 0.04$

H_a : Difference > 0 $P > t = 0.98$

H_a : Difference < 0 $P < t = 0.02$

Table 2.3. Menem vs. Non-Peronist

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	33	1.25	0.28	0.67 1.82
Menem	10	2.59	0.68	1.04 4.13
Other	23	0.66	0.18	0.30 1.03
Difference		1.92	0.52	0.87 2.98

Degrees of freedom: 31 $t = 3.7199$

H_0 : Mean FDI/GDP_(Menem) – Mean FDI/GDP_(Other) = Difference = 0

H_a : Difference $\neq 0$ $P > |t| = 0.00$

H_a : Difference > 0 $P > t = 0.00$

H_a : Difference < 0 $P < t = 1.00$

Table 3: Argentina FDI World Ratio (%)**Table 3.1. Pro-Labor vs. Other**

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	33	0.93	0.11	0.70 1.15
Peronist	14	1.23	0.21	0.77 1.69
Other	19	0.71	0.09	0.52 0.89
Difference		0.52	0.21	0.10 0.95

Degrees of freedom: 31

t = 2.5020

H₀: Mean FDI/World FDI_(Perón) – Mean FDI/World FDI_(Other) = Difference = 0H_a: Difference ≠ 0 P > |t| = 0.02H_a: Difference > 0 P > t = 0.01H_a: Difference < 0 P < t = 0.99**Table 3.2. Democracy vs. Autocracy**

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	33	0.93	0.11	0.70 1.15
Democracy	22	1.02	0.16	0.69 1.34
Autocracy	11	0.75	0.10	0.52 0.98
Difference		0.27	0.24	0.21 0.75

Degrees of freedom: 31

t = 1.1321

H₀: Mean FDI/World FDI_(Democracy) – Mean FDI/World FDI_(Autocracy) = Difference = 0H_a: Difference ≠ 0 P > |t| = 0.27H_a: Difference > 0 P > t = 0.13H_a: Difference < 0 P < t = 0.87**Table 3.3. Menem vs. Other**

Group	Obs	Mean	Std. Err.	95% Conf. Interval
Combined	33	0.93	0.11	0.70 1.15
Menem	10	1.63	0.17	1.26 2.00
Other	23	0.62	0.08	0.45 0.79
Difference		1.01	0.17	0.67 1.35

Degrees of freedom: 31

t = 6.0686

H₀: Mean FDI/World FDI_(Menem) – Mean FDI/World FDI_(Other) = Difference = 0H_a: Difference ≠ 0 P > |t| = 0.00H_a: Difference > 0 P > t = 0.00H_a: Difference < 0 P < t = 1.00

Table 4: Argentina OLS Results

Dependent Variable FDI/GDP (Difference)	Model 1	Model 2	Model 3	Model 4	Model 5
Constant	0.166 (0.340)	0.401* (0.220)	0.363 (0.230)	0.375 (0.235)	0.377 (0.240)
FDI/GDP_{t-1}	-0.455*** (0.141)	-1.262*** (0.165)	-1.293*** (0.173)	-1.304*** (0.177)	-1.306*** (0.181)
World FDI Outflows (US\$ Billions) (Difference)		0.016*** (0.003)	0.016*** (0.003)	0.016*** (0.003)	0.016*** (0.003)
GDP per Worker (US\$ 1,000) (Difference)		-0.112 (0.112)	-0.127 (0.127)	-0.111 (0.131)	-0.108 (0.135)
Trade/GDP (%) (Difference)		0.037 (0.068)	0.091 (0.091)	0.102 (0.094)	0.104 (0.097)
Savings/GDP (%) (Difference)			-0.116 (0.125)	-0.135 (0.131)	-0.127 (0.138)
Govt. Consumption/GDP (%) (Difference)			-0.016 (0.091)	-0.008 (0.093)	0.002 (0.105)
Pro-labor	0.965** (0.459)	0.935*** (0.312)	0.930*** (0.325)	0.950*** (0.332)	0.968** (0.348)
Political Constraints (Difference)				-0.932 (1.570)	-0.551 (2.272)
Pro-Labor x Pol. Constraints					-0.810 (3.417)
N	32	30	30	30	30
R²	0.3177	0.7488	0.7582	0.7622	0.7629
Adj R²	0.2707	0.6965	0.6813	0.6716	0.6562
Durbin-Watson d-statistic	2.056	2.086	1.984	1.991	2.017
Z(t) (DF unit root test of residuals)	-5.542	-4.943	-5.153	-5.175	-5.246
MacKinnon approximate p-value	0.000	0.000	0.000	0.000	0.000

Standard error in parentheses; Significance levels: * p < .10; ** p < .05; *** p < .01

**Table 5: Foreign Capital Stock and Flows
Argentina (1923-1955)**

Year	Foreign Capital (US\$ Million)	
	Stocks	Flows
1923	3,088	48
1927	3,474	386
1931	3,661	187
1934	3,485	-76
1940	3,164	-321
1945	2,651	-513
1949	1,255	-1,396
1953	1,487	232
1955	1,537	50

Source: (Altamir, Santamaria et al. 1967)

**Table 6: Foreign Direct Investment Flows
Argentina (1966-1973)**

Year	FDI Inflows (1970 US\$ Million)
1966	2.8
1967	14.4
1968	33.8
1969	61.3
1970	9.8
1971	9.5
1972	8.3
1973	14.0

Source: (Rapoport 2000)

Table 7: Union Density 1985, 1995

	Union membership as a percentage of:			
	Non-agricultural labour force		Wage and salary earners	
	1985	1995	1985	1995
Argentina	48.7	25.4	67.4	38.7
Bolivia	-	16.4	-	-
Brazil	-	32.1	-	43.5
Chile	11.6	15.9	-	-
Colombia	11.2	7.0	-	-
Costa Rica	22.9	13.1	29.1	16.6
Dominican Rep.	18.9	17.3	-	-
Ecuador	-	9.8	-	-
Paraguay	-	9.3	-	-
Peru	-	7.5	-	-
Canada	31.2	31.0	36.7	37.4
Mexico	54.1	31.0	59.6	42.8
United States	15.0	12.7	18.0	14.2
Uruguay	19.9	11.6	-	-
Venezuela	25.9	14.9	29.8	17.1
Americas (Average)	23.0	15.9	39.7	35.4
Asia (Average)	22.0	16.6	27.7	19.5
Africa (Average)	24.2	14.0	30.2	32.8
Europe (Average)	53.4	41.3	58.1	47.0

Source: (International Labour Office 1997)

Table 8: Union Density 1995

Country	Union membership as a percentage of formal sector wage earners (1995)
Argentina	65.6
Bolivia	59.7
Brazil	66.0
Chile	33.0
Colombia	17.0
Costa Rica	27.3
Ecuador	22.4
Paraguay	50.1
Peru	18.3
Mexico	72.9
Uruguay	20.2
Venezuela	32.6

Source: (International Labour Office 1997)

Table 9: Argentina FDI Inflows by Sector (1992-2002)

Sector	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002¹
Oil and Gas	1,222	277	502	436	1,046	105	1,313	17,830	2,689	796	1,177
Mining (except Oil and Gas)	4	-6	17	140	682	72	11	15	48	103	48
Manufacturing	634	858	1,798	2,186	2,776	3,308	1,147	1,950	1,487	49	596
Food, beverages & tobacco	384	338	1,014	793	405	360	256	1,192	476	6	-45
Textiles & leather	--	39	-18	80	15	36	-5	-49	-12	-37	-5
Paper	-102	27	31	119	375	335	89	15	91	-195	29
Chemical, plastic & rubber	217	350	325	792	937	770	232	762	695	395	177
Cement & ceramics	33	47	26	33	20	51	306	0	-25	-35	-31
Metal & manuf. metal	-120	26	245	-31	86	569	96	-18	74	-20	784
Machinery & equipment	-152	-32	60	8	165	106	111	360	-64	-47	-165
Auto & Transp. equipment	373	64	116	392	774	1,082	65	-313	253	-17	-147
Utilities (Elec., Gas & Water)	2,119	1,116	124	1,111	681	1,527	932	951	446	197	-57
Trade and Services	82	42	339	318	523	150	699	742	51	662	-427
Transportation and Comm.	36	-19	245	634	145	845	260	714	3,870	167	-715
Banking	191	418	160	512	747	2,366	1,757	746	382	235	163
Other	143	106	452	272	350	788	1,173	1,038	1,445	-42	-9
Total	4,432	2,793	3,637	5,610	6,951	9,161	7,292	23,986	10,418	2,166	775

¹ Provisional results

Source: Dirección Nacional de Cuentas Internacionales, Ministerio de Economía y Producción, Republica Argentina.

http://www.mecon.gov.ar/cuentas/internacionales/documentos/ied_arg_activ_econ.xls

Figure 1: FDI/GDP in Argentina (1970-2002)

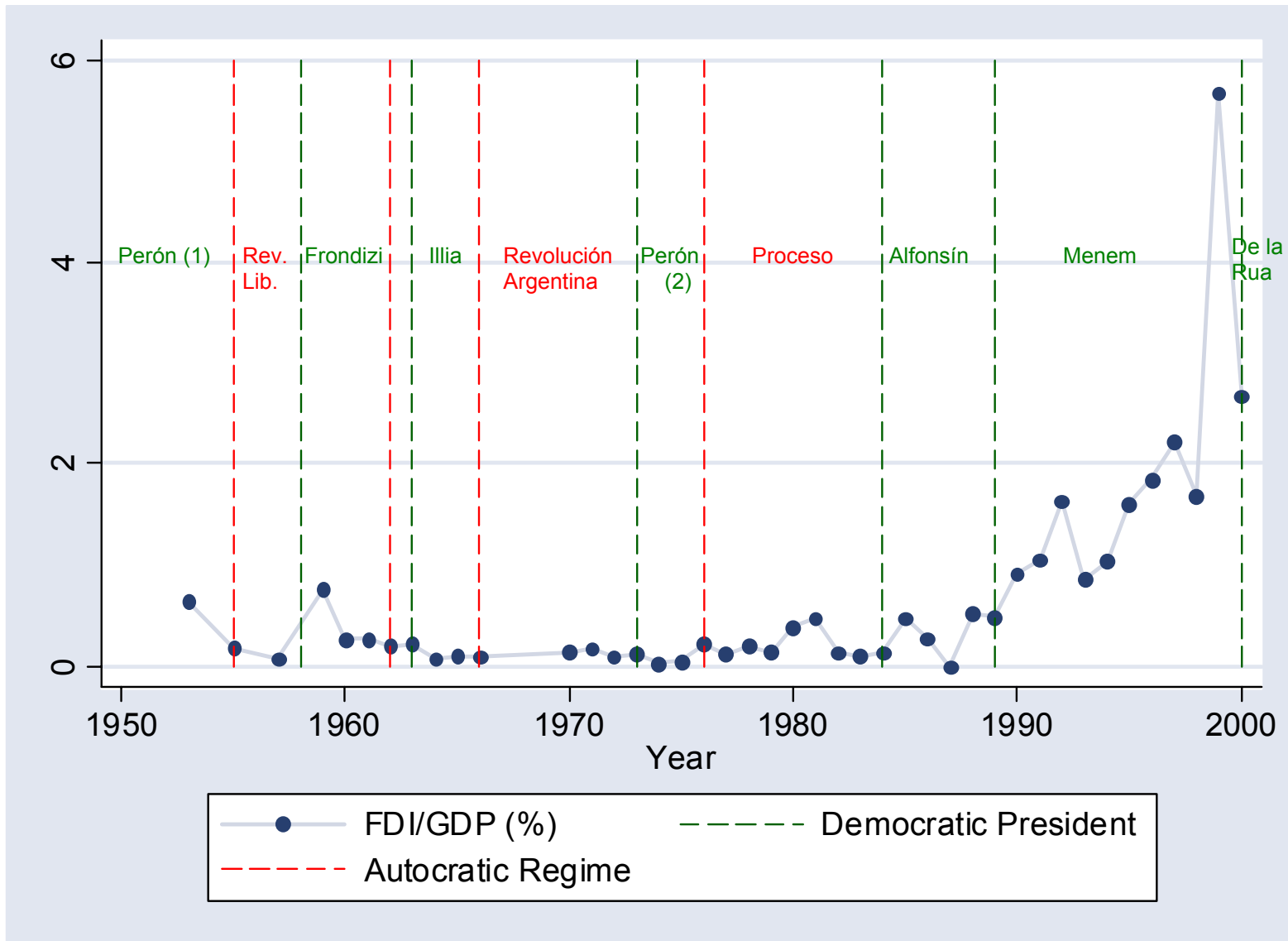
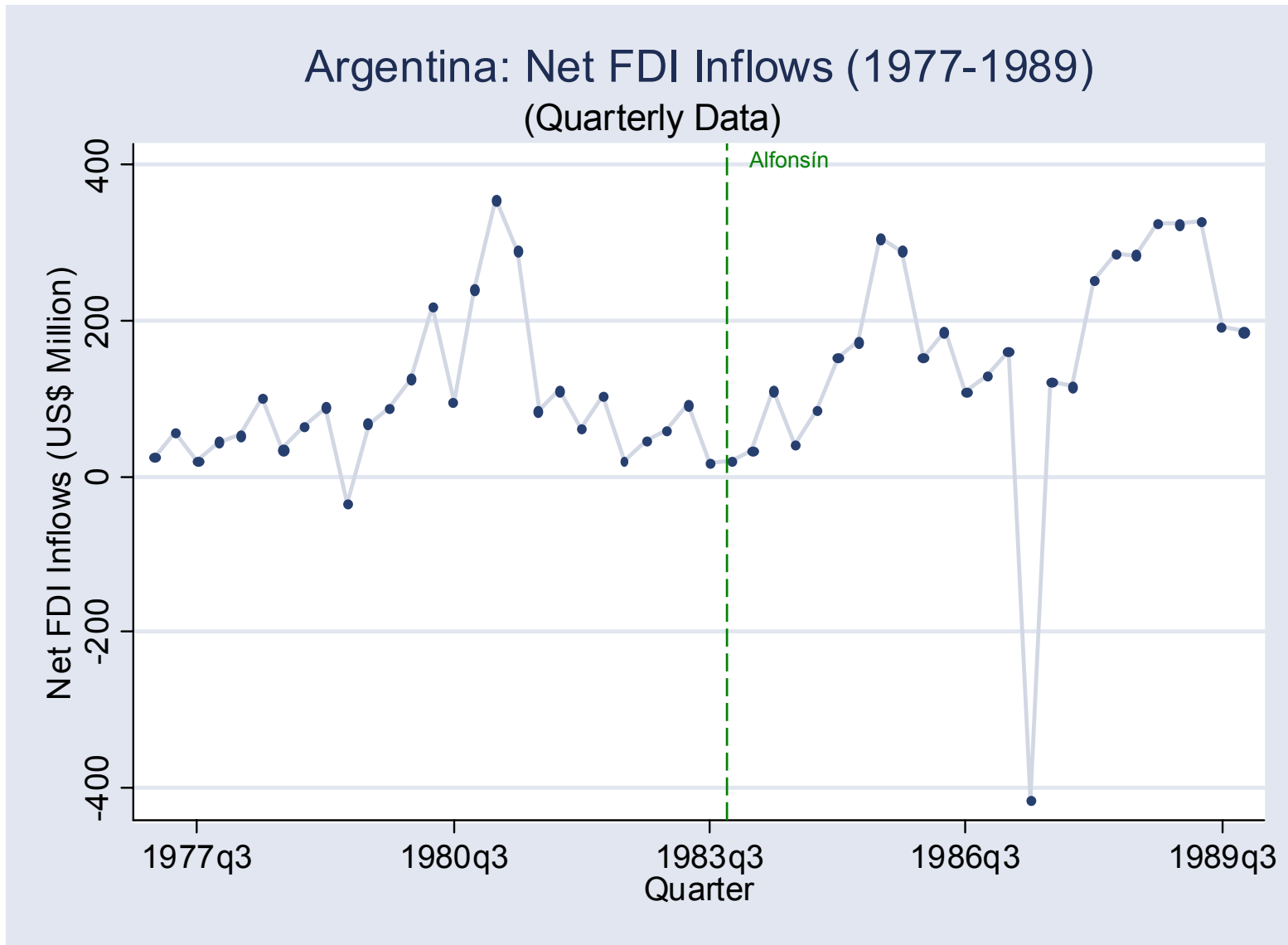


Figure 2: Net FDI Inflows (1977-1989)



APPENDIX 1: DATA DESCRIPTION:

FDI net inflows (current US\$): Foreign direct investment is net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows total net, that is, net FDI in the reporting economy less net FDI by the reporting economy. Data are in current U.S. dollars. Source: IMF, IFS online.

Political Constraints: proxy for institutional constraints on policy-making (institutional and partisan veto gates). Henisz (2000) builds an index of Political Constraints (POLCONV). Relying on a simple spatial model of political interaction he derives a measure of how constrained the chief executive is in her choice of policies. He identifies the number of independent branches of government with veto power over policy change in each country. It is a measure of the likelihood of change in policy given the structure of political institutions (the number of veto points) and the preferences of the actors that hold each of these points (the partisan alignment of various veto points and the heterogeneity or homogeneity of the preferences within each branch). Possible scores for the final measure of political constraints range from zero (most hazardous) to one (most constrained).

GDP per worker (constant price entry): GDP per worker is gross domestic product divided by the economically active population. GDP is the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the value of the products. Penn World Tables 6.1.

Savings (% of GDP): Gross domestic savings are calculated as GDP less final consumption expenditure (total consumption). Penn World Tables 6.1.

Government Share of GDP: government consumption as a share of GDP. Penn World Tables 6.1.

Trade/GDP (%): Trade is the sum of exports and imports of goods and services measured as a share of gross domestic product. Penn World Tables 6.1.

Appendix 2: Comparison of LAPs Conditions:

	1945 D.-Ley 23,852/45	1958 Ley 14,455	1973 Ley 20,615	1979 Ley 22,105	1988 ⁷⁵ Ley 23,551
Term of appointment of delegates	4 years	2 years	4 years	3 years	4 years
Re-election	No limit	No limit		1 term	No limit
Voting	Plurality	Plurality	Plurality	Over 20% of valid votes; at least 50% participation	Plurality
Number of delegates	No provision	No provision	5-15: 1 16-40: 2 71+: 3 + 2%	Less than 1%	10-50: 1 51-100: 2 100+: 2 + 1%
Demand for extraordinary meeting		10% of union members	20% of union members	5% of union members	15% of union members
Union participation in politics	No restriction; decided by general assembly or congress	No provision	Allowed to take positions and support political parties Exempted	Banned	No provision
Taxations and contributions (on union property and activities)				Exempted	Exempted
Intervention in local unions	No provision	No provision	According to the federation's statute	Banned	According to union's statutes; decided at the highest union level (national congress)
Grievances	List of illegal actions by employers; decided by Consejo Nacional de Asociaciones Profesionales (CNAP)	Adds conditions for termination by employers due to workers' actions; due process in CNAP decisions	List of illegal actions by employers only; renames CNAP.	Reinstates illegal worker behavior; no special jurisdiction.	Decision requires a judicial proceeding.
Social welfare funds	No mandatory fund	Union controlled	Union controlled	Government controlled (Ley 18,610)	Union controlled

⁷⁵ Law 23,071 of 1984 the Alfonsín government regulated elections for normalization of unions, to rid of bureaucratized leaders and all vestiges of military intervention in the previous years.

Appendix 3: Foreign Investment Statutes 1948-2000

Year	Instrument	Conditions
1948	Decreto 3347/48	-Establishes the Comisión Nacional de Radicación de Industrias. -Offers selective incentives for investment in manufacturing.
1953	Ley 14.222 (Decreto Regl. 19.111/53)	Foreign Investment Statute of 1953: First integral regulatory regime for foreign investment: -Grants national treatment to foreign investors. -Investment in equipment, intangible assets or capital. -Creates the Registro Nacional de Inversiones Extranjeras. -Government license required prior to investment; projects evaluated by the Comisión Interministerial de Inversiones Extranjeras. -Grants benefits to foreign investors: access to credit, preferential access to foreign exchange, tax holidays for import of capital goods and inputs.
1955	Circular xxxx/55 (BCRA)	-Frees exchange rate market; eliminates multi-tier system -Repeals restriction on profit repatriation -Central Bank gradually released currency for repatriation of dividends and capital.
1955	Circular 2324/55 (BCRA)	-License would only be granted to those projects that did not affect domestic businesses and would establish in “convenient” locations. -Projects that promote economic development, reduce foreign exchange and be compatible with government priorities.
1956	Circular 2881/56 (BCRA)	<i>Régimen de re-equipamiento industrial:</i> - Compensates domestic firms that would be affected by the import of machines with preferential access to foreign exchange to purchase foreign equipment.
1957	Decreto-Ley 16.640/57	-Repeals the regime established by Ley 14.222.
1958	Decreto 1594/58	-Investment projects need Executive branch approval. -Creates the Departamento de Inversiones Extranjeras.
1958	Decreto 2483/58	-Establishes the Comisión Asesora de Inversiones Extranjeras.
1958	Ley 14.780	Foreign Investment Statute of 1958, grants investors: -National treatment. -Tax and tariff breaks. -Repatriation of profits and capital (the latter with restrictions). -Preferential access to credit, energy supplies and public utilities. (Additional conditions established in Ley 14.781 de Promoción Industrial)
1961	Ley 15.803	-Ratifies the US-Argentina Investment Guarantee Agreement. -Grants US investors access to OPIC investment insurance.
1963	Decreto xxxx	-Annuls oil contracts signed under the Frondizi administration.

1971	Decreto-Ley 19.151	<ul style="list-style-type: none"> -Projects subject to prior study by Secretary of Planning and Government Action. -Investment licenses approved by Executive decree, which would define the conditions of repatriation of profits and capital on case-by-case basis. -Promotes joint-ventures and other forms of association with domestic firms. -Foreign investors could only buy non-voting shares. -Limited access to domestic credit. -Over 85% of management and technical personnel should be Argentine nationals.
1973	Ley 20.557 Foreign Investment Statute of 1973:	<ul style="list-style-type: none"> -Excludes foreign investors from investment promotion incentives. -Investors sign an investment contract; contract conditions needed Executive or Legislative approval depending on the sector. -Limits on dividends repatriation; principal could only be remitted after 5 years, and no more that 20 percent/year of original investment value.
1976	Decreto-Ley 21.382 Ley de Inversiones Extranjeras de 1976:	<ul style="list-style-type: none"> -Broad definition of investment. Includes capital, intangible assets and capital goods. -Equal treatment; allowed to short-term credit (long-term credit was restricted, and required government approval) -Access to industrial promotion incentives (Decreto-Ley 21.608/77). -Free repatriation of capital (after 3 years) and dividends in “normal times”. Banned when Central Bank declared “state of foreign exchange emergency” (could be exchanged for government bonds denominated in foreign currency). -Dividends exceeding 12% of investment subject to excess profits tax. -Negative list of sectors where investment is banned. -License required for investment in: public utilities (including telecommunications, electricity, gas, transportation, postal services), media, education, energy, financial services and insurance. -License required from projects that exceed US\$ 5 million, denationalize a local firm, or investment promotion is a condition for the project. -Subsidiaries are treated as independent legal entity from parent firm.
1980	Decreto-Ley 22.208 (Decreto Regl. 1031/81)	<ul style="list-style-type: none"> -Eliminated prior approval requirement for investments in banking, and transportation. -Approval required for projects that denationalized firms with assets worth more than US\$10 million, and all projects over US\$ 20 million.
1981	Decreto-Ley 22.426 (Decreto Regl. 580/81).	<p>Technology Transfer Law:</p> <ul style="list-style-type: none"> -All technology transfer contracts need to be filed with the INTI (National Institute for Industrial Technology). -Limits royalty payments to 5% of net value of product sales. -No royalties to be paid for use of brand name.
1984	Decreto 1506/84	<ul style="list-style-type: none"> -Aims at preserving the level of reserves. -Bans right to repatriate dividends and principal (through 1987). -Investors are compensated with foreign currency denominated government bonds.
1987	Resolución 520 (Ministerio de Economía) Comunicaciones A 1035, A 1056 y A 1059 (BCRA)	<p>Regulate debt-equity swaps program.</p> <p>-</p>
1989	Ley 23.696 (Decreto Regl. 1105/89)	<p>Ley de Reforma del Estado (Reform of the State Act)</p> <ul style="list-style-type: none"> -Authorized privatization of public utilities. -Allowed foreign investors participation in the privatization process.

- 1989 Ley 23.697
(Decreto Regl. 1225/89) Ley de Emergencia Económica (Economic Emergency Act)
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- 1993 Decreto Regl. 1,853/93 Regulated the conditions of the 1976 investment statute:
-No need to obtain license prior to investing.
-Right to remit dividends and principal without restrictions.
-No tax on “excessive profits”.
-Exemption of import tariffs and value added tax on imports of capital goods and turnkey plants (suspended in 1996 by Executive Decree 937/96).

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