Financial and taxation justice: a historic debt

The Argentine experience shows that development is not possible without economic autonomy and domestically mobilized resources, such as taxes. The successive political and economic crises that have shaken the country demonstrate that when the development model prioritized the financial sector over the productive sector the result was dismal for the vast majority of the population. It is imperative for the State to regain control of the economy, make it less dependent on foreign capital, and implement a fairer tax system and finance production as well as consumption.

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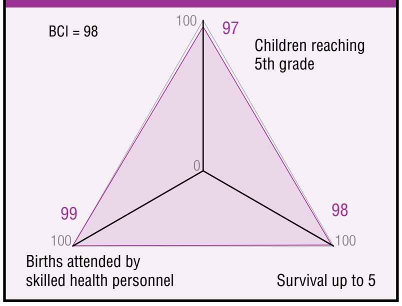
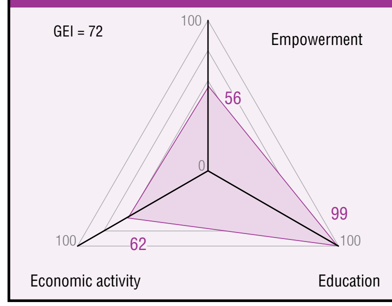
Basic Capabilities Index (BCI) 2010



Gender Equity Index (GEI) 2009



The path towards development is not a chimera projected into the future; we are treading it today with democratic practices, and in modern societies it is possible for governments to lead the economy and not the other way around. What has happened in the last few decades in Argentina makes it very clear that reducing the country's dependence on foreign financing strengthens its autonomy in economic policymaking.

Recent history shows that autonomy is a necessary condition for development, but it cannot be achieved if the country is dependent on external financing. Without such financing, taxes would have to become a legitimate and viable basis for domestic resource mobilization, without which development is simply not possible.

Argentina has improved with regard to taxation (see the following section) in that in recent years as it has managed to increase the ratio of taxes to GDP to 30%, although this is still far short of the 50% level that pertains in developed countries. However, the tax system is still regressive insofar as those who earn less contribute proportionally more, and it is still pro-cyclical as its yield follows the ups and downs of consumption. The largest tax contribution comes from indirect taxes, of which the main one is the value added tax (VAT). This is currently levied at 21% (very high compared to global levels) and there are very few exemptions or lower-rated items. By contrast, the income from financial investment is exempt.[1]

One very important measure taken by the current administration, led by Cristina Fernández, was to nationalize state employee retirement and pension funds, which had been privatized in the 1990s. It has thereby regained control of a source of domestic financing for development and has not had to private-sector seek loans with double-digit interest rates.

A brief history

Until the military coup in 1976, the Argentine economy was essentially a real economy, characterized by a pattern of accumulation based on import substitution. After 1976 this was replaced by an arrangement that favoured the financial sector over the productive economy. In this new system the oligopolies took out loans to invest in the domestic financial market rather than to expand production, repaying them with currency that was provided by the state through its own foreign indebtedness. In order to implement this model, the state used force to grind down the working class and repress protest, resulting in a era of terror in which tens of thousands of people were killed or disappeared.

These changes were accompanied by changes in the functions of the State, since it was the State that maintained domestic interest rates at higher levels than international rates, in order to increase their value in the Argentine market. This was the objective of the 1977 financial reform, which ensured that the State would no longer be financed through the central bank but would seek financing through the financial sector.[2] Before democracy was re-established in 1983, the State took over the private debts of hundreds of enterprises, and the country's foreign debt mushroomed from USD 7 billion to USD 45 billion in just seven years.[3]

This model was consolidated in the 1990s, putting Argentina solidly in line with the Washington Consensus, which included deregulation, relaxation of labour laws, privatization, public expenditure reductions, taxation discipline, and economic, trade and financial liberalization. In addition to impoverishing large swathes of the population, this policy produced large-scale de-industrialization, outsourcing, unemployment, increased foreign indebtedness, and structural poverty that according to National Statistics and Census Institute stood at 56% in 2002.

After four years of recession, the one-to-one peso to the dollar exchange rate collapsed, leading to the financial crisis of 2001. This marked the end of a 30-year period in which the real economy was at the service of the financial economy, and opened the way for change that could provide an opportunity to reverse this trend.

Starting in 2003 the Néstor Kirchner Government embarked on a strategy of high economic growth that stimulated employment and improved the quality of life of the working class. Over the next six years, GDP increased at an annual rate of 8%, the economy maintained a tax and foreign surplus and there was a successful process of debt reduction. This was made possible through a range of measures that included competitive currency exchange rates, retention of export taxes, government control of the capital account and measures to stimulate production. However, further progress towards development meant the Government had to tackle some limiting factors and find an alternative to financial valuation as a capital accumulation model.

The financial system

It could be said that a financial system does not function as such when it can no longer finance production. The far-reaching deregulation that followed the 1977 reform meant the system of specialized banks was replaced by a universal bank model, which gave

1 Tax exemption for the profits made by physical persons through financial rents – this includes fixed-term deposits and income from the purchase, sale and dividends derived from shares and government bonds.

2 Adrián D´Amore, Interview with economist Eduardo Basualdo, "Los sectores dominantes no quieren que siga aumentando la participación de los asalariados", *Zoom*, 30 May 2008. Available from: <www.rayandolosconfines.com.ar/reflex62_basualdo.html>.

3 María de Monserrat Llairó and Raimundo Siepe, "La evolución del endeudamiento externo argentino y su relación con los organismos financieros internacionales: desde 1976 a la salida del default (February 2005)", Latin American Research Centre for Development and Integration, Faculty of Economic Sciences, University of Buenos Aires.

a clear advantage to the commercial banks over the investment, development, cooperative and public banks. Credit is concentrated in the financing of consumption, enabling the banks to enjoy secure profits by charging very high interest rates that are very often disguised in credit cards or other purchase systems. So although the banks have high levels of liquidity they are not making the loans necessary for productive investment. Hence it has turned out that the dictatorship's financial institutions' law is negatively affecting the credit situation for small and medium producers and hampering redistribution, and it will have to be reformed if the country is to develop.

Foreign direct investment

Foreign direct investment (FDI) increased greatly during the wave of privatization in the 1990s, but what this involved was more a change of ownership than a genuine process of investment as such. In that period transnational enterprises came increasingly into the Argentine economy and many domestic enterprises were sold to external owners.

This foreign capital now controls most of the industry in the country. In recent years FDI has gone more and more into extractive industries such as the oil business and mining, and to activities linked to other primary products such as soybeans, but all of these sectors have a very low impact in terms of providing jobs. To make matters worse, the profits are sent to head offices abroad and the production processes damage the environment and constitute a danger to the local population. To rectify this situation the country needs much stricter regulations and a new kind of relation with the movers of foreign capital that will make it possible to promote development instead of merely producing primary goods for export.

Foreign debt and capital flight

The Government has reduced the debt-to-GDP ratio from 120% to 40% in less than five years, but it must avoid contracting further indebtedness so as not to hang a mortgage round the neck of future generations. In order to obtain financing for development, the Government will have to annul the mechanisms whereby capital generated in the country is systematically sent abroad, thereby keeping growth separate from capital accumulation. Insofar as it underpins this capital flight, the financial system has contributed to economic instability and repeated collapses.[4] Therefore it is essential to change the model, to leave financial revaluation behind and to place the financial system at the service of production and development.

At present, the Government is planning to use a portion of central bank reserves to set up a fund to ensure debt payment, although sectors of the opposition would prefer this to be done with resources generated by cuts in public spending. While assets such as reserves can of course be used to cancel liabilities such as debts, there are two important considerations to be kept in mind. First, the legality and legitimacy of these liabilities must be clearly determined, since many private debts contracted during the dictatorship period, for example, were taken over by the State, but now the courts have ruled that some of these transactions were illegal. Second, foreign debt repayment should be subordinated to the priorities of a development strategy.

In the 2010 national budget, some 10.16 billion Argentine pesos (about USD 2.6 billion) were allocated to health and somewhat less than USD 5 billion went to education and culture, but the amount allocated to interest payment on the public debt was USD 6.8 billion.[5] The country can hardly be aiming at development if debt interest is eating up nearly as much investment as in health, education and culture put together.

Instead of waiting for genuine productive investment to materialize due to confidence on the part of foreign and local investors, the State itself should be promoting the opening up of new conditions to foster productive business, and it should guide investment into areas that are strategically important for economic development. For example, if the Government sets up a new development bank this could be a good instrument to channel the resources from contributions to retirement pension funds into development projects, along the lines of the successful National Development Bank of Brazil.[6]

Another important initiative of this kind is the Banco del Sur,[7] which is mandated to foster development and regional integration in Latin America by opening up new alternatives for financing based on the principles of equality, equity and social justice.

Today Argentina's economy is highly concentrated towards primary products, with a high proportion of foreign capital, and consequently the US dollar operates as the value reserve and the core element around which economic relations are organized. For the country to grow its economic priorities must include changing its productive structure, bringing about a shift from foreign to domestic capital, and tackling the problem of concentration of the means of production. It will also have to dismantle the neo-liberal structure of the central bank, discuss the matter of its autonomy and make changes to its founding charter. A government entity that is in charge of formulating exchange rate, monetary and financial policy cannot be so divorced from the wishes of the people, nor can its only aim be to maintain the value of the country's currency without considering the structural conditions that actually define that value.

Concluding reflections

All of the factors analyzed here contribute to the country's ongoing poverty, poor showing on human development indexes and failure to advance the Millennium Development Goals (MDGs). In addition, both development and democratization also depend on advancing gender equality. Women's economic empowerment, through greater education and income opportunities, and the autonomy needed to take advantage of them, would constitute real progress not only towards the education, electoral and employment indicators in MDG3, but towards many other MDGs, including poverty reduction, improving maternal health and reducing infant mortality.

In spite of these realities, human rights of Argentine women are still not seen as a development goal and there is no comprehensive program to mainstream gender equality into development. If the human right to development, which is based in the principles of the UN charter and was proclaimed by the UN General Assembly in its 1986 Declaration on the *Right to Development*, is to be made effective in practice, civil society organizations must demand the prompt implementation of concrete public policies and strategies to ensure decent conditions of life and allow people to lead fruitful lives within the framework of sustainable development for the whole country. ■

4 For example during the hyperinflation of 1989-1990, the 2001 crisis and the current blockage in the financial account that started with the beginnings of the international crisis in 2007.

5 Ministry of Economy and Public Finance, official data from the 2010 budget. Available at: <www.mecon.gov.ar>.

6 This National Development Bank (BNDES), set up to foster import substitution industrialization, became the body responsible for formulating and executing industrial policy in Brazil. Even in the liberal phase in the 1990s, the BNDES accounted for some 25% of the total credit offered by the banking system. In 2002, its percentage share reached one of its highest peaks (33%), which meant it was complying perfectly with its mandate to act in an "anti-cyclical" way. Source: Claudio Golonbek and Emiliano Sevilla, "Un estudio de caso sobre Banca de Desarrollo y Agencias de Fomento," Centro de Economía y Finanzas para el Desarrollo de la Argentina, Working Document No. 20, May 2008. Available from: <www.cefid-ar.org.ar>.

7 Set up in 2009 by Venezuelan President Hugo Chávez, it includes Argentina, Bolivia, Brazil, Ecuador, Uruguay and Venezuela.