

Argentine Agriculture under GATT

Sergio H. Lence

GATT Research Paper 94-GATT 4
February 1994

**Center for Agricultural and Rural Development
Iowa State University
Ames, Iowa 50011**

S.H. Lence is an assistant professor, Department of Economics, Iowa State University.

This material is based upon work supported by the Cooperative State Research Service, U.S. Department of Agriculture, under Agreement No. 89-38812-4480.

Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author and do not necessarily reflect the view of the U.S. Department of Agriculture.

CONTENTS

Abstract	v
Current General Policies	2
Current Agricultural Policies	3
Effects of Current Policies on the Agricultural Sector	5
Impact of the GATT Negotiations	7
Policy Perspectives	8
References	9

ABSTRACT

Argentina is the world's second largest exporter of grains, oilseeds, and oilseed products, accounting for approximately 10 percent of world trade in these products. Traditionally, Argentina's economic policies have taxed the agricultural sector, which produces goods for exports, to subsidize the mostly insulated industrial sector. Despite this unfavorable treatment, the agricultural sector has remained Argentina's economic mainstay and competes successfully in world markets.

Recurrent economic crises have led to substantial changes in Argentine economic policies, which may eventually reduce the agricultural sector's burden of subsidizing the manufacturing sector's growth. Although this transition may take several years to accomplish, the predicted outcome is even greater competitiveness of Argentina's agricultural exports in world markets.

From the perspective of the General Agreement on Tariffs and Trade (GATT), Argentina's agricultural sector stands to benefit greatly from trade liberalization. Argentine farmers have been taxed rather than subsidized, so they have no preferential treatment to lose in the GATT negotiations. Also, subsidized agricultural production and exports from countries such as those in the European Community have greatly undermined the profitability of Argentine farm businesses. If these countries agree to decrease or remove their subsidies as a result of the GATT, the Argentine agricultural sector should benefit.

ARGENTINE AGRICULTURE UNDER GATT

Argentina is an important producer of crops and animals that grow in a temperate climate. Argentina is the world's second largest exporter of grains (mainly wheat, corn, and sorghum), oilseeds (mainly soybeans), and oilseed products (soybean, sunflower, and flaxseed byproducts) and holds a 10 percent share of world trade in these products, compared with the 40 percent share held by the United States. Argentina is also a major exporter of livestock products (mostly beef and sheep) and fruits (citrus, deciduous, and canned deciduous).

For many decades, Argentine economic policies have been characterized by the transfer of resources from the agricultural sector to other sectors of the economy. Key tools for this redistribution were the imposition of export taxes on most agricultural products, the banning of exports of some other products (e.g., flaxseed), and exchange rate controls. This scheme has historically served three main purposes. First, export taxes provided an important source of fiscal revenues because other taxes (especially income taxes) were evaded by most taxpayers. Approximately 15 percent to 20 percent of government revenues were traditionally obtained from export taxes. Exchange rate controls have also been used to obtain fiscal revenues because exporters had to convert dollars at the official exchange rate, which averaged between 10 percent and 20 percent lower than the black market exchange rate. Second, export taxes and bans, and exchange rate controls reduced food expenditures for the industrial labor force. And third, the higher taxation on agricultural exports compared with taxes on corresponding processed products subsidized local processing industries, encouraging domestic industrialization.

In the 1980s, economic conditions in Argentina deteriorated dramatically. Massive external debt coupled with low world prices for agricultural products exported by Argentina contributed significantly

to this phenomenon. As a result, recent economic crises are forcing Argentina to restructure its economy.

Current General Policies

Two of the key elements of economic policies being implemented are the emphasis on reducing the public deficit and the opening of the economy. One of the most important events that has occurred in the last few years is the general recognition that the huge public sector deficit is one reason for the country's poor economic performance. Some of the measures being taken to reduce this deficit are (1) increasing tax collection and imposing new taxes, (2) selling public enterprises to private concerns, and (3) reducing the number of public employees and decreasing the salaries of the remaining public workers.

These measures are now complemented by the unprecedented elimination of printing money to finance the public deficit. In 1991, the Argentine Congress passed a bill that prevents the executive branch from expanding the monetary base unless gold or foreign currency assets of the Central Bank increase at a parallel rate. This means that every austral in circulation must be backed by a hard-currency instrument. As a result, the exchange rate has become virtually fixed. In addition, transactions are now legal in U.S. dollars as well as in local currency.

The other usual way to finance the deficit, namely borrowing in the domestic market, has also been eliminated. Traditionally, banks were able to lend only approximately 15 percent of total deposits to private borrowers, with the remaining 85 percent being borrowed by the public sector at a guaranteed interest rate. The disappearance of the public sector as the major borrower is translating into a major restructuring of the financial and commercial systems and may lead to the collapse of many banks and other financial and commercial intermediaries.

To open the economy, the Argentine Congress recently passed a bill that relaxes many of the prevailing restrictions on hiring and firing workers. This unprecedented law attempts to lower labor costs in the local private sector to make it more competitive in external markets and to enhance its

position in the domestic market to face competition resulting from the opening of the economy.

Simultaneously, import tariffs are being relaxed and greatly simplified.

A treaty signed by Argentina with Brazil, Uruguay, and Paraguay to form MERCOSUR is consistent with the goal of opening the Argentine economy. MERCOSUR is scheduled to evolve into a four-country common market by 1995. Bolivia and Chile are also showing interest in joining this common market, and MERCOSUR's agenda includes talks with the United States to include it in this treaty.

In addition, the Argentine government recently confirmed its decision to open the economy by signing an investment-protection treaty with the United States. The pact is the first of its kind signed between the United States and a South American country. The treaty provides guarantees against arbitrary confiscation of assets and assurances that there will be no limits on repatriation of profits.

Current Agricultural Policies

The major component of Argentine agricultural policies, namely export taxes, was formally eliminated in 1991. Some export taxes remain for specific purposes, however, and amount to approximately 5 percent of the FOB export prices. Of these remaining taxes, the most important are a 1.5 percent tax to fund the National Institute of Agricultural Technology and a 3 percent tax for statistical purposes. More important, a 6 percent export tax on oilseeds is still in place. Because neither oil nor meal bears an export tax, this tax provides a covered subsidy to the oilseed crushing sector that encourages domestic processing.

The economic relief attributable to the partial elimination of export taxes has been more than offset by an increase in the total tax burden faced by Argentine farmers. The following are the most important characteristics of the current tax regime:

1. Including the agricultural sector in the value-added tax (VAT) system. All agricultural products now pay a VAT of 16 percent, which by law the executive branch can increase up to 18 percent to eliminate the fiscal deficit. The VAT is refunded for any amount exported.
2. High taxes on sales. In addition to the VAT, sales taxes amount to approximately 8 percent for grains and approximately 4.7 percent for cattle.

3. High taxes on assets. A new tax on all assets taxes land at 1 percent of its fiscal value and cattle and other farm investments at 2 percent of their value. In addition, the tax on fixed assets (including all farm fixed assets) adds up to 3.9 percent more.
4. More tax control. Greater controls greatly reduce the possibility of tax evasion (in particular, of income taxes).
5. Taxes on checks. To increase fiscal revenues until other sources of financing are found, checks are being taxed at 1.2 percent of the face value. Although part of this tax can be used as payment of the income tax, the check tax is a heavy burden, especially for marketing agents.

Participation of the public sector in commercial policy is now being restricted. Traditionally, the Argentine Grain Board (AGB) bought approximately one-half of the annual domestic wheat consumption at harvest time. This scheme served the double purpose of supporting farm prices at a period of high supply and securing the needs of local wheat mills during the second half of the crop year. The AGB no longer purchases wheat, but it still negotiates export deals with specific countries (e.g., Brazil). In addition, the AGB continues to offer farmers a credit program with payment-in-kind. The AGB lends farmers 30 liters of diesel fuel per hectare during planting, to be paid with wheat at the moment of harvest at a ratio of 3.47 kilograms of wheat per liter of diesel fuel. This program is not a subsidy because it amounts to an annual real interest rate of approximately 20 percent, assuming a wheat price of U.S. \$90 per metric ton.

Port elevators, which were a monopoly under government control until 1979, are likely to be sold to the private sector. The AGB has already sold most of its country grain elevators. These sales may add more efficiency to grain exports and make Argentina even more competitive in world markets. Traditionally, exporting through AGB-owned ports has been expensive and resulted in less competitive Argentine grain exports.

Historically, diesel fuel prices were subsidized to support the industrial sector, but it simultaneously benefitted the agricultural sector. In the last few years, however, this has changed: the current price of diesel fuel is U.S. \$0.30 per liter, which is considerably higher than in previous years.

Recently, the Argentina government's executive branch announced a decree that may drastically change the overall economy. This attempt at deregulating the Argentine economy eliminated all import

and export quotas, freed all professional fees and commissions, suppressed regulatory boards, and removed most of the power of labor unions to negotiate pay levels and manage retirement and health-care schemes. These measures are expected to produce substantial cost savings for local producers.

For the agricultural sector, the decree's most important changes are:

1. Elimination of regulatory agencies, including the AGB, the Argentine Meat Board, the Argentine Forestry Institute, and the boards governing sugar and wine production and trade.
2. Suppression of production quotas for cane sugar, tobacco, cotton, yerba mate, wine, grapes, fruit, and dairy products.
3. Elimination of regulations and oversight bodies governing customs, road cargo, and transportation.
4. Simplification of foreign trade operations, including elimination of all minor taxes, leaving only custom tariffs and the VAT.

Effects of Current Policies on the Agricultural Sector

Despite partial elimination of export taxes, the overall tax burden has increased sharply. This increase is translating into zero investment and an extremely limited capacity for growth of existing farm enterprises. The low profitability in traditional agricultural activities is leading to a search for new business alternatives. Prominent among these is growing rapeseed and barley as alternatives to producing wheat. Rapeseed planting is being actively encouraged by oilseed processors, who guarantee a price equal to 92 percent of the sunflower seed price at harvest.

Formal sources of farm credit have been virtually nonexistent for many years, in particular for long-term investments. The reasons for this were crowding out by the public sector, which could pay much higher interest rates than those that the private sector could afford, and economic instability, which made long-term investments very risky. The recent changes in public policy have partially altered this situation, with banks and other financial institutions actively seeking borrowers for dollar loans of up to a few years. If persistent, this situation should offset (at least partially) the limits to farm growth attributable to the tax burden.

The disappearance of the public sector as the major borrower coupled with the lower inflation rate are having other important effects on the agricultural sector. First, a mechanism no longer exists to allow exporters to enter U.S. dollars several months in advance of grain purchases at a partially insured buyback exchange rate (informally called *prefinancing*). This mechanism allowed exporters to make considerable profits (the real rate of return to prefinancing often exceeded 5 percent per month), which led to overexpansion in the exporting sector. Eliminating this financial scheme has severely hurt exporters and may cause bankruptcy for many of them. Indirectly, farmers are also hurt because this system allowed exporters to increase bids for agricultural products.

Second, the sharp reduction in nominal interest rates (from more than 10 percent per month before April 1991 to a mere 1.8 percent by September 1991) has meant losing the major source of profits for most of the agents comprising the commercialization channel. The generalized practice of delaying payments to farmers for a few days to make overnight investments gave marketing agents huge profits with no genuine investment and predictably led to overexpansion in this sector. If current measures persist, there will be an important reconversion of the marketing system. In this case, however, farmers are benefitting because the low inflation rate means that their revenue in real terms remains almost unchanged during the interval between selling and receiving payment.

In addition to the lower revenues attributable to lower nominal interest rates, marketing agents are being squeezed by the tax on checks (1.2 percent of the check's face value). This tax has sharply increased transaction costs and is encouraging farmers to find more efficient ways to sell their products.

The allowance for commercial transactions in U.S. dollars as well as the incipient stability of the domestic currency are causing noticeable growth in the Argentine grain futures market. In this market only grain futures are traded, but in 1991 a new futures market began operating with live cattle futures and options. The wider use of futures will likely (although not immediately) lead to more rational and efficient use of resources at the farm level and especially in the domestic commercialization channels.

Finally, the recent decree deregulating the economy is expected to have a sizable impact on domestic production costs. Specialized economists estimate that, because of this deregulation and the new tariff structure, domestic production costs will decrease by 5 percent to 20 percent.

The Impact of the GATT Negotiations

Farmers in Argentina have been and continue to be remarkably unprotected by their government. If anything, they have borne a relatively large share of the financial burden of funding policies aimed at developing the industrial sector and redistributing income. The only major subsidies that farmers had were a low diesel fuel price (actually aimed at supporting the industrial sector) and lax enforcement of income taxes (although this is not specific to the agricultural sector because tax evasion has been a generalized phenomenon in the economy). Recently, however, the diesel fuel price increased sharply and tax evaders are being firmly prosecuted.

Given current farm policies, it is clear that farmers have very few prerogatives to lose in the General Agreement on Tariffs and Trade (GATT) negotiations. The overall effect on farm production of current and past policies has been overwhelmingly negative.

In contrast, the nonfarm agricultural sector, particularly the industries involved in manufacturing farm inputs and processing farm products, has received varying degrees of protection from the government. The main protection tools have been trade barriers, import and export tariffs, and/or quotas. The overall effect of this policy on farm production has been negative, but it has led to the development of some important agricultural industries (prominent among these is the oilseed processing industry). As noted, import tariffs are being reduced and export taxes have been eliminated, but differential export taxes to protect the oilseed industry are still in place. Eliminating differential taxes on oilseeds should increase oilseed production and increase the ratio of oilseed exports to oil and meal exports.

Policy Perspectives

A change in the overall direction of current policies seems highly unlikely. Although there will certainly be isolated attempts to return to some of the old policies, it does not seem feasible that any such attempts would be long-lived.

The executive branch's agenda includes introducing a bill in the Congress whereby only the legislative branch would be allowed to change export taxes on agricultural products. This bill is potentially beneficial to the agricultural sector because it would limit the power of the Minister of Finance, giving more stability to agricultural policies. In addition, it seems quite likely that differential taxation of oilseeds will be eliminated soon.

REFERENCES

The material contained in this paper was gathered from informal interviews with officials from both the public sector (i.e., Department of Agriculture of Argentina, Argentine Grain Board, National Institute of Agricultural Technology) and the private sector (i.e., Buenos Aires Grain Exchange, Federation of Grain Dealers Associations, Buenos Aires Grain Futures Market, Buenos Aires Cattle Futures Market, Argentine Stock Exchange, exporters, brokers, and farmers). The interviewees share no responsibility for the views expressed here.

Other sources of information are *The New York Times*, *The Wall Street Journal*, *Latin American Weekly Report*, local Argentine newspapers (*La Nacion* and *Ambito Financiero*), local Argentine specialized magazines (*Margenes Agropecuarios*, *Agromercado*, and *Revista de la Bolsa de Cereales*), and the following report:

Hazera, Jorge. 1988. "Argentina." In *Global Review of Agricultural Policies*. Washington, DC: U.S. Department of Agriculture, Economic Research Service.