



Limited Distribution
LC/BUE/L.150
March 1996

E C L A C

Economic Commission for Latin America and the Caribbean

Buenos Aires Office



**BUSINESS STRATEGIES AND INDUSTRIAL
ADJUSTMENTS: THE CASE OF ARGENTINA ^{1/}**

Working Paper # 67



Bernardo Kosacoff *

* Opinions expressed are those of the author and do not necessarily represent the views of the Organization.

^{1/} This paper is based on previous work done for the project "The transformation of the Argentine Economic System: international trade and industry" supported by the Volkswagen Foundation and submitted at the Conference "Confronting the future in Argentina", held on February 1-2, 1996, at the Institut of Latin American Studies of the London University. Helpful comments by Daniel Kampel and Adrian Ramos are gratefully acknowledged. Translated from the original in Spanish by Daniel Kampel.

J- ABR 1996

TABLE OF CONTENTS

SUMMARY	1
INTRODUCTION	2
1. CHANGES IN THE 1975-95 PERIOD	3
2. THE INDUSTRY DURING THE CONVERTIBILITY PLAN	6
3. RETHINKING A COMPETITIVE STRATEGY	10
ANNEX	16

SUMMARY

The Argentine economy is experiencing a major transformation process through a stabilization and structural reform program inspired in the "Washington Consensus", based on trade openness, deregulation and privatization. Such consensus implicitly assumes undifferentiated business reactions to the implementation of these programs and a resulting new specialization pattern compatible with macroeconomic discipline and global insertion.

However, the analysis of the Argentine industry for the last two decades -and in particular, during the Convertibility Plan- makes it evident that the phenomenon of business reactions is a very complex one. In fact, diverse and opposing business strategies with sequences and times differing from both the openness process and modifications in the key macroeconomic parameters can be seen. A firm's previous evolutionary process, changes in the international paradigm, dynamism of the domestic market, the endowment and expansion of natural resources, select industrial and trade policies, and the profile of the business people are all determinant factors of such reactions.

The two main strategies developed between 1975 and 1995 by firms can be characterized as either offensive or defensive. The former involves both investments and deep organizational changes. Its diffusion is limited to 400 firms spread throughout the industry that nonetheless represent approximately 40% of the industrial output. The latter stresses survival mechanisms such as increasing assembly and commercialization of imported goods and it has been applied by some 25,000 firms. However, these mechanisms have negative effects on both employment and the development of technological capabilities.

In spite of current difficulties -deeper since the "Tequila" effect- Argentina's industrial scenario is potentially promising. It is a country with an intermediate industrial development and a relatively important stock of qualified resources. It faces the challenge of improving its competitiveness and there are many courses of action that can be taken in this regard. Among these are: 1) the movement of industrialization processes towards differentiated products with higher value-added; 2) the structuring of productive networks that provide the critical mass for industrialization; 3) the restructuring, from an "industrial" viewpoint of some aspects of the privatization process; 4) the deepening of "horizontal" policies, in particular, the qualification of human resources and the structuring of the national system of innovation; 5) the establishment of a financial system capable of orienting resources from internal and external savings to projects with high economic and social rates of return, at suitable interest rates and maturity terms.

January 1996.

INTRODUCTION

The Argentine economy is experiencing a major transformation process. Stabilization is not merely the solution of simple disequilibria but profound structural reforms needed to overcome coordination failures and return the economy to an equilibrium path. Exceedingly volatile relative prices, fiscal and external disequilibria, extreme preference for flexibility of the economic agents, high uncertainty, permanent inflation and even some hyperinflationary episodes had long been the dominant features of the economic environment that conditioned the implementation of economic policy.

In that context recommendations originating in stabilization and structural reform programs inspired in the "Washington Consensus" -based on trade openness, deregulation and privatization of state-owned enterprises- are not enough to thoroughly understand the multiple aspects that accompany the dynamics of structural change. In particular, the lack of an analysis of business reactions to the implementation of these programs stands out. An undifferentiated behavior at microeconomic level that would lead to a new specialization pattern, compatible with macroeconomic discipline and international insertion, is implicitly assumed.

However, the experience that emerges from the analysis of the Argentine industrial sector for the last two decades makes it evident that the phenomenon of business reactions is a very complex one. In fact, observed changes are characterized by diverse and opposing strategies with sequences and times differing from both the openness process and modifications in the key macroeconomic parameters. Likewise, it can also be verified that the dynamics of the structural change was strongly influenced by the previous evolutionary process; that public and private institutions have not yet adapted to the new scenario; and that, in many cases, private benefits generated by business strategies did not coincide with social benefits.

The purpose of this paper is to contribute to the analysis of the recent process of industrial transformation in Argentina. In particular, it will focus on the factors that determined different business reactions in the dynamics of structural change between 1975 and 1995. Likewise, the effects of changes in the macroeconomic conditions, the international scenario and the linkages between the firm and the market will also be considered. The entire process will be assessed, not only in terms of production of industrial goods but also in terms of the generation and development of technological capabilities, necessary for the establishment of a specialization pattern in a context of transformation and global insertion.

The first section makes a stylized analysis of the central features of the Argentine industrial transformation over the last two decades. An evaluation of the possible determinants of business reactions

is also made considering two extreme behavior patterns. The first one is called offensive restructuring while the other is the survivors' strategy that is characterized as defensive¹.

The second section refers to behavior of firms during the Convertibility Plan. Two stages are distinguished: the first one belongs to the 1991-94 period; the second one starts with the modification of the international interest rate in early 1994 but it is only after the Mexican devaluation towards the end of that year that most effects are felt (the "Tequila" effect).

Lastly, some comments on industrial policy and the eventual development of a new specialization pattern are made, considering some issues that must be kept in mind to define a competitive strategy.

1. CHANGES IN THE 1975-95 PERIOD

Between 1975 and 1995 the Argentine industrial sector lost its productive dynamism, employment generation and leadership in investment abilities that had characterized it in the past. This sector has been deeply transformed since 1975. Although its size remains similar the organizational model is far different². In fact, this transformation was the result of two "avenues": offensive restructuring and defensive strategies of survival.

Offensive restructuring implies strong investment in machinery and equipment and, at the same time, deep organizational changes. The implementation of this strategy has led to a remarkable increase in productivity, matching levels of the best international standards. The degree of diffusion of offensive restructuring is limited to approximately 400 firms that represent approximately 40% of the 1995 industrial output. In that sense, we can state that there is a large number of remarkably successful microeconomic cases. Nonetheless, they are not yet strong enough to generate a new specialization pattern for the Argentine industry capable of sustaining a long-run model of development.

In which sectors are these firms found? They are spread throughout the industry, even in those

¹ See Kosacoff, B. (1994), La industria argentina: un proceso de reestructuración desarticulada, CEPAL, Documento de Trabajo N° 53, Buenos Aires.

² For further reading on overall Argentine industry, see Azpiazu, D. and Kosacoff, B. (1989) La industria argentina: desarrollo y cambios estructurales, CEAL, Buenos Aires; Chudnovsky, D. (1991) La reestructuración industrial argentina en el contexto macroeconómico e internacional, CENIT, Buenos Aires; Nochteff, N. (1991) "Reestructuración industrial en la Argentina: regresión estructural e insuficiencia de los enfoques predominantes" in Desarrollo Económico N° 120, Buenos Aires.

branches most affected by the processes of openness and macroeconomic instability. However, it is possible to highlight four key areas. The first one corresponds to the transformation of basic input industries (mainly producers of intermediate inputs of common use such as iron and steel, petrochemistry, cement, oil refineries and aluminum). There are between 20 to 25 modern plants of this kind operating on an international scale³, which were all the result of explicit government policies.

The second area is the outgrowth of the notable dynamism of the stock of natural resources, which broke four decades of stagnation. In that sense, it can be seen that this new expanded capacity of natural resources is linked with some industrial activities in the final stage of production. These resources are processed in plants that meet the best international standards, as is the case of the oilseeds industry, the fishing complex, and others⁴.

The third area - the automobile industry - differs completely from what it was in the past. Within this sector the transformation has been very heterogeneous. Some car part makers that supply assembly terminals are close to the best international standards. But assembly plants, while more modern than in the past, are still far from having the best practices. Besides, there is an important increase in imports partially offset by the greater export capacity of the car part makers⁵.

Lastly, during the Convertibility Plan some new and very modern industrial plants linked with the strong increase of mass consumption of differentiated goods in the domestic market have appeared. Between 30 or 40 producers of dairy products, chocolates, sweets, telephone equipment, and other industrial activities can be included in this area⁶.

What is the "second avenue"? This is the survivors' avenue: survivors from the late-seventies

³ For the particular cases of the iron and steel industry and the petrochemical complex see Bisang, R. (1989), Factores de competitividad de la siderurgia argentina, CEPAL, Buenos Aires; and López, A. (1993), Impacto del proceso de ajuste estructural sobre las estrategias empresariales en la industria petroquímica: el caso argentino, Buenos Aires, respectively.

⁴ For the particular case of agribusiness, see Obschatko, E. (1993), Estudio de competitividad agropecuaria y agroindustrial: el complejo agroindustrial argentino, Secretaría de Progración Económica and Secretaría de Agricultura y Pesca, Ministerio de Economía y Obras y Servicios Públicos, Buenos Aires.

⁵ See Kosacoff, B., Todesca, J. and Vispo, A. (1991), La transformación de la industria automotriz argentina. Su integración con Brasil, CEPAL, Documento de Trabajo N° 40, Buenos Aires.

⁶ See Subsecretaría de Inversiones (1995), Argentine investment updated, Ministerio de Economía y Obras y Servicios Públicos, Buenos Aires.

openness, from the macroeconomic crisis of the '80s and from the new competitive conditions established by the convertibility. From 1975 to 1995 a large number of firms disappeared and very few newcomers were incorporated into the industrial structure. Aside from small workshops, some 25,000 firms are characterized by defensive strategies and represent 60% of the Argentine industrial output.

However, these industrial plants are clearly very different from what they were twenty years ago. They too have registered a remarkable increase in productivity. Nonetheless, they still lag far behind international best practices. Is this distance larger or smaller than in the past? This cannot be determined. Although productivity has increased an estimated 100% on average and these firms show a comparatively better performance they are still far from being able to compete in an open economy structure.

Why did competitiveness increase in these plants? There are three sources that feed the productivity increment. The first one is the drop in employment that started in the mid-seventies and still continues. The same capability to produce goods with lower employment can be seen. The second corresponds to organizational changes. Most plants have gradually incorporated modern organizational practices. The third originates in generalized investment. Selective investments have been made in all industrial plants, which are highly associated to the business cycle. This happened under Martínez de Hoz, under the Austral Plan, and again under the Convertibility Plan. Manufacturing is basically made with machinery and equipment bought either in the '50s or the '60s. The coexistence of technologies of different generations typically results in production bottlenecks. When the activity level grows very precise investment targeting specific problems can be verified, such as resolving painting or packaging problems, or equilibrating production lines. The plant structure itself remains unmodified but key investment affects a firm's productivity level. At any rate, these industrial plants continue to maintain the basic features of a workshop from the import substitution stage⁷. They are completely out of scale. On average, the Argentine industry has only 5% to 10% of the optimum scale observed at the international technical frontier and have very few economies of specialization. Besides, the industrial sector continues to be characterized by excessive integration and by very limited development of specialized suppliers and subcontractors.

What are the reasons for the existence of the opposing reactions registered at the level of the firms? Business behavior has always been conditioned by the macroeconomic environment and the resulting set of incentives and regulations. The failure of the Argentine openness experiment of the late '70s became a turning-point for the import substitution strategy of industrialization (ISI). The later evolution of the different

⁷ See Katz, J. and Kosacoff, B. (1989), El proceso de industrialización en la Argentina: evolución, retroceso y prospectiva, CEAL, Buenos Aires.

firms and sectors was not only determined by their situation at that time but also by the following factors: first, the previous evolutionary path and the maturity of the development of competitive capabilities at the level of each firm and sector; second, changes in the technological paradigm at the international level and the intensity these changes had for each sector; third, the size and dynamism of the domestic market within the new context of open economy and economic integration into the Mercosur common market; fourth, the endowment and expansion of natural resources (in the case of Argentina, natural resources have recently shown a remarkable dynamism contrasting with the lengthy stagnation that prevailed during the import substitution strategy of industrialization); fifth, the select industrial and trade policies applied over the last twenty years.

A sixth and very important aspect is the profile of the economic agents in the business sector. That profile must be considered on two levels. First, whether the firm is a subsidiary of a transnational corporation (TNC), a large national holding, or an SME. Reactions vary according to different sets of incentives. Second, their evolutionary path shows how a firm's attitudes and behavior depend on organizational structure, degree of risk aversion, attitude towards innovation, etc. For example, an SME that has either completed a generational change or that has experienced an important restructuring cannot be compared to another that is still undergoing an undefined and conflictive transitional process.

2. THE INDUSTRY DURING THE CONVERTIBILITY PLAN

Convertibility⁸ was welcomed by business people for a number of reasons. First was the achievement of stability that diminished uncertainty in the markets. Concern was reduced to defining a competitive strategy given the new economic environment. Second was the increase in demand. In fact, the activity level rose continuously for 19 uninterrupted quarters, although growth differed between sectors. Third was the wealth effect. Associated to the latter and in a context of currency overvaluation, there was a rise in future expected income and a reduction in the rate at which economic agents discounted it.

These three elements affected the relationship between the firm and the market. In the new prevailing conditions with lower transaction costs and uncertainty levels, what does the firm itself produce? What does the firm purchase from suppliers? The network of suppliers, the externalization of services, the

⁸ For a detailed analysis see Canavese, A. (1992), "Hyperinflation and convertibility-based stabilization in Argentina" in A. Zini Jr. (Ed.), *The market and the state*, Elsevier, North Holland; Bouzas, R. (1993), "¿Más allá de la estabilización y la reforma? Un ensayo de la economía argentina a comienzos de los '90" in *Revista de Desarrollo Económico* N° 129, Vol. 33, Buenos Aires; Porta, F. (1995), *Cuatro años con tipo de cambio fijo: ajuste estructural o ajuste recesivo?*, CENIT, Documento de Trabajo N° 21, Buenos Aires.

cooperation between firms, levels of horizontal and vertical integration, all have to be redefined. This is the adjustment of the whole organizational model of the firm to the new environment. And these are the deep changes seen in the firms during convertibility.

These positive factors also had their negative counterparts, specially for firms that adjusted defensively. Trade openness limits pricing by firms. Unlike past practices, firms can no longer transfer their increments in costs to prices. In that sense, the Convertibility Plan was remarkably successful at stabilizing prices, while deep changes were also made in relative prices. These later changes favored non-tradable goods to the detriment of industrial prices that compete with foreign goods⁹ affecting the firms' cost structures. Industrial firms, specially SMEs, were also negatively affected by the improvement in tax collection.

So, what mechanisms do firms have to offset the cost increments in the new environment? There are basically three mechanisms that can reduce medium costs and allow firms to survive. The first one is the above-mentioned productivity increment. The second one emerges from the higher levels of activity and market concentration. Of course, it is assumed that a larger scale of production diminishes medium costs. The third one is through organizational changes, mergers and investments. In a complementary way, the government implemented a set of deregulatory measures with the purpose of improving the systemic conditions of the economy¹⁰.

However, the struggle against medium costs has diminishing returns, mainly because firms still operate with basic equipment bought in the '60s or '70s and do not restructure offensively. Hence, the reduction of medium costs finds restrictions very easily while costs increase.

Changes in the financial market and the firms' form of financing¹¹ are also important.

⁹ See Fanelli, J., Kacef, O., and Machinea, J. (1994), Precios relativos y competitividad industrial, Instituto de Desarrollo Industrial, Unión Industrial Argentina, Documento de Trabajo N° 19, Buenos Aires; Gerchunoff, P. and Machinea, J. (1995), "Un ensayo sobre la política económica después de la estabilización", en Bustos, P. (ed), Más allá de la estabilidad: Argentina en la época de la globalización y la regionalización, Fundación Friedrich Ebert, Buenos Aires.

¹⁰ See Azpiazu, D. (1993), Desregulación, privatizaciones y apertura en la economía argentina. Reflexiones preliminares sobre sus efectos en el sector industrial, CEPAL, Buenos Aires; Sguiglia, E. and Delgado, R. (1994), Los efectos de la desregulación sobre la competitividad de la producción argentina, Grupo Editor Latinoamericano, Colección Estudios Políticos y Sociales, Buenos Aires. This latest work obtained the Fulvio Salvador Pagani Prize given by Fundación Arcor.

¹¹ See Bonvecchi, C. (1995), El financiamiento de las pequeñas y medianas empresas, mimeo.

Stability recreates a totally different financial system. As can be seen the financial requirements of firms have notably risen. Why? In the first place, because the activity level has grown. And most importantly, because commercial credit has reappeared. During the high inflation period the necessary working capital was low. The buyer had to pay in advance, production was made with this money, and when the merchandise was delivered the indexation difference was collected. Now the merchandise is paid for within 60 to 90 days and there is a higher level of activity. Financial requirements can be offset partly by commercial credit and partly by banking credit. In spite of the growing monetization of the economy, the financial market is segmented. This has determined an important increase in firms' indebtedness, mainly concentrated in foreign currency due to its lower cost and has also raised their financial exposure¹².

Firms have entered into a delicate equilibrium, which depends greatly on the activity level. In this equilibrium, the profits rate has been reduced and, thus, the volume of profits can only be maintained through increments in the activity level. But that requires risking more money than in the past, increasing the indebtedness and financial exposure of firms.

This set of elements determined the transition of a business from a workshop to an enterprise. ISI's typical industrial workshop is being replaced by more complex organizations with the following characteristics: 1) firms still manufacture goods; 2) imported inputs and parts are substituting for local providers in order to reduce medium costs; 3) assembly activities are becoming increasingly important in detriment to manufacturing¹³; 4) firms are more inclined to distribute and commercialize imported goods. Foreign producers identified domestic manufacturers as their best partners since these have already established distribution and commercialization networks, know the needs of local customers and are in a condition to provide post-sale services. The emphasis on assembly activities and commercialization (specially stressed by defensive restructuring strategies) helps firms to sustain their position in the market but this process also has two evident negative effects. One, the labor force has not been incorporated. Two, and most importantly, new technological capabilities that would allow manufacturing of differentiated products with higher value-added are not being developed.

¹² According to a study by Fundación Capital of 76 firms quoted on the Buenos Aires Stock Exchange -representing approximately 90% of the total stock - 1) the degree of indebtedness (liabilities/net worth) has doubled; 2) negotiable debentures became a significant financial instrument; 3) indebtedness in U.S. dollars deepened and there is no market for long-run loans in pesos; 4) access to international financial markets has complicated recently; 5) the percentages of payment arrears have increased. See *Ambito Financiero* newspaper, August 18, 1994.

¹³ According to Report # 3 of provisional results of the 1994 National Economic Census released by the Instituto Nacional de Estadísticas y Censos (INDEC) the relationship between the gross value-added in manufacture and the gross value of production was notably reduced from 43.4% in 1986 to 36.3% in 1994.

Manufacturers have suffered on three different levels since modifications occurred in the international financial conditions in early 1994 and, specially after the "Tequila" effect. These levels are: 1) the financial framework; 2) the wealth effect and 3) the level of activity and the destination of production.

Changes in the financial market have seriously troubled firms. Restrictions on loans have become overwhelming. In most cases international credit -including commercial- was interrupted, or else, maturity terms shortened and rates increased. New credit lines were unavailable, and the real interest rates of domestic credit were incompatible with any business. When deposits later returned, banks preferred a "wait and see" behavior to assuming risks.

A large number of commercial credit contracts were broken, associated to the growth of formal and informal pre-bankruptcy and bankruptcy procedures. Refinancing became most common and there is no known case in which interest was added owing to payment arrears. Insofar as financial claims some assets were definitively lost. All this has resulted in a financial mismatch with growing debts and reduced loans.

The "wealth effect" was one of the characteristics of convertibility that most notably affected firms. This effect was depressed in 1995. The combination of a reduced level of activity, financial disequilibrium and business fragility lowered the present value of the firms. This fall affected the firms' financing, since their value as collateral had diminished. In fact, their financial exposure grew and they were rated as credit risks. That becomes even clearer with the return to normal financing conditions. It is no longer a question of financing supply but of reliable banking customers.

Finally, in relation to the evolution of the activity level, the breakdown of the expansive cycle is clear and an almost 7% reduction in the industrial output in 1995 can be seen¹⁴. Financial restrictions and the situation of the labor market -the rate of unemployment climbed from 6% in October 1991 to 16.4% in October 1995- negatively affected the domestic market, specially hitting convertibility's dynamic sectors. In contrast, exports rose, with intermediate goods as its main beneficiaries.

¹⁴ A growth path lasting 19 quarters ended in the first quarter of 1995 during which the industrial output increased by more than 30%. In the second quarter of 1995 the activity level fell by 4.1%, reaching a fall of 7% for the entire year. The contraction affected the diverse sectors differently. Most affected were the producers of durable consumer goods (in particular the automobile industry) which had led the industrial recovery since the beginning of the Convertibility Plan until 1994. Only the producers of intermediate goods, which had a contractive performance during the first years of convertibility, have recently shown improvements.

Many factors can explain this important increase in industrial exports¹⁵. Changes in the Brazilian situation, the remarkable improvement in prices -specially commodities-, the depression of the domestic market, and gains in competitiveness in some industrial sectors are among the most important. However, a word of caution is important before making a positive assessment of this rise in exports. Exports are concentrated in few firms and sectors, with rather fragile high value-added productive links. The Brazilian market is undergoing cyclical difficulties and, in some cases, exports are just an attractive means to obtain a reasonable scale of production and cover variable costs.

Unlike past experiences, reduction in the activity level affects firms in dissimilar ways. Minor falls alter their break-even point, which can then have a negative effect on the chain of payments.

Nonetheless, there is today a more sophisticated diagnosis of firms than in the previous phase of import substitution. A large number of firms were involved in negotiation processes on the advice of consultants and research teams. Besides, credit operations, contracts with foreign suppliers and the development of commercial and technological linkages and representation agreements opened the firms' frontiers.

In recent years, transference of majority stock holdings at rather low prices of enterprises undergoing financial difficulties though well positioned in the long term can be seen. These buyers are in a completely different position. They can obtain financing at lower rates; they have technological support to carry out restructuring processes and they have long-term objectives. Brazilian, Chilean and TNCs have shown interest in participating in these transactions. The food sector has been specially targeted. This is obviously a selective and not generalized phenomenon.

3. RETHINKING A COMPETITIVE STRATEGY

During 1994 the debate on industrial policy has been reopened with greater intensity. Three aspects have dominated the debate. The first one refers to the special regime that rules the automobile industry. Its spectacular results have generated a wide span of opinions that range from its justification to its possible extension to other industrial activities. The second one is related to the trade deficit, specially in the industrial sector. The third one focuses on the impact that the intense restructuring process is producing on

¹⁵ See Cepeda, H. (1995), Una visión sobre el desempeño exportador de 1994: el caso de las manufacturas de origen industrial, Instituto para el Desarrollo Industrial, Unión Industrial Argentina, Nota N° 51; Bisang, R. and Kosacoff, B. (1995), "Tres etapas en la búsqueda de una especialización sustentable. Exportaciones industriales argentinas 1973-1993", in Kosacoff, B., (ed.), Hacia una nueva estrategia exportadora, Universidad Nacional de Quilmes.

employment.

The unfavorable conditions that prevailed in international markets until mid-1994 (a fall in prices, excesses of supply and the proliferation of unfair trade practices) and the shock trade-openness policy had adverse consequences on a wide range of manufacturing activities. The combination of such effects with the limited flexibility demonstrated by the economic authorities to pressure firms and activities to restructure resulted in growing sectoral claims.

In the face of those claims the government adopted a set of measures, some selective and others of a more horizontal type. It was certainly not easy for the authorities to maintain a balanced position. On the one hand, concern in the business sector was justified. On the other, critics pointed to three factors: 1) the existence of similar situations in non-benefitted activities and/or firms; 2) the influence of those measures on macroeconomic discipline and 3) the lack of business commitments that would accelerate the improvement of competitiveness.

At present a significant number of provisions affecting industrial development are in force. Among the most relevant ones are: 1) a decrease in the costs of industrial goods, specially the tradable ones, by reducing payroll taxes; 2) changes in trade policy, in particular the implementation of anti-dumping duties, import quotas and specific taxes and 3) sectoral policies, specially concentrated in the automobile sector. These are complemented by a set of instruments of a horizontal character, which confront many generalized problems of the industrial sector¹⁶. However, all these actions do not suffice to make up a restructuring strategy. Linkages between the different instruments are also scarce and this reveals the need to redesign public and private institutions committed to industrial development.

Even though there exists a wide consensus on the importance of sustaining macroeconomic stability, fiscal discipline, less state intervention and trade openness as central aspects of the "new economic model", it is also considered that they constitute necessary but not sufficient conditions to achieve a sustainable growth process. In that sense, a new pattern of industrial specialization is also essential. Such a pattern should rescue positive values from the rich tradition originated in the long drawn-out process of Argentine industrialization and not simply be the result of the free functioning of the market forces.

¹⁶ Some of the most important complementary measures are: the regime of industrial specialization; draw-back regimes; a 4-point interest rates subsidy for SMEs; a program for the development of supplier networks; a national system of quality and norms certification; industrial information and statistics; the development of productive poles; export and investment support through Export-Ar and Invertir Foundations; BID-supported technological development; employment and training programs by the Labor Ministry.

The recognition of "market failures" and weaknesses of institutions attempting to upgrade performance in highly imperfect markets as well as the development of dynamic comparative advantages generated a debate on industrial policy. This discussion will hardly find an answer in the repetition of instruments and the institutional framework from ISI. The challenge is the same as in the past, but the internal and international conditions have changed¹⁷.

Argentina embarked on a process of increasing integration into the world economy when all sectors had not yet achieved the necessary competitive strength to take advantage of this openness. There is still much to be done in this direction.

It is a country with intermediate industrial development with a considerable potential to improve. Hence, it is important to coordinate the efforts of firms, workers and institutions that have not yet adjusted to the new scenario. There is no clearly defined strategy to encourage necessary efforts to develop competitiveness in either the public or private sectors.

With this in mind, Argentina is now facing the challenge to improve its competitiveness. There are numerous courses of action which can be taken in this regard, five of which will be mentioned here: 1) the movement of industrialization processes towards differentiated products with higher value-added; 2) the structuring of productive networks that provide the critical mass for industrialization; 3) the restructuring, from an "industrial" viewpoint of some aspects of the privatization process; 4) the deepening of "horizontal" policies, in particular, the qualification of human resources and the structuring of the national system of innovation; 5) the establishment of a financial system capable of orienting resources from internal and external savings to projects with high economic and social rates of return, at suitable interest rates and maturity terms.

What is the starting point? Over the last twenty years, Argentina has increased its development of natural resources and has enlarged the production of basic industries. However, the international economic scenario shows that these kinds of industries cannot compete efficiently. There is a basic need for further improvement, departing from these industries towards chains of higher value-added.

¹⁷ The debate on industrial policy has recently widened, particularly in industrialized countries where increasing competence and globalization can be seen. See Esser, K. and others (1993), América Latina - Hacia una estrategia competitiva, Instituto Alemán de Desarrollo, Berlin, 1992; Pérez, W., ¿Dónde estamos en política industrial?, mimeo, Santiago de Chile; Reich, R. (1991), The work of nations, Vintage Books, New York; World Bank, (1992) Fundamental issues and policy approaches in industrial restructuring, Washington; Chudnovsky, D. (1993), La política industrial y tecnológica en transición. Los casos de los Estados Unidos y el Japón, Proyecto Fundación Volkswagen/CEPAL; Bianchi, P. (1993), Technology and human resources in Europe after Maastricht, University of Bologna, Italy.

Argentina has the potential of strengthening technological capabilities that will then allow it to move away from standardized products (low value-added) to more differentiated and highly specialized ones (high value-added). Basically, this requires the structuring of a national system of innovation, with strong technological capabilities and fundamental investment in human resources. As an intermediate country, Argentina still has a relatively important stock of qualified resources, in spite of the deterioration that it has suffered in the past years. At the same time, it is a known fact that Argentina's industrialization is over a century old, but defective in terms of both plant size and specialization capabilities, hit by strong macroeconomic disequilibria such as current account deficits and high fiscal costs. Nevertheless it has simultaneously generated the production of industrial goods and a large number of technological capabilities. This clearly constitutes a departure point that only few societies can show.

With all its ups and downs Argentina is confronting the challenge to move towards chains of greater value-added. Examples are many: from wheat to differentiated food products, from steel to mechanized car parts -that can be inserted in the globalization process- and from leather to sophisticated accessories and clothing. Improvement in this direction can help to strengthen productive capabilities and expand current markets. Modernization and automation will be then not only possible but essential: They are basic requirements to participate in international trade. The new world economic organization makes it ever more difficult to commercialize low quality products, goods whose production does not contemplate proper environmental protection and by-products of social dumping (very low wages).

By advancing in the chain of higher value-added it will be possible to modernize, automatize and robotize the industry. At the same time, new job positions which undoubtedly require high investments in training human resources will be available. It will be necessary to establish linkages between firms, the educational system (particularly, the university) and between the public and private sectors.

The road to differentiation also has another side. The sustained development of a competitive industry requires systematic actions that offer critical mass necessary for an active involvement in the international division of labor. This requires involving both the diverse productive activities and the different economic agents.

Competitive systems are based on productive complexes with increasingly diffuse barriers between primary activities, industry and services. For a good to be competitive, it must be the result of a structured and efficient productive chain. The participation of different types of enterprises is vital. It is very difficult to advance in specialization channels and, simultaneously, have macroeconomic impact without the participation of large corporations (transnational enterprises and large national holdings). But, at the same

time, there is no successful industrial experience that developed without efficient SMEs becoming specialized suppliers and subcontractors. That encourages the development of new competitive organizations based both on economies of scale and flexible specialization.

The process of privatization constitutes one of the most significant structural changes in the last years. Its effects are not limited to macroeconomics, fiscal accounts and income distribution. They also affect industrial competitiveness. One aspect to be considered is the possible generation of positive spillovers in the economy. This can lead to the increment of systemic competitiveness. The efficiency, quality and prices of the services provided by privatized firms form an essential part of the industrial costs and conditions competitive potential. The design and functioning of regulatory frameworks that can guarantee the achievement of these objectives and also protect individual consumers, becomes essential. A less considered aspect -but certainly significant is the possibility that privatized enterprises can constitute networks of specialized suppliers and subcontractors. In a context of greater efficiency and competence these networks will allow firms to generate competitive advantages, not only as domestic suppliers but also as possible international ones.

The fourth course of action mentioned above consists of the set of horizontal policies characterized by the generation of positive externalities towards the industrial sector as a whole. These policies have a less discriminatory character. The main two are: 1) the qualification of human resources - which involves strengthening the fragile educational system, establishing linkages between the educational and the productive systems and the deepening of on-the-job training programs; and 2) the development of a national system of innovation. This system should fit the technological demands of an economy that confronts the challenge of competitiveness.

There are also numerous problems which are common to all firms, and specially SMEs, whose solution lie more in managerial competence than budget expansions. Among these can be mentioned the spread of quality management criteria, the development of subcontractor networks, ongoing courses for business people, the diffusion of automation technology, the evaluation of environmental standards and the adaptation of technical norms. In sum, the difficult challenge of competitiveness is mainly concentrated in a new industrial specialization that tends to incorporate greater technical progress and qualified human resources, strengthening a transformation process based on growth and greater equitable distribution.

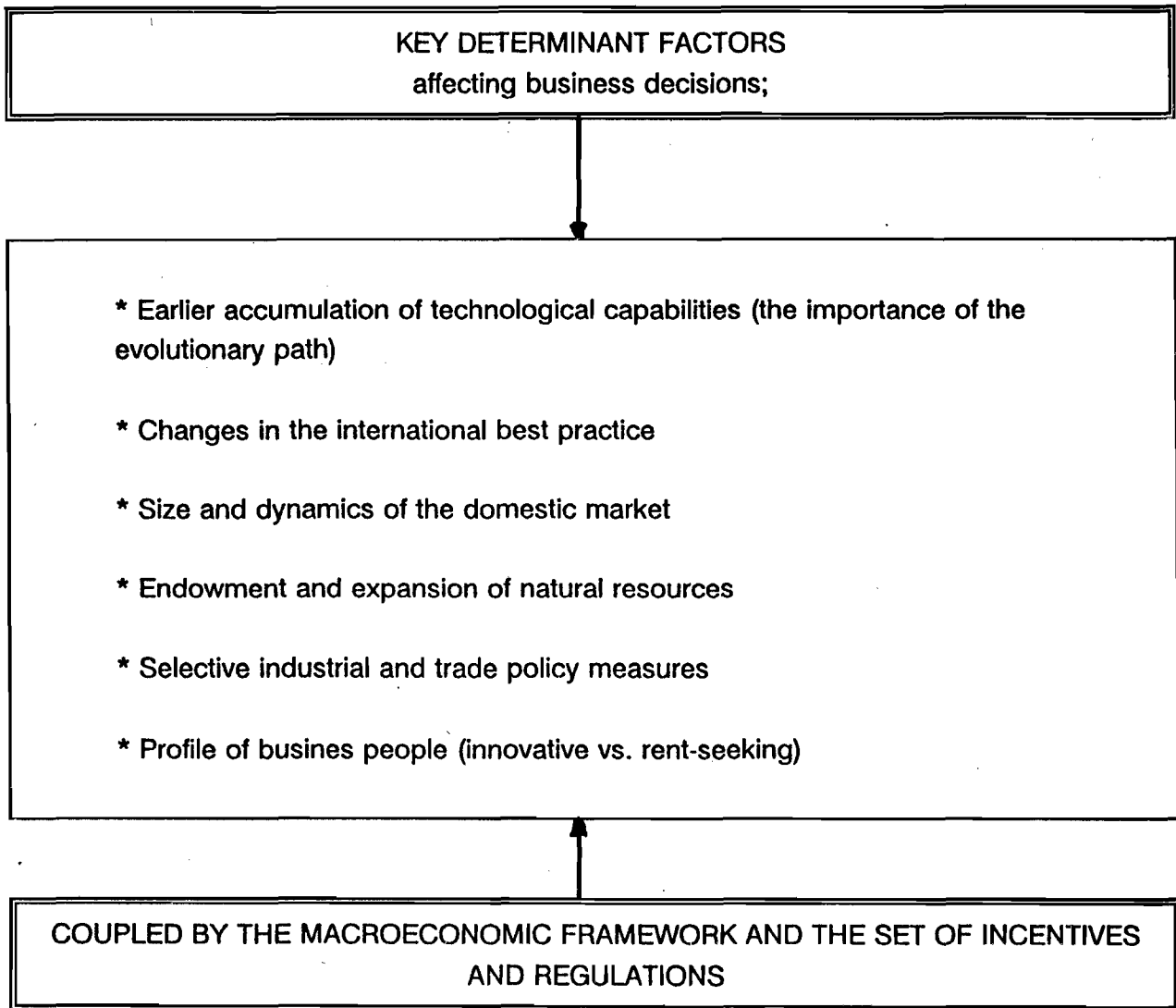
Finally, it will be impossible to carry out all these actions if the country cannot count on a financial system capable of providing -in volume, prices and maturity terms- the capital resources needed to undertake this transformation. In that sense, the completion of the financial reform constitutes a pending

task. Until now, banking institutions have fragmented the market and rationed credit to small firms. But, whenever they provided resources to SMEs the rates, maturity terms, and collateral requirements were beyond these firms' possibilities. Very little progress can be made without recreating financial instruments and institutions fully capable of detecting intermediation opportunities in the savings-investment process.

ANNEX

BUSINESS STRATEGIES (1975-1995)

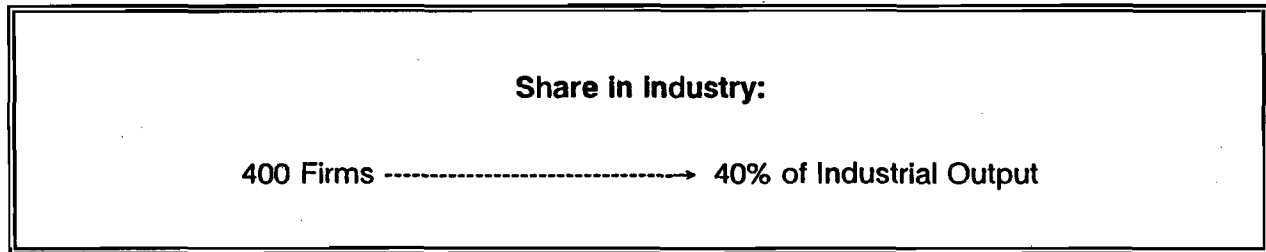
Departing from different initial positions, several behavior patterns can be seen:



Bernardo Kosacoff
Conference - February 1996
ILAS - University of London

OFFENSIVE RESTRUCTURING (1975-1995)

Characterized by radical changes in the processes of investment and diffusion of organizational changes that allow firms to reach productivity levels similar to the best international standards (regarding labor, defective products, use of energy and raw materials, production time, return on capital and so on).



These firms are spread throughout the whole industrial sector. They are also responsible for the rise in market concentration and export dynamics.

Outstanding areas

1. **Basic inputs** (aluminum, cement, paper, petrochemistry, oil refineries, iron and steel industry)
2. **Processing of natural resources** (natural gas, wood, fishing, oilseeds)
3. **Restructured automobile industry** (core of select car parts makers)
4. **Differentiated mass consumer goods for the domestic market** (Consumption growth during Convertibility: sweets, beer, non-alcoholic beverages, dairy products, household cleaning products, newspapers.)

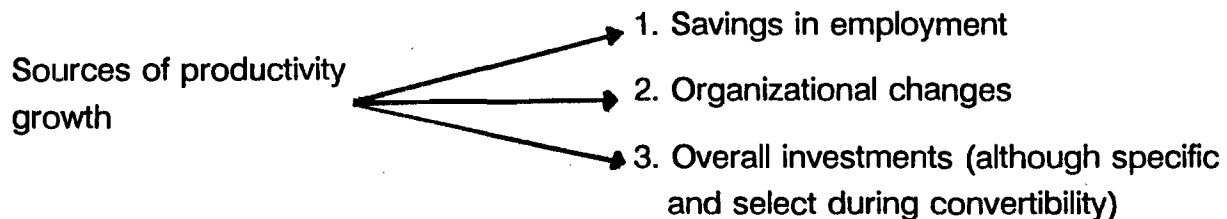
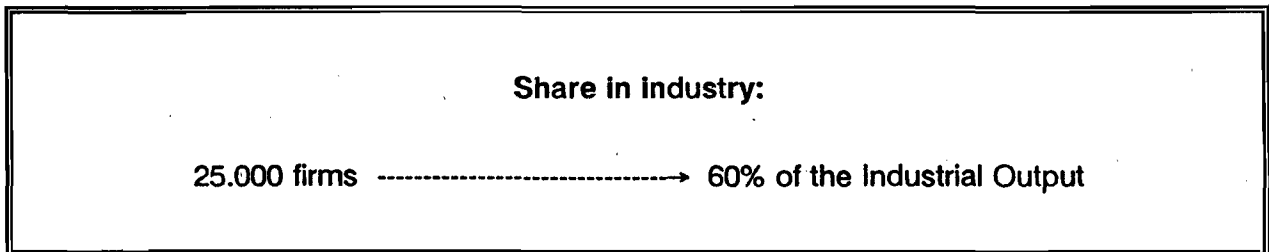
Key transformation factors

- Active policies, previous skills.
- Expansion of endowment of resources.
- Active policies. Globalization strategy.
- Expansion of the domestic market.

Bernardo Kosacoff
Conference - February 1996
ILAS - University of London

DEFENSIVE STRATEGIES (1975-1995)

These apply to most industrial firms. Characterized by strong productivity increases (doubled, on average) compared with their past performance, but still below the best international standards. These firms survived the 1978-81 opening experience and the macroeconomic crisis of the '80s. Now facing the new conditions under convertibility.



However, their plants continue to operate with machinery of different technologies (basic equipments is outdated, yet functional).

They have not overcome their problems of:

1. **ECONOMIES OF SCALE** (less than 10% of the optimal scale)
2. **ECONOMIES OF SPECIALIZATION** (excessive integration, little development of specialized suppliers and subcontractors)

Bernardo Kosacoff
Conference - February 1996
ILAS - University of London

1991 - 1994 SITUATION

POSITIVE ASPECTS FOR ENTERPRISES

- | | |
|----------------------------|--|
| 1. Stability | Conditions for the functioning of market mechanisms are recreated. Uncertainty is reduced. |
| 2. Growth of demand | Uneven behavior across sectors, but with very positive general level |
| 3. Wealth effect | Rise in the present value measured by estimated future income discounted by real interest rate |

Redefinition of the firms-market boundaries

MAKE OR BUY?

Development of key specific skills within the firms and greater externalization of activities.

Redefinition of the levels of horizontal and vertical integration of firms:

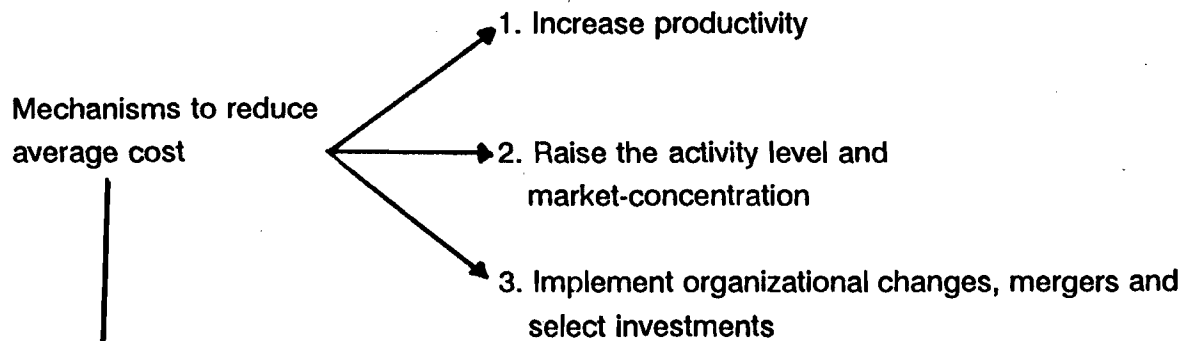
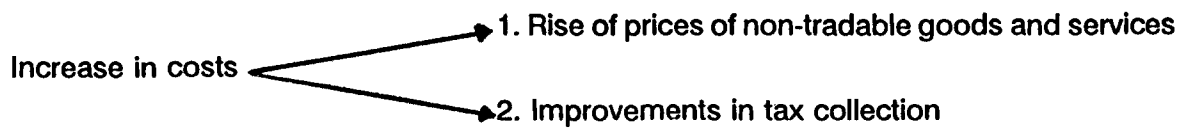
- * Domestic supplier and subcontractor networks
- * Provision of imported inputs and parts
- * Segmentation of markets, differentiation of products and growing importance of complementary services
- * Outsourcing

Changes in market orientation: more openness

RETHINKING THE ORGANIZATION OF THE ENTERPRISE

NEW COMPETITIVE CONDITIONS

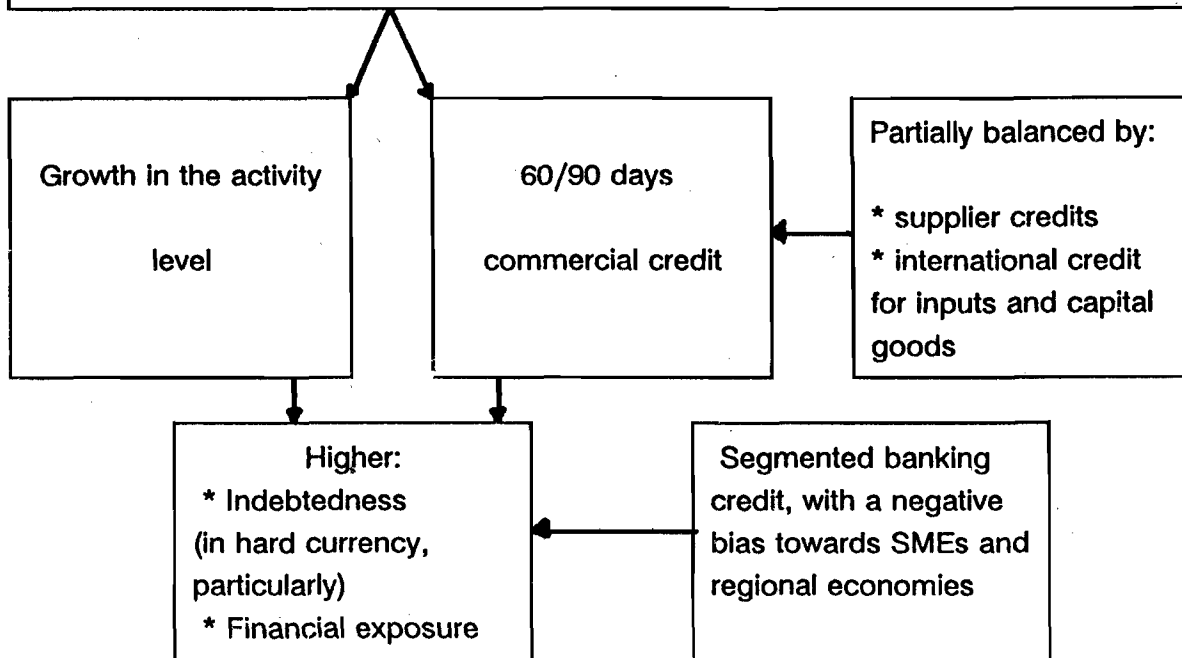
Economic openness -----> Impossibility to transfer the increase in costs to prices



Decreasingly important due to the lack of offensive restructuring

Stability and international financing restore commercial credit

Increase in financial requirements because of:



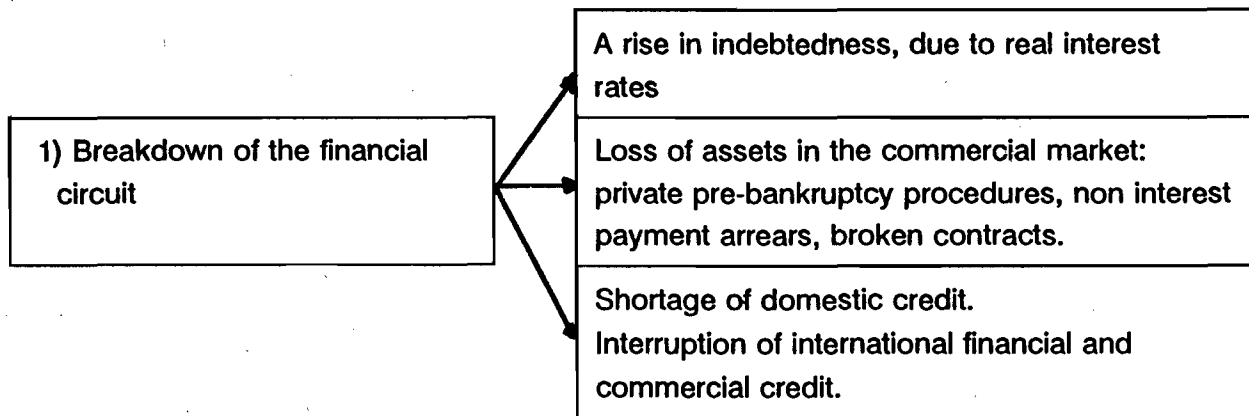
Fragile equilibrium of firms:

- * fall in the rate of profits
- * acceleration of indebtedness and financial exposure
- * importance of maintaining the activity level

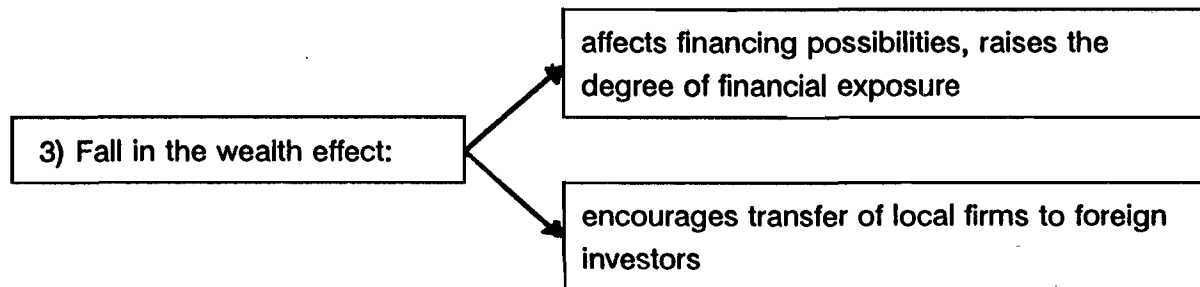
From the "Workshop to the enterprise"

- * Reduction of added-value in order to diminish costs and compete with imports:
 - > Increase of imported inputs and parts in the production function.
 - > Greater assembly activities
- * Growing importance of commercial and distribution chains and customer services
 - > representatives, commercialization of imported products and complementary services

CHANGES SINCE THE 'TEQUILA EFFECT'



2) End of the domestic demands dynamics



4) Remarkable dynamics in industrial exports

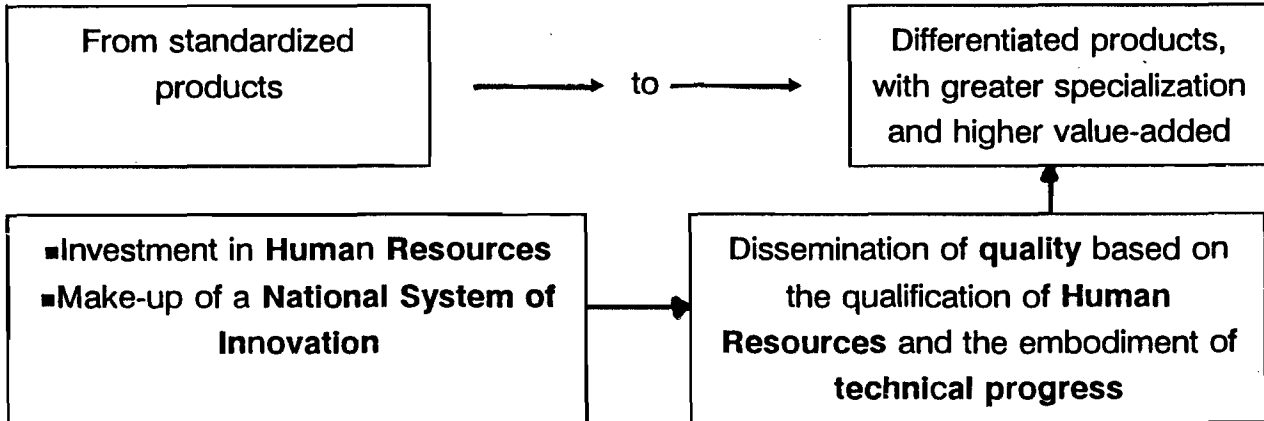
- Limits:
- * reduced number of firms
 - * few links in the value-added chain
 - * counter-cyclical character
 - * dependant on external factors (Brazil, international prices)
- == => systematic efforts are necessary to develop new competitive skills

5) New restrictions:

- * expansion of uncertainty --> new position for the firm-market link (e.g. level of productive integration, relationship with domestic and foreign suppliers, internalization of financial and productive functions.)
- * the magnitude of unemployment
- * pro-cyclical trait of investments
- * need to raise public savings through transfers from the private sector
- * limits of prices deflation
- * the recessive circle
- * functioning of the financial system

BUILDING A COMPETITIVE STRATEGY

STRENGTHENING OF VALUE-ADDED CHAINS



Examples:

wheat -----> differentiated food products

leather -----> sophisticated leather goods

steel -----> mechanized car parts

privatized services -----> structured networks of production with specialized suppliers and subcontractors

Modernization ---> Market expansion ---> increase in **productivity** and generation of **new highly qualified job positions**

Breaking of false dilemmas

Large corporation vs. SMEs -----> **networks**

Domestic markets vs. exports -----> **global strategies**

Industry vs. agriculture vs. services -----> **systemic complexes**

Market vs. government intervention -----> **complementary efforts**

Horizontal vs. sectoral policies -----> **intervention with social evaluation**

Stabilization vs. economic development ----> **structural changes**

Bernardo Kosacoff
Conference - February 1996
ILAS - University of London

Documentos de trabajo de la Oficina en Buenos Aires de la Comisión Económica para América Latina y el Caribe (CEPAL), de distribución limitada.

- [1] Los servicios de consultoría en la Argentina: la oferta local y la experiencia exportadora. [1983].
- [2] Política económica y procesos de desarrollo. La experiencia en Argentina entre 1976 y 1981 [1983].
- [3] Las empresas públicas en la Argentina: su magnitud y origen. [1983]
- 4 Nota sobre la evolución de la economía argentina en 1982. [1983].
- 5 Estadísticas económicas de corto plazo de la Argentina. Tomo III: precios, salarios y empleo. [1983].
- 6 Exportación argentina de servicios de Ingeniería y construcción. [1983].
- 7 La crisis económica internacional y su repercusión en América Latina. [1983].
- 8 Argentina y la cooperación interregional Sur-Sur. Un análisis de la cooperación económica con la India e Indonesia. [1983].
- 9 América Latina y la nueva situación económica mundial. [1983].
- 10 Estadísticas económicas de corto plazo de la Argentina. Tomo V: moneda, crédito y finanzas públicas. [1984].
- 11 Un enfoque alternativo para el análisis del desarrollo regional: estudio de la estrategia de crecimiento agrícola de la región NOA en el decenio 1970-80. [1984].
- 12 Nota sobre la evolución de la economía argentina en 1983. [1984].
- 13 El proceso de industrialización en la Argentina en el período 1976-83. [1984].
- 14 La evolución del empleo y los salarios en el corto plazo. El caso argentino. 1970-1983. [1985].
- 15 Nota sobre la evolución de la economía argentina en 1984. [1985].
- 16 Las empresas transnacionales en la Argentina [1985].
- 17 Principales consecuencias socioeconómicas de la división regional de la actividad agrícola. [1985].
- 18 Tres ensayos sobre inflación y política de estabilización. [1986].
- 19 La promoción industrial en la Argentina. 1973-1983. Efectos e implicancias estructurales. [1986].
- 20 Estadísticas económicas de corto plazo de la Argentina: sector externo y condiciones económicas internacionales. [1986].
- 21 Nota sobre la evolución de la economía argentina en 1985. [1986].
- 22 Exportación de manufacturas y desarrollo industrial. Dos estudios sobre el caso argentino. 1973-1984. [1986].
- 23 La distribución personal del ingreso en el Gran Buenos Aires en el período 1974-1983. [1986].
- 24 Nota sobre la evolución de la economía argentina en 1986. [1987].
- 25 Desplazamiento rural y cambios recientes en los procesos de urbanización regional. [1987].
- 26 Nota sobre la evolución de la economía argentina en 1987. [1988].

- 27 La promoción a la inversión industrial en la Argentina. Efectos sobre la estructura industrial. 1974-1987. [1988].
- 28 Estadísticas económicas de corto plazo de la Argentina: cuentas nacionales, industria manufacturera y sector agropecuario pampeano. [1988].
- 29 Tendencias y fluctuaciones del sector agropecuario pampeano [1988]
- 30 Biotecnología e industria farmacéutica. Desarrollo y producción de interferón natural y recombinante en un laboratorio argentino [1988]
- 31 Nota sobre la evolución de la economía argentina en 1988 [1989]
- 32 Proceso de industrialización y dinámica exportadora: las experiencias de las industrias acelera y siderúrgica en la Argentina [1989]
- 33 Nuevas formas de inversión de las empresas extranjeras en la industria argentina. [1989]
- 34 Política industrial y desarrollo reciente de la informática en la Argentina. [1990]
- 35 Sistemas de promoción a las exportaciones industriales: la experiencia argentina en la última década. [1990].
- 36 La desarticulación del pacto fiscal: una interpretación sobre la evolución del sector público argentino en las dos últimas décadas. [1990].
- 37 Nota sobre la evolución de la economía argentina en 1989. [1990]
- 38 Difusión de tecnologías de punta en Argentina. Algunas reflexiones sobre la organización de la producción industrial de IBM. [1991]
- 39 Nota sobre la evolución de la economía argentina en 1990. [1991]
- 40 La transformación de la industria automotriz argentina. Su integración con Brasil. [1991].
- 41 Importación de bienes de capital. La experiencia argentina en la década del ochenta. [1991]
- 42 Evolución reciente del complejo electrónico en la Argentina y lineamientos para su reestructuración. [1992]
- 43 Internacionalización y desarrollo industrial: inversiones externas directas de empresas industriales argentinas. [1992]
- 44 El MERCOSUR en el período de transición. Funcionamiento institucional, participación empresarial e impacto sobre el comercio. [1992]
- 45 Coordinación de políticas macroeconómicas: Aspectos conceptuales vinculados con el Mercosur. [1992]
- 46 Nota sobre la evolución de la economía argentina en 1991. [1992]
- 47 Balance del comercio internacional de manufacturas de Argentina: las tendencias al incremento del comercio internacional [1992].
- 48 Exportaciones industriales en una economía en transformación. Las sorpresas del caso argentino. 1974-1990 [1993]. (Hay versión en Inglés)

- 49 La inversión en la industria argentina. El comportamiento heterogéneo de las principales empresas en una etapa de incertidumbre macroeconómica. [1993]
- 50 Nota sobre la evolución de la economía argentina en 1992. [1993]
- 51 El comercio internacional de manufacturas de la argentina 1974-1990. Políticas comerciales, cambios estructurales y nuevas formas de inserción internacional. [1993]
- 52 De la sustitución de importaciones a la globalización. Las empresas transnacionales en la industria argentina. [1993].
- 53 La industria argentina. Un proceso de reestructuración desarticulada [1993].
- 54 Industrialización e incorporación del progreso técnico en la Argentina [1994].
- 55 Nota sobre la evolución de la economía argentina en 1993. [1994].
- 56 Rueda de negocios y cooperación empresaria en el Mercosur: análisis y seguimiento de las ruedas de negocios organizadas por el SEBRAE. [1994].
- 57 Calificación de los recursos humanos e industrialización. El desafío de los años ochenta. [1994].
- 58 Tecnologías de organización y estrategias competitivas. [1994].
- 59 Tres etapas en la búsqueda de una especialización sustentable. [1995].
- 60 Nuevas bases de la política industrial en América Latina. [1995].
- 61 Participación de las empresas transnacionales en las exportaciones argentinas [1995].
- 62 Las filiales argentinas de las empresas transnacionales de EE.UU. Rasgos centrales y desempeño reciente. [1995].
- 63 Vientos de cambio: los nuevos temas centrales sobre las empresas transnacionales. [1995].
- 64 Nota sobre la evolución de la economía argentina en 1994. [1995].
- 65 Perfil de la inserción externa y conducta exportadora de las pequeñas y medianas empresas industriales argentinas. [1995].
- 66 Hacia la calidad total: la difusión de las normas I.S.O. de la serie 9000 en la Industria argentina. [1995].
67. Estrategias empresariales en la transformación industrial argentina. [1996].