

# CRS Report for Congress

Received through the CRS Web

## Argentina: Political and Economic Conditions and Relations with the United States in 2000

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### Summary

In Argentina's presidential election, held on October 24, 1999, Fernando de la Rúa of the Alliance coalition defeated Peronist candidate Eduardo Duhalde, ending the 10-year rule of the Peronist party. President de la Rúa has continued the economic reform and trade liberalization measures implemented by his predecessor, Carlos Menem, which were effective in stabilizing the Argentine economy after the hyperinflation of the 1980s. In recent years, however, economic conditions have deteriorated and the success of President de la Rúa's administration will likely depend on the success of his economic reform program. In addition to labor law reform to address the unemployment problem, President de la Rúa has taken steps to improve economic conditions, reduce levels of public spending, and eliminate corruption. In December 2000, the Argentine government announced a financial package agreement with the International Monetary Fund (IMF) and other lending institutions to strengthen Argentina's economic reform program. Some analysts believe that the financial package combined with additional structural and labor law reform will achieve the administration's economic goals. However, others maintain that Argentina must change its exchange rate policy to improve economic conditions.

### Political Situation

In Argentina's presidential election held on October 24, 1999, Fernando de la Rúa defeated Peronist candidate Eduardo Duhalde, ending the 10-year rule of the Peronist party. President de la Rúa represented the coalition called the Alliance for Work, Justice, and Education, a partnership between the centrist Radical Civic Union (UCR) party and the mostly leftist Front for a Country in Solidarity (FREPASO) party formed for the October 1997 elections. President de la Rúa won the election with 48.5% of the vote, while 38.1% of the votes went to Eduardo Duhalde and 11% to Domingo Cavallo of the Action for the Republic (AR) party. In the chamber of deputies, the Alliance coalition

won the largest single block of deputies, but not the majority, with 122 out of 257 seats. The Peronists maintained the majority in the senate with 35 of the total 67 seats.

**Historical Background.** The December 1999 presidential elections were the fourth since Argentina returned to civilian democracy in 1983, after seven years of military rule. Argentina's successful return to a stable civilian democratic rule is regarded as remarkable by many observers, considering the country's extensive period of political instability. From 1930 to 1983, the government had numerous military coups, 25 presidents, 22 years of military rule, and 13 years of rule by the authoritarian populist leader Juan Domingo Perón.<sup>1</sup> Perón, who initially ruled as elected president from 1946 until his ouster by the military in 1955, established a formidable political base through support from trade unions. Peronism survived as a political movement despite attempts by the military and anti-Peronist sectors to defeat it. Perón was exiled until 1973 when he returned to win the presidency once again. In 1976, the military again intervened and ruled until it fell into disrepute in the aftermath of Argentina's defeat in the 1982 Falkland Islands war with Great Britain. In 1983, Raúl Alfonsín of the UCR was elected President for a six-year term. While Alfonsín was credited with restoring democratic institutions during his tenure, he left office in 1989 before his term was up because of a chaotic economy characterized by hyperinflation.

In 1989, Peronist Carlos Menem was elected president for a six-year term and was reelected in the May 1995 elections for a four-year term.<sup>2</sup> President Menem was successful in launching a major overhaul of Argentine domestic policy, turning the country's economic situation around. Although Argentina's successful return to democratic rule and stable economic conditions were widely hailed, the Menem presidency faced problems. Some observers characterized his government as authoritarian, claiming it weakened the powers of the Congress and the judiciary. Other political problems included charges of corruption in high-level governmental circles. Some high profile unsolved crimes, such as the 1992 bombing of the Israeli embassy and the 1994 bombing of a Jewish community center, both in Buenos Aires, contributed to charges of corruption.

**President de la Rúa's Administration.** Since taking office in December 1999, President de la Rúa has continued the previous administration's economic policy of structural reform and open markets. In his inaugural address, President de la Rúa emphasized that the three priority areas for his administration would be to reduce levels of public spending, address unemployment, and eliminate corruption. The president has followed a program of spending cuts, tax revenue increases, and provincial revenue sharing reform to lower the fiscal deficit. He has pursued labor law reform measures to ease existing hiring and firing restrictions to allow for a more flexible labor market, which would stimulate employment and allow the economy to react more readily to external shocks. In addition, President de la Rúa has taken anti-corruption actions such as cracking down on tax evasion, creating an Anti-Corruption Bureau, investigating alleged

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<sup>1</sup> Waisman, Carlos H. "Argentina: Autarkic Industrialization and Illegitimacy," in *Democracy in Developing Countries, Volume Four: Latin America*, Ed. By Larry Diamond, Juan J. Linz, and Seymour Martin Lipset. Boulder, Colorado: Lynne Rienner Publishers, 1989, p. 63.

<sup>2</sup> Argentina's constitutional reforms in 1994 changed the length of the presidential term from six to four years.

wrongdoing by former officials, and “tightening” disclosure rules on official discretionary expenditures.<sup>3</sup>

When President de la Rúa took office in December 1999, unemployment levels were high (14.5%), the fiscal deficit was higher than the target level, and the country was in a recession. In the first few months of his administration, President de la Rúa moved fast to initiate key portions of his political program. Some of his early successes included winning congressional approval for major fiscal deficit reductions, initiating labor reform measures, and developing political support from sectors of the Peronist party for key parts of his political program.

Another significant accomplishment for President de la Rúa’s administration in 2000 was concluding two sets of talks with the IMF and other international lending institutions on financial package agreements to strengthen the Argentine economic reform program. In March 2000, the administration successfully concluded negotiations on a three-year stand-by arrangement from the IMF supporting the government’s 2000-2002 economic program. In December 2000, the government announced another agreement with the IMF and other international lenders on a financial package of nearly \$40 billion (see below). Key elements of the agreement include continuing commitments to structural reforms and reducing the fiscal deficit.

President de la Rúa’s government had high public approval ratings in the first few months of his administration, but increasing doubts over economic recovery, a recent corruption scandal, and a second set of unpopular spending cuts affecting government salaries and pension payments have diminished public confidence in his abilities. In November 2000, President de la Rúa’s approval ratings dropped to 23%, down from the 70% approval rating only ten months earlier. The president is also having political difficulties within his cabinet and the governing coalition. A recent bribery scandal in the senate prompted him to make cabinet changes, but not to the satisfaction of some government officials within the coalition. He replaced some cabinet members, but held on to two officials who had been associated with the corruption scandal. In protest, Vice President Carlos Alvarez, who argued the two officials should be removed, resigned immediately. Other influential officials also resigned amid the cabinet reshuffling.<sup>4</sup>

The future success of President de la Rúa’s administration may depend on how well the economy does. Some analysts believe that the IMF loan agreements combined with additional structural and labor law reform will help the struggling economy. Others believe that financial packages and economic reform measures are not enough and that Argentina must change the currency board policy to achieve economic growth and international competitiveness. However, changing the fixed exchange rate would likely prove politically difficult for the administration since the U.S. dollar is so widely used within the country and most Argentines support the currency board policy.

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<sup>3</sup> Business Monitor International, Ltd. Latin American Monitor (LAM): Southern Cone, April 2000.

<sup>4</sup> LAM, Nov. 2000, pp. 1-2.

## Economic Situation

With a nominal GDP of \$283 billion in 1999, Argentina's economy is the second-largest in South America. During most of the 1990s, the Argentine economy expanded as real GDP increased by an average annual rate of 5.2%. After Brazil's 1998 financial crisis and currency devaluation, however, Argentina's economy went into a recession, largely because Brazil is Argentina's largest export market. Real GDP decreased by 3.1% in 1999 (see **Table 1**). In 2000, slight economic growth resumed, but unemployment remains high at an estimated 15%. The overall fiscal deficit as a percentage of GDP decreased between 1996 and 1998, but increased considerably in 1999. Managing the fiscal deficit remains one of the government's primary economic goals.

**Table 1. Selected Economic and Financial Indicators: 1985-2000**

	1985	1990	1995	1996	1997	1998	1999	2000*
Real GDP (1997 US\$b)	191.5	187.0	256.8	271.0	293.0	304.4	294.8	300.8
Real GDP Growth	-7.6	-2.4	-2.8	5.5	8.1	3.9	-3.1	1.7
Unemployment rate (%)	6.1	7.5	17.5	17.2	14.9	12.8	14.2	15.0
Inflation - CPI (%)	672.2	2314.0	3.4	0.2	0.5	0.7	-1.8	0.4
Current Acct. Bal. (US\$b)	-1.0	4.6	-5.0	-6.5	-12.0	-14.5	-12.2	-10.8
Overall Fiscal Balance** (% of GDP)	-3.0	0.7	-2.3	-3.2	-2.1	-2.1	-4.1	-2.3

\* Estimated

\*\* A negative number indicates a budget deficit

Sources: 1) IMF (report on Argentina) 2000; Standard and Poor's DRI, *The World Outlook. An Analytical Guide to International Business*, Third quarter 2000; LAM, November 2000.

During the 1990s, the Menem Administration dramatically reversed Argentina's economic decline by implementing aggressive free market policies and macroeconomic reforms. These included the establishment of a currency board which establishes a fixed exchange rate of the Argentine peso on a one-to-one basis with the U.S. dollar, trade liberalization, privatization of state industries, and public administration reform. As a part of the free market reforms, the Menem Administration opened up the Argentine economy more fully to international competition by liberalizing foreign investment and trade regulations and joining a regional common market (MERCOSUR) along with Brazil, Paraguay, and Uruguay. As a result of these policies, Argentina experienced a strong period of economic growth in the early 1990s. In the second half of the decade, however, Argentina experienced two recessions, partially as a result of external shocks caused by the 1995 Mexican financial crisis, the stronger value of the U.S. dollar, and the 1998 devaluation of Brazil's currency.

The establishment of a currency board is widely credited as the main instrument responsible for Argentina's reduction of inflation in the early 1990s. The currency board effectively prohibits the government from stimulating the economy by printing new currency not backed by gold or dollars. Former President Menem had considered a proposal to replace the Argentine peso with the U.S. dollar, but there is no clear indication whether President de la Rúa has intentions of implementing such a policy. While adopting

the U.S. dollar as an official currency may benefit the economy, primarily by stabilizing inflation, there are also potential economic costs.<sup>5</sup>

The currency board was successful in eliminating the hyperinflation of the 1980s, which averaged 355% annually. By 1993, Argentina's inflation rate had dropped to 10.6% from more than 3000% in 1989.<sup>6</sup> With the currency board, however, the Argentine government cannot devalue the currency to stay competitive in the international market and is limited in fiscal policy adjustments to stimulate the economy. To improve the fiscal balance after the economic shocks in 1995 and 1998, the government cut spending and increased taxes, putting more deflationary pressures on the economy.

Although some analysts maintain that Argentina's economy is fundamentally sound because inflation is under control and the fiscal deficit appears to be manageable, there are widespread concerns about sluggish economic growth and high unemployment. President de la Rúa's unpopular budget cuts and tax increases are adding to deflationary pressures on the economy and stifling wage and employment growth. In November 2000, millions of workers formed the largest strike in years to protest the government's economic policies. Continuing recent concerns about Argentina's economic prospects have raised the possibility among investors that Argentina may not be able to meet its debt obligations in 2001, an outcome that could easily lead to financial crisis.

In December 2000, in a crucial move to avoid a financial crisis, Argentina unveiled an economic program to enhance domestic and external confidence in the economy. The program, a financial package of \$39.7 billion, was agreed to by the Argentine government, the IMF, the World Bank, the Inter-American Development Bank (IDB), the Spanish government, and other lending institutions. It includes a \$13.7 billion line of credit from the IMF, \$5 billion in loan commitments from the World Bank and IDB, and \$1 billion from the government of Spain.<sup>7</sup> The goal is to provide Argentina with sufficient liquidity to avoid defaulting on its debt and to restore investor confidence. Some analysts maintain, however, that economic problems will continue unless Argentina eliminates the currency board to allow for increased competitiveness of Argentina's exports in the world market and to provide a more flexible fiscal policy to respond to economic problems. Others note that the present administration appears committed to the currency board on grounds that, with Argentina's "de facto dollarization" through a fixed exchange rate, a sudden change could cause significant economic disruption, at least in the short run.<sup>8</sup>

## U.S.-Argentine Relations

U.S. relations with Argentina since the country's return to democratic rule have been strong. Under the Menem Administration, Argentina made contributions to peacekeeping

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<sup>5</sup> For more information see CRS Report RS20105. *If Argentina Decides to use the U.S. Dollar, What Does It mean for both Countries?* by Gail Makinen. March 5, 1999, 6 p.

<sup>6</sup> Standard and Poor's DRI, *The World Outlook*, Third quarter 2000.

<sup>7</sup> *Washington Post* article and IMF statement.

<sup>8</sup> International Monetary Fund. Argentina: 2000 Article IV Consultation and First Review Under the Stand-By Arrangement, and Request for Modification of Performance Criteria. September 5, 2000.

operations worldwide. It participated in the Gulf War and made contributions to peacekeeping operations in Haiti. In October 1997, the United States designated Argentina as a non-NATO ally which gives Argentina access to surplus NATO hardware and facilitates congressional approval of future weapons purchases from the United States. Argentina has also actively cooperated with the United States on anti-drug measures. President de la Rúa has maintained Argentina's close relations with the United States. In 2000, the United States and Argentina signed a Memorandum of Understanding on anti-corruption cooperation to promote government anti-corruption efforts, efficiency and transparency. The two countries also signed an extradition treaty in 2000 that provides for extradition of fugitives from justice, including each country's nationals. Argentina has also actively cooperated with the United States on anti-drug measures.

President de la Rúa's administration is continuing the previous administration's trade liberalization policies and has stated it is committed to participating in the Free Trade Area of the Americas (FTAA) negotiations. Argentina's trade policy reforms have helped boost U.S. trade and investment flows. Exports of U.S. goods expanded from \$1.2 billion in 1990 to \$4.9 billion in 1999, an increase of more than 300%. Major U.S. exports to Argentina include non-electrical machinery (27%), chemicals and allied products (19%), and electrical machinery and related equipment (17%). U.S. imports from Argentina increased from \$1.5 billion in 1990 to \$2.6 billion in 1999, a 73% increase. Major U.S. imports from Argentina include petroleum and natural gas (18%), food and kindred products (16%), and petroleum refining products (11%). After years of trade deficits, the United States had increasing trade surpluses with Argentina during most of the 1990s. In 1999, the surplus decreased to \$2.3 billion (36%) from \$3.6 billion in 1998.<sup>9</sup>

Despite the market opening measures of the 1990s, Argentina continues to maintain a number of trade barriers. Since 1993, Argentina has maintained duties on footwear in spite of a World Trade Organization (WTO) ruling against them. Argentina also applies restrictions on certain U.S. agricultural products including fresh pork, Florida citrus, and certain California fruit. Other trade issues involve intellectual property protection. In pharmaceutical and agrochemical products, Argentina's patent legislation is inconsistent with WTO obligations. Piracy of computer software, video, cable television and recorded music also remains a problem in Argentina. The United States has initiated WTO consultations to address intellectual property rights issues.<sup>10</sup>

Several bilateral agreements between the United States and Argentina help promote U.S. foreign direct investment in Argentina. The agreements include an Overseas Private Investment Corporation (OPIC) agreement and an active U.S. Export-Import Bank program. In addition, the two countries have a bilateral investment treaty which gives U.S. investors Argentina national treatment in a number of sectors and allows for international arbitration of investment disputes. The stock of U.S. direct investment in Argentina increased from \$2.5 billion in 1990 to \$16 billion in 1999. The United States is the second largest foreign investor in Argentina.<sup>11</sup>

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<sup>9</sup> Data compiled by the U.S. International Trade Commission.

<sup>10</sup> U.S. State Department. *Argentina Economic Trends - May 2000*.

<sup>11</sup> U.S. Department of Commerce, *Country Commercial Guide: Argentina*, 2001.

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