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Argentina: Political and Economic Conditions and U.S. Relations

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Summary

With the restructuring of over $100 billion in defaulted bond debt in June 2005, Argentina appears to have emerged from its economic and political crisis. While the country was under considerable stress in 2001 and 2002, the democratic political system weathered the crisis. President Néstor Kirchner, elected in 2003, has made bold policy moves in the areas of human rights, institutional reform, and economic policy that have helped restore Argentines' faith in democracy. Economic growth has rebounded, from a decline of almost 11% in 2002 to 8.8% in 2003 and 9% in 2004. Nevertheless, the center-left Peronist government still faces considerable challenges, including the ability to build the political consensus needed in order to ensure future sustainable economic growth and financial stability. For additional information, see CRS Report RL32637, *Argentina's Sovereign Debt Restructuring*.

Political and Economic Background

Argentina's political upheaval in late 2001 and 2002 should be viewed in the context of its historical political development. Before 1930, Argentina enjoyed some 70 years of political stability that facilitated rapid economic development and made Argentina one of the world's wealthiest countries. It ranked seventh in the world in per capita income in the 1920s.[1] In contrast, from 1930 until 1983, Argentina experienced significant political instability, characterized by numerous military coups, 25 presidents, 22 years of military rule, and 13 years of "Peronism."[2]

[1] Thomas G. Sanders, "Argentina and the Politics of Economic Distress," UFSI Field Staff Reports, 1988-89, No. 4, p. 1.

[2] Carlos Waisman H. "Argentina: Autarkic Industrialization and Illegitimacy," in *Democracy in Developing Countries, Volume Four: Latin America*, edited by Larry Diamond, Juan L. Linz, and Seymour Martin Lipset, Boulder, Colorado: Lynne Rienner Publishers, 1989, p. 63.

When the military intervened in 1943, the regime came to be dominated by a colonel serving as Secretary of Labor, Juan Peron, who went on to build a formidable political base through support from the rapidly growing union movement. Peron was elected president in 1946 as the candidate of the Argentine Labor Party, which later became the Peronist Party. During his presidency, Peron bestowed considerable benefits on Argentina's working class through wage increases, fringe benefits, and the creation of a social security system. He also emphasized rapid industrialization of the economy by establishing state-run industries protected by trade barriers, a process also known as import-substitution industrialization.[3]

Peron's mobilization of the working class had an enduring effect on Argentina's political system over the next four decades. Even when Peron was ousted by the military in 1955, Peronism as a political movement survived despite attempts by the military and anti-Peronist sectors to defeat it. After his ouster, a series of civilian and military governments ruled until 1973 when Peron was reelected to office after 18 years of exile. Just a year later, however, Peron died and was succeeded by his second wife Isabel, who had little political experience. Economic and political chaos ensued, with political violence surging and Argentina experiencing its first bout of hyperinflation. As a result, the military intervened once again in 1976, but this time ruled directly until 1983, when it fell into disrepute in the aftermath of its failure in the Falkland Islands (Islas Malvinas) war with Great Britain in 1982. It was during this period that the military conducted the so-called "Dirty War" against leftists, guerrillas, and their sympathizers, and thousands of Argentines "disappeared."

In 1983, Argentina returned to civilian democratic rule with the election of Raul Alfonsin of the moderate Radical Civic Union (UCR). Alfonsin was widely credited with restoring democratic institutions, but economic conditions during his tenure were chaotic, with hyperinflation and considerable labor unrest. As a result, Alfonsin left office six months before his six-year term ended, letting the winner of the 1989 election, Carlos Menem of the Justicialist Party (PJ, or the Peronist Party), take office early.

Menem transformed Argentina from a state-dominated protectionist economy to one committed to free market principles and open to trade. Most state enterprises were privatized; hyperinflation was eliminated; and the economy was opened up to foreign trade and investment. In 1991, under the direction of Minister of Economy Domingo Cavallo, the government pegged the Argentine peso to the U.S. dollar and limited the printing of pesos to the extent that they were backed by U.S. dollars, a policy which helped keep inflation in check, but as is now known, became a major factor in Argentina's recent financial turmoil. (The dollar peg led to an overvaluation of the peso, and continued overspending led to large increases in external debt.) What made Menem's transformation of Argentina even more extraordinary was that he broke with the traditional Peronist protectionist policies favorable to the working-class and labor. Under Menem, the PJ began to attract middle-class voters and even some business interests.[4] Yet increasing corruption and high unemployment at the end of Menem's second term

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[3] William Ratliff and Roger Fontaine. *Changing Course: The Capitalist Revolution in Argentina*. Stanford, California: Hoover Institution, 1990, pp. 12-13.

[4] Manuel Pastor and Carol Wise, "From Poster Child to Basket Case," *Foreign Affairs*, November/December 2001.

were factors that led to the defeat of his party in the October 1999 elections; Menem himself was prohibited constitutionally from seeking a third term.

From De la Rua to Duhalde. Fernando de la Rua won the October 1999 presidential race as the candidate of a coalition known as the Alliance for Work, Justice, and Education, that brought together de la Rua's moderate Radical Civic Union (UCR) and the leftist Front for a Country in Solidarity (Frepaso). Although there was initial optimism when de la Rua took office in December 1999, that optimism had faded by the end of 2000 because of doubts about the government's ability to bring about economic recovery and because of corruption in the administration. While the government negotiated several financial arrangements with the International Monetary Fund (IMF) in 2000 and 2001, it was unable to fulfill IMF-imposed conditions relating to spending cuts. The IMF ultimately declined further financial support in December 2001, because Argentina could not produce a balanced budget. Argentines began rapidly withdrawing dollars from banks until the government limited withdrawals to $1,000 per month. The denial of access to bank funds, combined with already high poverty and unemployment rates after four years of recession, sparked widespread opposition to the government.

As confidence in the government evaporated, widespread demonstrations erupted around the country, with thousands calling for the President's resignation. Protests turned violent with rioters battling police with stones and bottles; 27 people were killed in the protests and hundreds were injured. Some blamed riot police for overreacting to peaceful demonstrations. As a result of the violent protests, President de la Rua fled the presidential palace and resigned on December 20, 2001, paving the way for a series of interim presidents from the Peronist party. Peronist Senator Eduardo Duhalde ultimately became president on January 1, 2002, with a mandate from Congress to serve out the remainder of de la Rua's term. Duhalde, who had been Vice President under Menem from 1989-1991, Governor of the Buenos Aires province, and the PJ's 1999 presidential candidate, was one of the most well-known and powerful Peronist leaders.

President Duhalde faced daunting political and economic challenges when he assumed office, most significantly the ability to quell social unrest associated with the country's financial instability. Protests against banks and politicians continued in the first half of 2002, but the widespread social violence of December 2001 was not repeated, and the Duhalde government survived. Duhalde initially promised such populist measures as increasing the state's role in the economy and protecting local industries, but he did not pursue a protectionist economic model. In the end, the Argentine economy stabilized under the Duhalde government. As part of his economic plan, Duhalde abandoned the Argentine currency's one-to-one peg to the U.S. dollar that had been in place since 1991 and ultimately adopted a unified floating exchange rate in February 2002. While the Duhalde government was unable to secure IMF financing in 2002 because of lack of progress on key fiscal and other structural reforms, it did secure a seven-month IMF arrangement in January 2003, valued at almost $3 billion. The Duhalde government was also able to clear Argentina's arrears with the World Bank and the Inter-American Development Bank, which allowed new loans in early 2003 to finance social safety net programs in order to reduce the impact of the economic crisis on the poor.

Challenges for the Kirchner Government

Kirchner's Election. Provincial governor Néstor Kirchner, a center-left Peronist, was inaugurated to a four-year term as president on May 25, 2003. Kirchner had emerged from the crowded 19-candidate first presidential election round held April 27 with 22% of the vote. Former President Carlos Menem, a center-right Peronist, topped the field with 24.36% of the vote, and the two candidates were scheduled to compete in a second round on May 18. But when it became apparent that Kirchner was forecast to win with nearly 70% of the vote, Menem pulled out of the race. During the campaign, Menem had advocated a neo-liberal free-market strategy to resolve Argentina's economic problems, including adoption of the U.S. dollar and increased economic linkages with the United States. In contrast, Kirchner advocated a continuation of Duhalde's economic policies and pledged to keep on the current Minister of Economy, Roberto Lavagna, viewed as the man behind the country's recent economic recovery. He attacked Menem's neo-liberal rhetoric and vowed to demand a reduction in debt and interest rates when negotiating with international creditors. Kirchner was viewed as somewhat of a political outsider, not associated with the corruption legacy of the past, and his candidacy attracted independents, an important factor given that traditional politicians have been discredited.

Progress and Challenges for Kirchner. President Kirchner's bold policy moves in the areas of human rights, institutional reform, and economic policy have helped restore Argentines' faith in government. He has attacked corruption in the federal police force and in Argentina's Supreme Court, which had been stacked with the supporters of former President Menem. Upon taking office, President Kirchner purged the military's top officers and vowed to prosecute current and retired military officials responsible for human rights violations conducted during the last era of military rule. At a dedication of a Museum of Memory commemorating the thousands of Argentines killed in the so-called "Dirty War," Kirchner asked "for forgiveness on behalf of the state for the shame of having remained silent about these atrocities during 20 years of democracy."[5] He strongly supported the Supreme Court's June 2005 overturning of two amnesty laws from the 1980s that had blocked prosecution for killings under military rule, a move that could open the door to hundreds of prosecutions.

In the economic arena, the Kirchner government has overseen a strong revival of the Argentine economy, with economic growth rates of 8.8% in 2003, 9% in 2004, and an estimated growth rate of 6.6% in 2005. Unemployment has decreased from a high of about 24% in 2002 to about 13%in 2005. [6] In September 2003, after several months of tough negotiations, Argentina reached a three-year stand-by agreement with the International Monetary Fund (IMF) that provided a credit line of about $12.5 billion. Although IMF accords are not normally politically popular, the accord was widely praised in Argentina as an agreement with realistic fiscal targets that would enable Argentina to deal with such issues as employment and social equity. Argentina suspended its IMF loan program in August 2004 because of IMF pressure on completion of debt negotiations with bondholders and on Argentine progress in implementing key economic reforms. In 2005, the Kirchner government ultimately was successful in restructuring more than $100

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[5] Hector Tobar, "Argentine Ceremonies Cast Light on 'Dirty War'," *Los Angeles Times*, March 25, 2004.

[6] "Argentina: Country Report," Economist Intelligence Unit, July 2005.

billion in defaulted bond debt at about 34 cents on the dollar, saving the country more than $67 billion in the largest debt-reduction ever achieved by a developing country.[7] The agreement had been reached in early March, but the debt exchange was held up until June by two hold-out creditors that had obtained a court order.

In June 2005, Argentina requested negotiations for a new IMF economic program. IMF officials lauded Argentina for its strong recovery since 2001 but maintained that the government needs to take action in a number of areas in order to sustain the recovery. These include continuing responsible macroeconomic policies in order to guard against inflation; implementing structural reforms to boost productivity and growth; strengthening the financial system; normalizing relations with creditors; and ensuring that the benefits of economic growth are equitably shared and that the vulnerable are adequately protected.[8] Although Argentina's macro-economic recovery has been impressive, many poor and middle-class Argentines have yet to see major improvements in living standards. Although poverty rates have declined over the past three years, some 40% of the population was still estimated to be in poverty at the end of 2004, with some 15% of the population living in extreme poverty.[9]

In the political arena, President Kirchner has maintained strong popularity, with over 60% of Argentines supporting his leadership. The PJ is the only party with national organization, holding a majority of provincial governorships, 41 of 71 Senate seats, and 116 of 257 seats in the Chamber of Deputies. However, there is currently a struggle in the party between supporters of President Kirchner and former President Duhalde. In the upcoming October 2005 legislative elections, one-third of the Senate and one-half of the Chamber of Deputies will be contested. In some races, the pro-Kirchner faction of the party will field candidates under the banner of the Front for Victory (FV) running against Duhalde candidates as the official PJ candidates. Some observers believe that the Kirchner faction will emerge strengthened from the October election. The UCR and other opposition parties have objected to the PJ's fielding multiple candidates under separate banners as an attempt to flood the ballot with Peronists to the detriment of opposition parties.

U.S. Relations

U.S.-Argentine relations have been strong since the country's return to democracy in 1983 and were especially close during the Menem presidency. U.S. officials commend Argentina's contributions to peacekeeping operations worldwide, including a contribution to the current U.N. peacekeeping mission in Haiti. Because of its military contributions, the United States designated Argentina as a major non-NATO ally in 1997, a status that gives Argentina access to grants of surplus military hardware. In terms of trade, the United States exported $3.4 billion in goods to Argentina in 2004 (with machinery,

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[7] Adam Thomson, "Argentina Closes Door on Dollars $110 billion Debt Exchange," *Financial Times*, June 3, 2005.

[8] "IMF Executive Board Concludes 2005 Article IV Consultation with Argentina," International Monetary Fund, June 30, 2005.

[9] Country Report," Economist Intelligence Unit, June 2005, p. 29.

organic chemicals, and electrical machinery exports topping the list) and imported $3.7 billion in goods, about half consisting of oil imports.

Although U.S.-Argentine relations are close, at times there have been irritants in the bilateral relationship. The tough U.S. approach toward Argentina during its political and financial crisis in 2001-2002 caused some friction in the relationship. Many in Argentina perceived that the United States was deserting a close ally in time of need. This turned around to some extent in 2003 when the United States supported Argentina in its negotiations with the IMF. U.S. officials supported the September 2003 IMF agreement for Argentina and lauded the country's economic recovery, although they emphasized the need for the government to undertake fiscal, monetary, and banking reforms in order to maintain long-term economic growth and reduce poverty.

In 2004, United States Trade Representative (USTR) placed Argentina on the Special 301 Priority Watch list regarding intellectual property rights protection because of serious concerns over the lack of adequate protection for copyrights and patents. Although the country made some improvements to its patent law, USTR kept Argentina on the Priority Watch List for 2005 because its overall copyright, patent, and data protection regimes do not appear to meet international standards, with copyright piracy a significant problem.

U.S. officials have highlighted concerns about the tri-border area (TBA) of Argentina, Brazil, and Paraguay because of activities of the radical Lebanon-based Hizballah (Party of God) and the Sunni Muslim Palestinian group Hamas (Islamic Resistence Movement). According to the State Department's April 2004 report on terrorism worldwide, the TBA "has long been characterized as a regional hub for Hizballah and Hamas fundraising activities, but it is also used for arms and drug trafficking, contraband smuggling, document and currency fraud, money laundering, and the manufacture and movement of pirated goods." The State Department's April 2005 report on terrorism asserts that there is no credible evidence that operational Islamic terrorist cells exist in the TBA countries. U.S. officials have lauded engagement with Argentina on counter-terrorism issues, including efforts to crack down on Middle East fund-raising activities in the TBA. Argentine security officials, according to the State Department, have been especially vigilant in monitoring illicit activity and potential links to radical groups in the TBA.

The 108th Congress expressed concern regarding Argentina's investigation into the July 1994 bombing in Buenos Aires of the Argentine-Israeli Mutual Association (AMIA) that killed 86 people. Allegations have linked Hizballah to that bombing as well as to a 1992 bombing of the Israeli Embassy in Buenos Aires that killed 30 people. Both the House and the Senate approved similar resolutions (H.Con.Res. 469 and S.Con.Res. 126) on July 22, 2004, that urged Argentina to provide resources to investigate all areas of the AMIA case. In 2004, all 22 Argentine defendants charged in the 1994 bombing were acquitted by a three-judge panel that faulted the investigation of the original judge and prosecutors. The acquittal prompted protests by Argentina's large Jewish community. No one else has been charged in the attack, although an Argentine court re-confirmed the validity of international arrest warrants for 12 Iranian nationals and one Lebanese official believed to head Hizballah's terrorist wing. In early August 2005, the judge responsible for the AMIA investigation was removed from office for bribery and other irregularities.