

# CRS Report for Congress

Received through the CRS Web

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

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### Summary

With the restructuring of over \$100 billion in defaulted bond debt in early March 2005, Argentina appears to have emerged from its 2001-2002 economic and political crisis despite last minute U.S. court challenges that have delayed the bond exchange. The current administration of President Néstor Kirchner faces still considerable challenges, including the ability to build the political consensus needed in order to ensure future sustainable economic growth and financial stability. While the country was under considerable stress in 2001 and 2002, the democratic political system weathered the crisis and economic growth has resumed, from a decline of almost 11% in 2002, to 8.8% in 2003, and an estimated growth rate of 8.5% in 2004. President Kirchner's bold policy moves in the areas of human rights, institutional reform, and economic policy have helped restore Argentines' faith in democracy. For further information on Argentina's debt problem, see CRS Report RL32637, *Argentina's Sovereign Debt Restructuring*. For background on Argentina's economic crisis in 2001-2002, see CRS Report RS21072, *The Financial Crisis in Argentina*.

### Political 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.<sup>1</sup> 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."<sup>2</sup>

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

<sup>2</sup> Carlos Waisman H. "Argentina: Autarkic Industrialization and Illegitimacy," in *Democracy in* (continued...)

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.<sup>3</sup>

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

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<sup>2</sup> (...continued)

*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.

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

Menem, the PJ began to attract middle-class voters and even some business interests.<sup>4</sup> Yet increasing corruption and high unemployment at the end of Menem's second term 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 Rúa to Duhalde.** Fernando de la Rúa 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 Rúa's moderate Radical Civic Union (UCR) and the leftist Front for a Country in Solidarity (Frepaso). Although there was initial optimism when de la Rúa 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 Rúa 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 Rúa'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

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

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. As the governor of Santa Cruz province in Patagonia, Kirchner had a reputation as a good administrator. He 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. Upon taking office, President Kirchner purged the military's top officers and vowed to prosecute current and retired military officials responsible for past human rights violations conducted during the last era of military rule (1976-1983). He supported the successful congressional annulment of amnesty laws from the 1980s that had blocked prosecution for crimes committed during the period of military rule. At a dedication of a Museum of Memory commemorating the thousands of Argentines killed in the so-called "Dirty War" against leftists and their sympathizers, Kirchner asked "for forgiveness on behalf of the state for the shame of having remained silent about these atrocities during 20 years of democracy."<sup>5</sup> Kirchner 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.

In the economic arena, the Kirchner government reached a three-year stand-by agreement with the International Monetary Fund (IMF) in September 2003, after several months of tough negotiations, 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

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<sup>5</sup> Hector Tobar, "Argentine Ceremonies Cast Light on 'Dirty War'," *Los Angeles Times*, March 25, 2004.

implementing key economic reforms. It expected to renew talks with the IMF after making progress in restructuring its \$100 billion in defaulted bond debt. The bondholders had strongly criticized the terms of Argentina's initial restructuring proposal in September 2003, which included a 75% "haircut" or debt reduction. A new Argentine proposal in June 2004 included an agreement to pay billions in unpaid interest, but the proposal again was criticized by many bondholders.

The proposal was formally launched in mid-January 2005 and ultimately, some 76% of the bondholders accepted by the end of February, agreeing to at most 30 cents on the dollar.<sup>6</sup> The debt restructuring – reportedly the largest debt-reduction ever achieved by a developing country – will reduce Argentina's total debt from \$190 billion to \$125 billion.<sup>7</sup> As a result of the restructuring, Argentina renewed discussions with the IMF in early March 2005, and has asked for U.S. support in achieving a new IMF agreement. Last minute legal challenges by some creditors in U.S. courts have delayed the bond exchange, which had been expected on April 1, 2005.

Although Argentina's economic recovery has enabled it to achieve the macroeconomic targets set by the IMF, many poor and middle-class Argentines have yet to see major improvements in living standards. Unemployment (estimated at between 13-14%), poverty, and associated rising crime remain long-standing problems. Although poverty rates have declined over the past two years, some 44% of the population fall below the poverty line, and some 17% are classified as being in extreme poverty.<sup>8</sup>

President Kirchner also faces the challenge of continuing to bring about structural reforms in order to ensure sustainable economic growth and financial stability. These include efforts to make permanent a sustainable fiscal relationship between the central government and the provinces, utility-sector reform, and banking sector reform. The President's ability to bring about such reforms should be strengthened by his party's 2003 electoral successes, although some observers maintain that squabbles within the Peronist party have the potential of diminishing the President's ability to enact his legislative agenda. In addition to holding 16 of the country's 24 governorships, the PJ now has quorum majorities in both chambers of Congress. In the 257-member Chamber of Deputies, the PJ holds 130 seats, while the opposition UCR holds 47 seats. In the 72-member Senate, the PJ holds 40 seats and the UCR 16 seats.

## 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 U.N. peacekeeping mission in Haiti. Because of its military contributions, the

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<sup>6</sup> Larry Rohter, "Argentina Announces Deal on Its Debt Default," *New York Times*, March 4, 2005.

<sup>7</sup> Adam Thomson, "The Improbable Hero: Man in the News Nestor Kirchner," *Financial Times*, March 5, 2005; and Kelly Hearn, "Argentina Cuts Debt; Investors Hurt; Public Hopeful Swap Will Revive Shaky Economy," *Washington Times*, March 15, 2005.

<sup>8</sup> "Argentina: Country Report," Economist Intelligence Unit, December 2004, pp. 26-27.

United States designated Argentina as a major non-NATO ally in 1997, a status that gives Argentina access to grants of surplus military hardware.

While 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 have lauded the country's economic recovery, although they emphasize the need for the government to undertake fiscal, monetary, and banking reforms in order to maintain long-term economic growth and reduce poverty.<sup>9</sup> While Argentina's positions at the U.N. often coincide with those of the United States, Argentina declined to join the U.S. "coalition of the willing" in Iraq in 2003. For the last two years, Argentina also abstained from voting on a resolution in the U.N. Commission on Human Rights highlighting Cuba's poor human rights situation. The Kirchner government's closer relations with Cuba have raised concern among some U.S. policymakers.

The 108<sup>th</sup> 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. Both the House and the Senate approved similar resolutions — H.Con.Res. 469 (Ros-Lehtinen) and S.Con.Res. 126 (Coleman) — on July 22, 2004, that urged Argentina to provide resources to investigate all areas of the AMIA case, encourage U.S. law enforcement support, and encourage the establishment of an Organization of American States task force to assist in the investigation. On September 2, 2004, however, five suspects (including four Argentine police officers) were acquitted as accessories in the AMIA bombing because of lack of evidence. The acquittals prompted protests by Argentina's large Jewish community. Allegations have linked the radical Lebanon-based Islamic group Hizballah (Party of God) to the AMIA bombing as well as to a 1992 bombing of the Israeli Embassy in Buenos Aires that killed 30 people.

The State Department has highlighted concerns about the tri-border area (TBA) of Argentina, Brazil, and Paraguay because of activities of Hizballah and the Sunni Muslim Palestinian group Hamas (Islamic Resistance Movement). According to the State Department's annual report on terrorism worldwide (*Patterns of Global Terrorism*, April 2004) 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." 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.

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<sup>9</sup> U.S. Department of State, International Information Programs, Washington File. "Treasury Official Lauds Argentine Economic Recovery," April 22, 2004.