Argentina After the Menem Decade

EXECUTIVE SUMMARY

On October 24, 1999, Argentina elected Fernando De la Rúa as the successor to Peronist President Carlos Saúl Menem. De la Rúa, 62, was elected President for the centre-left coalition, the Alianza (Alliance), with 48% of the votes, and took office on December 10. The strong popular vote of confidence received in the polls contrasts with the political reality the De la Rúa administration will have to face: a hostile Senate, judiciary, trade unions and most provinces in the hands of the opposition. A coalition rule with a powerful opposition will require a new approach to politics in Argentina: consensus-building will have to become the norm. Jobs, citizen security and corruption are the key areas where Argentines will demand significant improvements from their new President. Recession, a growing fiscal deficit and debt are the main obstacles to De la Rúa's plans and social reforms. The situation is aggravated by a jobless rate of 14.5 percent and the International Monetary Fund's demands for further spending cuts in the year 2000. However, despite promises of a social and moral change, De la Rúa has vowed to continue with key elements of Argentina's economic policy and the fundamental lines of its foreign policy; the consolidation of Mercosur will be its number one priority.

RÉSUMÉ

Le 24 octobre 1999, l'Argentine a élu Fernando De la Rúa comme successeur au président péroniste Carlos Saúl Menem. Monsieur De la Rúa, âgé de 62 ans, a été élu président de la coalition de centre-gauche, l'Alianza (Alliance), avec 48 % du suffrage, et assumera la présidence à partir du 10 décembre prochain. Le solide vote de confiance de la part de la population le jour du scrutin contrastait nettement avec la réalité politique à laquelle va devoir faire face l'administration De la Rúa : un Sénat hostile, le pouvoir judiciaire, les syndicats et la plupart des provinces aux mains de l'opposition. Une coalition au pouvoir qui fait face à une forte opposition va exiger une nouvelle approche de la politique en Argentine : travailler par consensus va devoir devenir la norme. L'emploi, la sécurité des personnes et la corruption sont autant de domaines importants où les Argentins vont exiger des améliorations significatives de leur nouveau président. La récession ainsi qu'un endettement et un déficit budgétaire en hausse constituent les principaux obstacles aux plans et aux réformes sociales du nouveau président. La situation est encore aggravée par un taux de chômage de 14,5 % et par le Fonds monétaire international qui exige d'autres coupes dans les dépenses en l'an 2000. Toutefois, en dépit des promesses de changement social et moral, monsieur De la Rúa s'est engagé à conserver les principaux ingrédients de la politique économique argentine, et à maintenir les orientations fondamentales de sa politique étrangère; la consolidation du Mercosur sera sa première priorité.

RESUMEN

El 24 de octubre de 1999, la Argentina eligió a Fernando de la Rúa para suceder al Presidente Peronista Carlos Saúl Menem. De la Rúa, de 62 años, fue electo por la coalición de centro-izquierda (Alianza) con 48% de los votos, y tomó posesión de su cargo el 10 de diciembre. El gran voto de confianza popular recibido en las urnas contrasta con la realidad política que la administración de De la Rúa tendrá que enfrentar: un Senado y poder
judicial hostiles, and the hecho de que los sindicatos y la mayoría de las provincias están en manos de la oposición. Un gobierno de coalición ante a una oposición fuerte tendrá que adoptar un enfoque político diferente en Argentina en el que la búsqueda de consensos tendrá que ser la norma. Los argentinos reclamarán importantes mejoras a su nuevo Presidente en las esferas de empleo, seguridad ciudadana y corrupción. Los principales obstáculos que deberá enfrentar De la Rúa en la realización de sus planes y reformas sociales son la recesión económica, el creciente déficit fiscal y la deuda. A esta situación se añaden también una tasa de desempleo del 14.5%, y las exigencias del Fondo Monetario Internacional de que se reduzcan aún más los gastos en el año 2000. Junto a sus promesas de realizar cambios morales y reformas sociales, De la Rúa ha anunciado continuar con los principales lineamientos de la política económica y exterior de Argentina. La consolidación del MERCOSUR será su prioridad número uno.

THE NEW POLITICAL LANDSCAPE

Argentina is South America’s second-largest economy, with a population of 36 million. The country went to the polls on October 24, 1999 to choose a successor to Peronist President Carlos Saúl Menem. Fernando De la Rúa, 62, was elected President of Argentina for the centre-left coalition, the Alianza (Alliance), with 48% of the votes, avoiding the need for a runoff. Eduardo Duhalde of the Peronist Party received 38% of the votes, and Domingo Cavallo of the conservative Acción para la República, 11%. Half of the members of the lower house of Congress and some key governors were replaced. De la Rúa took office on December 10, 1999.

A coalition government for Argentina

De la Rúa has been a fixture in Argentine politics for nearly three decades. His legislative experience with the Radical Party stretches back 23 years. More recently, he became the first elected mayor of the city of Buenos Aires. Unlike its leader, the Alianza (Alliance for Work, Justice and Education) is a relatively new political force. It was created in 1997 with the purpose of offering a strong alternative to the ruling Peronist Party, and is an amalgamation of the centrist, century-old Radical Party (UCR) and the left-leaning FREPASO (Front for a Country in Solidarity), which groups dissident Peronists, moderate socialists, and Christian democrats.

In a campaign lacking passion and debate, De la Rúa concentrated on projecting an austere, serious image. “People say I am boring,” read campaign posters plastering the city of Buenos Aires. De la Rúa’s lack of charisma, which had been a political liability in the past, turned into a political asset in a society saturated with personality politics and Menem’s extravagant style during his tenure in office from 1989 to 1999.

MENEM’S MIXED LEGACY

The Economy

The accomplishments of the Menem administration are impressive. Menem is credited with having brought inflation from an annual rate of 3,000 percent in 1989 to less than 1 percent in the 1990s, one of the lowest in the world. The cornerstone of the anti-inflation program was the 1991 “Law of Convertibility”, which pegged the Argentine peso to the US dollar (and required that the money supply have an equal amount of foreign reserves deposited in Argentina’s Central Bank). Next, Menem pushed through a structural adjustment program that dramatically changed Argentina’s economy through economic opening, privatization and deregulation. Deepening relations with Brazil and consolidating Mercosur were major foreign policy achievements that served the process of deep and far-reaching reform of the market.

The Political System

On the domestic political front, Menem’s legacy is less bright. While President Menem has been credited with bringing the Argentine military under civilian control, the price he paid was to pardon the military leaders tried and charged with grave human rights violations under his predecessor’s administration. His administration is perceived as having eroded checks and balances by by-passing Congress with presidential decrees (President Menem issued more decrees than all previous Argentine presidents since 1816), and by politicizing the judiciary. The Menem administration also leaves Argentina with a widening income gap, a high jobless rate and a sharp rise in crime.

For the first half of the 1990s, most Argentines seemed willing to accept the trade-off: economic stability in return for the weakening of some democratic institutions. This acceptance allowed President Menem to change the constitution in order to make it possible to run for a second term in 1995. He attempted to
change it again for the 1999 election, but on this occasion he faced widespread opposition, especially from Eduardo Duhalde, presidential candidate for the Peronist Party, who had formerly been Menem's Vice-President. Feuding between the two most powerful leaders of Peronism clouded the presidential campaign, and did little for the party. Menem was often charged with covertly seeking to undermine Duhalde's presidential bid so that he could become the undisputed head of the Peronist Party in opposition. Unable to run this time, Menem's last move was to cover the city of Buenos Aires with posters announcing his comeback in the next presidential term, only days before the 1999 elections. All this made the “Menem 2003” campaign a bitter final act to the Menem decade in the eyes of many Argentines, not least to those of his own party.

DE LA RÚA'S PLATFORM

De la Rúa pledged a transparent and accountable government, and a fairer distribution of wealth among Argentines. Promises of social and moral change abounded in the Alianza campaign: «The state at the service of the people»; «Education and employment for all»; and «We are the moral force against frivolity and deceit» were some of the most popular slogans. De la Rúa has also hinted that he may investigate his predecessor's administration. De la Rúa also campaigned on improved tax collection, tighter controls on spending and better financing for small and mid-sized companies.

First Steps

One of the first announcements of the Alianza was the Law of Ministries. It will create a powerful advisory council, above the ministers, charged with the strategic planning of state policies. The new law proposes the creation of two new ministries – “Social Action” and “Infrastructure and Housing” – and the merging of ministerial and presidential bureaus in an attempt to lower costs and increase the efficiency of government procurement. The proliferation of departments has been seen as contributing to corruption, which many Argentines now believe to be pervasive. A job creation package and an anti-corruption plan are also among the first measures the De la Rúa administration has said it will take.

Despite the promise of change, De la Rúa has vowed to continue with key elements of Argentina's existing economic policy, including:

- The currency board system with the Argentine peso pegged to the US dollar
- financial commitments to the International Monetary Fund (IMF)
- free market reforms and privatizations
- trade liberalization
- Mercosur

New Cabinet

De la Rúa’s recently announced ministerial cabinet is a very much a compromise formula, with representatives from FREPASO and the different wings of the UCR. Key appointments include those of Jose Luis Machinea (Finance), Adalberto Rodriguez Giavarini (Foreign Affairs), Rodolfo Terragno (Cabinet Chief), Federico Storani (Interior), Graciela Fernandez Meijide (Social Action) and Alberto Flamarique (Labour).

THE NEW GOVERNMENT'S CHALLENGES

A Powerful Opposition

The De la Rúa administration received strong popular support in the polls, but it faces a difficult political reality: a hostile Senate, judiciary and trade unions, and most provinces in the hands of the opposition. De la Rúa's efforts to effect change may be frustrated by a multi-party Lower House in Congress (even though the Alianza now has the largest minority), and a Peronist-controlled Senate, which are not up for renewal until 2001. Peronists also control two thirds of the provinces, including the biggest and richest province of them all: Buenos Aires. The Peronist victory in Buenos Aires, in a hotly contested campaign against the Alianza, is expected to complicate the challenge of governing Argentina for the new President.

The victory of the Alianza is likely to change the way of doing politics in Argentina. «Argentina faces an unheard-of scenario: coalition rule with a very powerful opposition», said Roberto Becman of the Centre of Public Opinion Studies in Buenos Aires. The new government is expected to do a lot of negotiating with the opposition; a key test of De la Rúa's ability to govern will be how well he can work with the Peronists.

Cohesion of the Alianza

In a country with little tradition of coalition governments, maintaining the cohesion of the Alianza will be a challenge for the new president. Due to the composition of the Alianza, the new government will have to take a more gradual, consensus-building approach to designing policies. Yet, De la Rúa's continuous stress on consensus, and his delay in
appointing ministers and making his first policy announcements, are being used by the Peronist opposition to foster an image of the new President as too indecisive and weak to take tough measures.

**ECONOMIC OUTLOOK**

Recession, a growing fiscal deficit and debt are the main obstacles to De la Rúa’s plans for social reforms. The situation is aggravated by a jobless rate of 14.5 percent and the International Monetary Fund’s demands for further spending cuts in the year 2000.

**Recession**

After growing 50 percent in the last 10 years, reaching a GDP of $288 billion (US), Argentina’s economy is expected to shrink 3 percent this year. Despite the recession, the economy is stable, Central Bank reserves are high, and the beginning of a gradual recovery is forecast for the year 2000. Argentina’s recession seems to be largely the result of developments outside the country: global financial turbulence, weak international commodity prices (agricultural products account for 60 percent of Argentina’s exports), and currency devaluation and lower demand in Brazil – Argentina’s largest export market.

**Deficit**

Argentina’s growing fiscal deficit worries observers. Following the elections, it was reported that Argentina’s deficit would be around $5.7 billion (US) (2.5 percent of GDP), thus breaching the $5.1 billion (US) fiscal deficit target for 1999 set with the IMF. Uneasiness over Argentina’s economic future has diminished as a result of Congressional approval of the Fiscal Convertibility Law, which mandates a balanced budget by 2003, and of the strong backing from multilateral financial institutions, which have reiterated their intent to provide additional financial support if requested. The IMF in particular has maintained its public support for the country’s economic program, as this year’s fiscal results have mainly been the result of declining tax revenues due to the recession and rising interest costs.

It was also reported that next year’s deficit could soar to $10 billion (US) if tough measures were not taken. Announcements of spending cuts, fiscal discipline, and a new revenue-sharing agreement with the provinces are expected soon, but other pressing measures like labour and tax reforms may take longer. The new cost-cutting plan is likely to include the elimination of discretionary expenses and a reduction of funds allocated to unwanted appendages of the government, such as intelligence agencies. De la Rúa has declined to provide any further details about expenditure cuts, but he has indicated he plans to tackle the crisis with «shock economic measures» aimed at restoring market confidence and improving the country’s risk rating and lowering interest rates.

**Debt**

The rising debt burden is another problem. According to the IMF, Argentina’s public debt grew from 34 percent of GDP in 1997 to 41 percent of GDP in 1999 ($115.4 billion). The foreign debt amounted to $139.7 billion (US) as of December 1998; more than half of it in the non-financial private sector.

**The Achilles Heel of the Model: “Convertibility”**

The currency board system known as “convertibility” has served Argentina well for most of the 1990s: it was instrumental in reducing inflation to almost zero, achieving macroeconomic stability, and restoring investor confidence, thus making Argentina one of the most attractive emerging markets in the region. Yet the costs are high: an overvalued currency, inability to use monetary policy to fight recessions and high dependence on external capital flows. The government cannot print money, nor borrow money for public spending to generate employment, because investors would interpret this as lack of fiscal discipline. For the same reason, it cannot devalue the peso without risking a crisis of confidence and a surge in inflation. Furthermore, many private and public entities are heavily indebted in US dollars; having to service these debts in devalued pesos could cause a worrisome string of defaults.

Some analysts say outright dollarization is the way to escape the straitjacket of convertibility. They say this would ensure lower interest rates and external financing since it would eliminate the risk of devaluation (which increases interest rates) and foreign banks would be prepared to lend for longer periods. To their opponents, who claim that such a course would mean a surrender of monetary policy, they reply that Argentina already lost control of monetary policy when it pegged its peso to the dollar. In any case, there does not seem to be a political consensus for outright dollarization in Argentina at the moment.

**Prospects**

The recession seems to have bottomed out and Argentina should start recovering by the year 2000, according to IMF predictions. There is agreement
among economic analysts that, next to fiscal discipline, all efforts should be focused on an aggressive export strategy to bring Argentina back to the path of growth. The fact that agricultural output is expected to grow, encouraged by a gradual recovery in international prices, will contribute to this goal. There are concerns, however, that the US Federal Reserve’s rise in interest rates for the third time this year could lure investment away from the Buenos Aires stock market and could strengthen the US dollar, to which the peso is pegged. A stronger peso would further erode the competitiveness of Argentine exports and hamper efforts to revive the economy.

SOCIAL REALITIES

Jobs, citizen security and corruption are the key areas where Argentines will demand significant improvements from their new president, according to a study conducted by the Universidad Torcuato Di Tella during the presidential campaign.

Unemployment

Argentina has one of the highest jobless rates in Latin America. Under the Menem administration, the unemployment rate steadily grew from a low of 7 percent in 1989 to a high of 18 percent in 1995, then stabilizing around 14 percent for the last two years. Under-employment is also a problem. De la Rúa has said that creating jobs will be one of the first tasks facing his administration. His strategy to tackle unemployment will include an extensive public works plan. Many analysts and businesspeople argue that only labour law reform, which would make it easier to hire and fire employees, could reduce unemployment levels. But reform is strongly resisted by trade unions and some political parties and that is largely why De la Rúa avoided revealing his position on the matter.

Crime, poverty, inequality

Argentina has also experienced an unprecedented rise in crime in the last four years and most Argentines feel that their lack of personal security has become a major problem, particularly in the province of Buenos Aires. Several measures are being considered, including reforming the Penal Code to increase punishments, raising police force salaries, and implementing a “zero-tolerance” policy on criminals similar to that applied in New York City. Closely linked to rising crime are the issues of unemployment, increased drug consumption and income inequality. The gap between the rich and the poor widened in Argentina in the 1990s, according to the 1998 report of the UN Economic Commission for Latin America and the Caribbean (ECLAC-CEPAL).

Despite the steep increase of per capita income between 1990 and 1997 (37%, reaching $8,210 in 1997), which has made Argentina the wealthiest country in the region, regressive patterns of distribution persisted. Economic growth has also failed to have a significant effect on poverty. By 1998, the number of poor had climbed to 13.4 million, or 36 percent of the population, according to a study by the World Bank.

Corruption

Combating corruption is also high on the list of popular demands. On a 1-10 scale of the 1998 Transparency International Corruption Perception Index (a perfect 10 would be a totally corruption-free country), Argentina scored 3, along with Thailand, Romania and Nicaragua. A trend for more transparent politics is becoming apparent. Largely promoted by the Citizen Power Foundation (Poder Ciudadano), several candidates — including De la Rúa — made voluntary declarations of assets and personal income during the pre-electoral campaign. This was considered an important step towards greater transparency and accountability in the political life of Argentina. It was reported that one of the first bills the new administration plans to send to Congress will be an anti-corruption plan that will include:

- a requirement of a declaration of personal and family assets before any official is confirmed in his/her post;
- periodic reports on the use of public funds;
- unannounced auditing of public officials;
- a code of conduct for state employees; and
- public auditing of the finances of political parties.

FOREIGN POLICY: MERCOSUR, A PRIORITY

The new administration has vowed to continue with the fundamental lines of Argentina’s foreign policy. These include the consolidation of Mercosur, the maintenance of close relations with the United States and the European Union, and the continuation of negotiations with the UK over the Malvinas/Falkland Islands.

Mercosur

“It is important to strengthen, push and re-launch Mercosur”, De la Rúa said in Brasilia in November 1999. The new president said he chose Brazil as his first post-election visit abroad in order to reaffirm his support for the trade bloc, the cornerstone of the country’s trade policy.
Argentina-Brazil trade relations have been rocky since the January 1999 devaluation of the real that put Argentine products at a price disadvantage to Brazilian goods (see FOCAL Policy Paper, Shall We Samba? July, 1999). Argentina has sought to introduce protective measures for shoes, clothes and textiles, and Brazil has responded with retaliatory threats. Paper, cellulose and laminated steel have also spurred conflict. Negotiations are underway to resolve these controversies, and restrictions to Brazilian exports have already been agreed to for some products.

Many have argued that the time is ripe for further macroeconomic coordination. This should help to prevent many of the problems that Mercosur has today, as well as to send out a clear message to investors that the Southern Cone remains committed to Mercosur. While the political will for increased coordination seems to be present, diverging tax systems (Brazilian states enjoy great autonomy) and exchange rate policies (fixed in Argentina and flexible in Brazil) make it difficult in the short term. During their November meeting, Cardoso and De la Rúa considered alternative ideas to re-launch Mercosur, including developing a social agenda, a Maastricht-style monetary agreement, private-sector business pacts, Seattle Round teamwork, joint consulates (especially in Asia) and the creation of a Mercosur brand.

USA Relations

The new administration has indicated there will be a change of style concerning relations with the US. The “carnal relations and automatic alignment” with the US prevalent under Menem will be replaced by a more selective approach to the relationship. One of the consequences of the new approach is that De la Rúa will not pursue Menem’s request for NATO membership. Argentina was granted “special non-NATO US ally status” under Menem, causing considerable friction with Brazil. One issue in the bilateral relationship that will not change, however, is the US request for a more rigorous law of patents in Argentina – possibly the only dissonant issue in the harmonious Argentina-US relations during the Menem decade. The US government has already indicated to De la Rúa that the discussion over patents will not go away with Menem’s departure.

Negotiations with the European Union (EU)

During a trip to Paris to attend the World Congress of the Socialist International in November 1999, De la Rúa highlighted the new priority his administration plans to give to Europe, but he also reiterated Mercosur’s call for an end to European agricultural subsidies. Negotiations between Mercosur and the EU are scheduled to start in November 1999, after being endorsed at the June 1999 Rio Summit. The EU has not yet committed to a final date for tariff and service negotiations, nor has it agreed to a methodology to deal with the issue of agriculture; rather, negotiations will be tied to progress at the Seattle Round of the World Trade Organization (WTO) (See FOCAL Policy Paper The Rio Summit of June 1999 – Its Implications for the Summit of the Americas Process, November, 1999). Days after De la Rúa’s election, the Spanish judge seeking Pinochet’s extradition issued international warrants for nearly 100 Argentine military and police officers implicated in human rights violations during the military rule from 1976 to 1983. There have been early indications that the new President will not interfere with the extradition process.

The Free Trade Area of the Americas (FTAA)

Argentina has been actively involved in the FTAA process, acting as Vice-Chair of the Trade Negotiations Committee (TNC), chairing the Negotiating Group on Agriculture and hosting the first TNC meeting in June 1998. Argentina took over the TNC chair from Canada at the Toronto Trade Ministerial in November 1999. However, there is concern among enthusiasts of the FTAA that Argentina’s recession and Mercosur’s troubles may distract the attention of the new administration from pushing regional economic integration forward in high gear.

Multilateralism

Argentina is an active member of the Rio Group, the Organization of American States (OAS) and the United Nations (UN). Argentina currently ranks eighth among countries participating in UN peacekeeping operations with delegations in Cyprus, Croatia, Iraq-Kuwait, Bosnia-Herzegovina and Guatemala, among others. Argentine participation in such operations may decline as the new government tries to reduce the $80 million (US) deficit of the Foreign Ministry.

Argentina-Canada Relations

Bilateral relations between Argentina and Canada have deepened in the last few years. Growing Canadian investor presence ($2.23 billion (Cdn) in 1998), two-way trade flows ($409 billion (Cdn) in 1998), and cultural and academic links have nourished this relationship. Canadian direct investment remains the basis of Canada’s commercial relationship with Argentina. Canada is the third most important foreign
investor in the country, with investments concentrated in the oil and gas, mining and energy sectors. The election of Fernando De la Rúa should not affect the state of Argentina-Canada relations. Having pledged to maintain the basic tenets of his predecessor's economic and foreign policy, the investment climate and market access conditions for Canadian companies should not be altered.

Only in the event of currency devaluation – which has been repeatedly ruled out by the incoming administration, but remains an option – could there be an impact on Canadian interests. Devaluation would increase the competitiveness of Argentine commodities such as wheat and beef which compete with Canadian products. Devaluation would also mean abandoning the current currency-board system on which investor confidence in the country rests. Since Argentina is considered to be, after Chile, the country with the most solid economic fundamentals, a loss of investor confidence in Argentina would probably extend to the region as a whole.

CONCLUSION
De la Rúa represents stability with change. A moderate and seasoned politician, he has vowed to continue with key elements of Argentina's existing economic and foreign policy, which has gained him the support of multilateral financial institutions and foreign governments. De la Rúa holds much promise; he may be able to redress some of the democratic and social deficit that characterized the Menem decade, while completing the economic transformation initiated by his predecessor. While the political will seems to be present, his ability to deliver will depend on progress on the economic front. Argentina's medium-term prospects will depend largely on the strength of the economic recovery and the government's ability to successfully implement fiscal and labour reforms. Also, the new administration will be constrained by financial commitments undertaken by the previous administration, such as the 2000 budget. In brief, De la Rúa's administration has little room to manoeuvre, and it may find it difficult to fulfill high public expectations of significant improvements in social and economic conditions.

At the regional level, Canada should capitalize on the convergence of priorities with the new government and work together on issues of transparency, accountability and equity at the OAS, Summit and FTAA processes. Other areas where there is scope for cooperation are parliamentary relations, science and technology, and natural resources.