Economic, Financial, and Political Environment in Argentina

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Abstract

Interest is high in Argentina as an emerging economic power in the Americas. This paper analyzes issues pertinent to the relative advantages and disadvantages between the United States and Argentina for producing, transporting, processing, and marketing major agricultural commodities in the context of distribution to significant global markets. Designed as a tool for agribusiness students and prospective investment and trade partners, it outlines Argentina's economic, financial, and political history. The paper focuses on the past 15 years, with emphasis on the trade-related economic and political reforms in the presidencies of Carlos Menem and Fernando de la Rúa. Appendices give background on two wars, the "Dirty War" and the Falkland Islands War, and outline the participation of Argentina as a founding member of Mercosur, a customs union.

Key words: Agricultural commodities, agricultural markets, Argentina, commercialization, comparative economic analysis, economic environment, financial environment, global markets, political environment.

Executive Summary

Interest is high in Argentina as an emerging economic power. The five dominant countries in the Americas are the United States, Canada, Mexico, Brazil, and Argentina. This paper analyzes issues pertinent to the relative advantages and disadvantages between the United States and Argentina for producing, transporting, processing, and marketing major agricultural commodities in the context of distribution to significant global markets. It is a companion piece to two other Midwest Agribusiness Trade Research and Information Center (MATRIC) studies: *A Comparative Marketing Analysis of Major Agricultural Products in the United States and Argentina (Argentina Report 2)* by Sergio H. Lence and *A Comparative Analysis of Agricultural Transportation and Logistics Systems in the United States and Argentina (Argentina Report 3)* by Thomas J. Goldsby.

Argentina gained independence from Spain in 1816, and remained one of the world's ten richest countries until the early part of the twentieth century. Its fertile Pampas region produced enough wheat and beef to account for more than one-half of the world's beef and grain supplies. Both politically and economically, however, Argentina's condition deteriorated significantly in the latter half of the twentieth century. In the 1970s and 1980s, for example Argentina had military rule. At least 15,00 people "disappeared" or were killed in the "dirty war" conducted by Argentina's military regimes of 1976–83. While extremely unpopular, the military rule collapsed only after the defeat of the Falkland Islands invasion in 1982. (Detailed descriptions of the Dirty War and the Falkland Islands War can be found in Appendices A and B.)

Argentina began enjoying political freedom in 1984, when Raúl Alfonsín, the leader of the middle class Radical Civic Union, defeated the Peronist Party. Unfortunately, the country faced hyperinflation, culminating in an average inflation rate of over 3,000 percent in 1989, when Argentina was economically at its worst.

Against this backdrop, Carlos Menem was elected president of Argentina in May 1989. His predecessor stepped down early in July 1989, overwhelmed by hyperinflation and riots. Although Mr. Menem made promises during his campaign to advance the agenda of the Peronist Party, he made a complete about face and instituted conservative policies after his election. The central goal of his policies was to tame inflation. He pursued his anti-inflation plan through a convertibility law that fixed the Argentine peso at parity with the U.S. dollar in 1991. Other reforms included privatization of state-owned enterprises and reduction/elimination of government subsidies. The economic policies of Mr. Menem showed swift results. The economy started growing in real terms in 1993. The inflation, which was close to 3,000 percent in 1989 and 2,300 percent in 1994, was gradually reduced to 172, 25, 11, and 4 percent in 1991, 1992, 1993, and 1994, respectively. Mercosur, South America's customs union founded in 1991, started paying off. (Mercosur is described in detail in Appendix I.)

Just as Argentina's economic future appeared bright, an external shock hit the country in 1994–95. The shock was brought about by events related to economic reforms taking place in Mexico at the time. The Mexican government decided to let the Mexican peso float, which led to massive depreciation of the Mexican peso. Investors started to question the ability of most Latin American governments to stick to and stand behind their currencies. Because of this, all Latin American economies experienced a flight of capital. A sudden outflow from Argentina led to a liquidity crisis in the market, and four years of growth came to an abrupt halt.

The International Monetary Fund (IMF) came to the rescue of Argentina because it realized that Argentina was not insolvent but simply faced liquidity problems. However, the events generated skepticism in the minds of foreign investors. The fallout from the Mexican crisis hindered further economic reforms. Rather than increase the money supply to reduce the credit crunch faced by businesses and support an increase in jobs and wages, Mr. Menem remained committed to austerity in the form of his convertibility plan. As a result, despite economic hardship, the Argentineans gave him a resounding victory in his bid for a second term in office. When another crisis hit in 1998, the Argentine government was better prepared. Though a few small banks failed, a reformed financial system, in which foreign banks held more than half of total deposits, remained stable.

Although the Argentineans were better off in 1998 than they were in pre-Menem days, they were getting restless with deteriorating public services, corruption, and social insecurities arising from the economic changes. Mr. Menem tried to implement new economic reform proposals in 1999, but the year did not prove to be the turn-around one for which he had hoped. Burdened with a "lame duck" presidency, Mr. Menem was unable to forge ahead with his new proposals. He stepped down from the presidency on December 10, 1999, after a peaceful transition to the newly elected president, Fernando de la Rúa.

President de la Rúa's prospects depend heavily on the perceptions of the financial markets. Though, Mr. Menem's policies brought price stability and bursts of high growth, these achievements carried the cost of making Argentina heavily dependent on outside financing. Mr. de la Rúa has said that by the end of his four-year term he wants Argentina's credit rating to climb to "investment grade," which would give the country access to cheaper and more abundant credit.

THE ECONOMIC, FINANCIAL, AND POLITICAL ENVIRONMENT IN ARGENTINA

Historical Background

Argentina gained independence from Spain on July 9, 1816. Argentina remained one of the ten richest countries in the world until the early part of the twentieth century. Its fertile Pampas region produced enough wheat and beef to account for more than one-half of the world's beef and grain supplies. Both politically and economically, however, Argentina's condition deteriorated significantly in the latter half of the twentieth century. In the 1970s and early 1980s, for example, Argentina had military rule. The military regimes detained, tortured, and killed thousands of dissidents, real or alleged. At least 15,000 (by some estimates, 30,000) people "disappeared" or were killed in the "dirty war" conducted by Argentina's military regimes of 1976–83. (Appendix A gives background about this war.) While extremely unpopular, the military rule collapsed only after the defeat of the Falkland Islands invasion in 1982 (A description of the invasion can be found in Appendix B.) Raúl Alfonsín, the leader of the middle class Radical Civic Union, handed the Peronist Party the first defeat since its founding. Since 1984, Argentina has been labeled a "Free" country (Appendix C). A "Free" country is one where citizens have full civil liberties and political rights as in other industrialized countries.

Argentina before the Carlos Menem Presidency

Although Argentina began enjoying political freedom after 1984, the economy continued to deteriorate. The country faced hyperinflation, culminating in an average inflation rate of over 3,000 percent in 1989. (See Appendix D for a historical perspective on inflation.) The country's output grew slowly and erratically, (Appendix E), which gives a historical perspective on the growth in gross domestic product (GDP). The inflation-adjusted growth rate has ranged from –13.13 percent to 34.20 percent during the last 25 years. The overall effect of high inflation and erratic growth was a massive depreciation in the value of Argentine currency (Appendix F). Today's Argentine peso (which costs $1) was valued as high as $20 billion at the time the Military Junta took control of Argentina in 1974. It was valued at only $56,000 when Raúl Alfonsín took control in 1984, a decline of almost 100 percent. The value of the peso deteriorated from $56,000 to about $24 toward the end of his term in 1989, a further decline of almost 100 percent between 1984–89. The currency declined in value another 96 percent between 1989–91, when it was pegged to the U.S. dollar at parity.

Argentina's current currency is called the "convertible" peso. This was established on October 10, 1991, at a rate of 1 Peso = 10,000 Australs, which was the currency before the Peso. The Austral was formed on June 15, 1985, at a rate of 1 Austral = 1,000 Peso Argentino, which was the currency preceding the Austral. The Peso Argentino was formed on June 1, 1983, at the rate of 1 Peso Argentino = 10,000 Peso Ley, which was the currency before the Peso Argentino. The Peso Ley came into existence on January 1, 1970, at the rate of 1 Peso Ley = 100 Peso Moneda Nacional. The Peso Moneda Nacional had been in existence since November 4, 1899. In summary, Argentina dropped a total of 13 zeroes in four steps from its original currency, Peso Moneda Nacional, between 1970–91.

The Menem Presidency

Given the previous information, it is not an understatement to conclude that Argentina was economically at its worst in 1989. Inflation was running at almost 200 percent per month and looting was rampant. Against this backdrop, Carlos Menem was elected president of Argentina in May 1989. His predecessor stepped down five months early in July 1989, overwhelmed by hyperinflation and riots. Although Mr. Menem made promises during his campaign to advance the Peronist Party's liberal agenda, he made a complete about face and instituted conservative policies after his election. The central goal of his policies was to tame inflation. He pursued his anti-inflation plan through a convertibility law that fixed the Argentine peso at parity with the U.S. dollar in 1991 (Appendix F). Other reforms included privatization of state-owned enterprises and reduction/elimination of government subsidies.

The economic policies of Mr. Menem showed swift results. The economy started growing in real terms (i.e., inflation-adjusted) in 1993. The economy grew at a real rate of 0.62, 2.64, and 4.87 percent in 1992, 1993, and 1994, respectively (Appendix E). The inflation, which was close to 3,000 percent in 1989 and 2,300 percent in 1990, gradually reduced to 172, 25, 11, and 4 percent in 1991, 1992, 1993, and 1994, respectively (Appendix D).

The Crisis of 1994–95

Under the convertibility plan of 1991, Argentina essentially committed to put into circulation only as much money as could be backed by U.S. dollar reserves. Furthermore, Argentina could print new pesos (i.e., increase money supply) only to the extent that its U.S. dollar reserves increased. This was the only way to ensure that the peso maintained parity with the U.S. dollar. If Argentina printed pesos without a commensurate increase in U.S. dollar reserves, it risked losing the parity of the peso with the dollar. The government's commitment to maintain the parity gave confidence to foreign investors that the value of their investments would not erode because of the recklessness of the host government. Thus, foreign money started to flow into Argentina (Appendix G). From experiencing a net capital outflow of $8.1 billion and $5.9 billion in 1989 and 1990, Argentina experienced a net capital inflow of $0.2 billion in 1991, $7.4 billion in 1992, $9.8 billion in 1993, and $9.3 billion in 1994. The encouraging aspect of this capital inflow was that a good portion of it came in the form of Foreign Direct Investment (FDI). The FDI increased from $1.06 billion in 1989 to $4.0 billion in 1992; then it declined slightly but remained high at $3.3 billion in 1993 and $3.1 billion in 1994. The net of all other investments (including portfolio and others), that was in deficit until 1991, turned positive in 1992. It was $3.3 billion in 1992, $6.6 billion in 1993, and $6.3 billion in 1994.

Just as Argentina's economic future appeared bright, an external shock hit the country in 1994–95. The shock was brought about by events related to economic reforms taking place in Mexico at the time. The Mexican government decided to let the Mexican peso float. The decision led to massive depreciation of the Mexican peso. Investors started to question the ability of most Latin American governments to stick to their commitments to maintain parity or stand behind their currencies. Because of these occurrences, all Latin

American countries experienced capital flight. Although the net FDI was a record $4.6 billion in 1995, net capital outflow (due to portfolio and other investments) was $4.1 billion in 1995 (Appendix G). Argentina had become accustomed to bringing in capital—over $6.0 billion in the preceding two years. The sudden outflow led to a liquidity crisis in the market, and four years of growth came to an abrupt halt. The International Monetary Fund (IMF) came to the rescue of Argentina, because it realized that Argentina was not insolvent; it simply faced a liquidity problem. Of all the countries in Latin America, Argentina did not deserve to be the casualty of the Mexican crisis. However, the events generated skepticism in the minds of foreign investors.

The capital outflow caused the money supply to slide (because of the close ties that reserves have with money supply) and caused the interest rates to almost double from 10.06 percent in 1994 to 17.85 percent in 1995 (Appendix D). Many businesses could not survive the liquidity crunch and went bankrupt. This resulted in the worsening of unemployment from 7 percent in 1989 to almost 16 percent in 1995 (Appendix H). This calculated to a whopping 2 million unemployed of those people who were employable. Inevitably, the high unemployment led to recession. The real GDP shrank 3.78 percent in 1995 (see Appendix E).

The fallout from the Mexican crisis hindered further economic reforms. While the federal government had already achieved considerable cuts in wages, Mr. Menem wanted the states to also cut wages and balance budgets. However, the unemployed and the prospective unemployed, those threatened by the proposed job cuts at the state level, started protesting—often resorting to riots. The angry protests of state workers intimidated elected state officials, who abandoned plans to cut wages and jobs. However, in the absence of wage cuts, it became difficult for states to balance budgets. The situation was made worse by the slowing economy, which meant fewer revenues. Furthermore, businessmen were demanding an easing of the economic austerity that had made credit scarce and expensive. Mr. Menem succumbed to this pressure in late 1994 and made unrealistic promises to create thousands of new jobs and to cut Argentina's 12 percent jobless rate to 6 percent by 1996.

Mr. Menem could have accomplished this by increasing the money supply to (a) reduce the credit crunch faced by businesses and (b) support an increase in jobs and wages of public employees. Both of these practices are common in many countries facing recession. However, he knew these measures could also damage the reputation of a nation that promised low inflation and to maintain the value of its legal tender. For a nation like Argentina that had lost almost 100 percent of its currency's value many times over, this could have had disastrous affects. In fact, for Argentina, this might have meant losing years of reform. Accordingly, Mr. Menem, in a bold move, chose to remain committed to the convertibility plan. Instead of bowing to pressure from the public, he pushed for more economic reforms. The reforms at the forefront included the following.

- First, he wanted the state governments to reduce subsidies and privatize assets just as he had done at the central government level.
- Second, he wanted legislation to restructure the weak banks and privatize the healthy ones to bring efficiency, credibility, and confidence to the financial sector.
- Third, he wanted to improve the competitiveness of Argentine businesses, including reducing the cost of hiring and firing employees.

Mr. Menem had communicated effectively to his people that there was a connection between his economic austerity plans and economic growth. Moreover, he demonstrated that he, along with his advisors, notably the economic minister, Mr. Cavallo, had the ability to achieve fiscal growth. Therefore, despite economic hardship, the Argentineans gave him a resounding victory in his bid for a second term in office (which was only possible after Mr. Menem persuaded Congress to change the constitution to allow a second term). Argentineans should be commended, because it is rare to see such enthusiasm and support for a politician who wants to go on inflicting hardship on the people while presumably building a better future for them. Mr. Menem urged patience, arguing that the economy would rebound soon. He was banking on the convertibility plan to win the confidence of foreign investors and bring back the money that had fled the country.

Fortunately for Mr. Menem—and Argentina—both foreign investments and exports were up in 1996 and 1997 (Appendix G). The net capital inflow was $7 billion in 1996 and a record $13 billion in 1997. Of the total capital flow, the net FDI was $4.9 billion in 1996 and $6.3 billion in 1997. The increase in FDI was due to more privatization and the opening up of the mining sector (copper, gold, oil, and gas) to foreign investment. The net of portfolio and other investments, which was – $4.1 billion in 1995, increased to $2.1 billion in 1996 and to almost $7.0 billion in 1997. In addition, Mother Nature was generous; the world famous Pampas region produced a record grain harvest in 1995. Exports, which were $15.8 billion in 1994, increased to $21 billion in 1995, $23.8 billion in 1996, and $25.2 billion in 1997. This translates to an increase of 32.4 percent in 1995, 13.5 percent in 1996, and almost 6 percent in 1997. Moreover, Mercosur, South America's customs union, which was founded in 1991, started paying off. Argentina's exports to Mercosur members, notably Brazil, increased. (Appendix I gives a detailed description of Mercosur.) The businesses that survived the ending of protection and subsidies were now beginning to be strong competitors. The economy grew by 6.11 percent and 8.21 percent in 1996 and 1997 (Appendix E). It provided a much-awaited relief in the unemployment rate. Unemployment was down from 16 percent in 1995 to 13 percent in 1998 (Appendix H).

Although the people were better off in 1998 than they were in pre-Menem days, they were getting restless with the deteriorating public services, corruption, and social insecurities arising from economic changes. They laid four big failures at Mr. Menem's door. The first was that delivery of healthcare, education, and social services was inefficient. The control of delivery of these services had been transferred to state governments. In most cases, the services were run by the Peronists, who managed them poorly and were corrupt.

The second failure was that, despite two years of talks, Mr. Menem had not yet been able to persuade the Peronist labor leaders to accept more flexible labor laws. Because of unreformed labor laws, many firms, that were trying to become globally competitive, had responded to growth by increasing overtime rather than by hiring new workers. Pledges to free the labor market and to complete pending privatizations were hard to fulfill. Planned privatization of the airports and banks remained sequestered in the courts or faced massive resistance from opposition party members and employees.

The third problem attributed to Mr. Menem was the fiscal deficit. Revenues remained weak because of poor tax collection. One estimate put tax evasion at $20 billion a year. The government increasingly resorted to foreign debt to meet the shortfall. The government debt increased dramatically in the 1990s (Appendix M).

The fourth, and most serious, problem was corruption, which prevented a large amount of public money from reaching those for whom it was intended. Unlike in Chile, the civil service and the courts in Argentina did not function well. At the insistence of the IMF, the Argentine government planned to create a new financial court that would help banks to pursue bad debtors. But a lethargic and politicized judiciary did nothing to crack down on routine tax evasion or the misuse of public funds. The government did not give the people incentives to respect the law, and Argentina's recovery was affected by social discontent.

The Crisis of 1998

Despite these structural problems, Argentina's economy grew in 1996 and 1997 at a healthy inflation-adjusted rate of 6.11 percent and 8.21 percent (Appendix E). However, as seen in 1994–95, Argentina's recovery was not immune to external threats. In 1998, Argentina found itself in a sharp recession, once again. The GDP fell by 8.74 percent in real terms (Appendix E). Moreover, other economic indicators were showing signs of deterioration. For example, external dependence (as measured by trade volume as a percentage of GDP) had increased to 16.58 percent in 1997 from a low of 10.3 percent in 1991 (Appendix J). While this shows that Argentina has been looking outward, it also shows that Argentina is more susceptible to downturns in countries like Brazil, the destination of almost one-third of its exports. A more alarming factor is Argentina's debt/GDP ratio, which has increased steadily. It reached 38.08 percent in 1997 and is still considered "dangerously" high (Appendix J).

The officials cited three problems for the crisis of 1998.

- First, the world prices for Argentina's agricultural commodities have fallen to unusually low levels.

- Second, Brazil, which is its major trading partner is experiencing recession and devaluation.

- Third, the American dollar has appreciated, causing the Argentine peso to become overvalued and thus, uncompetitive.

Additionally, Russia's default in August of 1998 and Asia's economic turmoil have caused investors to flee emerging markets and raised the cost of Argentina's foreign borrowing, and therefore, its debt/GDP and debt service ratios. (See Appendix J.)

Almost 60 percent of Argentina's exports are commodities, mainly farm products. Over the past two years, their prices have plunged. Moreover, because of the quantity of its exports going to Brazil, Argentina has been hit hardest by devaluation of Brazilian currency. Automobile production has been cut in half with no turn around in sight. Also, manufacturers of other products are facing competition from cheap Brazilian imports. Russia's decision to default on its debts in August 1998 brought about a liquidity squeeze. Because of the scare among foreign investors, Argentine firms are finding it difficult to raise capital abroad. Large budget deficits mean that even the government has difficulty raising the money it needs to finance its budget deficit**.** Domestic investment has plummeted because foreign financing has become scarce and expensive. The strength of the U.S. dollar is keeping the Argentine currency over-valued and making exports expensive in the global marketplace.

Argentina's convertibility plan leaves it with few policy tools to deal with such external blows: it can neither devalue its currency nor ease monetary policy. Argentina's government, though, was much better prepared to deal with this external shock than the previous shock caused by the Mexican crisis. The government had arranged a line of credit for emergency use. Many of the weaker local banks had been closed and foreign banks (which garnered greater confidence than local ones) had been allowed to acquire local banks. Thus, in contrast to the 1995 recession, this time there was no flight of resources. Though a few small banks failed, a reformed financial system, in which foreign banks held more than one-half of total deposits, remained stable. Encouraged by the success of the convertibility plan, Mr. Menem announced a proposal to take the currency board a step further, and formally adopt the dollar (which already accounts for around 70 percent of Argentina's money supply). Argentineans use the dollar as their unit of account for all but the most immediate purposes. Some 60 percent of bank deposits and almost all savings accounts are in dollars. All long-term contracts such as mortgages or leases are transacted in dollars.

The year 1999 did not prove to be the turnaround one that Mr. Menem had hoped. Burdened with a "lame duck" presidency, he was unable to forge ahead with any of his reform proposals. He stepped down from the presidency (his attempts to change the constitution to allow a third consecutive term did not materialize) on December 10, 1999, after the peaceful transition to the newly elected President Fernando de la Rúa.

Argentina after the Menem Presidency

In many countries, hard times breed impatience with politicians and their economic policies. Yet Fernando de la Rúa, leader of the opposition Alliance, won the presidency on a commitment to continue on the path that Mr. Menem paved. Mr. de la Rúa defeated his opponent, Eduardo Duhalde, the candidate of Mr. Menem's Peronist party, who had campaigned as a populist, promising increases in pensions and imposing a moratorium on Argentina's foreign debt—popular sentiments in hard times. However, Argentineans distrusted Mr. Duhalde's populism because they remembered what it could do to an economy. They have lived through a closed and inefficient economy with a history of chronic macroeconomic mismanagement leading to hyperinflation. Most Argentineans over the age of 20 remembered those days and were determined not to see them again. That explains the broad support for Mr. de la Rúa, who endorses the convertibility plan and wants economic reforms to continue. These reforms have yielded spectacular results. Inflation has been tamed and the economy has grown. Productivity has soared, exports have boomed (rising by an average of 13 percent a year from 1991–97), and foreign direct investment has poured in (rising by an average of 17 percent a year from 1991–97).

The international community has rated Argentina very favorably on the economic freedom that has resulted from these reforms. According to the 1999 *Index of Economic Freedom*, Argentina received a rating of 2.50 (on a scale of 1 to 5, where 1 stands for total economic freedom and 5 stands for no economic freedom). The 1999 rating of 2.50 compares with 2.60, 2.65, 2.65 and 2.85 in 1998, 1997, 1996, and 1995, respectively. The 1999 rating puts Argentina fifth in the region and thirty-fourth in the world (see Appendix K). The countries ahead of Argentina in the region include the Bahamas, Chile, El Salvador, and Panama. Other major countries in the region, such as Brazil, Mexico, and Venezuela rank twentieth, eighteenth, and twenty-second in the region, respectively. This "economic freedom" rating is a composite of scores on 10 different economic aspects of a country. These include trade, taxation, government intervention, monetary policy, foreign investment, banking, wages and prices, property rights, regulation, and black market. Argentina scored 3, 3, 2, 5, 2, 2, 2, 2, 2, and 2, respectively (see Appendix L). In trade policy, Argentina's rating of 3 suggests a moderate level of protectionism. Argentina's average tariff rate is 9.4 percent, but some non-tariff barriers still exist. According to the U.S. Department of State, "Customs procedures are cumbersome and time consuming, thus raising the cost for importers." In tax policy, Argentina's rating of 3 suggests a moderate tax rate. The top individual income tax rate is 30 percent but the rate for the average income level is 6 percent. The top corporate income tax rate is 33 percent. Argentina also has a 33 percent capital gains tax and a value-added tax between 10.5 and 27 percent. Government intervention in the economy is low (with a score of 2). Monetary policy received a score of 5, which is probably an anomaly. Argentina has received a less favorable rating because of its hyperinflationary record of the past. It should, however, receive a much-improved rating in the future. The rating on foreign investment of 2 suggests low barriers for foreign investors in both manufacturing and the stock market. Foreign investment is banned only in the shipbuilding, fishing, and nuclear power generation industries. The government has reduced most barriers to foreign banking. There are no distinctions between foreign and domestic banks; both are treated equally, hence a rating of 2 on banking. The wages and price category received a rating of 2, suggesting low level of intervention. Price and wage controls are now history, except for a law on the minimum-wage level. Property rights (with a score of 2) are constitutionally secure in Argentina, even concerning pharmaceuticals and computer software. However, the judiciary is weak and can be lax in protecting rights. Regulations (with a score of 2) are few, except on privatized public-works enterprises. Black-market (with a score of 2) activity has shrunk to the point where it is minimal.

Although these reforms have led to high unemployment rates and closed factories that were the pride of the former manufacturing suburbs around Buenos Aires, life in the 1990s has become much better for many Argentineans. Moreover, people know—after facing two crises in the last decade (1994/95 and 1988/89)—that their currency is rock solid. The currency board and the banks are in a much stronger position to garner the confidence of investors.

Government budget deficits and foreign loans that have been amassed to finance the deficits are of primary concern (Appendix M). While the economy was growing, it was easy and cheap to borrow abroad to finance budget deficits; and the cost of doing so seemed affordable. However, in the wake of the recession, the budget deficit has risen, as tax revenues have fallen and the government's interest bill has soared. Total public-sector debt has risen from 39 percent of the GDP at the end of 1997 to an estimated 46 percent by the end of 1999. Including private sector debt, the total external debt is about 52 percent of the GDP. Argentina's debt-service ratio (a ratio of debt payments and exports, a figure closely watched by markets) is estimated to be over 60 percent. No other major emerging nation has a ratio as high. Moody's Investors Service, a credit-rating agency, has already downgraded Argentina's rating. It is encouraging to see that the Congress has approved a fiscal responsibility law that mandates a declining deficit until the federal budget reaches balance in 2003.

Unfortunately, the options of the new government are limited. It cannot ease monetary policy (i.e. devalue its currency or increase money supply because of the convertibility law) or embark upon a fiscal package to stimulate the economy (because of the fiscal responsibility law). It cannot raise taxes, as that would surely scuttle competitiveness and probably encourage more tax evasion. This means that the only option for restoring market confidence and improving competitiveness lies in structural reforms to make the economy grow internally.

Measures to improve competitiveness are not easy. Argentina has already accomplished many of the obvious productivity-enhancing reforms, such as privatization and trade liberalization. With the exception of two big banks and the airports, almost everything that the state owned has been privatized. The reforms that remain are harder politically.

One area in need of reform is the labor market. Labor markets were tight even during the boom years suggesting something has been wrong with the job market. The problem has been high payroll taxes that include high mandatory payments by employers to trade union-run health and benefits schemes. These schemes yield few services and foster corruption. So a big reduction in such employment costs means tackling union power. Many big firms have resorted to paying for these dues as well as private health insurance for their employees, thus raising the already-high cost of hiring workers. The high costs of hiring workers means that firms shy away from hiring new workers. Laws to make it easier to fire workers and hire temporary workers are deemed necessary.

A politically easier way to reduce business costs would be to reform the regulation of Argentina's public services. Many of the early privatizations of telecommunications, electric distribution, and roadways, for example, came with regulatory frameworks that restricted competition or, at least, were too generous to the new owners. Road tolls were indexed to inflation in the United States. Perhaps that was necessary in the early 1990s, but not now that Argentine consumer price increases are lower than those of the United States. Many Argentineans believe that some of these privatizations were tainted by corruption. Reforming the privatizations might be legally complicated, however.

Given the difficulty of making these structural reforms, Argentina's future is hard to predict. Recent history suggests that Argentina can survive external shocks and can easily bounce back if commodity prices strengthen and Brazil recovers. But there are many constraints as well. Argentina has already benefited from the rewards of its early reforms. Further reforms are politically and socially more difficult, and their impact on the economy is harder to show. Although the budget deficit must be brought into balance, there is an alarming level of debt that will continue to make investors nervous. Argentina's future depends upon the new president's economic good sense, political acumen, and good fortune.

The Presidency of Fernando de la Rúa

Although it may be premature to judge Mr. de la Rúa (he assumed the presidency in December 1999), it seems that he has moved swiftly to tackle fiscal and labor reforms. The Alliance party is attempting to cut the fiscal deficit to \$4.7 billion, down from \$7.1 billion last year. It has pushed through an unpopular set of tax proposals that may raise \$2.5 billion in revenue this year. It has also struck a deal with the states to cap the money they receive from the federal government. Mr. de la Rúa is dealing sternly with Argentina's powerful trade unions, too. A bill before Congress would make labor contracts flexible and allow collective bargaining at the company level. The bill faces resistance from many of the members of the Alliance's sizeable left wing, but it stands a reasonable chance of success.

These efforts have been noticed abroad. The IMF has agreed to offer Argentina a large contingency credit of $7.4 billion. In February 2000, Standard & Poor's revised its view of Argentina's outlook, from "negative" to "stable."

Within the country too, Argentineans are impressed by the new president. Polls give Mr. de la Rúa a 62 percent approval rating, compared with 41 percent for his government. That may be partly due to some carefully cultivated image of personal austerity. For example, he has promised to sell Tango 01, a Boeing 757, bought for $66 million by Mr. Menem as a presidential jet and a symbol of his extravagance. In January 2000, Mr. de la Rúa traveled on commercial airlines during his first foreign tour. On returning, he was careful to let it be known that he had passed through customs, just like any other Argentinean, and paid duty on his excess purchases.

He has also promised a "war on corruption." So far, not much has been accomplished. There is a crackdown on smuggling on the Paraguayan border, a promise to increase transparency by publishing information about state tenders on the Internet, and an indication that an investigation will be carried out on two senior officials from Mr. Menem's government for alleged corruption charges.

Another of Mr. de la Rúa's campaign pledges was to rein in the exorbitant tariffs charged by many utilities that had been privatized by Mr. Menem. Here, too, the government has moved cautiously, apparently from fear of damaging Argentina's image among foreign investors.

Mr. de la Rúa's prospects depend heavily on the perception of the financial markets. Though Mr. Menem brought price stability and bursts of high growth, these achievements carried a cost. The cumulative effect of a decade of fiscal deficits, albeit relatively small ones, has been to make Argentina heavily dependent on outside financing. Interest payments on the public debt have more than tripled since 1992; this year they will make up over 15 percent of total public spending, according to an estimate by Fundacion Capital, a Buenos Aires think-tank. The government has pledged to eliminate the fiscal deficit by 2003, under a fiscal responsibility law approved shortly before Mr. Menem left office. Mr. de la Rúa has said that by the end of his four-year term of office he wants Argentina's credit rating to climb to "investment grade." This would give it access to cheaper and more abundant credit.

Yet, achieving both targets may require more drastic reform than the government has so far attempted. Fiscal balance means persuading the provinces, many of them poor and mismanaged, to accept cuts in, and not just a cap on, transfers. And Mr. de la Rúa's labor bill does nothing to cut the heavy cost to employers of severance payments to fired workers. Its effect will also be limited, since the bill will cover only three-fifths of the country's workers.

Making austerity pay politically means far-reaching reforms of public services. A start is being made toward making them more efficient. The defense ministry, run by a liberal economist, has had its budget cut. The government announced this month that it was terminating one-third of the employees at the state intelligence service.

Despite Mr. de la Rúa's good start, most economists predict that the economy will grow by only 3 percent or so this year. That is not enough to have much effect on an unemployment rate of 14 percent. Returning Argentina to the 6 percent annual growth rate that Mr. Menem's officials were confidently predicting several years ago will mean slashing the cost of doing business in the country, including everything from credit and freight costs to telephone charges. Mr. de la Rúa's own rating may have been upgraded, but much work still lies ahead.

Appendix A: The "Dirty War"

The "dirty war," as it is called, happened in the 1970s. The war was fought in Argentina between the left-wing opposition members and the military regime of the time. The left-wingers were fighting for social justice and the military for Christian civilization. The military regimes detained, tortured, and killed thousands of alleged left-wing dissidents.

The ensuing democratic government of Raúl Alfonsín was hard-pressed to deal with the military personnel who were alleged to have taken part in torture and killings. However, with the goal of national reconciliation (and under presumed pressure from the military), he passed an amnesty law in 1987, called the "law of due obedience," that excused all low-level military personnel who had just been carrying out orders from the generals. This law did not pardon the high-ranking officers, who remained in jails during his term. However, those high-ranking officials received amnesty under a law called "full stop" from the successor of Mr. Alfonsín, President Carlos Menem. Consequently, the generals and their helpers are alive and legally in the clear, whereas over 10,000 people, alleged at the time to support them, are dead or have "disappeared."

However, families and supporters of the victims have not forgotten the dirty war or the people responsible for it. A group, the "Mothers of the Plaza de Mayo," still demonstrate once a week in front of the presidential palace, demanding the truth about their vanished children. Wounds were re-opened in 1995 upon publication of a book, *El Vuelo ("The Flight")* written by a journalist. He interviewed a former naval officer, Adolfo Scilingo, who gave chilling testimony about his part in dumping prisoners alive—albeit unconscious—into the sea.

The details were graphic. During 1976–78, prisoners were held and tortured at the notorious Naval School of Mechanics in Buenos Aires. When time came for them to "disappear," they were sedated and then flown on a naval aircraft. After take-off, they were re-drugged by another doctor, stripped, and pushed into the Atlantic Ocean. Each flight carried between 15 and 20 victims, which calculates to about 1,750 victims, a figure that may be grossly understated. After his first such flight, Captain Scilingo sought comfort from the chaplain at the base. He was told that war is war, and as per the Bible, the prisoners would die a Christian death. There were flights once a week—sometimes twice if the traffic was heavy.

The publication of the story led President Menem, who had been a prisoner himself, to call the captain a criminal. Mr. Menem called upon the Navy to strip the captain of his rank. The officials refused, arguing that an ex-officer was not the Navy's concern. The church leaders, under pressure, condemned any Catholic who might have taken part in the operation.

A Buenos Aires court asked the president for a list of people who "disappeared" at the naval school. The "Mothers of the Plaza de Mayo" demanded the names of those involved in "disappearances." Nothing came of these calls, except a public apology from General Martin Balza, the army commander since 1991, for his force's past. The Navy and Air Force have declined to apologize and are fighting to keep "the law of due obedience" from being repealed. The chief of the Joint General Staff has warned against "reviving old confrontations." Fernando de la Rúa, the current president, believes that annulment of the laws would split the country and would be a distraction from important current legislation.

People were infuriated when a former Navy captain, Alfredo Ignacio Astiz, criticized General Balza for his apology and labeled Mr. Scilingo a "traitor." (Mr. Astiz retired in 1996 but still draws a pension from the Navy.) Though he denies having tortured anyone, Mr. Astiz admits his role in identifying victims who were then tortured and "disappeared." He defends his actions by suggesting that he was taking part in cleansing Argentina of guerrillas so that democracy could survive. He went as far as warning journalists from publishing any more details of the "disappearances." He threatened that he and his friends were trained to kill and, if push came to shove, they might kill again. (One journalist was found mysteriously murdered a few days before.)

President Menem, opposition leaders, and human-rights groups were enraged and called on the Navy to punish Mr. Astiz. The Navy responded reluctantly by putting him under 60 days' arrest for supposedly "close" interrogation. Mr. Astiz, now 47, was known by the nickname, "the angel of death." With his blue eyes and boyish good looks, he infiltrated leftist groups and identified hundreds of people to be detained by the Navy. Several countries, including France and Sweden, have convicted him *in absentia* for the murder of their citizens. However, in Argentina, because of the 1980s laws, he is a free man. Efforts to annul the two laws that protect those involved in the "dirty war" have remained fruitless.

Appendix B: The Falkland Islands War

Argentina went to war with Great Britain over the Falkland Islands (to Argentineans, the Malvinas) in 1982. For Britons, the Falkland Islands war was a nasty incident that happened 18 years ago. For the Argentineans, the British victory in the islands is viewed as a theft of their national territory. The war, which claimed over 1,000 lives, remains a vivid and bitter memory for Argentineans.

Argentina owes much to the British settlers. The British built the railways and the port of Buenos Aires. They taught the Argentineans football, rugby, and British culture in general. Today, Britain is the third largest foreign investor in Argentina, after the United States and Spain. The two countries are close in international affairs, both good allies of the United States. Their troops serve side-by-side as United Nations (UN) peacekeepers.

Yet there are differences, especially over the Falklands. The two countries agreed in 1989 to sort out some differences, without bringing up who has claim over the island. That brought deals whereby Britain maintained the right to do oil exploration and fishing in a sea area between the islands and the mainland. However, the deals are in jeopardy because of Argentina's assertion that the waters belong to Argentina. Therefore, the argument goes, firms that find oil anywhere around the islands must pay royalties to Argentina, and all fishing boats must obtain licenses from Argentina.

The islanders, interestingly, claim to be self-governing in internal affairs. They refuse entry to visitors using Argentine passports (except relatives visiting war graves, and, occasionally, journalists) and obviously show allegiance to Great Britain. There is no direct air or sea link. They refuse to negotiate Argentina's claim on the islands. Britain also refuses to negotiate, despite urgings from the UN's decolonization committee. Britain has no incentive to talk. Its forces of some 2,000 men may cost $125 million a year, but the islands pay for themselves. The revenues come from sale of fishing licenses. There is also some chance that there may be oil in the region.

Perhaps the only way Argentina can lay a claim to the island is if it can entice the 2,200 islanders to want to become a part of Argentina. Argentina has implicitly disavowed the use force to achieve it, and has embarked upon a public relations campaign to charm the islanders (with presents of books and videos on Argentina's natural beauty). So far, results have been poor.

Appendix C: Political Freedom

Since 1972, Freedom House has published an annual assessment of state of freedom by assigning each country the status of "Free" (F), "Partly Free" (PF), or "Not Free" (NF) by averaging their ratings on political rights and civil liberties. Following are the scores for Argentina. Lower scores indicate greater freedoms. Scores between 1 and 2.5 are considered "Free," between 2.5 and 5.5 are considered "Partly Free," and 5.5 and 7.0 are considered "Not Free."

Year	Political Rights	Civil Liberties	Classification
1972	6	3	PF
1973	2	2	F
1974	2	4	PF
1975	2	4	PF
1976	6	5	NF
1977	6	6	NF
1978	6	5	NF
1979	6	5	NF
1980	6	5	NF
1981	6	6	NF
1982	6	5	PF
1983	3	3	F
1984	2	2	F
1985	2	2	F
1986	2	1	F
1987	2	1	F
1988	2	1	F
1989	1	2	F
1990	1	3	F
1991	1	3	F
1992	2	3	F
1993	2	3	F
1994	2	3	F
1995	2	3	F
1996	2	3	F
1997	2	3	F
1998	3	3	F
1999			

Appendix D: Inflation and Lending Rates

Year	Inflation	Lending Rate Percent PA
1966	31.9	
1967	29.2	
1968	16.2	
1969	7.6	
1970	13.6	
1971	34.7	
1972	58.4	
1973	61.2	
1974	23.5	
1975	182.9	
1976	444.0	
1977	176.0	
1978	175.5	
1979	159.5	
1980	100.8	
1981	104.5	
1982	164.8	
1983	343.8	
1984	626.7	
1985	672.1	
1986	90.1	
1987	131.3	
1988	343.0	
1989	3079.8	
1990	2314.0	
1991	171.7	
1992	24.9	
1993	10.6	
1994	4.2	10.06
1995	3.4	17.85
1996	0.3	10.51
1997	0.5	9.24
1998	1.0	10.64
1999	-1.8	13.00

Source: International Monetary Fund.

Appendix E: Gross Domestic Product and Growth Rates

	GDP	Exchange Rate	GDP	Inflation	Growth	Growth	Growth
Year	Pesos	Peso/Billion Dollars	Billion Dollars	Percent	Nominal	Real	Based on Dollar
1967	0.6	0.03	18.00	29.20			
1968	0.7	0.04	20.00	16.20	16.67	0.40	11.11
1969	0.8	0.04	22.86	7.60	14.29	6.21	14.29
1970	0.9	0.04	23.73	13.60	12.50	-0.97	3.84
1971	1.3	0.05	28.75	34.70	44.44	7.23	21.13
1972	2.1	0.05	42.00	58.40	61.54	1.98	46.10
1973	3.5	0.05	70.00	61.20	66.67	3.39	66.67
1974	4.9	0.05	98.00	23.50	40.00	13.36	40.00
1975	14.3	0.37	39.10	182.90	191.84	3.16	-60.10
1976	75.9	1.40	54.22	444.00	430.77	-2.43	38.68
1977	209.3	4.08	51.35	176.00	175.76	-0.09	-5.30
1978	523.4	7.96	65.75	175.50	150.07	-9.23	28.06
1979	1,425.0	13.17	108.20	159.50	172.26	4.92	64.55
1980	3,840.0	18.37	209.04	100.80	169.47	34.20	93.19
1981	7,474.0	44.03	169.75	104.50	94.64	-4.82	-18.80
1982	21,852.0	259.23	84.30	164.80	192.37	10.41	-50.34
1983	109,500.0	1,053.00	103.99	343.80	401.10	12.91	23.36
1984	790,920.0	6,760.00	117.00	626.70	622.30	-0.61	12.51
1985	5,305,000.0	60,180.00	88.15	672.10	570.74	-13.13	-24.66
1986	9,984,000.0	94,300.00	105.87	90.10	88.20	-1.00	20.10
1987	23,332,000.0	214,430.00	108.81	131.30	133.69	1.03	2.77
1988	111,062,000.0	875,260.00	126.89	343.00	376.01	7.45	16.62
1989	3,244,000,000.0	42,330,000.00	76.64	3,079.80	2,820.89	-8.14	-39.60
1990	68,922,000,000.0	487,590,000.00	141.35	2,314.00	2,024.60	-11.99	84.45
1991	180,898,000,000.0	953,550,000.00	189.71	172.00	162.47	-3.50	34.21
1992	226,847,000,000.0	990,640,000.00	228.99	24.63	25.40	0.62	20.71
1993	257,570,000,000.0	998,950,000.00	257.84	10.62	13.54	2.64	12.60
1994	281,645,000,000.0	999,010,000.00	281.92	4.27	9.35	4.87	9.34
1995	279,543,000,000.0	999,750,000.00	279.61	3.32	-0.75	-3.94	-0.82
1996	297,359,000,000.0	999,660,000.00	297.46	0.25	6.37	6.11	6.38
1997	323,386,000,000.0	999,500,000.00	323.55	0.50	8.75	8.21	8.77
1998	298,000,000,000.0	999,500,000.00	298.15	0.98	-7.85	-8.74	-7.85
1999							

Appendix F: Exchange Rate of Argentine Peso

Year	Peso/Dollar	Dollar/Peso	Change in Dollar Price of Peso
1967	0.00000000003	$33,333,333,333.33	
1968	0.00000000004	$25,000,000,000.00	-25.00
1969	0.00000000004	$25,000,000,000.00	0.00
1970	0.00000000004	$25,000,000,000.00	0.00
1971	0.00000000005	$20,000,000,000.00	-20.00
1972	0.00000000005	$20,000,000,000.00	0.00
1973	0.00000000005	$20,000,000,000.00	0.00
1974	0.00000000005	$20,000,000,000.00	0.00
1975	0.00000000061	$1,642,440,666.83	-91.79
1976	0.00000000275	$364,298,724.95	-77.82
1977	0.00000000598	$167,364,016.74	-54.06
1978	0.00000001004	$99,601,593.63	-40.49
1979	0.00000001619	$61,766,522.54	-37.99
1980	0.00000001993	$50,175,614.65	-18.77
1981	0.00000007248	$13,796,909.49	-72.50
1982	0.00000048545	$2,059,944.38	-85.07
1983	0.00000232610	$429,904.13	-79.13
1984	0.00001787000	$55,959.71	-86.98
1985	0.00008005000	$12,492.19	-77.68
1986	0.00012500000	$8,000.00	-35.96
1987	0.00037500000	$2,666.67	-66.67
1988	0.00087500000	$1,142.86	-57.14
1989	0.04230000000	$23.64	-97.93
1990	0.48760000000	$2.05	-91.32
1991	0.95360000000	$1.05	-48.87
1992	0.99060000000	$1.01	-3.74
1993	0.99900000000	$1.00	-0.84
1994	0.99900000000	$1.00	0.00
1995	0.99980000000	$1.00	-0.08
1996	0.99970000000	$1.00	0.01
1997	0.99950000000	$1.00	0.02
1998	0.99950000000	$1.00	0.00
1999	0.99950000000	$1.00	0.00
2000	0.99950000000	$1.00	0.00

Appendix G: Balance of Payments, 1989–97

	Figures in Million Dollars								
	1989	1990	1991	1992	1993	1994	1995	1996	1997
Current Balance	-1305	4552	-647	-5462	-7672	-10118	-2768	-3787	-10119
Exports	9573	12354	11978	12235	13117	15839	20964	23811	25223
Imports	-3864	-3726	-7559	-13685	-15543	-20077	-18726	-22189	-28418
Trade Balance	5709	8628	4419	-1450	-2426	-4238	2238	1622	-3195
Services -Credit	2193	2446	2408	2454	2454	2599	2860	3226	3271
Services -Debit	-2793	-3120	-4007	-4711	-5184	-5540	-5082	-5721	-6340
Balance on services	-600	-674	-1599	-2257	-2730	-2941	-2222	-2495	-3069
Income credit	276	1854	1746	2143	2174	3093	4395	4676	5468
Income Debit	-6698	-6254	-6006	-4559	-5101	-6352	-7611	-7924	-9673
Balance on Income	-6422	-4400	-4260	-2416	-2927	-3259	-3216	-3248	-4205
Current Transfers Credit	18	1015	821	785	599	542	541	429	450
Current Transfers Debit	-10	-17	-28	-124	-188	-222	-109	-95	-100
Balance on Transfers	8	998	793	661	411	320	432	334	350
Capital Balance	-8083	-5884	182	7373	9827	9280	574	7033	13257
Foreign Direct Investment	1028	1836	2439	4019	3262	2982	4628	4885	6298
Investment Abroad				7	1	-125	-155	-205	-28
Investment in Argentina	1028	1836	2439	4012	3261	3107	4783	5090	6326
All Other Investments	-9111	-7720	-2257	3354	6565	6298	-4054	2148	6959
Portfolio Investment	-1098	-1346	-34	910	28304	4537	5173	10868	10448
Investment Abroad		-241	-8261	-80	-2037	-185	64	-808	-901
Investment on Argentina	-1098	-1105	8227	990	30341	4722	5109	11676	11349
Other Investments	-8013	-6374	-2223	2444	-21739	1761	-9227	-8720	-3489
Investment Abroad	-399	661	426	2381	-695	378	-13587	-9005	-7168
Investment in Argentina	-7614	-7035	-2649	63	-21044	1383	4360	285	3679
Net Errors & Omissions	-5428	-6241	-2655	205	35	-16	12	-8	25
Overall Balance	-14816	-7573	-3120	2116	2190	-854	-2182	3238	3163
Reserves, less Gold	1463	4592	6005	9990	13791	14327	14288	18104	22320

Appendix H: Population and Unemployment

Year	Population in	Unemployment	Unemployed
1984		3.8	.152
1985		5.3	.216
1986		4.4	.178
1987		5.3	.230
1988		5.9	.251
1989	32.08	7.3	.323
1990	32.53	9.2	.441
1991	32.97	6.3	.696
1992	33.42	7.2	.827
1993	33.87	9.1	1.062
1994	34.32	11.7	1.400
1995	34.77	15.9	1.959
1996	35.22	16.3	2.047
1997	35.67		
1998	35.90	13.0	
1999			
2000			

Source: International Monetary Fund.

Appendix I: Mercosur

Mercosur was founded in 1991 as a customs union. Its four founding members include Argentina, Brazil, Paraguay, and Uruguay. Since Mercosur's founding, trade among the nations increased to $18 billion by 1997 from just $4 billion in 1990. Encouraged by its success, Chile and Bolivia have signed free-trade agreements with the group. Other countries are interested, too. For example, there is talk about a free-trade agreement between Mercosur and the European Union and between Mercosur and the North American Free Trade Agreement countries.

Mercosur has come under pressure since 1998 because of recessions of its two largest members, Brazil and Argentina. In 1998, for the first time, intra-region trade fell. Argentina's share of total exports going to Brazil had steadily increased from one-quarter to one-third during 1995–98. However, Brazil's currency devaluation raised the prices of Argentine products by 25 to 30 percent in *reals*. Brazilian goods, on the other hand, became cheaper in Argentina. As a result, Argentina's exports to Brazil plunged by 20 to 25 percent while imports from Brazil surged. If capital is allowed to flow freely, officials in Argentina fear that Argentine businesses may decide to put their factories in Brazil. This might cause further decline in the GDP of Argentina and contribute to more unemployment.

Officials from both countries have reasserted their commitment to Mercosur. Despite Brazil's currency devaluation, Argentina has not imposed any new barriers on Brazilian exports. Argentina has, nevertheless, sought "voluntary export restraint" agreements from producers in industries where there has been a sudden surge of Brazilian imports. Moreover, on April 19, 1999, Argentina announced anti-dumping duties on some Brazilian steel products. Brazil has also made some concessions. For instance, it has eliminated credits for exports to Mercosur members as well as a rule that required many Brazilian importers to pay in advance for products originating in Mercosur member countries.

However, Mercosur is far from realizing its goals of being an important customs union. Since 1991, the members have eliminated tariffs on most products except automobiles and sugar. However, they have made almost no progress in removing complex non-tariff barriers to intra-region trade. For instance, there is no common internal customs code, and licenses are still required for many imports. Freeing trade in services and government procurement is still in the talking stage. There has been absolutely no progress made towards a common external tariff. If the members are serious about forming a customs union, they must accept the fact that they no longer have unilateral freedom to change their own trade rules. Even if it remains just a free-trade area, the customs union can no longer shirk its agreement on a few common laws (on matters such as competition policy) and some minimal common institutions, including a permanent tribunal to settle trade disputes.

Another major problem with Mercosur is that there are two small countries and two large countries. Squeezed between Brazil and Argentina, tiny Uruguay has not always found life easy. Uruguay's population is well educated, relatively modern, democratic, and peaceful. Moreover, Uruguay has the most experience with free trade. Uruguay freed its currency and capital markets in 1974 and its trade in 1978. Nearly all of its banks are foreign-controlled, and in the capital, home to one-half of its 3.2 million people, shops tend to show prices in dollars. On the other hand, while Brazil and Argentina talk free trade, they are far from being committed to it. Brazil has a habit of acting first and consulting its smaller partners later.

In November of 1997, for example, Argentina proposed to Brazil to raise tariffs by 3 percent. Even though the World Trade Organization opposed it, Brazil agreed. Overnight, Mercosur's common external tariff went up by 3 percent without the knowledge of either Paraguay or Uruguay. Neither Uruguay nor Paraguay likes the higher tariffs or the process of reaching such a decision; however, they have no choice in such matters.

Uruguay has nothing to lose from open trade, but is not big enough to have built protected industries in the first place. So it had little to fear from Mercosur or the unilateral freeing of trade that preceded it. It is also well placed geographically, in the richest region of the Mercosur market. In fact, it is a good location for businesses that want to serve the whole market! The problem is that the Mercosur borders are more open in theory than in fact. Despite the talk of free trade, transporting goods across borders is still time-consuming (and, at times, a palm-greasing) affair. Uruguay must, however, remove former state monopolies in alcohol, cement, fixed-line telecommunications, oil, and electric distribution to improve its competitive base. The state sectors in Uruguay are not necessarily ill run, but if the two big neighbors privatize their way into real efficiency, Uruguay will be left behind, at no fault of the big neighbors.

Appendix J: Economic Indicators

Year	Eternal Dependence Trade/GDP	Liquidity (Reserves/ Imports in months	External Debt in Million Dollars	Debt/GDP	Debt Service Export
1988					36.00
1989	17.52	2.64	64,745	84.42	36.10
1990	11.38	8.05	61,144	43.26	34.10
1991	10.30	6.23	63,707	33.58	48.40
1992	11.32	6.52	67,569	29.51	34.40
1993	11.12	7.98	74,473	28.88	46.00
1994	12.74	6.71	77,388	27.45	35.10
1995	14.19	7.20	89,747	32.10	34.70
1996	15.46	7.78	93,841	31.55	
1997	16.58	7.71	123,221	38.08	
1998			129,332	40.00(e)	
1999				46.00(e)	60.00(e)

Source: International Monetary Fund, *World Bank Report, The Economist*

Appendix K: Ratings of Economic Freedom for Select Latin American Countries

Regional Rank	Rank	Country	1999	1998	1997	1996	1995
1	11	Bahamas	2.00	2.00	2.00	2.00	2.10
2	18	Chile	2.15	2.15	2.25	2.45	2.50
3	22	El Salvador	2.25	2.45	2.55	2.45	2.65
4	28	Panama	2.40	2.40	2.50	2.40	2.70
5	34	Argentina	2.50	2.60	2.65	2.65	2.85
7	41	Peru	2.60	2.80	2.90	3.00	3.40
10	45	Uruguay	2.70	2.70	2.70	2.80	2.90
16	75	Paraguay	3.05	2.85	2.75	2.65	2.75
17	81	Colombia	3.10	3.00	3.10	3.00	2.90
18	85	Mexico	3.15	3.25	3.35	3.35	3.05
20	90	Brazil	3.25	3.35	3.35	3.45	3.30
22	104	Venezuela	3.40	3.50	3.60	3.50	3.00

Appendix L: Ratings of Economic Freedom for Select Latin American Countries in 10 Different Economic Areas

Country	A[1]	B[2]	C[3]	D[4]	E[5]	F[6]	G[7]	H[8]	I[9]	J[10]
Bahamas	5	1	2	1	3	2	2	1	1	2
Chile	2	3+	1	3	2	3	2	1	2	2
El Salvador	3	3	1	3	1+	2	2	2+	3	3
Panama	3	3	3	1	2	1	2	3	3	3
Argentina	3+	3	2	5	2	2	2	2	2	2
Peru	2	3	1	5	2	2	2	2+	3+	4
Uruguay	2	3	3	5	2	2	2	2	3	3
Paraguay	2	2+	3-	4	1	2	3	4	4-	5
Colombia	4-	4	2	4	2	2	2	3	3	5
Mexico	2+	3+	2	5	2	4	3	3	4	3
Brazil	4	2+	3	5	3	3	2+	3	3	4
Venezuela	3	3+	3	5	3	3	3	3	3	5

1: Trade
2: Taxation
3: Government Intervention
4: Monetary Policy
5: Foreign Investment
6: Banking
7: Wages and Prices
8: Property Rights
9: Regulations
10: Black Market

Appendix M: Government Finance

Figures in Millions of Pesos					
Year	**Revenue**	**Expenses**	**Balance**	**Domestic Financing**	**Foreign Financing**
1989	153.4	174.8	-21.5	-8.6	30.1
1990	2,741.2	2,967.3	-226.1	346.9	-86.2
1991	8,028.5	8,991.5	-963.0	869.4	310.8
1992	12,889.0	12,962.0	-73.0	895.0	-118.0
1993	15,555.0	17,129.0	-1,574.0	1,740.0	1,283.0
1994	15,591.8	17,477.5	-1,885.7	863.2	1,256.8
1995	38,060.9	39,486.9	-1,426.0		
1996	35,501.0	40,734.6	-5,233.6		
1997					
1998					
1999					