



March 13, 1984

Dear John,

I think it possible you, & the Prime Minister, may be interested in seeing the enclosed two reports on the Argentine prepared for Lazard's by their Buenos Aires representative.

Yrs ever

Angus Thorne

I do not think these
pages add to the Prime
Minister's knowledge.

A.T.C. 5/3
p.a.

FEDERICO J. DUMAS

POLITICAL SITUATION

Election Results

The outcome of the general elections held on October 30 was undoubtedly a surprise, in part because the Radical party was the winner, but fundamentally due to their landslide victory over the Justicialista party; prior to elections opinions were divided as to which of the two parties would be the first minority, in any case there seemed to be a parity of forces.

It is the first time since their inception 40 years ago that the Peronists lose in an open election. The most positive aspect is that those who really lost were the peronist union leaders active in politics, who were quite predominant in certain key positions in the Justicialista party, with an image of autocratic and violent leadership. This defeat will most probably change the rigid internal structure of the party, opening it up to some democracy.

Political analysts interpret these results as a vote in favour of democracy and peace, of law and order, and against autocratic governments. The electorate has applied reasoning in casting its vote, it has not been guided by emotions.

It is probably a reflection of a basic change in the political situation in the country from that which has prevailed over the last 4 decades, and of a change in its social structure, which could be briefly described as follows:

--The free-negotiation salary policy applied between 1976 and 1980 produced a higher spread in wages. Those who benefited from this policy were the highly qualified personnel, who now clearly saw the inconvenience of returning to the justicialista policy of levelling wages, imposed by the unions.

--The 1980 Population Census reflects an important reduction in employment in industry and farming and an increase in those employed in services, mainly in the self employed who reached a 19% of total employment, both these occupations being typical middle class.

--The strongest social group of peronism in its origin was the lowest classes, mainly country people who had emigrated to Buenos Aires suburbs, who have now been replaced by inmigrants from neighbouring countries, who as foreigners do not vote.

The justicialista candidate for the Governorship of Buenos Aires Province symbolized this type of peronism. Obviously many voters, former peronists included, who had already improved their social standing, as already mentioned, wanted to establish

differences with this low class peronism and felt much more at ease with the radical candidate, Dr. Alfonsín.

This is why there is a hopeful renewed confidence in a new path which is just starting for the country. Hopeful because the path to consolidate political stability is not easy.

The Radical party is considered a party of democratic principles, not only because of their internal party politics but because they have a tradition of respect for individual rights and freedom of expression. They are considered to be in the same line of thought as the social democratic governments of western Europe.

The vote count on the presidential tickets showed a clear margin for Dr. Alfonsín of the Radical party with 52% over 40% of Dr. Luder of the Justicialista party. The remaining parties, which in 1973 elections accounted for 25% of the votes, only obtained 8%; those who suffered the greatest loss were the center parties which dropped from 20% to 1%, their electorate having backed Dr. Alfonsín. The backbone of the Radical party is the middle class, having attracted in this election the vote of the higher class but also part of the upper low class peronists. A factor to be borne in mind is that close to 1/3 of the electorate were young people voting for the first time.

The Radical party holds a clear majority in the Lower House with 52% of Congressmen, but the situation in the Senate is not so favourable as the Justicialistas have 21 Senators and the Radicals 18 over a total of 46. Six of the remaining belong to three provincial parties, 4 of which clearly back the Radicals, but the other 2, which can be the deciding votes, have not stated their position. Former President Frondizi's Party, MID, has one Senator. Decisions in the Senate have a high political importance as they are to approve promotions and retirements in the Armed Forces, the nomination of national judges and ambassadors.

At the provincial level the results have been somewhat different because the Justicialistas have 12 Governors, the Radicals 7 and the remaining 3 belong to provincial parties. It is noteworthy that the Radical governors were elected in the country's more important provinces, excepting Santa Fe: Buenos Aires, Córdoba and Mendoza, and they also control the city of Buenos Aires where the Mayor is appointed directly by the President.

Domestic Policy

The idea that a stable political system is necessary exists today among a wide part of the Argentine population. Instability is one of the most notorious Argentine vices.

It has been the reason for the pendular movements between authoritarian regimes and almost always populist regimes, having as a consequence that it has been impossible to think about long term policies, produced a vacuum of power and finally violence.

Agreement of opinion exists among argentines about the political formula for the legitimate practice of power. Democratic culture is not possibly built in a day, and is not the result only of the general consensus of a reaction against the opposite. Nevertheless, historical lessons have been very strong in the last 13 years to overpass.

The spectacular popular demonstration, wholesome and joyful, during the inauguration of a civil President with full constitutional legitimacy has been very unlike the inauguration, 10 years ago, of the peronist government in the middle of violence and domestic confrontation.

There are noticeable changes in political perception, the most significant one is the importance that a great part of the society assigns to the proceedings rather than to the results, which explains the noteworthiness of a dilemma that 10 years ago has been almost irrelevant: "democracy vs. authoritarianism". The Radical Party perceived those changes and used it as their symbol in the political campaign, which gave them the victory in the elections on last October 30.

The presidential message at Congress is a continuation of this line, where the ethic dimension of life and politics was the main thread. The objective of the current policy is to strengthen not only the government, but also a whole democratic system. The society must learn to live within a constitutional system, which will not be easy.

A potential bipartidism has arisen in the last elections: radicalismo and justicialismo accounting for 92% of the votes, with the latter one having been a minority for the first time in 40 years. But at the same time a new federal structure appears with 12 justicialista Governors, 7 Radicals and 3 of very representative provincial parties.

These results and Dr. Alfonsín's personal idiosyncrasy has consolidated the civil presidential power, within a constitutional structure. His leadership as head of the party and as candidate have been undeniable factors for a sort of electoral coalition and the victory.

This coalition made up of radical, center, youth, some low middle class and workers vote, dissimilar in nature, worries the Radical Party as well as the opposition.

Certainly today the Radical Party's position is placed in the center of the political spectrum, and from there it will

have to determine the way to consolidate in the future. It may slide to the left were it will have to dispute with the Justicialista Party a great part of its members and votes; it may slide slightly to the other side in order to strengthen the October 30's coalition, getting great part of the right, confronting a labour party. At the present time there is no clear evidence as to which will be its position.

The Radical Party is facing an internally very weak Justicialista Party, which will have to restructure deeply to keep in the future its significant role.

Mrs. Peron's brief visit -she is President of the party and settled in Spain- didn't help to clarify the situation. She surrounded herself mainly by notable individuals belonging to the party's political wing, whose importance in ballots is doubtful, leaving aside the union wing, considering them responsible for the defeat in the last elections.

These union leaders are now facing a union reorganization Bill submitted by the Executive to the Congress through which the stability of many of them will be in danger. This will be the new government's hardest struggle in Congress, the result of which is still uncertain because of the parity of forces in the Senate.

Beyond any detail, the debate going on is the control of the sources of power which the Justicialista Party has commanded for over 35 years, being the most powerful electoral force and managing itself in consecutive governments with extraconstitutional powers. Nobody assumes that the intent is to take away from the justicialistas their huge power and give it to the radicals, but if this power is more equitably distributed it would benefit not only the Radical Party but also the political stability of the country.

So far the political initiative is totally in the hands of the Radical Party that has to take advantage of the consensus which new governments have to strengthen even more its position. The ability and celerity in handling the disappeared and human rights issues allows one to assume that in the strictly political area it will be difficult to take this initiative away from them.

The Government, certainly, will try to maintain public interest on political matters, domestic as well as international, to have more time for the economic area to show results; for the time being nobody is demanding results with the exception of the economic team itself, or maybe the political team of the radicalismo.

International Policy

Argentina's strengthened image resulting from the last elections will undoubtedly be used by the new government to achieve the proposed objectives in this area.

The presence of many and high level foreign delegations in the inauguration ceremony shows that Argentina's isolation has ended. This isolation and loss of prestige before the international community of developed countries had its origin in three main points: institutional instability, human rights violations and lack of seriousness in handling the South Atlantic war.

The reactivation and normalization of international relations has been endorsed by the support and solidarity from most countries of the world and in particular by social-democratic governments.

The President stated clearly his will to solve Argentina's two serious international problems through peaceful negotiations, rejecting the use of force.

Definite actions are in process to reach, as soon as possible, a base treaty necessary to formalize the final agreement with Chile on the Beagle Channel conflict, based upon the peace proposal by the Vatican in 1978.

Certainly opinions will be heard against any agreement that does not contain the appropriation of the territory in dispute. Fortunately these opinions are from a minority group, of extreme nationalist extraction, not important but noisy, and will not be considered by the Government at the time of final decisions.

Mrs. Thatcher's personal message to Dr. Alfonsín sent through Italian Prime Minister Bettino Craxi, has been interpreted as the first step from Great Britain towards the normalization of diplomatic relations with Argentina. This gesture was a surprise given the obvious state of hostility between the two countries.

The Argentine Chancery's present desires are to obtain the reduction of the exclusion zone of 150 miles around the Islands and to convince Great Britain to stop the construction of a military airport on the Island. In return Argentina will be willing to officially suspend the state of hostility.

The resumption of negotiations for the recognition of sovereignty will be a second instance, estimating that there will be a long struggle in the international organizations, with more favorable conditions at this time.

Other diplomatic action will be developing close ties with Western Europe, in particular with Spain, France and Italy, basic countries of the European Common Market.

Relations with the Soviet Union and communist countries has not been specifically mentioned in the presidential message, but as the main buyer of argentine products, the Soviet Union will be considered with preference, especially in commercial topics, to improve its position as provider of equipment.

The Argentine Republic has never had close and extremely good relations with the United States in modern times. Since the South Atlantic war the relations have been quite strained, but with the change to a democratic government there have been clear indications of a reversal in this situation. Nevertheless a significant improvement towards close relations will be slow and not easy. Dr. Alfonsín is very much in accordance with the basic principles of the american people but he does not coincide with the policies of the conservative government of President Reagan. Anyway he is very much aware of the importance of the United States, specially on economic matters, so working relations shall be maintained on a pragmatic basis.

Hereto the United States has taken all the actions for improving the relations. The presence of Vicepresident Bush at the inauguration, the appointing of a new Ambassador, President Reagan's decision to lift the arms embargo have been corresponded just with a formal reply from the Argentine Chancery.

Relations with Japan will be at an intermediate level, positive but not intense, principally based on economic and trade matters of interest to both countries. However, given the absence of any negative position from the radical government to the Japanese government, the fluency and improvement in the relations will mainly depend on the diplomatic representatives of both countries, as well as the businessman.

Prime importance shall be given in international affairs to the relation with Latinamerican countries, in particular with neighbouring countries even though their internal political power structure is quite different from that now prevailing in Argentina. As mentioned above the dispute with Chile is expected to be resolved very shortly giving way to a much closer relationship including economic and commercial integration between both countries, with the materialization of projects which have had an unofficial approval for analysis since a few months ago.

Economic integration with Brazil is a most important matter which has been very difficult to achieve in a significant way over the past two decades. This situation is not expected to be changed significantly in the near future due in particular to the difficulties in the external sector of both countries. Nevertheless particular projects which might not find conflicting interests in the other country would probably find a favourable disposition from the governments for their implementation.

January 1984

ECONOMIC REPORT - JANUARY 1984

OFFICIAL ECONOMIC DOCUMENT

The present government's economic team is beginning to hear criticisms and receive claims regarding its action from different sources. These form two groups, on referring to the lack of a consistent global economic plan, and the other stating that the present policy is only a continuation of the former administration's one whose objectives were of a monetary type and led towards recession.

President Alfonsín himself came out in defense of his team and its economic plan, strongly attacking his detractors, accusing them of being "the Process's technocrats". The President's attitude of taking upon himself the responsibility of the economic action being taken, can cause him some problems in the future, if the objectives proposed are not accomplished.

So as to face these criticisms, the Ministry of Economy issued a paper entitled "Outline of an immediate programme to reactivate the economy, increase employment and real salaries and attack the obstacle of inflation". But this goal was not completely fulfilled. The 30 pages were not enough to subdue critics: the first group continues claiming the non-existence of a plan which should include, apart from the goals, those means to accomplish them, and the second group still considers the programme as monetarist and recessive.

Those who claimed about the means, received a description of the goals, and those who protested about the objectives, received promises beyond real possibilities, which may turn into a "boomerang" in a not too distant future. Part of the opposition will no doubt carefully keep the paper with the intention of showing it up in January 1985.

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The document contains a criticism, as could be expected, of the former government and then a listing of the 1984 programme's main objectives, summarised as follows:

- 1 - The programme proposes a reduction of the budget deficit from 14% of G.D.P. in the 4th quarter of 1983 to 4% at the end of 1984 and to continue this way during 1985 until it is eliminated.
- 2 - Currency issuing due to deficit will be reduced from a monthly average of 12,5% in 1983 to a 5% in December 1984.
- 3 - It is expected that the Monetary Regulation Account's deficit, that represented 4,5% of G.D.P. in the last quarter of 1983, will be reduced to 2% by the 4th quarter of 1984, by means of the progressive reduction of the minimum cash requirement.
- 4 - The expansion of the banking system credits to private activity will be strictly adjusted to the need of "moderately stimulating demand" and of increasing the working capital of the corporations, without inflationary consequences.
- 5 - Interest rates could reach a monthly rate of 4% by the end of 1984 for deposits and 4.8% per month for loans, in face of a 4% monthly inflation rate.
- 6 - "High Cost Branches" of the financial system will be eliminated and merging of banks will be stimulated to reduce operating costs.
- 7 - At short term, instruments of "an agreed upon price policy will be adjusted, through which companies will be able to transfer their cost increases (to prices), without introducing inflationary expectations and absorbing through cost reductions those increases which will produce improvements in the wages in real terms".

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- 8 - "It will be essential to avoid over and undervalued exchange rates".
- 9 - Real wages are supposed to increase approximately 6 and 8% between end of 1983 and end of 1984, in direct relation with an equivalent drop of the real interest rates.
- 10 - A non-inflationary improvement of salaries would represent in 1984 an active element in the growth of effective demand, together with a cautious credit expansion towards the private sector and the progressive drop of interest rates. Initially, reactivation will also be favoured by housing and agricultural expansion programmes. A 5% increase in overall GDP is expected.
- 11 - With a trade balance surplus of US\$ 3.5 billion it will be possible to pay only a part of the interests of the foreign debt, while a definite way of solving these problems is found, with the cooperation of the governments of creditor countries in order to obtain refinancing terms and reduction of interest rates.

It is not fair to claim immediate solutions, to all the problems inherited, furthermore it is generally accepted that the authorities have produced an adequate diagnosis of the situation, accentuating priority on inflation and on the monetary loss of control produced by the fiscal sector. At the same time, it is difficult to find anyone who does not share the above mentioned objectives.

Nevertheless, what is in doubt, and with enough reason, is if this plan, as defined, will be accomplished or not. This plan has objectives which are hardly compatible and therefore it is easy to think that some of them will have to be postponed to give way to those of first priority.

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The lack of explanations of "how" these goals can be accomplished has produced the loss of credibility in those goals. Considering the significant budget deficit, as an example, the public expenses, which are the most important cause of deficit, are only superficially mentioned in the document. The only cause of expense reduction mentioned specifically are military expenses, but no reference is made to public enterprises becoming private companies, or reduction of government employees.

In economy, actions are preferred to words, so that this discussion about the document's contents, and whether it has or lacks a sound basis, will become clear when the government starts taking the necessary steps and results are analyzed.

FEBRUARY'S ECONOMIC OUTLINES

The economic authorities maintained the strategy of announcing together the increase of salaries, public services fares and interest rates for February.

Last month's average increases of the most important economic factors are detailed as follows:

	Variation percentage over previous month		
	Dec 83	Jan 84	Feb 84
Salaries	18.5	12.0	11.0
Public services fares	22.9	10.0	10.0
Official exchange rate	21.6	16.4	12.5 (*)
Interest rate (**)	15.5	12.5	11.0
Expected inflation			
at the beginning of the month	30/35	10/11	10/10.5
at the end of the month	17.7	11.5	?

(*) Keeping end of January's rythm

(**) Active rate, monthly percentage.

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As can be observed, the economic authorities are intensifying the strategy initiated in January of inducing inflation to decline, based on an anticipated implicit trend to which the different factors are aligned.

In spite of the unexpected prices rise, produced mainly by beef, last months' results can be considered acceptable, nevertheless, most of these results were due to a careful administration of price increase authorizations to companies subject to direct control from the Secretary of Commerce. The companies have not yet started demanding price increases, as most of them applied preventive increases in anticipation of the present control.

This control system might soon crack as a consequence of accumulated pressure. Therefore progressive efforts are already being made to initiate a system of price agreements between the different sectors of production in order to avoid deviations from the original system, so well known during 1973-75, such as supplies shortage, overpricing, loss of quality, etc.

OTHER NEWS

- During January the Central Bank's international reserves increased in US\$ 554 million. The permanence of the expansive action of the foreign sector showed that the acceleration of delayed import payments were not enough to offset the monetary impact of the foreign currency income obtained from crop sales.

- During the month of January, the black market dollar rate increased considerably, passing from \$a 25/dollar on December 31st to \$a 35/dollar the last day of January. This variation substantially modified the gap between the official and black market rate, from 11% to 35% during the same period.

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- During January liquidity was significant. The best example of this is the interest rate of the interbank market, which was below the regulated official rate. The result of this high liquidity was the before mentioned free dollar increase, as the investors in the face of interest rate reduction, preferred to channel their funds towards foreign currencies, which had remained almost the same as from November.

- This liquidity also produced its effect in the Stock Market. The constant rise of quotations was not affected by the tax reforms, price controls and other problems which can affect industry, and produced a 50% improvement, which can be considered extraordinary.

- Seasonal problems of short supply, worsened by heavy rains, which made roads impassable for transporting cattle, were the factors causing the high beef prices. This 51% increase made the retailer price index of January increase two points, and having been sharper towards the second half of the month, it will also have a strong impact on February's indexes. Furthermore, this disparity of domestic price regarding the international one is worsening the economic situation of the packing beef sector dedicated to exports, and it can be expected that the first consequences of this will be seen during February.

- The new import system valid until June 30, 1984, was made public. As we anticipated in our last report, it is based on three groups of products. One of them prohibits the importation of a long list of products from livestock to cars; a second group which includes mainly capital goods is subject to previous approval from the Secretariat of Commerce, while a third group (pharmaceutical and medical raw materials) must be subject to the approval of the Ministry of Health and Social Welfare. As for the rest, the issue of permits is automatic.

Buenos Aires, January 1984



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