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21 November 1973

[Redacted]

MEMORANDUM FOR: Chief, OCT/WH/SAE

SUBJECT: The Argentine Economy, Foreign Investments, and United States Interests

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Attached are the three sections on the Argentine economy for your memorandum as per your request of 14 November 1973.

Any questions may be directed to [Redacted]

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Chief,
Latin America Branch, OER

Attachment:
As stated

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OER/D/LA: [Redacted]

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The Current State of the Argentine Economy

1. The Argentine economy in 1973 presents a mixed picture. GDP is expected to register a 4%-4.5% increase and the trade surplus to total between \$600 million and \$800 million. Price freezes and rollbacks instituted in June cut price rises to the point where inflation for the year will probably end up at around 35% to 45% -- far below the 56% registered in 1972.

2. Problems, however, continue to plague the Argentine economy. Public spending continues to exceed revenues at an alarming pace and the total deficit for the current year could exceed 8% of GDP; treasury outlays in the aggregate usually amount to 8%-9% of GDP. Artificially low prices for agricultural products, combined with increasing disincentives to agricultural production, threaten to undermine Argentina's chief source of foreign exchange. Thus, it is expected that Argentina will only have some 700,000 tons of exportable wheat surplus from the December/January harvest compared with 3.2 million tons exported from the 1972/73 harvest. It is clear that only a good corn crop and continued high world prices will enable Argentina to avoid serious balance of payments problems in 1974. Argentina's public external debt totals about \$3.2 billion. Service payments on the debt plus inelastic demand for the import of intermediate goods make high export earnings essential if an economic recession is to be avoided.

3. Peron continues to pursue aggressively previous regimes' policies of promoting non-traditional exports. For example, credits of \$200 million per year have been granted to Cuba and other substantial credits extended to Chile for the purchase of Argentine goods -- mainly manufactures. Although this policy will help offset revenue losses from lowered wheat and beef exports, the concessionary financing involved could further exacerbate domestic inflationary pressures. Increased export of manufactures, price controls, declining agricultural production and low profit margins will lead to increased shortages of consumer and producer goods. If wage demands lead to large increases in early 1974 while prices remain frozen, the situation will deteriorate even further.

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Foreign Investment in Argentina

1. Argentina's foreign investment climate deteriorated rapidly in the first months of Peronist rule. Bills introduced to expropriate and restrict foreign investment combined with fears generated by terrorist kidnapping, extortion, and murder have brought new investment to a virtual standstill. At stake is some \$3 billion in foreign direct investment, of which some \$1.4 billion represents the US stake.

2. After four months of legislative wrangling, a new Foreign Investment Law was approved on 7 November. Although the bill finally passed was far more reasonable than the original draft, the law is more restrictive than the Andean Foreign Investment Code and limits foreign equity to less than 20% in most sectors. In addition, profit remittances are limited to 12.5%. The law also gives explicit recognition of a recent Argentine Supreme Court decision (Parke-Davis) that ruled that intra-corporate payments for royalties, headquarters expenses, and interest, technical and management fees will be considered dividends. The adverse effect of this ruling will be minor because of the relatively small size of such charges, but many foreign subsidiaries may face sizable claims for back taxes.

3. Argentina also has "renationalized" foreign bank holdings acquired since 1966. Only about \$4 million in US equity appears to have been affected and the impact on US

business is far less than other measures nationalizing credit and bank deposits. These latter measures have seriously limited the discretionary power of local banking institutions, but the adverse impact of these new restrictions has been mitigated by the unprecedented price stability which has resulted in large positive interest rates for the first time in many years.

4. The Peronists have resisted attempts to make the foreign investment legislation too restrictive. They also have resisted congressional attempts to nationalize oil refineries and ITT holdings, and provincial efforts to expropriate large agricultural holdings in southern Argentina. In addition, it now appears that the uproar over the US memoranda of concern over moves against foreign investment was more a reflection of political infighting within Peronist ranks than any concerted anti-US campaign.

5. The major deterrents to foreign investment in Argentina appear to be more economic than political. Continued price freezes and rollbacks have cut severely into profit margins and have resulted in shortages and a growing black market for a variety of goods. The problem emanates from price control measures that have been accompanied by a record monetary expansion which has nearly doubled the currency in circulation during the last 12 months.

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6. Besides the adjustment to the new economic environment, many US interests now face a threat presented by extensive lines of credit Argentina granted Cuba. Refusal by US subsidiaries to trade with Cuba could result in such reprisals as limitations on domestic sales, tax persecution, substantial fines, and possible imprisonment of corporation executives.

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The United States and Argentina

Foreign Investment

1. Threats to US investments have subsided in recent months with the exception of the Cuban trade problem. There is no doubt, however, that Argentine policies will generally discourage substantial new investment because of the economic climate as well as restrictions on foreign capital.

Brazil and Chile

2. Argentina continues to view Brazil as an adversary, and disputes over hydroelectric developments in the Plate Basin are a symptom of this continuing rivalry. Peron's concern over Brazil's hemispheric influence was probably a consideration in Argentina's extension of \$215 million in credits to the new Chilean junta. The United States will remain a potential target of nationalistic fervor as it develops closer ties with Brazil and Chile.

Bilateral Balance in Trade and Payments

3. The Peronists expressed desire for "multinationalism" also has extended to trade policies. They are actively seeking bilateral balance in trade and payments with all nations. Since the United States traditionally runs a trade surplus with Argentina, its share of the Argentine market will continue to decline in the years ahead.

Argentina and World Commodity Markets

4. The US bilateral trade surplus in its trade with Argentina reflects the small amount of US purchases of beef and grain -- Argentina's major exports. Argentina usually has been an export competitor in grains, particularly wheat and corn. At present world prices and demand levels, however, competition among grain suppliers is indirect and low key. However, any significant drop in world grain prices could lead to some deterioration in US-Argentine relations. The United States has banned large imports of Argentine beef because of the diseases endemic among Argentine cattle. As a result, Argentina's major markets continue to be Latin America and Western Europe.

5. Argentina requires continuing imports of raw materials and intermediate goods for its manufacturing industries, as well as machinery and equipment. These comprise the major US exports to Argentina. A current critical Argentine need is steel scrap. Argentina continues to press the United States to increase the licencing of adequate exports of this now scarce material.

6. Argentina appears to be well supplied with petroleum despite a growing gap between consumption and domestic supply. Peron appears to have sufficiently friendly ties with the Middle East to avert any serious cut-off of petroleum supplies in the near future.

Other Problems

7. Problems in negotiating civil aviation agreements represent one of various continuing issues between the United States and Argentina. Other sources of friction have been the termination of the US/military mission in Argentina and Buenos Aires' new Trade Law which runs counter to GATT provisions.

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