

POLITICAL RISK IN ARGENTINA

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1. INTRODUCTION

Unfortunately, it is well known that the political risk in Argentina has increased during the last decade (2000 – 2010). Institutional quality and rule of law have been “forgotten” by the different administrations and the country is now facing the consequences¹.

In this last decade, we have witnessed the passing of laws affecting private property and contracts; expropriation processes; default of sovereign debt; passiveness of the government when faced with extended strikes or blocks (including block of an international border crossing); unclear parameters in the granting of regulatory approvals; breach of law by the government or disregarding of the Congress’ constitutional prerogatives; etcetera.

In this paper, we (i) first indicate and briefly describe some particular cases which harmed the institutions or the rule of law in the last decade; (ii) secondly, we include some notes on positive considerations which uphold an optimistic perspective; and (iii) lastly, we provide recommendations for potential investors doing, or planning to do, businesses in Argentina.

2. POLITICAL RISK IN ARGENTINA - RELEVANT CASES

(a) *Pesification*

In December 2001 the government imposed strict limits on bank withdrawals and rescheduled term deposits in order to reduce the threat of collapse of the banking sector.²

On January 6, 2002 the congress passed the Law of Public Emergency N° 25,561, which ended the convertibility regime and pesified the economy. The Decree N° 214/02 provided the conversion of US dollar denominated loans into Argentine Pesos at a AR\$ 1 per USD 1 rate; and the conversion of US dollar denominated deposits into pesos at an exchange rate of AR\$ 1.40 per USD 1.

In order to compensate the losses that the conversion of the deposits and loans caused to many financial institutions, the government issued bonds called *Boden 2007 and Boden 2010*. In addition to this compensation the government issued new bonds called *Boden 2012* in May 2002. Finally, in October 2003 they issued yet another bond called *Boden 2013*.

Judicial and arbitral actions were filed for thousands alleging the unconstitutionality of the emergency regulations. In 2005 the Supreme Court (in “Galli c. PEN”) settled all existing disputes by ruling that the pesification of deposits was constitutional in light of the prevailing economic conditions at the end of 2001.

(b) *Default of sovereign debt*

¹ There is a consensus that the sustainable economic growth of a country is closely related to the rule of law and the quality of its institutions, as stability and predictability encourage long term investments. This connection has been deeply investigated and demonstrated by authorized economists, such as Douglas North, co-recipient of the 1993 Nobel Prize in economics.

² The Republic Argentina - Prospectus supplement dated January 10, 2005

On 23 December 2001, the recently elected president of Argentina, Adolfo Rodríguez Saa, announced that the country was going to default in its sovereign debt.

Argentina's sovereign debt ascended by December 2001 to U\$S 132,143 million and public bonds represented 72% of that amount.³ Creditors were estimated to be approximately 700,000 around the world.

In 2003 in the International Monetary Fund – World Bank meeting in Dubai, the Secretary of Finance presented the official offer: 75% reduction with no recognition of past due interests (an offer that then suffered only a slight amendment). During this process Argentina succeeded in restructuring USD 62,500 million, equivalent to 76% of the debt.

On 29 April 2010 the Argentine government (together with Citibank, Barclays and Deutsche Bank) opened a new debt restructuring process, aimed at those holdouts that had not entered into the 2005 debt exchange. The offer period is not yet closed but Argentine officials expect to reach 60 to 70% of acceptance.

(c) Cases before the ICSID

Many foreign investors in Argentina suffered severe losses as a consequence of the *pesification* in 2001 and the suspension of tariff adjustments formula established by the government. A great number of claims were filed with the International Center for the Settlement of Investment Disputes (ICSID). Twenty nine out of the existing 127 claims before the ICSID were filed against Argentina. Most of them are related to the suspension of the tariff adjustments formula in the areas of water supply services, gas supply and distribution, and electricity generation and supplying. The government has been actively negotiating with the companies litigating in the ICSID offering them some kind of compensation in exchange for their dismissal of the arbitration procedures.

(d) Audiovisual media law (“Ley de medios”)

The Argentinean Congress passed a new law of audiovisual media on 10 October 2009, which establishes a new series of rules for the regulation of open signal, cable, and satellite television and radio. The new media law is supposed to seek the “decentralization and democratization” of the media by protecting small, local providers.

However, the new law is seen as politically biased as it aims to limit the largest media private group in Argentina, *Grupo Clarín*, which has been highly critical of the Kirchner’s administration. The new regulation allows certain companies that are close to the current administration to acquire broadcasting licenses. This law has been strongly criticized by the opposition, who filed a request for an injunction. The government’s appeal reached the Supreme Court and is pending final sentence.

(e) Nationalization of private welfare system (“AFJP”)

The Law N° 26,425 (the “AFJP Nationalization Law”) dated December 9, 2008, created a single public welfare system based on the distribution of state assistance and eliminated the 14 years old private welfare regime based on investments capitalization. In doing so, the law transferred the assets held by the AFJPs,

³ La Nación, 2001. La Argentina entrará hoy en default. *La Nación*. 24 December 2001. [online] Available from: <<http://www.lanacion.com.ar/361819>> [Accessed 8 June 2010].

including publicly traded shares, to the Guaranty Fund for the Sustainability of the Public Welfare Distribution Regime of the ANSES. The nationalization of the AFJPs was based on allegations of the Government about mismanaging of the funds by the AFJPs, while the opposition believed that the Government's decision responded to their need of cash in order to comply with public debt payments.

The law sets that the compensation for the expropriations cannot exceed the stock capital of the managing companies. In addition it establishes that, if applicable the Government will grant to the AFJP shareholders, public bonds already issued or to be issued by Argentina. Please note that the law regulating these compensations has not yet been passed by the Congress and that the only "compensation" taken so far by the Government was the incorporation of the AFJPs employees into the public administration.

(f) Participation in private companies

As a result of the nationalization of the pension system in late 2008, the stock portfolios held by those AFJP, on behalf of future pensioners, were transferred to an agency of the Argentine Government dealing with pensions (ANSES). The federal government acquired shares of 37 companies listed in the Buenos Aires Stock Exchange. Therefore, all of a sudden the Argentine government became an important (although not controlling) shareholder in a number of companies throughout many industries. The holding of such shares allowed the national government to appoint members to the boards of directors and participate in the everyday business of these companies.

(g) Expropriation of "Aerolíneas Argentinas"

In 2008 the national government decided to expropriate the airline Aerolíneas Argentinas, based on mismanagement by the Spanish group Marsans, by then controller of the company. The Congress passed the expropriation law on 22 September 2008. Since the parties could not reach an agreement on the indemnification amount, a judicial proceeding has been initiated for such purpose and the decision is still pending. Thus, although the expropriation process had not been completed, the government took control of the management of the company, based on an arbitrary and "ad-hoc" interpretation of the expropriation law.

The Spanish group Marsans announced that is planning to file a lawsuit before the ICSID demanding an appropriate compensation.

(h) Withheld on exports (*retenciones*)

The increases during the last years in international prices for some of Argentina's principal commodity exports, such as soy, have contributed to increases in Argentina's exports. The agricultural sector has been the most benefited. Based on that, the Federal Government found a good source of generating tax revenues and imposed a high withheld tax on exported agricultural products by Resolution N° 125/2008. This Resolution was strongly criticized and provoked a conflict between the Government and the agricultural sector. Due to this serious situation the Congress decided to resolve the problem by considering the Resolution among its chambers. Finally, because of the vote from the House President and current Vice President, Julio Cobos, the Resolution was rejected. This attitude generated a deep division between Julio Cobos and the President Cristina Fernandez de Kirchner.

It is also worth mentioning the export withholdings recently imposed to the mining sector. In December 2007, the Domestic Commerce Secretary jointly with the Mining Secretary, delivered some notes ordering Customs to charge the export

duties (withholdings) established in 2002 also to those who had been granted tax stability by that date.⁴

Just a few of the 13 mining companies affected by this order decided to initiate judicial claims against it. On August 13, 2009, the Federal Court of Appeals of the Province of Salta, considered that the mentioned notes were inapplicable to certain mining project with tax stability already granted. Some other cases are currently in the National Supreme Court, with decision pending.

3. POSITIVE CONSIDERATIONS

The purpose of this section is drawing attention to some considerations that may hopefully drive a positive change in the Argentine climate for investments.

(a) Political Environment

Despite the political and institutional risks, it must be said that, from a historical standpoint, Argentine politics have recently achieved a stable democratic system. In fact, between 1930 (year of the first military coup) and 1983, only one freely elected government has completed its term in Argentina. Since 1983, nine presidents completed 27 years of uninterrupted democracy, overcoming several and deep crisis. Apparently, the typical "pendulum motion" (from nationalistic to more liberal governments) is not as extreme as it was in the past.

Focusing in the political climate of recent years, there are grounds to believe that the presidential election of 2011 could be the start point for a better political climate in Argentina. Since the conflict with the farming sector and the mid-term legislative elections of 2009, the negative public image of the Kirchner's administration reached 70%. Surveys reflect that the government's disrespect for laws, as well as the high level of corruption, is among the main claims of society. At the same time, opposition parties are coordinating efforts in the Congress aimed at imposing, or replacing, some of the constitutional limits to the Executive Power. Also, the opposition leaders are working to reach a consensus on the basic public guidelines for the next government, which include the restoring of institutions and rule of law, in order to promote investments.

(b) Economics and Perspectives

Notwithstanding the described political risk, statistics reflects that Argentine economy has grown at an average annual rate of 8.5% between 2003 and 2008.

Also, Argentina is still the third largest economy in Latin America. In 2008, it ranked behind Brazil and Mexico in terms of gross domestic product.⁵

Lastly, the global economic perspectives for the next years are also favorable for Argentina, which is rich in natural resources with a growing global demand (i.e., foods; minerals; nuclear and renewable energy; etc).

(c) Judicial Independence

Saving some exceptions, the Judicial Power has proved to be independent from the government or political pressures. This independence has compensated or balanced, and it will hopefully continue balancing, many of the damages caused by the poor institutional quality.

⁴ Until 2007, the Government recognized that those benefiting from tax stability did not have to pay the export duties established by Resolution 11/02, from the Ministry of Economy and Infrastructure.

⁵ World Development Indicators database, World Bank, 19 April, 2010.

Just to provide a few examples, in June 2009 the National Supreme Court of Justice understood that the equalization tax on income should not be applied to the mining companies that had obtained stability before this tax came into force⁶. In this case, the Supreme Court stated that admitting the applicability of the tax despite of the stability granted to the company would imply disregarding the aim pursued by the tax stability regime (i.e., fostering mining investment in Argentina).

In January 2009, a resolution issued by a Ministry imposed the need of requesting licenses for the importation of certain goods, affecting the imports of such goods in breach to several international treaties signed by Argentina. In view of this unconstitutional restriction, many judges granted precautionary measures suspending the effects of such resolution and allowing the companies to import their goods without getting this newly created license.

Also, a judge granted a precautionary measure suspending a public bidding, as he considered the terms of the bidding to be "tailor-made" in favor of a company closely linked to the national government.

Lastly, on a high profile case, in January 2010 a judge ruled a precautionary measure suspending the effects of a decree issued by the national government to allow the use of the Central Bank's reserves.

4. RECOMMENDATIONS FOR INVESTORS

Notwithstanding these positive considerations, prospective investors may want to consider the following:

(a) Choice of Jurisdiction and law in contracts: this is always a good idea

The choice of law clauses are valid under Argentine law and local courts will uphold such choice of law clauses in any lawsuit, provided certain conditions are met, among others that the foreign law does not conflict with public policy of Argentina. Likewise, choice of forum clauses are valid and binding upon those parties, and a final judgment of a foreign court will be enforced by the courts of Argentina without re-examination or re-litigation of the matters thereby adjudicated, provided a simple exequatur proceeding is followed.

When the pesification took place (please see 2.(a) above), only those contracts governed by foreign law were exempted. Since then, investors regard the choice of alien fora as a protective measure that is particularly effective.

(b) Multilateral and Official Credits Agencies: always excellent partners

Even during Argentina's worse economic crisis, multilaterals and official credit agencies were always somehow protected.

Any investment in which a multilateral or credit agency is involved shall benefit from certain degree of artificial political stability.

(c) Political Risk Insurance: MIGA & OPIC

The Political Risk Insurance Center, who is part of the World Bank Group, rated Argentina with a 4.7 (out of 10) in their Investor Protection Index. In addition, in

⁶ The Argentine Mining Investments Act provides for a 30-year period of fiscal stability for mining projects which have an approved feasibility study.

their latest report on Argentina they stated that *"even if the [current] debt swap is a success, Argentina will still owe over than USD 4.8bn (interests not included) to the Paris Club creditors. (...) As a result, short-term prospects for a change in our cover policy are slim"*.⁷

Agencies such as OPIC and MIGA have been very active in mitigating political risk throughout the region. Prospective investors in major infrastructure or construction projects usually hedge their risks with these agencies.

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⁷ Political Risk Insurance Center. Country Analysis: Argentina. [online] Available from: http://www.pri-center.com/country/country_specific.cfm?countrynum=11 [Accessed on 8 June 2010]