

SCHOOL *of*
INTERNATIONAL SERVICE
AMERICAN UNIVERSITY
WASHINGTON, DC 20016

Argentina's Mistreatment of Foreign Investors

A Critique of U.S. Foreign Policy

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Background reading materials

Arturo C. Porzecanski, "From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default," *Chicago Journal of International Law*, Summer 2005:

Argues that it is a rogue sovereign debtor like Argentina, rather than any rogue private creditor rushing to the courthouse to block a debt-restructuring deal, that poses the greatest threat to the the integrity of the international financial architecture.

Background reading materials

Hal S. Scott, "Sovereign Debt Defaults: Cry for the United States, not Argentina," *Washington Legal Foundation Working Paper #140*, September 2006:

Argues that recent US policy of siding with a sovereign defaulter like Argentina is fundamentally misguided, and that creditor rights must be strengthened by paring back the protections sovereign debtors are currently afforded under the Foreign Sovereign Immunities Act.

During his recent visit to New York, President Kirchner rang the opening bell at the NYSE...



... and *The Wall Street Journal* rightly asked: “What’s going on here?”

Quite the Bell-Ringer

September 20, 2006; Page A26


If the New York Stock Exchange has stood for any single thing across its illustrious history, it has been a commitment to free markets. The Exchange proudly claims an "unwavering commitment to investors and issuers." But the emerging world of globalized, electronic markets has given the NYSE an identity crisis of late, and none more so than this morning when the honored task of ringing the hallowed opening bell goes to, of all people, Argentine President Néstor Kirchner. Could it be some post-modern economist at the Exchange has redefined the meaning of free markets?

Last time we checked, it was a mortal sin at the NYSE to stiff a creditor. In late 2001 and in 2002 the Argentine government reneged on \$82 billion in private-sector debt, confiscated dollar bank accounts, devalued the peso and tore up utilities contracts. Mr. Kirchner took office in 2003, and rather than reverse the trend, he continued the assault on the rule of law.

At first he refused to negotiate with creditors and later forced them to take 34 cents on the dollar. Argentine economic policy under Mr. Kirchner has consisted of bad-mouthing investors and profits, constructing new state enterprises and imposing price controls to damp inflation, now running in double digits. This week the Kirchner government began pressuring banks to make new home loans even as 170,000 Italians filed for arbitration in Washington against Argentine non-payment on its debt.

What's going on here?

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How two troubled neighbors conducted themselves

	<u>Argentina</u>	<u>Uruguay</u>
Imposed a blanket freeze on bank deposits	Yes	No
Applied controls on capital inflows and/or outflows	Yes	No
Forced the currency redenomination of financial assets and/or liabilities (at different exchange rates yet!)	Yes	No
Put on selective price controls	Yes	No
Broke contracts allowing for price increases in line with currency depreciation	Yes	No
Suspended the application of bankruptcy and/or foreclosure laws	Yes	No
Refused to make a good-faith effort to reach a collaborative agreement with creditors	Yes	No
Failed to treat private creditors in a comparable manner (never mind private creditors vis-à-vis official creditors)	Yes	No
Imposed enormous losses on bondholders	Yes	No
Refused to pay court and/or arbitration awards	Yes	N/A

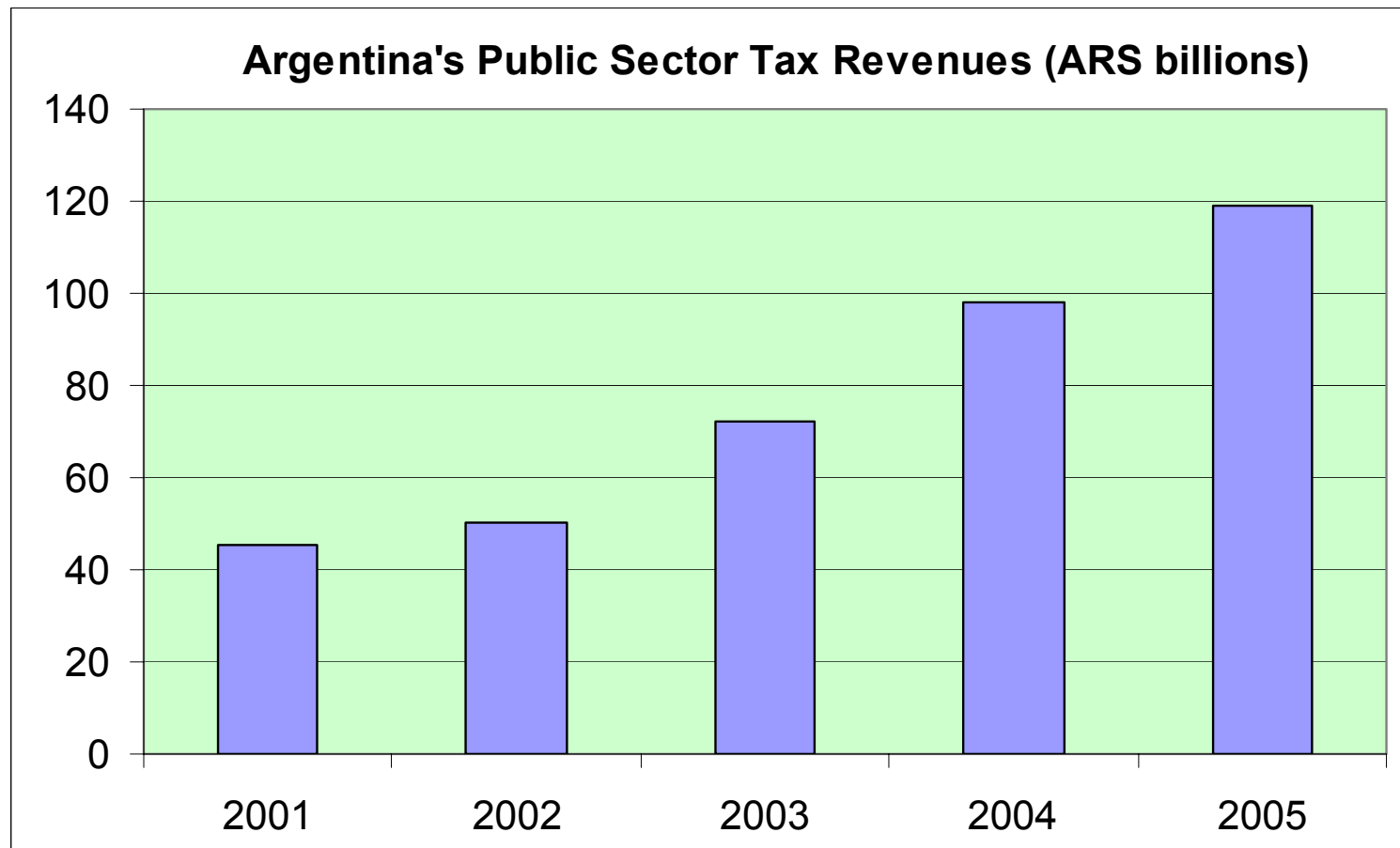


Treatment of bondholders during a debt restructuring

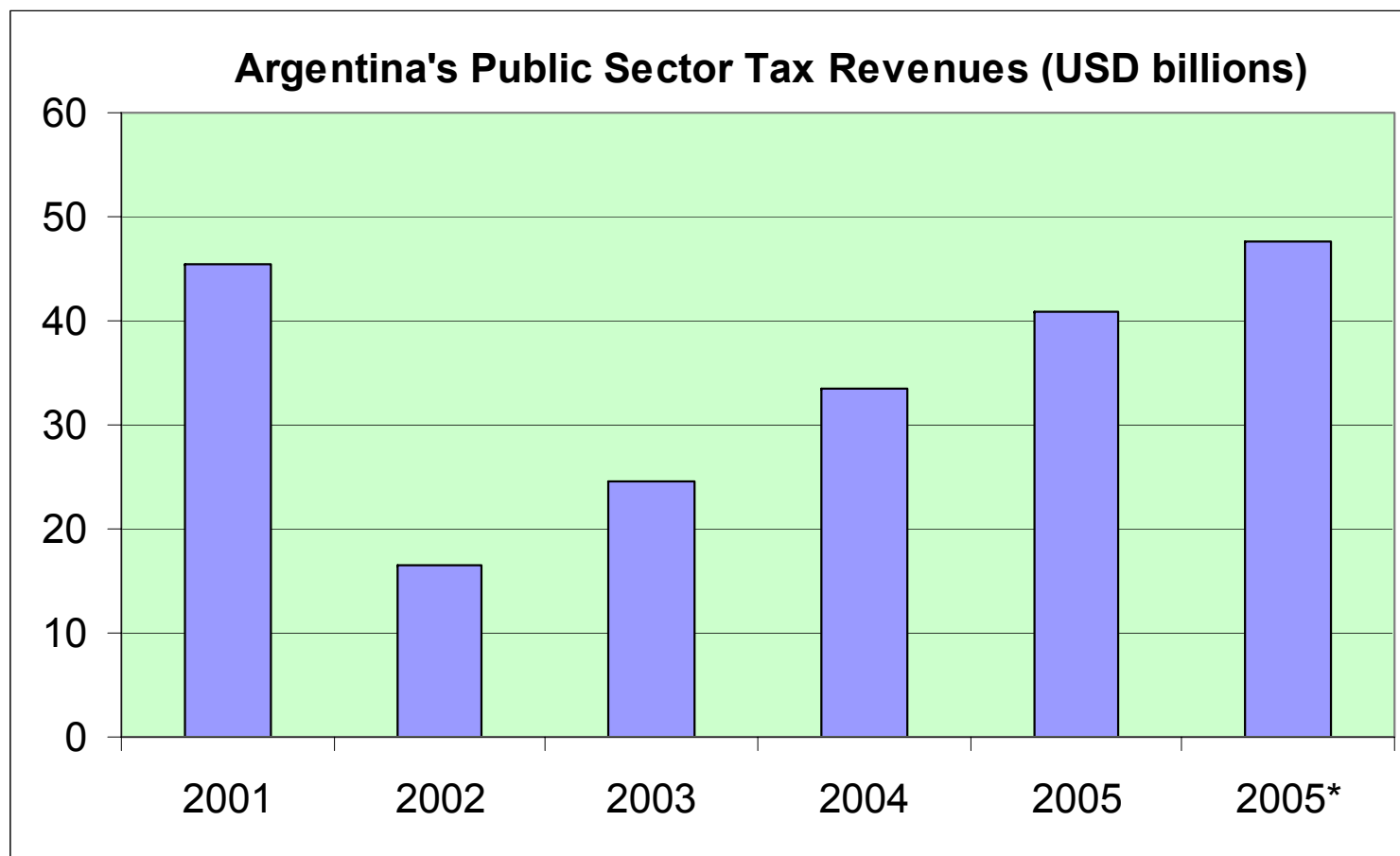
	<u>Best Practice</u>	<u>Argentina</u>
Stop incurring debt when you already are -- and claim to be -- overindebted	Yes	No
Make a good-faith effort to reach a collaborative agreement with creditors	Yes	No
Seek debt relief appropriate to the nature of your liquidity/solvency problem	Yes	No
Treat all private creditors in a comparable manner	Yes	No
Recognize interest arrears, and treat them preferentially vs. past-due principal	Yes	No
Make a good-will, up-front cash payment -- especially when you have the cash	Yes	No
Seek the financial support and endorsement of the multilateral agencies	Yes	No
Aim for 100% creditor participation	Yes	No



Argentina's unwillingness to pay was not a function of its inability to pay



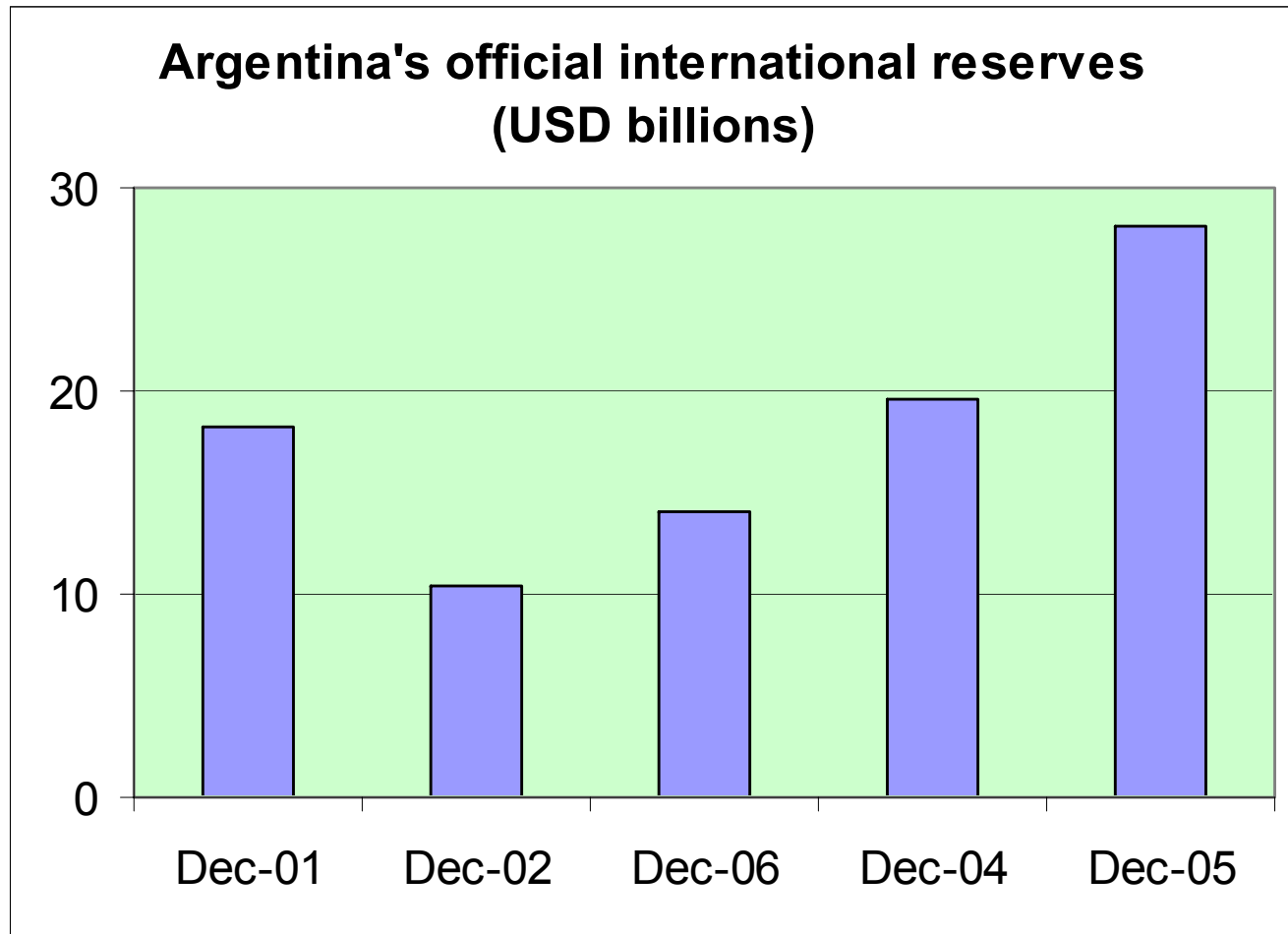
Argentina's unwillingness to pay was not a function of its inability to pay



* At likely market-determined 2005 exchange rate of 2.5 ARS/USD.



Argentina's unwillingness to pay was not a function of its inability to pay



So far, the Argentine approach to obtaining debt relief is not being imitated

Comparison of recent sovereign debt restructurings

	<u>Argentina</u>	<u>Uruguay (Just before Argentina)</u>	<u>Dom. Rep. (Just after Argentina)</u>
Per capita income (USD)*	12,723	8,280	7,326
Scope (USD billions)	81.8	5.4	1.1
Number of bonds	152	65	2
Jurisdictions involved	8	6	1
Months in arrears	41	None	None
Recognition of interest arrears	Partial	N/A	N/A
Extended maturities	Yes	Yes	Yes
Principal forgiveness sought	Yes	No	No
'Haircut' on Discount bond (%)	66.3	0	0
Lowered coupons	Yes	No	No
Participation rate (% of eligible)	76	93	97

Note: "N/A" stands for not applicable.

** Adjusted for purchasing power; 2004 data for Argentina and Dominican Rep., 2003 for Uruguay.*



The debt restructuring process is not yet over

Gross Public Debt Awaiting Restructuring (USD billions, including interest arrears)

	<u>As of 31-Mar-06</u>
Total	31.5
To Paris Club, other official creditors and commercial banks	7.4
To bondholders who did not participate in the exchange	24.1

Bondholders have filed dozens of lawsuits mainly in US, German and Italian courts

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

-----x
Marcello Barboni, Individually And On Behalf :
Of All Others Similarly Situated, : 06cv5157 (TPG)
 :
Plaintiff, : CLASS ACTION COMPLAINT
 :
v. :
 :
Republic of Argentina, :
 :
Defendant :
-----x

Plaintiff Marcello Barboni, by his attorneys, alleges as follows in this class action complaint against the Republic of Argentina:

I. PARTIES

1. Plaintiff Marcello Barboni owns beneficial interests in bonds with International Securities Identification Number (“ISIN”) XS0076397248, maturity date of May, 2004, and coupon rate of LIBOR + 1.6 percent (“Bonds”) that were issued by Argentina but upon which Argentina has refused to pay interest or principal, causing monetary damages to Plaintiff and



Many rulings against Argentina have been obtained, but they have gone unpaid

United States District Court, S.D. New York.
GREYLOCK GLOBAL DISTRESSED DEBT
MASTER FUND, LTD., and Greylock Global
Opportunity Master Fund, Ltd., Plaintiffs,

v.

THE REPUBLIC OF ARGENTINA, Defendant.
No. 05 Civ. 4246(TPG).

Feb. 17, 2006.

OPINION

GRIESA, J.

*1 Plaintiff funds are the beneficial owners of certain bond indebtedness issued by defendant The Republic of **Argentina**. The Republic defaulted on such indebtedness in December 2001 during a profound fiscal crisis. Plaintiff is suing to recover amounts due to it as a result of the default and has moved for summary judgment.

The motion is granted.



Foreign direct investors have filed many claims against Argentina with the International Court for the Settlement of Investment Disputes

THE WORLD BANK GROUP

ICSID

Cases

List of Pending Cases

1. *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*
(Case No. ARB/97/3)

Subject Matter

Water and sewer services concession agreement

(a) Original Arbitration Proceeding

Date Registered

February 19, 1997

Date of Constitution of Tribunal

December 1, 1997

**34 out of 105 pending cases (as of 10/1/06) involve claims against Argentina
-- the most against any single country**

ICSID cases involving Argentina

Pending:

AES
 Aguas de Barcelona
 Asset Recovery Trust
 Azurix
 BP America
 Camuzzi
 CGE
 CIT Group
 CMS Gas
 Continental Casualty
 DaimlerChrysler
 EDF Intl.
 El Paso Energy
 Enersis
 Enron
 Gas Natural
 LG&E Energy
 Metalpar
 Mobil
 Pan American Energy
 SAUR Intl.

Pending (cont'd):

Sempra Energy
 Siemens
 Suez
 Telefónica
 Total
 TSA Spectrum
 Unisys
 Vivendi
 Wintershall

Concluded:

Azurix
 Houston Industries

Discontinued:

Endesa
 France Telecom
 Lanco
 Mobil
 Pioneer
 RGA Reinsurance



The first claim against Argentina decided by the ICSID is unrelated to the 2001-02 financial crisis, but it does not bode well for the government

XI. Decision

442. For the reasons above stated, the Tribunal unanimously decides:

1. That the Respondent did not breach Article IV(1) of the BIT.
2. That the Respondent breached Article II(2)(a) of the BIT by failing to accord fair and equitable treatment to Azurix's investment.
3. That the Respondent failed to accord full protection and security to Azurix's investment under Article II(2)(a) of the BIT.
4. That the Respondent breached Article II(2)(b) of the BIT by taking arbitrary measures that impaired Azurix's use and enjoyment of its investment.
5. To award compensation to Azurix on account of the fair market value of the Concession in the amount of US\$165,240,753 (one hundred sixty-five million two hundred forty thousand seven hundred fifty-three US dollars), including in part the additional investments made by Azurix to finance ABA.
6. To award interest compounded semi-annually on the amount referred to in

"I will stress the importance of Argentina respecting its obligations to honor any arbitral awards made under the U.S.-Argentina Bilateral Investment Treaty."

E. Anthony Wayne, Statement to Senate Foreign Relations Committee, May 10, 2006



The prevalence of neo-populism in Argentina

	<u>Best Practice</u>	<u>Argentina</u>
Tax your leading export industries	No	Yes
Increase government spending sharply, especially ahead of elections	No	Yes
Have the central bank target the exchange rate rather than inflation	No	Yes
Keep inflation from spiraling up via administrative controls (e.g., utility rate freezes, price "accords" and export bans)	No	Yes
Maintain interest rates low even when inflation exceeds official targets	No	Yes
Guide the allocation of bank credit (e.g., to benefit the construction industry)	No	Yes
Enlarge the role of the state (e.g., by renationalizing privatized firms)	No	Yes
Postpone needed structural reforms	No	Yes



But reliance on price controls, for example, which artificially keeps measured inflation down...

Argentine Annual Inflation Slowed in September (Update1)

By Eliana Raszewski

Oct. 4 (Bloomberg) -- Argentina's annual inflation rate fell to a one-year low in September, pulled down by government- set price controls.

Annual inflation slowed to 10.4 percent in the 12 months through September from 10.7 percent in August, the National Statistics Institute said. The monthly inflation rate was 0.9 percent, up from 0.6 percent in August.

"It does look like the price agreements are working right now," said Matthew Festa, a Latin American economist at research firm 4Cast Inc. in New York. "In that sense the band- aid will hold into 2007 at which time it will be hard to forecast exactly when it will stop working. In the medium to long run this type of method for controlling prices is unsustainable."

President Nestor Kirchner, unwilling to ease back on the government spending surge that has in part sparked the inflation pickup, has sought out written commitments from dozens of company executives in the past year to hold down prices. He also has refused to allow electric and telephone utilities to raise prices since he took office in 2003.



**... has predictably adverse consequences
on investment and production...**

Argentina Orders Companies to Import Diesel to Cover Shortages

By Daniel Helft

Oct. 3 (Bloomberg) -- Argentina ordered oil companies including Repsol YPF SA and Petrobras SA to import diesel fuel to cover shortages that have caused farmers to delay plantings of crops such as corn and soybeans, said Ernesto Ambrosetti, chief economist for the country's biggest farmers association.

Cristian Folgar, Argentina's under secretary of energy, informed Ambrosetti, who works at Argentina's Rural Society, and other agricultural association leaders of the government decision in a meeting last night in Buenos Aires.



... and causes adverse spillover effects in neighboring countries

Economist.com

WORLD
THE AMERICAS

Chile's search for reliable suppliers

OVER the next couple of years Chile is likely to be Latin America's fastest-growing economy, as it was for much of the 1990s. But there is one big potential brake: energy. With little oil or coal of its own, Chile imports two-thirds of its energy, relying especially on Argentina's natural gas. Some \$4 billion has been invested in gas pipelines and gas-fired power plants. Until recently, Chile was importing 20m cubic metres of Argentine gas per day. This provided a quarter of central Chile's electricity and almost 60% in the north.

But Argentina's government has frozen the price of gas at home: consumption has soared and investment fallen. Since last year it has imposed unilateral cuts in gas exports to Chile of 20% (and at times 50%). Chile has avoided power cuts, mainly because heavy winter rains boosted hydroelectric output. But it urgently needs more reliable suppliers.



U.S. policy response to Argentine mistreatment of foreign investors

Maintain "excellent" bilateral relations throughout -- presumably for the sake of Argentine cooperation on anti-terrorism and peace-keeping initiatives



U.S. policy response to Argentine mistreatment of foreign investors

Provide a safe harbor at the Bank for International Settlements -- the Swiss-based "central bank's central bank" -- for Argentina's international reserves, presumably to minimize disruptions to the international payments system



BANK FOR INTERNATIONAL SETTLEMENTS

Immunities

The property and assets of the BIS - along with assets of third parties entrusted to the BIS - enjoy immunity protection in many jurisdictions from such governmental measures as expropriation, seizure or confiscation. In addition, the BIS has been granted various immunities at the jurisdictional level in Switzerland, the country of its seat, in the Peoples Republic of China, where the BIS has a representative office in Hong Kong SAR, and in Mexico, where a new representative office has recently been established. The main purpose of these immunities is to protect central bank assets held with the BIS from measures of compulsory execution and sequestration, and particularly from attachment.



U.S. policy response to Argentine mistreatment of foreign investors

Grant sizeable new IMF, IBRD and IADB loans during 2003-04, in apparent violation of IMF "lending into arrears" policy, and despite broken Argentine promises to engage in "meaningful and constructive negotiations" with creditors -- presumably to forestall a default by Argentina to the multilateral agencies

The New York Times

September 11, 2003

Argentina Reaches Deal On 3-Year Aid Package

By TONY SMITH


A day after defaulting on a \$3 billion debt payment to the International Monetary Fund, Argentina said today that it had clinched a three-year aid package from the fund without having to make any major concessions on points it considers crucial to help revive its moribund economy.



U.S. policy response to Argentine mistreatment of foreign investors

Have the U.S. Treasury and the Federal Reserve file *amicus curiae* briefs on the side of Argentina in a pre-emptive move to discourage courts from using a broad interpretation of the *pari passu* clause in bonds to allow the attachment of Argentine payments to other creditors such as the IMF -- presumably to preserve "consensual, orderly" sovereign debt restructurings and to avoid disruptions to the Fedwire payments system

United States Court of Appeals
FOR THE SECOND CIRCUIT



**BRIEF FOR THE UNITED STATES OF AMERICA,
AS AMICUS CURIAE IN SUPPORT OF AFFIRMANCE**

**BRIEF OF AMICUS CURIAE FEDERAL RESERVE BANK
OF NEW YORK IN SUPPORT OF APPELLEES**

U.S. policy response to Argentine mistreatment of foreign investors

Fail to insist, bilaterally or via the IMF, upon the usual, nearly unanimous acceptance of whatever debt restructuring proposal Argentina would put forth to its creditors, which would have encouraged Buenos Aires to come up with a less punishing proposal -- presumably to retain the right to recognize a restructuring that was far less successful than all prior ones

Comparison of recent sovereign debt restructurings

	<u>Argentina 2005</u>	<u>Dom. Rep. 2005</u>	<u>Ecuador 2000</u>	<u>Pakistan 1999</u>	<u>Russia 1998-2000</u>	<u>Ukraine 1998-2000</u>	<u>Uruguay 2003</u>
Participation rate (% of eligible)	76	97	97	95	98	95	93



U.S. policy response to Argentine mistreatment of foreign investors

Fail to insist -- publicly, at least -- that Argentina must honor its debt obligations to official lenders like the Ex-Im Bank; settle with bondholders who did not accept the government's first offer; and start paying all court judgments and arbitral awards mounting against it.

IMF Executive Board Concludes 2006 Article IV Consultation with Argentina

Public Information Notice (PIN) No. 06/93

July 28, 2006

Directors also encouraged the authorities to seek a consensual solution to the remaining government arrears to both official and private sector creditors, noting that this would be in Argentina's own interest.



What have been some of the dividends reaped in the international economic arena from treating Argentina with kid gloves?

✓ Commercial alliances with Hugo Chávez



Kirchner was the first Latin American leader to visit Chávez (in Nov. 2005) after the Venezuelan's falling out with Mexico and the U.S. over rejection of the FTAA at the Summit of the Americas. The two signed a deal to build a gas pipeline between the two countries. Kirchner confirmed that Venezuela would become a full member of Mercosur.

What have been some of the dividends reaped in the international economic arena from treating Argentina with kid gloves?

✓ Financial alliances with Hugo Chávez



President Chávez has already bought some \$3.5 billion of Argentine government bonds. The two governments have said they will launch the "Bonds of the South," valued at \$5 billion, later this year or in early 2007, to finance infrastructure projects.

What have been some of the dividends reaped in the international economic arena from treating Argentina with kid gloves?

- ✓ **A strategic alliance linking Havana, Caracas, La Paz and Buenos Aires**



Kirchner hosted in Córdoba (in July 2006) a Mercosur Summit meeting attended by the four original members plus new member Venezuela, represented by President Chávez. Cuban Leader Fidel Castro and Bolivian President Evo Morales attended the meeting as a "gesture of support."

What have been some of the dividends reaped in the international economic arena from treating Argentina with kid gloves?

✓ A “bad neighbor” policy vis-à-vis Chile and Uruguay



President Kirchner (shown here addressing a protest rally last May) has been whipping up nationalist feelings against Uruguay over the construction of paper mills in that country instead of in Argentina -- supposedly because of potential environmental damage. The IFC is set to release the results of an environmental impact study of the projects under way.

So, what is the message the U.S. has been sending?



Tom Shannon interview with Clarín of Buenos Aires (9/21/06)
[freely translated from the published Spanish version]

Q: "If our bilateral relations are so good, how come the U.S. recently voted against two IADB loans to Argentina [the main one for \$580m for the electricity sector, approved despite U.S. objections reportedly raised because of the Argentine freeze on utility rates]?"

A: "It is a big mistake to read into our voting how we prize or not a country. Our Treasury Department has its own way of doing things and sometimes they think that development banks should not fund certain projects. It has nothing to do with our bilateral relationship."

So, what is the message the U.S. has been sending?



Tom Shannon interview with Clarín of Buenos Aires (9/30/06)
[freely translated from the published Spanish version]

Q: "How much damage will be done to our bilateral relationship by our voting in favor of Venezuela for the [U.N.] Security Council?"

A: "... We share many interests and values with Argentina, no matter what differences we may have. ... We share profound interests, regardless of what the media says. ... We have to realize that this business of the Security Council is not actually a bilateral issue, because it does not pertain to the relationship between our two countries. The vote is a global issue."

**The time has come for a
reassessment of our
relationship – and policy
toward – Argentina**

