# Should Argentina Be Welcomed Back by the Capital Markets?

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# "Should Argentina be Welcomed Back by the Capital Markets?"

by

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## Introduction

After a relatively brief interruption in access to the world's financial markets in late 2008 and early 2009, Latin America has been experiencing a renewed wave of capital inflows – so much so that the issue of how best to ride this wave has become a major policy concern. The intensity of investor interest in the emerging markets generally, and in Latin America in particular, has been heightened by the prospect of renewed monetary expansion in the United States, and thus by the outlook for persistently low interest rates and bond yields. The search for fixed-income returns higher than the 1-5% range that prevails in much of Europe, as well as in Japan and North America, has now led bond investors to venture into increasingly risky territory, such as single-B-rated credits – Argentina among them.[1]

[1] Ratings for Argentina quoted throughout correspond to those assigned to foreign-currency bonds issued by the national government.

This is why several single-B-rated Argentine corporations, provinces and the municipality of Buenos Aires have been able to issue bonds this year for the first time in over a decade, raising almost $3 billion through the end of October at yields mostly in the range of 9½ % to 12½%.[2] And recently, an Argentine property developer completed the first initial public offering of shares in Buenos Aires in more than two years, with two-thirds of the stocks sold to foreign investors as global depositary receipts.[3] Evidently, even equity investors are jumping on the bandwagon.

The return of Argentina to the world capital markets is a watershed event worth noting and discussing. After all, this is one of the few emerging-market countries characterized by nearly a decade's worth of capital flight measured in the many billions of dollars per annum – namely, a place from which most investors have been fleeing for safer and more attractive destinations elsewhere, much like investors have done (on a larger scale) in Venezuela.[4] It is also a country whose national government has defaulted on its loan and bond obligations numerous times in recent decades, and despite having failed to fully cure its 2001 default to official and private creditors, has stated its intention of returning to the international markets to issue a sovereign bond as soon as it finds it sufficiently attractive to do so.[5] So the question of whether financial intermediaries and institutional investors should welcome Argentina back to the global capital markets is certainly relevant – especially for those with short or partial memories who may be tempted to rush in without a full understanding of the risks involved.

## At First Sight

A bird's eye view of Argentina could easily lead some to believe that Argentina has come such a long way from its troubled past that its creditworthiness might be underappreciated by the rating agencies, and that its riskiness may be exaggerated by the bond markets. After all, Argentina is a member of the G-20 club of leading nations; it ranks among the top 30 economies in the world; it is a stable and peaceful democracy; and many of its main economic indicators look very healthy.

[2] Drew Benson, "Arcor Tops Government in Bond Market With Overseas Sales," Bloomberg News, October 21, 2010, available at *http://www.bloomberg.com/news/2010-10-21/arcor-tops-government-in-bond-market-with-overseas-sales-argentina-credit.html*.
[3] Eduardo Thompson, "Argentina's Two-Year IPO Drought Ends as Real-Estate Developer Sells Stock," Bloomberg News, October 29, 2010, available at *http://www.bloomberg.com/news/2010-10-29/argentina-s-two-year-ipo-drought-ends-as-real-estate-developer-sells-stock.html*.
[4] This author's estimates, based on official balance of payments data, are that net capital outflows excluding government and central bank transactions, and errors and omissions, averaged over $8 billion per annum in Argentina during 2004-2009. The Institute of International Finance estimates that capital flight ("net resident lending abroad") averaged nearly $7 billion per year during the same period.
[5] Drew Benson and Ben Bain, "Fernandez Rejects 8% Yield Overseas to Pay 12% in Pesos," Bloomberg News, September 28, 2010, available at *http://www.bloomberg.com/news/2010-09-28/fernandez-rejects-8-yield-overseas-to-pay-12-in-pesos-argentina-credit.html*.

For example, *Argentina's per capita income measured in current dollars*, a variable that usually correlates quite well with sovereign ratings because it is a general measure of capacity to pay foreign-currency obligations, has recuperated strongly in recent years. It now exceeds $8,000 (see Figure 1), such that Argentina currently fits comfortably within the range of per capita incomes of developing countries that are rated BBB/Baa1-Baa3.[6]

**Fig. 1: Per Capita Income (US$ per year)**

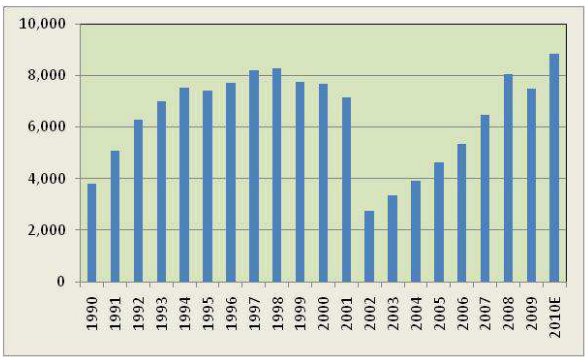



**Fig. 2: Unemployment Rate (% as of mid-year)**

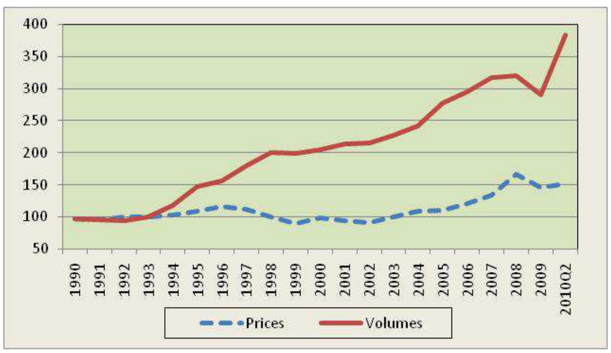

*Source Fig. 1: Argentina Ministry of Economy and Public Finance and Central Bank of Argentina (2010 consensus forecasts).*
*Source Fig. 2: Argentina INDEC (EPH Puntual 1990-2002, EPH Continua 2003-2010), for May or June.*

Argentina's vigorous economic recovery from the protracted and deep recession of 2000-2002 is reflected in the steady drop in urban unemployment, which has come down from above 20% and has settled at around 8% during the eight quarters through mid-2010 (see Figure 2). These are very good levels, last seen in the early 1990s before the economy was restructured and many low value-added jobs in inefficient companies disappeared. This is another achievement that normally supports a country's creditworthiness, because it correlates with higher private-sector incomes and government revenues.

[6] Moody's Investors Service, Moody's Statistical Handbook: Country Credit, May 2010, p. 11. The mean per capita income for Baa1-Baa3 developing countries was $8,100 in 2009; Argentina's per capita income is much higher on a purchasing-power-adjusted basis (around $14,000), and also falls within the Baa1-Baa3 range as per Moody's. Ibid, pp. 16-18.

Argentina's economy has been helped by *a boom in the prices of its commodity exports*, stimulating greater investment and output, particularly in export-oriented agriculture.[7] Indeed, export prices and volumes have each averaged about 65% higher during 2008-2010 than in 1999-2000 (see Figure 3). As a result, the country's merchandise export earnings have more than doubled, from around $25 billion per annum a decade ago to a yearly average of over $60 billion during 2008-2010 (see Figure 4). This is the kind of noteworthy expansion in hard-currency earnings that improves several of the ratios (e.g., external debt to exports) that are usually calculated to help assess a country's creditworthiness.

**Fig. 3: Export Prices and Volumes (1993=100)** **Fig. 4: Merchandise Exports (US$ billions)**





*Source Fig. 3: Argentina Ministry of Economy and Public Finance.*
*Source Fig. 4: Argentina Ministry of Economy and Public Finance and Central Bank of Argentina (2010 consensus forecasts).*

The export boom has generated *a significant expansion of government revenues*, because commodity exports have been taxed directly, and once the export-led recovery trickled down to urban consumers, a virtuous cycle of higher private-sector incomes and augmented government revenues and spending ensued. Indeed, Argentina has never

[7] Argentina's terms of foreign trade (incorporating the evolution of both export and import prices) during the past three years have been the most favorable in nearly three decades. See Argentina Ministry of Economy and Public Finance, Secretariat of Economic Policy, Economic Information: External Sector, available at *http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html*. The share of agriculture in nominal GDP more than doubled in 2002-2004, to almost 10% from under 4.5% in 1999-2001. See Ibid, Economic Information: Economic Activity.

before seen as great an expansion of government income as in recent years, such that revenues have grown to the equivalent of more than 33% of GDP from an average of around 21% of GDP in the late 1990s (see Figure 5).[8] The fast pace of revenue growth has allowed for a massive reduction of the burden that government obligations – whether paid or in arrears – imposed on the government's revenue base (see Figure 6). This sovereign creditworthiness indicator, which has now dropped to around 150% from a peak of nearly 800% in 2002, is actually below the levels prevailing in the late 1990s, when the sovereign was rated BB/BB/Ba3.[9]

**Fig. 5: Government Revenues (% of GDP)***

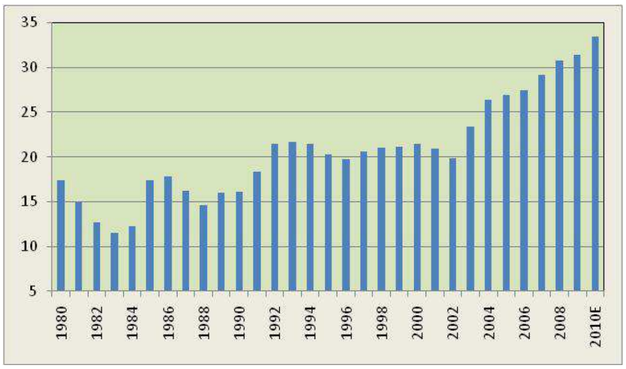
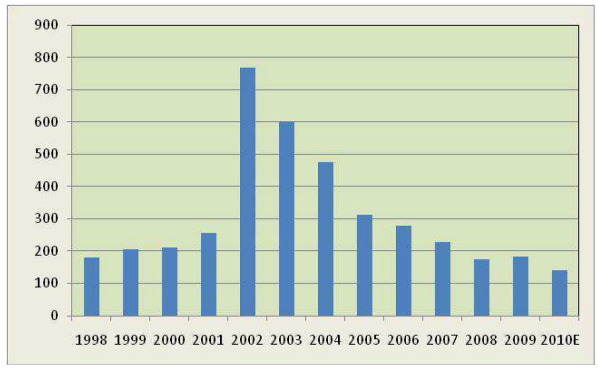



**Fig. 6: Government Debt (% of Revenues)****




** Net of tax rebates and inclusive of mandatory social security contributions and provincial revenues; 2010 estimate based on January-September year-on-year revenue growth and consensus GDP forecasts as of September 2010.*
*Source Fig. 5: Argentina Ministry of Economy and Public Finance and Central Bank of Argentina (2010 consensus forecasts).*
*** Includes debts that were not tendered to the exchanges of 2005 and 2010; 2010 estimate based on the mid-2010 debt/revenues ratio, incorporating an estimate of the effect of the 2010 debt exchange.*
*Source Fig. 6: Argentina Ministry of Economy and Public Finance, Asociación Argentina de Presupuesto y Administración Financiera Pública and author's calculations.*

The export bonanza, which has made it possible for Argentina to run *substantial surpluses in its foreign trade* (averaging about $15 billion per annum during 2002-2009), despite a surge in imports, has more than compensated for the previously-mentioned net capital outflows. If Argentina had had a market-based, exchange-rate regime, the resulting net influx of foreign exchange would have led to a meaningful appreciation of the Argentine peso. However, it has been government policy to have the Central Bank of Argentina intervene frequently in the currency market in order to keep the peso (ARS) weaker than otherwise. In the five years to September 30, 2010, the ARS has depreciated in nominal terms by 36%, from ARS2.91/USD to ARS 3.96/USD, a period

[8] The revenue figures include pension contributions from employers and employees, but the renationalization of the pension regime in late 2008 probably accounts for less than one fifth of the ten percentage-point increase in the ratio of revenues to GDP.
[9] Sovereign foreign-currency ratings as per Standard & Poor's, Fitch and Moody's, respectively. Moody's downgraded Argentina to B1 in October 1999; the others first downgraded it in late 2000 (Standard & Poor's) and in early 2001 (Fitch).

during which most emerging-market currencies, including those of Argentina's neighbors, have appreciated. [10]

One result of frequent central bank intervention to mop up excess dollars coming into Argentina has been *a major accumulation of official international reserves.* Despite having had to transfer periodically many billions of dollars out of reserves to the government, the central bank has seen its hoard of foreign exchange boosted to more than $50 billion since July of this year, up sharply from less than $20 billion prior to 2005. As can be seen in Figure 7, and as is true about its fiscal revenues, Argentina's official international reserves have likewise reached their highest point in contemporary history.

Until recent years, the country's total foreign debt, and the government's own obligations to non-resident investors, used to be a huge multiple of the central bank's international reserves. Now the country's external debt liabilities are two-and-a-half times the level of reserves, a fraction of their magnitude even in the late 1990s (nearly six times the level of reserves), when Argentina was deemed to be a much better credit (see Figure 8). At these levels, the country's foreign debt is once again compatible with higher sovereign credit ratings.[11]

**Fig. 7: Official International Reserves (US$ billions)**

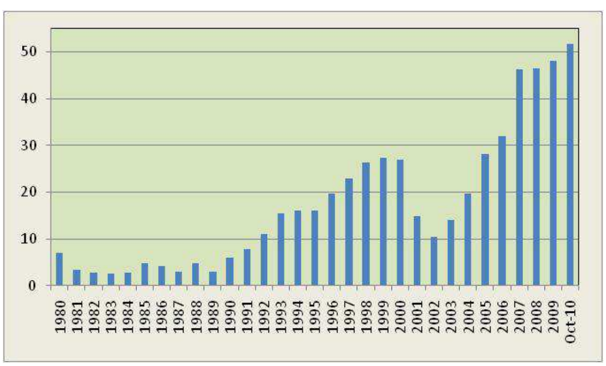
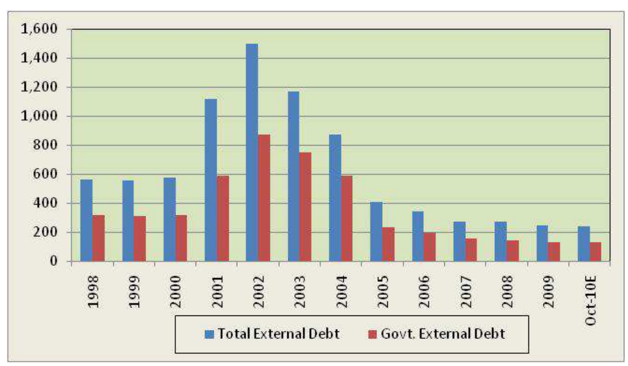



**Fig. 8: External Debt (% of international reserves)***




** Excludes government bonds owned by non-residents that were not tendered into the debt exchanges of 2005 and 2010.*
*Source Fig. 7: Argentina Ministry of Economy and Public Finance (1991-2010) and International Monetary Fund (1980-1990).*
*Source Fig. 8: Argentina Ministry of Economy and Public Finance.*

[10] During this same 5-year period, the Brazilian Real (BRL) appreciated in nominal terms by 24%, and the Chilean peso (CLP) by 9%, versus the USD.

[11] According to Moody's, the mean ratio of external debt to official international reserves for Baa1-Baa3 developing countries was 300% in 2009, and for Ba1-Ba3 countries it was 259%. See Moody's Investors Service, op. cit., pp. 201-202.

## A Closer Look

There is a great deal of country risk that is not captured by these indicators, however, so it would be naïve to rush to the conclusion that Argentina is a creditworthy or relatively safe place in which to invest.

First, *the government has been spending virtually all its enormous revenue windfall,* such that in fact there are hardly any extra, genuine resources available to support the existing – or any new – public indebtedness. The Argentine authorities have not been publishing comprehensive data on the public-sector accounts, but whatever statistics they do release for the central government show, despite the windfall, a string of only modest fiscal surpluses during 2002-2008 – and then a small deficit for 2009, when the economy and tax revenues went through a temporary downturn.

However, the International Monetary Fund (IMF) has been publishing a more comprehensive data set that includes provincial government finances, and where spending is recorded on an accrual, rather than cash, basis – namely, it includes all payments that are contractually due to be made by the government. As can be seen in Figure 9, the IMF's figures show a string of operating deficits rather than any surpluses. This is consistent with the fact that the public debt has grown from mid-2003 until mid-2010 by the equivalent of $37 billion (net of all debt forgiveness), which is equivalent to around 15% of average GDP during that 7-year period.[12] Therefore, the impressive trend in tax revenues to GDP, or in the ratio of government debt to revenues highlighted previously, paints a completely misleading picture of Argentina's renewed capacity to pay its domestic or foreign obligations. The growth in spending apparently has been channeled as follows: the civil-service headcount in the central government has increased by one-third from the 1999-2002 average; subsidies to consumers (mainly on energy) have increased by at least three percentage points of GDP; and other forms of social spending have likewise risen by over three percentage points. This has happened during a period of rapid GDP growth, such that all spending categories have increased to a greater or lesser extent, and government expenditures as a whole have quadrupled in nominal terms from 2002 through 2009.[13]

**Fig. 9: Fiscal Accounts (% of GDP)[14]**

| | 2006 | 2007 | 2008 | 2009 | 2010E |
|---|---|---|---|---|---|
| *As per IMF:* | | | | | |
| Public sector revenues | 29.9 | 31.5 | 33.4 | 33.9 | 34.6 |
| Public sector spending | 31.0 | 33.6 | 33.7 | 37.6 | 38.1 |
| Overall balance | -1.1 | -2.1 | -0.3 | -3.7 | -3.5 |
| *As per Argentina:* | | | | | |
| Overall balance* | 1.8 | 1.1 | 1.4 | -0.6 | |
| Overall balance** | 1.3 | 0.9 | 0.9 | 1.0 | |

* Non-Financial Public Sector.
** National Public Sector.

*Source: International Monetary Fund and Argentina Ministry of Economy and Public Finance.*

[12] Perspectiv@as, "La dinámica de la deuda pública en la era K," September 24, 2010, available from the author.
[13] Spending at the level of the Non-Financial Public Sector was ARS 71 billion in 2002 and reached ARS 327 billion in 2009. See Argentina Ministry of Economy and Public Finance, Secretariat of Economic Policy, Economic Information: Public Finance, available at *http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html*; Gasto Público Consolidado, available at *http://www.mecon.gov.ar/peconomica/docs/gp_cons.xls*, and Asociación Argentina de Presupuesto y Administración Financiera Pública, Estadísticas Fiscales, Capítulo VI, Ocupación en el Sector Público, Table VI.2, available at *http://www.asap.org.ar/images/stories/file/estadisticas/cap6/6.2.xls*.
[14] Expanded sources: IMF, Regional Economic Outlook: Western Hemisphere, May 2010, p. 60, and October 2010, p. 81; Argentina Ministry of Economy and Public Finance (MECON), Secretariat of Economic Policy, Economic Information: Public Finance, Table A6.1 (A), available at *http://www.mecon.gov.ar/peconomica/basehome/infoeco_ing.html*; and Asociación Argentina de Presupuesto y Administración Financiera Pública, Estadísticas Fiscales, Capítulo I, Ahorro-Inversión-Financiamiento, Table I.2.2., based on MECON, available at *http://www.asap.org.ar/images/stories/file/estadisticas/cap1/1.2.2.xls*.

The provincial and municipal governments that have issued bonds abroad, or might do so in the near future, are all rated single-B, and all indications are that their financial situation is precarious indeed. As a group, their financial performance has tended to deteriorate: they ran a collective overall budgetary surplus equivalent to 1% of GDP in 2004, then moved to a balance in 2006-2007, and they have been in deficit ever since.[15] It is troubling to see them issue debt in dollars that carry double-digit coupons when there is no reasonable assurance that their revenues will grow at double-digit rates during the life of those bonds.

Second, *serious allegations have been made in recent years about the accuracy and integrity of official inflation data in Argentina,* casting doubt on all kinds of economic indicators that use price indexes as a deflator, as in the case of real GDP, real wages, real interest rates and real exchange rates. Numerous private-sector estimates of inflation, as well as official inflation measures computed by several provincial governments, point to a much higher inflation rate than calculated and published by the national statistical agency. The agency, known for its acronym INDEC, was purged of key staff in early 2007, allegedly for the individuals' unwillingness to keep fudging the numbers to keep reported inflation down.[16] Numerous economic consultants, universities and business groups have started a veritable cottage industry sampling consumer prices and calculating alternative inflation figures. The credibility gap has become so large that, in the IMF's leading publication, the *World Economic Outlook*, Argentina is the only country in the world whose inflation and GDP statistics are accompanied by a footnote explaining that the numbers cited have been challenged by private analysts.[17]

According to the government's figures, inflation in Argentina (using year-on-year monthly figures) has averaged 8.4% per annum during the period from January 2007 until September 2010. In contrast, according to the Fundación de Investigaciones Económicas Lationamericanas (FIEL), which is a highly reputable, business-sponsored economic research institute in Buenos Aires, inflation during that period has averaged

[15] Asociación Argentina de Presupuesto y Administración Financiera Pública, op. cit., Capítulo I, Ahorro-Inversión-Financiamiento, Table I.5.1.2, available at *http://www.asap.org.ar/images/stories/file/estadisticas/cap1/1.5.1.2.xls.*
[16] "Economics for Dummies," The Wall Street Journal, February 20, 2007.
[17] See, for example, IMF, World Economic Outlook, October 2010, p. 80, 183-184 and 189-190.

20.5% – a time-and-a-half difference. As can be seen in Figure 10, the gap between the two measures of inflation has been persistently large, and other independent estimates of inflation produced in the capital city and in distant provinces yield a discrepancy that is roughly of the same magnitude. The passage of time means that the cumulative difference in inflation statistics has grown very large (see Figure 11): according to the government, prices have gone up by less than 50% since the beginning of 2006, but as reckoned by FIEL and many other alternative sources, prices have actually skyrocketed by almost 130%.

**Fig. 10: Inflation (% year-on-year)**

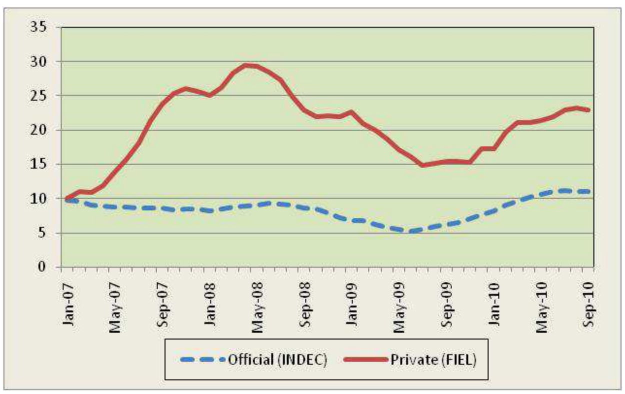
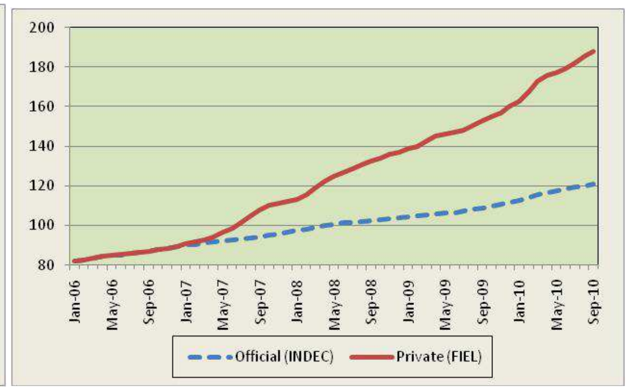



**Fig. 11: Consumer price indexes (April 2008 = 100)**




*Source Fig. 10 & 11: INDEC and FIEL.*

The implications are serious. The Argentine authorities believe that their fiscal and monetary policies are sound and appropriate; the great majority of independent economic analysts and the IMF itself, on the other hand, disagree and think that these policies have been highly expansionary and downright imprudent.[18] Clearly, inflation measured in single digits tends to support the government's position, whereas inflation measured continuously in double digits provides ammunition to the critics. If inflation is indeed running very high, it suggests that the government would be well advised to slow down the growth of public spending, and that the central bank should tighten monetary policy by moving away from an informal exchange-rate target, because its purchases of dollars have contributed – despite costly sterilization operations – to an excessive monetary expansion. Indeed, the monetary aggregates have been growing at year-on-year rates of over 25% as of late, well beyond what is deemed prudent if inflation is indeed running at the relatively slower pace the government says it is.

[18] IMF, Regional Economic Outlook: Western Hemisphere, October 2010, pp. 29-30.

Inflation running at close to 10%, never mind at close to 30%, also undermines the case for regarding Argentina as creditworthy. Inflation rates have historically correlated quite well with sovereign credit ratings; in general, the higher the inflation, the lower the ratings, especially in years past when the worldwide dispersion of inflation rates was much greater than nowadays. Still, the mean annual inflation rate for investment-grade developing countries was 4% in 2009, whereas for single-B countries it was 6%; indeed, the single-B category is the only one that encompasses half-a-dozen countries with double-digit inflation, Argentina and Venezuela among them.[19] They probably belong there, because high-inflation countries are usually characterized by imprudent fiscal and monetary policies, feature unsustainable exchange rates and tend to engender social and political unrest – sooner or later.

Moreover, higher-than-officially-recognized inflation in Argentina has cheated domestic and international investors who held inflation-adjusted (so-called CER-indexed), peso-denominated bonds, large quantities of which were issued in 2002-2004 paying 2% plus the inflation adjustment. In 2005-2006, before inflation allegedly got out of control, these inflation "protected" securities accounted for more than 40% of Argentine government debt outstanding, but by now the proportion has fallen to less than 25% of total, as investors shunned them because they realized that they would not be compensated appropriately.[20] As investor appetite for CER-indexed debt dried up, government bonds, which pay a floating interest rate (BADLAR), have taken their place.

Third, *investors must be mindful of the implications of Argentina having yet to fully cure its massive default to private and official creditors.* Earlier this year, the government reopened its punishing debt exchange of 2005 and a number of holdout bondholders capitulated and accepted the steep losses and new long-term bonds offered by Argentina. They had held out in the understandable hope that the country's strong economic recovery of recent years, and the government's historic revenue bonanza, would have led to an improved offer such that they would not have to renounce up to two-thirds of their principal claim. By now, about 92% of bondholders have tendered their old, defaulted bonds, either in 2005 or earlier this year, but the remainder, who are owed more than $16 billion (including accrued interest), now constitute a hard core of unpaid creditors.[21] Many of them have won court judgments worth billions of dollars against Argentina, and are pursuing every remedy legally available to enforce them.[22]

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[19] Moody's Investors Service, op. cit., pp. 30-32.

[20] Argentina Ministry of Economy and Public Finance, Secretariat of Finance, National Bureau of Public Credit, Public Debt Report as of 06-30-2010, Table A.20, available at *http://www.mecon.gov.ar/finanzas/sfinan/documentos/deuda_publica_30-06-2010.xls.*

[21] The government's calculation of principal and interest due to holdout bond investors appears in Ibid, Table A.1.2.

[22] For example, U.S. District Court Judge Thomas Griesa granted a court order in May freezing $3.1 billion in Argentine assets in the United States at the request of NML Capital Ltd. and Kenneth Dart's EM Ltd., and a U.S. appeals court upheld that order in August. Lately, NML asked the same court to enforce "equal treatment" (*pari passu*) among Argentina's creditors, claiming the country is wrongly paying other debts before those of the holders of defaulted bonds, an argument with potentially widespread ramifications. See Andrew M. Harris, "Argentine

Should the government decide to come back to the international bond markets, the creditors could conceivably attempt to block any such issuance until Argentina satisfies its outstanding judgments, and failing that, the creditors probably would try to attach any of the proceeds from the sale of new securities before they reach the government's pockets.

Argentina is also in protracted arrears to certain foreign commercial banks and suppliers, in the amount of $850 million, and it has not paid on several awards for nearly $1 billion entered against the government as a result of arbitrations under the International Centre for Settlement of Investment Disputes (ICSID).[23] Moreover, there are a number of additional cases making their way through ICSID that could result in multi-billion-dollar awards. At present, there are 27 cases pending against Argentina. They represent more than one-fifth of all cases currently before ICSID and a whopping 84% of all cases brought against any of the G-20 member nations.[24] All of these claims against Argentina constitute actual or contingent liabilities that could cause complications for new investors down the road, and which eventually will have to be settled one way or another.

A related concern is the fact that Argentina has not cured its default on debts to the Paris Club of official bilateral lenders, who are owed close to $7 billion, of which more than $5 billion is in arrears.[25] Indeed, Argentina is the only G-20 member government that is in default on its loan obligations to its fellow members – and it has been in default to them for nearly a decade. In recent weeks, the Argentine authorities have stated their intention to negotiate with the Paris Club and to reach a rescheduling agreement within a few months.[26] Until this becomes a reality, however, investors contemplating purchasing a new global bond issued by Argentina should be mindful that, if and when the Argentine government and its creditor counterparts negotiate a restructuring of these past-due amounts, the Paris Club will likely apply its principle of "comparable treatment" to private creditors. For instance, when countries as diverse as Indonesia (1998), Pakistan (1999), Russia (1999) and the Dominican Republic (2004) encountered financial difficulties and reached out to their official creditors, the debt relief

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Bondholder Asks U.S. Court for 'Equal Treatment' Among Creditors," Bloomberg News, October 20, 2010, available at *http://www.bloomberg.com/news/2010-10-20/argentine-bondholder-asks-u-s-court-for-equal-treatment-among-creditors.html*.

[23] Op. cit., Public Debt Report as of 06-30-2010, Table A.3, and Republic of Argentina prospectus subject to completion dated January 28, 2010, filed with the U.S. Securities and Exchange Commission under Schedule B of the Securities Act of 1933, pp. 11-12.

[24] ICSID, List of Pending Cases, available at *http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListPending.*

[25] Ibid., Public Debt Report as of 06-30-2010, Table A.3. Argentina reports owing $6.6 billion and the Paris Club reports being owed $6.9 billion, see Paris Club, Annual Report 2009, p. 44, available at *http://www.clubdeparis.org/sections/communication/rapport-annuel-d/2009-rapport-annuel1218/downloadFile/file/RapportAnnuel_AnnualReport_2009.pdf.*

[26] Drew Benson and Rodrigo Orihuela, "Argentina's Paris Club Debt to be Resolved by Early 2011, Lorenzino Says," Bloomberg News, November 17, 2010 , available at *http://www.bloomberg.com/news/2010-11-17/argentina-s-paris-club-debt-to-be-resolved-by-early-2011-lorenzino-says.html*.

they obtained from the Paris Club was conditioned on securing comparable relief from their bankers and bondholders. This was true even when debt to private creditors was small or was not yet falling due, as in the cases of Pakistan and the Dominican Republic.[27] Therefore, potential foreign investors in (and lenders to) Argentina are likely to become embroiled in a restructuring of their claims as a concession to any future accord between Argentina and its official creditors. For all practical purposes, new creditors to Argentina have a target on their back.

Fourth, *the controversy over the true rate of inflation is part of a larger picture of lack of transparency in Argentina.* Argentina is also the only member of the G-20 that refuses to abide by its treaty obligations to the International Monetary Fund, which include allowing the IMF to inspect its books and evaluate the country's economic performance and policies – especially its exchange-rate policies under a so-called Article IV Consultation. The IMF is supposed to hold bilateral discussions with its member governments usually every year, but Argentina has not hosted the Fund since 2006. Apparently, the authorities in Buenos Aires do not wish to be questioned on their economic statistics, nor to be criticized for their economic policies, including their manipulation of the exchange rate.[28]

The country is also the only member of the G-20 that has just been put on probation by the Financial Action Task Force (FATF), an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The FATF Plenary Meeting just recently "expressed its disappointment and serious concern regarding Argentina's failure to implement an adequate and effective AML/CFT [anti-money laundering and counter-terrorist financing] system and will engage closely with Argentina to ensure that it quickly rectifies the identified deficiencies."[29] Argentina has either failed to comply, or has complied only partially, with 42 out of the 49 standards recommended by the FATF. The FATF complete report, to be published shortly, apparently denounces corruption

[27] In return for a Paris Club debt rescheduling of payments due in 1999-2000 (along Houston terms), Pakistan was forced to reschedule three Eurobonds maturing during 1999-2000 even though the amounts involved were relatively small. And in exchange for a Paris Club debt rescheduling of some arrears and payments due in 2004 (along Classic terms), the Dominican Republic was required to reschedule a Eurobond maturing in 2006 and another one falling due in 2013. See Arturo C. Porzecanski, "Debt Relief by Private and Official Creditors: The Record Speaks," International Finance, Summer 2007, p. 202.

[28] In late November, the Argentine authorities requested IMF technical assistance on the design and methodology of a new national consumer price index, but the main problem is not the absence of such a comprehensive index, but rather the manipulation of the 440 prices which serve as inputs for the existing index for the greater Buenos Aires metropolitan area.

[29] FATF, "Outcomes of the FATF Plenary Meeting, Paris, 20-22 October 2010," available at *http://www.fatf-gafi.org/document/21/0,3343,en_32250379_32235720_46252373_1_1_1_1,00.html.* A full report on the case of Argentina will be published by the FATF in the weeks to come, but the Executive Summary, which details the 42 standards that Argentina is not in full compliance, has been posted and is available at http://www.fatf-gafi.org/dataoecd/51/5/46336120.pdf.

and impunity in Argentina, and is the harshest ever published by that high-level group on any of its member governments.[30]

Part of the problem may be rooted in Argentina's default on its foreign obligations, its ongoing effort to prevent state funds from falling into the hands of disgruntled creditors, and its noncompliance with court judgments and arbitral awards. As a result, the government has had to minimize its bank accounts abroad, make payments in cash (e.g., to its own diplomats abroad), move money in roundabout ways through the international financial system, and leave as small a paper trail as possible.

Moreover, many stories of official corruption and maladministration, or of suspected illicit or improper activities on the part of government officials, have come to light in recent years in Argentina – something else for potential investors to consider, particularly since neither the government nor the judiciary has been keen to investigate (never mind prosecute) them. To recall just two of the most prominent episodes, the late President Néstor Kirchner used to boast that when he was the governor of the province of Santa Cruz in the 1990s, he had "safeguarded" hundreds of millions of dollars of provincial funds by moving them into Swiss banks ahead of the peso's devaluation in 2002. However, there has never been a full disclosure of how much was shifted overseas, how much has been repatriated to Santa Cruz, or what has happened to the earnings on those deposits abroad. Earlier this year, a former vice governor of that province denounced Mr. Kirchner for having stolen some of those funds, but various petitions for an investigation of the matter have come to nothing.[31]

The presidential campaign of the Cristina Fernández de Kirchner was marred by the "suitcase scandal," which involved the arrival into Argentina of nearly $800,000 in cash carried in a suitcase by someone flying in from Venezuela on a jet chartered by an Argentine state-owned company. Several individuals connected to the episode were later charged in the United States with various crimes and were tried and sentenced to prison. The authorities in Argentina and Venezuela did not pursue an investigation, perhaps because a member of President Kirchner's cabinet, who remains in that post until now under President Fernández de Kirchner, was allegedly linked to secret money transfers from Venezuela to Argentina.[32]

[30] Hugo Alconada Mon, "Lavado: ultimátum para la Argentina," La Nación, October 22, 2010, available at *http://www.lanacion.com.ar/nota.asp?nota_id=1317449.*

[31] La Nación, "El ministro de Economía santacruceño negó que se hayan gastado los fondos," May 28, 2010, available at *http://www.lanacion.com.ar/nota.asp?nota_id=1269479*. The most extensive documentation on this matter appears in MDZ Online, "Fondos de Santa Cruz, los documentos secretos del kirchnerismo," May 28, 2010, available at *http://www.mdzol.com/0/vnc/imprimir.vnc?id=212706.*

[32] Mort Lucoff and David Voreacos, "Venezuelan Agent Gets 4-Year Term in U.S. in Suitcase Scandal," Bloomberg News, March 17, 2009, available at *http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ab4eYiOss9jo;* and Terra, "Oposición pide juicio político de ministro De Vido por 'caso del maletín'," undated, downloaded November 3, 2010, available at *http://www.terra.com.ve/actualidad/articulo/html/act1444015.htm.*

Fifth, *key institutions of relevance to foreign investors have been undermined by recent governments in Argentina.* Beyond the aforementioned interference with the official statistical agency (INDEC), it is worth recalling that the central bank has been manhandled and the country's privately-managed pension funds have been nationalized, with each case illustrating prominent instances of abuse of executive authority and of interventionist policies. Earlier this year, President Fernández de Kirchner signed an executive order telling the central bank to transfer $6.6 billion to the government, and when the bank's president, Martín Redrado, refused because his legal counsel advised him that the central bank charter allowed him to transfer funds only with congressional approval, he was fired. A judge later reinstated Mr. Redrado, because, according to said charter, President Fernández de Kirchner likewise did not have the power to dismiss a central bank president without congressional authorization. In the end, the legislature approved the transfer of funds and Mr. Redrado's replacement, but the whole episode demonstrated vividly how institutions relevant to the country's financial stability and creditworthiness have been intimidated or trampled.[33]

The country's private pension funds were nationalized in late 2008 under the guise of "saving" them from losses related to the downturn in world financial markets in the wake of the collapse of Lehman Brothers. The government's initiative was duly passed by the legislature, but ever since then the pension funds have become buyers of first resort of the government's obligations, such that nearly two-thirds of their holdings are government bonds. The bonds they purchase carry very low interest rates, which is expedient for the government but not for would-be pensioners.[34] The nationalization of the pension funds has therefore undermined the development of Argentina's capital markets and promises to impoverish pensioners over time.

A final element is *to consider where Argentina ranks according to various criteria that have some relevance to the assessment of a country's creditworthiness.* For example, according to The World Bank's Doing Business 2011 report, Argentina ranks in 115th place in the "Ease of Doing Business" category, out of a total of 183 economies.[35] The country comes out in 87th place in the World Economic Forum's Global Competitiveness Report 2010-2011, out of a total of 139 economies.[36] Argentina ranks in 105th place, out of 178 countries, in Transparency International's 2010 Corruption Perceptions Index.[37] And in the Heritage Foundation-Wall Street Journal 2010 Index of Economic Freedom, Argentina is in 135th place, out of 179 countries.[38]

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[33] Eliana Raszewski, "Paying Debt With Reserves Puts Fernandez Ally at Argentina's Central Bank," Bloomberg News, September 22, 2010, available at *http://www.bloomberg.com/news/2010-09-23/paying-debt-with-reserves-puts-fernandez-ally-at-argentina-s-central-bank.html.*

[34] Ismael Bermúdez, "El Gobierno se financia cada vez más con plata de la ANSES," iEco-Clarín, June 30, 2010, available at *http://www.ieco.clarin.com/economia/Gobierno-financia-vez-plata-jubilaciones_0_144900005.html.*

[35] See *http://doingbusiness.org/data/exploreeconomies/argentina.*

[36] See *http://www.weforum.org/documents/GCR10/Full%20rankings.pdf.*

[37] See *http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results.*

[38] See *http://www.heritage.org/index/ranking.aspx.*

**Figure 12: Argentina's Ranking as per Different Surveys**

| | Argentina's rank | Total number of countries | Rank on 0-100 Scale* |
|---|---|---|---|
| Doing Business | 115 | 183 | 39 |
| Competitiveness Report | 87 | 139 | 37 |
| Corruption Perceptions | 105 | 178 | 41 |
| Economic Freedom | 135 | 179 | 25 |
| **Average** | | | **35** |

** On this scale, 100 is the highest (best) score and 0 is the lowest (worst) score.*
*Source: World Bank, World Economic Forum, Transparency International and Heritage Foundation.*

The message conveyed by the uniformly low rankings obtained by Argentina – as can be seen in Figure 12, on average it ranks in the bottom third of countries as per these four surveys – is that the country is a relatively unfriendly, uncompetitive, opaque and repressed place in which to invest or do other business.

## Conclusion

In sum, should Argentina be welcomed back by the international capital markets? All things considered, the answer is negative. Despite the allure of high yields, investors and financial intermediaries are well advised to approach Argentine fixed-income and equity investment and trading opportunities with extreme caution, because they embody substantial market and default risks. Notwithstanding an impressive economic recovery, the country's ability to service its financial obligations remains quite limited, and the government's attitude toward official and private creditors, as well as toward court judgments and arbitral awards, remains one of contempt. The country is ranked uniformly low in various measures of the business climate, competitiveness, transparency, corruption and economic liberty. Therefore, Argentina – including its sovereign, sub-sovereign and most corporate issuers – is classified correctly as a very risky, single-B credit by the leading rating agencies.

Argentina remains an outlier in the community of nations. It is the only nation in the G-20 group of countries that is in protracted default on its financial obligations to its fellow members. It is the only country in the G-20 that refuses to abide by its treaty obligations to the International Monetary Fund. It is the only member of the G-20 to have received a "thumbs down" from the leading governmental organization that sets and monitors standards to combat transnational financial crimes. It is the G-20 member with by far the most investor claims against it in the world's premier dispute resolution center. The country's conduct is, in sum, an embarrassment to the otherwise honorable members of the G20 assemblage of countries.

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