

Pariah in the World Economy: How Should Countries Respond to Argentina's Return to Economic Nationalism?¹

Lisa Brandt and Fredrik Erixon

Lisa Brandt (lisa.brandt@ecipe.org) and Fredrik Erixon (fredrik.erixon@ecipe.org) are Trade Policy Analyst and Director, respectively, at ECIPE

CRISTINA FERNÁNDEZ, THE President of Argentina, looks to be the new “Nina from Argentina”, the girl in the famous Noël Coward hit song that refused to dance. For someone who travels in a Presidential plane called Tango 01, dance should not be an alien concept. But the President has shown no willingness to move to the tunes of international cooperation, or the rules for global commerce that Argentina has voluntarily ratified. President Fernández certainly marked herself

out at the G20 summit in Mexico last summer. While world leaders gathered to discuss important issues of the world economy, the Argentinian President was pursuing another mission as she chased David Cameron, the UK Prime Minister, to hand over a package of print outs of old United Nations resolutions on the Falkland islands.

A populist with a knack for foul and insulting political

SUMMARY

Assessing Argentina's trade and investment policies, this Policy Brief discusses possible strategies for the European Union and the international community to respond to Argentina's turn to economic nationalism. The intention of the Argentinian government to strengthen national industries and stabilise its current accounts has led to irrational policies and irresponsible behaviour. Its manifest disrespect for international agreements and rules on trade and investment stretches from import restrictions and licencing schemes to impulsive nationalisation of companies. The European Union should not turn a blind eye to Argentina's mis-

behaviour. Indeed, the economic power relations might induce the EU to retaliate with protective measures targeting Argentinian exports. However, such a tit-for-tat approach is unlikely to incentivise Argentina to cease its provocative misconduct. Together with other major economies, the EU should instead use the legal and diplomatic tracks in order to defend the economic interests of its companies and industries. The EU should exhaust the legal mechanisms in the framework of the WTO and the ICSID and not retaliate against Argentina unless such measures have been sanctioned by international bodies be-

forehand. In parallel, diplomatic efforts should be intensified in order to reason with Argentina. Ultimately, it is up to Argentina whether or not it prefers to continue to act in violation of the international agreements that it has voluntarily ratified. Unless Argentina displays a greater interest in engaging in constructive dialogue and respect for the rules, there is no point in inviting it to meetings and work processes relating to international economic cooperation, such as the G20. Similarly, if Argentina continues to flaunt its obligations in the IMF, it should not remain as member.

ploys, President Fernández had recently backed a controversial and offensive TV advertisement for Argentina's Olympic team, picturing a hockey player training on the Falklands, that ended with the tagline: "To compete on British soil, we train on Argentine soil". And then, in Mexico's Los Cabos, she wanted to make a mockery out of the G20 summit by playing to her domestic gallery over the Falklands issue. It is not surprising that politicians or commentators are now calling on world leaders to kick Argentina out of the G20 club of countries.

Behind the President's brazen attitude hides a rapidly deteriorating economy – some would even say an economic morass. The spectacular economic recovery by the end of the last decade has ground to a halt. Export growth has petered out as world demand is growing at a slower pace and as commodity prices have dropped. As Argentina in the past years has refused to open its books to the International Monetary Fund (IMF) to open its books – and as the government has obviously doctored its inflation statistics – no independent analyst knows the full state of the economic problems. The Argentinian government is in a perennial struggle with the IMF over the government's refusal to comply with IMF obligations, clearly a breach that could result in Argentina losing its membership of the IMF. Its defiance of IMF rules is no minor breach. Its manipulation of inflation statistics has made investors in inflation tied bonds lose money. More than 20% of Argentina's government debt tied to inflation and an estimate by a U.S. consultancy suggests that investors have lost about 7 billion U.S. dollars in the past five years due to the underestimation of inflation.

Equally important, a series of profound policy mistakes have undermined Argentina's economy and spurred inflation. Irrational policy measures have been implemented in attempts to control inflation or secure foreign currencies. Argentina was once one of the world's richest economies, but decades of bad policy choices in the past century demoted the country in the world league of wealth. Nobel Prize winner Mario Vargas Llosa has summarised the sorrows of Argentina: "There are countries which are rich and there are countries which are poor. And there are poor countries which are growing rich. And then there is Argentina."

President Cristina Fernández, like her husband (the late Néstor Kirchner, who preceded her as President), has continued that tradition and repeated many of the past mistakes. It is not an exaggeration to say that they have been trying to take the country back to an older era of Peronism. Many of the economic reforms of the 1990s, when the remarkable President Carlos Menem (and old Peronist who became a liberal reformer) and Harvard economist Domingo Cavallo ran Argentina's economic policy, have been repealed. It is again a blend of economic populism, heavy-handed state interventionism, corporatism, protectionism and blatant disrespect for private property that make up economic policy.

Companies like the former state energy behemoth YPF², a subsidiary of the Spanish energy company Repsol, have in effect been renationalised by the government. Pension funds have been raided and nationalised to plug gaps in the public finances. Trade and investment barriers are being ramped up. Exchange and capital controls are heightened. Argentinians can no longer exchange currency and travel abroad without having to justify their choice to the government. Taxes are rising, particularly in areas known to be in opposition to the President's left-wing populism. The tax authority is almost run like a fiefdom for Fernández' political clan. The fiscal deficit expanded in 2011, despite startling levels of growth, and inflation now exceeds 25% (according to credible non-official estimates). Nothing suggests that the economic situation is getting any better. On the contrary, the Argentinean economy is in for further turbulence.

The President, who started her political career as a Peronist senator from Santa Cruz, was initially a defender of human rights and civil liberties, but has now turned to increasingly autocratic practices to silence her critics. "She is like Putin, but without the nukes", said an opposition politician at a recent conference. As new oil sources have been discovered in Patagonia, and as Argentina increases its role as a producer of energy and fuels, that parallel may be more apt than most people think. For many observers, Argentina has already become what one economic commentator called a "pariah in the world economy".

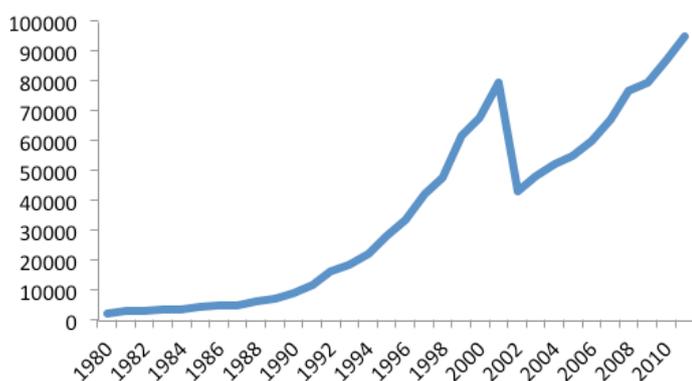
This paper examines the economic policies of the Argentinian government, especially its trade and investment

policies – or foreign economic policy – in recent years. It is obvious that Argentina’s policy behaviour has strained relations to its trading and investment partners. And the question that this paper particularly aims to discuss is: how should other countries respond to Argentina’s turn to economic nationalism? The old adage still applies: if a country shoots itself in the foot, other countries will not be better off by shooting themselves in the foot in retaliation. Yet Argentina’s misbehaviour in the world economy has reached such proportions that inaction can no longer be the policy response.

ARGENTINA FLAUNTS ITS INVESTMENT OBLIGATIONS

LIKE MOST OTHER emerging economies, Argentina’s economy has become increasingly dependent on foreign investments over the past three decades. The programme for deregulations and privatisations in the 1990s spearheaded a rise in foreign investment flows and the interest of foreign firms to do business in and with Argentina.³ As shown in Chart 1, inward FDI really took off in the early 1990s. The stock of inward FDI grew by approximately a factor of six in the ten years leading up to the Peso crisis in 2001.

CHART 1: INWARD FOREIGN DIRECT INVESTMENT (STOCK) TO ARGENTINA (USD MN)



Source: UNCTAD

During the period preceding the Peso crisis, Argentina also took many steps to improve investment protection for foreign investors, in effect to give them rights to national treatment. Argentina has concluded more than 50 bilateral investment agreements with its economic part-

ners (see annex). Since its ratification of the ICSID convention in 1994, the key multilateral investment-protection treaty, it is also a member of this leading international institution for settlement of investor-state disputes.⁴

‘With a few exceptions’, Argentina’s foreign investment regime is characterised as ‘an open one’, by the WTO in its most recent Trade Policy Review from 2007, which assesses the parameters of openness to foreign participation and national treatment of foreign companies. That largely remains true. The basic policy towards foreign direct investment is still open. But new investment restrictions have been imposed since 2007 – and these restrictions not only address inward FDI but outward FDI. Last year, for instance, the Argentinian government demanded all insurance firms to repatriate all their foreign investments.⁵ And just before the year-end the Argentinian parliament approved a new Rural Land Law, which limits how much land a foreigner can own in Argentina.

When the World Bank ranks countries in terms of “protecting investors”, Argentina comes in as number 111, just ahead of Russia and Syria, countries hardly famous for their hospitality to foreign investors.⁶ Investment protection is considerably weaker in Argentina than in the Latin American region. Importantly, recent events, such as the renationalisation of YPF, have eroded key principles of investment openness and given foreign investors new reasons to worry. But it is only the tip of the iceberg. Argentina’s perennial battles in courts with various investors have undermined its credibility as a safe destination for investments.

Notwithstanding the limitations in the Argentinean Constitution (Article 17), which confines expropriation of private property to cases of public interest, sudden expropriations have recently become a landmark of the Argentinean government’s nationalist and populist economic policy. Following the renationalisation of the *Aerolíneas Argentinas* in 2008, when the state acquired 99.4% of the shares, and of the private pension funds AFJP⁷ the same year, President Fernández prompted a shockwave in April 2012 when announcing the intention of the Argentinean government to expropriate YPF.

This decision is symptomatic of the increasingly irrational economic behaviour of the Argentinean government.

Neglecting both its international commitments in the World Bank's ICSID as well as in bilateral investment treaties, Argentina is becoming more and more of an irresponsible player in the international field. The case itself reveals how President Fernández thinks about the economy and economic policy.⁸ Excessive state interventionism in the Argentinian energy market – predominantly to keep energy prices very low – turned a traditional surplus producer of energy into a net importer. Energy pricing collapsed and the inevitable rise in energy costs fuelled already accelerating inflation in Argentina. In 2011, the Argentinean government was forced to import fuels to the value of \$9bn 2011. Ham-fisted state restrictions had effectively forced energy companies to invest outside Argentina. After an agreement engineered by Néstor Kirchner in 2007, the YPF had to use a big part of the profits to pay shareholder dividends to enable one of the big owners, Enrique Eskenazi, to pay the loans used to purchase the shares. When YPF discovered surprising amounts of shale oil and gas, the value of the company soared. And the government now wanted to get its hands on the new-found wealth. Based on allegations of under-investment in the shale gas fields, the President announced that the state would acquire Repsol's 51% share in YPF – without any compensation to the holders of these shares. The state simply grabbed the shares owned by Repsol – a popular move in Argentina as it returned an old state champion back to the government – without paying anything for it.

In response, Repsol has sued the Argentinean government under the investment treaty between Argentina and Spain. This is not the first time that Argentina is subject to an investor-state dispute settlement. Far from it. The Argentinean government is one of the most frequent respondents in ICSID cases. Manifestly ignoring the rules of the game, Argentina has demonstrated a systematic disrespect of its ICSID commitments. This is illustrated by the numerous cases initiated against Argentina. Often related to the exchange control regime established in 2001 following the economic crisis, 48 claims were filed against Argentina between 1999 and October 2006. Out of the total 167 cases currently pending in the ICSID (as of December 19, 2012), Argentina is respondent in 25 cases. Most of these disputes are related to utility and energy, notably production and distribution of gas and water services, electricity generation, but also debt instruments, financial services and highway construction.⁹

For foreign companies, achieving a favourable verdict from the ICSID in an investment dispute against the Argentinean state has not proved to be a guarantee that compensation will be awarded. Argentina has refused to respect many of the ICSID rulings.

In its defence, Argentina has invoked article 54 of the ICSID convention¹⁰, arguing that companies have to go through a legal procedure in an Argentinean court in order to have the decision enforced. While the argument is legally correct as far as Argentinian law is concerned, the Argentinean government have conveniently ensured that such proceedings have been politically undermined to such an extent that it is in effect impossible to claim an award granted by ICSID.

Furthermore, ICSID tribunals and ad hoc annulment committees have repeatedly rejected Argentina's interpretation of article 54, and argued that it has the responsibility to immediately honour the award ruling.¹¹ No other country party to the ICSID convention shares the Argentinean practice. Yet Argentina persists in its view that it should effectively be exempted from complying with the rulings of ICSID tribunals. It is a strategy that legally works as no other country has sovereignty over Argentina – and because the other counter strategies have appeared too confrontational or too risky: retaliating against Argentina, or initiating a process to kick it out of the ICSID convention.

In the case of the expropriation of the YPF, the international community has been unified in its condemnation. Spanish Prime Minister Mariano Rajoy expressed his 'profound malaise', while assuring that Spain will defend the 'legitimate interests' of Repsol. Rajoy underlined that the Argentinean decision comes with 'no justification and no economic reason'¹². Since the issue concerns a bilateral investment deal, the EU's legal status with regard to intervention is uncertain. Criticising Argentina's decision, EU Trade Commissioner Karel De Gucht nevertheless underlined that not only do these restrictive policies cause significant problems to foreign investors; they also hurt Argentina itself in its quest to attract foreign investment. This aspect was also stressed by former World Bank President Robert Zoellick, then still in office, who called the Argentinean move a 'mistake', while recognising that the decision is prompted by 'populist pressures'.

Illustrative of the dilemma that foreign investors face, Zoellick asked the rhetorical question, 'what investor in their right mind would put their money in a country that nationalises industries?'¹³

Beyond the verbal criticism, the policies, which put Argentina on 113th place out of 183 on the World Bank Doing Business Ranking 2012, are already having repercussions on the inflow of investment as foreign companies vote with their feet. In April 2012, Brazilian mining company Vale Doce stated that it was reassessing its \$3bn investment plan in a potash project in Argentina due to political risk and other obstacles¹⁴. Moreover, on June 4th, the Canadian uranium mining company Cameco announced its decision to pull back from an exploration project that was supposed to be a joint-venture with Calypso Uranium Corp. Although the move was claimed by Cameco to be based on a 'strategic shift', it was interpreted by analysts to be a reaction to the unsecure and deteriorating investment climate in Argentina. In this respect it can be noted that the regulations on investment in Argentina force companies to repatriate revenues from mining exports and oblige them to purchase equipment from domestic producers.¹⁵

Previously, foreign investors could invest in Argentina under basically the same conditions (national treatment) as Argentinean operators, as well as withdraw their investments at any time. However, the free flow of investment was interrupted in 2001 with the introduction of the exchange control regime, restricting external transactions and notably transfers of profit and interest. Although the investment regime has been modified and relaxed, approval from the *Banco Central de la República Argentina* is required before repatriation of investment can take place, if the transactions surpass \$2 million per month.

Other capital controls include the minimum time period for investment of 365 days - a restriction in place to protect the nominal exchange rate. Also, certain classes of inbound investment are subject to local deposit obligations of 30% of the amount.

BMW BECOMES A RICE EXPORTER: ARGENTINA'S TRADE POLICY

A MEMBER OF the World Trade Organization since 1995, and founding member of the GATT, Argentina has bound 100% of its tariff lines on goods. Argentina's tariff schedule basically follows the common external tariff scheme of the Mercosur customs union¹⁶, formed in 1991 between the four countries of Argentina, Brazil, Paraguay and Uruguay. There are, however, exceptions to the common external tariff of the Mercosur, for example in the areas of computer- and IT equipment and sugar, where the member states are allowed to set their tariffs individually. Zero-tariffs apply in principle on intra-Mercosur trade, with the exemption of automotives and sugar.

Argentina's most important trading partner is its Mercosur partner Brazil, which accounts for 32% of the imports and 21% of the export. The EU is Argentina's second most important trading partner in terms of value (17% of imports, 16% of exports), thereafter comes China, the U.S., Chile and Mexico.

Despite its 100% binding coverage, Argentina has a significant degree of base-level protectionism in the form of high duties on a great number of tariff lines. In addition, the considerable difference between the bound tariff rates on imports and the applied rates increases the unpredictability of the trading environment. The average bound tariff rates is 32.4% for agricultural products and 31.8% for non-agricultural goods, compared to the average applied tariff rates of 12.6% for agricultural products and of 9.8% for non-agricultural goods.¹⁷

In particular, Argentina maintains high duties in some sectors of great interest for European exporters, for instance electric machinery and equipment (bound rate 34.95%; applied rate 11.5%), chemicals (bound rate 25.23%, applied rate 5.43%), pharmaceuticals (34.43%; 7.93%), essential oils and cosmetics (24.17%; 17.25%), vehicles (34.53%; 25.46%); and articles of iron and steel (35%; 14.24%).¹⁸ In addition to the custom duties, Argentina charges a statistical tax of 0.5% of the value of most goods imported under the MFN tariffs.

In addition to these trade-adverse customs policies, Argentina has recently not played a very constructive role

when it comes to promoting trade at the multilateral level. First, despite its stated commitment to the WTO, to Mercosur, to open an economy and to multilateral liberalisation, Argentina is not willing to embark on a new wave of market access liberalisation. Argentina maintains that ‘trade liberalization cannot be detached from the need of governments to retain sufficient room to conduct active policies in pursuit of their economic and social objectives’¹⁹. It resists material improvements of key trade-policy areas like export restrictions and non-tariff barriers.

Moreover, while emphasising that the paramount objective of the Doha Round is to promote development, Argentina holds that ‘there could be no progress in NAMA and services if the developed countries failed to take seriously the commitment to an effective contribution in agriculture’²⁰. Thus, with agriculture being a clear Argentinean priority in multilateral negotiations, its main, if not only, interest lies in achieving reductions in support and tariffs in the agricultural foreign countries’ agricultural sectors. It is, of course, only natural for Argentina to pursue its mercantile interests in trade negotiations, but Argentina’s position has not been based on a straightforward reciprocal approach, which would have consisted of offering own market access reforms in exchange for new market access in agriculture. On the contrary, Argentina has not been inclined to offer any new effective market access in key industrial and services sectors.

Second, Argentina is not participating in plurilateral agreements like the Information Technology Agreement and remains steadfastly outside the Government Procurement Agreement. It actually envisages extending its ‘Buy Argentine’ regime to cover further entities, in addition to the already existing preference margin of 5-7% that favours domestic producers and services providers.

Third, Argentina has repeatedly introduced measures that are inconsistent with its WTO commitments. There have been a number of cases filed against Argentina in the WTO Dispute Settlement Body, the majority of which are by the EC/EU (8 out of 15 cases since 1995). Disputes concern, for instance, intrusive measures restricting imports of footwear, textiles, clothing and apparel; and countervailing duties on agricultural products such as wheat, olive oil and peaches. There have also been a num-

ber of complaints against Argentina’s imposition of anti-dumping duties on products like drill bits, carton-boards, ceramic tiles, poultry, chains and fasteners. Argentina was in fact the fourth largest imposer of antidumping duties per year between 1998 and 2005, with a particularly high frequency of imposing this type of measures during the recession 1999-2001. Moreover, the allegedly insufficient protection of patents for pharmaceuticals and of test data for chemicals has also been subject to dispute settlement.²¹

Fourth, akin to many countries anxious about the effects of the economic crisis on the economy, the Argentinean government has conceded to populist pressures to protect domestic industries by imposing various types of restrictions and non-tariff barriers hindering foreign competitors from entering the market. Not against the rules, one might say, if it was not for the fact that Argentina is stretching the use of trade remedies to the limit, as charged by a critical recent joint statement by countries in the WTO Council on Trade in Goods²². Or, even beyond the limit of what is permitted, according to the European Union, which took action in May 2012 by requesting consultations with Argentina over its measures that restrict the imports of goods, including pre-approval requirements, licensing and import-export balancing. In August 2012, the United States, Japan and Mexico followed suit by (separately) requesting consultations with Argentina.²³ Recently, parties requested a panel to be established in order to settle these disputes as Argentina did not agree to change its policy during the initial consultations.

These complaints appear to concern merely the tip of the iceberg of Argentinean trade barriers, consisting of a cobweb of behind-the-border restrictions aiming to maintain a positive trade balance, substitute imports with national products and services, and protect domestic industries.

In February 2012, Argentina introduced an obligation of pre-registration and pre-approval for all imported products. The declaration in question, *Declaración Jurada Anticipada de Importación* (DJAI), implies that importers must submit an application to the Argentinean authorities for approval before placing an import order abroad. There is no guarantee of approval and the processing period is set to 3 to 15 days.

The DJAI was introduced in addition to already existing requirements of import licenses, which can be of automatic or non-automatic character, depending on the product. Automatic licences are in principle always approved provided that companies comply with the procedural formalities. The list of products covered by this regime has been expanded since 2008 to cover more than 2000 tariff lines, including merchandise goods such as aluminium, machinery, mechanical appliances, manufactured products, cotton textiles, auto parts, tyres, water pumps, electrical transformers, advertising material, printed matter etc. In addition, a somewhat stricter non-automatic licensing requirement applies to sensitive products. Such a licence must be granted before import of certain products, including cars, car parts, motorcycles, bicycles, ovens, TV/video sets, some electronic products, metallurgical products, footwear and textiles. In addition to the licence schemes, import bans are placed on certain used or refurbished goods, including tires, medical equipment, auto parts, some ICT products as well as clothing.

Concerned by these measures, foreign companies complain not only about delays, arbitrary application of the regulations and lack of transparency, but also about systematic informal pressure exercised by Argentinean authorities. In order to obtain import licences, foreign companies can in practice be forced to increase investment in production sites in Argentina, to use local content in their products or to balance imports with exports of Argentinean goods. For instance, in order for BMW in Argentina to import cars or car parts, it must export something in order to balance the current account at the firm level. Consequently, BMW in Argentina is now engaged in the agricultural sector and exports rice and other agricultural goods. The Argentinian government maintains that firms have entered these arrangements on a voluntary basis, but the simple fact is that firms are afraid of losing business in Argentina if they do not comply with the wishes of the government. This firm-level export-for-import scheme is absurd. It is a desperate measure to improve Argentina's trade balance and to get much-needed foreign currency, but it erodes many of the gains that can be derived from trade and Argentina's growth potential. The intervention – even if not embodied in an official regulation – violates core principles of the WTO.

Moreover, Argentina applies reference prices to thousands of products. This pricing system undermines the operation of market-based exchange between countries. In principle, the goal is to control and stop under-invoicing of goods that are imported from specific countries. Custom duties have to be paid based on the reference price set by the Argentinean authorities for each product. The reference price thus serves as a minimum price for imports when they enter the market.

Other non-tariff barriers holding back imports include restrictions on ports of entry. Since 2005, this measure applies to a number of sensitive goods; certain textiles, shoes, electrical machinery and manufactures, which have to go through specific custom inspections in order to ensure that eventual price differences between the declared price and the Argentinean reference price are offset by duties and taxes.

Exports from Argentina are subject to export taxes and occasionally to temporary restrictions with the aim of ensuring domestic supply, managing the trade balance, controlling the exchange rate, and encouraging Argentinean industries to move up the value added chain. In 2011, the value of the collected export taxes was equivalent to 15.6% of the total value of all exports from Argentina. That is a remarkably high level of export taxes. High rates apply particularly to cereals like products of soybean and sunflower, wheat and corn, but also biodiesel. There is also a general registration requirement for all products, to control the quantities. The government can, and sometimes do delay exports in order to assure domestic supply. Restrictions have recently been applied to for instance wheat, corn, beef and dairy products.

Export restrictions are a fast-growing problem in the world economy. Argentina is one of the countries that are most at fault. Few other countries restrict their exports to the degree that Argentina does. While members of the WTO have the right to levy export taxes – unless they have agreed not to in accessions negotiations and protocols – they are not allowed to use other export restriction policies unless they are critical to ensure supply of foodstuffs or other essential goods. Argentina has used that exemption to the maximum, and arguably overstepped the limit for what can be authorised under it.

TIT-FOR-TAT: HOW NOT TO DEAL WITH ARGENTINA?

IT HAS BECOME increasingly obvious to policymakers that the approach to Argentina has to be reconsidered, and preferably changed. For many in Europe, it seems like the renationalisation of the YPF, a foul state grabbing of assets held by Repsol, was the straw that broke the camel's back. Many officials now argue that the status quo is no longer an option – or that path dependence (just continue to do what we have always done) no longer can masquerade as policy. Argentina's misbehaviour in the world economy requires action. But the question is: what action?

Some officials and commentators in Europe have argued that it is now time to retaliate against Argentina's grabbing of YPF with protectionist measures targeting Argentinean exports. While such measures may appeal to some notions of justice, it is neither a judicious nor an economically rational strategy. The argument put forward by some has been that Argentina stands to lose much more than the EU from an escalated tit-for-tat or eye-for-an-eye type of retaliatory conflict. This may sound convincing. While the EU represents 17-18% of Argentina's export, Argentina represents less than 1% of the EU's total export. Any government in Argentina's position, goes the argument, would respond constructively to a hard-power strategy by the EU.

This may be true. But there is no law of nature that forces irrational governments to start acting rationally, not even when their continuous irrational behaviour is subject to economic punishment. History has taught us that governments which act as irrationally as the Argentinian government tend to behave in an unpredictable way when faced with threats. They may escalate conflicts rather than moderate or end them when faced with retaliations or hard-power reactions. Consequently, retaliatory reactions are rarely diligent strategies to address problems of the kind that Europe and others today encounter in their dealings with Argentina.

There are two other arguments that should cause officials to be wary of moving towards a tit-for-tat style, retaliatory protectionism. *First*, retaliatory protectionism is effectively a strategy to raise one country's cost of import in order to punish another country. Such strategies have

been compared to shooting oneself in the foot, just because someone else is shooting himself in the foot. Or as economist Joan Robinson argued: if a trading partner throws rocks into her harbour, it would only be silly for you to throw rocks into yours. It may appear fair to do so, but it is not a rational economic strategy, nor does it really conform to sound principles of justice. Those that primarily will be hurt, for instance, by EU trade-retaliatory measures against Argentina are importers in Europe and exporters in Argentina, none of which could be held responsible for the policy of the Argentinian government.

Second, obligations under the WTO offer no exemptions for retaliatory protectionism as long as the Dispute Settlement Body has not authorised such measures (which it could do if a country does not comply with DSB rulings against it). Consequently, trade restrictions that would be noncompliant with WTO obligations in non-retaliation circumstances will still not be compliant if the EU pursues a trade-retaliatory agenda. And if the EU believes Argentina has violated agreements, the moral and legal force of the EU's argument against Argentina's actions will be eroded if it behaves in the same way.

A milder version of a retaliatory strategy, and one that has recently been proposed as an appropriate strategy to counter Argentina's renationalisation of the YPF, is to suspend trade preferences for Argentina under the Generalised System of Preferences. A recent resolution from the European Parliament, among others, suggested such action.²⁴ It is a milder form of retaliation because it will not flaunt WTO obligations. Tariff preferences under the GSP reach beyond the EU's obligations in the WTO, suspending the preferential treatment of imports from one country is thus not restricted by international law.

It is also a strategy with a precedent. The EU has used this strategic instrument previously, notably by the decision in July 2010 to withdraw the GSP+ preferences for Sri Lanka, due to its failure to implement three UN Conventions²⁵ that are part of the conditionality in order to benefit from the GSP+ system. Furthermore, withdrawing preferences is right at the heart of the strategy used by the United States to get the Argentinean government to comply with ICSID rulings. President Barack Obama announced in March 2012 that the United States will suspend the preferential market access granted to Argentina

under the General System of Preferences programme due to the failure of Argentina to “act in good faith” and compensate U.S.-owned companies subsequent to ICSID arbitrations²⁶. This decision is in line with the Bilateral Investment Treaty between the U.S. and Argentina, which states that an award against one of the countries should be enforced without delay.

The U.S. decision to suspend trade preferences is related to two ICSID rulings. One dates back to 2005, when Argentina lost a case and was ordered to pay \$133.4 million plus interest in compensation to U.S. owned CMS Gas Transmission for damages suffered in an infrastructure investment project. The year after, in a ruling in favour of Azurix, an American water services company, the ICSID ordered Argentina to pay \$165.2 million in compensation.

Restricting or suspending trade preferences can sometimes be a powerful strategy to make other countries change their behaviour. Argentina’s economy would undoubtedly be hurt if the EU, say, took away the country’s preferential access to the EU market. Between 20 to 30% of Argentina’s exports to Europe benefit from preferential tariffs. Yet it is not a strategy that the EU could deploy vis-à-vis Argentina as a response to its expropriations of Repsol’s shares in YPF. In the first place, the EU, unlike the United States, cannot really use GSP suspensions for retaliatory purposes. It can suspend the preferences for countries that do not comply with the conditions for receiving special preferential status, but those conditions are not linked to a country’s unwillingness to honour its obligations in an investment treaty. Even if the EU could use GSP suspension as a retaliatory tool, it would not work in the case of Argentina.

If the EU was to copy the U.S. suspension of trade preferences, Repsol would first have to walk through a legal process in an ICSID tribunal (a process that now has started) on the basis of the Bilateral Investment Treaty between Argentina and Spain. That process will take time. If the tribunal awards compensation to Repsol, which is highly likely, there will have to be a refusal, or significant delay, to paying Repsol the award for the EU to make the case that Argentina is not “acting in good faith”. When such a process has matured into a basis for retaliation, Argentina will already have graduated from the EU’s system of trade preferences. There would be no preferences to suspend.

The EU recently made the decision to reform its GSP system substantially. One of the major changes is that middle-income countries, like Argentina, will lose their preferential status. The reform, which was ratified by the European Parliament in June 2012, has been presented as part of a larger EU development strategy, and the European Commission has argued that the graduation of middle-income countries will open new export opportunities for the poorer developing countries that will maintain their status while the tariffs on goods from other developing countries will increase. This argument about a direct substitution effect is dubious – exports from poor developing countries to the EU are unlikely to change much as a consequence of this reform²⁷ - but the fact that the EU has already decided to graduate Argentina from its preference system makes GSP suspension an impotent instrument.

As this and previous sections have shown, it is difficult to retaliate effectively against countries that misbehave. There is a direct cost involved for the country imposing the retaliatory measures. Quite often the retaliation does not achieve its intended result – that is to change another country’s policy behaviour. This is part of the reason why economic sanctions have a record of many failures.²⁸

There are also other restrictions, in addition to those previously discussed, that diligent policymakers should respect when considering a counter-strategy against non-cooperative countries. For instance, a tit-for-tat retaliatory strategy²⁹ that imperils other investments or economic interests is in most cases not worth pursuing. This is especially important to remember in matters of investment. Simple political economy models of investment openness suggest that the originating country gains economic power vis-à-vis the investment-receiving country. Beggars cannot be choosers, it is said, and if a country wants to receive inward investments it has to respect certain conditions relating to investment protection.

Yet this view of the “power relation” between investor and investee countries is only partially true. It can be described as a “flow” rather than “stock” view on investment openness and protection. Equally important is the fact that a country which has a big stock of investment in another country has an interest in defending that stock of investment against predatory or discriminatory behaviour

from the host government. And defending that stock of investment will in some instances take primacy over other economic interests. The EU, for instance, has a 50 billion euro stock of investment in Argentina. Argentina's stock of investment in Europe, however, is only around 1.8 billion.³⁰ If the EU and Argentina would dance the tit-for-tat retaliatory tango, it is not unlikely that the EU would come out with bigger bruises than Argentina.

HOW TO DEAL WITH ARGENTINA

ARGENTINA'S MISBEHAVIOUR in the international economy requires a response. European policymakers – comprising both national and European policymakers – should choose a strategy that defends the investment and trading rights of its firms. Moreover, it is also justified in initiating a diplomatic process to revisit the role of Argentina in international efforts to collaborate on economic policy. Let us discuss these two tracks in greater detail.

The legal track

GOVERNMENTS SURPRISINGLY OFTEN shy away from the strategy of defending investment and trading rights that are codified in international agreements, at least they see this as the last line of defence. They should not. International economic agreements, like bilateral investment treaties or accords under the auspices of the World Trade Organization, have been designed to offer legal solutions to economic disputes involving governments. They have been created – and signed by governments – in order to be used, not to collect dust in libraries. A structured legal solution is much more preferable than a political solution based on retaliation, or the spirit of revenge represented in other ways than direct retaliation. It allows examination of a country's behaviour by independent bodies. It gives both disputing parties rights to defend their positions. Rulings based on such a process stand much better chances of being accepted by the losing party. It is not the heavy hand of economic and political power that will rule.

The Argentinean government is already subject to many complaints and law suits regarding its obligations in international trade and investment agreements. Two important ones have recently been added: Repsol is seeking

investor-state dispute settlement under the Argentina-Spain Bilateral Investment Agreement, and the European Commission has filed a complaint against Argentina in the WTO. Both moves are fully merited. While Repsol's suit came relatively soon after the Argentinean government's seizing of its property, it took far too long for the EU to challenge the Argentinean government in the WTO for its import licensing scheme and the unofficial import-for-export requirement.

Two things are important now. First, the EU and European governments should follow the legal tracks to their end points. This means allowing time for the legal processes to arrive at rulings. Furthermore, in the investment dispute, there should also be an expressed preparedness to claim awards even if the Argentinean government refuses to honour a ruling by cash settlement. For various policy makers in Europe, this means that they should not interfere in an eventual process by Repsol to get property held by the Argentinean government abroad expropriated. That task will be more challenging than it sounds. Invariably, such resolutions to dispute rulings will infect political relations.

It is critically important that rulings are respected – and it is not only important for the company that has been awarded. For an international agreement to maintain its integrity, and usefulness, all legally based alternatives for claiming an award should be exhausted if the losing country refuses to pay the award. Obviously, this is a problem today in matters related to Argentina. The number of unsettled cases has grown to become too many. The Argentinean government has been allowed to effectively change the legal consequence of losing investment disputes – either by non-compliance with rulings or by delaying tactics that exhaust awarded parties and deter companies from bringing new disputes. This strategy should not be allowed to continue and it can only be stopped if the opportunity costs for the Argentinean government increase.

Similarly, if the EU wins the new case against Argentina in the WTO, there should be preparedness to fully uphold the integrity of that ruling. A consequence of that principle is that the EU may have to retaliate against Argentina. If that happens, however, it would be a retaliation sanctioned by the WTO. Such retaliation would impose costs on European importers. But there is a difference

– arguably a profound difference – between retaliation sanctioned by the WTO and other forms of retaliation. In the former case, it is legal and based on the systemic interest of maintaining the integrity of the WTO’s dispute settlement system. If that integrity is allowed to be eroded by countries’ non-compliance, the entire system is at risk of unravelling. The WTO itself has no power to police compliance with its rulings. The system is based on the self-interest of countries to comply with rulings negative to themselves, because they will at some point be dependent on other countries’ compliance when they have won cases. One can discuss the effectiveness of such an institutional structure, but it is only on rare occasions that countries have had to seek authorisation by the WTO to retaliate because countries have not changed a behaviour that the WTO Appellate Body has deemed non-compliant.

Second, there should be renewed efforts by EU officials to build a larger coalition of WTO members that challenges Argentina’s import licensing policy and export-for-import scheme. This is an important part of increasing the opportunity costs for Argentina of continuing to misbehave. The greater the number of countries that participate – and the larger the share they represent of Argentina’s export – the more weight this strategy will carry. The EU is an important market for Argentina, and the country should at this point be assumed to comply with a negative ruling. But in the event that Argentina refuses to change its policy despite a negative ruling, and that the EU is only authorised to retaliate to a small value that is disproportionate to the gross negligence of Argentina to abide by its WTO obligations, then there is a much better chance that Argentina will change its policy if other economies of importance to Argentina’s export are also part of the process.

The diplomatic track

FINALLY, LET US discuss the possibilities of larger diplomatic efforts to deal with Argentina’s systemic disrespect for international economic cooperation. It has been suggested that the EU should suspend its bilateral dialogue with Argentina and the negotiations over a bilateral trade agreement with the Mercosur. That is not a good strategy as the EU has an interest in maintaining diplomatic dialogue with Argentina as well as in concluding a trade agreement that involves other countries, especially a

more important economy like Brazil. However, those trade negotiations have not progressed much in the past years and are unlikely to come to fruition anytime soon. Effectively, the EU-Mercosur negotiations have already been suspended, albeit not officially.

It is more important for the EU to engage in dialogue with other world economies about Argentina’s role in the G20 and the IMF. Does Argentina have a future in these organisations? It is an issue for Argentina to decide whether it wants to remain in the IMF. But it is increasingly obvious that the IMF’s odd process with Argentina has to be charged with new energy. Such energy can only be released once Argentina makes the choice either to comply with its obligations or to face a process of penalties and, ultimately, exclusion. Argentina’s behaviour is not acceptable: its manipulation of economic statistics has huge implications for financial relations, especially those who hold inflation-adjusted assets.

Similarly, it is time for other members of the G20 to stop inviting Argentina to G20 meetings and work processes. The G20 does not supervise or negotiate international economic law. It is a loosely held format of cooperation without any rules of membership. There are no legal procedures to disinvite a country from the G20. Argentina has displayed a remarkable disinterest in using the G20 as a platform for constructive dialogue with other countries and participating in the key areas of discussion. Furthermore, Argentina is not really a country whose participation in the G20 is critical in order for the membership to comprise the twenty largest economies in the world, nor is it essential with respect to the legitimacy of the G20. The question, therefore, is what Argentina really has to gain from remaining a member of the G20, apart from national pride?

There will be resistance if Argentina is disinvited, especially from Brazil, which is unlikely to gain from taking on such a fight with a neighbour. Yet that should not hinder other G20 members from going in that direction. After systematically violating its obligations under international agreements and treaties, Argentina has to face the music. Yet although Argentina’s misbehaviour on the international scene has reached a crescendo recently, other countries should remain cool but firm in their policy responses. Tit-for-tat retaliation is not likely to be very

constructive in trying to persuade Argentina to dance to another tune. The EU should therefore be careful not to retaliate with measures that are not sanctioned under the legal systems of the WTO or the ICSID. Instead, the EU should put pressure on Argentina by cooperating with other countries and by patiently defending its rights through legal and diplomatic tracks.

ENDNOTES

1. Previous versions of this paper have been presented at the Spanish Ministry of Economy (September, 2012) and the U.S. Treasury (October, 2012).
2. Yacimientos Petroliferos Fiscales (YPF)
3. Mauricio Rojas (2002) *The Sorrows of Carmencita*. Timbro.
4. International Centre for Settlement of Investment Disputes (ICSID) is an institution for investor-state dispute settlement under the auspices of the World Bank. Argentina signed the ICSID Convention on May 21, 1991. The deposit of the ratification was registered on October 19, 1994 and the Convention entered into force on November 18, 1994.
5. UNCTAD (2012), *World Investment Report 2012: Towards a New Generation of Investment Policies*. Geneva: UNCTAD
6. Information retrieved from the World Bank's Doing Business Index, accessed at <http://www.doingbusiness.org/data/exploreeconomies/argentina#protecting-investors>
7. Las Administradoras de Fondos de Jubilaciones y Pensiones (AFJP)
8. Economist, "Argentina's energy industry: Fill 'er up". Economist, April 21, 2012. Accessed at <http://www.economist.com/node/21553070>
9. ICSID: List of pending cases
10. ICSID Convention, Article 54 states that:

(1) Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State. A Contracting State with a federal constitution may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.

(2) A party seeking recognition or enforcement in the territories of a Contracting State shall furnish to a competent court or other authority which such State shall have designated for this purpose a copy of the award certified by the Secretary-General. Each Contracting State shall notify

the Secretary-General of the designation of the competent court or other authority for this purpose and of any subsequent change in such designation.

(3) Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought."

11. See e.g. *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic's Request for a Continued Stay of Enforcement of the Award (March 5, 2009), or C. Schreuer, L. Mallintopp, A. Reinisch, and A. Sinclair (2009) *The ICSID Convention: A Commentary*. Cambridge: Cambridge University Press.
12. Gobierno de España (2012) Boletín de Prensa Nacional : 'Rajoy advierte de que la "injustificable" expropiación de YPF puede perjudicar a toda Latinoamérica', available at : http://www.lamoncloa.gob.es/serviciosdeprensa/boletin-prensanacional/_2012/boln20120418.htm
13. Bloomberg (2012-04-19)'Zoellick says Argentina's nationalization makes it an 'outlier'', available at: <http://www.bloomberg.com/news/2012-04-19/zoellick-says-argentina-s-nationalization-makes-it-an-outlier-.html>
14. MercoPress, (2012-06-05) 'Brazil re-assessing its 3bn dollars potash project in Argentina due to 'political' risk', accessed at: <http://en.mercopress.com/2012/06/05/brazil-re-assessing-its-3bn-dollars-potash-project-in-argentina-due-to-political-risk>
15. MercoPress (2012-06-05)'Major Canadian uranium mining company leaves Argentina fearful of populist policies', accessed at: <http://en.mercopress.com/2012/06/05/major-canadian-uranium-mining-company-leaves-argentina-fearful-of-populist-policies>
16. Mercado Común del Sur (Spanish)
17. WTO Tariff Profiles: comparison between Simple average final bound and simple average MFN applied for year 2010
18. Wits, weighted average bound MFN duties compared to weighted average applied MFN duties, tariff year 2010
19. WTO (2007) Trade Policy Review, Argentina
20. WTO (2007) Trade Policy Review, Argentina
21. Information retrieved from the WTO's online register of trade disputes.
22. WTO Council for Trade in Goods (2012-03-30) 'Argentina's import restricting policies and practices: Joint Statement by Australia, the European Union, Israel, Japan, Korea, Mexico, New Zealand, Norway, Panama, Switzerland, Chinese Taipei, Thailand, Turkey and the United States', available at: http://eeas.europa.eu/delegations/wto/documents/press_corner/2012_03_30_joint_statement_argentina.pdf

23. WTO Dispute Settlement cases:DS438, DS444, DS445, DS446
24. European Parliament resolution of 20 April 2012 on the legal security of European investments outside the European Union (2012/2619(RSP)); available at: <http://www.europarl.europa.eu/sides/getDoc.do?type=MOTION&reference=P7-RC-2012-0214&language=EN>
25. According to the European Commission, Directorate-General for Trade, Press release: 'EU temporarily withdraws GSP+ trade benefits from Sri Lanka' (2010-02-15); Sri Lanka failed to implement the International Covenant on Civil and Political Rights, the Convention against Torture and the Convention on the Rights of the Child.
26. The White House, Office of the Press Secretary, 'Presidential Memoranda – Trade Act of 1974 Argentina', March 26, 2012
27. Fredrik Erixon (2012) "The EC Communication on Trade, Growth and Development – Comment" in *The Next Decade of EU Trade Policy: Confronting Global Challenges*. Overseas Development Institute. Accessed at <http://www.odi.org.uk/resources/details.asp?id=6693&title=eu-trade-policy-international-development-global-challenges#downloads>
28. For a comprehensive analysis of the successes and failures of economic sanctions, see Gary Clyde Hufbauer et al (2007) *Economic Sanctions Reconsidered*. Washington: Peterson Institute of International Economics.
29. It should, again, be emphasised that legally defending a country's trading or investment rights is not a retaliatory strategy.
30. Information on stocks of bilateral foreign direct investments retrieved from the European Commission document on EU-Argentina economic relations. Accessed at http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113344.pdf

LATEST PUBLICATIONS:

What is Driving the Rise in Health Care Expenditures? An Inquiry into the Nature and Causes of the Cost Disease

[ECIPE Working Paper No. 05/2011](#)

By Erik van der Marel, Fredrik Erixon

Future-Proofing World Trade in Technology: Turning the WTO IT Agreement (ITA) into the International Digital Economy Agreement (IDEA)

[ECIPE Working Paper No. 04/2011](#)

By Hosuk Lee-Makiyama

Chasing Paper Tigers – Need for caution and priorities in EU countervailing duties (CVDs)

[ECIPE Policy Brief No. 01/2011](#)

By Hosuk Lee-Makiyama

Digital Authoritarianism: Human Rights, Geopolitics and Commerce

[ECIPE Occasional Paper No. 5/2011](#)

By Fredrik Erixon, Hosuk Lee-Makiyama

Indian Trade Policy After the Crisis

[ECIPE Occasional Paper No. 4/2011](#)

By Razeen Sally

The Crisis and the Global Economy: A Shifting World Order?

[ECIPE Occasional Paper No. 3/2011](#)

By Razeen Sally

Is the Renminbi Undervalued? The Myths of China's Trade Surplus and Global Imbalances

[ECIPE Working Paper No. 2/2011](#)

By Sylvain Plasschaert

Chinese Trade Policy After (Almost) Ten Years in the WTO: A Post-Crisis Stocktake

[ECIPE Occasional Paper No. 2/2011](#)

By Razeen Sally

Value For Money: Getting Europe's Trade and IPR Policy Right

[ECIPE Occasional Paper No. 1/2011](#)

By Fredrik Erixon

A Guide to CAP Reform Politics: Issues, Positions and Dynamics

[ECIPE Working Paper No. 3/2011](#)

By Valentin Zahrnt

Food Security and the EU's Common Agricultural Policy: Facts Against Fears

[ECIPE Working Paper No. 1/2011](#)

By Valentin Zahrnt

Securing Korea's Prosperity in the Next Century: An analysis of the Korea-EU Free Trade Agreement

[ECIPE Occasional Paper No. 4/2010](#)

By Fredrik Erixon, Hosuk Lee-Makiyama

Ukraine After the Crisis: Recovery and Reform, not Revolution or Russification

[ECIPE Policy Brief No. 04/2010](#)

By Fredrik Erixon

Baltic Economic Reforms: A Crisis Review of Baltic Economic Policy

[ECIPE Working Paper No. 4/2010](#)

By Fredrik Erixon

Stepping into Asia's Growth Markets: Dispelling Myths about the EU-Korea Free Trade Agreement

[ECIPE Policy Brief No. 03/2010](#)

By Fredrik Erixon, Hosuk Lee-Makiyama

Vested and Invested Interests: The Role of Investment Protection in EU-Russia Relations

[ECIPE Policy Brief No. 02/2010](#)

By Fredrik Erixon, Iana Dreyer

The European Centre for International Political Economy (ECIPE) is an independent and non-profit policy research think tank dedicated to trade policy and other international economic policy issues of importance to Europe. ECIPE is rooted in the classical tradition of free trade and an open world economic order. ECIPE's intention is to subject international economic policy, particularly in Europe, to rigorous scrutiny of costs

and benefits, and to present conclusions in a concise, readily accessible form to the European public. We aim to foster a "culture of evaluation" – largely lacking in Europe – so that better public awareness and understanding of complex issues in concrete situations can lead to intelligent discussion and improved policies. That will be ECIPE's contribution to a thriving Europe in a world open to trade and cross-border exchange.

www.ecipe.org

Phone +32 (0)2 289 1350 Fax +32 (0)2 289 1359 info@ecipe.org Rue Belliard 4-6, 1040 Brussels, Belgium