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INGLORIOUS ISOLATION

ARGENTINA'S ECONOMIC AND FINANCIAL POLICIES ARE SLOWING DOWN TRADE WITH ITS NEIGHBOURS

Kristin Wesemann / Marc Koch

Argentina has its back to the wall. But the fact that President Cristina Fernández refuses to accept this state of affairs has become all too clear, particularly with her now notorious utterance: "Today is the 31st of July and the world keeps on turning".¹ This shows the president does not have a clear understanding of the long-term effects of the technical default that was announced on the previous day. It is true Argentina's 2014 default is not on the same scale as the country's bankruptcy in 2002. At that time, Argentina was thrown into poverty almost overnight because it could no longer service its 100 billion U.S. dollar debt. Today its debt is somewhat more manageable at around 46 per cent of GDP.² In the wake of legal action by hedge funds, a New York district court has ordered Argentina to repay its outstanding debts, but even this should not present a problem as they only amount to some 1.3 billion U.S. dollars. Yet Argentina is refusing to comply with the court's verdict because it is afraid that a specific clause will result in a flood of other existing debtors who took their share of the haircut between 2005 and 2010 believing they can get all their money back. There is currently some legal debate about whether this could actually happen.

1 | "Una batería de medidas de impacto social para recuperar la iniciativa", *La Nación*, 1 Aug 2014, <http://lanacion.com.ar/1714841> (accessed 4 Sep 2014).

2 | Cf. German Trade & Invest, "Wirtschaftsdaten kompakt: Argentinien", May 2014, http://ahk.de/fileadmin/ahk_ahk/GTaI/argentinien.pdf (accessed 4 Sep 2014).

So it is wrong to talk about another sovereign default – Argentina is certainly not bankrupt. Perhaps “unwilling to pay” would be a more accurate description. The final collapse of negotiations with the hedge funds at the end of July was greeted with remarkable calm in Argentina. There was no sense of panic during the weeks of talks in New York, and few Argentinians were surprised when, in his normal gruff manner, Minister of the Economy Axel Kicillof announced the breakdown of negotiations. This was because the negative effects will not be felt for many years. By then, a different president will be in power in the country on the River Plate. The roots of the Argentinean crisis go back many years. The economy has barely grown since 2011 and it is being strangled by currency controls and absurd import regulations. The government has failed to get a grip on inflation while at the same time attempting to win voters over with lavish public spending.

This vicious circle would only tighten still further in the event of a sovereign default, says Luis Palma Cané of economic consultants Fimades: “This would result in fewer U.S. dollars entering the country. Then it would become clear that our country has little legal cer-

tainty, which would isolate us still more in the eyes of the world. We would be able to import even fewer goods and primary products, which would have a negative impact on

Under Néstor Kirchner, Argentina’s economic policies were already oriented towards a certain degree of separation and specific populist actions.

industrial production and our GDP.”³ Under Cristina Kirchner’s late husband, former President Néstor Kirchner (2003 to 2007), Argentina’s economic policies were already oriented towards a certain degree of separation and specific populist actions. For example, in 2006 beef exports were banned almost overnight in order to keep prices low on the domestic market. The result was the collapse of one of Argentina’s main export industries. Today, the country exports less meat than Paraguay or Uruguay. At present, Argentinian soy farmers have to pay 35 per cent of their turnover in export taxes. So it is hardly surprising that they stockpile the soy crop that is in such demand overseas, particularly in China. Soy exports are a major source of the urgently needed currency reserves.

3 | Luis Palma Cané quoted in *El Liberal*, “Economistas advierten sobre los costos de un nuevo default”, 23 Jul 2014, <http://elliberal.com.ar/ampliada.php?ID=144966> (accessed 4 Sep 2014).



A dozing regional organisation: Mercosur was meant to create a common market and a free trade area. But despite many summit meetings, like the one in Mendoza in 2012, the goals have not been reached so far. | Source: Fernanda LeMarie, Ministerio de Relaciones Exteriores, Comercio e Integración, flickr ©100.

After gaining power in 2007, Cristina Kirchner continued to press ahead with these policies, and indeed has consolidated them still further. This is exemplified by the expropriation of the Spanish energy company Repsol in April 2012 and the nationalisation of the oil company YPF, in which Repsol held a majority stake. This coup gave Kirchner's government a much-needed boost among its supporters after Argentina – a country rich in natural resources – began importing oil in 2011 and energy prices soared. The dispute with the hedge funds – which are often called *fondos buitres* or “vulture funds”, not just by the Argentinian government – also took on a nationalistic tone: Kirchner's solution was to ask “Patria o Buitres?”, “Fatherland or vultures?”. By using such a slogan, the President is consciously drawing parallels with a historic dispute of the 1940s, when presidential candidate Juan Domingo Perón fought back against his political opponent, U.S. ambassador Spruille Braden. The catchphrase at the time was “Braden o Perón?”. And Kirchner's desire for confrontation has grown so strong that she is not afraid of drawing tasteless parallels. During the Gaza conflict she accused the hedge funds of firing “financial rockets” over Argentina.⁴

4 | “Cristina Kirchner y su comparación con Gaza: ‘Esto también es violencia, son misiles financieros, que cuestan vidas’”, *La Nación*, 31 Jul 2014, <http://lanacion.com.ar/1714687> (accessed 4 Sep 2014).

Fig. 1
Member states of Mercado Común del Sur (Mercosur)



Source: Own depiction.

This mixture of isolationism, lack of legal certainty and erratic economic policy decisions has made life difficult for investors and Argentina’s trading partners alike. Mercosur, the trade association co-founded by Argentina in 1991 whose members include Brazil, Paraguay, Uruguay and more recently Venezuela, is now eking out a somewhat

lean existence in terms of regional economic policy.⁵ What began as ambitious project to create a common market, customs union and free trade zone is now mired in an end-less trench warfare between the individual member states. It has certainly not achieved its objectives, as bemoaned by Uruguay’s Vice-President Danilo Astori: “We have never managed to set up a common market, the customs union is in tatters and the free trade zone is simply not functioning because there is no free movement of goods and services. Mercosur is in a state of almost total incapacity.”⁶ This is largely due to the behaviour of Mercosur’s two largest member states. Brazil and Argentina have long been wrangling over every possible area of economic policy, including trade restrictions, import restrictions and customs tariffs.

Table 1
**Argentina’s trade balance 2010 to 2014,
in billion U.S. dollars**

	2010	2011	2012	2013	2014 (prognosis)
Exports	68.2	84.1	80.9	81.7	74.3
Imports	56.8	74.3	68.5	73.7	68.0
Saldo	11.4	9.8	12.4	8.0	6.3

Sources: N. 2; José Hidalgo Pallares, “Prevén un desplome de las exportaciones y el saldo comercial, y mayor escasez de divisas”, *La Nación*, 14 Aug 2014, <http://lanacion.com.ar/1718476> (accessed 4 Sep 2014). The Newspaper *La Nación* relies on data of Cámara de Exportadores de la República Argentina (CERA), http://cera.org.ar/new-site/contenidos.php?p_seccion_izq_id=340 (accessed 5 Sep 2014).

In 2013, Brazilian mining company Vale halted construction of a huge potash mine in Argentina, which would have been one of the largest investment projects of recent years. Since then, talks on a free trade agreement between the European Union and Mercosur have failed because of the

5 | Cf. Kristin Wesemann, “Lonely Together: South American Alliances Mercosur and Unasur Face Crisis”, *KAS International Reports* 2/2014, <http://kas.de/wf/en/33.36787> (accessed 4 Sep 2014).
6 | Danilo Astori quoted in *El Observador*, “Astori apuesta por Alianza de Pacífico y denuncia ‘inacción’ del Mercosur”, 3 Jun 2013, <http://elobservador.com.uy/noticia/252185/astori> (accessed 4 Sep 2014).

uncompromising stance of the Argentinian President, who prefers to stress the asymmetries between the two blocs rather than seek a joint way forward.⁷

Table 2

Regional Trade 2013

	Exports to Argentina in billion U.S. dollars	Ratio of Argen- tina of total ex- ports in per cent	Imports from Argentina in billion U.S. dollars	Ratio of Argen- tina of total im- ports in per cent
Brazil	19.6	8.1	16.5	6.9
Chile	0.8	1.0	3.9	4.9
Uruguay	0.5	5.4	1.6	14.2

Sources: N. 11; Germany Trade & Invest, "Wirtschaftsdaten kompakt: Chile", 05/2014, http://ahk.de/fileadmin/ahk_ahk/GTaI/chile.pdf (accessed 4 Sep 2014); German Trade & Invest, "Wirtschaftsdaten kompakt: Uruguay", May 2014, http://ahk.de/fileadmin/ahk_ahk/GTaI/uruguay.pdf (accessed 4 Sep 2014) and calculations by the authors.

Argentina's latest default also has consequences for Mercosur. The contagion could spread to other economies – and particularly to Brazil, Argentina's largest trading partner – if the problem is not resolved quickly.⁸ Even though Brazilian Finance Minister Guido Mantega has stressed his government's belief that Argentina is in no way insolvent,⁹ Brazil's economic circles and press have reacted with horror to its neighbour's political situation. Even Kirchner herself has been the subject of strong criticism.¹⁰ Its neighbour's difficulties could not have come at a worse time for Brazil. Its own economic growth has slowed, its people are burdened by rising inflation and exports are falling. This is

7 | Cf. Marc Koch, "Hoch gezielt und knapp daneben", *Deutsche Welle*, 27 Jan 2013, <http://dw.de/p/17SUD> (accessed 4 Sep 2014).

8 | The Wharton School, "Will Argentina's Default Unleash Further Contagion?", 11 Aug 2014, <http://knowledge.wharton.upenn.edu/article/will-argentina-default-unleash-contagion> (accessed 4 Sep 2014).

9 | Cf. Sofia Fernandes, "Para Mantega, situação na Argentina é de 'impasse'", *Folha de S. Paulo*, 31 Jul 2014, <http://www1.folha.uol.com.br/mercado/2014/07/1493771-para-mantega-situacao-na-argentina-e-de-impasse.shtml> (accessed 4 Sep 2014).

10 | "A ruinosa trajetória da Argentina kirchnerista", *O Globo*, 1 Aug 2014, <http://oglobo.globo.com/opiniao/a-13450905> (accessed 4 Aug 2014).

partly a result of the situation in Argentina. The country was previously Brazil's third-largest export partner, after China and the USA.¹¹



Partners in trade: The fiscal policy of Cristina Kirchner does not only affect Argentina. Brazil's President Dilma Rousseff (l.) has to face an increasing inflation and a drop in exports. | Source: Roberto Stuckert Filho, Blog do Planalto, flickr ©1990.

In the first six months of 2014 there was a sharp drop in the amount of goods crossing Brazil's southern border, and car exports fell by as much as 35 per cent. "Argentina is the largest buyer of goods produced here",¹² comments José Augusto de Castro of Brazil's export trade association. The automotive sector in particular has few alternatives. 85 per cent of its exports go to Argentina. And for many small and medium-sized enterprises in the Brazilian states of Rio Grande do Sul and Santa Catarina, Argentina is their only market. The bottom could fall out if Argentina's recession continues.

One thing seems certain: the value of the Argentinian peso will once again fall drastically. This will have an impact on Argentina's economically powerful neighbours.

11 | Cf. German Trade & Invest, "Wirtschaftsdaten kompakt: Brasilien", May 2014, http://ahk.de/fileadmin/ahk_ahk/GTAI/brasilien.pdf (accessed 4 Sep 2014).

12 | José Augusto de Castro quoted in "Default de Argentina pegará a Brasil", *CNN Expansión* [min. 1'33], <http://exp.mx/v001CLP> (accessed 4 Sep 2014).

Uruguay, for example, has concerns about the effect on its tourism industry. Every year, 1.76 million Argentinians cross the River Plate for their holidays. This is already not exactly cheap, but any devaluation of the peso would take it beyond the reach of many Argentinians. Exports would also be affected. In the case of Uruguay, this mainly concerns textiles, paper and household appliances. On the other hand, this small country has announced record levels of foreign capital investment for June alone. According to its Central Bank in Montevideo, 4.4 billion

U.S. dollars of deposits were held in private accounts, the highest level since 2002. 75 per cent of these deposits were made by Argentinians.¹³ However, Uruguay has been

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successfully exercising a kind of "de-Argen-

tinisation" (*desargentización*)¹⁴ of its economy. Flying in the face of tradition, its largest neighbour is no longer the country's main target in terms of goods exports and the movement of capital. Chile has taken similar steps. After taking office, socialist President Michelle Bachelet also set a totally different course in terms of economic and regulatory policy. "We have to a large extent unhitched ourselves from the Argentinian economy. Trade amounts to perhaps three per cent, and exports to Argentina one per cent. The default has no impact in terms of real trade,"¹⁵ asserts Chilean economic expert Alejandro Alarcón.

Bolivia – one of the Kirchner administration's closest allies – supplies its neighbour with 17 million cubic metres of gas every day and likes to be paid for it in U.S. dollars. This amounted to 582 million U.S. dollars in the first quarter of this year alone. The Bolivian government under Evo Morales is trying to dispel fears that Argentina will no longer pay its gas bills as a result of the default. But to be

13 | Cf. Rubén Ramallo, "Depósitos argentinos en Uruguay alcanzan el mayor crecimiento en seis años", iProfesional.com, 28 Jul 2014, <http://iprofesional.com/notas/192094-Ante> (accessed 4 Sep 2014).

14 | Alejandro Rebossio, "La crisis de deuda de Argentina amenaza con daños a países vecinos", *El País*, 2 Aug 2014, http://economia.elpais.com/economia/2014/08/02/actualidad/1406951994_850485.html (accessed 4 Sep 2014).

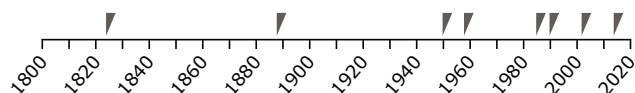
15 | Alejandro Alarcón quoted in "Chile y el default de la Argentina", *Clarín*, 1 Aug 2014, http://clarin.com/opinion/Chile-default-Argentina_0_1185481485.html (accessed 17 Aug 2014).

on the safe side, it holds a guarantee from Argentina to the tune of 400 million U.S. dollars which represents two months' supply.¹⁶

The psychological effects of the Argentinian default on the region's trade and finances should not be underestimated. They could also lead to contagion in other markets. This may not be fair but it is conceivable, warns Mauro Guillén, a Latin America expert at the Wharton Business School: "Whatever happens in [the financial markets] of Brazil, Chile, Mexico and Peru should have nothing to do with Argentina, but somehow the market associates Argentina with the region. [...] It is discouraging to see that markets don't discriminate in a better way between Argentina and the other countries of the region."¹⁷

Fig. 2

Argentina's defaults since 1800



Source: "Argentina's debt saga. No movement", *The Economist*, 31 Jul 2014, <http://econ.st/UPDB9C> (accessed 5 Sep 2014).

In this respect, it is striking that Argentina's political allies and partners have indeed expressed their solidarity on the hedge fund dispute, but that this has generally been a token rhetorical gesture.¹⁸ Even left-leaning blocs such as Unasur and Mercosur have generally reacted with caution. Nevertheless, at the last meeting of the BRICS countries held in July 2014 in Fortaleza, Brazil, the Argentinian president canvassed support for her position and particularly sought out the support of Russian president Vladimir Putin. Kirchner can claim a political victory in the

16 | "Argentina retrasaría pagos por el gas", *Clarín*, 26 Jun 2014, http://clarin.com/opinion/Argentina-retrasaria-pagos-gas_0_1163883609.html (accessed 4 Sep 2014).

17 | Mauro Guillén quoted in The Wharton School, cf. n. 8.

18 | Cf. "América Latina sale en defensa de la Argentina en la pelea con fondos buitres", *Perfil*, 25 Jun 2014, <http://perfil.com/internacional/America-Latina-sale-en-defensa-de-Argentina-en-la-pelea-con-fondos-buitres-20140625-0029.html> (accessed 04 Sep 2014).

way Putin declared Argentina to be a “strategic partner”¹⁹ and announced they would work together on the peaceful use of nuclear power. In return, Kirchner explicitly praised the project agreed upon by the BRICS group in Fortaleza to set up a new joint development bank, saying: “We salute the decision to build a development bank that addresses commercial and infrastructural aspects, but also focuses on mending a deranged financial world order.”²⁰

The President is convinced her economic and foreign policies will lead to a “fairer” financial order. Although Argentina cannot match the financial power and key economic indicators of these countries, she would like to see her country included in the BRICS group. But with her ideological view of the BRICS bank, it seems likely she and others are setting themselves up for disappointment. Günther Maihold of the German Institute for International and Security Affairs comments: “The spectrum ranges from an expectation that the capital markets can be excluded via a cross-border finance system, to a revival of the 1970s fantasies that it could now be possible, with international help, to pursue national development under the banner of protectionism. The BRICS bank will no doubt know how to avoid such aberrations”.²¹

However, Argentina is not only targeting the BRICS Development Bank for ideological reasons. It is also strongly motivated by the possibility of getting fresh loans from the new bank. Argentina has not issued debt abroad since its sovereign default 12 years ago. It has been repaying its debts from currency reserves. After these reserves fell by one third over subsequent years, in early 2014 Argentina

Argentina has not issued debt abroad since its sovereign default 12 years ago. It has been repaying its debts from currency reserves.

19 | Natasha Niebieskikwiat, “‘Argentina es el principal socio estratégico en América latina’ dice Putin”, *Clarín*, 11 Jul 2014, http://clarin.com/politica/Argentina-principal-estrategico-America-Putin_0_1172882818.html (accessed 4 Sep 2014).

20 | Cristina Kirchner quoted in “Cristina Fernández critica ante los BRICS el ‘pillaje’ financiero y niega default en Argentina”, *Información y análisis de América Latina*, 16 Jul 2014, <http://infolatam.com/2014/07/16/la-presidenta-argentina-critica-el-pillaje-financiero-de-algunos-paises> (accessed 4 Sep 2014).

21 | Günther Maihold, “Die BRICS-Bank – der Einstieg in eine neue Weltfinanzordnung”, *SWP-Aktuell* 53, Aug 2014, 5 et seq., http://swp-berlin.org/fileadmin/contents/products/aktuell/2014A53_ilm.pdf (accessed 4 Sep 2014).

massively devalued the peso, removed state subsidies and in the months that followed made some very surprising moves towards the global financial markets. In May, it struck a deal with the Paris Club, an informal institution comprised of state and public creditors, to repay 9.7 billion U.S. dollars of existing debt within the next five years. And the dispossessed Spanish energy company Repsol was paid five billion U.S. dollars in compensation for the nationalisation of its stakeholding in YPF. This about-face could be the first sign of a change of direction in Argentina's financial and economic policy – and hence of a return to or at least rapprochement with global markets. No official explanation has been given for these actions. But it is conceivable that Axel Kicillof, who took up the post of Minister of the Economy at the end of 2013, has realised the country has to fulfil certain conditions if it is to regain international confidence. But this opportunity seems to have been wasted as a consequence of the recent default.



Una causa nacional: The dispute over the U.S. hedge funds, or *fondos buitres* (vulture funds) as they are called in Argentina, is charged with a nationalistic rhetoric. Therefore, "Fatherland or Vultures" became Cristina Kirchner's slogan. | Source: Benjamin Dumas, flickr ©1999.

In December, the RUFO clause (Right Upon Future Offers)²² expires which, in the wake of the New York decision in favour of the hedge funds, could lead to a flood of legal claims

22 | Cf. Analía Llorente, "Qué es la cláusula RUFO y cómo afectaría a la Argentina", Cronista.com, 22 Jul 2014, <http://cronista.com/economiapolitica/-20140722-0090.html> (accessed 4 Sep 2014).

from existing debtors. All the Kirchner administration's bluster about the hedge funds seems to have been an attempt to gain a breather. Observers are convinced Argentina will be urgently seeking a solution with the hedge funds after January 2015. 40 per cent inflation, a further deepening of the recession and the threat of massive job losses are causing mounting pressures at home. The nervousness of the government is shown by its recent pronouncement that the highly controversial anti-terror law should be applied against the subsidiary of a U.S. corporation which abruptly filed for bankruptcy, on the grounds that this "is harmful to economic and financial order" and terrorises the public.²³ However, this very public threat could not be justified under the very broad provisions of the anti-terrorism law, so it was withdrawn by the president the very next day. It was aimed at investors who held shares in the company and who also worked with one of the hedge funds with whom Argentina is at loggerheads.

Observers are convinced Argentina will be urgently seeking a solution with the hedge funds after January 2015. A further deepening of the recession is causing mounting pressures at home.

Yet even if there is a settlement of this bizarre dispute with the hedge funds, Argentina will still find it difficult to access fresh loans at good rates. Investors, too, are bound to remain sceptical for the time being. Although they know the country's potential, they fear "the teenage attitude that rules are there to be broken", as government policy has recently been described in *The Economist*.²⁴ At the end of 2015, Kirchner has to stand down from the presidency after serving two terms. This is written in the constitution and the government gave up on plans to change this after the parliamentary elections of 2013. Her successor will face a difficult legacy. Along with problems at home, he or she will have to end the country's isolation from global markets. Economist Fausto Spotorno believes this will be no easy matter: "The problem is that Argentina has not exactly behaved like a reliable borrower over recent years, like someone you can trust. And because this has not happened, there is now, of course, always doubt about

23 | Mariana Verón, "Cristina buscará que se aplique la ley anti-terrorista contra una empresa", *La Nación*, 15 Aug 2014, <http://lanacion.com.ar/1718881> (accessed 4 Sep 2014).

24 | "The Luis Suárez of international finance", *The Economist*, 5 Jul 2014, <http://econ.st/WZE8XW> (accessed 4 Sep 2014).

how much Argentina can be trusted as a borrower today.”²⁵ It has hardly been a *década ganada*, a winning decade, as the President and her late husband loved to call it. It is now time for Argentina to start winning – above all to start winning back lost confidence.

25 | Fausto Spotorno quoted in Marc Koch, “Argentina, otra vez entre la espada y la pared”, *Deutsche Welle*, <http://dw.de/p/1Ciqn> (accessed 4 Sep 2014).