

CEPS COMMENTARY



Thinking ahead for Europe

Duel between the EU and Argentina: Weapons in the EU Arsenal

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Relations between the European Union and Argentina are under severe strain. For years, the Argentinean government has been involved in a diplomatic dispute with the United Kingdom over the status of the Falkland Islands (*Las Islas Malvinas* to the Argentines). It recently decided to take advantage of Spain's current economic weakness to attack a major Spanish investment in the country. On April 16th, the Argentinean government expropriated 51% of Repsol's shares in YPF, a former state-owned oil company, which had been privatised in the early 1990s. This action provoked a public outcry in Madrid and beyond, especially in the European Commission. In this Commentary, we explore its longer-term impact on relations between the EU and Argentina.

The Spanish government reacted vehemently to Argentina's action, which was criticized by the Industry Minister José Manuel Soria as "a hostile decision against Repsol, a Spanish company, and consequently against Spain and the Spanish Government". José García-Margallo, Minister for Foreign Affairs, pointed out that the decision violated the bilateral agreement of 1991 on expropriations. Spain is now also looking for support from the EU institutions in its bilateral conflict with Argentina.

The EU condemned Argentina's moves early on. Catherine Ashton, the EU's High Representative for Foreign Affairs, said on April 17th that "this announcement is cause for grave concern. YPF is an important EU investment in Argentina. A takeover sends a very negative signal to international investors and it could seriously harm the business environment in Argentina." The European Parliament also adopted a resolution on the matter,¹ describing the nationalisation as dangerous for Argentina, as it would increase the "legal insecurity" and make investors more cautious about the security of their investments. Thus, the country's economic growth could also be jeopardized.

But the boldest action from the EU came on May 25th, when it challenged Argentina on import restrictions in the WTO. According to the rules of procedure, the Europeans and Argentineans had 60 days in which to solve the conflict. No agreement has been reached, however, and the EU might now request a WTO Panel to be convened in order to rule on the legality of Argentina's measures. This process might result in the imposition of significant fines on Argentina.

¹ European Parliament resolution on the legal security of European investments outside the European Union (2012/2619(RSP), 18 April 2012.

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Another important action was taken several days later, on June 13th, when the EU revised its Generalised System of Preferences, resulting in an increase of duties on Argentina's exports to the EU. The impact is estimated to be worth a loss of \$3 billion annually in Argentinean exports to the EU.²

For its part, Repsol has demanded \$10 billion in compensation for the nationalization of YPF. The Argentinean government has refused to pay, citing among the reasons the "environmental harm" that Repsol has inflicted on Argentina.

On May 15th the Spanish company decided to take the first step towards legal action against Argentina in the World Bank's International Centre for Settlement of Investment Disputes (ICSID). To initiate ICSID arbitration, Repsol notified the Argentinean government that there is a dispute under the Treaty for Investment Promotion and Protection agreed between Spain and Argentina. If there is no agreement between the parties in six months, the next step will be to take the case to the ICSID. Subsequently, on June 8th, Repsol lodged an appeal of unconstitutionality of the YPF nationalization under the Argentinean judicial system. The latest move taken by the company has been to press charges against its former subsidiary in the United States on grounds that YPF deliberately failed to comply with Securities and Exchange Commission (SEC) requirements to provide investors with relevant information. The situation further deteriorated when on July 13th the government in Buenos Aires unilaterally terminated its fiscal agreement with Spain and other countries on avoiding double taxation, creating huge problems with the fiscal authorities for Spanish companies and entrepreneurs.

The fall-out from the crisis in relations between the EU and Argentina could manifest itself in any one of several different ways, but the EU has several policy options available to it to respond to these developments, depending on its strategy. We explore both the possible fall-out as well as the policy options below.

1. Souring investors on doing business in Argentina

With the deterioration in the business environment, there is a real risk that international investors will turn away from Argentina. The EU is Argentina's most important foreign investor and its second-most important trading partner.³ Following the events of this summer, however, the prospects for growth of investments from the EU to Argentina are significantly diminished. Therefore we should expect a decrease of European FDI inflows to Argentina and potentially also a decrease in trade volumes.

- The EU strategy needs to reflect a continued commitment to engage with Argentina at the same time that it takes all necessary steps to protect its own interests in the country. Accordingly, the EU should proceed with the WTO case and use it as political leverage in its dialogue with the Buenos Aires government to change the Argentinean foreign trade and investment stance. This engagement on the European side to solve the dispute in a legal and diplomatic manner should seek to improve Argentina's image among international investors, which would be in the country's best interest. At the same time, this strategy would be in the EU's interest, as many of the stakeholders are European and they would stand to benefit from an authoritative ruling in their favour.

² Martin Kanenguiser, "Sube el riesgo de perder ventajas comerciales", *La Nación*, 29 April 2012 (<http://www.lanacion.com.ar/1469151-suba-el-riesgo-de-perder-ventajas-comerciales>).

³ The EU is Argentina's second-largest export market after Brazil and before China and the US. The EU is also the biggest foreign investor in Argentina, accounting for about one-half of foreign direct investment in Argentina, with the EU's investment stocks in 2011 worth €49.5 billion in important areas such as telecoms, automotive and energy (see <http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/argentina/>).

2. Challenging Argentina's standing in international fora

Argentina is South America's second largest country by land area (after Brazil), the eighth-largest country in the world by land area and the largest among Spanish-speaking nations. By virtue of its size, history and rich cultural traditions, it is a member of nearly every international diplomatic, political and economic organization. If all efforts at engagement prove fruitless, however, the EU's objective could be to marginalize the country politically in these organizations for as long as it refuses to alter its policy.

- Among the more controversial ideas circulating and one that has already been widely discussed is the removal of Argentina from the G-20. Some influential decision-makers in the US and the EU have called for Argentina's continued membership in the G-20 to be made conditional on its "adherence to international norms of economic relations and commitment to the rule of law".⁴ Many leading newspapers have also called for Argentina's expulsion from the G-20.⁵ There are no formal rules on G-20 membership; therefore any attempt to remove (suspend/replace) Argentina would require a political compromise with other G-20 members, most notably US, Russia, China (all three of which are UN Security Council members, with Russia slated to chair the G-20 in 2013) and Brazil (a regional powerhouse). This move, however, remains rather unlikely due to the probable lack of unanimity in G-20, but also undesirable as it would represent a major escalation of the conflict.
- Other opportunities to pursue this strategy are presenting themselves this fall, as Argentina is seeking to become a (rotating) member of the UN Security Council for the 2013-14 term, as well as a member of the UN Human Rights Council for 2013-15.⁶ The success of this tactic, however, would require the formation of an international coalition in support of such moves.
- The problems between the EU and Argentina are also expected to be prominently addressed during the upcoming EU-LAC (Latin America and the Caribbean) Summit, foreseen for January 2013 in Santiago, Chile.
- Even in the extreme situation in which Argentina would refuse to obey the WTO decision, the EU has other means at its disposal to punish its partner. The sanctions would have to be financially severe for the Buenos Aires government, and could include, for example, the freezing of Argentinean assets in Europe.

3. EU investment agreement with Argentina

A total of 19 member states (plus Croatia) have bilateral investment agreements with the Republic of Argentina.⁷ Under the Treaty of Lisbon, the EU obtained exclusive competence

⁴ "Lugar calls to suspend Argentina from G20", Press Release of US Senator Richard Lugar, 14 May 2012 (<http://lugar.senate.gov/news/record.cfm?id=336772>). See also letter of Martin Callanan, MEP and leader of the European Conservatives and Reformists group in the European Parliament, to High Representative Catherine Ashton on 20 April 2012 (<http://ecrgroup.eu/?p=6360>).

⁵ Among others, The Wall Street Journal, The Washington Post and The Economist; see for example: "The Argentine Model: Why not expel a thieving Buenos Aires from the G-20?", *Wall Street Journal*, 17 April 2012 (<http://online.wsj.com/article/SB10001424052702304432704577349830438299066.html>).

⁶ The UN Security Council rotating members are pre-decided on a regional basis to ensure fair geographical representation and confirmed in the UN General Assembly by a 2/3 majority. However, a unified European (EU and other like-minded countries) approach could result in Argentina's failure to obtain 2/3 support. Such a development would be a major diplomatic defeat for the Argentinian government. The Human Rights Council members are elected by a absolute majority in the UN General Assembly.

⁷ The only EU countries that do not have a bilateral investment agreement with Argentina are Cyprus, Estonia, Ireland, Latvia, Lithuania, Malta, Slovakia and Slovenia. More information is available on the

in the field of investment relations with third countries, but until a new EU investment treaty with Argentina is reached (which currently is not on the agenda), the previous bilateral agreements remain in force.

- In order to be able to better serve its interests, the EU should seek a new EU-Argentina investment treaty (which would replace the 19 bilateral agreements between EU states and Argentina). This agreement, however, should be made conditional on the solution of the pending WTO case. Once the current conflicts are solved, the new investment treaty can be negotiated. If such an agreement could be reached, it would probably prove the most promising channel for inducing change in Argentina's behaviour and respect for international rule of law.

4. EU-Mercosur Free Trade Agreement

The EU launched the first talks on a regional free trade agreement (FTA) with the Mercosur countries in 1995.⁸ The primary economic issue of contention has been agricultural subsidies.⁹ Recent internal developments within Mercosur have given the EU cause for concern, including the suspension of Paraguay as a member and the inclusion of Venezuela as a full member. This latest crisis involving Argentina could be yet another challenge, effectively putting on hold the negotiations aimed at creating a free trade area.

- Clearly, the entire regional strategy based on developing inter-regional FTA needs further reflection by the EU institutions. Both the Council and the Commission need to examine whether region-to-region free trade is at all feasible. If not, as seems to be the case, then a new strategy could be to focus on bilateral FTA negotiations or multi-party talks.
- The EU's policy towards the Andean Community (composed of Bolivia, Colombia, Ecuador and Peru) has undergone a similar change in strategy. Following intensive negotiations on an FTA between the EU and the Andean Community, the talks were suspended in 2008. The region-to-region process was replaced by a set of multi-party FTA negotiations between the EU and three countries from the region (Ecuador, Colombia and Peru). In 2010, a tri-party FTA agreement was signed between the EU and Peru and Colombia.

These examples clearly show that not only are the EU's relations with Argentina at stake, but the EU's international credibility depends on finding an effective solution to the crisis. The EU needs to defend its principles (i.e. rule of law) with all the economic, diplomatic and political clout it can muster. Inaction will be severely penalized by further deterioration in the respect accorded to international norms in Argentina and elsewhere. At the same time, strong EU engagement to solve the problem should bring positive effects.

website of the Organization of American States (http://www.sice.oas.org/ctyindex/ARG/ARGBITs_e.asp).

⁸ The Mercado Común del Sur (Common Market of the South) is an economic and political agreement among Argentina, Brazil, Paraguay, Uruguay and Venezuela.

⁹ See Andreas Schneider, "The EU-Mercosur Free Trade Agreement: The Implications for Trade in Agriculture", CEPS Policy Brief No. 107, CEPS, Brussels, 21 June 2006.