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Will New Regulations Derail Energy Investment in Argentina?

Inter-American Dialogue's Latin American Energy Advisor

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Q and A: Will New Regulations Derail Energy Investment in Argentina?

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Last Wednesday, the government of newly re-elected President Cristina Fernández de Kirchner ordered oil, gas and mining companies to repatriate all proceeds from export sales in a bid to control significant capital flight, Dow Jones reported. According to national statistics agency Indec, oil, natural gas, metals and other related products accounted for $7.7 billion in exports during the first nine months of the year. Is the new regulation a good idea? Will the regulation have a significant effect on oil and gas companies, which have long faced what they call burdensome taxes and pressure to keep domestic prices low? What consequences could the new regulations have on badly-needed investment in the country's energy sector?

A: José Martínez de Hoz, partner at Perez Alati, Grondona, Benites, Arntsen & Martinez de Hoz, Jr. in Buenos Aires:

"By eliminating a key guarantee for investors in these businesses, the measure further weakens the already eroded legal stability, particularly in connection with the energy sector. Remember that, at least with regard to hydrocarbons, the dismantling of the legal framework on the basis of which investments were made began in 2002 with the pesoefication and interference with supply contracts, export withholdings, export restrictions, etc. Although the alleged purpose of the measure is to provide an equal treatment for all products, the true goal is to offset capital outflow. By forcing hydrocarbon and mining exporters to repatriate 100 percent of their export proceeds, the government avoids having to use Central Bank reserves to sustain the value of the peso. However, since the enactment of the measure last week (coupled with other regulations), the demand for foreign currency has significantly increased and resulted in additional foreign exchange restrictions. The measure alters the regulatory framework and rights granted under ongoing hydrocarbon and mining concessions and permits. By undermining legal stability, it will hinder future investments. Companies will probably become hesitant to disburse millions of dollars when the rules affecting their ability to maintain or transfer profits abroad are unclear and changed regularly at the government's discretion. In any case, this measure cannot be read alone. It is part of a series of measures, affecting not only the energy and mining sectors, that generally cast doubts on foreign investors' ability to freely dispose of their profits. Banks will also likely take notice of these measures, since energy companies will no longer have funds abroad that are exempt from 'Argentine risk.' For example, immediately following the enactment of the decree, Fitch downgraded the rating of several major Argentine oil companies. The reasoning was the increased exposure to transfer and exchange risks and the increasing intervention of the government in the oil and gas sector."

A: Daniel Artana, chief economist at FIEL in Buenos Aires:

"The government decision to mandate that mining, oil and gas companies repatriate 100 percent of proceeds from exports was one out of several decisions to tighten controls on the foreign exchange market in Argentina either by augmenting the supply of foreign exchange or by reducing its demand. It is likely that these companies may have difficulties down the road repatriating dividends, but it is unlikely that they will be forced to default on their debt because that would trigger major problems for the government. However, the decision is likely to reduce the already low foreign direct investment into the economy. Tighter controls on the foreign exchange markets may coordinate a speculative attack. So far, capital flight has been soaring, but private deposits in the domestic financial system were still growing in real terms. Depositors may expect more and more controls down the road and this may end in a self-fulfilling prophecy. The government should work instead on providing consistency to its policy mix by improving the fiscal accounts and running a more moderate monetary policy."

A: Claudio Loser, senior fellow at the Inter-American Dialogue:

"Two weeks ago Cristina Fernández de Kirchner had a resounding triumph at the polls, as she became reelected as president of Argentina. Today, the law of 'unintended consequences' has virtually eliminated her political honeymoon period. Argentines, many of them having voted for her, are now voting with their wallets and are seeking to take their savings out of the country. They are afraid of restrictions on their assets and a black market is already developing. The Argentine private sector may have as much as $150 billion abroad and, so far this year, money was leaving the country at a tune of $2-3 billion each month. In such circumstances, the recently announced measure ordering that oil, gas and mining companies repatriate all proceeds from export sales is another nervous and ill-directed measure by the government, similar to that applied to other types of activities. Even though energy companies are subject to strict controls, it is almost certain that they will find ways to under-invoice exports and over-invoice imports and have other ways to keep money abroad. Argentines, and Latin Americans in general, have seen these measures in the past—last century's history is full of abandoned foreign exchange control measures. Companies will also reduce their investments as the price of their output (measured in black market dollars) will fall even further, making their operations less profitable, if at all. Exactly the opposite of what the government has in mind."

A: Isabella Alcañiz, post-doctoral fellow and visiting professor at the University of Pennsylvania:

"The purpose of this new regulation, which reverts back to a 1964 law and leaves without effect a special waiver bestowed by Néstor Kirchner to oil and mining companies, is to curb worrisome capital flight and stabilize the local exchange market. It is expected this measure will result in an additional yearly $3 billion to Central Bank reserves. The Fernández de Kirchner administration has also ordered the repatriation of all offshore investments of insurance companies, with the same objective. While these demand-side measures will probably help shore up Argentina's reserves in the short run, they do little to reduce inflation-driven demand for U.S. dollars. Reaction to the new regulation among oil and mining companies has been cautious. Many of these firms were already repatriating their export proceeds in excess of the 30 percent required by the waiver. On the other hand, reaction among market actors has been strong and swift. Because of this measure, Fitch and Moody's have already downgraded several of the country's energy companies, including YPF-Repsol and Petrobras Argentina. On its own, the new regulation is not enough to guarantee investment in the sector, which would require other types of incentives. However, the measure will likely have a negative effect on foreign investors' mood, affecting overall investment in the Argentine economy and adding even more pressure on foreign reserves currently held by the Central Bank."

A: Luciano D. Gremone, director of Corporate Ratings at Standard & Poor's in Buenos Aires:

"The Argentine government recently issued a decree compelling oil, gas and mining companies to repatriate all export revenues and convert them into Argentine pesos in the local foreign-exchange market. Until now, oil and gas producers in the country benefited from a special regime that allowed them to maintain up to 70 percent of export proceeds abroad. In and of itself, this new measure should not have a material impact on the companies' cash generation ability. However, the option of keeping abroad a substantial portion of export proceeds was a key fact in assessing if the foreign currency ratings of companies in the sector can exceed our assessment of transfer and convertibility (T&C) risk for Argentina. The new regime would make this more difficult, absent other insulation factors. Nonetheless, in our opinion, the credit importance of the special repatriation regime had been diminishing in recent years as hydrocarbon exports decreased in line with declining production and increased internal demand fostered by economic growth. The main objective behind the old special regime was to add long-term predictability with regards to capital movements in industries with long repayment periods that require well-anticipated planning. Although it is early to assess the impact of the recent announcement on investments for the sector, we consider that those (particularly for exploration) depend much more on other factors comprising the overall institutional risk, including prices and taxes schemes."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*