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Argentina's economy

As Suez packs up, the locals dive in

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President Kirchner's government wants new investors to sustain Argentina's recovery. But only some need apply

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LAST month, Argentina's president, Néstor Kirchner, intimated that he hoped to attract new foreign investors to his country during a visit to New York. His economy minister, Roberto Lavagna, met managers from foreign car firms, stressing the need for fresh investment to sustain a strong recovery from the country's economic collapse of 2001-2. So a decision on September 9th by Suez, a French conglomerate, to walk away from its contract to run the Buenos Aires water company could hardly come at a less opportune time. For the issue raised by Suez's dispute with the government is whether Argentina offers sufficient guarantees of the rule of law to attract new money.

Suez's problems arose from the decision of a previous government, in 2002, to convert water tariffs from dollars to devalued pesos and freeze them. Aguas Argentinas, the water company in which Suez has a controlling 46% stake, accepted that as an emergency measure, and maintained its service and workforce. But in years of talks with Mr Kirchner's officials, it could not strike a deal on new rules of the

game. The government refused to raise tariffs as much as Suez wanted, or to share responsibility for some of the firm's dollar debts; new investment projects were derailed because the government insisted on the right to choose the contractors who would execute them. Suez invested \$1.7 billion in Argentina; it had already written off €700m (\$840m) of losses there.

Mr Kirchner wished Suez good riddance; a senior official threatened legal action if it did not serve out the remaining year of its contract. Mr Lavagna, who has often said that the government should be more flexible with privatised utilities, insisted that Suez's departure would have no effect on other potential investors. Many others are less sanguine. "Argentina will pay a cost for this," says Daniel Artana of FIEL, an opposition-leaning Buenos Aires think-tank. Foreign investors "will see that they didn't settle a dispute."

But Argentina's recovery has consistently confounded the naysayers. The economy is set for a third straight year of growth of over 7.5%. Luck, in the form of high prices for farm exports, has played a part. But despite Mr Kirchner's penchant for economic intervention, and his tough approach to foreign firms, investment has recovered almost to its level of the late 1990s (see chart)—a level high enough to allow the economy to grow at a steady 3.3% a year, says Mr Artana.

The problem is that faster growth is needed to help the 38.5% of Argentines who still live in poverty in a once-rich country. And luck can turn. According to Mr Lavagna, the share of investment in GDP needs to rise by two percentage points to sustain healthy growth.

Much recent investment has been in housebuilding and by small firms reinvesting profits—"too many bricks and too few machines" as Claudio Loser, an Argentine former IMF official, puts it. Larger firms remain cautious, especially about long-term projects. Several things hold them back. They include doubts about the government's intentions; an annual inflation rate which is creeping towards double figures; and the still partly unrepaired state of Argentine capital markets. In addition, continuing price controls restrain investment in energy infrastructure, raising fears of power and fuel shortages next year.

Foreigners, in particular, will need reassurance on many of these points. But does Mr Kirchner really want them? Only in some businesses, seems to be the answer. The evidence is that he would prefer utilities to be controlled by locals. Earlier this year, another French utility, Electricité de France, sold 65% of Edenor, a big electricity distributor, to Dolphin, an Argentine private equity fund, for some \$100m.

Dolphin's boss, Marcelo Mindlin, is well-connected with the government, although many of his investors are foreigners. On taking over Edenor, he obliged Mr Kirchner by accepting a smallish tariff rise and dropping the company's claim against the government at the World Bank's International Centre for the Settlement of Investment Disputes (where foreign firms are demanding almost \$20 billion in compensation from Argentina). In return, the government may provide Mr Mindlin with cheap loans for new investment. Officials say that after a congressional election on October 23rd they will move to settle disputes with other energy providers.

Some of Argentina's privatisations of the 1990s were flawed by corruption and monopoly, but electricity and water were successful, with tariffs falling and coverage expanding under arms-length regulation. The new model looks more like *criollo* capitalism, in which favoured businesses operate in close partnership with government. It may work, for a while at least. But foreigners, even in other businesses such as manufacturing, may want firmer guarantees before banking on it.



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