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HIGHLIGHTS

Argentine Economy Rebounds with a Bang

After Argentina's default and devaluation in 2002, economists said that a return to prosperity would take many years, but suddenly the economy is rebounding. In a special interview with *LALBR*, Merrill Lynch's Pablo Goldberg examines the strength of the recovery and the serious challenges that lie ahead. Page 3

Fixing the Disconnect Between Mexico's Patent Office and Drug Review Agency

Mexico's Ministry of Health in the past approved generic drugs that it found were medically safe, even when the drug violated patents on file with the Mexican PTO. A new law is designed to make a patent review part of the process. Page 4

Making Sense of Brazilian Antitrust Decisions

Brazil's antitrust policy has been difficult to discern due to seemingly inconsistent rulings over mergers and acquisitions. A better understanding of the antitrust agency's historical mandate and operational philosophy sheds light on recent—and future—decisions. Page 2

New Law Brings Big Changes to Brazil's Electricity Sector

Under the new law, electricity may only be sold according to two alternative structures, and most costs can be passed along to customers. Page 12

Colombia, Latest LatAm Country to Consider Changes to Constitution

The Colombian Congress is now considering a proposed constitutional amendment that would permit a popular president to be re-elected. Similar efforts in other Latin American countries have extended terms, but at great costs. Page 24

Pressures Mounting for Ecuador to Loosen Reins on Social Spending

The easiest course of action might be for the government to endorse a plan to redirect funds from debt buybacks to increases in social spending. But the effects on a future IMF agreement and international credit in general would be negative. Page 25

Special Report: Managing the Withholding Tax Burden in Latin America

An examination of withholding tax regimes in Argentina, Brazil, Chile, Mexico and Venezuela. Page 29

Recovery (from page 6)

Decrees 180 and 181 and sought a temporary restraining order that would bar any curtailment of their gas supply pending a final judgment. The complaint also seeks an order requiring the government to restrict natural gas exports to Uruguay, Brazil and Chile to the extent necessary to meet domestic demand. On March 12, 2004, a federal judge in Santa Fe granted the temporary restraining order, which was immediately appealed by the government.

Meanwhile, as the Santa Fe case winds its way through the courts, the government appears to have bowed further to local pressure. Recently, the Secretariat of Energy released Resolution 265/04,² which "suspends

excess gas exports . . . useful to internal consumption" and charges the Sub-Secretariat of Fuels with the task of devising a plan to ration gas exports and transport capacity. Despite the use of ambiguous language (there's no definition of either "excess" or "useful"), the measure forces natural gas exporters to sell first to domestic buyers at regulated prices—and at the expense of lucrative export contracts.

With cold weather and peak consumption periods approaching, further rules are expected soon, including rules to implement Decrees 180 and 181 and the export rationing program called for by Resolution 265. Let's hope these rules don't leave Argentina in the dark.

¹Published in the Official Gazette on February 16, 2004.

²Published in the Official Gazette on March 26, 2004 □

Argentine Legal Developments

by Muñoz de Toro & Muñoz de Toro, Buenos Aires

Fixing of New Term for Liquidation of Exports

On March 2, 2004, Communication "A" 4108 of the Central Bank of Argentina was published in the Official Gazette, which modified item 3 of Communication "A" 3473. The new communication established a 90-business day term for the liquidation of foreign currencies derived from exports of goods and services. The communication also extended the term for an additional 180-business days where buyers fail to pay the transaction and foreign currencies are derived from the liquidation of the proceeds of export insurance.

CNV Modified Definition of "Small- and Mid-Sized Companies"

On March 8, 2004, General Resolution No. 458/04 of the Argentine Securities and Exchange Commission (Comisión Nacional de Valores—CNV) was published in the Official Gazette, modifying the definition of "small- and mid-sized companies" (*pequeña y mediana empresa*—PYME). Furthermore, other important modifications include (i) the possibility of exempting companies defined as PYME from the requirement of creating an Audit Committee, and (ii) the requirement to file a sworn statement supporting the company's classification as PYME as one of the documents necessary to request the registration, both for the issue of notes and shares.

AFIP Clarified Certain Issues Related to Tax on Credits and Debits of Bank Accounts and Other Operations

On March 16, 2004, the AFIP issued Communication No. 1/04 clarifying that debits from bank accounts of employers, through which funds are used to pay sala-

ries, are subject to the Tax on Credits and Debits of Bank Accounts and other operations as from April 3, 2001, the date of the effective application.

Regulation of Labor System

On March 19, 2004, Law No. 25,877 was published in the Official Gazette regulating the existing labor system. The law provides as follows, among other aspects: (i) repeal of Law No. 25, 250 (Labor Amendment); (ii) unification of laws related to the termination of the employment agreement, advance notices and severance payments; (iii) unification of the test period irrespective of the type of company and prohibition to extend the period by means of a collective bargaining agreement; (iv) creation of an employment promotion policy by reducing Social Security contributions of those companies that comply with the relevant requirements; (v) elimination of the convenience control by the Ministry of Work, Employment and Social Security in relation to the confirmation of collective agreements; (vi) collective bargaining agreements, which term has not elapsed, will be in full force and effect until a new collective agreement replaces it, except as otherwise agreed in the agreement; and (vii) creation of the Integral System of Work and Social Security Inspection, for the control and supervision of the compliance with the labor and social security rules throughout the country.

Extension of Term to Participate in Mortgage Refinancing System

On March 24, 2004, Decree No. 352/04 was published in the Official Gazette extending for an additional term of 60-business-days, as from its expiration, the term to exercise the option to participate in the Mortgage Refinancing System created by Law No. 25,798.

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Legislation (from page 7)

Extension of Partial Reimbursement of VAT in the Case of Certain Transactions with Credit and Debit Cards

On March 24, 2004, Resolution No. 211/04 of the Ministry of Economy and Production was published in the Official Gazette extending, until March 31, 2005, the effectiveness of the system provided for by Resolution 207/03. Such resolution granted credit cards users a reimbursement equal to 3 points of the general rate of the Value Added Tax (VAT) levied on purchases of personal property located or placed in the national territory, or the contract for the rendering of services or hire of personal property to be carried out in the country. Such extension also applies to the system implemented for transaction with debit cards, established by Decree No. 1402/01, amended by Decree No. 1548/01.

CNV Adopts New Accounting Standards in Line with International Standards

On March 24, 2004, General Resolution No. 459/04 of the CNV was published in the Official Gazette incorporating to Rules of the CNV (N.T. 2001) Techni-

cal Resolution No. 21 of the Argentine Federation of Professional Councils of Economic Sciences, continuing with the process of adoption of professional accounting standards in line with international accounting principles for the purpose of facilitating the comparison of financial statements. Such resolution replaces Technical Resolutions Nos. 4 and 5, and contemplates (i) the assessment of the proportional equity value, (ii) consolidation of financial statements, and (iii) the information to disclose on related parties.

Adoption of Precautionary Measures in Relation to Natural Gas Supply Problems and their Consequences on the Energy Wholesale Supply

On March 26, 2004, Resolution No. 265/04 of the Energy Secretariat was published in the Official Gazette establishing measures to prevent a crisis in the internal supply of natural gas and its consequences on the energy wholesale supply. The rule (i) provides for the suspension of exports of natural gas surplus that may be used in the internal supply, and (ii) instructs the Undersecretariat of Fuels to create a program for the rationing of gas exports and of the use of transport capacity originally reserved for those purposes. □

Interview (from page 3)

comeback took place very quickly. A forecast of 6.5 percent growth for 2004 now appears to be conservative. But to answer your question, the level of real GDP by the end of this year will probably be 3 percent above Argentina's GDP of late 2001. Late 2001 was before the devaluation and default on the debt, but this was also

If the peso appreciates very fast, it will slow down economic recovery.

the third year of a recession. 1998 was the year when economic growth peaked and started the slow decline that accelerated significantly in 2001 and 2002. Argentina's economy by the end of this year will be only 5 percent below the 1998 peak, in real terms. So, the comeback by the end of this year is going to be quite impressive, again, in real terms. When we look in dollar terms, things look different because the currency has depreciated from 1:1 with the dollar to 3:1. Because of the devaluation, the comparison in dollar terms looks much different. In dollar terms, the economy by the end of 2004 will amount to only about 50 percent of the \$300 billion size it was in 1998.

Palpable Sense of Relief

LALBR: How does the economic recovery translate in

terms of local market demand? Is there a sense of a return to prosperity on the avenues of Buenos Aires?

Goldberg: Aggregate demand has improved, but certainly does not account for all the increase in economic activity. Net exports have contributed significantly to the recovery. Exports are up somewhat, but where we really see a difference is in the drop in imports. The devaluation has made imports very expensive, and the amount of imports has dropped as a result. So even though the economy by the end of the year will be just 5 percent below 1998, domestic demand by the end of the year will still be 14 percent below where it was in 1998. Clearly, when compared to 1998, aggregate domestic demand has suffered significantly and this is reflected in the high level of unemployment. On the streets and in the businesses of Buenos Aires today the sense of general anxiety about the crisis has dissipated. There is a more relaxed feeling, almost a sense of excitement. This more positive perspective is not due to a comparison of the economy with 1998, but because the last two years were so bad. A year and a half ago many people feared a general economic collapse with no end in sight. Now there is a palpable sense of relief that the economy has changed direction.

LALBR: When will the domestic market, as measured by demand, come back up to the 1998 level?

Goldberg: Even in real terms, it will probably take three or four more years. Part of the reason for this

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delay is due to the effects of the sudden stop of capital inflows. The reversal of capital inflows signaled that the Argentine economy needed to undergo dramatic changes to the trade sector. The adjustments came in the form of a depreciation of the exchange rate, contraction of the economy, and drop in imports. So domestic demand will take longer to recover than the overall economy.

Stronger Peso a Challenge to Recovery

LALBR: *The peso has already strengthened, and recently the Central Bank took actions to try to keep the peso at lower levels. Does a stronger peso threaten the recovery?*

Goldberg: If the peso appreciates very fast, it will slow down economic recovery. The authorities know that; that's why they have been acting to support the dollar. Much of the large fiscal surplus that has recently

been generated is being used to buy foreign currency in order to prevent the peso from appreciating. The real exchange rate is going to lag compared to other economic indicators, because the Central Bank will make it lag.

LALBR: *Prices of agricultural commodities on world markets are high now. Argentina, as a major exporter*

Soy prices, at very high levels today, are providing an important source of foreign exchange to this economy.

of agricultural goods, has benefited. What is the risk to the recovery if commodity prices fall?

Goldberg: Foreign prices, particularly the price of soy, have been critically important in the recovery of the economy. Soy prices, at the very high levels today, are

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Argentina—The Big Picture

	1998	1999	2000	2001	2002	2003	2004F	2005F
Real GDP growth	3.9	-3.4	-0.8	-4.4	-10.9	8.7	6.5	1.9
GDP Nom (ARS bn)	299	284	284	269	313	284	284	269
GDP \$bn	299	284	284	269	102.6	131.3	145.9	144.5
Industrial Production growth	2.2	-6.5	-0.3	-7.6	-10.5	15.8	4.0	1.9
Private Consumption growth	3.5	-2.0	-0.7	-5.7	-14.4	-2.0	-0.7	-5.7
Gross Fixed Investment	6.5	-12.6	-6.8	-15.7	-36.1	-12.6	-6.8	-15.7
Inflation year end	0.7	-1.8	-0.7	-1.5	41.0	3.7	7.0	11.0
Inflation average	0.9	-1.2	-0.9	-1.1	25.9	22.3	5.3	9.0
Exchange Rate average	1.0	1.0	1.0	1.0	3.3	3.1	2.9	2.9
Exchange Rate year end	1.0	1.0	1.0	1.0	3.4	2.8	3.0	3.2
Interest Rates year end	10.7	13.8	14.8	54.9	33.1	10.1	10.0	12.0
Exports (\$bn)	26.4	23.3	26.4	26.6	25.4	29.2	32.5	31.8
Imports (\$bn)	31.4	25.5	25.2	20.3	9.0	14.2	14.1	12.2
Trade balance (\$bn)	-5.0	-2.2	1.2	6.3	16.3	15.1	18.4	19.6
Current Account (\$bn)	-14.6	-12.0	-8.9	-4.5	9.2	8.2	11.5	11.3
Current Account (% of GDP)	-4.9	-4.2	-3.1	-1.7	9.0	6.3	7.9	7.8
International Reserves (\$bn)	24.9	26.1	25.7	13.6	9.1	12.7	19.3	25.5
Fiscal Balance (% of GDP)	-1.4	-2.6	-2.4	-3.0	-1.2	1.4	0.0	0.0
<i>Source: Merrill Lynch</i>								

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providing an important source of foreign exchange to this economy. Soy is Argentina's number one export. The country is the largest exporter of soy oil in the world. Soy complex, which consists of soy, soy oil and other soy products, accounts for one-third of Argentina's exports right now. One of the risks going forward for Argentina is the possible deterioration in export prices. So the economic recovery faces potential challenges from both the real exchange rate and foreign prices of commodities. The importance of these two factors is magnified because Argentina is earning much money from exports.

Construction Industry

LALBR: *What other sectors have led the recovery?*

Goldberg: The construction industry has shown a dramatic turnaround. This is because construction costs in dollar terms have dropped significantly. Many Argentines were able to send dollars abroad before the collapse of the banking system when the dollar was

I do not foresee a dramatic deterioration in the fiscal accounts.

still linked to the peso one to one. Now one dollar buys three pesos, so those with dollars out of the country have found greater purchasing power in the real estate sector. Construction for new properties has rebounded sharply. We have seen a very important pick-up in construction of second homes, of refurbishing of vacation housing, things like that. The increase in the construction industry has generated an important pick-up in the economy because the sector is very labor intensive.

Inflation Increases Tax Revenues

LALBR: *One of the reasons that Argentina's convertibility plan failed was that the government found ways to spend more than it was earning in tax revenues. Is the government now balancing its books?*

Goldberg: At the public sector level, real wages have contracted significantly. The government has not conceded many increases in public sector wages and pensions. The depreciated real wages at the public sector level have permitted an important part of the fiscal recovery.

LALBR: *So is the government now balancing its fiscal accounts?*

Goldberg: The public sector has inflated away from its fiscal problem. Basically, revenues have increased with inflation. That is, as inflation increased, so have

revenues from consumption and other taxes. Even though revenues have increased, some expenditures have stayed more or less constant in peso terms, which implies an important depreciation in real terms.

LALBR: *As the peso strengthens or export prices fall, the present surplus will decline. Will the government be able to avoid deficit spending?*

Goldberg: I think the government will surprise many with its fiscal policies. I do not foresee a dramatic deterioration in the fiscal accounts, although they might not show the primary surplus that some investors would like.

Inflation in 2005

LALBR: *How high will inflation be in 2004 and 2005?*

Goldberg: We are looking at 7 percent inflation for 2004 and 11 percent for 2005. Probably the government will use inflation as a fiscal tool in order to compensate for potential loss of revenue from lower soy prices in the future. Another factor behind rising inflation will be rising prices for electricity and other public utilities.

M&A Prospects

LALBR: *Do you expect to see a surge in mergers and acquisitions? Prices of assets are low in dollar terms, and the market is expanding. This should be a good time to buy.*

Goldberg: Argentina went through a very important and dramatic restructuring of its corporate sector during the nineties. Many companies were bought by international companies. There may not be a lot of targets left to buy. Moreover, many companies cut fat and increased productivity in the nineties. With the pressure of the Currency Board [the arrangement that was supposed to guarantee the convertibility of the Argentine peso with the U.S. dollar; the Currency Board collapsed in January, 2002], productivity gains and cost cutting activities were prioritized. Going into the current cycle, the structure of its corporate sector will be a strong point for the Argentine economy.

LALBR: *Argentines are again starting to put their money in bank accounts. What is going to be required for the banking sector to return to good health?*

Goldberg: Banks are starting to offer some lines of credit, but there aren't many takers—more demand is necessary. It might take some time until we get a more active credit picture in Argentina but we are seeing some recovery now.

Avoiding a Relapse

LALBR: *How can the government best ensure that the current recovery is going to continue?*

Goldberg: There are several things the government can do. First, it needs to try to create or continue to invest

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in the recovery of the rule of law. Due to the massive collapse of the economy and the breakup of some very important institutions, such as the Currency Board, the regulatory framework has deteriorated. It would be good for the current administration to put a priority on normalizing the regulatory environment. The government would do well to resolve the debt default, to keep its fiscal accounts in order, and to improve social conditions so that the policy is sustainable from a political perspective.

LALBR: *One of the rules that the Argentine government has violated was its promise that companies that purchased utility companies that were being privatized in*

the '90s would enjoy the freedom to raise prices. However, the government has frozen prices on electricity and other utilities since the crisis of January, 2002. Will the government end these price controls?

Goldberg: Clearly, there is a need for a re-thinking of the whole utility situation. Prices have been kept constant in peso terms in some cases, and that means a drop in dollar terms. There will very likely be a readjustment of prices for public utilities which will add to inflation pressure. Argentina needs energy to grow and the private sector needs to be permitted to operate, even while keeping in mind the burdens on consumers due to the economic crisis that is being slowly resolved. There should be important incentives for the private sector to invest in the energy sector as a whole, energy companies should be permitted to make a profit, and the problems of consumers need to be considered. □

BOLIVIA**New Tax on Checks to Go into effect in May**

by Pablo Rojas

On April 1, 2004, Bolivia's President Carlos Mesa promulgated a law that has created a Tax on Financial Transactions. The new law will take effect as of May 1st 2004, and will be valid for two years.

Until the new tax law becomes effective, the government plans to work with representatives of Bolivia's Banking Association. The purpose of said combined work is to design the administrative and technical mechanisms for the collection of the Tax on Financial Transactions.

The Tax on Financial Transactions is part of the government's Economic Plan aimed at reactivating Bolivia's economy and paying the country's fiscal debt. The government projects that the Tax on Financial Transactions will collect almost \$90 million in the first twelve months of its application, and \$70 million during the second year of application.

The Tax on Financial Transactions establishes a tax of (0.3 percent) on financial transactions during its first year of its application, and (0.25 percent) during the second year. The following types of financial transactions are exempt from the new tax law: transfer of funds abroad; movements in saving accounts in (Bs.); saving accounts with less than (\$1000); and credits and debits in time deposits. □

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NAFTA Tribunals Seen as Threat to U.S. Courts

The North American Free Trade Agreement tribunals that hear challenges to U.S. court rulings have been criticized by some legal experts as a threat to the U.S. judicial system, according to recent press reports.

Under Chapter 11 of NAFTA, which received little consideration when the agreement was approved in 1993, companies based in Canada, Mexico or the United States can file claims appealing decisions by another nation's courts and the government of the country whose court system has been challenged successfully must pay damages. "This is the biggest threat to United States judicial independence that no one has heard of and even fewer people understand," according to John D. Echeverria, a Georgetown University law professor.

In 2002 Senator John Kerry (D-MASS), the presumptive Democratic presidential nominee, offered legislation that would have limited the jurisdiction of Chapter 11 panels. The Senate rejected his amendment. About a dozen cases have been filed against the three NAFTA countries, mostly in connection with environmental and other regulations. Although the United States has yet to lose a case, the issue is likely to be raised again in Congress.