

Summary of the Presentation and Discussion
“The Argentine Debt Restructuring Experience: Structural and Legal Challenges”

Organized by:
Columbia University’s
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Commentator: **Joseph Stiglitz**, Professor at Columbia University, Co-Chair of the Committee on Global Thought, Co-Founder and Co-President of the Initiative for Policy Dialogue at Columbia University

Commentator: **Jeremy Pam**, Fellow, Columbia Law School and former practicing sovereign debt restructuring lawyer

Moderator: **Jose Antonio Ocampo**, Professor in the School of International and Public Affairs (SIPA), Fellow of the Committee on Global Thought at Columbia University, and Director of Economic and Political Development concentration at SIPA.

PRESENTATION – Sergio Chodos

The context of the international financial market has changed dramatically in the last twenty years with capital markets having grown sharply due to the development of new instruments. These changes have introduced serious implications for stakeholders involved in sovereign debt transactions. With the appearance of secondary debt markets, the interests and incentives of issuers and holders are no longer aligned. Moreover, the relative size of multilateral

organizations is quite small compared to the total size of the financial market. This new setting calls for alternative rules and arrangements to the usual debt restructuring.

The Argentinian sovereign debt restructuring represents a different paradigm from the one of the market consensus. The 2001 new Argentinian paradigm was centered in promoting an effective payment capacity. Indeed, Argentina created a relationship of creditor-debtor where incentives were rightly aligned. This demonstrated good faith to creditors by linking the repayment capacity to growth. This new paradigm was consistent with the broader objectives of economic growth and stability. It could be argued that this created an unprecedented trend towards sustainable debt. This was evidenced by the fact that in the case of Argentina, the IMF did not play a supporting role.

On the other hand, the market consensus paradigm, usually supported by the IMF, accepts a scenario in which the market is used as the main criteria to set repayment goals, disregarding actual repayment capacity. Under this market paradigm the stakeholders of sovereign debt are reduced to issuers and holders, making the market dealers the major beneficiaries.¹

DISCUSSION

First commentator – Professor Joseph Stiglitz

This issue of Argentina's debt needs to be put in historical context; especially because there are other countries that currently have cases in court regarding their sovereign debt. Most importantly, other countries like Greece could eventually go into default. Under these circumstances, the specific outcome of Argentina's case in the New York's court could have significant consequences at the international level by setting precedent for the creation of debt restructuring mechanisms.

Every civilized country including the United States has a bankruptcy law, but in the international law framework there is no comprehensive law or mechanism for the equivalent of bankruptcy that applies to national governments. After the case of the Argentinian default in 2001, the IMF intended to create a mechanism that would allow countries to follow a procedure for default intended to give them a fresh start in the same way that our domestic bankruptcy laws do with corporations.

This parallel expresses the notion of debt sustainability, where growth is at the core of the arrangement so that the country can be able to repay its debt again. However, the United States firmly opposed this initiative and therefore it did not follow through. Historically, debt

¹Refer to slides for further details

restructuring arrangements have not been sustainable because repayments are set according to optimistic projections of growth that are not necessarily fulfilled. Years later, that country is again incapable of paying its debt.

Currently, there is no international framework to help countries incapable of paying their debt. Certainly, there is no mechanism that exists comparable to the one under the provision of the United States bankruptcy law. Utilizing the concept of sustainable debt restructuring by tying their repayments to actual growth, Argentina aligned the interests of debt holders to the interest of the country.

In order to fully understand the context of the Argentina's case the changes in the markets of debt that occurred after the 1980s must also be considered. Originally, the creditors of sovereign debt were banks and countries were debtors. Despite pressures on the side of creditors, a restructuring agreement could normally be reached. However, with the emergence of secondary debt markets, the holders of sovereign debt are no longer proper stakeholders. The people who have debt do not necessarily have an economic interest in the actual outcome of the country.

With the possibility of buying a credit default swap (CDS), whether the country is able to pay its debt is no longer of interest to the holder (since securities ensure the default by more than a hundred percent). This creates evident perverse incentives in the system. A key example of this is Argentina's US law suit over vulture funds using litigation risk strategies. These funds bet on making a profit out of unpaid debt bought from a previous holder who did not accept a restructuring deal.

Some of the arguments against Argentina include the claim that the country was irresponsible and therefore defaulted. There are also claims about the restructuring being unfair or that Argentina could have done better. In fact, Argentina was the best student of the IMF and maybe that is precisely why default was the ultimate outcome. Also, labeling restructuring as unfair may not be correct since whatever the outcome, Argentina was willing to share the gains with the debtors. Additionally, it must be noted that other cases such as Peru and Ecuador have shown that the traditional way to restructure sovereign debt has not led to growth, recovery and repayment.

Second commentator – Jeremy Pam

The dynamics that characterize the restructuring of sovereign debt are embedded in a longer historic perspective. There is a clear pattern of avoiding restructuring of debt that today looks like a mistake (with multiple references to Latin America's "lost decade").

Although there is a long history of systematically trying to avoid restructuring debt, in retrospect the outcome of debt restructuring looks inevitable. The 1980s in Latin America are a particular example of creditors (Banks) trying to circumvent loss from any type of restructuring. This was repeated in the 1990s with the capital markets financial crises, and then again in the 2000s with a new round of sovereign debt crisis from which Argentina emerges as the most visible case. In the crisis of the 2000's, creditors were not necessarily banks but bond holders which made it more difficult to negotiate restructuring.

Historically the forms of debt and the types and techniques of restructuring have been less important than the imperative of lending to sovereigns. However, in financial crises the restructuring of sovereign debt, if made properly, eliminates debt overhang- improving the macro economic situation and creating a healthy economy that produces growth with which debt can then be repaid.

There is no international standard framework for sovereign debt agreements. Existent clauses (in particular the pari passu clause) are interpreted according to context and situation. This very lack of a standardized set of rules at the international level puts some countries in a vulnerable position where negotiating credit becomes difficult, and contracts confusing.

These dynamics carry institutional implications, the most important being that restructuring of debt under default is necessary. A continuing denial of restructuring has been proven to fail, although it does not mean it will not be tried. There are many ways in which restructuring can be done but there is no way to avoid the political aspects of it. This inherently political process of sovereign debt restructuring entails both national and international politics involving many actors including public officials, citizens and the media. Therefore, it should not place much reliance on formal institutions to solve the conflicts as an absolute solution. There is no silver bullet for debt restructuring.

Q & A Session

Can growth confidently be attributed to the way the restructuring of the debt after the default was made? What has been the role of increasing commodity prices for the last decades?

What are the alternatives for Argentina in terms of confronting the current suit from the vulture funds? What are the available legal strategies?

Apart from the international debtors, what would you say about the holdouts in Argentina?

Argentina has lost access to financing due to the default, how constrained is Argentina right now and is the restructuring helping?

What lessons can be learned from Argentina's debt restructuring in the face of the current suit?

Sergio Chodos

Looking at exports you can see that growth has also been driven by manufacturing. Commodities have not accounted for a hundred percent of the growth in Argentina. If Argentina would have had to be servicing debt, the growth levels would have been much lower.

The strategies available to Argentina right now do not necessarily ignore the international legal framework-- why would we do that? The consequences of the New York court rule are more important for future cases of country default and will have implications beyond just Argentina. Greece and Jamaica have had experiences where traditional debt restructuring has not worked. At some point you need to ask the question: "Who are you really bailing out? Are you bailing out the country or the private debtors?"

Argentina lacks access to finance for different reasons including technical factors related to the behavior of the funds, and CDS with conflicted incentives.

Professor Stiglitz

Growth is partly attributed to the processes of restructuring. There would have been some growth without restructuring but it would not have been robust. In fact, by the time of restructuring, the price of commodities could not have been predicted. In the restructuring process the parties agreed to share the risk of uncertainty and potential gains of growth.

Such as in the case of credit default swaps, when the people holding the debt have no interest in the solution of the problem, negotiation changes fundamentally. We can also look at the US case where household debt has not been restructured. There are many lessons to be learned.

Jeremy Pam

Regarding the many versions of the pari passu clause, I am not sure these represent deliberate strategies by writers of contracts. Maybe some are just accidental and not intended to have a coherent meaning for a particular outcome.