

Guest post: implications of the US Supreme Court ruling on Argentina

By José Antonio Ocampo of Columbia University

The US Supreme Court decision not to review the prior findings of New York courts on Argentina's dispute with non-participants in the 2005 and 2010 debt renegotiations (the so-called holdouts) has major implications for Argentina and for those who did take part in the renegotiations. But beyond that it has a paradoxical effect: it makes the negotiation of an international bankruptcy regime inevitable.

The court decisions have their own legal logic – though it may be argued that courts should show flexibility in the application of the law when unusual circumstances arise, such as the unsustainable situation that forced Argentina to default a decade ago.

Beyond the legal logic, however, the decision makes no economic sense. Risky bonds pay their buyers a premium in relation to the perceived probability of default. Forcing full payment at the original terms of the contract when that contingency has already taken place makes a nonsense of that premium and of the bonds' pricing on secondary markets. Most of the holdouts, after all, bought their bonds at heavily discounted prices because the previous owners saw little chance of being paid.

Default had obvious costs for Argentina in terms of access to capital markets. But it did allow the country to grow at rates of close to 7 per cent a year from 2002. Bondholders in the renegotiation benefited from this because interest payments were linked to the country's growth.

Forcing full payment is highly inequitable for the 93 per cent of bondholders who voluntarily participated in the renegotiations. Furthermore, those original bondholders who sold their bonds at distressed prices had already taken a sizeable loss that the holdouts will now capture as an extraordinary gain. This is why the holdouts are often referred to as "vulture funds". They are engaging in speculative behaviour that has no social benefit.

Blaming Argentina for not having used collective action clauses (CACs) makes little sense, as these were very unusual in New York bonds at the time the debt was issued. They only became widespread from 2003.

In any case, CACs are no panacea, as was shown in the 2012 restructuring of Greek bonds issued in London, when in many cases the majority participation required by the CACs was not reached. Furthermore, when several separate contracts are involved, aggregation is a major problem under CACs, which are still rare (except in Europe for new bond issues) and largely untested.

The most important effect of the US rulings, however, is that they discourage any future voluntary debt renegotiation, for obvious reasons: if investors know they have a chance to claim full payment through the courts, why would they take part in any restructuring?

This is why the International Monetary Fund warned in a document discussed by its board last year that the decision that the Supreme Court now ratified would have systemic implications, in that voluntary renegotiations of debts would become more difficult if not impossible. So, the US Supreme Court has in practice forced the negotiation of an international bankruptcy regime.

This is what the US government wanted to avoid when it sided with Argentina in this case. In 2003, Washington killed off the IMF-led negotiations for a Sovereign Debt Restructuring Mechanism (SDRM) and pushed instead for voluntary market negotiations and CACs. Other governments opposed at the time to the SDRM also sided with Argentina.

Thanks to the Supreme Court's ruling, it is now time to go back to the table to negotiate a mechanism of that sort.

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