Argentina's Debt Imbroglio – Without Tears, Part I

Anna Gelpern explains how Argentina's default in 2001 unleashed riots, political turmoil, and a legal battle among creditors with far-reaching consequences.

Transcript of interview recorded July 30, 2013.

Steve Weisman: About a dozen years ago, Argentina defaulted, and there ensued a debt crisis and a rescue that still have repercussions today because the creditors are battling in court in New York over who gets paid. Anna Gelpern, a nonresident senior fellow at the Peterson Institute who also teaches law at Georgetown is here with me, Steve Weisman, to walk us through the details and the implications.

Anna, first, what happened a dozen years ago? How much money was at stake and what was the original rescue plan?

Anna Gelpern: It was about $80 billion to begin with. At the time, it was the largest sovereign bond default in modern memory and, until Greece, the largest restructuring. The country went through a series of major crises. This was quite comparable to a major depression and it ended up treating its creditors, particularly its foreign creditors, but also its domestic creditors, very harshly.

Argentina took about four years to complete a debt exchange, which is pretty long by the standards of modern bond restructuring. In the spring of 2005, about three quarters of its foreign creditors agreed to take roughly a third of what they had been owed before.

In 2010, another five years later, another almost 20 percent came in. So at the moment Argentina has exchanged about 93 percent of the debt that originally defaulted on for new performing debt. Now that debt did really well, actually, and the creditors did much better than expected thanks to some incentives that were included in the package. But then still we have about 7 percent of the creditors that refuse to take the deal, some of whom are very rigorous and demanding to be paid in full.

Steve Weisman: What do the holdout creditors want? They want 100 percent, not 33 percent, not 70 percent, but 100 percent?

Anna Gelpern: Absolutely, they want what they’re owed and in a world where you don’t have bankruptcy, nobody can force them to take less than they're owed under the contract, which is the basic conundrum of government debt. On the one hand, it is virtually impossible to collect a debt from a government that is determined not to pay you. If I don’t pay my bank, the bank can take my house. If a government doesn't pay a bank, there's very little that a bank can take. Most sovereign property is immune from seizure.

On the other hand, if I'm down and out, I can file for bankruptcy and then my creditors can no longer sue me. That's not the case with sovereign governments. A determined creditor can continue to chase a recalcitrant government around the world for decades. This is sort of one of those permanent, *Road Runner, Tom and Jerry* races that never ends.

Steve Weisman: We'll get to the legal technicalities in a second, but these creditors have succeeded up to a point in making their case in New York courts. But that has upset some people including the U.S. government. Why?

Anna Gelpern: It's an interesting situation. On the one hand, the creditors have succeeded in getting some favorable rulings. On the other hand, they really haven't collected on their debts. But the rulings that they got within the past year, if in fact they stand, would allow creditors, not so much to grab sovereign property, but to interrupt payment flows. Interrupt payments made by, in this case, Argentina on its performing restructured debt. So the orders say, "Argentina, if you are going to pay the folks who agreed to take $0.33 on the dollar, you must also at the same time like before, pay the folks who did not agreed to any such thing and are still owed a hundred cents on the dollar. And you must pay each of them what their contracts specify, which is $0.33 in once case and a hundred cents in the other.

Steve Weisman: That seems unfair. But let's talk less about the fairness than about the implications on the world scene. There have been debt restructurings or exchanges or haircuts or whatever, in Greece and maybe other places in the future. The U.S. government seems to be concerned that if the holdout creditors get rewarded for holding out, it will be harder to carry out restructurings with other countries.

Anna Gelpern: Precisely. The interesting part is that the United States intervened twice in the Court of Appeals, and France has now intervened. By all accounts the IMF [International Monetary Fund] wanted to intervene. And their interventions were not driven so much or even primarily by the inherent unfairness of this, or the apparent unfairness of this outcome, nor by particular concern about Argentina.

Rather the concern is that the next time a country tries to restructure its bonds when its debt is unsustainable, it's not a question of unwillingness to pay. Creditors who might otherwise have agreed to a reduced payment would be worried about having this reduced payment intercepted by the holdouts, right? [They] are going to wait for the deal to be done and then sue just like Argentina's holdouts did in order to intercept to block payments on the new debt.

Creditors wondering whether they should participate in a restructuring [will] ask themselves, "Do I really want to take $0.33 or should I hold out for $ 0.40?" This time, the creditor says, "Oh my, I'll agree the $0.33 and then I won't even get that."

And that's what's driving the concern by the official sector –that restructurings in the future will be gummed up with these worries.

Steve Weisman. Anna, let's stop there and in Part II, we'll pursue some of the details and some more implications.

Anna Gelpern: Thanks so much.