



The US Supreme Court Upend the World of Sovereign Debt

Anna Gelpern explains the impact of a Supreme Court decision rejecting Argentina's argument that it should be allowed to pay its restructured debt without paying the holdout creditors who refused to participate in its debt restructurings over the past decade.

Transcript of interview recorded June 17, 2014. © Peterson Institute for International Economics.

Steven Weisman: Argentina has been battling with its creditors for the better part of the decade after it defaulted in 2001 around Christmas time. The United States Supreme Court, however, dealt Argentina a blow in its efforts to get hold-out creditors to accept less than the full value of the debt they were owed. Anna Gelpern, nonresident senior fellow at the Peterson Institute, is the world's leading expert on this extremely complicated problem. I'm Steve Weisman. Anna, what did the Supreme Court do?

Anna Gelpern: On Monday, we got two decisions from the Supreme Court. One was a one-line announcement refusing to review decisions by the lower Federal Courts in New York, which ordered Argentina to pay the creditors who refused to participate in their debt restructuring whenever they paid creditors that did participate.

There was another decision on Monday. That one was a full-blown opinion that followed a hearing in April, but ironically perhaps, that one is somewhat less important. It essentially ruled that creditors were entitled to discovery on Argentina's assets worldwide. For example, if the creditors would ask Bank of America in New York to tell them about any and all accounts Argentina had around the world, including perhaps ones that were associated with diplomatic military properties, they could do that even though the property itself could not be attached to satisfy a judgment.

Steven Weisman: Argentina has labeled these hold-out creditors as vultures. They weren't necessarily the original holders of the debt, they bought the debt. They are trying to now make money off of it. Are they going to get repaid or does Argentina have any other recourse?

Anna Gelpern: This is a wonderful question. In some ways, it's two separate questions. Whether or not Argentina has any other recourse is an independent question from whether the hold-outs would ever get paid, because even though the Supreme Court, the Federal Court of Appeals for the Second Circuit and the District Court in the Southern District of New York, they all said that Argentina must pay, no ifs, ands, or buts.

Argentina is a sovereign state. You can't make it pay, right? So the question really is how much Argentina might be able to avoid the court decisions. It may not have any more judicial recourse or it may have a sliver of procedural possibilities here and there but really not much. But still, Argentina could simply refuse to pay, and ultimately the creditors could not go to Argentina and take the customs houses or take the tax revenues or seize Argentina's stuff. They try on occasion but usually they fail.

The interesting thing about this first Supreme Court decision, the one-liner that refused to review the lower court's rulings, was that it doesn't ultimately target Argentina. The import of that first decision is that it simply orders Argentina not to pay anyone unless it pays ev-

everyone and it threatens anyone who might help Argentina pay some creditors but not others with sanctions imposed by the Federal Court in New York.

At this point, the target of the court's remedy is not really Argentina but anyone who might help Argentina. And the goal is to isolate Argentina and make it really difficult for Argentina to have any financial dealings outside its borders, which is the one and only thing you can ultimately do to a sovereign. You can't seize their stuff but you can boycott them and this is what the ultimate significance of this first decision is.

Steven Weisman: But everyone has been more or less boycotting them ever since they defaulted, no? We now know that Argentina has a bad habit of repudiating its debts or defaulting, so effectively nobody wants to lend it money anyway.

Anna Gelpern: There is some of that, but it's actually a pretty active and unsettled debate in theory and in policy about how much the markets really do punish countries that default on their debts. It is true that Argentina has not been able to borrow on the international capital markets. It has not been able to raise new money for a good long time. However, it has been able to issue debt under domestic law and foreign investors have invested in that debt. And more importantly, Argentina has an enormous stock of restructured debt as a result of several restructuring operations—the first of which was in 2005 and then another one in 2010—where it restructured 93 percent of the debt in which it defaulted in 2001.

So those new restructured bonds have been serviced; Argentina has been paying them on schedule and wants to continue paying them on schedule. The New York decision prohibits it from paying them unless it also pays the hold-outs.

Steven Weisman: That decision is the one that was upheld?

Anna Gelpern: Exactly. Argentina hasn't been a total pariah. Argentina has certainly had a rather cordial relationship with the people who hold its performing debt, which has been trading. It certainly fell in this last decision but it's been doing just fine and people have been investing in Argentina. Right now, it is going to get much harder for those creditors that had maintained a relationship with Argentina and who were paid by Argentina to continue getting paid; it would take a lot of maneuvering.

Steven Weisman: One fear in the community of experts on international debt is that this decision will now jeopardize future debt restructurings and indeed encourage people to hold out for countries in trouble. What do you make of those implications?

Anna Gelpern: There are two camps of opinions on this Argentina saga. Some people say, "Look, this is all about one extreme, very badly behaved debtor, Argentina, perhaps also one extreme very determined creditor, NML Capital and whatever happens with them does not apply to anyone else." I do not subscribe to that view. I think that—despite a lot of language about Argentina's bad behavior—nothing in the opinions limits their implications to the particulars of the Argentina case.

We know what a problem country looks like. We don't know what a no problem country looks like. We do not know what it would take for a country to avoid Argentina's fate. For example, right now, there's litigation against Grenada which has very different debt contracts from Argentina, which certainly doesn't have the same prolonged history of default and battling with

holdout creditors that Argentina has. And yet the very same claims were raised against Grenada as had been raised against Argentina and the case hasn't been resolved.

What we know now is that creditors have the capacity to ask a court after a restructuring to block payments on the new restructured debt. If you are a creditor contemplating going into a restructuring, you have to now factor in the possibility that any new discounted payments to which you agree would be stopped on behalf of the holdouts. So your incentive to participate is diminished.

Steven Weisman: As a public policy matter, does this decision deal a blow not just to Argentina, but to the ability of authorities to stabilize credit crises in the future?

Anna Gelpern: Absolutely, right. It makes restructuring harder. It takes the existing system for restructuring sovereign debt—which rested on the idea that you couldn't block these flows. You couldn't ultimately go after the debtor. The debtor could credibly tell creditors if you don't participate, you may not be paid, right? That is no longer the baseline. What the baseline is we don't know. Our current state is uncertainty. Therefore, countries that borrow in the capital markets as well as institutions like the IMF, creditor countries who lend money to other countries and restructure them in the Paris Club, they now have to think about, "How will the next crisis go? What are the incentives for creditors to participate? How many will go in? Are we going to be stuck with a protracted crisis?" especially considering that recently, crises have been resolved pretty quickly under the old system. We don't know what's going to happen going forward.

Steven Weisman: Thank you very much, Anna.

Anna Gelpern: It's a pleasure.

