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After Argentina: Government Debt Crises, Global Finance and the Law

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The question I have been asked to address is whether the debt crisis in Argentina back in 2001-02, and the fallout from the crisis more than a dozen years later, has or has not changed the world of sovereign debt and cross-border finance.

My answer to the question posed is a resounding "No." In my opinion, neither Argentina's financial crises nor the country's checkered history of litigation and arbitration outcomes have managed to change, or are likely to change, the world of sovereign debt and cross-border finance.

News about what goes on inside Argentina does not impact bond markets outside Argentina, and I haven't heard from my friends and contacts in the investment community that they have lost sleep over how the *pari passu*, aggregation or other clauses read in the indentures of the many bonds that they own. If anything, the Argentina litigation saga has persuaded them that New York law and the U.S. courts – and only them – can be trusted to deliver prompt and fair outcomes. This explains why, when investors got nervous about Puerto Rico bonds earlier this year, in the wake of their being downgraded to junk, they insisted that all new issuance out of the island be done subject to New York, and no longer Puerto Rico, law. And the Commonwealth has since obliged.

It is true that we have learned a thing or two about the enforceable rights of creditors when dealing with a sovereign, and also about how much a deadbeat sovereign can get away with before being ostracized by the community of nations. For example, for a dozen years and until a few months ago, Argentina had not paid one cent of principal or interest owed to the U.S. Ex-Im Bank and its equivalents elsewhere around the

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world. While that disqualified Argentina from getting new export credits or foreign aid, it did not lead our government or other governments to treat Argentina as a pariah. They have remained a member of the G-20 in good standing, for example, and as we speak the Argentine delegation is on its way to Australia for this weekend's summit.

And for the past 7 years, Argentina has not complied with its obligations to the IMF under Articles IV and VIII, yet it has barely been slapped on the wrist, so that is also thought-provoking. And most notoriously, for the past many years, Argentina has refused to pay on arbitral awards and court judgments against it, in blatant violation of its treaty and other supposedly binding legal commitments.

But these things that we have learned have not changed the world of sovereign debt and cross-border finance. Just like a supermarket regards pilferage as a normal cost of doing business as long as it remains under control, so the investor community, and evidently also the official community, have been willing to tolerate a rogue sovereign debtor in their midst as long as its behavior does not prove contagious.

The rest is not news. A quarter-century ago we already knew that if governments adopt overly loose fiscal and monetary policies, and scare away domestic and foreign investors by disrespecting property rights and the rule of law, they will generate high inflation, currency weakness, economic stagnation, social polarization, and political instability. In Argentina, it's a lamentable case of déjà vu all over again, because they have had several prior bouts of reckless populism.

A quarter-century ago we already knew that lawyers will pretend that indentures intended for corporate obligors can usefully be copied and pasted for use by sovereign debtors. We also recognized that lenders and investors are reassured by thick prospectuses that list their many rights as well as their debtor's many obligations. We had learned that despite the formal surrender of sovereign immunity in standard contracts written under New York, English or other law, and regardless of the ratification of international treaties, sovereigns are NOT like the rest of us: They can always exercise their sovereign right to do whatever they want. They can always repatriate their attachable assets, walk away from their obligations, and go into financial hibernation, until either new political leadership emerges at home or else a new generation of investor-fools comes of age abroad.

A quarter-century ago we already knew how to restructure sovereign debt in the fastest and least traumatic way. The government in financial difficulties must make a prompt and good-faith effort to reach a collaborative agreement with its creditors. It should seek debt relief appropriate to the nature of its liquidity or solvency problem; treat all private creditors in a comparable manner; recognize interest arrears, and treat them preferentially vs. past-due principal; seek the financial support and endorsement of the official community; make a good-will, up-front cash payment, especially when the government has the cash; and, last but not least, always aim for 100% creditor participation.

Argentina threw away this well-known playbook and decided to get really tough with its creditors – something that has proven so damaging, in so many ways, that nobody else has wanted to follow in its footsteps. Rather, virtually every other sovereign in trouble has behaved according to the well-worn playbook.

A quarter-century ago we already knew that in every sovereign debt restructuring there would be holdouts. That is why sovereign debtors tried very hard to minimize them, by adopting confidence-building economic policies and reforms that offered the prospect of strong upside to creditors who accepted up-front losses as part of a justifiable debt restructuring. And what was done about the few holdouts that remained? Their claims would be bought out by the large creditors, or anonymously by the sovereign acting through a financial intermediary, or else their claims would be honored as per their original contract. In short, holdouts have always been around, and they have always been bought out.

That's harder to do when you have a lot of holdouts, of course: in Argentina's case, about half of foreign bondholders turned down the government's punishing offer of early 2005 – including over 200,000 retail and institutional investors – thereby guaranteeing an unprecedented holdout problem. The situation was aggravated by two other bad decisions made by Argentina: to include in the restructuring indenture a clause guaranteeing participating creditors that they would get, at least for a decade, whatever better offer any holdouts would ever get; and also by Argentina enacting a law that prohibited any government from dealings with its holdout creditors.

By now you are probably realizing why the world of sovereign debt and cross-border finance has been mostly oblivious to Argentina's egregious behavior. The overwhelming majority of issuers and investors feel that the case is unique and won't be repeated. And so far, so good. To be sure, governments don't like the thought of them ever becoming hostage to creditor minorities, though it is mostly within their power to prevent that. Many creditors, meanwhile, agree that it would be good for questionable contract clauses to be written in a way such that they mean what they say, and also for restructurings to be approved by super-majorities and not by unanimity, as was the custom until a decade ago.

Therefore, there is a movement afoot to clarify the infamous *pari passu* clause, and also to enhance collective-action clauses, in order to facilitate meaningful changes to contracts without having to hold votes on a bond-issue by bond-issue basis. But life goes on, and deals are getting done day in and day out, regardless of whether contract language is improved or not, because the case of Argentina and its holdout investors is regarded – and rightly so – as an aberration.