

Argentina threw its creditors under the bus

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By Arturo C. Porzecanski

Carlos Mauleon, the former Barclays Capital investment banker who handled Argentina's 2005 debt restructuring, recently wrote a guest post on *beyondbrics* justifying that infamous transaction: "Whatever you may think of Argentina, ... the one good decision its leaders made was to aggressively restructure [the public] debt back in 2005" because "the question is, did [Argentina] have a better choice? Not really."

But it did. Here's why.

After discussing the case of Greece in 2011-12 and its supposed relevance to Argentina's situation in 2005, Mr Mauleon concluded with a plea that while "the rhetoric and economic policies of the Argentine government post restructuring muddle the justification of their approach and provide ample ammunition for the holdouts, the courts as well as public opinion to throw the country under the bus," we should refrain from doing that, at least in our minds.

However, it was Argentina that threw its creditors under the proverbial bus a dozen years ago – and needlessly so.

To recall, President Eduardo Duhalde stopped debt-service payments to bondholders and official bilateral creditors in January 2002, and in the sixteen months that he was in office, he never reached out to his local and international investors to explain himself – never mind to work out collaboratively on a solution to cure the default. By the time he stepped down at the end of May 2003, and his elected successor Néstor Kirchner took the reins of power, next-door Uruguay had already successfully refinanced its public debt in a creditor-friendly manner without ever missing a single payment – and despite having had to face fiscal, currency, banking, and economic shocks fully comparable to those in Argentina.

Second, President Kirchner took another twenty months until he finally presented bondholders with a punishing, take-it-or-leave-it debt exchange offer – a delay of three years since January 2002 intended to encourage creditor capitulation to whatever proposal Argentina would finally put on the table. His economy minister at the time, Roberto Lavagna, went so far as to announce that the government would regard any investor participation rate above fifty percent as having effectively cured the country's default. The clear implication was that even if nearly half of all bondholders failed to accept the terms of the ruinous debt exchange, they would be ignored and go unpaid. To ensure that the message was heard loud and clear, the government passed a law forbidding the reopening of the debt exchange in the future – the so-called “Lock Law” which has been cited by the courts as evidence of the country's ill will.

Third, Argentina's economy was sufficiently recovered by early 2005, largely thanks to a commodity export boom, such that the government only needed a modest amount of debt-service relief from its creditors. For example, the country's official international reserves had doubled from early 2003 to early 2005, from under \$10bn to over \$20bn, and so had government tax revenues measured in dollars between 2002 and 2004. And yet, the authorities pleaded on-going and future poverty by referencing a proprietary debt-sustainability model which failed to reflect the strong economic rebound underway, incorporated excessively pessimistic forecasts, and was never validated – never mind endorsed – by the IMF, as was customary in prior sovereign debt restructurings. During 2006-12, the economy ended up growing twice as fast as the government's estimates as of late 2004, with actual export earnings and tax revenues outperforming official gloomy forecasts by even wider multiples.

The good news about Argentina's economic and fiscal recovery of 2003-04 began to circulate around the international investor community, and thus the credibility of the government's plea to be treated as if the country was still in the midst of an economic emergency started to erode. The improvement in Argentina's capacity to pay was already so evident by early 2005, when the government put its demand for massive debt forgiveness on the table, such that one-fourth of the bondholder universe (by par value of claims) refused to enter into the debt exchange. The holdout component would surely have been larger still if the authorities had not intimidated the investor base as aggressively as they did, encouraging large-scale creditor capitulation.

Therefore, it should be crystal clear that Argentina and its financial advisors *did* have much better choices: they should have put forth a more reasonable and credible proposal based on consultations or negotiations along the lines of the Uruguay refinancing; better yet, they should have done so much earlier (say, in 2002) to restore their reputation and thus their access to the world's financial markets.

By early 2005, the government had the financial wherewithal to put forth a debt exchange that would have been viewed as realistic and thus fair, because it captured the strong economic recovery and the favourable winds that were blowing in Argentina's direction at the time. Such a

proposal could have gathered the usual degree of support (around 95 per cent, as per many other sovereign debt restructurings), minimizing any holdout problems. However, for domestic political reasons, the authorities chose to default and then exhibited protracted unwillingness to pay, choosing a confrontational path which has haunted Argentina and its creditors to this day.

It has set such a bad example that no other nation has dared to follow it since.

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