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At Debt's Door: What Can We Learn from Argentina's Recent Debt Crisis and Restructuring?

Alan Cibils & Rubén Lo Vuolo[1]

Argentina's spectacular December 2001 economic crash and default were the culmination of a debt-led development process that began in the late 1970s. Much has been written about the crisis and its causes, and many interpretations have been put forth as to why it occurred. Despite overwhelming empirical evidence to the contrary, the International Monetary Fund (IMF) and the financial establishment still claim that the root cause of Argentina's crisis was the public sector's inability to reduce its deficit.[2] Other explanations have included the more esoteric "debt intolerance" concept, or that the default itself was the cause of Argentina's 2002 economic collapse.[3]

This paper argues that none of these explanations hold up under scrutiny. Rather, the December 2001 default and economic crisis were the logical outcome of a massive debt accumulation process which resulted from two main factors. First, the negative effects of policy prescriptions by the international financial institutions (IFIs), particularly the IMF and the World Bank (WB), enthusiastically implemented by Argentine officials. In other words, US-trained Argentine officials and IFI staff acted like a team in which there was a high degree of agreement on the economic policies to be implemented. Second, a series of exogenous shocks which ranged from US interest rate hikes to financial crises in Asia, Russia, and, finally, Brazil. These shocks led to spiraling costs of public sector borrowing and to massive capital flight as the system unraveled.

The combination of inconsistent macroeconomic policies and exogenous shocks led to an economic collapse of historical proportions in December

2001.[4] While the Argentine fixed exchange rate regime had managed to survive the Mexican and Asian financial crises, the Brazilian crisis proved too much for an economy straining under the effects of an overvalued currency. A recession set in during the last quarter of 1998 and that recession was to become a depression. By the end of the depression in the second quarter of 2002, Argentina had lost almost 20 percent of its GDP.[5]

Under these conditions, and as a result of the exponential growth of Argentina's public debt, this paper argues that sovereign default was not only a logical consequence, it was also a necessity. Given the three-year-long economic recession, economic reactivation would have been uncertain, and perhaps impossible, in the absence of such a default. Also fundamental to economic recovery was the abandonment of the fixed exchange rate regime; the result allowed for a more realistic set of relative prices.[6]

Section I of this paper will provide a description of the main reasons behind Argentina's debt accumulation for the 1990–2001 period. Section II will evaluate the central role played by the IMF both before and after the 2001–2002 crisis. Section III will briefly discuss issues surrounding the actual costs of Argentina's sovereign default. Section IV will address the main issues surrounding Argentina's debt-restructuring process. This paper will then conclude with a list of lessons that can be drawn from Argentina's experience with debt, default, and the IMF.

I. THE 1990S: ORTHODOX REFORMS AND EXPLOSIVE GROWTH OF PUBLIC DEBT IN ARGENTINA

The origins of Argentina's debt troubles can be traced back to the 1976 military dictatorship. When the military took power, Argentina's public debt totaled approximately $8 billion.[7] By the time the military left seven years later, the public debt had more than quintupled to $45 billion.[8] However, the latest chapter in Argentina's debt-accumulation saga began in 1989, when Carlos Menem was elected president in the midst of substantial social unrest and economic instability brought on by very high inflation

rates. Menem had campaigned on a traditional populist discourse, promising higher wages and a "productive revolution." Campaign discourse notwithstanding, as soon as Menem took office it became clear that his policies would be diametrically opposed to those he had promised just weeks earlier. During 1989 and 1990, two different economy ministers made unsuccessful attempts to reduce high inflation and economic turbulence.[9] These attempts included a series of orthodox fiscal and monetary policy measures, such as a freely floating exchange rate, a radical reduction of fiscal spending, and the first privatization of state enterprises. Additionally, debt-service payments on Argentina's public debt, which had been in a virtual state of default since 1988, were resumed.[10]

Partly as a result of these policies, there was another hyperinflationary episode toward the end of 1990.[11] Consequently, in early 1991 Menem appointed Domingo Cavallo, a Harvard-trained economist, as economy minister. Cavallo promptly implemented a radical, Washington Consensus[12] (WC)-inspired stabilization and economic restructuring program known as the Convertibility Plan. The main components of this plan were the following: (1) trade liberalization; (2) financial and capital account liberalization, including equal treatment for foreign and domestic capital; (3) privatization of all state-owned enterprises; (4) prohibition against printing money unless backed by dollars in the Central Bank's reserves; and (5) pegging of the peso to the dollar by law, on a one-to-one exchange rate.

The Convertibility Plan's primary stated objective was to reign in inflation and to provide a strong anchor for expectation formation.[13] However, the plan's unstated objectives went much further. Over the next decade the plan would produce a profound transformation on the Argentine economy and society that would definitively dismantle what was left of the Import Substitution Industrialization (ISI) era Welfare State. In other words, state enterprises, utilities, and social security were all to be

privatized, state intervention in the economy was to be drastically reduced, and health and education were to be decentralized.

The success of the Convertibility Plan hinged upon attracting foreign capital inflows. The hope was that foreign capital flows would set off a "virtuous cycle" of economic growth and general welfare improvements for the population (through "trickle down" effects), which would then lead to further investment flows and so on.[14] Solving the public debt problem was seen as key to attracting foreign capital.[15] Therefore, a "once-and-for-all solution" to the debt problem was devised. Official faith in this strategy was such that Minister Cavallo stated in 1993 that "the public debt will be insignificant by the end of the century."[16]

The "once-and-for-all solution" consisted of two main parts. The first component of the solution to the debt problem consisted of allowing privatization of state enterprises to be purchased partly with Argentine public debt bonds.[17] This was the case for the national telephone company, *Entel*, and the national airline, *Aerolíneas Argentinas*.[18] This operation greatly favored holders of Argentine debt, since they were given full credit for bonds that were trading at 15–20 percent of their nominal value on the open market.[19]

The second component of the solution to Argentina's debt problem came with the Brady Agreement, signed in December of 1992. According to this agreement, Argentina would swap its $21 billion debt to commercial banks, plus $8.3 billion in late payments, for 30-year Brady bonds with lower interest rates and an average capital reduction of 35 percent.[20] The main result of this swap, illustrated in Table 1 below, was the atomization of Argentina's creditors from a few Northern commercial banks to hundreds of thousands or millions of bondholders around the world.

How permanent was this solution to Argentina's debt problem? The data in Table 1 shows that Argentina's public debt continued to grow at an alarming rate throughout the 1990s, reaching explosive levels toward the end of the decade when the much publicized default occurred.[21] Perhaps

the main result of the Brady bond swap was that Argentina was able to regain access to financial markets.[22] Renewed access to these markets enabled the debt accumulation process that eventually resulted in the largest sovereign default in history.

What were the reasons behind this explosive debt accumulation? Perhaps the most widespread explanation given for Argentina's December 2001 debt crisis is that the country was unable to reign in its runaway fiscal spending and therefore needed to borrow increasingly large sums to both finance its deficit (since, by law, Argentina was unable to finance itself by printing money) and to service its rapidly accumulating debt. For example, according to Anoop Singh, the IMF's former Western Hemisphere Director, "failures in fiscal policy constitute the root cause of the . . . crisis."[23] This view continues to be voiced by high ranking IMF officials and is mentioned repeatedly in the IMF's Independent Evaluation Office report on the IMF's role in the Argentine crisis.[24] Many orthodox economists, in Argentina and abroad, and much of the business media support this view as well.

When examined against actual data, however, the contention that Argentina's spiraling debt was caused by runaway fiscal spending or debt intolerance becomes untenable. Based on available data, three main causes emerge for Argentina's 1990s debt buildup. First was the growth in debt service due to external shocks. Second was the privatization of social security. Third was the growth of private sector demand for foreign

Table 1: Evolution of Argentina's Public Debt Stock (1990-2001) (in millions of period-end dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Bonds	8,406	7,378	11,292	41,926	47,421	58,341	68,841	74,054	78,212	85,804	93,079	97,315
as % of Total Debt	14.6%	12.5%	19.2%	65.8%	65.7%	66.5%	70.9%	73.2%	69.6%	70.4%	72.7%	67.4%
IFIs	8,222	7,962	7,104	10,501	11,894	15,384	16,367	16,790	19,122	20,311	21,764	32,362
as % of Total Debt	14.3%	13.5%	12.1%	16.5%	16.5%	17.5%	16.9%	16.6%	17.0%	16.7%	17.0%	22.4%
Bilateral Debt	8,159	8,816	9,001	9,559	10,731	11,614	10,162	8,104	7,455	5,918	4,561	4,477
as % of Total Debt	14.2%	15.0%	15.3%	15.0%	14.9%	13.2%	10.5%	8.0%	6.6%	4.9%	3.6%	3.1%
Commercial Banks	30,944	32,874	30,265	1,180	1,567	1,816	1,452	1,423	3,646	5,029	2,461	2,015
as % of Total Debt	53.7%	55.9%	51.5%	1.9%	2.2%	2.1%	1.5%	1.4%	3.2%	4.1%	1.9%	1.4%
Short-Term Debt	0	0	0	0	0	0	0	0	3,295	4,174	5,108	6,746
Other Creditors	1,851	1,811	1,083	508	587	617	283	731	628	641	1,045	1,537
Total	57,582	58,841	58,745	63,674	72,200	87,772	97,105	101,102	112,358	121,877	128,018	144,452

Source: Kulfas and Schorr (2003)

exchange, created by the very nature of the previously discussed economic restructuring program known as the Convertibility Plan.

A. Growth in Debt Service Due to External Shocks

It is difficult to find evidence that the government's fiscal policy played a significant role in bringing about the December 2001 debt crisis. Table 2, seen below, shows the central government's revenue, spending, interest payments, and primary and overall budget deficit or surplus from 1993–2001. Although the government budget does move from a surplus of 2.7 billion pesos in 1993 (1.2 percent of GDP) to a peak deficit of 8.7 billion pesos by 2001 (3.2 percent of GDP), this worsening of the fiscal balance is not a result of increases in government spending.

Rather, the worsening of the fiscal balance can be explained by the country being hit with a series of exogenous interest-rate shocks that caused a debt spiral and, eventually, a default.[25] The shocks that hit Argentina can be seen from the data on the government's primary balance[26] in Table 2, below. The primary balance moves from a surplus of 5.6 billion pesos (2.4 percent of GDP) in 1993 to a surplus of 1.5 billion (0.5 percent of GDP) in 2001. But this worsening of the primary balance was not a result of government decisions to increase spending. Primary spending was 19.1 percent of GDP in 1993, and 18.6 percent for 2001. Rather, Argentina became stuck in a debt spiral in which higher interest rates increased the debt and the country's risk premium. Argentina's unrestricted capital mobility and currency board system—a deadly combination—made it impossible for the country to withstand the external shocks. A recession that would become a depression began in late 1998, substantially eroding economic activity and fiscal revenues. The government's response, following IMF prescriptions, was to implement increasingly orthodox economic policies, which only deepened the recession. This combination

Table 2: National Government Spending and Revenue (1993-2001) (in millions of current pesos)

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Revenue	50,726.5	51,078.2	50,293.6	47,668.9	55,376.7	56,726.1	58,455.4	56,570.5	51,318.6
Total Spending	47,996.0	51,365.3	51,666.9	52,933.3	59,653.3	60,799.6	63,223.8	63,362.1	60,037.9
as % of GDP	20.3%	20.0%	20.1%	19.5%	20.4%	20.3%	22.3%	22.3%	22.3%
Interest Payments	2,914.0	3,150.3	4,083.5	4,607.9	5,745.0	6,660.3	8,223.6	9,656.0	10,174.6
as % of GDP	1.2%	1.2%	1.6%	1.7%	2.0%	2.2%	2.9%	3.4%	3.8%
Deficit or Surplus	2,730.5	-285.9	-1,373.3	-5,264.4	-4,276.6	-4,073.5	-4,768.4	-6,791.6	-8,719.3
as % of GDP	1.2%	-0.1%	-0.5%	-1.9%	-1.5%	-1.4%	-1.7%	-2.4%	-3.3%
Primary Spending	45,082.0	48,214.0	47,583.4	48,325.4	53,908.3	54,139.3	55,000.2	53,706.1	49,863.3
as % of GDP	19.1%	18.7%	18.4%	17.8%	18.4%	18.1%	19.4%	18.9%	18.6%
Primary Surplus or Deficit	5,644.5	2,864.2	2,710.2	-656.5	1,468.4	2,585.8	3,455.2	2,864.4	1,455.3
as % of GDP	2.4%	1.1%	1.1%	-0.2%	0.5%	0.9%	1.2%	1.0%	0.5%

Source: Economic Information, Ministry of Economy, Argentina

of policies and events led to ever-higher interest rates and debt-service payments until default became all but inevitable in December of 2001.

Some economists have argued that the economy could have adjusted to and recovered from the external shocks, if only wages had fallen enough:

> If Argentina had a more flexible economic system, especially in its labor markets, its economy would have been more able to adapt to the rigors of the Convertibility Plan; unemployment would have been lower; growth would have been stronger; fiscal deficits would have been smaller; and interest rates would have been lower because creditors would have had more confidence in the capacity of the Argentine government to service its obligations.[27]

Any macroeconomic policy regime that requires such a fall in nominal wages is, as a practical matter, untenable. Theoretical and political issues aside, suggesting a drop in wages as the solution to the Argentine recession shows a profound lack of knowledge of the workings of the Argentine labor market. Regardless of what the labor legislation says, in reality, virtually half of all employment is informal, with no benefits and substantially lower wages than the formal sector.[28] In other words, the Argentine labor market has had a high degree of flexibility for almost a decade, rendering the argument of lower wages irrelevant.

Considering the array of problematic policies already in place, it is also difficult to imagine any fiscal policy—assuming it were even politically possible to cut enormous amounts of government spending—that could have avoided the December 2001 crisis. The overvalued currency, the size and growth of Argentina's debt (mostly denominated in foreign currency) relative to export earnings, and the free mobility of capital all contributed to the inevitable crisis that materialized in 2001.

B. Privatization of Social Security

Another main cause for Argentina's 1990s debt buildup is the Argentine government's decision in 1994 to privatize the public pay-as-you-go social

security system that had been in existence since 1967.[29] This decision was strongly promoted and supported by the World Bank and the IMF and had a major impact on Argentina's fiscal accounts.[30] As Table 3 shows, the lost revenue, plus accumulated interest costs, amounted to nearly the entire government budget deficit in 2001.[31]

Table 3: The Fiscal Impact of Social Security Privatization (percent of GDP)

	1994	1995	1996	1997	1998	1999	2000	2001
Lost Soc. Sec. Rev	-0.5%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%
Interest Rate	10%	10%	10%	10%	14%	14%	20%	20%
Interest Costs	-0.01%	-0.10%	-0.20%	-0.30%	-0.60%	-0.86%	-1.59%	-2.16%
Additional Deficit	-0.51%	-1.10%	-1.20%	-1.30%	-1.59%	-1.86%	-2.59%	-3.16%
Cumulative Debt	-0.51%	-1.62%	-2.72%	-3.83%	-5.35%	-7.50%	-10.05%	-13.49%

Source: Baker and Weisbrot

The reason social security privatization had such a substantial impact on government accounts is really quite simple and should have been easily predicted. The government lost most of the social security contribution revenues, which, following privatization, were funneled to the private pension funds. However, the government's expenditures on social security remained the same, as all of the retirees on the pay-as-you-go system continued to collect their pensions from the government. In this way, a substantial gap was created which, according to the data in Table 3, amounted to 1 percent of GDP each year between 1995 and 2001.

Due to restrictions on deficit financing imposed by the Convertibility Plan, the government's options were to either increase revenues, radically lower expenditures, or borrow to cover the gap. The government resorted mainly to borrowing, which contributed to the debt spiral.[32] This increased

borrowing, coupled with the external shocks described earlier, produced an explosive debt accumulation process that collapsed in December 2001.[33]

C. The Balance of Payments: Demand for Foreign Exchange

A third cause for Argentina's debt buildup can be found in the very nature of the convertibility regime itself, which created a growing demand for foreign exchange from both the public and private sectors. The public sector demand for foreign exchange was based on two needs: (1) the need to keep Central Bank reserves equivalent to pesos in circulation (as per the Convertibility Law), and (2) the need to make debt-service payments that were primarily in foreign exchange.[34] Private sector demand for foreign exchange resulted from a need to finance imports, which, given the overvalued peso, resulted in a growing trade imbalance. This was only reversed during the recessionary periods.[35] The private sector also showed a growing preference for the dollar over the peso, as witnessed by increasing dollar-denominated bank deposits and the dollarization of many economic transactions.[36]

As a result, throughout the 1990s, both the private and public sector had negative current account balances. The only way to ensure a current account surplus was through sustained capital account surpluses. While foreign direct investment partially satisfied this need, overall it proved insufficient to meet the demand for foreign exchange.[37] As a result, the foreign exchange gap was covered with both public and private debt.

Starting in the mid 1990s, increasing capital flight worsened this situation, resulting in a growing private current account deficit, as shown in Table 4. According to several authors,[38] the private foreign exchange deficit was covered with public sector reserve accumulation, due primarily to new debt issues. As a result, private behavior (particularly that of large business conglomerates) worked against the survival of the convertibility

Table 4: Disaggregated Balance of Payments Data (1992—2001)
(annual averages in millions of dollars)

	1992-94	1995-99	2000-01	Total '92-'01
CURRENT ACCOUNT	-8.908	-10.654	-6.854	-9.370
Private Sector	-6.650	-6.818	-1.448	-5.694
Trade Balance	-2.633	-380	5.033	27
Financial Services	-913	-2.515	-2.411	-2.013
Real and Other Services	-3.104	-3.924	-4.070	-3.707
Public Sector	-2.258	-3.836	-5.406	-3.677
Financial Services	-2.141	-3.728	-5.322	-3.571
Real and Other Services	-117	-108	-84	-106
CAPITAL ACCOUNT	11.842	13.711	2.761	10.960
Private Sector	8.595	4.902	-5.309	3.968
Foreign Direct Investment	4.783	10.602	7.428	8.221
Portfolio and Other Investment	4.097	-548	-5.814	-208
Capital Flight	-3.772	-9.935	-6.170	-7.333
Foreign Debt	3.487	4.783	-753	3.287
Public Sector	3.247	8.809	8.071	6.993
Foreign Debt	3.247	8.809	8.071	6.993
BALANCE OF PAYMENTS	2.934	3.056	-4.093	1.590
Private Sector	1.945	-1.916	-6.758	-1.726
Public Sector	989	4.973	2.665	3.316

Source: Kulfas and Schorr (2003)

regime, which subsisted as long as it did thanks to continued public indebtedness.[39]

In sum, a combination of exogenous shocks, privatization of the social security system, and capital flight were the main factors responsible for the debt buildup of the 1990s. These problems were compounded by both the economic recession that began in the third quarter of 1998, which later became a full-fledged depression, and the recessionary fiscal policies that the government implemented at the behest of the IMF.

D. Debt Intolerance?

Some have argued recently that Argentina may suffer from "debt intolerance," given that it has "serially defaulted" on its debt throughout its almost two hundred-year history.[40] According to this argument, the default and crisis are due to economic characteristics acquired over two centuries and to the government's irresponsibility in borrowing beyond its level of "debt tolerance."[41] Damill has convincingly argued against this view.[42] The country's remote past is, for all practical purposes, irrelevant to the current situation. It is hard to argue that Argentina's financial crisis in the late 1800s had any direct bearing upon the crisis of 2001. By placing the emphasis on the remote past, proponents of the "debt intolerance" theory tend to ignore the very real policy mistakes of the 1990s that had a direct bearing on debt accumulation and the subsequent default.

Be that as it may, it is interesting that financial markets—which actually loan the money—completely ignored the notion of debt intolerance in the Argentine case, lending far beyond the level that Reinhart has suggested.[43] Furthermore, the IMF itself ignored the notion of debt intolerance in Argentina, as witnessed by its almost $10 billion loan to Argentina just three months before the economic collapse.[44] Given Argentina's post-default success with new debt issues, and given that the country's debt-to-GDP ratio is currently greater than 80 percent, it would appear that

financial markets still do not consider debt intolerance to be a relevant concept.[45]

II. THE IMF AND POLICY FORMULATION IN ARGENTINA

Following the Argentine financial meltdown, the IMF went to considerable lengths to show that Argentine officials were entirely to blame for the collapse of the Convertibility Plan.[46] However, as will be shown, the IMF had substantially participated in Argentina's macroeconomic policy formulation before, during, and after the crisis, and is therefore also partially responsible for the economic collapse.

First, as the IMF's Independent Evaluation Office (IEO) report clearly states, the IMF supported Argentina's policy reforms during the 1990s, including the privatization of social security, which was the main cause of the country's fiscal problems, described earlier.[47] IMF support was explicit, as privatization was a condition in several of the IMF agreements with Argentina during the 1990s.[48] Further, the IMF's invitation to President Menem to address the Joint Annual Meetings of the Board of Governors of the IMF and the World Bank Group in October 1998 was a clear sign of the IMF's approval and support for the economic policies implemented in Argentina during the 1990s.[49]

Second, when the depression began in late 1998, the IMF conditioned its financial assistance on a series of fiscal spending cuts aimed at reducing the fiscal deficit.[50] As pointed out above, the deficit was not due to increased fiscal spending but to debt-service payments that spiraled out of control as a result of exogenous shocks and the privatization of social security. IMF-recommended fiscal spending cuts acted procyclically, deepening the crisis until the system collapsed. Spending cuts resulted in a drop in economic activity, which, given Argentina's tax structure, resulted in drops in fiscal revenue and increases in the fiscal deficit. At that point, further fiscal spending cuts were implemented, and so on and so forth, feeding the economy's downward spiral.

Third, the IMF tripled its exposure to Argentina (from $5 billion to $15 billion) just three months before the default.[51] This postponed the Convertibility system's collapse, thus deepening the capital flight process that was already taking place and that eventually resulted in the December 2001 run on deposits.

However, the IMF's participation in the Argentine crisis does not end with the December 2001 default. According to official Argentine government documents, following the crisis, the IMF committed substantial errors in three key areas: (1) diagnosing the crisis and its aftermath, (2) making projections about the evolution of key economic variables in the post-crisis months, and (3) making policy prescriptions.[52]

Among the projection errors committed by the IMF, the official document mentions two examples.

> IMF economists first ignored, and then refused to accept, empirical evidence presented to them in June 2002 that indicated that the drop in economic activity had bottomed out and that there were strong signs of economic reactivation. Based on these indications, Argentine authorities projected an 11 percent drop in GDP for 2002. However, as late as September 2002, IMF technical staff were projecting a GDP contraction of 16–20 percent. Actual GDP growth for 2002 was -10.9 percent.[53]
>
> Then, despite the IMF's projections of a substantial drop in GDP, the IMF also projected a real exchange rate appreciation. This was to be caused by real and nominal exchange rate "overshooting," which IMF staff believed would be substantial due to the chaotic exit from the fixed exchange rate regime. Basically, IMF staff believed that relative prices would continue to be very close to what they had been during the fixed exchange rate regime. In contrast, Argentine officials believed that due to the prolonged recession and the abrupt interruption of capital flows, the equilibrium real exchange rate would be substantially depreciated compared to the convertibility real exchange rate. Actual data proved that Argentine official projections were correct.[54]

According to the Argentine official document, the IMF also generally disregarded Argentine policy initiatives, insisting on its own policy prescriptions.[55] Given the IMF's errors in diagnosing the crisis and its effects, its policy prescription errors were also substantial.

- In February 2002, after the fixed exchange rate was abandoned, the IMF insisted on a totally free floating exchange rate regime, which Argentine authorities implemented against their better judgment. The IMF's argument supporting its plan was that the foreign exchange market would automatically reach a new equilibrium. However, just as the Argentine authorities feared would happen, the price of the dollar shot up because of a speculative bubble that appeared to have no ceiling. The price of the dollar stabilized only when Argentine authorities implemented a "dirty float" in April 2002. The IMF, however, rejected the dirty float exchange rate regime, arguing that the Central Bank's international reserves did not belong to the country and could therefore not be freely utilized to prop up the currency.[56]
- The IMF also opposed the Argentine government's decision to make optional the swap of frozen bank deposits for bonds (the swap was required to normalize the banking system). Instead, the IMF wanted to make the swap compulsory, illustrating a lack of comprehension of the volatile social and political situation in Argentina during 2002. A compulsory swap would likely have caused more social upheavals at a time when stabilizing policies were badly needed.
- For the financial system, the IMF recommended the same shock treatment that had had failed in Indonesia following the 1997 Asian crisis. The IMF advised drastically reducing the number of financial institutions, seeking an accelerated purge of the banking system by closing down banks not deemed viable. The government, however, preferred a gradualist approach, since the number of banks had already dropped considerably since the 1995 Tequila crisis. The government also believed that, in time, those financial institutions that were not viable would close on their own.[57]

- As is the norm, the IMF continued to demand fiscal spending cuts following the December 2001 crisis. However, the default on much of the public debt meant that Argentina would run a primary and overall surplus for the first time in many decades, making spending cuts unnecessary.[58]

Further, the IMF went considerably beyond its mandate, making recommendations unrelated to the IMF's purview or areas of expertise. For example, in the months following the crisis, the IMF called for a change in Argentina's bankruptcy law to remove protections for firms filing for bankruptcy and to provide better conditions for creditors.[59] The IMF also actively lobbied for the repeal of the "economic subversion" law, under which the government could investigate white collar crimes committed by firms, banks, or individuals.[60] At the time, the law was being used to investigate capital flight that had violated banking restrictions implemented during the crisis. Both laws were modified according to the IMF's demands.[61] Finally, the IMF also insisted that privatized utilities be allowed to increase fees as they saw fit.[62] Utility rates had been frozen in the post-crisis months pending contract renegotiations with the privatized utilities, due to systematic and well-documented contract violations. Despite the fact that many of these renegotiations are still pending, many utility rates have been steadily increasing for the last few years.[63]

In sum, it is clear that the IMF was partially responsible for the Argentine crisis. The IMF actively participated in the design of the macroeconomic policy environment that resulted in the December 2001 collapse. As a result, Argentine authorities concluded that "the IMF's technical staff appears not to be totally up to the task of dealing with a situation where a large crisis has erupted and should, therefore, give local authorities a greater margin to formulate and implement economic policies necessary to deal with the crisis."[64]

III. HOW COSTLY WAS SOVEREIGN DEFAULT?

Some have argued that Argentina's default was too costly, stating that the dramatic drop in GDP in 2002 was a direct consequence of that default.[65] However, Argentina's sovereign debt default provides arguments for a powerful refutation of the conventional wisdom regarding the costs of default. The consensus among orthodox economists and experts in international finance was that Argentina would suffer severe long-term consequences for breaking the rules in such a spectacular way: a huge sovereign default, combined with what was widely denounced in the business press as a refusal to bargain with creditors, and a contentious relationship with the IMF.[66] The result, however, has been quite the opposite.

Before considering the hypothetical costs of default, it is useful to lay out the sequence of events in order to better understand the issues. First, by January 2002, Argentina was in an economic depression which had begun in the last quarter of 1998. As a result of the depression and of IMF-sponsored fiscal austerity measures, it had become increasingly difficult to balance fiscal accounts—a problem that was temporarily solved by taking on new debt.[67] Consequently, it became clear that the convertibility regime had become unfeasible, as its continued existence hinged on increasingly unavailable foreign capital flows. Second, the abrupt end of foreign credit to Argentina in late 2001 resulted in the much publicized default and sealed the fate of the convertibility regime.[68] Third, the exit from the convertibility regime in early 2002 was unplanned and disorderly.[69] The currency was initially fixed at a higher value vis-à-vis the dollar, eventually being allowed to float freely per IMF recommendations, causing substantial dislocation in the economy.[70] When, contrary to IMF prescriptions, a managed float was adopted for the exchange rate in late April 2002, the economy began to emerge from the crisis.[71]

Given the sequence of events, it should be clear that the deepening of the crisis in 2002 was due far more to the effects of the depression and chaotic

exit from the fixed exchange rate regime than to the default itself. However, even from the perspective of those that blame the default for the crisis, the default was still the least costly option available. Further, even if one insisted on blaming the crisis on the default, a convincing argument can still be made that defaulting was the least costly option available. Over the three-month period following the December 2001 default, the economy continued to decline, losing about 6.3 percent of its GDP.[72] The loss in GDP is an upper bound for the cost of the default because it is almost certain that, even if the best of all possible non-default solutions had been brokered, there would still have been a further decline in GDP before the economy recovered. In reality, the cost of Argentina's default was almost certainly less than zero, since any non-default solution reached at that time would most likely have cost the country more, in terms of continued lost output, than did the default.

Within a few months of the default, economic recovery was well under way, and there was positive growth for the last three quarters of 2002.[73] The Argentine economy grew by 8.8 percent in 2003 and by 9 percent in 2004 and 2005.[74] Thus, from the perspective of "shock therapy"—a harsh adjustment, necessary to get the economy back on a sustainable growth path—the post-default adjustment was successful and delivered quick results. Therefore, even if one insisted on blaming the economic crisis on the default, it is difficult to avoid the conclusion that default was the right choice for Argentina.

In fact, even taking the worst estimate of the cost of default (6.3 percent of GDP), it is still virtually equal to Mexico's loss from the 1995 peso crisis (6.2 percent of GDP), where Mexico was assisted with a $40 billion IMF package.[75] It is also substantially less than the cost of adjustment during the Asian economic crisis, where Indonesia lost more than 13 percent of GDP.[76] It is important to remember that the Argentine government received absolutely no outside assistance during the entire crisis. Quite the opposite occured, in fact there was a very large net drain of money out of Argentina

to multilateral creditors.[77] In 2002, as poverty and unemployment reached record levels, and as the recovery was just getting under way, the country made net payments totaling $4.1 billion, or more than 4 percent of the GDP, to multilateral creditors.[78] For 2003–2004, there were further net payments of $5.9 billion.[79] From a purely economic standpoint, the default seems a success. More importantly, the economy was able to get back on a solid growth path, something that could have taken much longer if it had retained its crushing debt burden.

It is hard to imagine that Argentina would have done better by trying to please the IMF and other creditors. The previous four years of depression, as well as the demands put forward by the IMF in its protracted negotiations with Argentina during 2002, indicate that continued stagnation and even further decline were likely possibilities if the country had pursued tighter monetary and fiscal policies. Also, the acceptance of an unsustainable debt burden would have undermined the confidence of foreign investors. The Argentine government made the best decision that it could under the circumstances, and it probably avoided further chaos by choosing default and rejecting IMF prescriptions.

IV. DEBT RESTRUCTURING AND BEYOND

In early 2003, it became clear that Argentina was emerging from its political and economic crisis. As a result, the IMF and defaulted creditors increased pressure on Argentina for a solution to its $100 billion default debt. After intense negotiations, including two different Argentine official debt-restucturing proposals, a debt restructuring swap was opened and a substantial portion of the defaulted bonds were swapped. Despite this relative success, many questions remain regarding Argentina's public debt sustainability. The following section discusses the debt-restructuring process and its implications.

A. Leaving the Default Behind: From Dubai to Buenos Aires

The process to emerge from default began in September 2003, when Argentina issued a set of conditions to creditors under which it was willing to restructure its debt.[80] Conditions included a 75 percent capital reduction, or "haircut," considerably lower interest rates and longer maturities, and no recognition of interest payments accrued since the default.[81] Creditors were outspokenly opposed to these restructuring conditions and demanded a better offer.[82] One of the more outspoken groups, the Global Committee of Argentine Bond-holders (GCAB), even teamed up with the IMF to pressure Argentina for a better deal for private creditors.[83]

IMF and creditor pressure resulted in a new offer on June 1, 2004. Known as the "Buenos Aires Proposal," the new offer represented a 100 percent improvement for defaulted creditors over the Dubai guidelines. Interest rates were doubled, the haircut was reduced from 75 percent to roughly 45 percent, and recognition of past-due interest since the default was recognized as a part of the debt.[84] The Buenos Aires offer, however, was still not accepted by either the IMF or the creditors. The Argentine government's offer, nonetheless, was final because officials claimed that the resulting debt-service load was the maximum the country could afford to pay based on realistic sustainability assumptions.[85] Thus, for the first time in the history of modern defaults, the debt restructuring swap proceeded without the explicit support of the IMF.

The debt-swap process ended on February 25, 2005, with a 76.15 percent acceptance rate.[86] This was no small accomplishment and did indeed have several important aspects. The deal implicitly recognized the impossibility of servicing the pre-default debt under the terms with which it was issued. Additionally, Argentina successfully resisted substantial pressure from the IMF and the financial establishment to improve the offer. Further, the new bonds issued as a result of the debt restructuring were for a lower amount and at lower interest rates, thereby improving Argentina's debt-service

terms over those existing prior to the default. And finally, the default was resolved after three years of uncertainty.

Specifically, the financial results of the debt restructuring swap can be summarized as follows:

- Of the $81 billion in defaulted debt, $62.318 billion, or 76.15 percent, entered the debt-swap. Holders of roughly $19 billion did not accept the terms and conditions of the swap and remain as holdouts.[87]
- For the $62.318 billion that entered the swap, the Argentine government issued $35.261 billion in new bonds. That is, the "haircut," or reduction on the nominal value of the defaulted bonds, was 43.4 percent.[88]
- The maturity of the new bonds is considerably longer (up to forty-two years) than the old bonds and the interest rates are considerably lower. [89]
- The currency structure of the new debt also changed considerably. A full 37 percent of the total stock of post-swap debt is now denominated in pesos. Morever, the rate of return on these bonds is tied to inflation, making them by far the most profitable investment in the Argentine public debt bond pool.[90]
- The debt-to-GDP ratio went from 113 percent at the time of default in December 2001, to 72 percent after the default. However, this does not take into account the $19 billion that did not enter the debt-restructuring. Therefore, total debt-to-GDP ratio is actually 87 percent when one takes holdout debt into account.[91]

Accordingly, even though the capital reduction was considerably less than the 75 percent proclaimed by the government, one can still consider the debt restructuring to have been a success, particularly given the lack of support from the IMF and the G7. Several factors made this result possible. On the international front, low interest rates and a lack of good investment options, the decreasing credibility of the IMF both within and outside the institution, and a generalized belief that the Argentine fixed exchange rate

regime had run its course, were all key. Another important factor was the lack of alternatives for private creditors vis-à-vis the Argentine government debt restructuring offer. An indication of this lack of alternatives was the relatively high acceptance rate of the Buenos Aires Proposal by creditors even in the face of a substantial capital reduction.

B. Troubles with the Official Approach to Debt Restructuring

The government presented the results of the debt restructuring swap as a resounding success. The IMF, as well as the creditors owning 24 percent of the defaulted debt who did not participate in the debt restructuring swap—referred to as "holdouts"—claim that the default is not yet fully resolved. While this is problematic, there are other fundamental problems that Argentina's post-debt-swap situation leaves unsolved.

1. Acceptance of All Pre-Default Debt as Valid

Perhaps one of the most troubling aspects of the Argentine government's approach to debt restructuring is that it unquestioningly accepted all pre-default debt as valid. By doing so, the official strategy ignored the substantial irregularities committed by the military dictatorship (1976-1983) when contracting the debt.[92] The official strategy also validated all of the financial speculation cycles and scams of the past two-and-a-half decades. These cycles typically consisted of a period of growing private and public indebtedness, followed by capital flight and eventually the "socialization" of private debt (i.e., the transformation of private debt into public debt) as the financial crisis erupted.[93] These cycles were compounded by repeated debt restructuring episodes, which turned out to be major scams in which the financial and corporate sectors benefited greatly from overpriced bonds, and the public sector (i.e., the taxpayers) was repeatedly and cumulatively saddled with the costs of financial speculation.

Critics have rightfully argued that the government should have used the debt restructuring opportunity provided by the default to carry out a long-overdue, in-depth examination and depuration of the stock of public debt.

2. IFI Debt Unquestioned

Equally troubling is the Argentine government's treatment of international financial institution (IFI) debt. The official approach has been to fully honor the approximately $32 billion debt to the IFIs without even trying to get more favorable repayment conditions (for example, lower interest rates and/or a longer repayment timeline). Official justification for this approach was that G7 support was needed for the debt-swap to be successful. In this view, to challenge the validity of IFI debt would have been too costly and could have threatened the success of the debt-restructuring effort.

As time has shown, Argentina's strategy regarding IFI debt failed, since the IMF and the G7 never did back the Argentine debt-restructuring process. As a result, the strategy on IFI debt imparted (1) a larger capital reduction on private creditors; (2) preferential treatment to those who bear substantial responsibility for the Argentine catastrophe; and (3) larger fiscal surpluses (or new indebtedness) in order to face a hefty IFI debt-service load during the next decade.

3. Paying Off the IMF: Poster Child Till the Bitter End

If the Argentine official strategy vis-à-vis IFI debt was questionable, the strategy on IMF debt was downright scandalous. Official debt-service sustainability projections had been based on an agreement with the IMF that would have provided for the rollover of 100 percent of IFI capital payments for the foreseeable future.[94] However, in order to refinance this debt, an agreement with the IMF was necessary. This would have required implementing the usual list of IMF-sponsored policies, many of which were directly responsible for the 2001 economic crisis.

Clearly, the government could not submit to such conditionality and risk turning the economic recovery into yet another recession. It is also clear that Argentina had substantial leverage that it could bring to bear in its negotiations with the Fund. With a debt of roughly $10 billion,[95] Argentina was the IMF's third largest debtor behind Brazil and Turkey. As the old adage goes, "if you owe the bank $10,000, you have a problem; if you owe the bank $10 billion, the bank has a problem."

Given this situation, the Argentine government had several options available. First, it could have continued to service the debt with the IMF according to the original payment schedule, as Argentina had been doing since the last agreement failed in August 2004. Alternatively, it could have unilaterally restructured its debt with the IMF, making its maturity equal to that of restructured bonds (thirty-five years on average). A third option would have been to unilaterally restructure its debt with the IMF, imposing similar conditions to those imposed on private creditors (capital reduction, reduction of interest rates, and substantially longer maturity). Finally, Argentina could have defaulted to the IMF as a way to recover some of the losses caused by IMF blunders.

However, rather than taking any of the above options, President Kirchner's administration opted for a solution suggested by the IMF itself: to pay the IMF in full, three years ahead of schedule, using Central Bank international reserves.[96] Thus, in early January 2006, the Kirchner administration took $10 billion from the Central Bank's international reserves and paid off the IMF, proving that Argentina was willing to be the IMF's poster child until the bitter end.[97] The government presented the IMF debt cancellation as part of their *desendeudamiento*, or debt-reduction strategy. In reality, Argentina's net stock of public debt did not change, since the Argentine Treasury had to issue new bonds in order to compensate the Central Bank for the reserves it was taking to pay off the IMF.[98]

According to the government's rhetoric, with this payment Argentina was able to finally liberate itself from the IMF.[99] While it is true that Argentina

needed to rid itself of the IMF, and it is also true that the IMF is no longer in the picture, this was the worst possible to way to get rid of the IMF. Given the IMF's shared responsibility for Argentina's economic crisis, and given Argentina's ongoing high hunger, poverty, and unemployment rates, it is questionable whether this was the best use of $10 billion.[100]

4. Post-Default Debt Fully Recognized

Also questionable was the official approach to the roughly $35 billion public debt issued in the months following the default and devaluation. The financial system entered a new crisis as a result of the 2002 devaluation and because many bank customers had dollar-denominated loans. In order to avoid massive bankruptcies, the government converted all loans to pesos at the old exchange rate of one peso to one dollar, and issued bonds to the banks for the difference between the old and the then-current nominal exchange rates.[101] In the process, the government bailed out countless large corporations, many of which produced mostly for export markets and made dollars in exchange—corporations that were in no risk of bankruptcy due to the devaluation.[102]

However, most of this new debt is owned by the local financial system, which explains why the official strategy was to accept all debt as legitimate and to continue making payments on this debt as originally contracted.[103] Critics have maintained that beneficiaries of this new debt issue should have been identified and a tax levied against those who benefited unduly. This was not done and, as a result, the Argentine taxpayer and defaulted creditors must pay for this unnecessary corporate bailout.

C. A Heavy Burden

Many issues factor into the question of how much of a solution to Argentina's decade-long debt problem this latest debt-swap represents. Clearly, much depends on the debt-service structure for the years ahead, and on other factors such as macroeconomic performance and economic growth,

fiscal revenue, the exchange and inflation rates, the balance of payments, and foreign interest rates.

Table 5 contains a schedule of Argentina's debt-service obligations for the period 2006–2016. Before interpreting the data, it is necessary to make some important clarifications about payments that are excluded from the table:

- The data assumes the January 2006 $10 billion payoff to the IMF as having taken place and, therefore, does not include any debt-service payments to the IMF;
- The data does not include debt-service payments on the $10 billion in bonds issued by the Treasury to the Central Bank in compensation for the international reserves used to pay off the IMF;
- The data does not include $5.3 billion that the Treasury owes the Central Bank and is supposed to pay back in 2005;[104]
- The data does not include payments for the "GDP-linked" coupons on restructured bonds;[105]
- The data does not include debt-service payments for new debt issued in 2006 or later;[106]
- The data does not include payments on the roughly $24 billion holdout debt;
- The data does not include $2.5 billion debt to the Paris Club and other official creditors, which is still in default and pending restructuring; and
- The "Total" column includes payments due after 2016 but not shown in the table.

Table 5: Argentina Debt-Service Schedule (2006-2016) (in millions of US dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
Interest	2,989	2,754	2,434	2,424	2,204	1,948	1,690	1,508	2,051	1,976	1,872	53,867
IFIs	786	643	490	395	325	267	217	176	141	110	82	3,871
Rest	2,203	2,111	1,944	2,029	1,879	1,681	1,473	1,331	1,910	1,866	1,790	49,996
Capital	10,568	7,584	6,583	8,173	6,579	6,899	5,251	2,825	2,797	2,769	2,435	121,331
IFIs	2,465	2,556	1,966	1,497	1,323	1,121	958	784	688	620	557	25,270
Rest	8,103	5,028	4,617	6,676	5,256	5,778	4,293	2,041	2,109	2,149	1,878	90,798
TOTAL	13,557	10,338	9,017	10,597	8,783	8,847	6,941	4,333	4,848	4,745	4,307	169,935
as % of GDP	6.78%	4.92%	4.13%	4.70%	3.77%	3.67%	2.79%	1.69%	1.83%	1.74%	1.54%	

Assumptions:

GDP USD	200,000	210,000	218,400	225,607	233,052	240,743	248,687	256,645	264,345	272,275	280,443
GDP Growth Rate		5.0%	4.0%	3.3%	3.3%	3.3%	3.3%	3.2%	3.0%	3.0%	3.0%

Source: Author's calculations based on Economy Ministry data

When added up, the data not included in Table 5 amounts to substantial payments, making the debt-service schedule all the more onerous. Bearing that in mind, several conclusions can be drawn based on the data in Table 5.

First, Argentina's debt-service obligations through 2011 exceed 3 percent of the GDP. Furthermore, through 2009, Argentina's yearly debt-service obligations exceed 4 percent of the GDP. Even with IMF debt service out of the picture, the government will have to issue new debt in order to meet its debt-service payments. New debt issues and growth rates above 3 percent will result in heftier debt-service payments in the short- and medium-run, which means that the debt-service load will be considerably heavier than what Table 5 shows.

Second, Argentina's debt-service schedule, augmented by new debt issues, implies that the government will need to have large, sustained primary fiscal surpluses for many years to come. Indeed, a recent publication by economists from the University of Buenos Aires concludes that Argentina will have to maintain a primary surplus of 3 percent of GDP and positive growth rates for the next twenty-five years in order to meet debt-service payments.[107] Obtaining such results would require a break from Argentina's two hundred-year history, since the country was never able to achieve such macroeconomic performance on a sustained basis.

Furthermore, obtaining a primary surplus of this magnitude on a sustained basis depends on several factors. A primary surplus depends on high rates of growth because Argentina's tax structure is highly dependent on economic activity. Therefore, in order for fiscal revenue to keep up with debt service, high rates of growth are necessary. However, high growth rates also impact debt service since many of the restructured bonds have "GDP-linked" coupons. A primary surplus also depends on tight control of fiscal spending. In order to obtain and sustain a surplus, fiscal spending must be kept in check. This means continuing to postpone public sector wage increases and other urgent needs, such as dealing with still alarmingly high rates of poverty, indigence, unemployment, and dealing with the

profound crises in the education and public healthcare systems. A third factor in obtaining a primary surplus is export growth because one-third of fiscal revenues come from export taxes. In other words, maintaining a primary surplus means that exports will need to continue to grow apace. Furthermore, since two-thirds of Argentina's public debt is denominated in foreign currency, maintaining a trade surplus is also key to getting the foreign exchange needed to meet debt-service payments.

Third, maintaining a trade surplus depends on being able to maintain price competitiveness, and price competitiveness depends on being able to maintain a competitive exchange rate and low salaries, in relative terms. In other words, this means being able to continue to postpone long-delayed real wage improvements for Argentine workers who have seen their income consistently eroded in real terms for the last three decades of WC-sponsored policies.

Fourth, inflation control is another key component of the government's policy agenda. Inflation has two major potential impacts with regards to debt service. First, inflation affects consumer and investor expectations and can eventually negatively impact economic growth. Second, 37 percent of Argentina's restructured public debt is denominated in domestic currency and is linked to inflation. An increase in inflation directly impacts the country's debt-service commitments. Additionally, in order to keep inflation in check, the government's main objective is to maintain the set of relative prices that resulted from the maxi-devaluation that took place in early 2002. This means keeping wages repressed—a difficult task in the face of increased demands for redistributive policies to make up for many years of real-wage decline.

Fifth, debt sustainability also assumes that Argentina will be able to issue new debt, at reasonable interest rates and maturities, in order to finance current debt service. With local banks already heavily exposed to the public sector—roughly 50 percent of bank portfolios are in state securities—new funding may be hard to come by. Relying on foreign capital could

complicate matters further, as capital inflows are generally motivated by short-term speculative behavior, and can have destabilizing effects on the nominal exchange rate—the centerpiece of the government's macroeconomic policy.

The overriding conclusions are simply that, in the "best case" scenario, for the next thirty years, debt service will continue to be a dominating factor of Argentina's economic, social, and political life. Additionally, there is no chance that the regressive effects of three decades of WC-sponsored policies will be undone in the short- or medium-run. Specifically, this means postponing redistributive policies, not dealing with highly concentrated and unequal power structures within the economy, and not dealing with still alarmingly high levels of poverty, indigence, and unemployment.

In sum, it is hard to conclude that Argentina has finally left its stop-and-go financial cycles of debt accumulation, crises, and restructuring behind. Argentina's debt-service schedule, especially in the short- to medium-term, is hefty; being able to keep up with it depends on maintaining the highly unequal economic structure of the past decades.

IV. CONCLUSION: WHAT CAN WE LEARN?

Argentina's experience with debt and financial crises over the last decades provides important lessons.

1. Default can be a viable option: Clearly default is not something to be taken lightly, but it has been and will likely continue to be an option for sovereign borrowers. The Argentine case shows that defaulting was not as disastrous as many had predicted. Indeed, the default helped Argentina to end the unviable fixed exchange rate regime and it freed up resources to deal with the multiple dislocations produced by the structural changes that resulted from the devaluation. Whether the time and resources were put to best use in Argentina is a different matter, but it is unquestionable that the default was the correct and most efficient option, given the circumstances.

2. Public debt should be subject to strict scrutiny and rules: This is fundamental to avoiding excessive indebtedness and financial cycles and crises, which are costly and undesirable. It is also fundamental that the process by which a country takes on new debt be scrutinized by the country's representative institutions, such as its congress or parliament, and that new debt be subject to extensive sustainability analysis.

3. It is easier to default on foreign lenders than domestic lenders: It is clear from the government bailouts—of privatized pension funds, banks, and the corporate sector—that it is easier to default on foreign bondholders than on domestic bondholders and powerful economic actors. The reason for this should be clear. The main consequence of a default on foreign borrowers is political and perhaps financial. Defaulting on domestic borrowers would almost certainly have substantial political repercussions, in addition to severe economic and financial consequences.

4. Pleasing financial markets should not be the aim of debt-restructuring processes: For a debt-restructuring process to result in a sustainable and serviceable debt load, it must be based on an economy that grows thanks to strong internal markets. For this to take place, it is fundamental to have productive investment and an equitable distribution of income. This is opposite to the Washington Consensus prescriptions, which are centered on financial liberalization and the free flow of speculative funds.[108] Those are precisely the policies that feed the financial stop-and-go cycles that Argentina has experienced for the last three decades, the results of which are well known: unsustainable debt loads, financial crises, defaults, and record levels of poverty and unemployment.

5. A return to international capital markets is not a sign of success: Neither should a return to international capital markets be taken as a sign of financial health. If debt sustainability is contingent on renewed access to international capital markets, then most likely, debt-dependence will not have been fully severed.

6. Ending financial stop-and-go cycles and debt-led capital accumulation should become a priority: Argentina is a prime example of the failure of financial liberalization and "debt-led"

development policies.[109] Since dependence on foreign capital flows and indebtedness do not lead to sustainable development, it is of prime importance to abandon these policies in favor of economic policies that promote sustainable and egalitarian growth. It is essential to reclaim the language, ideas, theory, and policies of development economics, which neoliberal economics has discarded. A strong state, capable of efficiently and effecitvely intervening in and regulating economic activity, is essential.

7. Debt restructuring should be approached globally, and not exclusively as a financial issue: By approaching the debt issue exclusively in financial terms, Argentina ended up with a debt-service schedule that substantially reduced its freedom to undo the nefarious legacy of decades of WC-type policies. Furthermore, Argentina also wasted an opportunity to examine its debt-accumulation process and to make sure those who benefited unduly were taxed accordingly. These issues should have been addressed in order to ensure a fairer distribution of the burden of debt service.

8. The success of a debt-restructuring process cannot depend on prolonged, large primary fiscal and trade surpluses: In the Argentine case, the success of the debt-restructuring process depends on large and sustained primary fiscal and trade surpluses. This strategy is questionable and its chances of success are dubious. First, a large primary surplus drains resources from the economy that could be used to foster investment and job creation, and to contribute to a more equitable distribution of income. Second, economic cycles are endemic to market economies, and Argentina is certainly no exception. To assume that an economy will indefinitely have positive growth, in addition to primary and trade surpluses, is unrealistic. Unfortunately, this is precisely the assumption made in the government's sustainability analysis.

9. The IMF is incapable of predicting financial crises and lacks the tools or knowledge to deal with a crisis once it erupts: If there is a lesson that stands out from the Argentine experience, it is that the IMF does not possess the know-how or the appropriate theoretical framework to forecast or effectively deal with financial crises. The IMF's "one size fits all" approach to economic policy and crisis

resolution has failed repeatedly around the world. Asian nations have learned this lesson well and their massive foreign reserve accumulations now serve as an insurance against ever having to follow IMF advice again. While reserve accumulation can be costly, it is bound to be less costly than following the IMF's advice.

10. Once the crisis erupted, the IMF was more eager to cash-in and get out than to provide assistance: After the crisis erupted in December 2001, the IMF did not provide Argentina with any new funds.[110] Furthermore, the IMF's efforts appeared to be geared primarily toward reducing its exposure in Argentina.[111] Unfortunately, Argentina did exactly as the IMF expected, using its Central Bank reserves to cancel its IMF debt in advance.

11. The international financial institutions must be redesigned: The IMF's substantial mishandling of the Argentine (and other) financial crises clearly points to a need for institutional redesign. The IMF and The World Bank's grossly mistaken policy prescriptions point in the same direction. It is clearly necessary to redesign the IFIs in such a way as to create a true international lender of last resort that will provide financial assistance to countries experiencing a crisis. Additionally, IFIs should be accountable for the policies they prescribe and the results they produce.

History will tell if the lessons from the Argentine debt debacle will help to modify the current process of international economic integration, in particular the development policies of peripheral countries. If debt default is used simply as a shortcut to return to the liberalized international capital markets, then clearly not much will have been learned. Rather, the task ahead should be to define a development strategy that leaves behind the model of spasmodic debt-accumulation cycles.

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Argentina's Recent Debt Debacle (Intergovernmental Group of 24 (G24) Working Paper, 2005).

[2] "In our view, failures in fiscal policy constitute the root cause of the current crisis," declared Anoop Singh, IMF Director for Special Operations, in Buenos Aires on April 10, 2002, four and a half months after the default. Anoop Singh, Director for Special Operations, IMF, Press Briefing, Introductory Remarks on the Role of the IMF Mission in Argentina (Apr. 10, 2002) *available at* http://www.imf.org/external/np/tr/2002/tr020410.htm. This view is repeated by IMF officials to this day and is a central part of the IMF's Independent Evaluation Office report. *See* INT'L MONETARY FUND INDEP. EVALUATION OFF., THE IMF AND ARGENTINA, 1991–2001, at 14 (2004), *available at* http://www.imf.org/External/NP/ieo/2004/arg/eng/pdf/report.pdf (hereinafter IMF Report 2004).

[3] *See* Carmen M. Reinhart et al., *Debt Intolerance* 3, 34 (Nat'l Bureau of Econ. Research, Working Paper No. 9908, 2003); Carmen M. Reinhart & Kenneth S. Rogoff, *Serial Default and the "Paradox" of Rich to Poor Capital Flows* (Nat'l Bureau of Econ. Research, Working Paper No. 10296, 2004).

[4] *See generally, e.g.,* Alan B. Cibils et al., *Investigación – La Argentina desde la cesación de pagos: el FMI y la depresión*, REALIDAD ECONÓMICA, 2002 (Arg.); RUBÉN LO VUOLO, ESTRATEGIA ECONÓMICA PARA LA ARGENTINA: PROPUESTAS (2003) (describing the policies that led to the crisis).

[5] *See* Instituto Nacional de Estadística Censos, http://www.indec.gov.ar/ (providing economic census data).

[6] *See* Lo Vuolo (2003), *supra* note 4, at 54-64.

[7] Matías Kulfas & Marín Schorr, *La Deuda Externa Argentina diagnóstico y lineamientos propositivos para su reestructuración*, *in* CENTRO INTERDISCIPLINARIO PARA EL ESTUDIO DE POLITICAS PUBLICAS (Fundación OSDE, 2003), *available at* http://www.ciepp.org.ar/publicacionesDP.htm.

[8] *See generally* ALEJANDRO OLMOS, TODO LO QUE USTED QUISO SABER SOBRE LA DEUDA EXTERNA Y SIEMPRE LE OCULTARON: QUIÉNES Y CÓMO LA CONTRAJERON (Ediciones Continente ed., 2004) (1989).

[9] The first was Néstor Rapanelli, a senior executive at a large Argentine transnational corporation. In December 1989, he was replaced by Erman González.

[10] González committed to paying $100 million per month which, given the stock of debt and accumulated arrears, was essentially symbolic and intended to show Argentina's intention to honor its debt.

[11] *See generally* Lo Vuolo (2003), *supra* note 4.

[12] The term "Washington Consensus" was first used by economist John Williamson to indicate a set of policies promoted by the Washington-based IFIs and the U.S. Treasury. They broadly include trade and finance liberalization, tight fiscal and monetary policies, and freely floating exchange rates. The terms "neoliberal," and "new orthodoxy" are also used to refer to these policies and subsequent modifications. While the "consensus" appears to be cracking, the term "Washington Consensus" will still be used for its succinctness. *See* John Williamson, *What Washington Means by Policy Reform*, *in* LATIN AMERICAN ADJUSTMENT: HOW MUCH HAS HAPPENED? (Inst. for Int'l Econ., John Williamson ed., 1990)..

[13] *See generally* Mario Damill et al., Argentina: Una Década de Convertibilidad– Un Análisis del Crecimiento, el Empleo y la Distribución del Ingreso (2002).
[14] *See* RUBÉN LO VUOLO, ALTERNATIVAS: LA ECONOMÍA COMO CUESTIÓN SOCIAL 47-54 (2001) (Arg.).
[15] Kulfas & Schorr, *supra* note 7, at 15.
[16] *Id.*
[17] *Id.*
[18] *Id.* at 19.
[19] Kulfas & Schorr, *supra* note 7, at 20.
[20] *Id.* at 20-22.
[21] *See generally* Cibils et al., *supra* note 4; Lo Vuolo (2003), *supra* note 4 (providing a more in-depth discussion on the default).
[22] Kulfas & Schorr, *supra* note 7, at 20-22.
[23] Anoop Singh, Director for Special Operations, IMF, Press Briefing, Introductory Remarks on the Role of the IMF Mission in Argentina (Apr. 10, 2002) *available at* http://www.imf.org/external/np/tr/ 2002/tr020410.htm.
[24] *See, e.g.,* IMF Report 2004, *supra* note 2, at 37-43.
[25] An interest-rate shock occurs when, for example, a key foreign interest rate (such as the U.S. Fed's short-term interest rate) increases and, as a result, Argentina's debt-service load increases (because much of Argentina's foreign debt was contracted at variable rates).
[26] The primary balance or primary fiscal surplus/deficit is the government's fiscal result (surplus or deficit) excluding debt-service payments.
[27] Michael Mussa, *Argentina and the Fund: From Triumph to Tragedy*, *in* POLICY ANALYSES IN INTERNATIONAL ECONOMICS, July 2002, at 9.
[28] *See* Noemí Giosa Zuazúa, *La estrategia de la administración Kirchner para enfrentar los problemas del mercado de empleo*, at 12, CENTRO INTERDISCIPLNARIO PARA EL ESTUDIO DE POLITICAS PÚBLICAS, (Análisis de Coyuntura No. 12, 2006).
[29] *See* Dean Baker & Mark Weisbrot, *The Role of Social Security Privatization in Argentina's Economic Crisis*, April 2002, *at* http://www.cepr.net/publications/ argentina_2002_04.htm.
[30] *See generally* Laura Goldberg & Rubén M. Lo Vuolo, *La reforma de la reforma: un nuevo sistema de previsión social para la Argentina*, *in* CENTRO INTERDISCIPLINARIO PARA EL ESTUDIO DE POLITICAS PUBLICAS (Serie Documentos de Trabajo, No. 45, 2005), *available at* http://www.ciepp.org.ar/trabajo.htm (providing a detailed analysis of how Argentina's social security privatization failed).
[31] *See* Baker & Weisbrot, *supra* note 29, at 2 (discussing the assumption behind the calculations in table 3).
[32] *See* Cibils et al., *supra* note 4.
[33] Ironically, the government ended up borrowing substantial amounts from the privatized pension funds, which ended up with bonds worth 16 percent of the defaulted debt. This, in turn, gave the privatized funds substantial bargaining power since the government needed the funds to participate in the debt-restructuring process in order for it to have any chance of success. As a result, all talk about pension system reform has

been abandoned by the current administration. *See* Ismael Bermúdez, *El gobierno anuncia el acuerdo con las AFJP,* CLARÍN (Arg.), October 7, 2004

[34] Kulfas & Schorr, *supra* note 7, at 33-39.

[35] Recessions resulted from contagion from the Mexican peso crisis (1994-1995), the Asian crisis (1997), and the Russian and Brazilian crises (1998).

[36] One of the goals of the fixed exchange rate regime was to strengthen the peso. However, private sector preference for the dollar was an indication that, at least on this point, the convertibility regime failed.

[37] Kulfas & Schorr, *supra* note 7, at 34.

[38] *See, e.g.,* Mario Damill, *El balance de pagos y la deuda externa pública bajo la convertibilidad,* BOLETÍN INFORMATIVE TECHINT, July-Sept. 2000 (Arg.); Matias Kulfas, *El rol del endeudamiento externo en la acumulación de capital durant la convertibilidad*, REVISTA ÉPOCA, Nov. 2001 (Braz.).

[39] *See generally* Kulfas & Schorr, *supra* note 7.

[40] *See generally, e.g.,* Reinhart et al., *supra* note 3; Reinhart & Rogoff, *supra* note 3.

[41] *Id.*

[42] *See generally* Mario Damill et al., *La deuda Argentina: historia, default y reestructuración*, CEDES, Apr. 2005, *available at* http://www.observatoriodeladeuda.org/Documentos/Frenkel_Debt.pdf.

[43] Reinhart et al. estimates that Argentina is "safe" with a debt-to-GDP ratio of 15 percent. Reinhart et al., *supra* note 3, at 34-35. Argentina's current debt-to-GDP ratio is five times as high, and yet it has not had any trouble issuing new debt. For current debt data, see Ministerio de Economia y Produccion, www.mecon.gov.ar.

[44] Press Release, Int'l Monetary Fund, IMF Augments Arg. Stand-By Credit to $21.57 Billion, and Completes Fourth Review (Sept. 7, 2001), *available at* http://www.imf.org/external/np/sec/pr/2001/pr0137.htm [hereinafter IMF 2001 Press Release].

[45] *See generally* Jorge Schvarzer & Pablo Orazi, *Estimaciones sobre el flujo de pagos futuros de la deuda. Un scenario de vencimientos que sigue presentando dificultades*, *in* CENTRO DE ESTUDIOS DE LA SITUACIÓN Y PERSPECTIVAS DE LA ARGENTINA (Notas de Coyuntura, Nov. 22, 2006).

[46] The prime example of this is the extensive report produced by the IMF's so-called Independent Evaluation Office. *See generally* IMF Report 2004, *supra* note 2.

[47] *See* Cibils et al., *supra* note 4.

[48] *See, e.g.,* Press Release, Int'l Monetary Fund, IMF Approves Three-Year Extended Fund Facility for Argentina (Feb. 4, 1998), *available at* http://www.imf.org/external/np/sec/pr/1998/pr9801.htm; Press Release, Int'l Monetary Fund, IMF Approves Extension, for Fourth Year, of EFF Credit to Argentina (Apr. 6, 1995), *available at* http://www.imf.org/external/np/sec/pr/1995/pr9518.htm.

[49] *See* Carlos Saul Menem, President of the Republic of Argentina, Statement at the Annual Meetings of the Boards of Governors of the IMF and the World Bank Group, (Oct. 6-8, 1998) *available at* http://www.imf.org/external/am/1998/speeches/pr05e.pdf.

[50] *See, e.g.,* Press Release, Int'l Monetary Fund, IMF Approves US$7.2 Billion Three-Year Stand-By Credit for Argentina (Mar. 10, 2000), *available at* http://www.imf.org/external/np/sec/pr/2000/pr0017.htm; Memorandum of Economic Policies of the

Government of Argentina (Feb. 14, 2000), *available at* http://www.imf.org/external /np/loi/2000/arg/01/index.htm.

[51] *See* IMF 2001 Press Release, *supra* note 44.

[52] *See* MINISTERIO DE ECONOMÍA Y PRODUCCIÓN, ARGENTINA, EL FMI Y LA CRISIS DE LA DEUDA 19 (July 2004) (Arg.) *at* http://www.mecon.gov.ar/analisis_economico/nro2/2 _fmi_crisis_deuda.pdf (hereinafter EL FMI Y LA CRISIS DE LA DEUDA).

[53] *Id.* at 19-20.

[54] *Id.* at 20.

[55] *Id.* at 20-21.

[56] *Id.* at 21.

[57] *See id.*

[58] *Id.*

[59] *Id.* at 24.

[60] *Id.* at 24-25.

[61] When a country signs an agreement with the IMF, it gives up part of its sovereignty with regards to economic policy making since the IMF imposes its conditions and policies in exchange for a loan. However, the IMF also managed to override Argentina's political sovereignty by demanding policies and changes in the country's legal framework that had nothing to do with the Fund's chartered mandate.

[62] EL FMI Y LA CRISIS DE LA DEUDA, *supra* note 52.

[63] The situation with privatized utilities is still very much in flux. Two privatization contracts have been rescinded: the national mail system and the national waterworks system. However, other privatized utilities have been allowed to increase their rates significantly: road tolls, telephone, gas, and electricity. Contractual violations have yet to be dealt with.

[64] The Ministerio de Economía y Producción is the Argentine equivalent of the U.S. Treasury Department. It is the government ministry in charge of economic policy. *See* EL FMI Y LA CRISIS DE LA DEUDA, *supra* note 52, at 10.

[65] The costs of default go considerably beyond the purely economic. It is well known that unemployment, poverty, and indigence rates reached record levels in 2002. However, here too one must consider what would have been the costs had there not been a default and had the depression continued for a few more quarters. We do not have the counterfactual, but it is hard to believe that the latter option would have had lower social costs.

[66] *See* Mark Weisbrot, Shock Therapy That Changed the World: How Argentina's Default and Recovery Changed the IMF and the International Financial System (June 23, 2005) (unpublished paper, on file with the Center for Economic and Policy Research).

[67] *See generally* Cibils et al., *supra* note 4.

[68] *Id.*

[69] *See* Lo Vuolo (2003), *supra* note 4, at 54-64.

[70] *Id.* at 57-60.

[71] *Id.*

[72] *See* Weisbrot, *supra* note 66, at 17.

[73] *See* Ministerio de Economía y Producción, Información Económica, *at* http://www.mecon.gov.ar/peconomica/basehome/infoeco.html [herinafter Información

Económica] (providing on-line monthly and quarterly information on the Argentine economy).

[74] *Id.*

[75] *See* Weisbrot, *supra* note 66, at 17.

[76] *Id*.

[77] Información Económica, *supra* note 73.

[78] *Id*.

[79] *Id.*

[80] *See generally* Ministerio de Economia y Produccion, Información sobre Deuda Argentina [Argentine Public Debt Information], http://www.argentinedebtinfo.gov.ar/ (providing official debt-related information, including information on the restructuring conditions) (last visited Apr. 6, 2007).

[81] *Id*.

[82] The main bond-holder associations have websites with documents and press releases clearly stating their positions. *See generally* Global Committee of Argentina Bondholders, http://www.gcab.org (last visited Mar. 4, 2007); Task Force Argentina, http://www.tfargentina.it (last visited Mar. 4, 2007); American Task Force Argentina, http://www.atfa.org (last visited Mar. 4, 2007); and Interessengemeinschaft Argentina, http://www.ig-argentinien.org (last visited Mar. 4, 2007).

[83] The Global Committee of Argentina Bondholders (GCAB) held a presentation at the joint World Bank-IMF meetings in Washington D.C., in October 2004. No other foreign creditor group was present. *See* GCAB Presentation on Occasion of the IMF/World Bank Annual Meetings, Oct. 4, 2004, *at* www.gcab.org/images/WB2004_Presentation _Final.pdf.

[84] For data pertaining to the debt, visit Subsecretaría de Financiamiento, http://www.mecon.gov.ar/finanzas/sfinan/ (last visited Apr. 4, 2007).

[85] *Id.*

[86] *Id.*

[87] If interest payments due since the default are added, holdout debt becomes roughly $24 billion.

[88] Subsecretaría de Financiamiento, *supra* note 84.

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] For more information on this particular segment of Argentina's public debt, see Eduardo M. Basualdo, *Deuda externa y poder económio en la Argentina*, NUEVA AMÉRICA, 1987 (Arg.); Alan Cibils & Rubén Lo Vuolo, *Nothing Certain but Debt and Taxes: Lessons From Argentina's Recent Debt Debacle* (Intergovernmental Group of 24 (G24) Working Paper, 2005) and the references there cited.

[93] This happened in 1982, when Domingo Cavallo was president of the Argentine Central Bank, and again in 2002, accounting for much of $35 billion post-default debt issues.

[94] *See generally* Argentina Debt Sustainability Analysis spreadsheets, *at* http://www.argentinedebtinfo.gov.ar/documentos/argentina-dsa.zip.

[95] At the time of the default, Argentina owed the IMF roughly $15 billion. Between January 2003, and August 2004, there were two successive agreements in place which provided for the roll over of capital payments. However, when in August 2004, the IMF inexplicably delayed approval of an agreement review, Argentina unilaterally decided to suspend the agreement. From that point on, Argentina paid the IMF in full and on time each time a payment came due.

[96] In June 2005, the IMF concluded its Article IV consultation with Argentina. In the press release, the IMF explicitly stated that "most Directors considered appropriate that the authorities should have the flexibility to draw on their international reserves to finance the significant levels of debt service, including repurchases to the Fund…" IMF Executive Board Concludes 2005 Article IV Consultation with Argentina, Pub. Info. Notice No. 05/83, June 30, 2005, *available at* http://www.imf.org/external/np/sec/pn/2005/pn0583.htm.

[97] *See* Decreto No. 1599, Dec. 15, 2005.

[98] *Id.*

[99] *See* Palabras del Presidente de la Nacion, Nestor Kirchner, en el acto de anuncio del plan de desendeurdamiento con el fondo monetario internacional, (Dec. 12, 2005) (President Nestor Kirchner's speech announcing the cancellation of Argentina's debt with the IMF) *available at* http://www.presidencia.gov.ar/discursos.aspx.

[100] While the poverty rate has dropped from its 54 percent peak in 2002, it is still at 34 percent. That is ten points above the poverty rate in May of 1998, before the last depression began. Indigence (basic needs unmet) is currently 12.2 percent, also down from its peak of 27.7 percent in 2002, but more than double its level in May 1998 (5.3 percent). Finally, while unemployment was down from 24 percent at the peak of the crisis, it is still at 14.1 percent. Underemployment is currently at 11 percent, which means that 25 percent of the economically active population currently has trouble finding full-time work. Furthermore, 48 percent of those currently employed are informally employed with no benefits, lower incomes, and no legal protection. *See* Instituto Nacional de Estadística Censos, http://www.indec.gov.ar/ (providing economic census data).

[101] *See* Jorge Schvarzer & Hernán Finkelstein, *Renegociación de la deuda: un panorama confuso de montos quitas, pagos y sustentabilidad futura*, CENTRO DE ESTUDIOS DE LA SITUACIÓN Y PERSPECTIVAS DE LA ARGENTINA (Notas de Coyuntura No. 16, 2004).

[102] In reality, most of these corporations did very well with the devaluation since their products became internationally much more price-competitive, overnight.

[103] Lo Vuolo (2003), *supra* note 4, at 61-64, 82-87.

[104] Technically, the Treasury is supposed to pay back Central Bank loans during the year following that in which it was granted. However, there is no penalty associated with non-repayment except that no new loans will be granted until the old ones are paid off.

[105] Roughly speaking, GDP-linked coupons pay the equivalent of 5 percent of the difference between actual and projected GDP in real terms. According to Schvarzer et al. if Argentina continues to grow at high rates, these payments could be substantial. *See generally* Schvarzer & Orazi, *supra* note 45. In 2006 alone Argentina will have to pay $367 million for these coupons.

[106] Between January and June 2006, the government had issued $2.3 billion in new debt.

[107] Jorge Schvarzer, et. al., *Estimaciones sobre el flujo de pagos futuros de la deuda. Un escenario de vencimientos que sigue presentando dificultades*, CENTRO DE ESTUDIOS DE LA SITUACIÓN Y PERSPECTIVAS DE LA ARGENTINA, (Notas de Coyuntura Nº22, 2006).
[107] *See* Williamson, *supra* note 12.
[108] *Id*.
[109] Ilene Grabel has wittily and ironically called this "speculation-led development." Ilene Grabel, *Speculation-Led Economic Development: A Post-Keynesian Interpretation of Financial Liberalization Programmes in the Third World*, 9 INT'L REV. OF APPLIED ECON. 127-149 (1995).
[110] *See* Int'l Monetary Fund, Argentina and the IMF, http://www.imf.org/external/ country/ARG/index.htm (last visited Apr. 4, 2007); Argentine Public Debt Information, http://www.argentinedebtinfo.gov.ar/ (last visited Mar. 4, 2007).
[111] For example, see IMF 2001 Press Release, *supra* note 44; IMF Executive Board Concludes 2005 Article IV Consultation with Argentina, Pub. Info. Notice No. 05/83, June 30, 2005, *available at* http://www.imf.org/external/np/sec/ pn/2005/pn0583.htm.