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The Argentine Dilemma: “Vulture Funds” and the Risks Posed to Developing Economies

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Abstract

Post-crisis Argentina is a case study of crisis management through debt restructuring. This article examines how Argentina negotiated the external debt in the wake of the sovereign default in December 2001 and now confronts challenges posed by holdout creditors—the so called “vulture funds”. It argues that debt restructuring has put a straitjacket on the national economy, making it virtually impossible for healthy growth short of a break with the international economic order. While Argentina has successfully restructured a \$95 billion debt with an unprecedented “hair cut” (around 70% reduction in “net value of debt”), a sustainable growth appears out of reach as long as reliance on the government debt market prevails. In this cycle, the transmission belt of financial crisis to developing countries is characterized by the entry of highly speculative players such as hedge funds, conflicts of interests embedded in “sovereign debt restructuring” (SDR) and vulnerabilities associated with “emerging market debt”.

Keywords

Argentina, Post-Crisis Argentina, Debt Restructuring, Financial Crisis, Developing World Debt Crisis

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Background: Argentine Debt Restructuring 2005-Present

Facing a major recession tied to the global economic crisis of 1999, Argentina defaulted on nearly \$95 billion in debt on December 2001. The default was the “largest sovereign debt default in history” (Hornbeck, 2013:1). Unique among Argentina’s debt crises, the 2001 default resulted from a perfect storm precipitated by the failure of a government policy (neo-liberal reforms¹) inherited from a military dictatorship and pushed to the limit by President Menem. The “convertibility plan” that fixed the peso to the dollar in 1991 (1 peso=1 dollar) imposed rigid constraints on Argentina’s fiscal and monetary policy², forcing it to rely on excessive international borrowing, financial liberalization and inflow of foreign investment and privatization (“oligopoly buy-outs”) (Rozenwurcel and Bleger, 1998; Rock, 2002; O’Connell, 2005)

The 2001 default was also a product of crisis-driven, unsustainable policies aggravated by the IMF’s problematic lending. That big financial players were determined to bet on the debt of poor countries with little concern for risk also contributed. By then, Argentina’s debt service ratio had reached alarming levels and despite last minute interventions (“mega swaps”, “corralito”) to stay afloat, the government defaulted. Amid rising political unrest and soon after the resignation of President de la Rúa, President Duhalde abandoned the currency board regime (January 2002) and simultaneously devalued the peso (Hornbeck, 2013:1-3; Damill et al, 2005:57)

Soon afterwards, Argentina launched a popular recovery based on a successful debt restructuring aimed at “financial independence” from the IMF. Ignoring warnings about the dire consequences of a default, Argentina defied the “conventional wisdom” that successful recovery must be based on a dramatic fiscal restraint (cuts in government expenditures) and tight monetary policy (high interest rates). Unorthodox measures to reduce fiscal deficits (higher taxes on soybean exports) were combined with increased government spending (“pro-poor” policies, job creation), which gained momentum towards fast recovery (Milberg, 2012). From 2002 to 2012, Argentina grew at an average rate of 6% (Hallinan, 2014). These developments sparked a debate within economic theory over the drivers of Argentine recovery —whether it was state-led/demand followed (Keynesian view) or largely external (due to the global commodity boom and higher prices for agricultural exports)³.

While the Argentine default in 2001 was expected⁴, its outcomes (i.e., suspension of debt payments to foreign creditors and the following debt restructuring) were not. Politically, the default opened the way to the theory of “new developmentalism”, presented as the antithesis of neo-liberalism yet within a capitalist framework (Bresser-Pereira, 2012). Unexpectedly, the new government refused to restructure the debt in terms favorable to IMF and private bond holders. Unparalleled in history, the Argentine debt restructuring forced private creditors to accept the largest “haircut” ever, thus belying the notion that a semi-peripheral state was powerless against global financial capital. Cooper and Momani (2005) attributed this success to Kirchner’s “skillful diplomacy” of “segmenting the international creditors” based on their conflicting interests (short-vs. long-term).

The face value of bonds that Argentina owed to private investors was \$81.8 billion. In January 2005, after a series of unsuccessful attempts to placate various multilateral creditors, President Nestor Kirchner “abandoned negotiations to restructure the debt” (Hornbeck, 2013:1). He made a unilateral (“take it or leave it”) offer that Argentina exchange new bonds for the older (defaulted) bonds at a substantially lower value—30 cents on the dollar owed in default (Roos, 2014). Nearly 93% of the creditors accepted the discount rate of 30%, trading in their defaulted bonds for newly issued Argentina bonds⁵. In early 2006, Argentina paid the IMF in full (\$9.5 billion) from its foreign reserves, which amounted to \$27 billion (Datz, 2009:472). In 2014, it fully met its obligations to the Paris Club countries, around \$6.3 billion (Hornbeck, 2013:3; Hallinan, 2014).

However, the remaining 7% (the so called holdout creditors) rejected the 2005 and 2010 bond exchanges with the majority of creditors. Among these holdouts, Peter Singer, an owner of Elliot Management, a hedge fund, brought a lawsuit against Argentina demanding to be paid in full. In 2012, U.S. District Court Judge Thomas Griesa ruled on behalf of “vulture funds”, claiming that the “country can’t make bond payments until it compensates hedge funds that refused to accept restructured debt in the years following Argentina’s 2001 default” (Parks *et al*, 2014:parag.2). Although Argentina appealed Judge Griesa’s ruling, the U.S. Supreme Court refused to hear the appeal on June 16, 2014. Since the judge blocked Argentina from paying bondholders without paying hedge funds as well, the majority of creditors could not receive \$539 million due on discount bonds. Although Argentina did not fail to make the payment, S&P and Fitch Ratings reduced Argentina’s foreign debt rating to “selective default” on July 30, 2014 (Stevenson, 2014).

Theoretical Argument

The debt crisis literature maintains that a major default forces debtor governments to sacrifice sovereignty over financial policy for fear of retaliation from powerful creditors (Hertz, 2004). Although there is no “international bankruptcy court” to compel sovereign states to pay off debts, states may be denied access to international credit or risk having their overseas assets confiscated if they fail to restructure debt. Therefore, instead of defaulting on an entire debt, governments often negotiate with the debt holders (i.e., private creditors, governmental agencies, multilateral lending agencies) in exchange for partial reduction of their debt payments, which is called “debt restructuring”.

Offering a class-based and historically grounded analysis of this phenomenon, Soederberg (2005) reminds us that the evolution of “transnational debt architecture” favors the interests of global financial capital--private sector creditors in advanced capitalist nations-- over debtor states in the South. In examining the Argentine default (1999-2001), she shows that through market-led and “ad hoc” mechanisms for restructuring sovereign debts (like Paris and London Clubs, “Collection Action Clauses”), creditor nations reinforce “bargaining” and “disciplinary” powers over debtor states. Debt restructuring serves to socialize debt domestically “through increased forms of economic exploitation (lower wages, longer hours), higher taxes”, “higher interest

rates” and “cuts in government spending in terms of education, health and welfare” (Soederberg, 2005:933).

Soederberg also contrasts two mechanisms for restructuring Argentine debt (2001-2003) owed to international private creditors during the period 2001-2013: The IMF’s SDRM approach (“Sovereign Debt Restructuring Mechanism”) and the US Treasury’s CAC proposal (“Collection Action Clause”). She argues that while the first was more likely to serve the interests of debtor states, the second favored powerful financial interests (securities and bond industry associations) and their creditor state representatives, such as US Treasury Undersecretary John Taylor. The IMF approach was similar to Chapter 11 of US Bankruptcy law, one which allowed debtor states to buy time by calling a break on debt payments and reorganize debt in a timely manner. Serving as a “market-based approach” to debt management, the one pursued by the CAC contained a “super-majority of creditors” clause allowing foreign creditors (bondholders) “to approve a process that is believed to make it easier to restructure debt by allowing a majority of creditors to impose a deal” (Soederberg, 2005:945). Officially accepted during the 2003 Annual meetings of the IMF and the World Bank, the CAC made it easier for private creditors to obtain the best offer from debtor states and in a shorter time.

Helleiner (2006) presents a slightly different reading of debt restructuring initiatives during the period 1970-2003. He identifies “collective action problems” in the construction of a formal “Sovereign Debt Restructuring Mechanism” (SDRM) and indicates that not only private creditors but also some of the debtor states were opposed to the formation of SDRM. Indeed, as Miller and Thomas showed (2006:2), a “coalition of creditors, debtors and the US government” vetoed the IMF plan (SDRM), leading the way for the formation of CAC in 2003. Particularly, the main challenges to a satisfactory agreement on sovereign debt resolution and its afterwards stemmed from 1) “collective action problem involving sovereign debtors and private foreign creditors”, 2) “basic distributional conflicts embodied in any restructuring effort”, and 3) “uncertain behavior of private creditors’ states” (Helleiner, 2006:2).

The conflicts of interests were not exclusively reflected in formal debt negotiations involving the SDRM. The swap agreement that Argentina negotiated in 2005 was technically similar to a CAC deal—one based on the “inclusion of Collection Action Clause in sovereign bond contracts” (Miller and Thomas, 2006:2).

The case study presented in this paper (the “Griesa ruling”) demonstrates how contentious Argentina’s relationship has become with a minority of holdout creditors. The current claims of “vulture funds” are based on the “judicial enforcement of sovereign obligations (throughout holdout litigation)”⁶. Clearly, this enforcement protects creditor rights in particular, and global financial interests in general. There is also a contradiction in the claims that go against the “Argentine debt swap” negotiated between the majority of creditors and Argentine government in 2003-2005. While much resembling CAC than SDRM, the swap agreement involved a favorable haircut on Argentine debt that “was neither mediated by the IMF nor assisted by clauses to promote creditor coordination: It

was take-it-or-leave-it offer from the debtor, accepted by a supermajority of holders” (Miller and Thomas, 2006:6).

The rest of the paper examines the evolution of Argentine debt swap since 2005. It puts the conflicts embodied in the “holdout litigation” in historical perspective and argues that “vulture funds” claims would supersede the swap exchange negotiated in the first place. As Argentina refuses to pay “vulture funds”, financial interests (majority of bond holders still waiting to be paid) are also divided over whether the nonparticipating holdouts should be paid. We further claim that the international financial system has changed since the successful resolution of the Argentine debt. Confirming Rasmus (2014), the slow growth in capitalist centers (tied to Fed’s less easier monetary policy recently) and a shift of the center of the global recession to the semi-periphery has triggered a Latin American slowdown. This means that Argentina can no longer rely on a favorable external environment (“commodity boom”) to trigger a Keynesian (demand)-led recovery.

The U.S. position on holdout creditors (the Supreme Court decision backing the hedge fund deal against Argentina) is patently interventionist and a repudiation of Kirchner’s 2005 demands. However, although the U.S. is integral to the reproduction of “transnational debt architecture” that disguises and reinforces the “power global financial capitals over debtor states” (Soederberg, 2014:928), the financial interests of sovereign states, private creditors and debtor states are divided over the resolution of holdout payments. At a micro-level of analysis, the conflicts among different fractions of capital might prevent a hedge fund victory as Argentina may not be easily convinced into accepting the conditions of “Griesa ruling”. Hypothetically, the risk of losing an emerging debt market for the gain of few “vulture funds” may be too great for large banks from creditor nations (U.S., European Union). Selective payments to holdouts can lead to “moral hazard” when just a few bondholders benefit from sovereign default.

Argentina’s post-crisis indicators (higher inflation, devalued peso, rising unemployment, and worsening trade balance) and social unrest testify to its dependence on foreign capital and adaptation to neo-classical orthodoxy at home. Although the outcome of the gridlock with holdout creditors is too soon to predict, Argentina is facing yet another crisis flowing from its integration into the global debt structure.

“Vulture Funds” and the Emerging Market Debt

While “vulture funds” are just a microcosm of existing power relationships in debt restructuring, they pose unique challenges to sovereign bond contracts and global financial architecture. Basically, they are opportunists with even more speculative tendencies than the average private capital firm or hedge fund. Sabat describes them as a “*particular type of holdout creditor who through the secondary market buy distressed assets at a discount and then refuse to participate in sovereign debt restructurings*” (Sabat, 2013:1). They differ from other holdout creditors by aggressive litigation against the defaulting country “for the full face value of the debt”. Most often, “vulture funds” buy distressed government bonds from poor countries at fire sale prices, gambling on the possibility that through litigation the courts will award them the full price no matter the

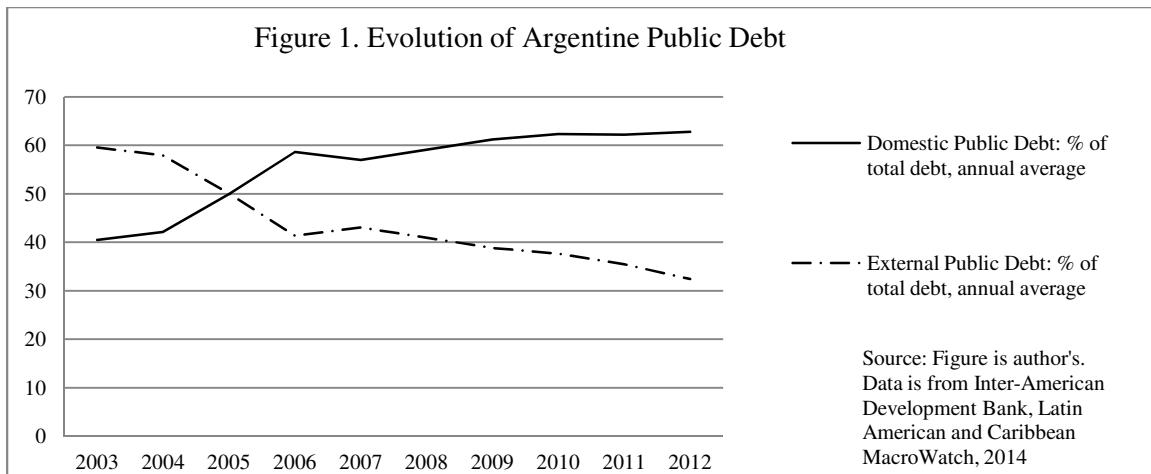
consequence to the debtor nation or more conventional debt holders (Ghosh and Vernengo, 2012).

“Vulture funds” have successfully won litigation against Congo, Peru and Liberia, and most recently the government of Argentina (Wilkie and Grim, 2013). They are willing to fight for their own narrow gains (highest return on investment) at the expense of global finance’s overall health and stability—especially sovereign debtors and other creditors. As a result, several commentators criticized vulture funds and “proposed mechanisms” to regulate their powers—especially the use of aggressive campaigns against defaulting governments, and the enforcing of “contractual claims against sovereign debtors through litigation” (Fish and Gentile, 2004:1043).

On the other hand, “vulture funds” are not simply an expression of aggressive lobbying on the part of financial institutions. It is part and parcel of the restructuring of the global financial order that has occurred since the resurgence of financial crisis in Latin America, Russia and Asia in the late 1990s. In the process, “vulture funds” became both the transmission belt of contagion as well as its agent in restructuring sovereign debts.

Rethel (2012) maintains that the mechanisms of “sovereign debt restructuring” have changed since the 1980s. The most important change has been the “disintermediation” of capital flows assisted by new instruments of debt financing in emerging market economies—increasingly away from official borrowing (commercial bank loans, IMF loans and governmental loans) towards domestic bond issuance and portfolio investment flows. Rethel calls this process a “domesticisation of emerging market debt”, which include securitized (government) debt issued in local currency (such as Treasury securities, bonds and stocks) and held by a wide range of domestic investors: the central bank, commercial banks and non-bank financial institutions such as hedge funds, mutual funds, pension funds and insurance companies (Bue *et al*, 2014:16). As a result, domestic debt accounted for a larger portion of total government debt in some of the low and middle-income countries. When debt was issued domestically, it served a number of purposes: 1) to gain “greater jurisdictional control over the debt issued by domestic economic actors, both sovereign and corporate”, 2) to “reduce the role of the dollar” and exposure of the issuer to currency risk by denominating debt in local currency, 3) to lead the way for development of national financial systems (especially “local currency bond markets”), 4) to restructure/recapitalize banking systems and refinance national debt in the wake of the Asian financial crisis (Rethel, 2012:130).

Since the early 1990s, domestic bond markets have become a major platform for debt financing in developing countries even while destabilizing them. As such it explains why Latin America is caught in a debt trap and why reliance on local bond markets may not necessarily resolve the debt crisis. Some disadvantages include short-term maturity of domestic debt, which increases exposure to “rollover” and “interest rate risks”. In developing countries, in addition to weakly regulated financial systems, the main challenges include “supply-side” constraints on the issuance of long-term debt at a “reasonable cost” (Bua *et al*, 2014:1).



Notes: According to Inter-American Development Bank, domestic and external public debt “exclude debt not presented to 2005 and 2010 debt swap. Refers to National Administration, Public Enterprises and Other Public Entities”.

With respect to Argentina, the sovereign debt structure highlights “financialization” of debt markets and the nation’s peripheral integration into the global economy. Figure 1 indicates the rising importance of domestic public debt during the period 2003-2012 within the total debt of Argentina. Overall, domestic debt has a higher proportion to total debt compared to external debt. In 2012, domestic public debt was 62.78% of total public debt whereas external debt was 32.4%. The exact composition of debt portfolio in terms of instruments, investor base and maturity structure cannot be ascertained with surety. For example, the data does not distinguish between different types of investors—i.e., percentage of debt held by commercial banks, the central bank, non-bank and other financial institutions (hedge funds, mutual funds, pension funds). A decisive trend is that Argentina has increased its borrowing in local government debt since 2003; there has been a growing importance of domestically issued debt, indicating the expanded role of capital markets for raising funds subsequently with the default in 2002. This trend in the structure of debt financing falls under the category broadly described as “financialization”—the “increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies” (Epstein, 2005:3)

Debt restructuring in the post-default period indicates the formation of public policy on behalf of decisive capitalist sectors⁷. The financial sector (especially commercial banks) seems to be the most concentrated investor base that benefited from sovereign debt restructuring. For example, the pesification of all dollar debts indicates how industrial recovery would not be possible without compensating bank losses. Dominant socioeconomic groups, such as agricultural producers and domestic industries, were indebted in dollars; they were anxious about not being able to pay back their debt in the event of devaluation. Therefore, they saw pesification as a mechanism to reduce their debt burden. Banks, while strongly preferring dollarization to devaluation, accepted pesification (as an “emergency measure”) to avoid massive bankruptcies or defaults on loan repayments (Calvo, 2008:18).

“Asymmetric pesification” reflected the emerging consensus between the financial elite and the Argentine state at the time. Pesification was asymmetric to the extent that it treated corporate debt and private deposits differently. The corporate debts were converted at the rate of 1 peso 1 dollar while all foreign currency bank deposits were rated at 1.4 pesos per dollar. Mounting a lobbying campaign, banks sought to be compensated for the costs of “asymmetrical” conversion of dollars to pesos. While the government attempted to tax oil exports to provide the funds for this purpose, lobbying pressures from petroleum companies preempted such a measure. As Calvo argued, “the power struggle took place and eventually led to a policy outcome that favored the most concentrated sectors of economic power” (Calvo, 2008:34). To absorb bank losses from “asymmetric pesification”, the Argentine government issued \$5.9 billion new debt and also “established different inflation adjusting mechanisms of deposits and pesoified credits” (Damill *et al*, 2005:66).

The Holdout Problem and the “Griesa Ruling”

The resolution of Argentine debt crisis highlights the dominance of financial capital over the rest of the economy. It also explains the dilemma facing the Argentine government—to address systemic stability towards economic recovery, the state had to placate the demands of powerful financial sectors. Imposing austerity and financing bank losses (“asymmetric pesification”) at the expense of ordinary citizens set a precedent favorable for debt restructuring in 2005 and 2010.

Argentina initiated bond exchanges in two stages. In January 2005, out of \$81.8 billion debt owed to bond holders, it exchanged \$62.3 billion of defaulted bonds for \$35.2 billion in new bonds. The amount of debt owed to private investors in 2010 remained around \$29 billion (bond principal plus interest). With the bond exchange concluded on December 31, 2010, the total participation rate increased to 91.3% of defaulted debt, which also included the 2005 participants. From 2010 to 2011, Argentina reduced the portion of debt owed to holdouts and the Paris Club of nations from 10% of total public sector debt to 7% of total public debt. From 2002 to 2010, international reserves also increased from \$10.4 billion to \$52.2 billion. During the period 2003-2008, the Argentine economy experienced an average growth rate of 8.5% and a primary surplus of 2.8% in revenues, enabling the government to refinance external debt at a faster pace than during 2001 or 2005 (Hornbeck, 2013:5-7).

Increased revenues and foreign reserves were not the only sources of debt financing. During restructuring, Argentina addressed the ongoing crisis by adopting austerity measures aimed at socializing the financial risks. In 2001, they included an attempt by the government to push for “zero deficits law” and fiscal tightening. Imposing a dramatic cut in public employee wages, the law also required pension cutbacks. These draconian measures led to the emergence of a “piquetero movement”, which organized employed and unemployed workers towards large-scale mobilization against austerity measures (Kabat, 2014:378).

Yet imposing austerity was not sufficient to address the ongoing crisis. With almost no

access to multilateral loans or external financing in capital markets, Argentina adopted the strategy of “monetizing debt” (Hornbeck, 2013:6). This involved refinancing or paying off debt by issuing government bonds and selling them to the central bank, domestic commercial banks, public or private investors and other governments (Mishkin, 2005). The “government debt market” became a major platform for financing deficits in other economies as well, such as Brazil, Turkey and Lebanon (Hardie, 2012).

With no real alternatives, Argentina negotiated the debt under duress. With its status as a semi-peripheral economy, Argentina came to capital markets at a disadvantage and thus was subject to the onerous conditions that would create a new round of instability. During these bond exchanges, new bonds were issued in order to raise money for repaying bonds coming due. The bonds benefited domestic and foreign investors who participated in the restructuring process, as well as Argentina in its role as recipient of portfolio capital flows. Datz showed that the bonds exchanged in the 2005 debt swap “registered returns of 25% and 50% respectively” and there were even considerable returns in “extremely risky bonds” (“junk bonds”) (Datz, 2009:475). After 2005, Argentina issued “Bonar” bonds under local laws, mainly purchased by big banks of core advanced countries (such as Deutsche Bank, Morgan Stanley, Citigroup) in “secondary markets” and paid three times higher than the government’s offer (8% interest rate) (Datz, 2009:473).

Furthermore, based on the bond swaps exchanged after 2005, Argentina “fulfilled its obligations” to the majority creditors (above 90%) who agreed to the debt restructuring. Few days prior to July 30, 2014, Argentina made semiannual payments on the restructured bonds by depositing \$539 million into the Bank of New York Mellon. However, U.S. Federal judge Thomas Griesa did not allow the bank to transfer the payment to Argentina’s creditors. He had earlier “ordered that Argentina could not pay the creditors who had accepted its restructuring until it fully paid—including past interest—those who had rejected it” (Stiglitz and Guzman, 2014:parag.2).

Debt negotiations made Argentina vulnerable to an attack by a minority of holdout creditors. First, the Argentine bonds were issued under New York law, meaning that Argentina had to pay its creditors from New York. Although Argentina could technically bypass the New York Court and transfer the jurisdiction of bond issuance and thus pay the exchange bondholders from Argentina, it did not have the complete list of bondholders, which was kept by a foreign financial firm. Neither the banks nor the foreign firms wanted to be perceived in “contempt” of a U.S. judge’s order (Eavis and Stevenson, 2014a).

In this round of debt negotiations, the complex set of arrangements between foreign bondholders and their governments put Argentina at a disadvantage. For example, many of the bondholders are “bound” by their own government rules “restricting them from holding assets under foreign jurisdiction” (*The Economist*, 2014:parag.7). Even if the majority of private creditors agree to the “rerouting” of bonds to Argentina to avoid paying “vulture funds”, Argentina still needs a financial intermediary outside of New York law. Finally “Argentina would need to convince Bank of New York Mellon, its current trustee, to release information about the bondholders to its new intermediary”,

which has already declared, it “will comply with any court order by which is it deemed bound” (*The Economist*, 2014:parag7).

In addition, paying out “vulture funds” increases the burden on Argentina because of the “RUFO clause”⁸ stated in Argentina’s bond prospectus. Buying Argentine bonds for a mere \$48 million in 2008, Griesa’s ruling would reward Singer’s NML capital handsomely-- \$832 million (“a return of 1,600%”). Under the same ruling, NML capital and other “vulture funds” (1% of the creditors) would also obtain \$1.5 billion. If the additional claims of other holdouts (6.6% of total creditors) were considered, the debt owed would amount to \$15 billion (Stiglitz and Guzman, 2014)—nearly half of Argentina’s total dollar reserves.

If Argentina pays off a minority of hedge funds before December 31, 2104, however, the “RUFO Clause” in the bond contract would kick in, thus allowing all bondholders to demand the “same treatment” as holdouts. This was reinstated with the aim of equal treatment for all creditors, i.e., “vulture funds” cannot be treated better than the majority of bondholders who accepted the debt restructuring (Lopez, 2014). Therefore if the clause takes effect, this might increase Argentina’s obligations to \$200 billion (Eavis and Stevenson, 2014a), a draconian penalty that would generate serious repercussions for the Argentine economy.

Within financial capital there is no consensus on how their interests can best be achieved but “vulture funds” continue the legal battle with Argentina aggressively. While the main group of bondholders are willing to exchange their bonds for new bonds, “vulture funds” refuse to “tender” the defaulted bonds and thus have received no payment. Instead, they demand full payment to litigant holdouts and increasingly put pressure on Argentina to obey the U.S. court ruling.

To press their demand for full payment, “vulture funds” formed a website called *Fact Check Argentina*, where they respond to the argument that Argentina was “forced” to default by a court ruling. The website is filled with claims that Argentina can indeed afford to pay the holdouts and chose not to do so, disrespecting the judge’s decision. It also publishes articles on the “costs” of not paying, floating a doomsday scenario in the likely event of default that includes a collapse of investments, capital flight, and ordinary people in Argentina suffering. Interestingly, by July 30th markets did not react as “vulture funds” predicted, “distinguishing” between, as Stiglitz and Guzman (2014) noted, a real default and Griesa’s order. The interest rates on various types of Argentine corporate loans were stable and the borrowing costs were “lower than the average for the whole year” (parag.10).

The Risks Posed to Developing Economies

Since the U.S. court ruling on behalf of “vulture funds”, the mainstream media’s response towards Argentina has been mixed. In liberal media like *Huffington Post* and *Project Syndicate*, several authors criticized Judge Griesa for encouraging speculative behavior and moral hazard among investors. They exposed the political connections between Peter

Singer's NML capital (a subsidiary of Elliot Management), American Task Force Argentina ("the group advocating the full payments on the bonds") and the Clinton administration (Wilkie and Grim, 2013). In *Project Syndicate*, Stiglitz and Guzman (2014) refused to call it a "default", noting that Argentina "was willing and able to pay its creditors, but was blocked by a judge from doing so". They further noted that: "Griesa's ruling, however, encourages usurious behavior, threatens the functioning of international financial markets and defies a basic tenet of modern capitalism: insolvent debtors need a fresh start" (Stiglitz and Guzman, 2014: parag.2). *New York Times* did not take an editorial position on the issue, rather describing events as they unfolded. *The Economist*, a vocal opponent of the Kirchners' policies, reported on Argentina's \$48 billion reserves at the BIS and the Elliot fund's unsuccessful attempt at seizing them (*The Economist*, 2011).

While Argentina has fully paid its debt to a supermajority of bondholders, it objected to settling with "vulture funds" who did not participate in the bond exchanges. Axel Kiciloff, the Finance Minister of Argentina, described the "negotiations as extortion", stressing that "We are not going to sign any deal which compromises the future of Argentines" (Eavis and Stevenson, 2014b:parag.6). On July 17, 2014, Argentina placed an advertisement in *New York Times* objecting to the notion that Argentina defaulted and added: "Default means not paying, Argentina does pay". Based on an article that appeared on the AFTA (American Task Force) website, Argentina characterized the demands of "vulture funds" as "overburdening" the country with debt "in order to make exorbitant profits" such as gaining strategic control over other countries' natural resources. The fact that AFTA links the payments to the U.S company Chevron, which may leave Argentina if it does not pay "vulture funds", may be a sign of their "ulterior motives" (*New York Times*, 2014). Although gauging the power of secretive hedge funds is problematic, they are undoubtedly a menacing force that exploited poor countries in the past.

It is unclear how far U.S. pressure on hedge funds to extract larger gains will go. The final U.S. resolution on this issue is still to be determined. Argentina has recently paid the Paris Club of Nations in full, including the \$500 million it owed to the U.S. government. Up till now, with laws prohibiting U.S. government agencies from lending to non-paying countries, the U.S. vetoed loans to Argentina at the Inter-American Development Bank and World Bank. Some members of Congress, allied with American Task Force Argentina, a "private lobby group" for hedge funds and holdout creditors, threatened Argentina with legislation such as the "Judgment Evading Foreign States Accountability Act of 2011". This bill, however, failed to attract a hearing in the House Committee on Foreign Affairs on November 29, 2012, having not much impact abroad. It was suggested that: "the committee lacked jurisdiction" and "there were larger foreign policy issues to consider" (Hornbeck, 2012:12).

The outcome of this case is ultimately dependent on negotiations between the Argentine state and various fractions of capital at both the domestic and international levels.

Repayment on the terms dictated by Griesa would ruin Argentina's economy, especially

if the “RUFO clause” triggers. This would lead to the depletion of Argentina’s foreign reserves. It is estimated that such a payment would cost every Argentine more than \$3500—“more than one-third of average per capita income” (Stiglitz and Guzman, 2014:parag.8). According to Roos (2014), the full payment to “vulture funds” (the “alternative” of default), would “also be particularly costly for the domestic elite, which is usually invested in government bonds and which derives much greater economic advantage from deep integration into global financial markets” (Roos, 2014: parag.8).

The conflicts of interests among different groups complicate the resolution of holdout claims. Holders of Argentine debt include American as well as European investors. Consequently states are inclined to protect their own economic interests. From the standpoint of investors, if Argentina settles with NML capital, it has to negotiate with the majority of bondholders to “waive” the “RUFO clause” merely to pay off “vulture funds” (Lopez, 2014). In that case, paying a minority of creditors leads to “moral hazard” because one groups gets a better deal than others. In 2013, a German court ruled in favor of Argentina, rejecting the “first petition from the holders of defaulted Argentine bonds”. Similarly, a Belgian court refused to cash in NML’s defaulted bonds and ordered “the lifting of the embargo on Argentine diplomatic bank accounts” demanded by NML (Buenos Aires Herald, 2013).

Generally, European and Latin American countries, especially France, Mexico and Brazil, supported Argentina during the Supreme Court’s review of the rival claims. With the exception of the U.S., Canada and Panama, Argentina has had the full backing of the “Organization of the American States”. As the judge’s order unfolded, the IMF sought to “intervene” on behalf of Argentina but the U.S. pressured it not do so (Quiggin, 2014:parag.14).

While the official U.S. position on this has not been clear, the interests of bigger capital may override the demands of a few hedge funds. Recently, the Obama administration has been concerned that New York may lose business to London if Argentina defaults as well as destabilizing financial markets (Rathbone *et al*, 2014).

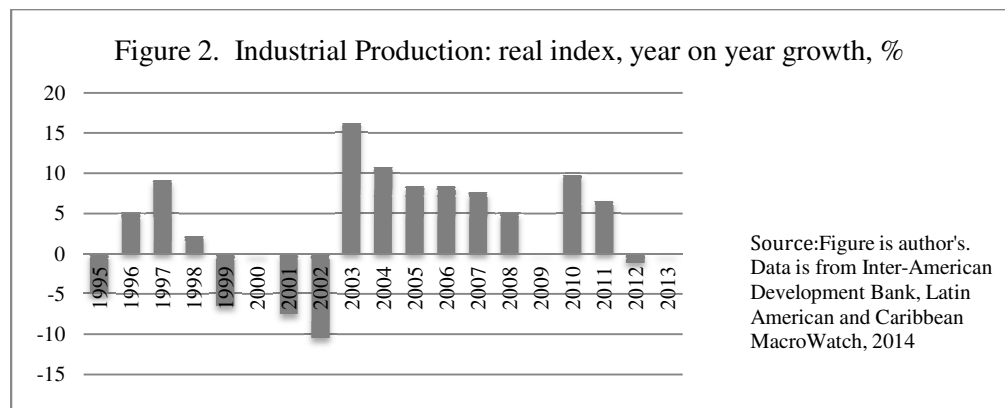
Whether long or short-term American interests prevail in Argentina depends on the lobbying power of the financial sector, which is difficult to ascertain at this stage. The more fundamental issue is whether the “mutual” interests of states to regulate finance can transcend the narrow interests of their financial sectors.

Symptoms of Financial Instability

The “Griesa ruling” is just a microcosm of the financial power structure confronting Argentina. A default on holdout payments has the potential of destabilizing Argentina’s economy as well as diverting funds from the public sector, infrastructure, health and education. However, to see “vulture funds” as the root cause of instability overlooks Argentina’s deeper integration into the global financial system. Argentina has not escaped the cycle of instability despite successfully restructuring debt since 2005.

Argentina is currently facing what some economists have called the “shift of the global economic crisis to emerging markets” (Rasmus, 2014). In describing the ongoing crisis as a “new type of debt-deflation”, Guillen (2011:187) identified “the limits of finance-dominated regime of accumulation characterized by securitization”. In Soederberg’s terms, the securitization of transnational debt has involved the emergence of a less regulated global financial order. It has in particular involved the emergence of neo-liberal, “exploitative strategies of accumulation” in debtor states in order to overcome the “crisis of over-accumulation”. Since the mid-1980s, such strategies have been characterized by a trend away from “less volatile bank loans” towards foreign portfolio capital and the arrival of new actors and institutions on international lending scene, such as hedge funds, mutual funds, pension funds. As a result, sovereign debt became more unstable and complicated (Soederberg, 2005:937-938).

While Argentina’s post-crisis model, one tied to Keynesian stimuli and export taxation, tried to break with “financialization” to promote industrial production (Figure 2) and regulate speculative capital flows, it still rests on financial “indebtedness”. In developing countries such finance-centered development is unsustainable because it generates “pro-cyclical borrowing” through government debt creation. In developing countries, government borrowing relies on access to capital markets during recessions and as such is susceptible to short-term capital flights (Panizza et al, 2009:666) that periodically wrack Latin America.



Argentina’s improved relations with the U.S. cannot be reduced to big power domination of a weaker nation, in effect making Argentina “cry uncle” as was the case with Nicaragua in the 1980s. Indeed, the failure of Keynesian responses to the sub-prime mortgage crisis (monetary stimuli and liquidity injections into U.S. banks) has kept neo-classical economics alive. As Rasmus (2014) explained, it has propelled the shift of financial crisis from the U.S. to “emerging markets”. Since mid-2013, the “dual character” of global recession has manifested itself through a reversal of “V shape” recovery. Once rapidly growing BRICS/commodity exporters (China, India, Brazil, South Africa, Russia) have slowed down while capitalist centers like the U.S., Europe and Japan are now stabilizing or growing at lower rates (instead of “stagnating”). The

slow growth in BRICS is also related to the Fed's announcement that it would restrict liquidity injections into banks and "consider raising interest rates" during summer 2013 (Rasmus, 2014:parag.22).

The recurrent instability undermines Argentina's ability to service debt (even in terms favorable to domestic elite). Argentina has become the weakest link in the regional economy during this new "deflationary" cycle. The crisis has reached Latin America through limited access to capital markets, depreciating currencies, declining trade and investment flows, capital flight and higher cost of accessing external funds. Unlike the Mexican and Brazilian economies, which have not experienced significant increases in capital outflows from 2007 to 2008, Argentina (along with Colombia) changed from "being net recipients of non-FDI financial flows to net exporters of financial resources" (Titelman *et al*, 2009:22).

Despite President Kirchner's radical rhetoric against "vulture funds", Argentina has adapted to the "Washington Consensus" lately. It has pursued more orthodox policies such as repaying the Paris Club of nations and paying off the Spanish oil company Repsol (\$6.5 billion). Meanwhile, unemployment is rising against declining industrial production (Figure 2) and plummeting capital inflows and international reserves. A rapid devaluation of the peso in January 2014 and the resulting inflation (nearly 23%) also led to currency controls and some tightening of monetary policy (ECLAC, 2014).

Summary and Conclusions

This paper examined how Argentina has negotiated debt since 2005 and some of the challenges remaining for the payment of holdout creditors—the so called "vulture funds". Putting the conflicts embodied in the "holdout litigation" in historical perspective, we argued that "vulture funds" claims would supersede the swap exchange negotiated in the first place. As Argentina refuses to pay "vulture funds", financial capital interests (majority of bond holders still waiting to be paid) are also divided over whether the nonparticipating holdouts should be paid.

Overall, the outcome of the deadlock with holdout creditors is uncertain. The clashing interests among creditor-debtor states and financial capital might prevent a hedge fund victory. Hypothetically, the risk of losing a debt market for the gain of few investors may be too great for larger banks. Full repayment to holdouts can lead to "moral hazard" when just a few bondholders benefit from default.

Argentina's post-crisis model was tied to Keynesian stimuli that elevated the role of the state over financial capital and encouraged industrial production. But the institutional and structural foundations of financial "indebtedness" remain in place. Such finance-centered development is not sustainable because it generates "pro-cyclical borrowing" through the sovereign bond market. In developing countries, government borrowing relies on access to capital markets during recessions and as such is susceptible to short-term capital flights (Panizza *et al*, 2009:666) that periodically wrack Latin America.

The “Grieta ruling” is just a microcosm of the transnational debt structure confronting Argentina. Given the end of “V-shape” recovery underway in emerging markets, Argentina needs to look for domestic sources of financing that rely on productive capital as engine of growth rather than financial such as external sector and sovereign bond market only. Resorting to the debt market perpetuates a cycle of instability that deepens Argentina’s peripheral integration into the global economy.

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¹ According to Soederberg (2005), in spite of the differences (timing and application) among developing countries, neo-liberal reforms facilitated a transition from Keynesian economic policies (such as trade and capital controls) to a “market-led restructuring” where loans from creditor states and international financial institutions were attached to “Structural Adjustment Programs” in debtor states. This required them to engage in “fiscal discipline, reordering public expenditures priorities, tax reform, liberalization of interest rates, competitive exchange rates, trade liberalization, privatization, deregulation and property rights” (Soederberg, 2005:938).

² From 2000 to 2002, Argentina’s total public debt increased from 45.7% of GDP to 166.3% of GDP (Hornbeck, 2013:3). The “convertibility plan” was based on the orthodox principles of fiscal and monetary discipline, which imposed strict conditions on the Argentina’s ability to manage a financial crisis. It stipulated that Central Bank support the “monetary base” exclusively with “foreign exchange reserves” rather than printed money (Rozenwurcel and Bleger, 1998:369). Thus, the plan relied on limiting the printing of currency to cover deficits, 2) prohibiting the devaluation of peso to increase exports and 3) using fiscal discipline (cuts in public expenditures) to counteract business cycles. This left the government with “no room” to address the recession following the 1997-1998 East Asian, Russian/LTCM crisis. With no option for a fiscal stimulus, Argentina relied on excessive international borrowing and fiscal discipline (cuts in public expenditures) to finance the deficit, which reinforced the recessionary cycle. The “convertibility plan” was a “straight jacket” for Argentina; fiscal deficits “were not restrained at either the provincial or national levels to thresholds required to support the convertibility plan. By 1993, debt began to grow, compounded by the practice of rolling it over. From 1995 to the end of 2001, the debt service ratio grew from 30% to 66%” (Hornbeck, 2013:2).

³ On the role of state and macroeconomic policies in “demand-led recovery”, see Cohen (2011), Weisbrot (2012), Weisbrot *et al* (2011), Frenkel and Rapetti (2008), Gruel and Riggiozzi (2007), among others. For the opposite view emphasizing the importance of external demand and Latin America’s integration into global capitalism via “agro-export model”, see Caldentey and Vernengo (2010).

⁴ For an analysis of detailed negotiations with the IMF, domestic and international creditors, especially the “mega swaps” exchanged with bond holders in June and November 2001, prior to the default in December 2001, see Datz (2009:466-468), Damill *et al* (2005:56), Hornbeck (2013).

⁵ The exchange offer was made in two stages. In 2005, Argentina restructured \$62.3 billion of the \$81.8 billion in principle—around 76% of the total debt in default. The debt exchange was re-opened in 2010, obtaining another \$12.4 billion of defaulted bonds and thus raising the amount of debt restructured to a 91.3% of original debt (Hornbeck, 2013:1).

⁶ As explained in Miller and Thomas’ review of literature on this topic (Miller and Thomas, 2006:3).

⁷ For in-depth analysis of economic, social and political transformations in Argentina during the 1990s and post-convertibility, see Azpiazu and Schorr (2010), Azpiazu and Nochteff (1998), Basualdo (2000; 2001).

⁸ “Rights Upon Future Offers” clause.