



Argentina's Defaulted Sovereign Debt: Dealing with the "Holdouts"

J. F. Hornbeck

Specialist in International Trade and Finance

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Summary

In December 2001, Argentina suffered a severe financial crisis, leading to the largest sovereign debt default in history. In 2005, after prolonged, contentious, and unsuccessful attempts to restructure the debt, Argentina abandoned the negotiation process and made a unilateral offer. The terms were highly unfavorable to creditors, but \$62.3 billion of the \$81.8 billion in principal owed was exchanged. A diverse group of "holdouts" representing \$18.6 billion did not tender their bonds and some have opted to litigate instead. These actions resulted in attachments orders against Argentine assets, leaving the country unable to access the international credit markets and mired in litigation. Holdout creditors also lobbied against Argentina's debt policy, which has triggered actions by the U.S. government and legislation in Congress (H.R. 1798 and S. 912 in the 112th Congress).

The lingering effects of the debt default became a legacy problem for Argentina. The government decided to open another bond exchange in 2010 to deal with remaining holdouts, on slightly less favorable terms than before. Argentina reduced its outstanding defaulted debt by another \$12.4 billion. As of December 31, 2010, Argentina reported that it owed private investors \$11.2 billion (\$6.8 billion in principal and \$4.4 billion in past due interest). Holdout creditors estimate that with additional interest, this number could be as high as \$15 billion by 2013, with \$1.3 billion under litigation in federal court. Argentina also owes the Paris Club countries \$6.3 billion in principal plus past due interest and penalties. The U.S. portion is estimated at \$550 million.

Argentina does not recognize the remaining private holdout debt in its official financial statements and is legislatively barred from making another offer to bondholders. Nonetheless, in the eyes of holdout creditors, the bond exchanges have set a precedent that cannot be condoned, even though 91.3% of total bondholders have accepted terms. Although Argentina continues to argue that the restructurings were negotiated solutions, they were not mutually agreed ones. Bondholders had to accept or reject the offers with the alternative being the promise of no restitution at all. Holdout bondholders remain unpaid while Argentina is current on its obligations to bondholders who participated in the two bond exchanges, an outcome that is currently being challenged in court under the equal treatment provision of the bonds. Recent court decisions have left Argentine central bank assets in the United States immune from attachment, but subject to an appellate decision expected on February 27, 2013, the Argentine government could be compelled to pay litigant holdouts their full \$1.3 billion claim.

The Argentine government filed its final papers before the appellate court on February 1, 2013, arguing that it would not be able to fulfill a court order requiring full payment to litigant holdouts. It did, however, suggest that to meet the concern over equal treatment it could arrange to reopen the previous bond exchange to allow those who did not participate in it to reconsider their position. Some holdouts have suggested that this may be an acceptable option. The issue remains unresolved pending outcome from the February 27, 2013, court proceedings. This report reviews Argentina's financial crisis, the bond exchanges of 2005 and 2010, ongoing litigation, prospects for a final solution, related U.S. legislation, and broader policy issues. These include lessons on the effectiveness and cost of Argentina's default strategy, the ability to force sovereigns to meet debt their obligations, and options for avoiding future defaults like Argentina's.

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Introduction

In December 2001, Argentina suffered a severe financial crisis, leading to the largest sovereign debt default in history. In 2005, Argentina abandoned negotiations to restructure the debt and made a unilateral offer on terms highly unfavorable to creditors. Still, \$62.3 billion of the \$81.8 billion in principal owed was exchanged. A diverse group of "holdouts" representing \$18.6 billion did not tender their bonds. Argentina completed a second bond exchange in 2010, capturing another \$12.4 billion of defaulted bonds (for a total of 91.3% of the original defaulted debt). At the close of 2010, Argentina reported that it owed private investors \$11.2 billion (\$6.8 billion in principal, \$4.4 billion in interest). Including additional interest, holdout creditors estimate they are now owed as much as \$15 billion. Argentina also owes the Paris Club countries \$6.3 billion in principal plus past due interest and penalties. The U.S. portion is estimated at \$550 million.

Argentina does not recognize the private holdout debt in its official statistics and legislation bars the government from making further offers to the holdouts. U.S. responses have been varied. Many of the "holdout creditors" have brought claims against Argentina in U.S. federal court totaling \$1.3 billion, resulting in judgments and attachment orders.¹ Recent court decisions have left Argentine central bank assets in the United States immune from attachment, but subject to an appellate decision expected on February 27, 2013, the Argentine government could be compelled to pay litigant holdouts their full \$1.3 billion claim. The U.S. government has also taken action and punitive legislation against Argentina has been introduced in the last three congresses.

Papers filed in appellate court on February 1, 2013, present the Argentine government's argument that it would not be able to fulfill a court order requiring full payment to litigant holdouts. The government did suggest, however, that it could arrange to reopen the previous bond exchange to allow holdouts who did not participate in it to reconsider their position. Some have suggested that this may be an acceptable option, but the issue remains unresolved.² This report reviews Argentina's financial crisis, the bond exchanges of 2005 and 2010, ongoing litigation, prospects for a final solution, related U.S. legislation, and broader policy issues

Background: Economic Crisis and Default

Argentina's 2001 debt crisis resulted from many factors. For the most part, Argentina overborrowed and fell victim to its own economic policies, but this was compounded by questionable lending and policy advice by the International Monetary Fund (IMF), a global recession, and international credit markets determined to chase high-yielding debt with inadequate regard to risk. Together, these factors propelled Argentina toward a position of unsustainable debt that ended in financial crisis, unprecedented default, and a controversial restructuring scheme.

¹ Attachment orders mean that courts can seize the country's assets or flows from any future international debt transactions, effectively blocking Argentina's access to the international credit markets. Actually collecting on these judgments, however, has been unsuccessful for many reasons. A list of claims against Argentina is summarized in, *Main Judgments and Pre-Judgment Claims Against the Argentine Republic*, provided by the Embassy of Argentina, December 2009. See also United States Securities and Exchange Commission, *Form 18-K, Annual Report of the Republic of Argentina*, September 30, 2011.

² Jude Webber, "Argentina Proposes New Debt Swap," *Financial Times*, February 3, 2013, and La Nación, *La Argentina Confirrió que no les Pagará a los Holdouts*, February 3, 2013.

The 2001 Financial Crisis

Argentina's 2001 financial crisis had its roots in a history of periodic macroeconomic policy problems, the Achilles' heel of Argentine economic strategy for much of the 20th century. Argentina has long relied on fiscal largesse as a basic policy tool, covering its shortfalls by expanding the money supply. These policies led to recurring bouts of high inflation and indebtedness, typically followed by temporary efforts to stabilize prices. Toward the end of the 20th century, Argentina experienced hyperinflation that eventually toppled the Alfonsín government in 1989, bringing Carlos Menem to the presidency, along with his well-known minister of economy, Domingo Cavallo.³

The Menem-Cavallo cure for chronic inflation was the now infamous "convertibility plan." Enacted on April 1, 1991, it set the stage for the crisis that would emerge a decade later. The plan legally guaranteed the convertibility of pesos to dollars at a one-to-one fixed rate and limited the printing of additional currency only to amounts supported by its reserve position (which could fluctuate with the amount of dollars entering or leaving the country). Upholding this promise, however, required that monetary and fiscal policies also be constrained—the money supply could not be expanded to cover deficits (as it is now). Therefore, to preserve this system, deficits either had to be eliminated or financed through debt.

At first convertibility worked well; it forced fiscal and monetary discipline on the government, which combined with strong economic growth, reduced inflation and debt service. Cracks in Argentina's economic policy, however, soon began to appear. The main problem was fiscal deficits, which 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%.⁴ The Argentine peso soon became greatly overvalued, reducing Argentina's competitiveness and ability to export, with predictable declines in public revenue needed to service debt.

Fiscal balances further deteriorated with a strengthening dollar (to which the peso was linked), competitive devaluations by its major regional trading partners (most importantly Brazil), and falling commodity prices. Argentina was already entering a four-year recession when the global downturn arrived in 1999, causing public revenue to fall further. The weaknesses of the convertibility plan's strict policy constraints were now exposed. It has been likened to a straitjacket precisely because the Argentine government had no policy room to address the recession. The convertibility plan, by definition, prohibited devaluing the peso to increase exports, and excessive debt eliminated the option for a fiscal stimulus to counter the economic downturn. The third option, reducing government spending, only guaranteed a deeper recession. By this point, there was already little chance of Argentina avoiding financial disaster.⁵

³ Gerardo della Paolera, Maria Alejandra Irigoin, and Carlos G. Bózzoli, "Passing the Buck: Monetary and Fiscal Policies," in *A New Economic History of Argentina*, ed. Gerardo della Paolera and Alan M. Taylor (Cambridge: Cambridge University Press, 2003), pp. 72-74. Inflation hit a high of nearly 200% per month in 1990 and as noted by these and other authors, high inflation is costly. It reduces the real value of money with the resulting loss of purchasing power equivalent to a large "inflation tax" on society as a whole.

⁴ *Ibid.*, and CRS Report RS21072, *The Financial Crisis in Argentina*, by J. F. Hornbeck. Debt service ratio = public sector debt/exports.

⁵ *Ibid.*, pp. 2-4. Argentina required a more, not less, competitive exchange rate to attract foreign currency needed for debt service. As long as the peso was pegged to an appreciating dollar, this was not possible, and with the addition of a procyclical fiscal policy, Argentina eventually was unable to cover its debt obligations.

In retrospect, it is also clear that in addition to Argentina's policy choices and an increasingly hostile global economy, actions by the international community were complicit in deepening the severity of Argentina's financial crisis. Global credit markets lent generously to Argentina, compounding the problem by chasing high yield even after risk factors began to rise to worrisome levels. Investment bank and credit agency reports overstated Argentina's strengths.⁶ Also, the IMF agreed to numerous lending arrangements made between 1991 and 2001 based on promised changes in Argentine policies, and economic assumptions and projections that ranged from being overly optimistic to wildly unrealistic. U.S. policies for much of the time could not be divorced from those of the IMF. Without the IMF, the convertibility plan would have collapsed much sooner. By its own admission, the IMF made repeated mistakes in surveillance, conditionality, and economic analysis that resulted in lending too much for too long into an untenable situation. Many economists would later argue that Argentina would have been better off had the IMF ended its support and pushed for debt restructuring much earlier.⁷

Faced with the unsustainable situation described above, and falling international credibility, Argentina was unable to roll over its debt. Financial panic and political unrest ensued. On December 20, 2001, President de la Rúa resigned and six days later, an interim government defaulted on Argentina's sovereign debt. Soon thereafter the government abandoned the convertibility plan and devalued the peso. Total public debt mushroomed from 45.7% of GDP in 2000 to 166.3% in 2002 (see **Appendix A** for data) and the default left the Argentine government in arrears with a number of international creditors.⁸ At the time, Argentina owed private investors bonds with a face value of \$81.8 billion, the Paris Club countries \$6.3 billion,⁹ and the IMF \$9.5 billion, among other domestic and multilateral obligations. Addressing the large private-sector debt was Argentina's most pressing problem, which was undertaken in a highly unusual manner.

Restructuring Sovereign Debt

A sovereign debt restructuring is a complicated matter and in Argentina's case the government faced three interrelated issues. It needed to formulate a strategy to (1) negotiate a solution with private creditors (2) repay or reschedule Paris Club debt and (3) reengage the IMF. In 2002, it was widely believed that a successful conclusion for Argentina was unlikely without meeting all three goals to some degree, in part because they are interrelated.

For example, the Paris Club generally does not entertain a sovereign debt restructuring proposal without the debtor country undergoing an Article IV review of its economy (standard practice for all IMF country members), and having an IMF lending program in place. Among other goals, the Article IV review provides one presumably unbiased assessment of Argentina's economic health

⁶ Paul Blustein, *And the Money Kept Rolling in (And Out): Wall Street, The IMF, and the Bankrupting of Argentina*. (New York: Public Affairs, 2005), pp. 5-8, 31-35, 198-200.

⁷ Apparently, the dominant view at the IMF, despite some strong internal opposition, was that the IMF could not abandon Argentina for fear of being viewed as the cause of its economic collapse. *Ibid.*, pp. 100-106, 134, 140-41, 157, CRS Report RL32637, *Argentina's Sovereign Debt Restructuring*, by J. F. Hornbeck, and IMF, Independent Evaluation Office, *Evaluation Report: The IMF and Argentina, 1991-2001*, Washington, DC, 2004.

⁸ The debt burden rose sharply and suddenly in part because of the devaluation, which greatly increased in peso terms foreign currency-denominated obligations (most were U.S. dollar and Euro based).

⁹ The Paris Club is a voluntary, informal group of 19 creditor nations who have agreed to act with a common approach to negotiate debt relief for developing countries unable to meet their external obligations. Members of the Paris Club agree to restructure and/or reduce official debt owed to them on a case-by-case basis, provided certain conditions are met. See, CRS Report RS21482, *The Paris Club and International Debt Relief*, by Martin A. Weiss.

and ability to repay its debt, although Argentina has been particularly distrustful of the institution since the 2001 crisis. In addition, the IMF usually does not consider a formal program until the "holdout" creditors have been offered a proposal. There was, however, little hope for a clean IMF review for Argentina at that time, and prospects for that changing have worsened considerably.¹⁰

These concerns raised two important questions: was Argentina willing to accede in whole or in part to these requirements, and if so, what was the sequence that would make the most sense to ensure that all three conditions were met? As it turned out, Argentina skirted the issue entirely, and moved ahead with the bond exchange without an IMF review, promising to deal with the Paris Club at some future date. As the value of Argentina's bonds plummeted, hedge funds specializing in distressed debt began to purchase the highly discounted debt and prepare for litigation. In so doing, these so-called "vulture funds" became, in effect, the closest thing to a coordinating group for private bondholders, but "average creditors" who sold their bonds, took an enormous loss.¹¹

The 2005 Bond Exchange

The financial crisis hit Argentina hard. Between capital flight and the large peso devaluation, much of the country's wealth evaporated nearly overnight. Poverty and unemployment skyrocketed, leading to street protests and political unrest. As Argentina turned to address its debt problem, it argued that bondholders would have to share in the misery that affected the whole country, and that the government had a moral duty to ensure this outcome. It was, as many argued, a matter of equity that the write-down on bonds be historically high, particularly given that continued lending from the IMF, investment banks, and foreign governments at a time when it was clear that Argentina faced an impending crisis had only compounded the financial problems. Perhaps most importantly, under these circumstances Argentina was simply in no position to repay such massive debt.¹²

A sovereign default means the government is no longer willing or able to pay the debt it has legally incurred in the international markets. Sovereign defaults occur periodically and are typically worked out in what amounts to a consensual understanding between creditors and debtors. This arrangement usually takes the form of a debt restructuring, which involves a formal and legal change in the contractual arrangements of the debt, such as reducing the face value of the obligations, issuing new bonds with lower interest rates and longer maturities, and capitalizing overdue interest, usually at a sizable loss to bondholders. Historically, a "successful restructuring" that results in a resolution that avoids prolonged litigation has typically captured a 90% or greater participation rate (there are always some holdouts) by offering no less than 50% on the net present value of the debt. Usually, this process unfolds with the assistance of the IMF

¹⁰ The IMF has registered grave concerns over the politicization of Argentina's national office of statistics for underreporting inflation since 2007 (see **Appendix A** for inflation differentials). The IMF renewed its objection in 2012 and issued a declaration of censure on February 1, 2013, for Argentina's breach of obligations under the IMF's Articles of Agreement. IMF, *Statement by the IMF Executive Board on Argentina*, Press Release No. 13/33, February 1, 2013.

¹¹ Amrita Dhillon, Javier García-Fronti, Sayantan Ghosal and Marcus Miller, "Debt Restructuring and Economic Recovery: Analysing the Argentine Swap," *The World Economy*, vol. 29, no. 4 (April 2006), pp. 392-393.

¹² Juan Pablo Bohoslavsky and Kunibert Raffer, "¿Qué Hacer con los Reclamos de los Acreedores Holdouts?," *Economía*, January 24, 2008 and Universidad de Buenos Aires. Plan Fénix. *La Argentina y su Deuda Externa: En Defensa de los Intereses Nacionales*. July 2004. <http://www.econ.uba.ar/planfenix>.

in setting macroeconomic targets that form the basis for a mutual understanding between debtor and creditor of a country's ability to repay its debt.¹³

Argentina began the debt restructuring process in 2002, negotiating with the IMF and investors for three years in search of a solution that it felt was commensurate with its deeply diminished economic and social reality. Facing a huge debt burden, Argentina adopted a hard line toward all parties, insisting on a large write-down of principal for private creditors and postponing action on Paris Club and IMF debt. After years of negotiations, which were criticized by both sides, Argentina eventually determined that it had reached an impasse with creditors and decided to act on its own. It suspended its agreement with the IMF and filed for a one-time unilateral offer with the Securities and Exchange Commission (SEC) to settle with private creditors. The Argentine legislature codified this commitment with the so-called "Lock Law" (*Ley Cerrojo*), which prohibited the government from reopening the exchange or making any kind of future offer on better terms, and suspended any future payments on the untendered debt. This action served the dual purpose of ensuring participating bondholders that they would not lose out on any better deal in the future and prodding, if not forcing, a relatively higher participation rate than might otherwise have been the case.¹⁴

On January 14, 2005, Argentina opened the bond exchange hoping to reach a final settlement on the \$81.8 billion face value of debt plus \$20.8 billion of past due interest (PDI). The default was unprecedented for its size (\$102.6 billion), lengthy resolution (over three years), low recovery rate (27%-30% on a net present value basis), and large residual holdout (24% of creditors). Bondholders and the IMF criticized Argentina for engaging in a process that stretched (creditors would argue flaunted) the accepted guidelines of sovereign debt negotiations. Nonetheless, of the \$81.8 billion face value of debt, \$62.3 was exchanged for \$35.2 billion of new bonds. Past due interest was not addressed. The Argentine government, however, was unable to settle the matter fully because \$18.6 billion of bonds were not tendered and remained in dispute along with accrued interest, \$6.3 billion of Paris Club arrears, and \$9.5 billion of IMF debt.¹⁵

Argentina addressed this remaining debt in multiple ways. First, in 2006 it decided to repay in full the \$9.5 billion owed to the IMF, relieving the government of any pressure to follow IMF policy constraints. Second, in 2008 and again in 2010, Argentina promised, but then postponed, plans to repay debt owed to the Paris Club countries.¹⁶ Third, it has resisted the litigation efforts of holdout creditors.¹⁷ Argentina remains steadfast in its determination to follow a policy of

¹³ For examples of five developing country defaults (Ecuador, Pakistan, Russia, Ukraine, and Uruguay) that had participation rates of 93%-98%, see Marcus Miller and Dania Thomas, "Sovereign Debt Restructuring: The Judge, the Vultures, and Creditor Rights," *The World Economy*, vol. 30, no. 10 (October 2007), p. 1497.

¹⁴ The Republic of Argentina, *Registration Statement No. 333-163784*, Securities and Exchange Commission, Washington, DC, April 9, 2010, p. 4. This document also contains Argentina's view of the crisis and 2005 exchange. The senior judge hearing the Argentine case would later refer to the Lock Law as "codified repudiation." Anna Gelpern, "Contract Hope and Sovereign Redemption," forthcoming (2013) in *The Capital Markets Law Journal*, p. 1. The draft version is available at <http://ssrn.com/abstract=2203123>

¹⁵ SEC, *Form 18-K, Annual Report of the Republic of Argentina*, September 30, 2011, pp. 142 and 146 and Fitch Ratings, *Argentina: Rapprochement with Creditors and Sovereign Ratings*, Special Report, November 19, 2009, p. 2.

¹⁶ The lengthy delay is perhaps a bit ironic given that Argentine debt played a central role in the formation of the Paris Club in 1956. See, Enrique Cosio-Pascal, "Paris Club: Intergovernmental Relations in Debt Restructuring," in *Overcoming Developing Country Debt Crises*, ed. Barry Herman, José Antonio Ocampo, Shari Spiegel (New York: Oxford University Press, 2010), p. 236.

¹⁷ Argentina's international bonds were issued under eight different jurisdictions including New York and a number of foreign countries. Some 38% of the untendered bonds were denominated in U.S. dollars. Those issued under the (continued...)

“financial independence.” It has been able to do so with the help of strong economic growth and use of unorthodox self-financing measures to meet fiscal needs.

The 2010 Bond Exchange

Prior to the 2010 debt exchange, Argentina owed approximately \$29 billion of bond principal and interest arrears to private investors and \$6.3 billion of loans to Paris Club countries, including nearly \$500 million in arrears to the United States.¹⁸ In 2009 the portion of “holdout” debt plus that owed to the Paris Club represented 21% of Argentina’s total public sector debt (this fell to 10% in 2010 and 7% in 2011). There were three major incentives for Argentina to resolve its outstanding debt issues. First, as with most countries, Argentina had relied on international capital markets to finance sovereign debt. Despite public statements eschewing foreign debt, by initiating a restructuring process in 2010, when the fiscal balance was positive, Argentina left open the option for reengaging the international credit markets.¹⁹

Second, opportunities for ad hoc financing were becoming increasingly difficult to find. In the absence of access to international capital markets, Argentina has met its financial needs by monetizing its debt, placing bonds with domestic government agencies, restructuring domestically held debt, selling bonds directly to the government of Venezuela, and nationalizing private pension funds. In a politically contentious decision that resulted in dismissal of the president of the Central Bank, the Fernández government by executive order began to borrow against Central Bank reserves to repay debt owed to multilateral development banks and other international creditors. In addition to undermining the independence of the Central Bank, this strategy effectively diminishes Argentina’s international reserve position and allows the government to defer difficult decisions on fiscal adjustment.²⁰

Third, market conditions initially favored placing debt, encouraging Argentina to move ahead with the bond restructuring. Interest rates were low by historical standards and liquidity high. These conditions changed when the debt problems emerged in the Eurozone, causing yields to rise, making the exchange more difficult, and precluding Argentina from selling any new debt as it had planned. The bond exchange, however, was already well underway.

By some measures, Argentina was also in better financial shape to address repudiated debt than it was during the 2001 crisis or the 2005 exchange. Argentina had a positive current account balance and had increased its international reserves from a low of \$10.4 billion in 2002 to \$52.2 billion in 2010. During the 2003-2008 economic recovery, Argentina had an average annual growth rate of 8.5% and the increased revenues had, until 2009, allowed it to maintain a primary surplus of 2.8% or higher (for data, see **Appendix A**). The primary surplus reflects the fiscal

(...continued)

jurisdiction of the State of New York are subject to U.S. law. Miller and Thomas, “Sovereign Debt Restructuring: The Judge, the Vultures, and Creditor Rights,” pp. 1492-1493, 1496, and 1502.

¹⁸ State Department estimates suggest Paris Club debt could be \$8.9 billion if penalties and additional accrued interest are included, a number that will be negotiated when settlement is arranged.

¹⁹ The official Argentine position has stressed that the need for financing was not the major incentive for restructuring its debt, but fiscal reality argues to the contrary. Ministerio de Economía y Finanzas Públicas. *Boudou Explicó en Diputados los Alcances de la Suspensión de la Ley Cerrojo*. October 28, 2009.

²⁰ International Monetary Fund, *Global Markets Monitor*, Washington, DC, December 16, 2009, p. 4.

surplus after non-debt expenditures have been paid, and so is a measure of resources available for debt service. Because of the global financial crisis, however, the primary surplus has been cut in half since 2009, levels inadequate to reduce Argentina's total public debt.

In 2009, Argentina began the initial process of setting up a new bond exchange, taking three important steps: (1) President Cristina Fernández de Kirchner lent full support for the deal (2) on November 18, 2009, the Argentine legislature temporarily suspended that portion of the 2005 "Lock Law" that prohibited reopening a debt restructuring offer, and (3) in December 2009, the Argentine government filed a preliminary prospectus with the SEC, which approved Argentina's request to issue new bonds. On April 15, 2010, the minister of economy announced the key features of the proposed bond deal. A formal offer was made on April 30, 2010.

The bond exchange closed on June 22, 2010, with a second stage concluded on December 31, 2010. Some \$12.4 of the eligible \$18.4 billion in bonds were exchanged (67.7%), leaving by one estimate \$6.0 billion untendered, although depending on how the 2005 exchange is accounted for, this number could be as high as \$6.8 billion. An IMF breakdown appears in **Table 1** and details of the bond exchange terms are found in **Appendix B**. Argentina advertised that a "successful" exchange would be one that exceeded a 60% participation rate because it would allow for a total participation rate, including the 2005 exchange, of over 90% of defaulted debt. When done through mutually-agreed negotiations, this threshold has been sufficient to resolve the default, allowing the sovereign eventually to participate in international credit markets, but this has not been the case for Argentina.

Table 1. Participation in Argentine 2010 Bond Exchange
(in billions of dollars)

	Participants	Non-Participants	Total
Main Non-Litigants	8.6	0.0	8.6
Italian Retail Investors	3.3	1.0	4.3
Litigants (hedge funds)	0.0	4.4	4.4
Others	0.5	0.6	1.1
Total	12.4	6.0	18.4

Source: International Monetary Fund, *Global Markets Monitor*, June 24, 2010, p. 6, adjusted for data in SEC, *Form 18-K*, September 2011, p. 142.

In Argentina's case, the 67.7% participation rate for the 2010 exchange allowed for a total participation rate of 91.3% of total defaulted debt, including the 2005 exchange participants. The remaining untendered bonds, however, continued to present a problem for Argentina given the ongoing litigation and attachment orders in place that would allow confiscation of proceeds from any new international bond offer. According to official Argentine sources, as of December 31, 2010, Argentina was in arrears with holdouts and the Paris Club in the following amounts:²¹

- \$11.2 billion to the holdouts worldwide (including \$6.8 billion in principal past and coming due, and \$4.4 billion in past due interest through December 2010).

²¹ SEC, *Form 18-K*, p. 140. Note that past due interest continues to accrue, thereby raising the value of Argentina's obligation. Argentina does not recognize this obligation and it is not counted in its official summary of public debt.

Holdout creditors argue that this number could be \$15 billion by 2013, of which \$1.3 billion is being litigated by hedge funds in U.S. courts, and,

- \$6.3 billion to the Paris Club, including PDI through December 31, 2010, plus addition interest and penalties.

Argentina has had at least three options to address this debt: (1) ignore holdouts and test its prospects in the courts; (2) attempt a third swap to capture remaining holdouts; and, (3) settle with holdouts. To date, Argentina has opted for the first strategy, but court rulings in 2012 and 2013 could force Argentina in another direction.

Holdout Responses Since 2010

In the eyes of holdout creditors, and apparently increasingly the U.S. courts, the 2005 and 2010 bond exchanges have set a precedent that cannot be condoned, even though 91.3% of total bondholders have accepted the terms. Although Argentina continues to argue that the restructurings took place after extensive negotiations, they were not mutually agreed solutions. Bondholders had to accept or reject the offers with the alternative being the promise of no restitution at all. Holdout bondholders remain unpaid while Argentina is current on its obligations to the bondholders who exchanged their debt, an outcome that is currently being challenged in court as illegal under the equal treatment (*pari passu*) provision of the bond contracts.

Because many bonds in the hands of holdouts were and may still be traded, ownership has been difficult to track. They were originally marketed in local country currencies: 58% in Euros, 38% in U.S. dollars, 2% in Argentine pesos, and the remaining 2% in other currencies. Currently, the value of bonds held by U.S. hedge funds is estimated to be approximately \$3.0 billion, of which \$1.3 billion is under litigation.²² Many of these funds are legally organized in countries outside the United States and known for their discrete treatment of investor information. Therefore, it is difficult to identify the nationality of fund investors, and by extension, the underlying ownership of the Argentine bonds in question.²³

Litigation and settlement strategies differ among bondholder groups. Institutional funds representing corporations and investment banks tend to negotiate for the best terms available in an exchange, most of which end up settling given the high opportunity cost of litigation. Retail (individual) investors often part with their bonds in the secondary markets early in the process. Hedge funds specializing in distressed debt typically purchase highly discounted bonds, eschew offers with large haircuts, and sue for full recovery. Their "holdout" strategy can be highly profitable for investors with patience. It rests on realizing capital gains on discounted bonds, often purchased after the default, and settling with the debtor country for a much higher price than paid in the secondary market. Historically, this strategy has worked well when holdouts dwindle to a small portion of total creditors, making it financially feasible for sovereigns to settle.²⁴

²² Correspondence with U.S. Department of State, January 2013 and discussion with American Task Force Argentina (ATFA), December 2012.

²³ A few funds are legally incorporated in the United States, the rest in the Cayman Islands, British Overseas Territories, Turks and Caicos, British Virgin Islands, Switzerland, and Luxembourg. *Main Judgments and Pre-Judgment Claims Against the Argentine Republic*, provided by the Embassy of Argentina, December 2009.

²⁴ Miller and Thomas, "Sovereign Debt Restructuring: The Judge, the Vultures, and Creditor Rights," p. 1497.

In the United States, some 151 individual cases have been filed against Argentina in U.S. District Court for the Southern District of New York (district court). Judgments have been entered in 108 cases for \$5.9 billion in principal and interest.²⁵ Many cases have since been settled by the two bond exchanges. Those that remain continue to litigate and although claims remain unresolved, U.S. federal courts have put increasing pressure on Argentina.

Recent Court Actions²⁶

There are now two major groups of U.S. bondholders. Exchange bondholders are those who have accepted one of the two debt restructuring deals offered in 2005 and 2010. Argentina remains current on all payments on the new bonds issued in exchange for the old bonds. The second group is the holdouts, who have not tendered the bonds in default and have received no payment. These two groups now find themselves effectively on opposing sides of the current legal battle with Argentina. There have been multiple legal motions and rulings in federal (district court) and the Court of Appeals for the Second District (appellate court). Two developments in 2011-2012 deserve attention.

The first issue revolves around attachment orders placed on assets held by Argentina's central bank (BCRA) in the Federal Reserve Bank of New York (FRBNY). District court found in favor of investors who argued that BCRA reserves should be subject to attachment orders as a representative of the Argentine government. In an interesting twist on appeal, the United States government was invited to submit a friend of the court brief (*amicus curiae*), which provided much of the rationale for overturning the lower court's decision. The United States noted that it in no way condoned or excused a foreign state's failure to comply with judgments of U.S. courts with respect to meeting its legal obligations to pay bondholders. It did argue, however, that there were broader issues to consider.²⁷

In short, on July 5, 2011, the appellate court overturned the lower court ruling, finding compelling, the arguments set out by the United States that BCRA assets in the FRBNY were immune from attachment because: 1) there is longstanding assurance by U.S. law that central bank assets held in this country are immune from attachment except for very narrow exceptions; 2) attachment could lead to large withdrawals of reserves from the United States, which could have a major impact on the U.S. economy and global financial system; 3) the United States has interest in promoting reciprocal treatment and principles of central bank immunity to safeguard U.S. reserves held abroad, and; 4) for other reasons.²⁸ On June 25, 2012, the U.S. Supreme Court declined to hear the case.

A second issue involves interpretation of the equal treatment provision of the bond contracts. The district court found in favor of holdout creditors who argued that paying the exchange bondholders while repudiating the holdout debtors has been a breach of this provision. In January

²⁵ SEC, Form 18-K, pp. 182-190, The Republic of Argentina, *Registration Statement No. 333-163784*, Securities and Exchange Commission, Washington, DC, April 9, 2010, and *Prospectus*, April 27, 2010, pp. 59-60.

²⁶ The following is a summary, not a legal analysis.

²⁷ United States Court of Appeals for the Second Circuit, Case 1487 NML Capital, LTD., and EM LTD., Plaintiffs-Appellees, v. Banco Central de la República Argentina, *Brief for the United States of America as Amicus Curiae in Support of Reversal*, Submitted November 3, 2010.

²⁸ *Ibid.* For a highly critical rebuttal, see Hal S. Scott, *Sovereign Debt Default: Cry for the United States, Not Argentina*, Washington Legal Foundation, Working Paper Series No. 140, September 2006, pp. 21-31.

2012, the court ordered Argentina to treat the two groups equally. The appellate court upheld the ruling on October 26, 2012, but remanded it to district court for technical clarifications, which the appellate court will again review when submitted.²⁹

In a second ruling along the same lines, district court again decided in favor of holdout litigants when on November 21, 2012 it ruled that with respect to a payment due to exchange bondholders on December 15, 2012, that they and the holdouts would have to be treated equally. The decision required that upon making its regular payment to exchange bondholders, Argentina would also have to pay holdouts their full \$1.3 billion claim.³⁰ This decision put Argentina in a difficult situation. It would either have to follow the court injunction, creating a much larger and immediate financial obligation, or pay neither group since the attachment orders could allow for seizure of the proceeds intended for the exchange bondholders. Argentina found both options unacceptable and argued that faced with this conundrum, it would effectively be forced to default on the exchange bondholders.

An appellate court stayed the lower court's ruling pending oral arguments to be presented on February 27, 2013, prior to the next payment due to the exchange bondholders.³¹ These court actions have left BCRA assets immune from attachment, but Argentina vulnerable to the prospect that it may be compelled to pay holdout litigants \$1.3 billion at some point in the future, which could have far reaching implications.³² The Argentine government filed papers in appellate court on February 1, 2013, arguing that it would not be able to fulfill a court order requiring full payment to litigant holdouts. The government did suggest, however, that it could arrange to reopen the previous bond exchange to allow holdouts who did not participate in it to reconsider their position. Some holdout groups have suggested that this may be an acceptable option, but the issue remains unresolved (see **Appendix B** for terms of the 2010 bond exchange).³³

Outlook and Policy Issues

In 2010, Argentina completed the second of two debt restructurings, mostly on its own terms, for one of the largest and most controversial defaults in sovereign debt history. There is little disagreement that in 2002 Argentina faced a desperate financial situation that required a radical restructuring of debt, including a large write-off by bondholders. Despite the historical precedent for sovereign debt restructurings, the Argentine case involved methods, processes, and deep discounts that were notably unprecedented, if not illegal. Argentina appears to be increasingly under pressure from U.S. court rulings to address the holdouts, although a final resolution may still be far off.

²⁹ United States Court of Appeals for the Second Circuit. *NML Capital, Ltd. v. Republic of Argentina*, August Term, 2011, Decided October 26, 2012. There is apparently room for considerable disagreement on the legal interpretation of the *pari passu* clause in sovereign debt contracts. Gelpert, *op. cit.*, pp. 7-9.

³⁰ The Economist, *Argentina's Debt Default: The Noose Tightens*, November 23, 2012.

³¹ Robin Wigglesworth and Jude Webber, "An Unforgiven Debt," *Financial Times*, November 28, 2012, p. 9.

³² U.S. district court has become increasingly intolerant of Argentina's intransigence, and in the words of one expert, "The desire to punish Argentina and the feeling that sovereign immunity taken to its logical extreme is making the court system look feckless may trump all other concerns in the end." Gelpert, *op. cit.* p. 12.

³³ Jude Webber, "Argentina Proposes New Debt Swap," *Financial Times*, February 3, 2013, and La Nacion, *La Argentina Confirmó que no les Pagará a los Holdouts*, February 3, 2013.

As data in **Appendix A** indicate, Argentina has been able to reduce its debt, if measured as a portion of GDP. It has benefitted from strong economic growth, driven by a lengthy resurgence in commodity prices. Economic conditions in both Argentina and the world, however, are in flux. Currently, Argentina is experiencing rising inflation and high interest rates. It is relying on a questionable policy of using central bank reserves and other internal financing mechanisms to finance the government and continues to follow an expansionary monetary policy. Fiscal and current account balances have also deteriorated and there is growing concern over capital and exchange rate controls among a long list of tightening financial and other market regulations. These trends do not bode well for chances that Argentina would be inclined to repay remaining disputed debt, irrespective of future court decisions.

As to the initial default, there appears to be few if any winners. Argentina's debt restructuring was costly for all parties, raising at least three broad policy questions. First, is there an effective strategy for policy makers to consider, particularly the U.S. Congress, in pressing Argentina to resolve the debt impasse? Second, are there alternatives to the Argentine solution, which in the absence of collective action, has led to unequal outcomes for creditors? Third, given the ongoing concern over sovereign indebtedness, currently related to Greece and the Eurozone more broadly, does Argentina present a plausible model for default?

Congressional Response

With Argentina's default on Paris Club debt, including approximately \$500 million owed to the United States government, a number of actions have been taken under U.S. law. U.S. agencies are prohibited from lending to a country that is in arrears on its debt to the U.S. government including the Export-Import Bank, Overseas Private Investment Corporation, U.S. Agency for International Development, and the U.S. Trade and Development Agency. The U.S. military is prohibited from offering Foreign Military Financing, exercising the Excess Defense Articles through 505 Drawdown authority, or fully using the Global Peacekeeping Operations Initiative funding. All foreign assistance is prohibited except for International Military Education and Training funding and certain programs related to countering terrorism and trafficking in narcotics or persons. Finally, as a matter of policy, the United States has begun to vote against any new loans to Argentina at the World Bank and Inter-American Development Bank, with the exception of those benefitting the very poor.³⁴

Policymakers remain frustrated at Argentina's reluctance to settle with U.S. bondholders and the Paris Club. Some Members of Congress have introduced punitive legislation in the last three congresses to pressure the Argentine government to reconsider its position. In the 112th Congress, Members introduced the Judgment Evading Foreign States Accountability Act of 2011 (H.R. 1798/S. 912), in part at the behest of the American Task Force Argentina (ATFA), a private lobby group representing some 40 constituent groups, including hedge funds.³⁵ It would attempt to pressure Argentina in a number of ways.

The bill cites Argentina for ignoring multiple judgments against it stemming from the 2001 default. Its major provisions would deny states deemed to be "judgment evaders" from issuing

³⁴ Correspondence from U.S. Department of State, January 12, 2010 and January 23, 2013.

³⁵ *Ibid.*, and Mark Weisbrot, "Vulture Funds Lobby Against Argentina," *America Latina en Movimiento*, August 6, 2009. <http://alainet.org/index.phtml>. Similar bills were introduced in the 110th and 111th Congresses.

debt in the United States (as is the case of private bond defaulters) and require that any future debt offerings carry a warning label that notifies would-be purchasers that the state had previously failed to satisfy outstanding judgments against it. This legislation has not had much traction, failing to receive a hearing. It was, nonetheless, marked up by the House Committee on Foreign Affairs Subcommittee on the Western Hemisphere on November 29, 2012. Despite support for U.S. interests in this matter, some Members have been reluctant to support the bill. In this case, it was argued that: 1) the committee lacked jurisdiction; 2) it might be considered imprudent to take action on the bill while the issue is before U.S. federal courts; and, 3) there were larger foreign policy issues to consider.³⁶

Opinions differ in Congress as to supporting the holdouts with legislation. First, because it is unclear if the remaining "holdouts" represent many if any U.S. retail investors, and in fact comprise, as best that can be determined, largely hedge funds incorporated offshore, it is difficult to discern the degree to which U.S. stakeholders are involved. Second, there may be concern over legislating against what amounts to be the actions of a single country. In fact, Argentina has expressed a strong reaction against this legislation, in part because it is viewed as being directed solely at Argentina and might be interpreted as tantamount to a threat of imposing economic sanctions. Third, there may be some recognition of a fundamental agreement in the United States given the Executive Branch under both Democratic and Republican presidents has taken available action. Fourth, the U.S. courts seem to be the logical venue for adjudicating claims in this case.

Still, some continue to argue that Argentina is a "rogue debtor" that does not deserve the deep debt forgiveness it forced on bondholders, should comport its behavior to international norms, and failure to enforce this outcome only invites other countries to default in similar fashion.³⁷ For the United States, neither sanctions nor legislative proposals have had any noticeable influence on Argentina, and actually may have reinvigorated Argentina's resolve to stay the course of default as long as possible. In the end, it appears that a combination of fiscal necessity, litigation, and international markets may yet have the greatest leverage on Argentine decision making.

Collective Action and Future Defaults

As one expert perhaps wryly notes, "Sovereign debt is unenforceable."³⁸ Argentina epitomizes this statement and years of costly litigation have not compelled Argentina to pay holdouts. Foreign holders of Argentine bonds faced a difficult choice, and the limited availability of a collective response mechanism diminished their negotiating position. The initial owners of the bonds clearly suffered, as did the Paris Club. Those who purchased highly discounted bonds in the secondary market, however, are betting that their patience and risk taking will be rewarded, should Argentina ever be forced to settle with them. In general, rather than rely on legal recourse, creditors as a whole have been better served by a quick and mutually-agreed sovereign debt workout, which historically has led to better and more equitable terms than those resulting in the Argentine case.

³⁶ U.S. Congress, House, Committee on Foreign Affairs, Subcommittee on the Western Hemisphere, 112th Congress, 2d sess., (112-188), *Markup, Judgment Evading Foreign States Accountability Act of 2011*, November 29, 2012.

³⁷ Scott, *Sovereign Debt Default*, p. 38 and Arturo C. Porzecanski, *Buenos Aires to Athens—The Road to Perdition*, Center for Strategic & International Studies, Washington, D.C., April 2, 2012, pp. 2-3.

³⁸ Gelpern, *op. cit.*, p. 1.

The lack of collective action was a serious problem in this case, resulting in unequal outcomes. The financial markets have since responded in ways that seek to avoid a second occurrence of a prolonged, costly, unilateral workout. The most important development along these lines has been the fuller, and more creative, adoption in the United States of collective action clauses (CACs) in sovereign debt contracts, the norm in British law. They can compel minority holdouts to capitulate to a negotiated solution agreed to by a supermajority, reducing, but not eliminating, the opportunity for holdouts to act separately, and often contrary to the interests of the majority. They are not full-proof answers to collective action, but CACs have proven useful at the margin and have become the "market standard" for sovereign bonds. Still critics argue that CACs with low creditor acceptance levels (less than 90%) undermine market discipline and invite lower settlements from defaulting countries.³⁹ CACs, however, are evolving and becoming more "aggressive," and so may still offer the best opportunity to resolved sovereign defaults in the absence of an alternative system.⁴⁰

The Argentine Model as Default Policy

In light of the sovereign debt restructuring negotiations with Greece and concern with debt of other Eurozone countries, questions have been raised as to the applicability of Argentine model for other countries. The situation in Greece, however, is significantly different, in no small part because it is a member of a European monetary union.⁴¹ On the face of the Argentine experience alone, however, it does not seem to offer a reasonable alternative. In fact, a number of important lessons emerge from the Argentine case.

First, a prolonged disregard for fiscal responsibility can have long-term economic, social, and political consequences. Second, a disorderly or non-negotiated debt workout has been extremely costly for Argentina. As a result, Argentina has had to resort to creative, but unorthodox financing mechanisms that cannot adequately replace conventional financing arrangements indefinitely. These have strained both Argentina's domestic and external account balances, increased a general distrust of the government, and may be setting the stage for another major financial setback. Such a strategy seems a highly undesirable model for other countries contemplating a sovereign default, and Greece has already opted for variations on more conventional approaches.

³⁹ Michael Waibel, "Opening Pandora's Box: Sovereign Bonds in International Arbitration," *The American Journal of International Law*, vol. 101, no. 4 (October 2007), p. 736 and Scott, *Sovereign Debt Default*, pp. 36-40.

⁴⁰ Herman, Ocampo, and Spiegel, op. cit. and Gelpert, op. cit., pp. 18-19.

⁴¹ For details, see CRS Report R41167, *Greece's Debt Crisis: Overview, Policy Responses, and Implications*, coordinated by Rebecca M. Nelson.

Appendix A. Argentina: Selected Economic Data, 2000-2012

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012 (P) ^b
GDP Growth (%)	-0.8	-4.4	-10.9	8.8	9.0	9.2	8.5	8.7	6.8	0.9	9.2	8.9	2.2
Overall Fiscal Balance (%)	-3.6	-6.8	-2.0	0.9	3.7	2.1	1.9	0.6	0.7	-0.8	-0.1	-2.3	-1.6
Primary Fiscal Balance (%)	0.4	-1.3	0.7	2.8	5.3	4.4	4.0	2.7	2.8	1.4	1.5	-0.1	0.5
Current Acct Balance (% GDP)	-3.1	-1.4	8.5	6.3	2.1	2.9	3.6	2.8	1.5	2.1	0.8	-0.3	0.2
Public Debt (% GDP)	45.7	53.7	166.3	138.2	126.4	72.8	63.6	55.7	48.5	48.5	45.1	41.2	39.9
Inflation Rate INDEC (%) ^a	-0.7	-1.5	41.0	3.7	6.1	12.3	9.8	8.5	7.2	7.7	10.9	9.5	10.2
Inflation Rate others (%)								15.0	25.0	15.8	10.9	22.0	25.0
Real Wages (index 2005=100)				85.2	93.1	100.0	108.9	118.8	129.2	144.3	163.0	196.1	231.8
Terms of Trade (index 2005=100)				100.3	102.2	100.0	106.0	110.0	124.6	118.9	118.4	126.3	121.9
International Reserves (\$ bn)	32.5	15.3	10.4	13.8	19.3	27.3	31.2	45.7	46.2	48.0	52.2	46.4	45.3
International Bond Issues (\$ mn) ^c	13,468	2,711	0	100	200	540	1,896	3,256	65	500	3,146	2,193	663

Source: United Nations Economic Commission on Latin America and the Caribbean (ECLAC), *Preliminary Overview of the Economies of Latin America and the Caribbean*, December 2012 and International Monetary Fund online statistics.

- a. Instituto Nacional de Estadística y Censos – Argentina's official government statistical office, which has come under criticism for understating inflation rates since 2007. Adjusted inflation rates have been added on the line below to reflect an estimate of private sector analyses of annual inflation rates since 2007.
- b. P = preliminary estimates.
- c. Includes sovereign, financial sector, and other commercial debt.

Appendix B. Summary of the 2010 Bond Exchange Terms

The 2010 exchange was structured to provide two different offers (see **Table 2**), one for retail or small investors, defined as those holding less than \$50,000 of defaulted bonds, and a second for institutional investors, or those holding amounts greater than \$50,000, a feature also present in the 2005 exchange. The retail investors were made a more generous offer to entice their support in order to ensure a minimally acceptable overall participation rate.

Table 2. Terms of Argentina 2010 Bond Exchange

Bond Characteristic	Retail Investors	Institutional Investors
Bond Type	Par Bond (pays full face value)	Discount Bond (66.3% reduction from face value)
Amount	Up to \$2.0 billion	Up to \$16.3 billion
Maturity Date	December 31, 2038	December 31, 2033
Annual Interest Rate	2.5%-5.25% increasing over time	8.28%
Past Due Interest (PDI)	cash payment	Separate 2017 Global bonds @ 8.75%
2010 GDP-linked warrant	yes, expiring by December 15, 2035	yes, expiring by December 15, 2035
2005 GDP Warrant Payments	No	No
Bank Commission	0.4%	0.4%

Source: Securities and Exchange Commission, *Amendment #5 to Argentina 18-K*, filed April 19, 2010, and *Prospectus Directive* filed April 27, 2010, pp. 11, 33-42, and 106-112.

The bond exchange addressed two aspects of outstanding debt. First, it covered the face (or par) value of the bond. This term refers to the principal or stated value on the bond when it was issued. Second, it covered past due interest (PDI), or a portion of unpaid interest. In each case, both retail and institutional investors received a bond in exchange for the defaulted debt, cash or a separate "Global" bond for PDI, and a separate GDP-linked security called a warrant that provides for additional payments under certain economic growth scenarios (see below).

The total value of securities eligible for exchange was \$18.4 billion, \$17.6 billion to cover principal and \$0.8 billion to cover unpaid interest accrued as of December 21, 2001, the point of default. The total amount covers the face value of defaulted debt, including the heavily discounted (reduced) value of the bonds owed to institutional investors, plus the PDI on bonds owed institutional investors (retail investors received cash for PDI, see below). There was a limit of \$2.0 billion of par bonds, but no limit on the issuance of discount bonds beyond the total \$18.4 billion of total securities as defined in the prospectus.⁴²

⁴² SEC, *Form 18-K*, p. 142.

Face Value

Retail investors received a par bond to compensate them for the full face value of the defaulted bonds they hold. Institutional investors, by comparison, received a discount bond reflecting a 66.3% reduction in the face value of the defaulted bonds they hold. In each case, new bonds were issued in exchange for the old ones, with the discount bond for institutional investors maturing in 2033 and carrying an annual interest rate of 8.28%. Par bonds for retail investors will mature in 2038, and carry a sliding annual interest rate beginning with 2.5% for the first 9½ years, 3.75% for the next 10 years, and 5.25% for the final 9½ years. Interest is paid semi-annually.

Past Due Interest

At settlement, retail investors were paid PDI in cash, covering interest from December 31, 2003, up to September 30, 2009. PDI for institutional investors was covered by a par "Global" bond maturing in 2017 with interest paid in semi-annual payments, carrying an interest rate of 8.75%. It covered interest from December 31, 2003 through December 30, 2009.

GDP-Linked Warrants

In the 2005 exchange, both retail and institutional investors received GDP warrants, which are securities that may be traded separately from the bonds to which they are attached. A warrant is a promise to make a particular offer under certain circumstances, often issued in connection to bonds to make them more attractive to investors. In this case, Argentina promises to make additional payments on the new bonds in the event that the Argentine economy grows faster than a predetermined and stated rate for any given year, as defined in the prospectus. The warrant is meant to compensate for bonds outstanding in December 2001 and interest accrued to December 30, 2001, but payment in any given year is based on better than expected economic performance in the previous year.

From a budgeting perspective, higher than anticipated economic growth tends to generate higher than expected public revenue. Argentina has effectively promised to use some of this revenue to make higher payments to bondholders, should economic conditions allow. This feature turned out to be particularly attractive for the 2005 exchange because Argentina emerged from its crisis with six years of very high economic growth, well above anticipated rates. Since 2005, Argentina has experienced strong economic growth, with the exception of 2009, and has remained current on its payments to Exchange bondholders.⁴³

Investors had hoped that the new deal would include the equivalent of past payments on warrants issued in the 2005 exchange, arguing that like past due interest, they were entitled to compensation from Argentina's better-than-expected fiscal position arising from very strong past economic growth as were the investors who exchanged their bonds in 2005. Argentina decided not to include such payments, reasoning that in rejecting the 2005 deal, the holdouts had declined to participate in that growth. Although market speculation had suggested that the absence of this provision might reduce the participation rate, Argentina was able to exceed its stated goal of a 60% participation rate.

⁴³ Jeffrey Williams, Emerging Markets Strategy, *Argentina: That Was Fun. Now What?* Citigroup Global Markets, July 23, 2010, p. 3.

Valuation

In the arcane world of bond valuation, analysts estimated the value of the exchange for discount bonds at between 48 and 51 cents per dollar value of the bond. These numbers compare unfavorably with the 60 cents on the dollar valuation of the 2005 exchange, which included a better than expected performance because of GDP-linked warrants.⁴⁴ Analysts estimated that inclusion of past payments of GDP warrants would have added 7 cents on the dollar to the offer. The defaulted bonds had traded recently in the market in a range of 48-50 cents on the dollar, nearly four times their lowest trade level of 11 cents recorded in September 2008.⁴⁵

Author Contact Information

J. F. Hornbeck
Specialist in International Trade and Finance
jhornbeck@crs.loc.gov, 7-7782

⁴⁴ Igor Arsenin and Carola Sandy, *Argentina's Debt Swap Offer: Good Enough*, Credit Suisse, New York, April 15, 2010, p. 1.

⁴⁵ International Monetary Fund, *Global Markets Monitor*, April 16, 2010, p. 5.