Why Argentina is Now Paying for its Dangerously Successful Economic Story

Jayati Ghosh and Matias Vernengo

Argentina is in the news again. The country that successfully managed an external debt restructuring after a major financial crisis in 2001-02, and eschewed the standard austerity package to benefit from a remarkable economic recovery, is being attacked by a combination of court rulings and aggressive moves in financial markets.

Elliott Capital Management, a vulture fund based in the tax haven Cayman Islands owned by conservative financier Paul Singer (a big donor to the Romney campaign), refused to accept the terms of the debt restructuring that was accepted by more than 92% of bondholders in 2005 and 2010. It has demanded payment in full, and has actively pursued its case in different courts across the world. A few months ago, the Argentine frigate Libertad, which ironically means freedom in Spanish, was seized in Ghana after a local judge ruled in favour of Elliott Capital Management. Judge Thomas Griesa has recently ruled in a district court in New York that the Argentinian government must pay $1.3bn to the same vulture fund – the full face value of their holdings plus accumulated interest starting in late 2001 – on the basis of an unusual interpretation of the pari passu clause in debt contracts.

Elliott and other "vulture funds" are not conventional investors. They buy bonds at discount rates during a crisis with the explicit intention of taking the distressed countries to court in foreign jurisdictions, while also holding out for payment in full with no renegotiation of the debt. Obviously vulture funds are not concerned with niceties such as how the debt was accumulated, the principle that debts should be served according to the debtor's capacity to pay or how the enforced payments will affect the wellbeing of the most vulnerable. They represent global finance in its most nakedly aggressive and exploitative form.

The Griesa ruling also contained an injunction that prohibited third parties from "aiding and abetting" any violation of his order, thereby preventing Argentina from being able to continue payments to the creditors that had accepted the restructuring. This has far-reaching implications beyond this case, because it calls into question all debt restructuring deals that are not just likely, but also necessary to preserve international finance. Why would those holding Greek bonds, for example, accept a debt restructuring plan that might be necessary for a solution and beneficial to all, if they know that vulture funds can hold out and receive judicial support in international courts?

The ruling also contradicts US internal bankruptcy laws, which force minority creditors to confirm to deals accepted by 70% of creditors. If this ruling is supported in the higher courts (both Argentina and other creditors have already appealed) it will create an unviable situation for global bond markets. Creditors will only be making one-way bets if no possibility of restructuring is accepted, making the only options all (full payment) or nothing (complete default).

But that is not the only onslaught Argentina is facing. This week the rating agency Fitch, which earlier gave US sub-prime bonds Triple A ratings, lowered Argentinian bonds to slightly above junk status. Many financial analysts are now predicting another Argentinian default.

But there is no reason to believe that the country is close to a default. The current account is in balance, international reserves are above $46bn and the ratio of debt service payments to exports is less than 20%. In the recent past, Argentina has been one of the fastest growing economies in the world, with unemployment falling from around 22% to close to 7%. So what explains all the downgrading and undermining of the country in financial markets and the media?

The real reason may lie in the very success of the country's economy after its default and forced debt restructuring process. After 2002, Argentina reversed the austerity measures promoted by the IMF, renationalised key productive sectors like aviation, pensions and most recently oil, increased social protection and income transfers to the poor, and reduced poverty substantially. Real wages have increased, and wage inequalities have been reduced.

This is a dangerously successful story. It shows that there is life after a default, and that austerity is not the best way out of a crisis. These are two lessons that clearly frighten financial markets and their allies within the judicial system, and obviously there is concern that other countries in financial distress could seek to emulate this example. Hence the eagerness to show that this is not a success story after all, and to keep the pressure on Argentina through court rulings, downgrades and similar measures.

Ironically, this may turn out to be counterproductive. It is not just that these recent moves are deeply unjust and anti-democratic – it is also that they threaten the global financial system itself. Allowing vulture funds to get precedence over other bondholders that accept restructuring undermines any possibility of renegotiating debts, without which no credit system can function. The "level of rancour" in Griesa's decision shows how important it is to have judicial systems that are not loaded in favour of purely profit-motivated private investors. Allowing rating agencies with extensive conflicts of interest to function without regulating them and setting up public alternatives creates misinformation without accountability.

Even a blatantly unjust capitalist system cannot survive this way for very long. So once again, international finance and its partners may be biting the hands that have fed it, with potentially disastrous consequences even for finance.

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