How to Solve Argentina's Debt Crisis: Will the IMF's Plan Work?

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I. INTRODUCTION

In January 2002, the Argentine government announced it would default on $141 billion in public sector debt—the largest default of a sovereign state in history. Having devalued its currency and gone through five presidents within a few weeks, Argentina was on a downward spiral and could no longer sustain its debt payments. Government limitations on bank withdrawals, an attempt to prevent a run on banks, resulted in violent street protests. Argentina’s debt crisis renewed debate over the need for an international mechanism through which countries can declare bankruptcy.¹ Nine months later, at the conclusion of the 2002 annual meeting of the International Monetary Fund (“IMF”) and the World Bank in Washington, D.C., delegates approved the creation of a sovereign debt restructuring plan that would enable countries suffering severe financial crises to renegotiate their payment terms with creditors.²

The plan is not a novel one. An IMF proposal for the creation of a sovereign debt restructuring mechanism, which would include a dispute resolution forum, was discussed and presented by Anne Krueger, the First Deputy Managing Director of the IMF, at previous IMF meetings.³ Now that the IMF has won the approval of many developed countries, it will move

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¹ See Mark Egan, USA: Emerging Markets Shrug Off IMF, G7 Debt Proposals, Rtr Eng News 10:10 (Sept 29, 2002). (“The idea [of establishing an international bankruptcy court] has been around for years but only gathered support in recent months after the economic collapse and subsequent default of Argentina.”); Alan Beattie, A Better Way for Countries to Default, Fin Times (Nov 6, 2001) (“The crisis in Argentina highlights the need for international agreement on how to deal with sovereign debt problems.”).
beyond the drawing board and begin developing tangible debt restructuring measures to present by the spring of 2003. Horst Koehler, head of the IMF, described the approval of their plan as "a kind of breakthrough ... There is a recognition that there is a gap in the international financial architecture."

The IMF proposed a "twin track approach" comprised of two parts that are to be simultaneously pursued: 1) a "contractual approach" involving the use of collective action clauses in sovereign bond contracts, which describe ex ante what will occur in the event of a default, to keep creditors from halting the restructuring process; and 2) a "statutory approach" allowing a supermajority of creditors to establish new, legally binding terms with the debtor country, and creating a dispute resolution forum to resolve disputes that may arise in the process. The International Monetary and Financial Committee, consisting of finance ministers from both developed and developing nations, is looking forward to the final version of the IMF's plan, especially the plan for an international bankruptcy court.

However, not all have been in favor of the IMF's proposed sovereign debt plan. At first, the leaders of the Group of Seven industrialized nations ("G7")—the United States, Canada, Japan, France, Italy, Germany, and Britain—only supported the contractual approach of including collective action clauses in foreign emerging markets' bonds. The top emerging economies ("G24"), which the plan was designed to help, as well as Wall Street, were not as supportive of the contractual approach. Even more contentious was the IMF's plan to form an international bankruptcy court. While the G24 stated that they would be "open-minded" toward the G7's proposal to include collective action clauses, they were "skeptical" about the international bankruptcy court. Wall Street representatives had a similar negative reaction.

Following a year of debate over whether to pursue collective action clauses and an international bankruptcy court, developed nations increasingly supported pursuing both options simultaneously in "a sort of belt and braces approach."

The US administration has moved beyond solely supporting the contractual approach to endorsing the IMF's progress toward a two-track approach. In fact, the entire G7, along with Belgium, Holland, Sweden, and Switzerland, has

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5 Krueger, Preventing and Resolving Financial Crises (cited in note 3).
6 See Glenn Somerville, USA: G7 Agrees Growth Has Slowed, Cites Risks, Rtr Eng News 12:21 (Sept 28, 2002) ("G7 members said there was support for including so-called 'collective-action clauses' in emerging-market bond issues sold to foreign investors.").
7 See id. See also Mark Egan, USA: IMF to Ponder Crisis-Prevention Tools at Key Meet, Rtr Eng News 11:07 (Sept 28, 2002).
8 See Mark Egan, USA: WRAPUP 2-Sovereign Bankruptcy Plan Gains Momentum, Rtr Eng News 21:40 (Sept 27, 2002).
endorsed the IMF’s twin track approach at side meetings held during the 2002 IMF and World Bank annual conference. The IMF is expected to present concrete proposals concerning the establishment of an international bankruptcy court by spring of 2003.

The most controversial point of the proposed reforms remains the formation of an international bankruptcy court, which falls under the IMF’s second track: the statutory approach. Accordingly, Part II of this Development describes the IMF’s statutory approach, emphasizing the international bankruptcy court. Part III argues that from Argentina’s perspective, the IMF’s statutory approach would not be an effective solution to its current debt crisis due to its history of difficult relations with the IMF and the potential it creates for infringing on Argentina’s sovereignty. Part IV examines the legal and market effects of the statutory approach and asserts that there are other means for restructuring debt that would have a less negative impact on the value of Argentine bonds. Three overall problems of international law posed by the statutory approach are identified in Part V: conflicts of law created if it is applied retroactively, cost-benefit analysis as it relates to the IMF’s purpose, and confusion concerning the IMF’s role. Part VI synthesizes the foregoing analysis and suggests that the IMF’s plan is not a viable solution for Argentina.

II. THE IMF’S STATUTORY APPROACH

The second track of the IMF’s overall plan for sovereign debt restructuring is the statutory approach. Under this approach, an international treaty would empower the majority of creditors to bind all other creditors to the terms of a renegotiated debt agreement with the debtor country. By eliminating the requirement that the unanimous consent of all creditors be reached in order to make changes to the terms of the debt agreement, minority interest creditors would no longer be able to prevent restructuring by holding out. The treaty would also establish a single dispute resolution forum with exclusive jurisdiction over disputes between the debtor country and its creditors, as well as disputes among creditors. The IMF argues that a single forum is necessary to maintain a uniform standard and consistent interpretation of the treaty across all jurisdictions. This treaty would be established through the enactment of an amendment to the IMF’s articles of agreement, which, once approved by two-thirds of the member nations, would be binding on all parties.

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9 The statutory approach is still in the development stage. The IMF has not stated that the approach will be implemented in Argentina, but has suggested that it should be. See Anne O. Krueger, Crisis Prevention and Resolution: Lessons From Argentina, available online at <http://www.imf.org/external/np/speeches/2002/071702.htm> (visited Mar 30, 2003).
10 See Krueger, Preventing and Resolving Financial Crises (cited in note 3).
11 See id.
In a broad sense, the statutory approach accomplishes through public law what the contractual approach of using collective action clauses accomplishes through private law: it provides a predetermined mechanism for renegotiating sovereign debt in the event of a default, and thus reduces transactions costs, increases predictability, and minimizes holdout problems. The contentious point of the statutory approach has been the formation of an international dispute resolution forum, also referred to as an international bankruptcy court. The court’s role, which has been equated to that of a domestic bankruptcy court, would first be to administer creditor claims, and second to resolve disputes between creditors and debtor countries, as well as disputes among creditors. The IMF’s statutory approach would require that every member nation treat the court’s decisions as legally binding. “In other words, they would need to be treated as though they were decisions of each member country’s national courts.”

The IMF laid out a detailed method of selection for determining who will preside over the bankruptcy court. A three-member panel would be selected through a five-step process beginning with a list of candidates nominated by each IMF member country. The list would be narrowed by the IMF’s Executive Board to about twenty-one individuals who then need to be approved by the Board of Governors. The members appointed to the court would then elect a Presiding Member who would in turn select a three-member panel for each country in crisis on a case-by-case basis.

III. ARGENTINA’S PERSPECTIVE

While other similar proposals for a sovereign debt system may be beneficial for Argentina, the IMF’s proposal would instead be problematic for two main reasons. First, Argentina has a history of difficult relations and mistrust with the IMF. Second, the IMF may encroach on Argentina’s sovereignty, raising questions of enforcement and legitimacy. Nevertheless, Argentina’s debt must somehow be restructured and a domestic bankruptcy-like proceeding for sovereign states is precisely what some international civil society movements have proposed.

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12 See id.
13 Id.
14 See id.
15 The problems associated with the retroactive application of the statutory approach to Argentina’s existing debt are discussed in Part V.
Argentina’s relations with the IMF have a history of sometimes being less than cordial, which emanates from Argentina’s resentment toward the conditions imposed by the IMF on its domestic fiscal policy as a prerequisite to securing new IMF loans. Furthermore, there is a danger that under the statutory approach the IMF’s leverage to impose such conditions will increase, thereby making it even less favorable from Argentina’s perspective.

The underlying causes for Argentina’s default involve multiple players and are beyond the scope of this Development. However, Argentina’s inability to secure additional loans from the IMF, combined with overspending, were immediate causes of its most recent default in January 2002. After Argentina announced its default, its animosity with the IMF became even more public. After months of failed discussions, the two finally returned to positive negotiations in September 2002. Given the history of their relationship, it is difficult to imagine Argentina submitting to discussions with its other creditors under the indirect supervision of the IMF.

The statutory approach would create an entirely new debt restructuring system with rules Argentina would be obliged to abide by in good faith or risk losing the ability to secure new IMF loans. Though the IMF insists that “an amendment of the articles would be used only as a legal tool to empower the creditors and the debtor, not as a way to extend the IMF’s legal authority,” the IMF could easily condition new loans on abidance with the statutory approach, thereby gaining an additional mechanism to force Argentina into adopting its domestic fiscal policy recommendations.

Salta (“CELEC”), Petition for International Arbitration; Verification of Legality; Renegotiation of Argentina’s Foreign Debt (June 20, 2002), available online at <http://www.jubilee2000uk.org/jmi/jmi-news/argentina200602.htm> (visited Mar 30, 2003) (requesting a stay of payments on foreign debt until an arbitration applying the principles of a Chapter 9 procedure is conducted).

See Chris Anstey, IMF’s Krueger Warns Argentina Default to Official Leaders Would Cut Off Aid, AFX News 10:50 (Sept 26, 2002) (IMF deputy managing director Anne Krueger said, “I don’t think it would be the end of the world if negotiations [with Argentina] broke down.”). See also Mark Egan, USA: Update 1—Not the End of the World if Argentina Talks Fail—IMF, Rtr Eng News 10:48 (Sept 26, 2002) (“Krueger’s comments were eerily similar to those by Economy Minister Roberto Lavagna on Wednesday, who defiantly said the government was capable of vanquishing a chaotic four-year depression without outside help.”).

See Ross P. Buckley, Rescheduling as the Groundwork for Secondary Markets in Sovereign Debt, 26 Denver J Int'l L & Pol'y 299, 301 (1998) (When Argentina defaulted in the 1980s and was in the midst of renegotiating its debt with the Bank Advisory Committee, the IMF refused to extend new loans several times unless the debtor country agreed to adopt a ‘structural adjustment program.’).
The same is true of the bankruptcy court. Though the IMF urges that it would be completely independent,\textsuperscript{20} it is difficult, if not impossible, to sever a court that will derive its legal existence from an amendment to the articles of the IMF. Furthermore, as discussed above, the IMF essentially selects the members of the court. Under these conditions, it is no wonder Argentina, along with many other countries in similar economic positions, is opposed to the statutory approach and especially the bankruptcy court.

The tenuous separation between the IMF's traditional role as a creditor and new potential role as leader of sovereign debt restructuring thus poses the danger that the IMF will gain a significant amount of control over Argentina's relations with other creditors and become an overwhelming force in the nation's economic policies. This raises several concerns regarding national sovereignty. While it is possible that under such a scheme Argentina's outstanding bonds may become more valuable, or at least stabilize in value (because certain foreign investors or developed countries would perceive greater security in having Argentina's economic policy run by the IMF), such arrangements fly in the face of internationally accepted principles of national sovereignty. Argentina is a sovereign nation with a right to determine its own fiscal policies, regardless of how those policies are perceived by outsiders.\textsuperscript{21}

In addition to the problems of legitimacy discussed above, there are enforcement issues as well. The dispute resolution forum proposed by the IMF is intended to be legally binding in the same way a decision of an Argentine court would be. However, in practice Argentina's judiciary may not have the power to enforce the forum's decisions.\textsuperscript{22} While the IMF can use its lending capacities to ensure that certain economic reforms are made, it cannot control how the policies and reforms are implemented. In fact, Argentina is so rife with political corruption that it can hardly implement its own reforms.\textsuperscript{23} Dependence

\textsuperscript{20} Krueger, \textit{Preventing and Resolving Financial Crises} (cited in note 3) ("Any dispute resolution forum would have to operate—and be seen to operate—independently not only of the \[Executive\] Board, but also of the governors, management and staff of the IMF.").

\textsuperscript{21} For a discussion of how the IMF's conditions do not necessarily enhance the lender-country's economic growth and are sometimes even counterproductive see Joseph E. Stiglitz, \textit{Globalization and Its Discontents} 46–52 (Norton 2002).

\textsuperscript{22} See Geoffrey P. Miller, \textit{Constitutional Moments, Precommitment, and Fundamental Reform: The Case of Argentina}, 71 Wash U L Q 1061, 1080–81 (1993). See also Tom Darin Liskey, \textit{Argentina's Menem Tells IMF He'd Agree to Aid Conditions}, Dow Jns Ind News 8:18 (Sept 27, 2002) (Argentina's appeals court ruled that the President's order converting dollar-denominated bank deposits into pesos was unconstitutional. This has not had much effect in practice other than to demonstrate to the IMF that there is little agreement among government branches on fiscal policy.).

\textsuperscript{23} See Mark Egan, \textit{Update 2–IMF Urges End to War of Words With Argentina}, Rtr Eng News 12:24 (Sept 26, 2002) ("The IMF chief also said Argentina displayed a marked 'lack of respect of law,' which also had to be addressed, noting that corruption was rampant in the business environment there.").
on this legally enforced strategy is likely to be ineffective. Argentina would more likely abide with the international bankruptcy court’s decisions if instead it relied on market forces to reach a mutually beneficial solution.

The Club of Paris is a past example of this type of successful debt renegotiation. In 1956, when Argentina was on the verge of defaulting on its loans, its creditors met in Paris and resolved to renegotiate their loan contracts with Argentina and created the Club of Paris, an institution designed to resolve debt controversies. Argentina was able to meet its obligations through interest rate concessions and a longer period for repayment in exchange for agreeing to reduce its risk of future default. Unlike the IMF, the Club of Paris is a private creditors’ organization that does not produce legally binding results and often seeks the advice of the IMF and the World Bank in resolving disputes. It is effective because of natural market forces: “It is the mutually assured benefit and cost between the parties that permit such an arrangement. ... The theory reduces to a simple comparison of the costs of agreement and costs of disagreement.”

Debt restructuring also became necessary in the 1980s when Argentina, along with several other Latin American countries, defaulted on its international loans. Its principal creditors, consisting of about a dozen of the largest international banks, joined together as the Bank Advisory Committee to renegotiate the debts. The Committee used its influence to force the smaller creditors to agree to the terms of the restructured debt. Now that the composition of Argentina’s debt has shifted from large syndicated bank loans managed by an identifiable group, to public bonds held by thousands, neither the Club of Paris nor the Bank Association Committee are the appropriate forum for restructuring Argentina’s debt. However, their relative success may be instructive for the development of a mechanism that achieves nearly self-enforcing, mutually beneficial solutions to which Argentina would be more amenable.

IV. Legal and Market Effects

Since this shift in the composition of sovereign debt, from syndicated bank loans to bonds held by multitudes of creditors, the sheer number and diversity of private creditors have made coordination significantly more difficult. The IMF’s statutory approach is advantageous in such a situation since it provides a single forum for the multitude of creditors and minimizes holdout problems. However, there are other means to these ends that may be more favorable to both debtor countries and their creditors. The statutory approach may

25 Id.
potentially reduce the value of foreign bonds and discourage future investors who fear becoming the minority bondholder bound to the terms of the majority. There are even concerns that the plan could lead to an increase in the number of defaults.\textsuperscript{26}

The IMF’s statutory approach would allow bondholders to change the core terms of their agreement by a supermajority vote, rather than requiring the traditional unanimous consent. This voting mechanism is designed to prevent minority bondholders from obstructing a new agreement by holding out to secure the full expected return on their investments, which is sometimes accomplished by filing a lawsuit in a US court.\textsuperscript{27} Not only do these lawsuits impose an additional expense for Argentina, but they also encourage bad investments as courts can be used to secure a full profit. More importantly, they preclude the possibility of arriving at a mutually beneficial solution for the repayment of outstanding bonds.

In response to the new dynamic of dispersed bondholders, several proposals have been made that do not involve supervision by the IMF or similar institutions and restrict or even obliterate the need for an international bankruptcy court. Steven L. Schwarcz suggests that sovereign debt restructuring is entirely possible without the supervision of a bankruptcy court, but rather through an international convention.\textsuperscript{28} Rory Macmillan seconds the notion that a sovereign debt work-out manager is unnecessary.\textsuperscript{29} Other suggestions include providing an indenture trustee for bondholders of foreign debt and developing bondholder councils to work toward renegotiating foreign government debt in the interest of the bondholders.\textsuperscript{30}

Argentina and Wall Street remain equally opposed to the IMF’s statutory approach, especially the bankruptcy court, because of its great adverse affects. The two main arguments against it are: first, it would force a minority of bondholders to accept the majority’s terms of renegotiation, thereby discouraging future investment; and second, it would force investors to rely on a


\textsuperscript{30} See id (Macmillan proposes two forms of bondholders councils. The first only serves an advisory capacity because its members would be appointed by the government, whereas the second version would have more decisionmaking authority since its members would be elected by the bondholders.).
shaky system of international law to recover investments, thereby increasing the risk and lowering the price of bonds.

However, it is not absolutely certain that the statutory approach would necessarily have a more adverse affect on future investors and the value of bonds than would including collective action clauses under the contractual approach, to which Wall Street and Argentina are not completely opposed. The crucial difference between the two approaches would be choice of law. As long as a specified country’s law is controlling (be it the law of the United States or of Argentina), and not a loose form of international law without precedent, the statutory approach has the potential to become similar to the renegotiating process currently conducted through the indenture trustee of a corporate bond.31

Wall Street investors further argue that the IMF’s statutory approach would make defaulting easier and more attractive to developing countries, thus creating a moral hazard problem.32 But there is little evidence supporting the notion that a sovereign debt restructuring system would necessarily cause more defaults. Argentina’s lengthy history of defaults33 was caused by a government plagued with military control, antitrade regimes, swings from socialist to democratic policies, unstable economic policies, and severe corruption. And that only roughly describes some of the domestic causes of the past fifty years or so. On the international front, there has been a host of unsound investments leading to unsustainable levels of debt for a developing country of only thirty-seven million. Providing a consistent structure under which debt can be more effectively managed is a valid goal.34 But a fundamental problem with the IMF’s statutory approach is the level of involvement the IMF seeks in a process that should be kept as flexible as possible to allow for adjustment in the world markets.

V. PROBLEMS OF INTERNATIONAL LAW AND ORDER

There are three main problems with the IMF’s statutory approach. First, it could potentially be applied retroactively to debt already incurred under different

31 See id at 86.
32 See Mike Esterl, Wall Street Blasts IMF Debt Restructuring Mechanism, Dow Jns Intl News 8:00 (Oct 16, 2002).
33 Argentina first defaulted on its loans in 1890, then again in the 1930s, then almost defaulted in 1952 bringing about the Club of Paris (see note 24), but did default again in 1982.
34 On September 20, 2001, US Secretary of the Treasury, Paul O’Neill, testified before the US Senate Banking Committee that finding a better method to cope with global economic challenges, such as loan defaults and devaluation in Latin America, remains near the top of the government’s list: “We need an agreement on an international bankruptcy law, so that we can work with governments that in effect need to go through a Chapter 11 reorganization instead of socializing the cost of bad decisions.” Hearing on The Condition of the Financial Markets before the Committee on Banking, Housing, and Urban Affairs, Rep No S Hrg 107-606, 107th Cong, 1st Sess 33 (2001) (testimony of Secretary Paul O’Neill).
terms. Second, the costs of administration and enforcement may exceed the benefits. Third, it generates confusion over the IMF's role in the world order as a lender of last resort, not a sovereign debt manager. As will be discussed below, each of these criticisms is especially problematic for Argentina. If, and when, the statutory approach is implemented, it may be too late to have any positive effects on Argentina.

If the statutory approach were to be applied retroactively to debt already incurred by Argentina, the results could be disastrous. First, this would provoke all sorts of conflicts of law that are beyond the scope of this Development, especially for bondholders that may have relied on US laws, particularly New York law, to govern their investments. Whatever debt terms were established could suddenly be changed or found incongruent with the IMF's plan. Lack of predictability could destabilize current investments and minimize the potential for new capital. The possibilities are endless. A retroactive application could hamper whatever progress had been made on the debt crisis.

Second, the statutory approach would present an uncertain increase in the IMF's administrative and operating costs for functions that are out of its scope. At the very least, additional time and resources would be spent on the rather complex and bureaucratic process of selecting members to the court and on attempts to enforce the court's decisions. The expenses could easily escalate, thus taking away from funds that could instead be utilized for the IMF's traditional purpose to serve as a lender of last resort.

Finally, there is a thin line dividing the role of the IMF as a lender of last resort, and its new potential role as the founder of a sovereign bankruptcy system. What should a country with a shaky economy, such as Argentina, do first—request additional IMF loans or go through the IMF's bankruptcy proceeding? A perfect illustration of the awkward position of the IMF is that the IMF does not plan to include its own loans under the forum's jurisdiction given their special nature. Argentina is estimated to owe $14.355 billion to the IMF, $8.707 billion to the World Bank, and $8.606 billion to the Inter-American Bank. Given that the IMF is the country's single largest creditor, its loan is an important element of an overall successful restructuring plan. Which debt should Argentina's limited funds service first—the IMF debt or the debt

35 See Nobles, Global Investing – The Debt Problems of a Silent Minority, Fin Times at P26 (cited in note 26) ("[T]he IMF proposal would allow contractual rights of minority creditors to be obviated retroactively in total contradiction to the 'rule of law'.").
36 See Krueger, Preventing and Resolving Financial Crises (cited in note 3).
37 Argentina Sees IMF Agreement; Will Miss World Bank Payment, Dow Jns Indl News 12:10 (Oct 8, 2002) (information current as of June 30, 2002).
managed by the IMF bankruptcy court? Given this conundrum, Wall Street is justifiably nervous. While the IMF has extended repayment deadlines and negotiations are ongoing, if the dispute resolution forum truly functions independently of the IMF Executive Board and Board of Governors, the new fiscal policy may not be comprehensive since the interests of private creditors may sometimes conflict with those of the IMF. If the forum takes into account the IMF loans and therefore does not function independently, then there is a greater risk of infringing upon Argentina’s sovereignty, as discussed above.

VI. CONCLUSION

The IMF’s statutory approach to restructuring sovereign debt will probably not prove to be a viable solution to Argentina’s debt crisis for several reasons. First, Argentina harbors a great deal of animosity toward the IMF, and the plan poses a real danger of infringing on its sovereignty by providing the IMF with additional leverage to impose more conditions in the form of policy recommendations. While the statutory approach may provide a mechanism with which to coordinate multitudes of bondholders and prevent holdouts, there are other viable solutions that address these issues with less bureaucratization. However, the effect on bond values and investor confidence remains to be seen and could probably be equated to the effects of the contractual approach to utilizing collective action clauses. It is unlikely the IMF’s plan would lead to an increase in sovereign debt defaults.

Finally, the conflicts of law problems that would arise if the statutory approach were to be retroactively applied to Argentina’s billions of dollars of existing debt, combined with potentially high costs of administration and enforcement, and a confusing new role for the IMF as both lender and debt manager, do not bode well for the plan’s success. An effective sovereign debt restructuring plan for Argentina would be one in which the process is less politicized and offers mutually beneficial solutions that are self-enforcing. While the notion of a sovereign debt restructuring mechanism is good in theory, the IMF is not the correct body to bring it into use.