Discredited – The Impact of Argentina's Sovereign Debt Default and Debt Restructuring on U.S. Taxpayers and Investors

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I. Introduction

Large, financial events often have consequences that are not immediately or readily appreciated. In December 2001, the government of Argentina initiated the largest sovereign debt default on record, suspending interest payments and principal repayments on 152 bond issues with a face value of more than $81 billion. Three years later in January 2005, Argentina announced its plan to restructure these defaulted debts under unusually harsh terms, offering new bonds with a net present value equal to just 27 percent of those they replaced, repudiating all past due interest, and vowing to unilaterally cancel its obligations to any lenders rejecting these terms. When only three-quarters of the lenders accepted the restructuring offer, the government formally repudiated the liabilities held by the hold-outs.

A new accounting shows that the Argentine government's actions have had enormous costs for everyone else. The direct financial losses incurred by its lenders in the United States, Europe and Latin America come to almost $84 billion ($74 billion net of tax benefits). Moreover, the default and its singular restructuring plan also generated indirect costs for ordinary taxpayers and private shareholders that never held Argentine debt, and which exceed the direct costs to the lenders. For example, the direct costs incurred by U.S. investors holding the defaulted bonds come to $9 billion, including their capital losses, defaulted interest payments and foregone investment returns. Those direct costs also lowered the taxes they ultimately paid to the U.S. and state governments, creating an indirect cost for American taxpayers of some $2.6 billion. The default and restructuring plan also triggered a sharp and sustained devaluation in the Argentine peso, depressing the shareholder value of American companies with significant investments in Argentina by nearly $8 billion. These indirect costs total $10.4 billion, greater than the $8.7 face value of the bonds held by Americans at the time of the default or their $9 billion in direct losses.

We further find that the Argentine default and restructuring cost its worldwide lenders some $74 billion and also generated additional indirect costs for taxpayers and shareholders around the world of more than $63 billion. The default and its aftermath also triggered three substantial bailout packages from the International Monetary Fund (IMF), financed by taxpayers in the member countries that contribute to the IMF's funding. These payments put at risk another $4.0 billion in funds contributed by U.S. taxpayers and $23.2 billion in funds provided by the taxpayers of all IMF contributing countries. Table 1, below, summarizes these direct and indirect costs.

[1] This report was prepared with support from the American Task Force for Argentina.

Table 1: Worldwide and U.S. Direct and Indirect Costs of the Argentine Default and Restructuring ($ billions)

	Worldwide	U.S.
Defaulted Debt Eligible for Restructuring, January 2005		
Principal (face value) restructured to new securities	$61.8	$6.6
Principal (face value) still outstanding	$19.4	$2.1
Total	**$81.2**	**$8.7**
Past Due Interest at Restructuring, January 2005		
Interest owed on securities that were restructured	$19.0	$2.0
Interest owed on securities that have not been restructured	$ 6.0	$0.6
Total	**$25.0**	**$2.7**
Direct Costs for Investors Accepting the Restructuring		
Capital losses	$29.5	$3.2
Past due interest payments, December 2001-January 2005	$19.0	$2.0
Foregone investment returns	$11.1	$1.2
Total Direct Costs	**$59.6**	**$6.4**
Tax benefits for capital losses	- $6.7 *	- $0.7
Total Net Losses	**$52.9**	**$5.8**
Direct Costs for Investors Rejecting the Restructuring		
Capital losses	$14.5	$1.6
Past due interest payments, December 2001-January 2005	$ 6.0	$0.6
Foregone investment returns	$ 3.5	$0.4
Total Direct Costs	**$24.0**	**$2.6**
Tax benefits for capital losses	- $ 3.3 *	- $0.4
Total Net Losses	**$20.7**	**$2.2**
Direct Costs for All Bond Investors		
Capital losses	$44.0	$4.7
Past due interest payments, December 2001–January 2005	$25.0	$2.7
Foregone investment returns	$14.6	$1.6
Total Direct Costs	**$83.6**	**$9.0**
Tax benefits for capital losses	- $10.0 *	- $1.1
Total Net Costs	**$73.6**	**$7.9**
Indirect Costs for Equity Investors and Taxpayers		
Shareholder losses - currency effects on foreign investment	$39.2	$7.8
Revenues losses for other taxpayers to offset	$24.2 *	$2.6
Total	**$63.4**	**$10.4**
Taxpayer Funds At Risk in IMF Bailouts of Argentina	**$23.2**	**$4.0**

***** Global estimates of foregone investment returns, tax benefits for capital losses, and total revenue losses calculated by applying American returns and tax treatment globally, and therefore can provide only a rough estimate.

The terms of the Argentine default produced other, more subtle costs across the global economy. Its adverse effects on the Argentine economy, for example, reduced exports to Argentina, and the long legal struggles over the terms of restructuring have claimed substantial costs. Perhaps more important, the apparent success of Argentina's harsh, take-it-or-leave-it approach to its lenders threatens to change the terms of international lending and ultimately reduce financial and technology transfers to developing nations. In this way, Argentina's debt policies could retard modernization in the developing world, ultimately imposing substantial costs for many millions of people.

America is not only the world's preeminent financial center and economic power; through its sponsorship of the World Trade Organization and the direct investments of American corporations, the United States also is the leading champion of globalization and the accelerated modernization it has generated in many developing nations. The Argentine default and restructuring strategy discourage the financial and technological transfers that drive this modernization process, and the U.S. government has a global responsibility to ensure that the Argentine approach does not become a new international standard. The American government also has a national responsibility to protect U.S. taxpayers and investors from losses created by the arbitrary actions of other governments – both the multi-billion dollar losses imposed by Argentina's default program and those which could follow if other countries adopt Argentina's strategy.

The United States can help meet both of these responsibilities by using its economic and diplomatic powers – including, for example, the prospect of terminating Argentina's participation in the "General System of Preferences" (GSP) – to persuade or require Argentina to respect the established, international norms of developing-nation finance. The goal should be Argentina's agreement to rescind its repudiation of the remaining 26 percent of its defaulted debt and past due interest payments, and provide more favorable terms for the holdouts and those who accepted the original restructuring under the threat of repudiation. Furthermore, any future IMF or World Bank loans to Argentina should be contingent on its providing satisfactory terms to lenders that held its defaulted debt. In addition, emergency IMF loans provided to governments in default to help them stabilize their foreign exchange position should be available initially for the purpose only of repaying its creditors -- which would restore its access to capital markets.

Should the current Argentine government persist in its current policies, the United States also should enact legislative reforms that will permit American bondholders to attach Argentine government assets in the United States. These reforms should include changes in the Foreign Sovereign Immunities Act to end immunity from attachment for central bank assets held at the Bank of International Settlements beyond those required for the conduct of the foreign exchange and monetary policy activities of any government in default. These reforms also should end immunity from attachment for U.S. assets of enterprises owned by a government in default and any commercial payments or goods flows in the United States that involve a government in default.

When Companies and Governments Cannot Pay Their Debts

When a government defaults on its sovereign debt, it is not subject to the orderly bankruptcy process that companies face when they default on their legal obligations. Business bankruptcy, once considered a form of economic death, has become a normal and carefully-regulated part of business life, because a fair and measured bankruptcy process clearly serves everyone's interest. Modern bankruptcy procedures not only ensure that a company in dire financial straits does not run up additional debts it cannot meet, they also protect a company's assets from an unorganized rush by its creditors to liquidate them. These procedures, then, ensure that each claimant can be assessed fairly, while the company's assets are protected for future and more productive use by a reorganized entity or other enterprises.[2]

Modern bankruptcy law also provides a powerful deterrent to irresponsible business behavior by imposing serious consequences on a failed firm's management and owners. Allowing companies to fail with no serious results for its executives and owners could encourage managers to take unnecessary and unreasonable risks, both economic and legal. Imagine, for example, the potential consequences if following the collapse of Enron, Congress had not increased the penalties for companies and their accountancy firms that fail to acknowledge their losses and misreport earnings and profits. In particular, the modern bankruptcy process essentially enables a failing company's creditors to determine its future fate. Typically, a failed firm's former creditors become its new shareholders and, under the bankruptcy court's purview, determine among themselves whether the company should survive in a reorganized form or close down and be liquidated. Nations such as Japan that protect their failing firms by creating large hurdles for creditors and other ways for insolvent companies to stay in business ultimately undermine their own productivity and growth, by locking up capital and expertise in companies that do not or cannot use them efficiently.

There are no international laws or procedures to ensure such an orderly and fair process when sovereign governments default on their debts.[3] A defaulting government's creditors have no opportunities to participate in its reorganization or, under most circumstances, lay legal claim to its assets. This relative immunity enjoyed by defaulting governments creates a serious, potential moral hazard in international lending to governments that ultimately could injure everyone. If a government can repudiate its debts with little consequence, and its creditors have no power to foreclose on any of its assets, the basic question, as two international public-finance experts recently framed it, is "why do sovereign borrowers ever repay?"[4] This moral hazard is greatest with respect to the foreign lenders to governments, because a sovereign default on its foreign loans can shift part of the burden of financing its projects from its own taxpayers to investors in other countries. Moreover, unlike a government's domestic lenders, foreign lenders cannot respond to a sovereign default by encouraging their countrymen and women to retaliate at the polls. And if there are no serious consequences for not repaying foreign lenders, why would any of them continue to lend to governments?

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[2] Oliver D. Hart , "Different Approaches To Bankruptcy," Harvard Institute of Economic Research, Paper No. 1903., September 2000.

[3] The International Monetary Fund has studied the possibility of constructing, at the supranational level, the equivalent of a "Chapter 11 for countries but taken no concrete steps. See Lee C. Buchheit, G. Muti Gulati and Ashoka Mody, "Sovereign Bonds and the Collective Will," *Emory Law Journal*, 2002.

[4] Alexander Guembel and Oren Sussman, "Sovereign Debt Without Default Penalties," February 16, 2006.

In the absence of a formal legal process for regulating sovereign debt defaults, akin to the modern bankruptcy procedures for corporations, a number of informal arrangements have arisen. In 1956, the world's major countries formed the Paris Club to apply the principles of bankruptcy to negotiations with defaulting nations over government-to-government loans. When banks replaced governments as the major lenders to developing countries in the 1970s, the London Club was established to apply a similar framework to negotiations between defaulting countries and *ad hoc* committees of the major commercial banks holding their debts.[5] The United States, the United Kingdom and several other countries also passed laws allowing individuals to sue foreign governments over conflicts involving commercial activities, including sovereign debts. However, the American version of that legislation, the Foreign Sovereign Immunities Act of 1976, provides few clear, practical alternatives for U.S. investors holding defaulted foreign bonds. While such investors can try to claim a debtor government's assets within its own borders or held in foreign institutions, countries quickly figured out how to organize their financial affairs in ways that make it very hard to reach any of their assets.

Yet, foreign lending by private institutional and individual investors to developing countries has increased enormously even in the face of 59 sovereign debt defaults from 1976 to 2004, including 16 cases since 1998.[6] Part of the explanation is the IMF's readiness to provide multi-billion dollar bailout packages that allow defaulting countries to restore a measure of economic stability, which in turn enable them to offer restructuring plans acceptable to their creditors. Equally important, the restructuring programs of most debtor countries have respected certain informal norms, including repaying lenders about half of the present value of their outstanding obligations in packages acceptable to 90 percent or more of the lenders.

As we will see, Argentina has not respected those norms. If left standing, the terms of the Argentine 2001 default and 2005 restructuring plan not only will cost private lenders in America and Europe, along with ordinary taxpayers and shareholders, tens of billions of dollars. In its current terms, the Argentine default and restructuring also create a new moral hazard that ultimately could sharply reduce international lending to many developing countries. In this case and others that may follow, the United States and the major countries of Europe, where most foreign holders of Argentine debt are located, have an affirmative responsibility to enforce the international norms of foreign lending.

II. The Characteristics of Argentine Sovereign Debt and Their Default

Argentina has more experience with sovereign debt defaults than most countries. From 1890 to 2004, the Argentine government defaulted on its debts five times, more often than all but three other countries (Brazil, Ecuador and Peru).[7] Despite their regularity in recent Argentine history, such sovereign defaults are not an inevitable part

[5] Laura Alfaro, "Creditor Activism in Sovereign Debt: "Vulture" Tactics or Market Backbone," Harvard Business School Case Study N9-706-057, April 20, 2006.
[6] *Ibid*, Exhibit 2.
[7] *Ibid.*

of a country's development process even in times of great economic stress. For example, while Indonesia defaulted during the 1997-1998 Asian financial crisis, Korea, Malaysia, Singapore, China, the Philippines, Thailand and Taiwan all continued to pay their debts.[8]

There is no doubt that when Argentina defaulted in late 2001, the country's economy and government were both experiencing considerable stress. 2001 was the third consecutive year of serious recession for Argentina, foreign direct investment had virtually stopped, and inflation, interest rates and the budget deficit all were soaring. The IMF had provided hard currency loans to keep the peso stable, on the condition that the government restore a measure of fiscal and monetary discipline. Argentina's economic problems became a serious crisis in December 2001, when the IMF denounced the government's inability to put its financial house in order and suspended its loans. This development was followed almost immediately by a banking crisis and violent public protests that produced a rapid succession of six presidents in two weeks.

When this crisis hit, the Argentine government's strategic planning for default was already well advanced. To insulate itself from efforts by foreign creditors to attach assets abroad, the government quietly had shifted its reserve and other financial assets from the Deutsche Bank in New York to the Bank of International Settlements in Basel, Switzerland or to banks in Argentina. To the same end, it had set up special trusts and other intermediary arrangements to carry out its offshore payments and arranged to pay government employees abroad through direct deposits in Argentine banks or payments sent in diplomatic pouches. Once these steps were taken and the crisis arrived in December 2001, the Finance Ministry announced a "moratorium" on servicing external debt to private creditors and, on January 3, 2002, Argentina formally defaulted by missing a $28 million interest payment due on an Italian lira bond. The default covered 152 separate bond offerings issued in eight legal jurisdictions and seven currencies, with a total face value of $81.2 billion and held mainly by U.S., European and Japanese institutional and retail investors. It was and remains today the largest debt default, sovereign or private, in history.

When Argentina defaulted on those loans, it was one of the largest borrowers in the developing world. Based on the J.P. Morgan's Emerging Market Bond Index Plus (EMBI+), it accounted for more than 20 percent of the value of all emerging market government bond issues. Argentina's sovereign debts had increased by two-thirds from 1995 to 2001, rising from $87 billion to nearly $145 billion. In 2001, Argentina also was the IMF's third largest borrower, accounting for about 15 percent of the Fund's loan portfolio, the second largest borrower at the Inter-American Development Bank (IADB) with 17 percent of its outstanding loans, and the World Bank's fifth largest borrower, accounting for 7 percent of the Bank's risk exposure.[9] Interest payments on these debts claimed some $9.5 billion in 2000 – nearly $800 million per month -- or 15.2 percent of

[8] Carmen M. Reinhart and Kenneth S. Rogoff, "Serial Default and the Paradox of Rich-to-Poor Capital Flows," American Economics Association, Papers and Proceedings, May 2004.
[9] Adam Lerrick, "Argentina: An Object Lesson for International Economic Policymakers," Statement to the Subcommittee on International Trade and Finance of the Committee on Banking, Housing and Urban Affairs of the United States Senate, March 10, 2004, http://banking.senate.gov/_files/lerrick.pdf.

the country's national budget and 3.4 percent of its GDP.[10] From the December 2001 default to the restructuring in January 2005, Argentine's total outstanding debt increased by one-third more, almost entirely from domestic sources, and reached $191.3 billion or 129 percent of GDP. In December 2005, following the restructuring and repudiations, the sovereign debt still recognized by the Argentine government amounted to $128.6 billion or 72 percent of GDP. Counting the repudiated debt and its past due interest as well, the total was $153 billion or 87 percent of the country's GDP.

Throughout this period, foreign investors held the majority of this debt, although their share began to decline when the Argentine economy turned down in 1998. At the time of the default, the share held by foreign investors was just under 60 percent (Table 2, below). As we will see, the default focused predominantly on this foreign-held debt.

Table 2: Argentine Debt Held by Domestic and Foreign Investors, ($ billions)[11]

	Sovereign Debt	Domestic Investors	Foreign Investors	Foreign Share
Dec. 1995	$87.1	$20.7	$66.4	76.2%
Dec. 1996	$97.1	$24.2	$72.9	75.1%
Dec. 1997	$101.1	$28.2	$72.9	72.1%
Dec. 1998	$103.1	$31.2	$81.2	72.2%
Dec. 1999	$121.9	$39.4	$82.5	67.7%
Dec. 2000	$128.0	$46.6	$81.4	63.6%
Dec. 2001	$144.5	$59.9	$84.6	58.5%
Dec. 2002	$137.3	$49.1	$88.3	64.3%
Dec. 2003	$178.8	$75.4	$103.5	57.9%
Dec. 2004	$191.3	$77.2	$114.1	59.6%
Dec. 2005	$128.6	$64.6	$64.0	49.8%

When the Argentine government announced the default, its sovereign debts totaled $144.5 billion, equal to 53.5 percent of the nation's GDP. While non-Argentines held only 58.5 percent of that, 97 percent of their holdings were denominated in foreign currencies. Nearly one-third also had been issued in foreign jurisdictions, while 43 percent was issued in Argentina and the remaining by international financial institutions (the IMF, World Bank and IADB) or under bilateral agreements with other governments. Nearly 43 percent of the total debt was held in Argentine Treasury bonds, bills and other short-term instruments, and another 30 percent were provincial-government debts that the national government assumed in October 2001 in preparation for the default. The quarter of the debt arising from loans from international institutions included $14 billion owed to the IMF, $9.7 billion owed to the World Bank, and $8.7 billion owed to the IADB.[12, 13] The following table (Table 3, below) provides a breakdown of the debt's composition.[14]

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10 Mark Weisbrot and Dean Baker, "What Happened to Argentina," Center for Economic and Policy Research, 2002, www.cepr.net/publications/argentina_2002_0-1_31.htm.

11 Ministry of Economy and Production, Argentine Republic.

12 Federal government debt includes multilaterals, bilateral, performing and non-performing debt to private creditors. IMF Article IV Consultation Staff Report No. 05/236, July 2005; http://www.imf.org/external/pubs/ft/scr/2005/cr05236.pdf.

Table 3: Composition of Argentine Government Debt, December 2001 ($ billions)

	Amount	Share
Bonds, T-bills and other short-term debts	$61.8	42.8%
Provincial Guaranteed Bonds	$42.3	29.3%
International Institutions (IMF, WB, IADB)	$32.4	22.4%
Bilateral Loans	$4.5	3.1%
Commercial Banks	$2.0	1.4%
Other Creditors	$1.5	1.0%
Total:	$144.5	100.0%

At the time of the default and the period leading to its restructuring, the Argentine government divided its obligations into three categories.

Table 4: Argentina's Sovereign Debt Categories, 2001-2004, ($ billions) [15,16,17]

	Amount	Share of Total
Performing Debt – Outside the Default	**$77.3**	**40.4%**
International financial institutions	$29.4	
IMF	*$14.1*	
IADB	*$7.8*	
World Bank	*$7.5*	
BODENs	$16.1	
Former provincial debt	$26.3	
Civil Service bonds	$ 0.8	
Others	$ 4.7	
Defaulted Debt Ineligible for Restructuring	**$7.8**	**4.1%**
Bilateral (including Paris Club)	$6.6	
Commercial banks	$1.2	
Defaulted Debt Eligible for Restructuring	**$106.2**	**55.5%**
Principal as of December 2001	$81.2	
Past Due Interest as of December 2004*	$25.0	
Total	**$191.3**	**100.0%**

* Not included in restructuring

[13] Miguel A. Kiguel, "Argentina's Public Debt," Undersecretary of Finance Argentina, World Bank; http://wbln0018.worldbank.org/LAC/lacinfoclient.nsf/1daa46103229123885256831005ce0eb/e1e73517114be92f85256bc30057076e/$FILE/MKiguel.pdf.

[14] Secretariat of Finance, Ministry of Economy and Production, Argentina's Restructuring Guidelines, September 2003. http://www.embargentina.or.jp/keizai/pdf/dubai_22-9_english.pdf.

[15] J.F. Hornbeck , "Argentina's Sovereign Debt Restructuring," Congressional Research Service, Report for Congress, October 2004; http://www.cnie.org/NLE/CRSreports/04Oct/RL32637.pdf.

[16] IMF Article IV Consultation Staff Report No. 05/236, July 2005; http://www.imf.org/external/pubs/ft/scr/2005/cr05236.pdf.

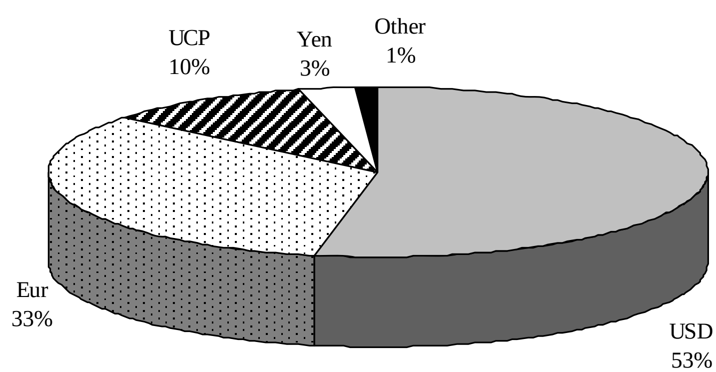
[17] Estimates incorporated data from the IMF 2005 report and revised data from the Argentine government. Therefore, these estimates are slightly different than those in CRS Report in October 2004.

The first category, accounting for more than 40 percent of the sovereign debt in 2001, was outside the default. It included loans from the IMF, World Bank and IADB, as well as "BODEN" bonds issued to compensate Argentine banks and depositors for the peso devaluation, provincial-government debt assumed in October 2001, and bonds issued to compensate civil service workers for recent wage cuts. In late 2002, Argentina also defaulted on its World Bank and IADB debts and, for one day in September 2003, stopped payments to the IMF until it accepted the government's terms. Almost all of the sovereign debts that the government continued to recognize were held by Argentines. The second category was comprised of loans which the government immediately repudiated and classified as ineligible for restructuring. These loans included debts to other countries, such as obligations to the Paris Club arising from the country's 1982 debt default, and totaled nearly $8 billion or 4.1 percent of the government's total obligations.

The third category, covering more than 55 percent of Argentina's sovereign obligations, was the $81.2 billion in loans declared to be in default and eligible for restructuring. About two-thirds were owed to foreign financial institutions and foreign retail investors. By the time of the restructuring offer in 2005, these loans also carried $25 billion in unpaid interest payments.

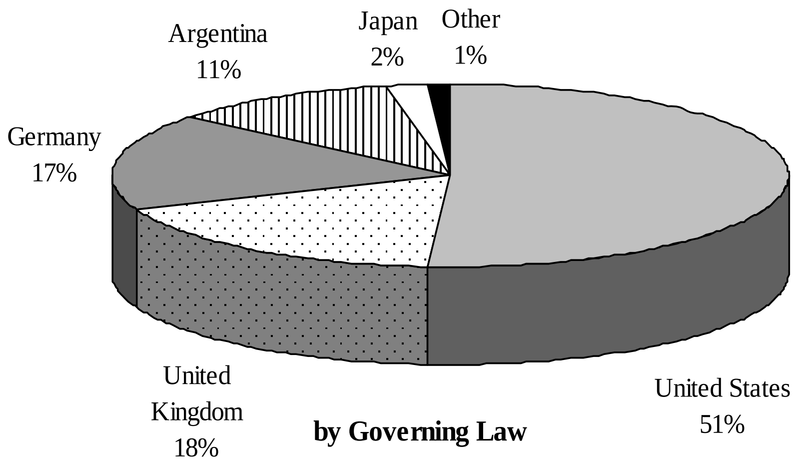
The default on these loans was a major global financial event. The debt included in the default consisted of 152 bonds issued in seven currencies and eight national jurisdictions, spanning the developed world. As seen in Figure 1, below, more than half of this debt was denominated in U.S. dollars, one-third was issued in Euros, 10 percent was issued in U.S. dollars and later converted to Argentine pesos ("UCP"), 3 percent was issued in Yen, and the remaining 1 percent issued in three other currencies. Justover 50 percent of the bonds in default had been issued under U.S. law, 19 percent had been issued in the United Kingdom, 17 percent in Germany, 11 percent in Argentina, 2 percent in Japan, and the remaining 1 percent in three other national jurisdictions.

Figure 1: Argentina's Defaulted Debt, by Currency and Legal Jurisdiction[18]



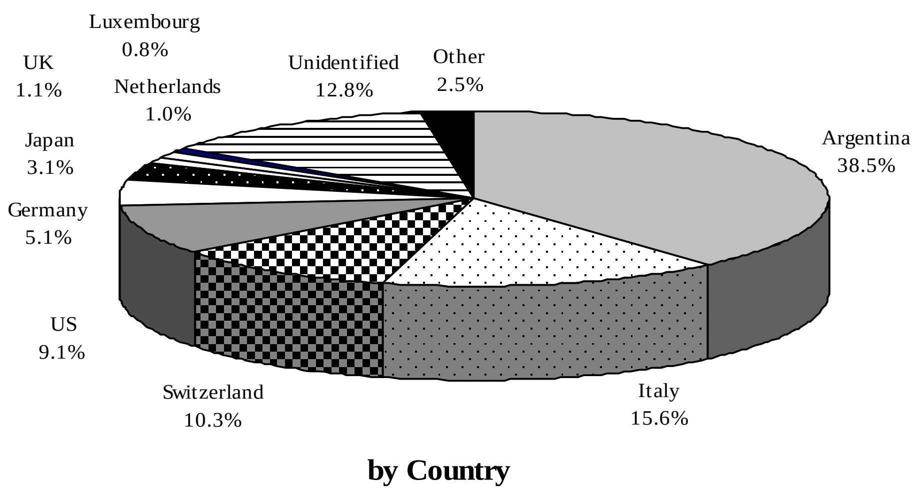
by Currency

[18] Secretariat of Finance, Ministry of Economy and Production, Argentina's Restructuring Guidelines, *op.cit.*



The Argentine Ministry of Economy and Production has estimated that 56.5 percent of the value of the defaulted debt was held by institutions and 43.5 percent by retail investors. The Argentine government also estimates that Argentines held a little more than one-third of the defaulted debt, with more than 60 percent distributed among lenders in many foreign countries. Italy, Switzerland and the United States account for more than half of all foreign holdings of the defaulted debt.

Figure 2: Eligible Debt for Restructuring by Country[19]



III. The Terms of the Buenos Aires Proposal and the 2005 Restructuring

By late 2004 -- three years after the initial default and 15 months after representatives of bondholders and international institutions rejected Argentina's so-called Dubai Guidelines for settlement -- the Argentine government faced more than 140

[19] *Ibid.*

lawsuits in the United States, Italy and Germany, including at least two pending favorable judgments totaling almost $900 million.[20] In this environment, Argentina released its “final terms” for its restructuring program, based on the “Buenos Aires Proposal” released several months earlier. In four crucial respects, the terms of the December 2004 restructuring offer diverged from those negotiated by other developing nations. First, Argentina never negotiated with its creditors but instead simply issued a series of take-it-or-leave-it proposals. Second, the Argentine government’s final offer of late 2004 repudiated any obligation to repay interest owed from the time of the default to the restructuring, amounting to $25 billion. Third, the offer provided a much lower value, per dollar of defaulted debt, than other restructurings by developing nations. Finally, the offer included provisions repudiating the debts of any bondholders who rejected it, making the proposal a unilateral, take-it-or-leave-it proposition. .

The Argentine government’s take-it-or-leave-it offer was very complex, based on the varying terms of 152 affected bonds and the terms of the three new bonds issued to replace them. The proposed cut in the value of the principal of those 152 original bonds – the so-called “haircut” that lenders would have to accept -- ranged from 64 percent to 82 percent. An IMF study calculated that the exchange reduced the net present value of the original debt by 75 percent, including the past due interest repudiated under the plan and assuming a 10 percent discount rate.[21] These terms provided bondholders much less compensation than plans offered in other developing-nation debt restructurings, which averaged 50 to 60 percent haircuts. Moreover, the plan stipulated that its terms were not subject to negotiation; and on February 9, 2005, the Argentine Congress enacted a law barring the executive branch from reopening the offer or reaching private settlements with non-participating creditors that differed in any way from the original offer.

In March 2005, the Argentine government announced that lenders holding $61.8 billion of the $81.2 billion in outstanding defaulted debt had accepted the offer, for a worldwide participation rate of 76.15 percent. In brief, Argentina exchanged those defaulted bonds, with a face value of $61.8 billion, for three new bonds with a face value of $35.2 billion ($15 billion in par-value bonds, $11.9 billion in discount bonds, and equivalent of $8.3 billion in quasi-par bonds). The full financial terms of the three new debt securities issued in the restructuring are provided in the Appendix, based on Argentina’s SEC filings.[22] The exchange also repudiated all past due interest from the default in December 2001 to the restructuring; and the new bonds carried lower interest rates and shorter maturities than the original bonds they replaced. Indeed the interest rates on the new paper, ranging from 2.08 percent to 5.96 percent, were extraordinarily low for any sovereign debt, much less for loans to a government that had just defaulted

[20] Alfaro, *op. cit.*

[21] Federico Sturzenegger and Jeromin Zettelmeyer, “Haircuts: Estimating Investor Losses in Sovereign Debt Restructuring, 1998-2005 International Monetary Fund Working Paper WP/05/137, 2005, http://www.imf.org/external/pubs/ft/wp/2005/wp05137.pdf

[22] In its amendment to the SEC, the Argentine government proposed different financial terms depending on whether at least 70 percent of the bondholders agreed to participate in the proposed restructuring.

Those participating included U.S. investors holding $6.6 billion out of total U.S. holdings of $8.7 billion in Argentine debt. This left unresolved the claims of investors holding 23.85 percent of the original debt. There was considerable variation in participation rates by the legal jurisdiction under which the bonds were issued. For example, more than 92 percent of the bonds issued under Japanese law were restructured, as were more than 81 percent of the bonds issued under U.S. law -- compared to only 64 percent of the bonds issued in Germany and 68 percent issued in the United Kingdom. (This analysis assumes U.S. participation was close to the 76.15 percent worldwide rate.)

Table 5: Share of Defaulted Debt and Participation Rate in Debt Restructuring, By Legal Jurisdiction[23]

	Share of Eligible Debt	Participation Rate
U.S.	51%	81.4%
U.K.	18%	68.0%
Germany	17%	64.1%
Argentina	11%	86.3%
Japan	2%	94.4%
Other	1%	69.5%
Total	**100%**	**76.1%**

IV. The Economic Costs of the Default for U.S. Investors and Taxpayers

The Argentine default imposed large costs on U.S. investors and taxpayers, both directly and indirectly. The direct costs include the capital losses and foregone interest payments incurred by American lenders who accepted the harsh restructuring terms, as well as those who rejected the offer and continue to hold the defaulted bonds. The default also cost those lenders the investment returns that holders of other emerging market bonds enjoyed in 2002-2005. We estimate that these three direct costs total almost $9 billion for U.S. investors in Argentine debt and nearly $84 billion for global investors. The indirect costs include the impact of the peso devaluation triggered by the default on the value of assets in Argentina held by foreign companies, an impact ultimately borne by their shareholders, and the costs to ordinary taxpayers of the tax write-offs and write-downs claimed by the investors who incurred large, direct losses in the default and restructuring. We estimate that these indirect costs total more than $10 billion for American shareholders and taxpayers, and nearly $64 billion for taxpayers and shareholders worldwide. In addition, the three IMF bailout packages for Argentina, which ultimately were financed by the taxpayers in the member countries, put at risk some $23 billion worldwide and $4 billion from the United States.

[23] World Bank, "Country Assistance Strategy for the Argentine Republic 2006-08," http://siteresources.worldbank.org/INTARGENTINA/Resources/1CASAr.pdf

Direct Costs for American and Worldwide Lenders

The total direct costs for worldwide investors who held Argentine defaulted debt total $83.6 billion in capital losses, interest payments never received, and foregone investment returns, including direct losses of $59.6 billion among those who participated in the 2005 restructuring and $24 billion for those who rejected the exchange. Among U.S. investors holding the defaulted bonds, the direct costs total about $9 billion, including direct losses of $6.4 billion among those who participated in the restructuring and $2.6 billion among those who rejected the exchange. As we will see, the capital losses and past due interest also reduced the tax liabilities of these investors, bringing down their net losses while creating additional costs for other taxpayers.

Table 6: Direct Costs of the Argentine Debt Default and Restructuring For Worldwide and U.S. Investors ($ million)

	Worldwide	U.S.
Investors Accepting the Restructuring Offer		
Capital losses	$29,479	$3,154
Interest Due, December 2001-January 2005	$19,038	$2,037
Foregone Investment Returns	$11,130	$1,191
Total	**$59,647**	**$6,382**
Investors Rejecting the Restructuring Offer		
Capital losses	$14,525	$1,554
Interest Due, December 2001-January 2005	$ 5,963	$ 638
Foregone Investment Returns	$ 3,486	$ 373
Total	**$23,974**	**$2,565**
All Lenders to the Argentine Government		
Capital losses	$44,044	$4,708
Interest Due, December 2001-January 2005	$25,000	$2,675
Foregone Investment Returns	$14,616	$1,564
Total	**$83,620**	**$8,947**

Bondholders Who Accepted the Restructuring Offer

Worldwide, 76.15 percent of the holders of Argentine defaulted debt accepted the restructuring offer, accounting for $61.8 billion of the $81.2 billion default. They exchanged those bonds with a face value of $61.8 billion for new bonds with face value of $35.2 billion. Their total losses, however, came to almost $60 billion: Their actual capital losses were the $29.5 billion difference between the market value of these new bonds and what they had paid for the bonds that defaulted; while their total losses also include $19 billion in interest payments suspended in the default and $11.1 billion in investment returns precluded by the default. American investors who accepted the restructuring offer absorbed almost $3.2 billion in actual capital losses, $2 billion in past due interest never paid or received, and $1.2 billion in foregone investment returns.

Capital Losses: We calculate the actual capital losses of the bondholders who accepted the restructuring by calculating the difference between their original purchase prices (the capital basis) and the market value of the bonds they received in the exchange. While the precise terms for exchange and restructuring differed among the 152 separate bond issues included in the default, we estimate those prices using the average market price of Argentine government discount bonds in the three years preceding the default, 1998-2000, which was about $0.75 for each dollar in face value. Therefore, we estimate that worldwide investors paid about $46.35 billion (the capital basis) for the $61.8 billion in Argentine bonds later exchanged in the restructuring. The new bonds had a total face value of $35.2 billion, comprised of $15 billion in par bonds, $11.9 billion in discount bonds, and $8.3 billion in equivalent par bonds.[24] At the time they were issued, these bonds traded at $0.48 per dollar of face value, so the market value of the $35.2 billion in new bonds was $16.9 billion. The global investors who accepted the restructuring, therefore, had actual capital losses of $29.45 billion ($46.35 billion - $16.9 billion = $29.45 billion) or 64 percent of the original capital basis.[25] American investors accounted for 10.7 percent of those participating in the restructuring, and their actual capital losses came to $3.15 billion.[26]

Repudiated Interest Income: The default also cost worldwide and U.S. lenders to Argentina the promised interest payments from the time of the default to the final restructuring. For the global and American holders of Argentine bonds who accepted the restructuring, the past due interest payments from December 2001 to January 2005 totaled $19 billion and $2 billion, respectively.

Foregone Investment Returns: The default also denied U.S. and global lenders to Argentine the additional returns they would have earned on their Argentine bonds, if they had earned the returns they could have expected but for the default. From 1995 to 2000, the investment returns on Argentine debt closely tracked those of Brazil and other Latin American nations; unsurprisingly, the investment returns on Argentine bonds diverged sharply from the other from the default to the restructuring. This is evident in Figure 3, below, charting the J.P. Morgan Emerging Market Bond Index Plus (EMBI+). Over the period 1995-2000, the total returns of Argentine government bonds correlated more than 90 percent with the returns on bonds of all Latin American countries. In 2001, however, the investment returns on Argentine bonds declined by almost 70 percent and by another 6 percent in 2002, while over the same years the returns for government bonds for the entire Latin American region (including Argentina) fell by only 6.5 percent (down 13.7 percent in 2001 and up 7.2 percent in 2002). Over 2002-2004, the total returns on Argentine government bonds were about two-thirds lower than those of Brazilian government bonds and one-half the returns of all Latin American government bonds.

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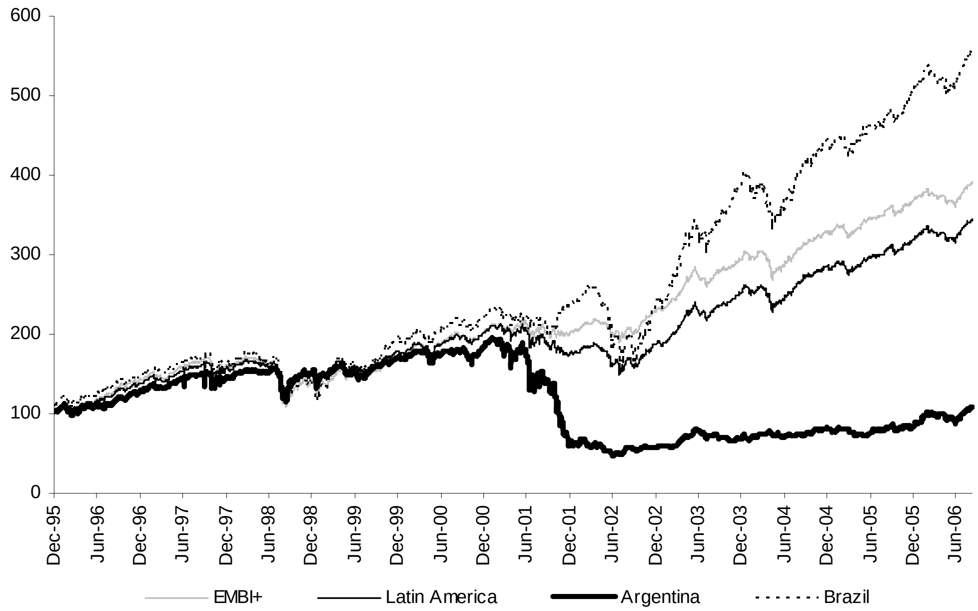
[24] Par bonds have no face value reduction, discount bonds were exchanged at 33.7 percent of the original face value. Quasi-par bonds were exchanged at 69.6 percent of face value. "Haircuts: Estimating Investor Losses in Sovereign Debt Restructuring, 1998-2005," Federico Sturzenegger and Jeromin Zettelmeyer, IMF Working Paper, WP/05/137, 2005; http://www.imf.org/external/pubs/ft/wp/2005/wp05137.pdf.

[25] This estimate, based on the capital basis, is conservative compared to 75 percent "haircut calculations" estimated by others, including the IMF.

[26] Our estimate is derived from an adjusted average of the Argentine government's estimate of 9.1 percent and the estimate by the Congressional Research Service of 12.3 percent. The discrepancies reflect the limited data available and the complexities of the 152 securities issued in eight national jurisdictions.

Figure 3: Investment Returns on Government Bonds,
Latin America, Argentina and Brazil, December 1995 – September 2006



Using a 90 percent correlation, we estimate that over 2002-2004, the investment returns on Argentine bonds would have been 24 percentage-points higher than their actual returns, but for the default. The worldwide investors who accepted the restructuring of $61.8 billion in Argentine bonds had paid about $46.4 billion for those bonds. Therefore, the default cost global investors an additional $11.1 billion in foregone investment returns. Again, since U.S. investors accounted for 10.7 percent of those accepting the restructuring, the default cost those U.S. bondholders $1.2 billion in foregone investment returns over the three year period 2002-2004..

Bondholders Who Rejected the Restructuring Offer

Worldwide bondholders who rejected the restructuring offer still own Argentine government bonds with a face value of $19.4 billion, including almost $2.1 billion held by U.S. investors. The total direct losses of these bondholders – including their actual capital losses, past due interest and foregone investment returns -- comes to almost $24 billion worldwide, including almost $2.6 billion lost by U.S. investors (Table 6, above).

Capital Losses: Based on the Argentine government's repudiation of the debts it owes bondholders who rejected the restructuring offer, their capital losses equal the price they paid for their worthless bonds. Since Argentine government discount bonds (non-par bonds) sold at an average price of $0.75 per-dollar face value in the three years preceding the default (1998-2000), those who subsequently rejected the bond exchange had paid an estimated $14.5 billion for those bonds (with a face value of $19.4 billion). Therefore, the actual capital losses of worldwide investors who rejected the restructuring came to $14.5 billion, including capital losses of American bondholders of $1.6 billion.

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Repudiated Interest Income: As noted earlier, the default also cost worldwide and U.S. lenders to Argentina their promised interest payments from the time of the default to the final restructuring. For investors who rejected the restructuring, the past interest payments for December 2001 to January 2005 totaled almost $6 billion worldwide and $638 million for American bondholders.

Foregone Investment Returns: Once again, the default also denied worldwide and U.S. lenders to Argentina the investment returns that they would have earned on their bonds, if Argentina's sovereign debt had continued to earn returns comparable to other countries in the region. Using the assumptions and procedures described above to calculate these foregone returns, we estimate that the default cost worldwide and U.S. investors who rejected the restructuring some $3.5 billion and $373 million, respectively, in forgone investment returns.

Indirect Effects and Their Costs for American Equity Investors and Taxpayers

The Argentine sovereign debt default also imposed substantial costs on taxpayers and equity investors who had not held the defaulted bonds, in both in the United States and other countries with large holdings of the bonds. These indirect costs fall into three categories. First, the default forced a drastic devaluation of the peso against the dollar, Euro and other major currencies, reducing the book value of existing investments in Argentina by American, European and other multinational companies, and thereby producing substantial costs for their shareholders. As detailed below, we estimate that the peso devaluation triggered by the default reduced the equity value of U.S. shareholders investing in Argentina by some $7.8 billion. Second, the direct costs described above reduced the taxes that American lenders holding the Argentine bonds paid to the U.S. federal and state governments, thereby creating a substantial indirect cost for other American taxpayers. We estimate that these tax consequences of the default cost American taxpayers some $2.6 billion. Finally, the default also triggered substantial bailout packages from the IMF, which were financed by the taxpayers of the country members contributing to the IMF funding. We estimate that these bailouts put another $4 billion from U.S. taxpayers at risk. Therefore, the Argentine default indirectly cost American equity investors in Argentina some $7.8 billion and American taxpayers $2.6 billion in foregone tax revenues, and put another $4 billion in taxpayer funds at risk.

We also have estimated these indirect effects on a worldwide scale. Based on total foreign investment in Argentina at the time of the default, the devaluation of the peso reduced the equity value of worldwide business investment in Argentina by more than $39 billion. The indirect costs for taxpayers worldwide are more difficult to calculate. Here we assume that the tax consequences in other countries would at least be comparable under U.S. tax law. By this assumption, the default cost worldwide taxpayers $24.4 billion. Since the U.S. tax burden is lower than other major countries, this rough estimate is probably conservative. Finally, IMF bailouts for Argentina put $23.2 billion in worldwide taxpayer funds at risk.

Table 7. Indirect Costs of the Argentine Default and Restructuring for Worldwide and U.S. Equity Investors and Taxpayers, $ billions

	Worldwide	U.S.
Shareholder Losses from Currency Effects	$39.2	$7.8
Revenue Losses for Other Taxpayers to Offset	$24.2	$2.6
Total	**$63.4**	**$10.4**
Taxpayer Funds at Risk in IMF Bailouts	$23.2	$4.0

Indirect Costs for Shareholders

Throughout the 1990s, multinational companies in the United States, Europe and Latin America made large direct investments in Argentina, especially after the Argentine Government implemented a series of domestic reforms to encourage foreign investment.[27] By the end of the decade, flows of foreign direct investment (FDI) into Argentina averaged almost $11 billion per year (1998-2001); and in 2001, the total stock of FDI in Argentina reached almost $80 billion. U.S. companies were the largest single source of this FDI, accounting for 25.6 percent of the flows in 1998-2001, followed by Spanish corporations with 18.7 percent. These investment inflows were largely concentrated in the manufacturing, petroleum and utility sectors.[28],[29] These stocks and flows of foreign direct investment are summarized in Table 8, below.

Table 8: Foreign Direct Investment Stocks and Flows to Argentina, by Country of Origin, 1998-2003 ($ billion)

	1998	1999	2000	2001	2002	2003
Total Stock	$47.9	$62.1	$67.8	$79.5	$43.1	$48.3
United States	$14.7	$15.4	$15.9	$19.4	$10.9	$10.9
Europe	$20.1	$31.3	$36.9	$44.0	$23.7	$26.2
Latin America	$10.6	$12.3	$11.5	$11.6	$6.2	$9.0
Others	$1.5	$3.1	$3.5	$4.5	$2.3	$2.2
Inflows	$7.3	$24.0	$10.4	$2.2	$2.1	$1.7
United States	$1.0	$2.9	$0.7	- $0.5	- $1.1	-$ 0.1
Pesos per US$	1.0	1.0	1.0	1.0	3.063	2.901

The default not only sharply reduced inflows of foreign investment (and in the case of the United States, produced net outflows from Argentina to the U.S.). It also

[27] For example, the Government eliminated restrictions on capital flows, especially from the U.S. under the Argentine-US Bilateral Investment Treaty, equalized corporate taxes for foreign- and Argentine-owned companies, created a free trade zone, and privatized more than 60 state-owned enterprises.
[28] Direct investments are valued at book value, which is the preferred approach for valuing assets pursuant in an international context; by contrast, portfolio investments are valued by marking to market. http://www.mecon.gov.ar/cuentas/internacionales/documentos/international_investment_position_methodology.pdf#search=%22foreign%20direct%20investment%20argentina%20methodology%22.
[29] Ministry of Economy and Production, Argentine Republic; U.S. Bureau of Economic Analysis.

sharply reduced the value of those investments measured in the currencies of the companies who owned them. Throughout the 1990s and into 2001, Argentina's Currency Board had used IMF funds to maintain the peso's legally-mandated one-to-one exchange rate with the U.S. dollar. When the IMF stopped disbursing those funds in October 2001 to protest the Argentine Government's refusal to discipline its budgetary and monetary policies, the pressures on the peso increased. Instead of taking steps to restore international confidence in the peso and demand for the currency, the Argentine government abolished the Currency Board as part of its debt default policy. Virtually overnight, the peso's exchange rate with the dollar fell from one-to-one to three-to-one. By September 2002, the peso had fallen even further and reached a low of 3.7 to a dollar. Over the period 2002-2004, the peso exchange rate with the dollar averaged about three-to-one, the level it achieved immediately after the default.

The sharp devaluation of the peso triggered by the default sharply reduced the flow of foreign investment into Argentina and created large book losses for the U.S. and other foreign companies with substantial investments there. In the three years following the default, the value of the stock of the country's foreign direct investment declined by $28.9 billion or more than 36 percent, from $79.5 billion in 2001 to $50.6 billion in 2004. Over the same period, total FDI inflows to Argentina totaled $10.3 billion. Therefore, we estimate that the peso devaluation triggered by the default reduced the value of all foreign direct investments in Argentina, and the shareholder value of the companies owning those investments, by $39.2 billion.[30]

American companies account for about 25 percent of total FDI in Argentina, and the value of all U.S. FDI in Argentina declined following the default by $8.4 billion or more than 43 percent, from $19.4 billion in 2001 to $11 billion in 2004. Over the same period, total FDI flows from America to Argentina went negative, with total outflows of $600 million. Therefore, we estimate that the peso devaluation triggered by the default reduced the value of U.S. foreign direct investments in Argentina by $7.8 billion. As a result, the Argentine default reduced the shareholder value of American companies invested in Argentina by $7.8 billion.

Table 9: Impact of the Peso Devaluation on the Value of Foreign Direct Investment in Argentina, 2001-2004, $ billions

	Global	U.S.
Change in the Value of the Stock of FDI	($28.9)	($8.4)
Value of FDI Inflows to Argentina	$10.3	($0.6)
Cost of the Devaluation for Firms with FDI in Argentina	($39.2)	($7.8)

[30] Standard & Poor's on October 9, 2001 downgraded Argentina's sovereign debt rating to CCC+ and Moody's on October 12, 2001 downgraded Argentina to the lowest in the world Caa3. S&P's in March 2006 raised its long-term sovereign credit rating on Argentina to B and its short-term sovereign credit rating to B.

Indirect Costs for U.S. Taxpayers

The Argentine default also reduced the taxes collected by federal and state governments, imposing an indirect cost on American taxpayers and companies with no holdings in Argentine bonds or direct investments in Argentina. These revenue reductions occurred as U.S. bond holders claimed tax benefits from the capital losses from the haircuts imposed in the restructuring or repudiation of their loans. The default also reduced the taxable investment returns which they would have earned but for the default, based on the rising market value of government bonds in other Latin American country from 2001 through 2004. Finally, the Argentine government's repudiation of its interest payments to the bond holders reduced federal and state revenues by lowering the taxable incomes of Americans and U.S. companies holding the bonds. The total revenue losses borne ultimately by all U.S. taxpayers, come to more than $2.6 billion.

- U.S. bondholders who accepted the restructuring were able to claim $3,152 million in capital losses, reducing their federal and state capital gains taxes by $720 million;

- Those same bondholders also lost $1,191 million in investment returns which they would have earned, but for the default, reducing federal and state revenues by $432 million;

- Those same bondholders also could not collect $2,037 million in taxable interest payments (December 2001-January 2005), reducing their federal and state individual or corporate income taxes by $739 million;

- U.S. bondholders who rejected the restructuring can claim $1,554 million in capital losses, reducing their federal and state capital gains taxes by $355 million;

- Those same bondholders also lost $373 million in investment returns which they would have earned, but for the default, reducing federal and state revenues by $135 million; and,

- Those same bondholders also could not collect $638 million in taxable interest payments (December 2001-January 2005), reducing their federal and state individual or corporate income taxes by $231 million.

Bond Holders Who Accepted the Restructuring Offer: We have established that U.S. bondholders who accepted the restructuring had capital losses of $3,154 million. To estimate the tax effect, we first apply the global allocation of Argentine debt holders to the U.S., and posit that 56.5 percent of bondholders are institutions taxed at corporate rates and 43.5 percent are retail investors, including partnerships, taxed at personal rates. The federal capital gains and income tax rates are 20 percent and 29 percent, respectively, for institutional investors, and 15 percent and 29 percent, respectively, for accredited investors. The average state and local capital gains and income tax rates are assumed to be 5 percent. On this basis, we estimate a combined, weighted average capital gains tax rate of 22.83 percent and a combined, weighted average income tax rate of 36.36 percent.

On this basis, we estimate that the default cost the U.S. Treasury, state and local governments, and ultimately American taxpayers, $720.1 million for the capital losses incurred by U.S. bondholders who accepted the restructuring ($3,154 million x 22.83 percent capital gains tax rate = $720.1 million). The interest payments which these bondholders also failed to receive would have been taxed at an average 36.36 percent combined federal, state and local rate; and therefore the default also cost U.S. taxpayers an additional $739 million. Finally, the investment returns which these bondholders also failed to earn also would have been taxed as ordinary income; and therefore, the default cost U.S. taxpayers another $432 million in tax revenues (see Table 10, below).

Bondholders Who Rejected the Restructuring: Using the same assumptions and approach to estimate the tax effects from the losses imposed on U.S. bondholders who rejected the restructuring plan, we calculate that the default and restructuring plan cost the U.S. Treasury, state and local governments, and ultimately American taxpayers, $355 million for the $1,554 million in capital losses incurred by U.S. bondholders who rejected the restructuring: Capital losses of $1,554 million, taxed at an average combined capital gains rate of 22.83 percent = $354.8 million. The default program also cost the U.S. bondholders who rejected the restructuring terms $638 million in interest payments due for December 2001 to January 2005, which would have been taxed as ordinary corporate or individual income. Applying our allocations for corporate and retail investors, and the average, weighted combined 36.36 percent federal and state tax rate for ordinary income, the Argentine government's repudiation of their interest obligations cost U.S. taxpayers another $231 million. Third, the default also denied Argentina's U.S. lenders who rejected the subsequent bond exchange some $373 million in income which they would have earned if the returns on Argentina's sovereign debt had continued to closely track those of other Latin American countries. This income also would have been taxed at a combined, federal and state rate of 36.36 percent, and therefore the default cost American taxpayers another $135 million in tax revenues.

Table 10: U.S. Federal and State Revenue Losses
From the Argentine Default and Restructuring, $ millions

	Amount	Tax Rate	Taxpayer Cost
Restructured Bonds			
Capital Losses	$3,154	22.83%	$720
Past Due Interest	$2,037	36.26%	$739
Foregone Investment Returns	$1,191	36.26%	$432
Total			**$1,891**
Non-Restructured Bonds			
Capital Losses	$1,554	22.83%	$355
Past Due Interest	$ 638	36.26%	$231
Foregone Investment Returns	$ 373	36.26%	$135
Total			**$721**
TOTAL			**$2,612**

IMF Bailout Packages

Taxpayers in the United States and other IMF member countries also financed three bailout packages totaling $23.2 billion extended to Argentina from mid-2000 to late-2003.[31] The first bailout in March 2000 was necessitated by the economic mismanagement which produced the conditions that led to the debt default. The IMF provided additional bailouts in January 2003 and September 2003 when the Argentine government refused to offer a restructuring plan that could have restored confidence in its willingness and ability to repay its future debts, and thereby enabled it to return to global capital markets.

When the IMF provides a bailout package, the taxpayers who ultimately supply the resources are at risk. Moreover, when a government repays its IMF loans, as Argentina has done, the funds remain with the IMF for future bailouts.[32] Since the United States provides more than 17 percent of the IMF quota, American taxpayers contributed the largest share of the resources used in the bailout packages to Argentina, or about $4 billion. While the three bailouts were funded through previous contributions to the IMF and thus did not involve new costs for taxpayers in member countries, the default put at risk billions of dollars which they paid in. Those risks for taxpayers in various countries are summarized in the following table.

Table 11: Selected IMF Members' Quotas and Taxpayer Funds at Risk in the Argentine Bailouts[33]

	Share of Quotas	Cost of Argentine Bailouts ($ million)
United States	17.40%	$4,037
Japan	6.24%	$1,448
Germany	6.09%	$1,413
France	5.03%	$1,167
United Kingdom	5.03%	$1,167
Italy	3.31%	$ 768

31 Three stand-by agreements approved by the IMF Board on March 10, 2000, January 24, 2003 and September 20, 2003. The IMF augmented the March 10, 2000 agreement by $7.0 billion on January 12, 2001 and another $7.2 billion on September 7, 2001.

32 Mexico for $50 billion package in 1995, Thailand for $17 billion in 1997, Indonesia for $34 billion in 1997, Korea for $57 billion in 1997, Russia for $16 billion in 1998, Brazil for $42 billion in 1998, Turkey for $10 billion in 2000 and Argentina for $20 billion in 2002; "Argentina: An Object Lesson for International Economic Policymakers," Adam Lerrick, March 2004.

33 IMF Members' Quotas and Voting Power, 2006; www.imf.org/external/np/sec/memdu/members.htm.

V. Conclusion

Actions taken by the Argentine government in late 2001 and early 2005 have imposed enormous and unnecessary costs on investors, shareholders and taxpayers in the United States, Europe and Latin America. If Argentina's leaders had heeded the International Monetary Fund and applied more discipline to their domestic fiscal and monetary policies, the IMF would not have suspended its emergency loans – and the default might have been avoided entirely, or at least it could have been considerably smaller. Moreover, if the Argentine government had offered a restructuring plan that respected the norms of international finance and provided an exchange that would have satisfied all of its lenders, the direct costs for those lenders and the indirect costs imposed on everyone else would have been much smaller.

As it now stands, the Argentine government's singular policies have cost its American lenders nearly $8 billion (including their tax savings), reduced the value of U.S. shareholders in companies with direct investments in Argentina by another $8 billion, and imposed revenue costs of $2.6 billion on American taxpayers. Worldwide, these policies have cost Argentina's foreign and domestic lenders some $74 billion, reduced the value of global shareholders in companies with direct investments in Argentina by more than $39 billion, and imposed revenue costs on global taxpayers of more than $24 billion. Furthermore, if the United States and other nations permit Argentina to pursue these policies, they could establish a new and dangerous standard in international lending which ultimately would impose large, future cost on investors, shareholders and taxpayers in the U.S. and worldwide. Such a development also could inflict huge costs of millions of other people in developing nations by eventually reducing access by their governments and businesses to the capital and technologies they need to modernize.

The United States government has a responsibility not only to American investors, shareholders and taxpayers but also to the global system to persuade or require the Argentine government to change these policies. The United States government also cannot permit Argentina's leaders to shift the costs of their irresponsible policies from their own taxpayers to Americans.

- The administration and Congress should prepare to suspend Argentina's benefits under the General System of Preferences until it agrees to provide terms for rescheduling the foreign debt and past due interest payments repudiated in the 2004 restructuring.

- Until the Argentine government offers reasonable terms to those American, European and Latin American lenders, and extends the same concessions to those forced to accept the original terms for restructuring under threat of repudiation, it should be denied access to the normal channels of international lending. The United States should use its influence and financial support of the International Monetary Fund and World Bank to ensure that any future loans to the Argentine government are conditioned on its agreement to provide terms acceptable to lenders holding its repudiated bonds.

- Following the 2001 default, the IMF provided three emergency loans to the Argentine government to stabilize its foreign exchange position at a time when its access to capital markets was blocked.[34] The most direct way for any government in default to secure that access is to repay its creditors, and therefore that should be the focus of such emergency loans. The United States should use its influence to ensure that future IMF loans to governments in sovereign default are available for the purpose of repaying their creditors and available for other purposes only after a default has been resolved satisfactorily.

- The Argentine Government also should not be allowed to use the Bank of International Settlements (BIS) to insulate itself from the normal legal process, as it did when it shifted its central bank assets from U.S. financial institutions to the BIS just prior to its default. The United States should use its influence to reform the rules of the BIS so that in cases of sovereign defaults, only those state assets held at the BIS to conduct necessary monetary policy and foreign exchange activities are protected from legal attachment by lenders holding defaulted debt.[35]

In a short-sighted and failed effort to dissuade Argentine president Nestor Kirchner from allying his country with the anti-American regime of Venezuelan president Hugo Chavez, the U.S. administration has sided with Argentina against American lenders – and indirectly against American taxpayers and shareholders -- in recent suits in U.S. courts to attach the assets of the Argentine government. The administration should reverse this misguided position. Moreover, if Argentina continues to resist its obligations to the international financial system, the administration and Congress should amend the Foreign Sovereign Immunities Act of 1976 to facilitate efforts by American holders of the defaulted debt to lay proper legal claim to Argentine government assets.[36]

- The central bank assets of a government in default on its sovereign debt held at the Bank of International Settlements should be protected from legal process only to the extent that they are required for the conduct of that government's foreign exchange and monetary policy activities; any additional foreign central bank assets of a government in default held at the BIS should not be immune from attachment by U.S. lenders through a normal judicial process.

- Any goods or payments flowing through the United States that involve the Argentine government, or governments involved in future sovereign defaults, whether

[34] Kenneth S. Rogoff, "Moral Hazard in IMF Loans: How Big a Concern?" *Finance & Development,* International Monetary Fund, Volume 39, Number 3, September 2002.
[35] See Hall S. Scott, "Sovereign Debt Default: Cry for the United States, Not Argentina," Washington Legal Foundation, Working Papers Series No. 140, September 2006.
[36] *Ibid.*

commercial in nature or not, should no longer be accorded immunity but be subject to attachment by its lenders through normal judicial process.

- The U.S. assets of enterprises owned by the Argentine government or by governments involved in future sovereign defaults also should be subject to attachment through the normal judicial process.

By the standards and norms of international lending respected by every other nation in the world, the actions of the Argentine government in its sovereign debt default and the unprecedented terms of its subsequent restructuring have been reckless and lawless. Restoring the order of sovereign lending is a critical test of the current U.S. administration's global economic leadership. To protect the historic process of globalization, as well as the interests of American investors, shareholders and taxpayers, the United States government should take the steps enumerated above and promptly require the Argentine government to restore that order and respect those norms and standards.

Appendix

Financial Terms and Conditions of the Bonds Offered by Argentina in the Restructuring of Its Defaulted Debt[37]

	Par Bonds	Discount Bonds	Quasi-par Bonds
Amount	$15 billion	$11.9 billion	Peso 24.3 billion
Currency	Existing debt securities denominated in US dollars, Euros or yen may be exchanged for new debt denominated in the same currency or in U.S. dollars or pesos. Securities denominated in other currencies except the peso may be exchanged for new debt denominated in dollars, Euros or pesos. Existing peso-denominated debt is exchangeable only for new peso-denominated securities.		Peso
Maturity	35 years from issue date	30 years from issue date	42 years
Interest Rate	1–5 years: 2.08% 6– 5 years: 2.50% 16–25 years: 3.75% 26– 35 years: 5.25%	1–5 years: cash=4.15%; capitalized= 4.36% 6–15 years: cash=4.88%; capitalized=3.63% 11–30 years: cash=8.51% capitalized=0.0%	Peso interest rate = U.S. dollar interest rate for 5.96% coupon (capitalized through year 10; then cash payment.
Governing Law	U.S. : Peso and U.S. dollar denominated securities U.K. : Euro securities Japan : Yen securities Argentina: Other peso and U.S. dollar securities		Argentina
Discount/ Convertibility	Par	Discount to nominal amount about 63 percent of the outstanding principal of the original debt securities.	Convertibility ratio of 29.5 percent, as of June 30, 2004: Equal to the difference between U.S. dollar appreciation and Ps.1.4/US$1 x CER(2.0976/2.975).
GDP-linked Unit	New debt securities issued with detachable GDP-linked units entitling holders to annual payments when Argentina's real GDP growth exceed 3 percent, based on 5% of the excess GDP divided by the average market exchange rate of pesos per US dollar, Euro or yen, in 15 days preceding the payment date.		

[37] United States Securities and Exchange Commission, Form 18-K/A Amendment No.1, Annual Report of the Republic of Argentina, June 2004; http://www.secinfo.com/dRY7g.1Jm.htm

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