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Argentina's debt restructuring

Tough deal

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Debtor governments should not conclude from Argentina that default is an easy option

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THE decline and collapse of Argentina's economy in 1998-2002 still arouses great passions, and not just among the people of that ill-starred country. No wonder. Argentina's chaotic default and devaluation, and its desperate efforts to stave these off, inflicted great hardship. By mid-2002, living standards had dropped by a fifth from their peak; unemployment soared to 21%. With hindsight, it is clear that the mistakes of many clever people—Argentine policy-makers, officials at the International Monetary Fund and America's Treasury, as well as the world's financiers—contributed to the debacle. Yet these passions risk clouding judgments over how Argentina should rebuild, and how the world should try to avoid a recurrence of such financial catastrophes.

That is especially so with regard to the country's debt. Recall that in December 2001 Argentina declared the world's biggest sovereign debt default (on bonds worth $81 billion). This week, Néstor Kirchner, Argentina's president, in a speech to Congress, claimed victory in his government's bruising campaign to force bondholders to accept a record write-down of their claims. The figures were not due to be released until after *The Economist* went to press. But Mr Kirchner said that “at least 70-75%” of bondholders have signed up to a deal that is worth around 35 cents on the dollar. Compare that with recent sovereign restructurings where creditors received twice that, and no wonder Mr Kirchner is crowing (see article).

Given that disparity, many argue that Argentina has got away with financial murder. The obvious worry is that other governments, especially in Latin America, may now conclude that default is a cheap option. If that happens, lenders would lose in the short run. But in the long run, Latin American countries would lose even more, as the cost of credit for all of them rose. Are these fears justified?

The answer has several parts. First, Argentina has hardly escaped scot-free. Its economy has bounced back strongly. Yet even with the temporary advantage of not servicing its bonds, from the moment of default Argentina has grown little more than Brazil, which continued honouring its debts. Four out of ten Argentines are poor, in what was once a middle-class country. Their banks and pension funds have been stuffed with low-yielding government paper.

Second, Argentina may not yet be out of the woods. In the other deals, more than 95% of bondholders signed up. Some of those who held out were, eventually, awarded their money in full by courts. Third, Argentina had less room to manoeuvre than some creditors claim. Even after the deal, its public debt will stand at around 75% of GDP (compared with 52% in Brazil). Admittedly, Argentina's debt will now pay much less interest than Brazil's. But the government has, in effect, committed itself to a primary fiscal surplus of over 3% of GDP for the foreseeable future. Offering more might merely have heralded a fresh default a few years hence.

The bigger worry is Mr Kirchner's political grandstanding. His rants against the IMF, bondholders and privatised utilities may sway Latin America's public opinion. His rhetoric also does nothing to encourage investment.

Meanwhile, the president has spurned a golden opportunity to push through the unpopular measures needed to turn recovery into sustained growth. These start with tariff rises for privatised utilities to unleash private investment in infrastructure and reforms of taxes and provincial finance. As the economy recovers, Mr Kirchner can hardly continue to claim a national emergency to ride roughshod over utility contracts.

Mr Kirchner still faces a battle with the IMF, to which Argentina owes $14 billion. An agreement to roll over some of this was suspended, pending the debt swap. In any new accord, the IMF is bound to insist on the structural reforms required to sustain growth. If Argentina is unwilling to stick to these conditions, the Fund should finally cease lending to its problem debtor—or risk even greater damage to its credibility.

Sharing the blame, and the pain

There are many lessons from this sorry saga. Small savers tempted by emerging-market bonds should realise that reward has risk attached. Most institutional investors got their money out of Argentina one way or another. Even so, they may not be so lucky next time. They would be wise to pick more carefully among emerging-market borrowers. The safe level of debt for emerging economies is lower than previously assumed. Lastly, it is wrong to imagine that default has become a painless route to prosperity. It has not.