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ARGENTINA'S ECONOMIC TROUBLES: DEBT AND THE IMF

Fernando Avelar*

IN recent times, Argentina has had several economic troubles that have all stemmed from a recession that began at the turn of the 21st century,¹ although some might argue that the economic troubles are rooted even farther in the past.² Whatever the original cause, Argentina is currently faced with new economic troubles and potential sanctions by the International Monetary Fund (IMF).³ Argentina faces financial trouble in the form of a highly devalued Argentine peso and lawsuits against it for failure to pay outstanding bonds that were defaulted on in 2002.⁴ In addition to Argentina's financial troubles, Argentina has to deal with warnings by the IMF for failure to provide adequate economic reports and the IMF has implied that more severe sanctions are in line if Argentina fails to comply.⁵

I. 2002 DEBT DEFAULT STILL HAUNTS ARGENTINA

One of the more recent disputes that has arisen involving Argentina deals with outstanding bonds that were defaulted on back in the early 2000s, which was the largest default by a sovereign nation in history.⁶ After the 2002 debt default, Argentina began the process of restructuring its debt and refinanced most of it to a more manageable level and a steep

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1. Peter Katel, *Argentina's Crisis Explained*, TIME (Dec. 20, 2001), <http://www.time.com/time/world/article/0,8599,189393,00.html>.
2. See *Q&A: Argentina's Economic Crisis*, BBC (Feb. 12, 2003, 6:54 PM), <http://news.bbc.co.uk/2/hi/business/1721061.stm>.
3. *IMF Warns Argentina to Fix Economic Data*, REUTERS (Sept. 18, 2012, 5:45 PM), <http://www.reuters.com/article/2012/09/18/us-imf-argentina-idUSBRE88H1BD20120918> [hereinafter *IMF Warns Argentina*].
4. See Helen Popper & Daniel Bases, *Argentina Appeals U.S. Court Order to Pay Holdout Bond Investors*, REUTERS (Nov. 27, 2012, 3:05 AM), <http://www.reuters.com/article/2012/11/27/uk-argentina-debt-idUSLNE8AQ00C20121127>; David Hasckel, *Argentina Vows to Honor Bond Maturity of \$200M Amid Market Fears of Default*, INT'L BUS. & FIN. DAILY (BNA) (Oct. 17, 2012).
5. *IMF Warns Argentina*, *supra* note 3.
6. Robert Shapiro, *The Truth Behind Argentina's Debt Problems*, HILL (June 28, 2012, 9:53 AM), <http://thehill.com/blogs/congress-blog/foreign-policy/235347-the-truth-behind-argentinas-debt-problems>.

discount.⁷ Approximately 93 percent of the bondholders agreed to swap out the defaulted debt for new restructured debt.⁸ The 93 percent of bondholders who accepted the restructured debt did so with a huge discount to Argentina because the new bond swaps are only paying 25 to 29 percent of what the initial bonds paid.⁹ The holdouts who refused to take the significant drop in payment and demanded a better payment sued Argentina in U.S. courts at various times between 2009 and 2011.¹⁰

These lawsuits occurred because Argentina previously declined to pay the holdouts any money.¹¹ Argentina stated that it would only pay money to those bondholders who accepted the new bond swaps and that it would refuse to pay the holdouts.¹² The U.S. Second Circuit disagreed with Argentina's position in *NML Capital, Ltd. v. Argentina*, and ordered Argentina to pay the holdout bondholders.¹³

In *NML Capital*, the Second Circuit focused on an equal treatment provision (i.e., a "pari passu clause") that was written into the initial bond contracts that obligated Argentina to treat all bondholders equally.¹⁴ According to Judge Parker from the Second Circuit, the equal treatment provision "bars Argentina from discriminating against [bondholders'] bonds in favor of bonds issued in connection with the restructurings and that Argentina violated that provision by ranking its payment obligations on the defaulted debt below its obligations to the holders of its restructured debt."¹⁵ This case affirmed the lower court's ruling and enforced the lower court's order by Judge Griesa, which called for \$1.3 billion to be deposited into an escrow account to be used to pay the holdouts.¹⁶ The problem with this order, at least from Argentina's point of view, is that the Argentine government is due to pay the restructured debt bondholders a minimum of \$3.3 billion in principal and interest in December of 2012.¹⁷ Part of the order from Judge Griesa includes barring payments by Argentina to the holders of restructured debt until payment of the \$1.3 billion is made to the holdouts.¹⁸ If Argentina ultimately refuses to pay the holdouts, the "U.S. courts could [potentially] embargo payments to the creditors who accepted the debt restructurings," which would ulti-

7. Popper & Bases, *supra* note 4.

8. *Id.*

9. David Haskel, *Argentina Defies U.S. Court Order to Pay \$1.33B to American Bondholders*, INT'L BUS. & FIN. DAILY (BNA) (Nov. 1, 2012).

10. *NML Capital, Ltd. v. Argentina*, 699 F.3d 246, 253 (2d Cir. 2012).

11. David Haskel, *Second Circuit Orders Argentina to Pay \$1.33 Billion to Bondholders*, INT'L BUS. & FIN. DAILY (BNA) (Oct. 30, 2012).

12. *Id.*

13. *NML Capital, Ltd.*, 699 F.3d at 250.

14. *Second Circuit Orders Argentina to Pay \$1.33 Billion to Bondholders*, *supra* note 11.

15. *NML Capital, Ltd.*, 699 F.3d at 250.

16. *Id.*; Popper & Bases, *supra* note 4.

17. Popper & Bases, *supra* note 4.

18. Katia Porzecanski, *Argentina Rating Downgraded by Fitch on 'Probable' Default*, BLOOMBERG (Nov. 27, 2012, 4:12 PM), <http://www.bloomberg.com/news/2012-11-27/argentina-downgraded-by-fitch-on-probable-default-from-ruling.html>.

mately cause a technical default.¹⁹ Another default by Argentina on its bonds would likely cause economic and political turmoil in Argentina.

Argentina has not hidden its intent to refuse to pay the holdouts which are mostly hedge funds any of the money owed under the defaulted debt.²⁰ Argentina has been using strong rhetoric against the hedge funds, calling them “vulture funds” because of their investments in distressed sovereign bonds.²¹ After the court ruling, the Argentine Economic Minister wrote on Twitter, “[w]e shall not pay a single dollar to the vulture funds.”²²

Even though no material decisions have been made by Argentina, it is already feeling the pressure from the ruling, as Fitch Ratings has downgraded Argentina's credit rating.²³ Fitch Ratings cut Argentina's credit rating down to CC, which means a “default by Argentina is probable.”²⁴ The financial market responded to the credit rating decrease with a 13 percent decrease in Argentine dollar bonds.²⁵

In October 2012, another event raised financial market concerns about Argentina's economic well-being. The governor of Chaco, a province in Argentina, paid U.S. dollar-denominated bonds in Argentine pesos.²⁶ This was frowned upon by the financial markets because of how devalued the Argentine peso is compared to the U.S. dollar, and in effect, the province paid less than what was owed because of the way the two currencies are valued.²⁷ The exchange rate that was used to calculate the equivalent of the U.S. dollar amount due in Argentine pesos was the official rate, but the official rate does not take inflation into account.²⁸ The unofficial rate, which does take inflation into account, is valued approximately 20 percent higher than the official rate.²⁹ On October 16, just a few weeks after payment was made by the Chaco governor, the U.S. dollar sold for \$4.73 Argentine pesos when using the official rate, but the unofficial rate was \$6.20 Argentine pesos, which meant that the bondholders were underpaid.³⁰

Chaco was forced to pay in Argentine pesos because it was unable to

19. Popper & Bases, *supra* note 4.

20. Haskel, *supra* note 9.

21. *Id.*

22. *Id.*

23. Porzecanski, *supra* note 18.

24. *Id.*

25. *Id.*

26. Ken Parks, *2nd Update: Argentina's Chaco Province Pays Dollar Bonds in Pesos*, WALL ST. J. (Oct. 8, 2012, 11:38 AM), <http://online.wsj.com/article/BT-CO-20121008-708193.html>.

27. *See Argentina Vows to Honor Bond Maturity Of \$200M Amid Market Fears of Default*, *supra* note 4.

28. Lucas Radicella, *Chaco Announces it Will Convert its Debt to Pesos*, ARG. INDEP. (Oct. 17, 2012), <http://www.argentinaindependent.com/currentaffairs/newsfromargentina/chaco-announces-it-will-convert-its-debt-to-pesos/>.

29. *Id.*

30. *See Argentina Vows to Honor Bond Maturity Of \$200M Amid Market Fears of Default*, *supra* note 4.

purchase dollars at the regulated exchange market in Argentina.³¹ Argentine President Cristina Fernández de Kirchner has started to ration hard currency and enact trade barriers to increase the central bank's international currency reserves, which are used to pay the Argentine government's creditors.³² Chaco's payment in pesos triggered a "massive Argentine securities selloff" based on the fear that other Argentine provinces would follow Chaco's lead.³³ The securities selloff prompted the Argentine Central Bank to issue a statement guaranteeing that all provinces will be sold enough dollars to cover their debts notwithstanding the restrictions in place.³⁴

If the above is any indication as to how financial markets react to the idea of Argentine default, then a technical default that could be triggered by the *NML Capital* order would likely lead Argentina into a recession like the one in the early 2000s.

II. IMF WARNS ARGENTINA

On September 17, 2012, the IMF board held a meeting to discuss whether Argentina had met its obligation to report some of its economic figures.³⁵ Argentina has been the target of increased criticism over the years for alleged under-reporting of inflation and exaggerated economic growth figures.³⁶ As a member of the IMF, Argentina has a duty to make accurate economic reports.³⁷ But, as of September 17, the IMF was not satisfied with the numbers reported by Argentina.³⁸

Under Article IV of the IMF's Articles of Agreement, Section 3 allows the IMF to survey the exchange rate policies of members.³⁹ In order for the IMF to do this, the member country "shall provide the [IMF] with the information necessary for such surveillance, and, when requested by the [IMF], shall consult with it on the member's exchange rate policies."⁴⁰ In addition, Section 5 of Article VIII gives the IMF the power to require national data from a member country in order for the IMF to effectively discharge its duties.⁴¹

Despite the IMF requirements for its members, Argentina seems to consistently provide inaccurate national data figures. For example, Argentina has reported its annual inflation rate at 10 percent, but private

31. Parks, *supra* note 26.

32. *Id.*

33. *Argentina Vows to Honor Bond Maturity Of \$200M Amid Market Fears of Default*, *supra* note 4.

34. Radicella, *supra* note 28.

35. *IMF Warns Argentina*, *supra* note 3.

36. *Id.*

37. Int'l Monetary Fund [IMF], *Articles of Agreement*, art. VIII, § 5 (2011), available at <http://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf> [hereinafter IMF Articles].

38. *IMF Warns Argentina*, *supra* note 3.

39. IMF Articles, *supra* note 37, art. IV, § 3.

40. *Id.*

41. *Id.* art. VIII, § 5.

economists have said that it is actually 24 percent.⁴² The well-known newspaper, THE ECONOMIST, published an article in February 2012 explaining why it would no longer publish the figures provided by Argentina's National Institute of Statistics (INDEC).⁴³ THE ECONOMIST explained that because the figures did not match reports by independent economists, it would no longer rely on INDEC's numbers to provide data about Argentina.⁴⁴

Argentina's erroneous reporting dates back to 2007,⁴⁵ which suspiciously coincides with the time period in which Argentine President Kirchner began to replace the personnel at INDEC in order to "improve operations."⁴⁶ The government also fined several researchers as much as 500,000 Argentine pesos each for reporting inflation rates that were above the official data.⁴⁷ As a result of these figures being consistently under-reported, the IMF warned Argentina that it had until December 17, 2012 to respond to the IMF's concerns about the data.⁴⁸ The IMF also stated that depending on Argentina's response on December 17, the IMF Executive Board would review the issue and take any additional steps necessary according to IMF procedures.⁴⁹

The procedures that the IMF refers to are located in the IMF Articles of Agreement. Under Article XXVI, when a member does not fulfill its obligations under the Articles of Agreement, the IMF may declare the violator ineligible to use the IMF's resources.⁵⁰ The resources mentioned refer to several different funds that are available to the member-countries to use to overcome economic difficulties or to combat poverty levels in developing countries.⁵¹ Article XXVI further provides ways to sanction members who persist in their failure to fulfill their obligations, including temporary suspension from the IMF⁵² and expulsion from the IMF completely.⁵³

42. *IMF's Christine Lagarde Says Argentina Faces 'Red Card,'* BBC (Sept. 24, 2012, 8:47 PM), <http://www.bbc.co.uk/news/world-latin-america-19709273>.

43. *Don't Lie to Me, Argentina,* ECONOMIST, Feb. 25, 2012, at 18, 18, available at <http://www.economist.com/node/21548242>.

44. *Id.*

45. *Id.*

46. Sandrine Rastello & Eliana Raszewski, *IMF to Put Argentina on Path to Censure Over Inflation Data,* BLOOMBERG (Sept. 18, 2012, 3:31 PM), <http://www.bloomberg.com/news/2012-09-18/imf-to-put-argentina-on-path-toward-censure-over-economic-data.html>.

47. *Id.*

48. Press Release, Int'l Monetary Fund, Statement by the IMF Executive Board on Argentina (Sept. 18, 2012).

49. *Id.*

50. IMF Articles, *supra* note 37, art. XXVI, § 2(a).

51. *What We Do,* INT'L MONETARY FUND, <http://www.imf.org/external/about/whatwedo.htm> (last visited Jan. 2, 2013).

52. IMF Articles, *supra* note 37, art. XXVI, § 2(b).

53. *Id.* art. XXVI, § 2(c).

III. MEDIA CONTROLS

The people of Argentina have not remained silent. Kirchner was re-elected last year, but only by a narrow margin, receiving 54 percent of the vote.⁵⁴ On November 8, 2012, the people of Argentina showed their discontent when they took to the streets for massive demonstrations.⁵⁵ The demonstrators—estimated to be between 250,000 and 500,000 people—rallied together to show their discontent with inflation, corruption, and media control.⁵⁶

The ruling party's principal opposition, the Radical Civic Union, has been weak for more than a decade since Argentina's recession in the early 2000s.⁵⁷ Because of this opposition vacancy, Argentina's media conglomerate Clarín has taken its place as Kirchner's primary political opponent.⁵⁸ Kirchner has responded to Clarín's opposition by pushing an anti-monopoly media law against Clarín that will effectively result in the dismantling of Clarín by requiring it to sell most of its broadcast stations in addition to its Cablevision network.⁵⁹

Clarín sought an injunction, challenging as unconstitutional a key article in the media law that limits the number of media stations a company can own.⁶⁰ The night before Clarín's December 7 deadline to present a plan to reduce its holdings, an Argentine court granted the injunction.⁶¹ The injunction will suspend Clarín's deadline until a lower court rules on whether the article in the media law is consistent with the Argentine constitution.⁶² The agency representing the government in the action had previously taken the position that the judges presiding over the case were being impartial because they had accepted benefits from Clarín and sought to recuse them.⁶³

Argentina's economic troubles are many, but all seem to relate to common factors, such as the debt default of the early 2000s. People outside of Argentina have also increasingly pointed to Argentina's current administration as borderline authoritarian because of how it has chosen to

54. Jonathan Gilbert, *In Argentina, Social Unrest but No Political Alternative to Kirchner*, *WORLD POL. REV.* (Nov. 28, 2012), <http://www.worldpoliticsreview.com/articles/12527/in-argentina-social-unrest-but-no-political-alternative-to-kirchner> (requires a subscription login).

55. Uki Goni & Jonathan Watts, *Argentina Protests: Up to Half a Million Rally Against Fernández de Kirchner*, *GUARDIAN* (U.K.) (Nov. 9, 2012, 1:25 PM), <http://www.guardian.co.uk/world/2012/nov/09/argentina-protests-rally-fernandez-kirchner>.

56. *Id.*

57. Gilbert, *supra* note 54.

58. *Id.*

59. *Grupo Clarin Wins Reprieve on Argentina Media Law*, *HUFFINGTON POST* (Dec. 6, 2012, 5:48 PM), http://www.huffingtonpost.com/huff-wires/20121206/lt-argentina-media-law/?utm_hp_ref=homepage&ir=homepage.

60. *See id.*; Jude Webber, *Argentina Grants Clarín Late Reprieve*, *FIN. TIMES* (Dec. 6, 2012, 12:36 AM), <http://www.ft.com/intl/cms/s/0/f506d986-3fc6-11e2-9f71-00144feabdc0.html#axzz2ELNJJoeO> (requires a subscription login).

61. *See Grupo Clarin Wins Reprieve on Argentina Media Law*, *supra* note 59; Webber, *supra* note 60.

62. *Id.*

63. Webber, *supra* note 60.

handle some of the country's more pressing issues.⁶⁴ The country's current economic outlook is in a state of flux because many variables exist that could ignite and cause another recession, which makes investing in the country a risky situation. If Argentina is to overcome its financial challenges, then it must start by meeting its legal responsibilities without jeopardizing its integrity.

64. See Nick Ottens, *Increasingly Authoritarian Kirchner Draws Mass Protests*, ATLANTIC SENTINEL (Nov. 12, 2012), <http://atlanticsentinel.com/2012/11/increasingly-authoritarian-kirchner-draws-mass-protests/>; *Kirchner's Landslide Could be Argentina's Slippery Slope*, COMMENTATOR (Oct. 26, 2011, 9:17 AM), http://www.thecommentator.com/article/575/kirchner_s_landslide_could_be_argentina_s_slippery_slope.

