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A Case Study in Third World Debt: Argentina

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I. General Considerations

After a third round of negotiations with its creditors, Argentina has found no solution to its external debt problem.[1] This dragging situation, which built up during the late 1970s and exploded shortly after Mexico's crisis in 1982, involves several actors and reveals grave deficiencies in the international monetary system. Until now it has been the debtor nations that have shouldered the heaviest burden.[2] Creditor countries as

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1. *See* THE ECONOMIST, Sept. 26–Oct. 2, 1987, at 86. "The official estimate for 1987 interest payments of $4.4 billion is more than 6 percent of GDP and is at least five times higher than the year's likely $800m trade surplus . . ."; *see also Latin American Debt—A Creaking Edifice*, THE ECONOMIST, Jan. 16–22, 1988, at 81.

2. For example, from 1981 to 1985, net resource transfers to Latin America were negative. During these critical years, more resources have been flowing out of these countries than into them.

Latin America 1981–1985 Billions of Dollars

Year	Net Capital Inflow	Interest repayments & foreign profits	Net Resource Transfer
1981	49.1	27.8	21.3
1982	27.6	36.8	−9.2
1983	6.1	34.9	−28.8
1984	11.6	37.1	−25.5
1985†	4.1	36.7	−32.6

†Preliminary

well as the international financial institutions—public and private—should join efforts and profit from this experience in order to find an effective and positive solution.[3]

This article reviews the development of the Argentina external debt, as it was built up, its crisis, and the subsequent negotiations. This review includes a description of some of the legal aspects involved and of the network that currently links countries, banks, and international organizations. Such interdependence demands new mechanisms that will allow countries to secure payment to investors or lenders, while at the same time enhancing their own economic development.[4]

Certainly, the lack of the debtor countries' participation in those political decisions indirectly affecting the fluctuation of currencies used in these transactions may constitute a legitimate claim for them.[5] Those decisions affect the relationships between debtors and creditors. The almost complete lack of coordination within the international monetary system, institutionally recognized by the international community since

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INTER-AMERICAN DEVELOPMENT BANK, ECONOMIC AND SOCIAL PROGRESS IN LATIN AMERICA, 1986 REPORT table III–8, at 35.

3. *See* GATT, *Trade Policies for a Better Future Report of Eminent Persons on Problems Facing the International Trading System*, in LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 1172 (J. Jackson ed. 2d ed.) [hereinafter J. JACKSON]; THE ECONOMIST INTELLIGENCE UNIT, THE WORLD IN 1988, at 81 (1988).

4. *See* WORLD BANK, WORLD DEVELOPMENT REPORT 93 (1985); Barnett, Galvis, Gouraige, *On Third World Debt*, 25 HARV. INT'L L.J. 83 (1984) [hereinafter Barnett]; Oechsli, *Procedural Guidelines for Renegotiating LDC Debt: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act*, 21 VA. J. INT'L L. 305, 314–15 (1981).

5. *See* Bryant, *Eurocurrency Banking: Alarmist Concerns and Genuine Issues*, 1 OECD ECONOMIC STUDIES 20 (Autumn 1983). "Growth in Eurocurrency banking tends to undermine the autonomy of the national economy not because Eurocurrency deposits are nonreservable or subject to less stringent regulation but because this growth represents a further exposure of domestic economies to the global economy." *Id.* "In principle, any one of the central banks would have power to influence the total volume of financial activity in the whole structure most dependent on its currency unit and those intermediaries located within national borders." *Id.* at 21. *See also* Larsen, *International Economic Linkages*, 1 OECD ECONOMIC STUDIES 58 (Autumn 1983):

> In the United States the combination of an expansionary fiscal policy and a tight monetary policy has resulted in historically high nominal and real interest rates which, in the framework of credible monetary policy and expectations of continuing large deficits in the federal budget, have translated into favorable expected yields on dollar assets and massive incipient capital inflows.

P. DRUCKER, CAMBIOS EN LA ECONOMÍA MUNDIAL 28 (Centro de Estudios Comparados):

> Los grandes paises han aprendido a utilizar la economia internacional de una manera que no tiene precedentes para evitar enfrentar desagradables problemas internos. Los Estados Unidos han utilizado las altas tasas de interes para atraer capitales extranjeros y evitar abordar el deficit interno, Japon ha promovido las exportaciones para mantener su nivel de empleo a pesar de una economia interna estancada. Esta *politizacion* de la economia internacional es ciertamente un factor que provoca la extrema volatilidad e inestabilidad de los flujos de capital y los tipos de cambio.

(Emphasis added.) W. BRANSON, MACROECONOMICS 360. Barnett *supra* note 4, at 94; M. BENJAOUI HACIA, UN NUEVO ORDEN ECONÓMICO INTERNACIONAL 85 (UNESCO 1979); *see infra* note 20.

1973,[6] adds an element of risk to these contracts, the allocation of which may have not been adequately achieved. For instance, the recent devaluation of the U.S. dollar reduces the economic burden of debtor nations, but at the same time imposes a burden on the world economy. The resultant slowdown will affect the debtor nations' ability to attract investments in order to maintain their levels of production and the industrialized nations' potential to sustain the present rate of increase of their imports from less-developed countries.

II. General Aspects[7]

Factors common to the major debtors underlie the economic and financial disturbances. Within the domestic factors, three major periods can be outlined:

(i) From 1960 to 1974, the region's average economic growth moved from 5.5 percent in 1961–1969 to 7.3 percent in 1970–1974, while foreign debt service was kept at about 15 percent of current export earnings.[8]

(ii) From 1974 to 1980, great expansion in public and private consumption expenditures was common. This, coupled with easy access to international credit, served both the public and private consumption patterns, and lead to their expansion and diversifi-

6. *See* C. COLLIARD, INSTITUTIONS DES RELATIONS INTERNATIONALES 706 (1978); Alejo, Villareal & Trejo Reyes, *Economía y Comercio Internacional*, DERECHO ECONIÓMICO INTERNACIONAL 66 (1976) [hereinafter Alejo]; Suratgar, *The International Financial System and the Management of the International Debt Crisis*, DEFAULT AND RESCHEDULING 157 (D. Suratgar ed. 1984); Debs, *The Development of International Equity Markets*, 4 B.U. INT'L L.J. 5, 6 (1986).

7. There is a framework used for Latin America as a whole that can be applied to Argentina. *See* INTER-AMERICAN DEVELOPMENT BANK, EXTERNAL DEBT AND ECONOMIC DEVELOPMENT IN LATIN AMERICA—BACKGROUND AND PROSPECTS (1984).

8. A country's *external debt* is the result of the sum of the current account deficit and net long-term capital inflow. *See* P. HALLWOOD, INTERNATIONAL MONEY—THEORY, EVIDENCE AND INSTITUTIONS 224; W. Branson, *supra* note 5, at 341:

> The international balance of payments is divided into two major accounts. The *current account* records income from the sale of currently produced goods and of services. . . . The current account also records payment for the imports of similar goods and services from abroad . . . . The second major account in the balance of payments is the *capital account*. This account measures the flow of funds [from the United States] to purchase assets from foreigners . . . and the flow of funds [into the United States] as foreigners purchase assets here. . . .

See also KINDLERBERGER, ECONOMÍA INTERNACIONAL 451; De La Dehesa, *Institutional Structure for External Debt Management*, EXTERNAL DEBT MANAGEMENT 88. *Debt service ratio* is the relation "of a country's debt service (interest and repayment of maturing debt) on public and publicly guaranteed debt to annual export earnings." P. HALLWOOD, *supra* note 8, at 225. By the end of 1982, Argentine gross external debt was U.S. $38 billion, and the debt service in 1983—as a percentage of exports—was 154 percent as to the total debt and 88 percent excluding rollover of short-term debts. *See* Griffith-Jones, *The Growth of Multinational Banking, the Euro-currency Market and Their Effects on Developing Countries*, in J. DEV. STUD., Jan. 1980, at 209:

cation in most cases on the basis of policies of open trade and financial liberalization.[9]

(iii) Since 1981–1982, most countries have been forced into adjustment programs to reduce private spending and public deficit and to reestablish a balance of payment equilibrium or surplus, in order to create conditions allowing them to pay back the loans. Even within this last period, some differentiation should be made as a result either of the content or of the procedure that the restructuring agreements have followed. From 1981 to 1984, the trend was essentially characterized by medium-term restructuring and the rearrangement of short-term debt. Since 1984, the techniques have become more elaborate, the terms have been stretched, and the role of the IMF has been enhanced.[10]

As to the external factors, the increase of oil prices due to both oil crises (1973–1974 and 1979–1980), the recessive economic trends in industrialized countries and the sharp increase in interest rates, both nominal and real, during these years, have all had a considerable impact on peripheral economies.[11]

> The roll-over credit was created, based on a floating interest rate that varies approximately with the cost of the money for the lender, who obtains his funds on the essentially short-term interbank market. Thus, although the loan to the developing country may have a long maturity (i.e., ten years), the interest rate is changed every time the credit is rolled over (usually every three or six months).

See also D. LESSARD & J. WILLIAMSON, FINANCIAL INTERMEDIATION BEYOND THE DEBT CRISIS 3 (1985); Barnett, *supra* note 4, at 89 n. 20: " 'Roll-over' is the process by which banks, instead of demanding payment when a remittance of principal falls due, renew loans and thus delay ultimate repayment. Banks do not, however, officially roll-over interest payments, but they do convert these payments to new loans, with similar results."

9. Contracting external debt generally has the purpose of financing investment or, eventually, smoothing consumption in case of problems with supply and balance of payments. *See* Dillon, *External Debt and Economic Management: The Role of the International Monetary Fund*, EXTERNAL DEBT MANAGEMENT 32 (H. Mehran ed.):

> Properly used, borrowed external resources can greatly benefit a developing country and contribute to its growth—they add to the total resources available to an economy over a given period . . . . Such borrowing is desirable when it is used to finance investment that is expected to yield an adequate rate of return or to smooth consumption in the face of an uneven aggregate supply, since it can provide a level of economic welfare that could not otherwise be attained . . . .

See also Divisi6n de Desarrolio Econ6mico de la CEPAL, *Políticas de Ajuste y Renegociación de la Deuda Externa en Latinoamerica*, LA DEUDA EXTERNA LATINOAMERICANA 12 (A. Bianchi ed.) [hereinafter A. BIANCHI].

10. *See* Clark, *Sovereign Debt Restructuring: Parity of Treatment between Equivalent Creditors in Relation to Comparable Debts*, 20 INT'L LAW. 857 (1986).

11. *See* INTER-AMERICAN DEVELOPMENT BANK, *supra* note 7, at 7; *see also* CÁMARA DE DIPUTADOS DE LA NACIÓN, DIARIO DE SESIONES, Marzo 12 y 13 de 1986, at 7852. The Secretary of Finance, Mr. Brodersohn, explained that the fall in the prices of the country's most important exports had a substantial effect on its capacity of repayment. For example, from 1984 to 1986 the price of wheat fell 32 percent, corn 28 percent, soybeans 25 percent, and sorgum 20 percent.

The importance of the role played by private bank loans in the financial commitments of sovereign nations increased during the 1970s. After the oil crisis and subsequent depression of the world economy, developing countries needed resources to pay their outstanding debts. Those debts could not be covered by exports, the prices of which had deteriorated.[12] On the other hand, money markets were suddenly flooded with the currency obtained by the OPEC countries due to the increase in oil prices.[13]

Private bank lending to developing countries expanded during the first three years of the decade at an annual average rate of 72 percent.[14] Some of this expansion, probably a considerable amount of it, may be attributed to the increase in Eurocurrency banking. Through this mechanism huge sums of money accumulated after the rise of oil prices in 1973 were poured into the market. "Eurobanking" has been described as that part of banking activity that leads to "the establishment of asset-liability relations with foreigners and the denomination of obligations in external currencies."[15] It is an aspect of the internationalization[16] of world finance that has introduced new guidelines into international economics, forcing the actors to find different forms of activity in order to compete in a broader and more heterogeneous market.[17]

The main characteristic of this Eurobanking system has been the substantial lack of government regulation. The rationales that traditionally led governments to require certain standards from banks in order to ensure financial stability within the countries were not applied to these activities

12. *See* CEPAL, *supra* note 9, at 5.

13. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 321 (1975) [hereinafter IMF 1975]. For a description of the "petromoney recycling" mechanism that took place during the 1970s, *see* Griffith-Jones, *supra* note 8, at 210.

14. *See* Griffith-Jones, *supra* note 8, at 204, 207.

15. *See* P. HALLWOOD, *supra* note 8, at 190; Barnett, *supra* note 4, at 87–88; Bryant, *supra* note 5, at 10; Griffith-Jones, *supra* note 8, at 206; Oechsli, *supra* note 4, at 304, 316.

16. For a concept of internationalization, *see* Debs, *supra* note 6, at 5.

17. *See* MORGAN GUARANTY TRUST COMPANY, WORLD FINANCIAL MARKETS 1 (Dec. 1986). It is useful to point out that during the last few years, trade in services has increased. Notwithstanding the importance of goods in the current account balance of a country, services are a major category. In the case of the United States, its service balance grants a positive result, since the surplus reached in 1983 was almost $54 billion; *see* J. JACKSON, *supra* note 3, at 835. It is very difficult to know the true range of this part of many countries' economies, due to the lack of statistics. A particular reference must be made to the banking activities in Latin America, which expanded notoriously during the 1970s. The importance of this sector in a nation's economy is a result not so much of its incidence on the GNP, but rather of its strategic position, since it can help to enhance development; it also controls the tools that link the country with the rest of the world's economy. Traditionally, banking activity had been severely controlled by the government in most Latin American countries. During the 1970s, however, more international financial presence in local markets was permitted, and foreign banks established offices. According to some research, during these years a negative trend that began in these economies found its easiest way of operating in the banks in the form of capital flights. *See* SELA, LOS SERVICIOS Y EL DESARROLLO DE AMERICA LATINA 59.

and all contracts were made on a nearly pure "free-market" basis. Transactions usually did not receive the guaranty of the State as a lender-of-last-resort, mainly because its currency was not involved.[18] According to Stephany Griffith-Jones, "this rapid growth of multinational banking is to a great extent attributable to the asymmetry between the stringent and detailed official regulations governing residents operating their own national currencies, and the great freedom of nonresidents to operate in foreign currencies from the same constrained national banking system."[19]

The risks that this activity created are demonstrated through the analysis of our case. It is necessary, however, to keep in mind that the assumptions germane in the international regulatory system (Bretton Woods) were not enough to build tools into the system to cope with many of the problems that occurred during the 1970s and the 1980s.[20]

This large-scale credit system was used mainly by developing countries. They did not qualify as "first-class borrowers" and, therefore, could not initially take advantage of the international bond market with its fixed interest rates.

Another expanding feature of these private loans was their being granted at variable interest rates,[21] based either on LIBOR or PRIME rate. The legal effect of this "variability" is to transfer the risks of the market to the borrower,[22] and eventually to increase the cost of servicing debt. During the 1970s, the IMF anticipated the negative effects that a "swing" in the rates would have, especially in the Latin American region. The interest rates, however, were remarkably low during those initial years, and indebtedness grew.[23] In the case of Argentina, 57.7 percent of its loans were under these terms by 1980.[24]

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18. *See* MORGAN GUARANTY TRUST COMPANY, *supra* note 17, at 4–5, 6. For a discussion of "lender-of-last-resort policy" and international banking, *see* Bryant, *supra* note 5, at 22.

19. *See* Griffith-Jones, *supra* note 8, at 205. A sensible proposal has been put forward by the Bank for International Settlements concerning capital standards. The aim of such a proposal is to create a uniform set of rules under which the banks of major industrialized nations would compete. A relevant aspect of the plan is that a minimum 8 percent capital-risk assets ratio is envisaged. This is a considerable enlargement, if one takes into account that the average equity-to-assets ratio of main American banks is only 3.23 percent. *See* *Levelling*, THE ECONOMIST, Dec. 12–18, 1987, at 92.

20. *See* Suratgar, *supra* note 6, at 154–55; *see also* MORGAN GUARANTY TRUST COMPANY, *supra* note 17, at 8, where it points out that the first moves to counteract excessively risky positions were taken by the banks. Further, "[t]he international monetary system displays a persistent asymmetry, assigning deficit countries the main burden of achieving external payments adjustment . . . . Thus the outstanding issue for the international monetary system remains how best to assure that surplus and deficit countries share trade and current account adjustment burdens." *Id.* at 11.

21. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 359 (1976) [hereinafter IMF 1976].

22. *See* Debs, *supra* note 6, at 8; Griffith-Jones, *supra* note 8, at 207.

23. *See* WORLD BANK, *supra* note 4, at 112; Barnett, *supra* note 4, at 92, 94; Suratgar, *supra* note 20, at 152.

24. Barnett, *supra* note 4, at 94 n. 53.

The increase in the number of banks—financially capable or not—lending to countries (although large banks had a competitive advantage during the first years[25]) led to consequences felt by the debtor countries today. Since it was assumed that sovereign debtors would not default,[26] lending to them was conceived as a perfect business.[27] A country's creditworthiness was, in several cases, considered only superficially by the banks,[28] and "conditionality"—the rule in dealings with official lenders—was not a requirement in order for developing countries to gain access to these sources of funds.[29] Some authors specifically address the issue of "bank responsibility," stating that the governments should require private banks to internalize the costs of imprudent lending as a condition for a reform of the renegotiations on foreign debt.[30]

III. 1973–1982: Building the Debt

In 1973 Argentina's debt service payments amounted to 18.3 percent of its export of goods and nonfactor services.[31] A report published by

25. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY SUPPLEMENT 179 (1977) [hereinafter IMF 1977]. On the other hand, once "syndicated loans" became usual, large banks also had advantages. They "managed" the negotiations and charged smaller banks an important "fee," since the smaller banks wanted to participate in the market, but were unable to handle the negotiations themselves. *See* CEPAL, *supra* note 9, at 13; Griffith-Jones, *supra* note 8, at 209 n. 16; Oechsli, *supra* note 4, at 311.

26. *See* Barnett, *supra* note 4, at 84.

27. And it has probably been one. Even after the crisis began, the banks, especially the U.S. banks, have made enormous profits. According to the information cited *supra* in note 2, "in 1986, the bank [Citicorp] earned $257m, or about 24 percent of its total income, on loans to countries in the Caribbean and in Central and South America." Citicorp's exposure in Argentina is U.S. $1.5 billion. Its total loans outstanding in Latin America are U.S. $14.8 billion. All Third World commitment, however, amounts only to about 10 percent of the bank's loan portfolio.

The measure adopted by Citicorp reflects a more realistic approach to the problem. But it hides its dangers, since if it is followed by all major creditors, it will reduce the amount of new money lent to the lesser developed countries, and create risky situations on the political side. The much-questioned Baker plan would completely fail if this were to happen. *See* Barnett, *supra* note 4, at 90.

28. *See* Griffith-Jones, *supra* note 8, at 210.

29. *See id.* at 209. It is very interesting to observe how, once the crisis started, "conditionality" extended its presence, and currently most negotiations with private creditors require a previous approval by the IMF, which necessarily means accepting "conditions."

30. *See* Barnett, *supra* note 4, at 132, where the authors explain that since the incorrect action was that taken by the banks, the fact of shifting to the debtor countries the costs of those irresponsible practices is a "Market Failure," and governments should avoid allowing the situation to advance to the point of default, which is much more difficult to handle. *See also* Sachs, *Managing LDC Debt Crisis*, BROOKINGS PAPERS ON ECON. ACTIVITY 419 (No. 2, 1986).

31. *See* IMF 1975, *supra* note 13, at 324. It is useful to compare statistics in order to observe the evolution of Latin American debt.

the World Bank[32] revealed that Argentine external public debt outstanding as of December 31, 1974, had the following characteristics:

	(in million U.S. dollars)
Disbursed only	3,345.0
Total	4,863.7
Bilateral Official	1,040.5
Multilateral	774.7
Suppliers	1,237.8
Banks	1,130.6
Other	680.1
Service Payments as % of exports of goods and nonfactor services	16.2

Argentina was already included within the group of eleven countries that accounted for 72% of the debt of developing countries to private financial institutions by the end of that year.[33] As of December 1975, the Argentine outstanding public external debt amounted to U.S. $4,698.5 million.[34]

TOTAL DEBT OUTSTANDING (in Billions of U.S. $)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
BRA.	13.8	18.9	23.3	28.6	35.2	48.3	57.4	66.1	65.7	88.2	96.5	102
MEX.	8.6	12.8	16.9	21.8	27.1	33.6	40.8	53.8	67.0	82.0	90.0	96
ARG.	6.4	8.0	7.9	8.3	9.7	12.5	19.0	23.2	35.7	38.0	45.5	48
VEN.	4.6	5.3	5.7	8.7	12.3	16.3	23.7	27.5	29.3	31.3	33.5	34

The data were obtained from Szapire, *Deuda Externa de los Paises en Desarrollo*, 3 CONTRIBUCIONES 25 (1985).

32. *See* IMF 1976, *supra* note 21, at 293.

33. *See id.* at 358. Flows of capital towards developing countries may come from the official sector, containing direct channels for capital flow such as bilateral aid, and from intermediaries, predominantly international or multilateral organizations, such as the International Monetary Fund and the World Bank. Argentina decided to become a member of both institutions in 1956. *See* Decreto Ley 15970, 31 de Agosto de 1956, in xvi–A ANALES DE LEGISLACIÓN ARGENTINA 843 (B.O. 12/IX/56) [hereinafter ADLA]. The role of these institutions, however, has adopted particular characteristics since 1982, which is analyzed later. Such particularity does not allow us to include them within the general category of creditors. Capital may also come from the private sector, which has direct mechanisms, predominantly direct investments, as well as intermediaries, represented by the commercial banks and the market of international bonds and other securities. *See* WORLD BANK, *supra* note 4, at 85. These latter, after increasing their participation so that by 1982 commercial banks were creditors of 82 percent of the total external debt of Latin America, have significantly retracted as a consequence of the crisis that began in 1982. Since then commercial bank lending has been organized mainly through rescheduling and refinancing agreements, altering the previous trend. *See* Robichek, *The International Monetary Fund: An Arbiter in the Debt Restructuring Process*, 23 COLUM. J. TRANSNAT'L L. 145 (1984).

34. *See* IMF 1977, *supra* note 25, at 284.

In 1976, due to a balance of payment deficit, Argentina was awarded Compensatory Financing by the IMF in the amount of SDR 110 million.[35] That same year, a "standby" agreement was approved by the Fund "in support of the government's financial program adopted in April 1976."[36]

In October 1977, a new "standby" agreement was approved that authorized the purchase over the subsequent twelve months of SDR 159.5 million in order to support a program aimed at strengthening the balance of payments and reducing inflation. As of December 31, 1977, outstanding bank claims against Argentina amounted to U.S. $4,863 million.[37] At that time Argentina's quota in the IMF remained at SDR 440 million and its net purchases totaled the equivalent of SDR 565.6 million.[38]

In 1978 the Second Amendment to the Fund's Articles of Agreement came into force and Argentina's quota increased to SDR 535 million. That amounted, however, to a reduction of 0.14 percent.[39]

International lending expanded until 1980.[40] Only then did the international community begin to realize the enormity of the problem it had created during the 1970s. Nevertheless, the issue was still understood as being a consequence of short-term imbalances of the balance of payments.[41] The process of multilateral debt renegotiations began once the crisis was openly revealed, anticipating what was to become a common practice after 1982. The combination of the roles of the commercial banks and the IMF began to accentuate itself. During 1981 and 1982, the Argentine Government assumed U.S. $9,600 million of private debt, under the regime of "exchange insurance contracts" and U.S. $1,400 million under swaps arranged by Banco Central.[42] From then on, renegotiations

35. *See* IMF 1976, *supra* note 21, at 101.

36. *See id.* at 252.

37. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 263 (1978) [hereinafter IMF 1978].

38. *See* IMF 1976, *supra* note 21, at 323.

39. *See* IMF 1978, *supra* note 37, at 106.

40. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 2 (1981) [hereinafter IMF 1981].

41. *Id.* at 187.

42. From 1976 onwards, the policy of the government sought and achieved the liberalization of the exchange rates and payments system. With the purpose of reducing inflation and adjusting the balance of payments, a policy of complete opening of the national economy in its commercial and financial spheres was possible due to the constant inflow of capital. The private sector, therefore, was able to contract loans in foreign currency. Many international banks established themselves in Argentina, and both those branches as well as local banks could lend foreign currency to local borrowers. After 1981, however, the government had to devaluate local currency, and restrictions were imposed on the financial market, limiting the sale of badly needed foreign currency. To avoid the bankruptcy of the industrial sector, special regimes were created by means of which a debtor of loans in foreign currency entered into a contract with Banco Central, which amounted to a future sale of foreign currency by that institution at a fixed price, not affected by future devaluations. Since at the time of performance Banco Central did not have enough currency to pay, bonds were issued. As a consequence, the state assumed the private sector debt under new terms (Act No. 22749). *See* CEPAL, *supra* note 9, at 16; J. RIVA, OPERATORIA BANCARIA EN COMERCIO

included private debt as part of the public external debt.[43] By the end of 1982, Argentina's public external debt had reached U.S. $27,474 million.[44]

IV. The Debt Crisis: Its Origins

There are several differing views as to the nature of the debt crisis. Some authors regard the problem as one of liquidity, "a temporary shortage of foreign funds with which to serve international debts."[45] The solution, according to this point of view, is to increase public international funding of the Third World debt. Within this perspective, the Baker Plan is perhaps the most relevant and well-known proposal coming from a government.[46]

As Geoffrey Sachs explains:

> [U]nder the plan, the commercial banks were encouraged to make new loans to the heavily indebted countries, specifically $20 billion of increased exposure

Exterior y Cambios—Aspectos Juridicos 114, 410 (1986); Cambiaso y Legon, *Caracteres y Circulación de los BONODS y PROMISSORY NOTES*, 17 Revista Del Derecho Comercial y de las Obligaciones 607.

43. Initially the participation of public debtors in the total share of the debt decreased. When the crisis was unavoidable, pressure was put on debtor governments to guarantee national private debt. Creditors therefore could rely on the existence of an additional debtor, the state, the solvency of which was traditionally undoubted. The current managing director of the IMF, M. Camdessus, has an interesting and realistic approach to the analysis of the debtors and the circumstances in which they went into huge borrowing. His description clearly emphasizes bankers' participation in the building up of the debts, and the difference between serious governments and "military dictatorships, and regimes of that type [who] are known to ignore financial and monetary concerns." Camdessus, *Governmental Creditors and the Role of the Paris Club*, in Default and Rescheduling, *supra* note 6, at 125. As to the linkages between public and private sector debt, see Mudge, *Restructuring Private and Public Sector Debt: Country Debt Structure?*, 20 Int'l Law. 847 (1986). As a consequence, once restructuring agreements began no major distinctions were made between both kinds of debt, and "the payment of private sector foreign currency debt becomes the responsibility of the sovereign as a practical matter if not a legal one." *See* Mudge, *Sovereign Debt Restructuring: A Current Perspective*, in Default and Rescheduling, *supra* note 6, at 88.

44. *See* International Monetary Fund, IMF Survey 27 (1984) [hereinafter IMF 1984].

45. *See* P. Hallwood, *supra* note 8, at 237; Barnett, *supra* note 4, at 84 n.4. This has been the traditional approach to the balance of payment deficit, the basis of the Bretton Woods system for some authors. *See* Alejo, *supra* note 6, at 67; R. Plan, External Debt Rescheduling 12 (1985), who explains why the banks support this approach and the "advantages" it has for them.

46. During the initial stage of the problem, this was probably the most influential thesis. The mechanisms used to combat this short-term insolvency were essentially two: (1) renegotiations with the banks and access to the international financial network prepared to cope with immediate shortages of funds (International Bank of Payments, Commodity Credit corporation, the U.S. Treasury); and (2) the central banks of most industrialized nations, which implicitly accepted acting as lenders-of-last-resort, even though with important reservations, so as to avoid enhancing this aspect of banking activity. *See* Guerguil, *La Crisis Financiera Internacional: Diagnosis y Prescripciones*, in A. Bianchi, *supra* note 9, at 260.

over three years, while the multilateral lending institutions were called upon to make $9 billion of new loans in return for policy adjustments in the debtor countries. The debtor countries were expected to continue to meet interest obligations on a timely basis.[47]

Another point of view regards the problem as one of long-term solvency, being directly related to the enhancement of the industrialized nations' economic growth.[48] Without any economic growth in the OECD nations, the Third World countries would not increase their exports, therefore the problem would need a different solution. According to some of these authors, improving the developing countries' conditions would require creating an international mechanism that would enable the debtors to "swap" the original debts owed to private banks for long-term bonds issued by the countries and guaranteed by an international organization. The claimed advantage of this hypothesis is that it was a more realistic approach. The debt could be transferred to the international organization not at its face value but rather at a lower amount, forcing the banks to write these assets (Third World countries' debts) off their books. The banks would then replace the assets with bonds issued by the international organization.[49]

The third point of view is that the problem is one of the exchange rate monetary system. Since the monetary system no longer has a fixed standard, these authors believe that the value of each currency depends strictly upon political decisions, such as those taken by the Central Bank authorities of each nation where currency is used in international finance.[50] What we may now find, therefore, could be described as the result of political management of monetary policies in which the Eurobanking community funneled funds from industrialized to developing countries without taking into account the creditworthiness of the borrowers.[51] The debtor nations relied on international inflation (during the 1970s inflation effectively made interest rates negative), trusting that these debts could be paid off without much sacrifice.[52] This assumption proved partially wrong, particularly during the first years of the 1980s. It is, however, still a possibility that should not be disregarded, due to the recent decline of

47. *See* Sachs, *supra* note 30, at 401.

48. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 21 (1987) [hereinafter IMF 1987] (opinions of Mr. Volcker, Mr. Schlesinger, and Mr. Rimmer de Vries); *see also* R. PLAN, *supra* note 45, at 10.

49. *See* Guerguil, *supra* note 46, at 272.

50. *See* Larsen, *supra* note 5, at 58. This was the reasoning followed in several oil-importing countries that had borrowed in order to pay their bills for imports needed after the second oil crisis (1979) and intended to turn large deficits into surpluses. The mechanisms used were essentially "stiffened import controls" and "currency devaluations." *See* MORGAN GUARANTY TRUST COMPANY, WORLD FINANCIAL MARKETS 3 (Sept. 1986).

51. *See* P. HALLWOOD, *supra* note 8, at 237-38.

52. For an analysis of this point of view, see Ramos, *Politicas de Estabilización y Ajuste en el Cono Sur, 1974-1983*, in A. BIANCHI, *supra* note 9, at 219.

the U.S. dollar, the currency in which a majority of the debts are outstanding.

V. The Crisis: From 1982 to the Present

Once default appeared an imminent threat to world finance, the major actors adopted distinctive roles in the negotiations. Perhaps the most interesting and important role has been that played by the International Monetary Fund.

Robichek has pointed out that the IMF's role as an "honest broker" called for the performance of three major tasks:

> The first is to help a country frame an adjustment program that would qualify it for a standby or extended arrangement with the IMF. This task involves the prudent exercise of conditionality. The second is to commit IMF resources in support of such an adjustment program, which involves setting the IMF's own contribution toward financing a country's balance of payment deficit. In setting its own contribution, the IMF takes into account the enhanced leverage which this commitment of its own resources affords the country with other foreign lenders and, more particularly, with the banks with exposures in the country. Third, the IMF intercedes directly in support of the country's efforts for raising external finance from third parties. This task is commonly referred to as its catalytic role.[53]

Most negotiations bypass the IMF. Generally, an agreement between the debtor and the Fund appears as a sine qua non of any settlement of external debt complications. This does not imply a consensus as to the way in which the IMF performs its tasks, for this remains one of the most debated topics.[54]

In January 1983, an agreement was approved between the IMF and Argentina, entitling that country to use SDR 2,020 million of IMF resources. SDR 1,500 million were granted under a 15-month "standby" arrangement in support of a government economic recovery program, and SDR 520.1 million were made available under the Compensatory Financing Facility. The first would be financed partially from the Fund's ordinary resources (SDR 745.7 million) and, in part, from resources borrowed by the Fund (SDR 754.3 million). The "Facility" was granted due to shortfalls recorded in total export earnings during 1982.[55]

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53. Robichek, *supra* note 33, at 146.

54. As to the role of the IMF, see Nowzad, *The Role of the IMF in Rescheduling International Debt*, in DEFAULT AND RESCHEDULING, *supra* note 6, at 131; Dillon, *supra* note 9, at 31; Ground, *Los Programas Economicas de Ajuste en America Latina*, in A. BIANCHI, *supra* note 46, at 157; Conklin, *The IMF and Economic and Social Human Rights: A Case Study of Argentina, 1958-1985*, in HUMAN RIGHTS QUARTERLY; R. PLAN, *supra* note 45, at 39.

55. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 38 (1983) [hereinafter IMF 1983].

The Argentine Government imposed a stern economic adjustment program in order to reduce inflation and public deficit, while at the same time increasing exports and tax collections. The balance of payments deficit was supposed to be lowered from almost U.S. $6.2 billion (1982) to U.S. $500 million in fifteen months. Almost simultaneously, a short-term credit bridge loan for U.S. $1.1 billion was obtained from commercial banks. It was to be paid back during 1983 with assets obtained from the IMF. Medium-term loans for U.S. $1.5 billion were also negotiated, and principles that were to govern rescheduling of debt service payments due in 1983 were agreed upon with the creditors.[56] In June 1983, Argentina planned renegotiation of its debt with the private banks on these terms:[57]

	Basis	**Amount Agreed (U.S. $/million)**	**Grace Period (years)**	**Payment Due (years)**	**Spread (on LIBOR/ PRIME)**
–Arrears up to the end of '82	100% ppal.	7000	3	7	2-1/8 to 2
–Vanquishments in 1983	100% ppal.		3	7	2-1/8 to 2
–New Credit Med. term '83	new financing	1500	3	4.5	2-1/4 to 2-1/8
Bridge loan		1100	7 (months)	14 (months)	1-5/8 to 1-1/2

The agreement was never signed,[58] and negotiations with the government were interrupted until the constitutional authorities were elected on October 30, 1983.

In his message delivered in Neufchatel, Switzerland, M. de Laroisiere, analyzing the effects of the debt crisis, said: "[F]or the meantime, it will be important to see that an indiscriminate or abrupt retrenchment of bank lending is avoided. If this were to occur, it would force adjustment . . . on a scale and in a time frame disruptive . . . to creditors and debtors

56. *Id.* at 39.

57. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 36-37 (1986) [hereinafter IMF 1986].

58. CEPAL, NOTAS SOBRE LA ECONOMIA Y EL DESARROLLO, No 424/425, Diciembre de 1985, at 18.

alike."[59] As we shall see, this "retrenchment" did occur, and the debt crisis was enhanced.

During most of this period, the main objective of the IMF was directed toward achieving adjustment policies in the debtor nations. It was expected that "the debtor countries themselves [must] demonstrate that they are taking the necessary steps to regain financial viability, while preserving their capacity to resume economic growth in the medium term."[60]

By the beginning of 1984, the debt renegotiation process between debtors and creditors increased. A significant number of countries found themselves in the need of rescheduling, and both debtors and creditors were gaining experience. It was alarming to observe that in a period of seven years, from 1974 to1981, debt service ratio in Latin America passed from 28 percent to 42 percent.[61]

The Alfonsin administration, elected in 1983, expected to receive more lenient treatment by the IMF and the banks, and was reluctant to increase economic adjustment. The target was to reach an agreement with the banks without any previous arrangement with the Fund. When the administration came into power on December 10, 1983, arrears amounted to U.S. \$3.2 billion, plus U.S. \$1.1 billion of arrears for "nationalized" private debt, and a current account deficit estimated at U.S. \$2.3 billion for 1984.[62]

In March 1984, a rescue program in the amount of U.S. \$600 million was arranged between four Latin American governments and the banks in order to avert what appeared to be an otherwise unavoidable default by Argentina on its commercial bank payments. The Federal Reserve intervened as guarantor for Argentina, who agreed to begin serious negotiations with the IMF for a standby agreement. These proved very difficult, and several Letters of Intent presented by the Argentine Government were rejected.

On December 28, 1984, Argentina reached a new fifteen-month standby agreement with the IMF for a total of SDR 1,419 million to be paid in six installments of SDR 236.5 million each.

During 1984–1985, Argentina entered its third round of negotiations with the banks, and new terms were reached:[63]

59. *See* IMF 1983, *supra* note 55, at 73.

60. *Id.* at 381; M. de Laroisiere, Message to the American Enterprise Institute, Washington, D.C., Dec. 5th, 1983.

61. *See* IMF 1984, *supra* note 44, at 26.

62. *See* Garcia & Junco, *Historia de la Renegociación de la Deuda Externa Argentina*, BOLETIN INFORMATIVO TECHINT-ENERO, No. 245, Febrero 1987, at 42.

63. *See* IMF 1986, *supra* note 57, at 38.

	U.S. $/ (million)	Years of payment- new cred.	Spread over LIBOR	Years (total)	(grace)	Comm.
Amort. resched.	13,900	1982–85	1.38	12	3	
New Credits	4,200	1985	1.63	10	3	0.63

In June 1985, a drastic turn in economic policy was implemented by the Argentine Government (the Austral Plan), which received the support of the IMF.[64] This plan paved the way for renegotiation and rescheduling with the eleven members of the Steering Committee, chaired by Mr. William Rhodes of Citibank. By the end of the year, the Argentine external debt amounted to U.S. $48.7 billion.[65]

In a meeting that took place in Buenos Aires in March 1986, the Group of 24 on International Monetary Affairs[66] issued a press communique that contained several noteworthy aspects. The debt problem was clearly acknowledged as predominately economic. It was recognized as not an isolated problem but one linked to the other economic problems of the international community. The success of a possible solution necessarily would require an increase of productivity in the debtor and creditor nations. However, the combined action of debtor and creditor nations should be the adequate response to this problem. Political aspects do affect world trade and political action must be adopted.[67] The role of the IMF, there-

64. One of the most debated topics in countries such as Argentina is whether the IMF exercises influence over the economic authorities exceeding what the more nationalistic parties consider appropriate. The "adjustment plans" traditionally recommended by the IMF are strongly criticized in the Southern hemisphere. As to the "Austral Plan" adopted by the Argentine authorities in June 1985, its main aspects were explained in a Congress session by Mr. Machinea, current president of Banco Central, then Adjunct Secretary of Political Economy. According to his remarks, this plan did not respond to the "Pollack model" because its three cornerstones were: (1) the freezing of prices, wages, exchange rates, and tariffs; (2) the reduction of the fiscal deficit; and (3) a monetary reform. *See* CÁMARA DE DIPUTADOS DE LA NACIÓN, DIARIO DE SESIONES, reunion 41, at 7849.

65. *See* CÁMARA DE DIPUTADOS, DIARIO DE SESIONES, Marzo 12 y 13, 1986, at 7851.

66. The Group of 24 was created in 1972, with the aim of unifying the positions of developing nations concerning monetary affairs, discussed principally at the IMF. It has produced three important documents concerning the improvement and reform of the international monetary system, the last one in Seoul, in October 1985. *See* E. Zalduendo, *Brief History of the Group of Twenty Four*, in G-24; DOCUMENTS OF THE G-24 (1972-1986) (1986).

67. *See* IMF 1986, *supra* note 57, at 90-91. There have been several arguments as to whether the solution to the LDCs' external debt will be essentially economic or, on the contrary, a result of a political decision of the industrialized nations. Certainly, most debtor nations have insisted in claiming from creditor governments responses that are not strictly tied to economic models, or that rely on "free market" principles, to achieve economic growth in debtor countries. Also within the creditor nations, public officials have sometimes expressed their views as to favoring a "political solution" to the problem. However, the

fore, was severely scrutinized in order to establish whether potentially available mechanisms had been utilized.[68]

The ministers insisted that a constant flow of credit to these countries was necessary in order to maintain production and enhance investment and thereby make debt payments possible.[69] The communique emphasized the close relationship between debtors, the IMF, and the private banks, as well as the need of a group effort to solve the problem.

VI. New Trends: The 1986–1987 Round of Negotiations

After the launching of the Austral Plan, the Argentine Government began communications with the IMF and the banks in order to obtain better financial conditions for the country's debt payments. By the beginning of 1987, the terms of a new stand-by agreement with the Fund were being discussed, while at the same time banks were consulted to determine the amount of new money that could be obtained under the "forced lending" mechanisms that are presently common. On July 23, 1987, the IMF approved an arrangement for SDR 1,113 million.[70]

The agreement reached in April 1987 between Argentina and the banks has the following characteristics:

	U.S. $/ (mill.)	Years of payment resched.	Spread over LIBOR	Years (total)	Years (grace)	Comm.
Amort.	25,300			19	7	—
		1982–86	13/16%			
Resched.	4,200			12	5	—
New	1,950		7/8%	12	5	—
Credit			----------over 1,500----------			
(comm. credit)	(400)		13/16%	4		

financial community, the IMF, and the governments have insisted on reaching solutions without disregarding market conditions. *See* MORGAN GUARANTY TRUST COMPANY, *supra* note 50, at 2; Segal & Pinto, *Inviabilidad del Cobro Compulsivo de las Deudas de un Estado por Otro y la Moral Económica Internacional*, LA LEY, *t. 1984-C*, at 1227; Barnett, *supra* note 4, at 116 (the authors suggest the possibility of establishing a "claims settlement" mechanism similar to the one created for the US-Iran conflict); *id.* at 134-35; R. PLAN *supra* note 45, at 24 (the author makes reference to the Mar del Plata meeting (Sept. '84), where eleven Latin American debtor nations consolidated the position adopted in Cartagena, expressing themselves in favor of a political dialogue with the OECD countries on the debt issue).

68. *See* IMF 1986, *supra* note 57, at 92.

69. *See id.*

70. *See* INTERNATIONAL MONETARY FUND, IMF SURVEY 233 (1987) [hereinafter IMF 1987].

This agreement has both rescheduling and refinancing aspects.[71] It regulates the Argentine Public Sector Borrowers' debt and establishes principles that will apply to the Argentine Private Sector Borrowers' debt as well.

A. Rescheduling

As to the Public Sector, the agreement covers all maturities of Specified Debt originally falling due on or after January 1, 1986. This includes "the principal maturities of Debt of Argentine Public Sector Borrowers (i) refinanced under the 1985 Refinancing Agreement and similar agreements and (ii) originally falling due or rescheduled to fall due on or after January 1, 1986,"[72] and other defined debt that has to be refinanced on the basis of similar principles.

The 1987 Agreement is a restatement and amendment of the 1985 Refinancing Agreement. The agreement contains substantially the same terms and conditions for each Argentine Public Sector Borrower (defined as obligor in the contract), the republic of Argentina as guarantor, Banco Central de la Republica Argentina, and the bank creditors.

The agreement affects currencies in that debt outstanding in European currencies, Yen, Canadian, and U.S. dollars will be refinanced in the original currency. Debt in other currencies will be redenominated into

71. The lack of a "procedure" has been a traditional difficulty in sovereign nations' debt rescheduling. Negotiations were traditionally dispersive, increasing costs and economic burden. *See* Suratgar, *supra* note 20, at 155:

> No mechanism exists under international law for putting a sovereign borrower into effective quarantine from its creditors, thus allowing time for a reorganization of its financial affairs with a view to ensuring that creditors receive equitable treatment consistent with its economy in an orderly way and in due course repay its creditors.

See also Oechsli, *supra* note 4, at 307. Several terms have been used. In a broad sense, "renegotiation" is used to encompass any kind of dealing between a debtor unwilling to default and his creditor. If a rearrangement of maturities and interest rates is designed for the debts included within the consolidation period, so that payments will be made according to a new deferred schedule, authors speak of "rescheduling." Instead, if creditors compromise new funds that permit timely performance by the debtor, this is denominated "refinancing," which "has the advantage of allowing the creditor banks to continue classifying all the old and new assets as 'performing loans'." R. Plan, *supra* note 45, at 26; *see* Mudge, *supra* note 43, at 87. Recently, some consideration has been granted to a different category, "debt relief," which "signifies any arrangement such as below-market interest rates, forgiveness of principal, or repurchase of debts by the debtor country at below par, that reduces the present value of contractual obligations of the debtor country." Sachs, *supra* note 30, at 398. The general rule elaborated is that each sovereign's situation has to be dealt with on a case-by-case analysis, since the terms of the renegotiation will need to be implemented taking into account the particular circumstances each country faces. *See* R. Plan, *supra* note 45, at 53; Barnett, *supra* note 4, at 83; Camdessus, *supra* note 43, at 125; CEPAL, *Políticas de Ajuste y Renegociación de la Deuda Externa en Latinoamerica*, in A. Bianchi, *supra* note 49, at 81; Mudge, *supra* note 43, at 86; Oechsli, *supra* note 4, at 308; Trichet, *Official Debt Rescheduling*, in External Debt Management, *supra* note 8, at 127.

72. Argentine Republic: 1987 Financing Plan Part V-D-11.

U.S. dollars. For the first group, however, a mechanism that "switches to home currency" has been included. That mechanism specifies the amount of debt eligible for currency switch and the timing (each interest payment data occurring during the two and one-half years following a currency switch election).

The essential terms of the 1987 agreement are:

(1) maturities originally refinanced under the 1985 Agreement will be repaid in twenty-five semi-annual installments commencing on May 2, 1994, and ending on May 2, 2006;

(2) maturities originally due or scheduled to fall due on or after January 1, 1986, will be similarly repaid in twenty-five semi-annual installments commencing on May 2, 2006.

A fixed schedule contains the percentage of amortization to be paid in each installment as determined (from 1 percent to 7.50 percent). As for the interest rates, the average for the 3–6 months U.S. dollar deposit LIBOR or the Domestic Rate (either secondary market 90–180–day, or certificates of deposit) are the only options available, and the spread is 13–16 percent per annum over both of them. PRIME is not included. A special clause links this agreement between Argentina and the commercial banks to the Argentine-IMF agreement. By the time the first amortization payment is made, Argentina agrees to have in effect an IMF program, or at least to allow enhanced IMF surveillance. This agreement is governed by New York law, and included in the agreement is a clause giving non-exclusive jurisdiction to the New York courts and an express waiver of sovereign immunity by Argentina.

B. Refinancing

New loans are made under a "Credit Agreement" for U.S. $1.55 billion and a "Credit and Deposit Facility" for U.S. $400 million. Banks may opt for "New Money Instruments" (NMI) up to a maximum subscription of U.S. $1 million each in lieu of all or part of the commitments under the new money facilities. The issuance and transfer of NMI securities are subject to compliance with applicable securities laws (New York law), including the United States Securities Act of 1933.

NMIs will be transferable to "Eligible Institutional Investors." This arrangement allows small lenders to end their contractual relationships with Argentina by transferrng the NMIs.

The First Facility is a nonrevolving, multicurrency, floating and fixed-rate term loan agreement with multiple disbursements linked to IMF disbursements, IBRD agreements, and disbursement levels from official sources. It contains an Investment Fund of U.S. $350 million, that covers medium-term lending for investment projects having a minimum term of

six years (including a four-year grace period) which must be coupled with "new funds" or "other funds" provided to an Argentine Entity.

The lenders for this Facility are a syndicate of all non-Argentine financial institutions with non-Argentine currency outstanding, those that have deposits with all Argentine Public and Private Sector Borrowers, or those that own securities (bonds, treasury bills, notes, and certificates of deposit) of, or have loaned money to, the foreign agencies and branches of banks currently owned by Argentina. These lenders will participate on a prorata basis. The credit will be available in five installments, which will match the drawdown dates under the 1987 IMF stand-by arrangement.

This agreement, however, is subject to a number of conditions, such as the existence of disbursements from official creditors the agreements with the Paris Club, disbursements from the IMF Compensatory Financing Facility and at least U.S. $100 million from the World Bank. These conditions must be satisfied for the first installment and similar conditions must exist for the other four installments. Obviously, the role of the IMF is influential, since a general reliance on the performance criteria it establishes underlies all the agreements.

The interest rates available to lenders are the LIBOR and the Domestic Rates previously described, with a spread of 7–8 percent per annum in both cases. Maturity begins on October 25, 1992, and repayment is to be made in fifteen equal semi-annual installments.

There is an "early participation" fee for banks that commit funds earlier. The agreement also contains "cross default" events linked to several agreements between the lenders and Banco Central.

Onlending has not been included within this agreement.[73]

The purpose of the Trade Credit and Deposit Facility is to provide credit to entities involved in export and import transactions. It is also a "syndicated loan" with a term of four years.

C. Alternative Participation Instruments

Within the "menu of options" system followed in the renegotiations, Part V—Section F of the Financing Plan describes several aspects of the "Alternative Participation Instruments." The purpose of issuing these bonds is to reduce the number of banks participating in the syndicated agreements, since "the Exchangeable Debt exchanged by any bank for

73. Onlending is a mechanism by which the borrower (a public agency) is able to use the borrowed funds by transferring then to the private sector of the country. The objective is to use the "new money" in the development of investment capacity and exports. Usually, this is a clause in the rescheduling and refinancing agreements between lenders and borrowers. *See* Mudge, *supra* note 43, at 847; *see also* Cámara de Disputados de la Nación, Diario de Sesiones, May 12 y 13 de 1987, at 7856; Argentine Republic: 1984-85 Financing Plan IV-A-2.

Alternative Participation Instruments (APIs) will not be included in the Base Date Debt . . . of such bank." At the same time, these "exit bonds" amount to an acquittal of the debt exchanged, since the interest rates payable are fixed at 4 percent and the repayment begins in thirteen years, following a twelve-year grace period.[74]

"Base Date Debt" is the concept used to delimit the group of lenders that have to participate in the Term Credit Agreement (U.S. $1.5 billion). On that basis, all banks that are qualified as holders of "base date debt" are syndicated in the new loan.

The opportunity for second-tier banks to avoid syndication lies in the ability of such banks to subscribe to APIs. This is done by means of an agreement between Banco Central, the Republic of Argentina, and each bank that chooses to convert debt for APIs. "[T]he Republic of Argentina will covenant that neither the APIs nor the Exchangeable Debt exchanged for them will be considered as part of a bank's base for the purpose of new money requests under concerted lending programs for 1987 or in the future." However, the subscription is limited to U.S. $5 million for each bank. The titles received are transferable in accordance with the regulations in force in each country governing "bearer" titles.

Apart from the above, a "Trade Credit Maintenance Facility" and a "Stand-By Money Market Facility" were created and the 1983 and 1985 Term Credit Agreements, as well as the 1985 Trade Credit and Deposit Facility, were amended.

VII. Capitalization of External Debt

Since 1983–1984, creditor banks have established a "grey" market in the cross-border loan obligations of several developing countries in order to achieve a less risk-concentrated country debt exposure in their portfolio. Debtors have been more willing to instrument their loans by means of bonds and, in some cases, to capitalize their debt.[75]

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74. The purpose of this option was, as explained, to simplify negotiations and to obtain certain reductions of interest and improvement of payment conditions. Unfortunately, banks have not resorted to this opportunity and prefer to retain their original rights even if as a result they must participate in new lending.

75. Among the countries that have established mechanisms for the "swapping" of external debt into equity or local currency are Mexico in 1985, Chile in 1985, Philippines in 1986, Ecuador in 1987, and Argentina with two programs, one in 1984 and a recent one in 1987. As to the ways in which debt swapping should take place, Martine Guerguil classifies the proposals into three major groups. The first holds that the conversion of debt should be tied to prevailing market forces, avoiding all government intervention. The real possibilities of payment and true value of each debt would result. Within this group some authors suggest "capitalizing" debt. The capital could be either (a) stock of private companies of the debtor nation (Allan Meltzer), or (b) "exchange participation notes," issued by the debtor country's central bank, which would grant rights to payments determined as a proportion of the

Initially, the banks' main objective in their debt conversion programs was that they obtain "negative pledge" clauses with each loan. These clauses limit the sovereign's ability to incur future debt that will rank ahead of the obligations governed by the negotiation agreement."[76] This has been overcome in subsequent renegotiations and programs have been organized with the banks' approval.[77] On the other hand, the debtors were fearful that by converting debt into local currency the resulting expansion in the money supply would immediately accelerate the economy, thus preventing them from achieving the inflation and fiscal deficit goals required by the IMF.[78] This has been avoided by limiting the amount of debt converted monthly to a fixed amount that does not produce sharp changes in the money supply.

There are essentially two procedures that have been implemented. One is "redenomination," the conversion of debt into local currency or titles

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country's foreign currency total inflow (Bailey). As a proposal, it is better linked to the amortization aspect of the debt. A second group of proposals relies on collective action by all interested parties: the debtors, the banks, and an international organization. The banks would reduce their exposure in unreliable credits by receiving safer credits in exchange. In the process they would have to make certain accounting adjustments to assume partial losses. On the other hand, debtors would have to initiate adjustment policies. The role of the international organization would be to act as broker, and the industrialized nations would offer their guaranty to the new credits. Within this group, some suggest the creation of "international bonds," which would be swapped for debt titles at below par value. Others merely require collective official guaranty on the outstanding debt, which would make negotiations between debtors and banks more relaxed. Finally, another suggestion indicates that debtors should unilaterally convert all debt into bonds. Dornbusch, under these lines, elaborated a plan for the Brazilian debt. *See* Guerguil, *supra* note 46, at 272.

76. *See* Hurlock, *Advising Sovereign Clients on the Renegotiation of their External Indebtedness*, 23 COLUM. J. TRANSNAT'L L. 39 (1984); Wickersham, *Problems of Documentation in Rescheduling of Sovereign Bank Debt*, in DEFAULT AND RESCHEDULING, *supra* note 6, at 120-21; Oechsli, *supra* note 4, at 321. This clause would be drafted in terms near to these: "The debtor ensures at all times that the obligations contracted under this restructuring agreement will, unconditionally, rank at least *pari passu* with any other External Indebtedness not or in any future moment outstanding." *See also* Carreau, *Le Droit International Économique*, in DOCUMENTS D'ÉTUDES-DROIT INTERNATIONAL PUBLIC 5 (1985). Article XI Clause *pari passu:*

> L'ouverture de crédit consentie par ledit contrat prendra rang *pari passu* avec toute dette de l'Emprunteur et notamment toute émission obligatoire ou opération realisée sur le marche international de même nature que celle prévue audit contrat, faite par l'Emprunteur après la signature des présentes, sauf accord des Banques participantes.
>
> L'Emprunteur s'engage a ne pas céder, assumer ou souffrir que subsiste toute sureté sur un quelconque de ses actifs, présents ou futurs, en garantie de toute dette contractée dans le cadre des hypothèses prévues a l'alinéa précédent, sans prendre toute disposition utile pour que le crédit prévu aux présentes soit garanti par une telle sureté au même rang que cette autre dette.

77. *See* Circular No. 111, Series of 1986, Program for the Conversion of Philippine External Debt into Equity Investments, Central Bank of the Philippines, chapter I section 2.

78. *See Global Debt—the Equity Solution*, in EUROMONEY—A SUPPLEMENT TO EUROMONEY AND CORPORATE FINANCE 10, 81 (Jan. 1988).

payable in local currency that allows the country to arrange investment programs and increase the amount of local capital. The second system, "capitalization," converts debt into stock of either public or private enterprises. The latter has the advantage of avoiding inflationary pressures. It may, however, lead to a mere transfer of existing capital from local owners into foreign hands without improving the country's productive capacity.

The Argentine program for the conversion of external debt into local currency can be defined as a redenomination mechanism. The program's purpose is to perform investment projects in the private sector and it aims at increasing the country's export capacity. The initial program will be discussed, as well as the main modifications to which it was subjected during the month of October 1987.[79]

The procedure has two stages. The first involves the creditor's presentation of an *investment project,* which must be declared eligible by the Ministry of Finance according to both formal rules and its compatibility with the overall program's aims. Once declared eligible, the second step involves the proper exchange of the debt. The potential investor presents a *conversion request* to Banco Central de la Republica Argentina in order to obtain the needed funds in local currency. The funds are obtained by converting debt titles the creditor owns. Since there is a limited quota of convertible debt, bidding takes place in order to determine which tenders are more advantageous. The ones chosen will be able to convert the external debt titles into local currency and to apply the funds received to the performance of investment projects previously approved.

The essential requirements with which an investor must comply are as follows: (1) the presentation of external obligations considered convertible;[80] (2) entry of Matching Funds; (3) submission of a conversion request and a schedule when the investment project exceeds U.S. $2.5 million; and (4) provision for adequate guarantees.

The financial scheme on which the program's success depends is based on the belief that the investor will be attracted by the possibility of converting his titles, which were obtained in the "grey" market of foreign debt bonds at a discount, in order to receive local currency for the converted titles at their face value. The greater the discount the titles suffer in the market, the higher the profit the investor will receive when those titles are converted at the official currency rate in Buenos Aires. Most programs followed by other countries do not convert the titles at face

79. *See* Banco Central de la Republica Argentina, Comunicación 'A' 1109 (27 de Octubre de 1987) and *Anexo—Programs de Conversión de Deuda Publica Externa.*

80. This includes most obligations of the public sector, excluding short-term commercial debt and credits granted or guaranteed by non-Argentine official agencies.

value. Instead they do so at a discount that is smaller than the one prevailing in the market.[81]

For example, conversion would be financially attractive if $D + MF = MV + MF'$ where: D is the nominal amount of convertible debt in the local currency at the official currency rate; MF are the converted Matching Funds in local currency at the official currency rate; MV is the market value of the external obligations converted at the parallel market;[82] and MF′ is the equivalent of the Matching Funds in local currency if converted at the parallel market.

This gain had its counterpart in the investor's obligation to bring into the country an amount of "fresh" capital at least equivalent to the nominal amount of debt converted. These "Matching Funds" are expected to be disbursed on or after May 1, 1987, and will account for 100 percent or 50 percent of each dollar according to its origin. The Matching Funds are 100 percent if: (a) the funds are capital investment not to be redeemed or distributed for the minimum years provided for by the Argentine foreign investment law; (b) the funds were long-term private source financing with a minimum term of six years and a minimum grace period of four years; or (c) the par value of BONEX[83] is purchased in U.S. dollars in the primary market from Banco Central at 0.96 par value, which Banco Central generally intends to make available. Of each dollar only fifty cents would qualify as Matching Funds if they were: (a) project loans disbursed by the International Finance Corporation and the International Investment Corporation; or (b) funds disbursed in accordance with generally applicable government regulations outside of Argentina with a term of no less than eighteen months by multilateral or official non-Argentine entities (or by any person in association with such entities) for the purchase of goods or services that have been imported into Argentina; or (c) funds allocated from the Investment Fund in accordance with the requirements of that Fund, or unloaned funds with a minimum term equal to that required under the Investment Fund (such loaned funds to count against the relevant lending quota).[84]

81. As of November 1987, the quotes for public debt titles in the secondary market were approximately 50-53 percent for Chile, 48-52 percent for Mexico, 55-60 percent for the Philippines and 33-37 percent for Argentina (all of their par value). *See* EUROMONEY, *supra* note 78 at 26-27.

82. In Argentina the exchange rates were pegged to the U.S. dollar until October 1987, and the market was controlled by the government. There was a parallel market, which, although illegal, operates and was taken into account by the monetary authorities in their regulation of the monetary supply and the determination of the exchange rates.

83. These are External Bonds of the Argentine Republic, a category of negotiable instruments issued by the Argentine Government.

84. ARGENTINE REPUBLIC: 1987 FINANCIAL PLAN part II, annex 3 (April 24, 1987).

On the whole this requirement was considered to be excessively restrictive. The reaction was, therefore, initially cold on the part of the banking community. An additional disadvantage to which objections were raised was the conversion of the debt and Matching Funds at the official exchange rate which is, at times, up to 40 percent lower than that of the parallel market. Both aspects have been modified. Concerning the latter, the foreign currency market has been deregulated. A unified market for foreign currency was established in October 1987, with no entry and exit restrictions. In relation to the former, the one-to-one requirement has been dropped. The new ratio of extra funds accepted by the Argentine Government is 70 percent to 30 percent. In addition, the authorities will allow the 30 percent to be in Australes (the local currency), and not exclusively in foreign currency obtained in foreign markets.

As to the *conversion guarantee*, it must be constituted before the bid takes place, either by means of a deposit or of a bank bail, both in an amount equal to 1 percent of the convertible debt. If the Matching Funds are for projects which exceed U.S. $1 million, after the bid their entry can be secured by a guarantee similar to the previous one, but in an amount equal to 3 percent per year of the balance of additional funds that remain to be converted. That guarantee will be proportionally forfeited if the conversions do not take place according to the schedule that was presented and approved in the bidding process.

The conversion request that complied with the formal requirements was to be graded according to the formula: Grade = F/D, where F = Matching Funds and D = Convertible Debt. The greater the additional capital, the higher the grade the request would receive. The conversions were to be on this basis. This aspect has been modified as well. As of February 1988, the decisive factor in the second stage is now "the percentage of reduction on the nominal value of the debt paper that the project agrees to accept in converting the debt into Australes," or discount. If, however, the total of tenders does not cover the bimonthly quota, all will be approved.[85]

The attractiveness of this scheme is the favorable exchange rate it offers. As of November 1987, quotes for Argentine public debt paper in the secondary market were 33–37 percent of face value. The scheme grants the investor the possibility of obtaining an effective exchange rate of 100 percent or higher.

An investor may, after the conversion is decided, solicit the conversion of the interest that is due at the time of the conversion. Both interest and principal are to be deposited in a local intervening bank. The effect of the deposit is to extinguish the external obligation that has been converted. The funds deposited are freed according to: (1) the completion of the

85. *See* EUROMONEY, *supra* note 78, at 82.

different stages of the investment project for which they were approved by the intervening authority; (2) the entry of the Matching Funds according to the initial arrangement; and (3) compliance with the specified ratio between Matching Funds entered and converted funds freed. As each stage is performed, the guarantees for the conversion of debt and for the entry of Matching Funds (if they exist) will be proportionally reduced.

Finally, the program contemplates the participation of a local intervening bank that acts as a supervisor of the execution of the project. That bank is responsible to Banco Central for keeping a file for each investment project. In case of nonperformance by the investor, sanctions may amount to the loss of the guarantees and of the right to continue with the project or the conversion, depending on the case. Justifications may be considered by the authorities, who as a whole will follow the general principles contained in the Argentine Republic 1987 Financial Plan in the interpretation of these regulations.

VIII. Conclusion

Some essential aspects of the Argentine external debt process have been described. Others have been omitted for reasons of brevity, but are certainly relevant (i.e., capital flight, rescheduling with the Paris Club, and co-financing).

Argentina's case is not unique among Third World countries. Due to its social and economic characteristics, however, its chances of development should be greater than those of many other lesser developed countries. The debt, as it stands today, is a serious impediment to any possible economic growth and, at the same time, threatens the political stability of the newly established democratic government. The traditional powers of sovereign nations under classical international law—such as the freedom to elect a social, cultural, and economic system—have been severely undercut by the present restriction on the use of the country's resources.

Trade conditions are an essential part of possible improvement. All the industrialized countries must respond to the need for increasing imports from lesser developed countries, whose products have been largely excluded from the benefits of free trade and comparative advantage. Until more adequate solutions are achieved, and while countries are forced to mortgage their future, there seems to be little chance of promoting "social progress and better standards of life in larger freedom."[86]

86. U.N. CHARTER preamble.