

Argentina's debt crisis

May 2020



Summary

In 2016 the Argentine government of Mauricio Macri borrowed \$6.5 billion to pay off US-based vulture funds. The move, which delivered huge profits to the vulture funds, was the start of a huge stream of external private sector lending to the government of Argentina from 2016 to 2018. Interest rates on these loans were 6-8%, far higher than interest paid for similar loans to Western governments.

Much of Argentina's debt is owed in foreign currency, making the country more vulnerable to external economic shocks. When the lending boom stopped in mid-2018, the peso collapsed, causing rapid inflation, recession and a new debt crisis. In mid-2018, the IMF agreed a \$44 billion bail-out package: its largest ever loan programme to any country. However, because the IMF didn't require any debt restructuring before issuing the loan, or the use of the capital controls, the bail-out funds received simply left the country in the form of debt interest and principal payments and capital flight.

Argentina now has a clearly unsustainable debt situation with high debt payments due to the private sector for years to come, alongside large debt payments to the IMF due in 2022 and 2023. In late-2019 Macri's government finally accepted the need for capital controls and a debt restructuring. However, before implementing either, he was beaten by Alberto Fernandez in the October Presidential election. New Economy Minister Martin Guzman has called for a deep debt restructuring with both the private creditors and the IMF. In February 2020, the IMF finally accepted that Argentina's debt is unsustainable, and that a meaningful debt reduction is needed from private creditors.

Private creditors lent recklessly to Argentina at high interest rates, contributing to an unsustainable lending boom which has now bust. The onus is now on these creditors to take responsibility for their role in Argentina's new debt crisis and accept Argentina's proposals for a deep debt restructuring. The IMF broke their own rules in effectively bailing out previous lenders and enabling capital flight through their loan programme. They should acknowledge the mistakes they made in the Argentina loan programme, accept that this means they also need to write-down in Argentina's debt owed to them, and adopt clear guidelines to ensure they implement their own policy of only lending to countries in debt crisis if a debt restructuring or default takes place.

1. Background: Argentina's battle with the vulture funds

Argentina's recent run of debt crises began in the 1970s. From 1976 to 1983, Argentina was run by a military dictatorship which ran a 'dirty war', killing or disappearing between 9,000 and 30,000 people. Political parties and trade unions were banned, whilst religious groups had to apply for approval with the state.

Between 1976 and 1983 the military dictatorship was lent \$21 billion, compared to \$6 billion in the previous eight years. As with many countries at the time, the main lenders were private banks, awash with dollars needing to be lent out due to the high oil prices. Lenders to the military regime also included the UK government, who backed loans for Argentina to buy two warships, two helicopters and missiles, which were later used in the invasion of the Falkland Islands (see Box 1 below).

An Argentinian court case in 2000 found that loans to Argentina under the dictatorship were part of “a damaging economic policy that forced [Argentina] on its knees through various methods ... and which tended to benefit and support private companies – national and foreign – to the detriment of society”.

At the start of the 1980s, the US government increased interest rates on the dollar. At the same time, global recession led to a collapse in prices for Argentina’s commodity exports. The increase in interest rates and fall in revenue from commodities led to a debt crisis for many countries, including Argentina. However, Argentina continued to pay its debts, supported by bailout loans from the IMF and World Bank. This prevented the foreign banks which had lent the money from being bankrupted.

Poverty and inequality in Argentina increased dramatically. Between 1986 and 2002, the number of people living on less than \$5.50 a day increased from 1.5 million to 16.7 million.¹

On Christmas Eve 2001 Argentina stopped paying its debts and devalued the peso. For the first three months after the default, the economy continued to decline. But after a further currency devaluation and introduction of capital controls to prevent money leaving the country, the economy began to grow rapidly again. Welfare payments were increased to help the poorest cope, while non-IMF approved taxes on exports and financial transactions were introduced to increase government revenue. Poverty levels began to fall immediately, and by 2013 the number of people living on less than \$5.50 a day was down to 3.5 million.²

In 2005, Argentina finally reached a deal with its creditors, where it agreed to pay 35p in every pound that was owed. Vulture funds refused to take part in the debt restructuring. Instead, they brought court cases demanding full payment on debts they had bought cheaply when other lenders were selling them off during the crisis. In 2014, two vulture funds - NML Capital and Aurelius - got a New York judge to rule that unless Argentina paid the vulture funds in full, it was not allowed to pay any of its creditors. The Argentinian government at the time, under President Cristina Fernández, refused to pay the vulture funds huge profits, so instead it was forced to stop paying its other private lenders.

2. The lending boom from 2016 to 2018

The Fernández government lost the election in 2015, and in 2016 the new government under Mauricio Macri agreed to pay off the vulture funds. Under the deal, Argentina agreed to pay the vulture funds \$6.5 billion.³ This meant the vulture funds received 75% of what they were claiming, which amounted to all of the face value of the debt plus some of the interest and charges. This was a huge amount more than other creditors had received, and it is estimated that it delivered the vulture funds a profit of over 1000% of what they paid for the debt. Martin Guzman, then of Columbia Business School, estimated that vulture fund NML Capital paid \$48 million for some bonds it bought in 2008 and received approximately \$620 million for those bonds, a profit of almost 1,200%.⁴

¹ World Bank. World Development Indicators database.

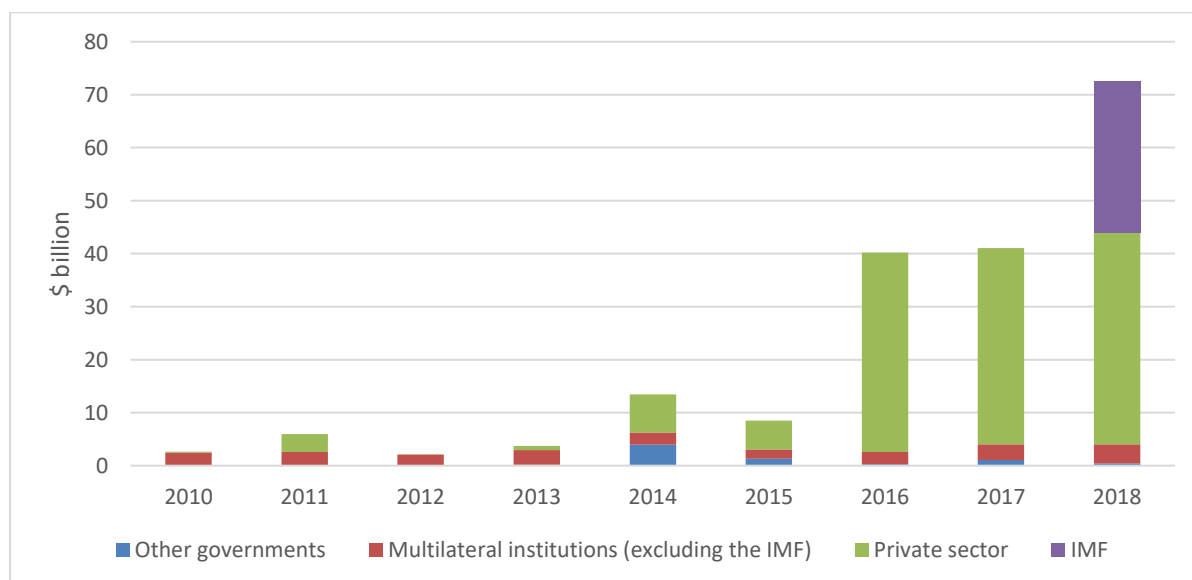
² World Bank. World Development Indicators database.

³ <https://money.cnn.com/2016/02/05/news/economy/argentina-makes-official-offer-to-hedge-funds/>

⁴ http://www.nytimes.com/2016/03/01/business/dealbook/argentina-reaches-deal-with-hedge-funds-over-debt.html?_r=2

Argentina funded the vulture fund pay-off by borrowing through new bond issuances. The Macri government chose to borrow significantly more than it needed to pay off the vulture funds. In April 2016 it borrowed \$16.5 billion through bonds owed in dollars, with interest rates of 6.25% - 7.62%.⁵ This was the start of a two-year lending spree to Argentina. In total, between 2016 and 2018 the Macri government borrowed \$115 billion from external private lenders. By 2018, it was paying \$10 billion a year just in interest to external private lenders.⁶

Graph 1. External loans to government of Argentina, by creditor, 2010 - 2018⁷



3. The debt crisis and IMF bailout of lenders

In May 2018 the Argentine peso began falling in value against the dollar. In just five months it lost over 50% of its value. The loss of confidence in Argentina may have been triggered by concerns over a drought reducing agricultural exports, but once it began it became a self-fulfilling prophecy. The fall in the value of the peso led to more foreign exchange leaving the country as speculators panicked that their pesos would be worth less, leading to increases in the relative size of foreign currency denominated debt, leading to further falls in the peso.

The economy entered recession, shrinking by 2.5% in 2018 and by 3.1% in 2019. The falling value of the peso caused inflation to soar, averaging 54% in 2019. The central bank increased interest rates rapidly to try to keep money in the country and stabilise the value of the peso, but this contributed to the recession. Meanwhile, no capital controls were introduced, so money was allowed to keep flooding out of the country. Poverty has started rising again – the number of people living on less than \$5.50 was up to 4.3 million in 2018, the latest year with figures available.⁸

In June 2018, the IMF agreed to lend up to \$56 billion over three years to Argentina. This was the IMF’s largest ever loan agreement to any country. Under IMF rules, the Fund is not supposed to lend to countries with unsustainable debts unless there is a debt restructuring or default. However, for middle income countries like Argentina there is no clear mechanism to assess debt sustainability. At the time, the IMF judged Argentina’s debt to be “Sustainable, not with a high probability”. This was

⁵ <https://www.reuters.com/article/us-argentina-bonds-bids/argentina-returns-to-global-debt-markets-after-15-years-idUSKCN0XG2W0>

⁶ World Bank International Debt Statistics database.

⁷ Calculated by Jubilee Debt Campaign from World Bank International Debt Statistics database, February 2020.

⁸ World Bank. World Development Indicators database.

despite it projecting that external debt service would reach 25% of government revenue and 47% of exports in 2019 – well over the thresholds the IMF uses to assess debt sustainability for low- and lower-middle income countries.

Furthermore, IMF loans are not supposed to be used to fund capital flight out of a country. The Fund's Articles of Agreement state "the Fund may request a member to exercise controls" to prevent its general resources being used to meet a large or sustained outflow. However, this was not done, so the foreign exchange lent by the IMF to Argentina effectively allowed interest to external creditors to keep being paid, and capital flight by both local and foreign investors.⁹

4. Debt restructuring finally accepted

In August 2019 the Macri government finally admitted it needed to restructure the external private debt, and also said it needed to delay payments on the IMF debt. In September 2019 Argentina finally introduced capital controls. With \$44 billion of the \$56 billion of IMF loans disbursed, the lending of the remaining \$12 billion has been suspended.

In October 2019, Alberto Fernandez of the Justicialist Party defeated Mauricio Macri in the Presidential election, with former President Cristina Fernandez de Kirchner becoming Vice-President. In December, economist Martin Guzman was appointed as Economy Minister.

The Argentine government is now seeking a deep restructuring of the country's debt. In February 2020 Martin Guzman told an Argentine Congressional hearing "It's necessary to have a deep debt restructuring," and "It's clear that there's going to be frustration on the part of bondholders."¹⁰ Also in February 2020, the IMF finally accepted that Argentina's debt is "unsustainable" and that "a definitive debt operation—yielding a meaningful contribution from private creditors—is required to help restore debt sustainability with high probability".¹¹

Defaults on debts to private lenders are expected as payment dates come due in 2020. Dollar denominated bonds coming due to be paid in the next few years are trading at less than half their face value.

5. Who the debt is owed to

According to the IMF World Economic Outlook, Argentina's total public debt is \$414 billion (93% of GDP), as of end-2019. From various sources we have been able to identify who \$378 billion of this debt is owed to. Over half the debt is owed in foreign-currency denominated bonds: \$120 billion of bonds issued by the Macri government after 2016, and \$87 billion from before this, a bulk of which is debt that was restructured in 2005 or 2010.

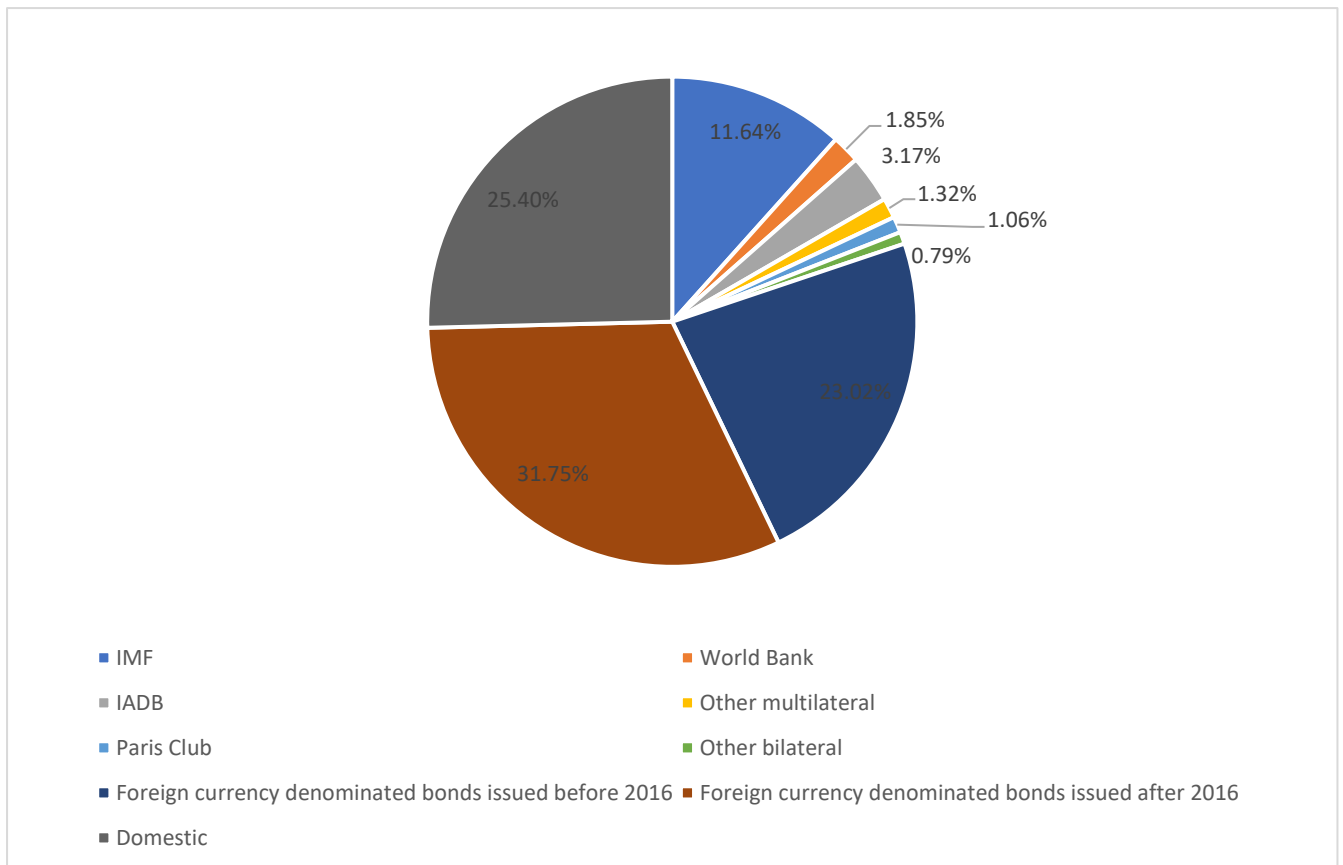
Around a quarter of the debt is owed in pesos, presumably primarily to Argentine financial institutions. Over 10% of the debt is owed to the IMF, with relatively small amounts owed to other multilateral institutions (6%), Paris Club governments (1%) and other governments (>1%).

⁹ <https://www.brettonwoodsproject.org/2019/10/why-did-the-imf-fail-to-take-pre-emptive-measures-in-argentina/>

¹⁰ <https://www.bloomberg.com/news/articles/2020-02-12/argentine-needs-deep-debt-restructuring-economy-minister-says>

¹¹ <https://www.imf.org/en/News/Articles/2020/02/19/pr2057-argentina-imf-staff-statement-on-argentina>

Graph 2. Estimate of Argentina’s government debt by creditor, 2019¹²



Based on figures in the IMF July 2019 loan review, we estimate that government external debt service¹³ reached 29% of government revenue in 2019 (\$43 billion), the highest since 2003, and 53% of exports.¹⁴

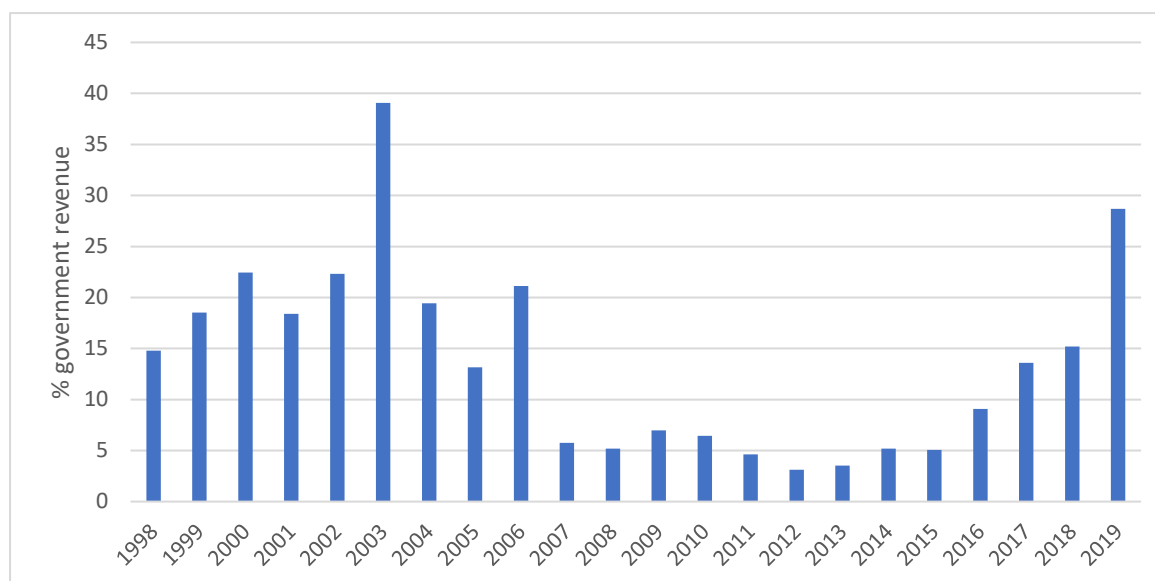
¹² Estimated by Jubilee Debt Campaign from IMF website, World Bank International Debt Statistics Reorg analysis, Paris Club website and <https://clsbluesky.law.columbia.edu/2019/12/03/restructuring-argentinas-sovereign-debt-navigating-the-legal-labyrinth/>

¹³ Debt service is both interest and principal payments

¹⁴ The IMF estimated that Argentina’s exports would be \$80.7 billion in 2019.

<https://www.imf.org/en/Publications/CR/Issues/2019/07/15/Argentina-Fourth-Review-under-the-Stand-By-Arrangement-Request-for-Waivers-of-Applicability-47116>

Graph 3. Argentina government external debt service, 1998 - 2019¹⁵



Box 1. Odious debt: The debt owed to the Paris Club

The \$3.8 billion of debt owed by Argentina to Western governments, known collectively as the Paris Club, has a long history, with some of it dating back to odious loans to the military dictatorship of the 1970s.

In particular, some of Argentina’s debt to the UK comes from loans to the military junta to buy two warships with accompanying helicopters and missiles. Following campaigning by Jubilee Debt Campaign, in 2012 the UK government admitted that 38% of Argentina’s debt to the UK comes from arms sales, all of which were prior to the return of democracy in 1983.

In 1979 then Foreign Secretary David Owen approved the sale of the Lynx helicopters. David Owen acknowledged that: *“Important questions of principle do anyway arise given the scope of size of potential arms sales to a regime whose human rights record is worse than Chile [which was under an arms embargo from the UK at the time], and which could come close to a confrontation with us over the Falklands.”*¹⁶

However, the Secretary of State went on to say in a letter to the Ministry of Defence: *“I think we must recognise that it is not possible to achieve complete consistency in our approach to this problem and that to attempt to do so would impose unreasonable constraints upon us. For instance, as you will know, we have already indicated that there is no Foreign Office objection to the sale of the Lynx helicopters ... I know it could be argued that these items would be relevant in any threat to the Falkland Islands, but we will never achieve perfect consistency.”*¹⁷

Both the destroyers and Lynx helicopters were used in the invasion of the Falklands in 1982.

¹⁵ For 1998 to 2017 figures are calculated from the World Bank International Debt Statistics and IMF World Economic Outlook. For 2018 and 2019 they are calculated from the IMF World Economic Outlook and <https://www.imf.org/en/Publications/CR/Issues/2019/07/15/Argentina-Fourth-Review-under-the-Stand-By-Arrangement-Request-for-Waivers-of-Applicability-47116>

¹⁶ Owen, D. (1979). Letter: Arms Sales to Argentina. Foreign and Commonwealth Office. 26/01/79.

¹⁷ Owen, D. (1979). Letter: Arms Sales to Argentina. Foreign and Commonwealth Office. 26/01/79.

Some of the debt was still outstanding in 2001 when Argentina defaulted on debt payments to the Paris Club as well as the private sector. Unlike most of the private sector, the Paris Club refused to negotiate unless Argentina began implementing IMF-prescribed policies. Argentina refused and remained in default to the Paris Club, until 2014.

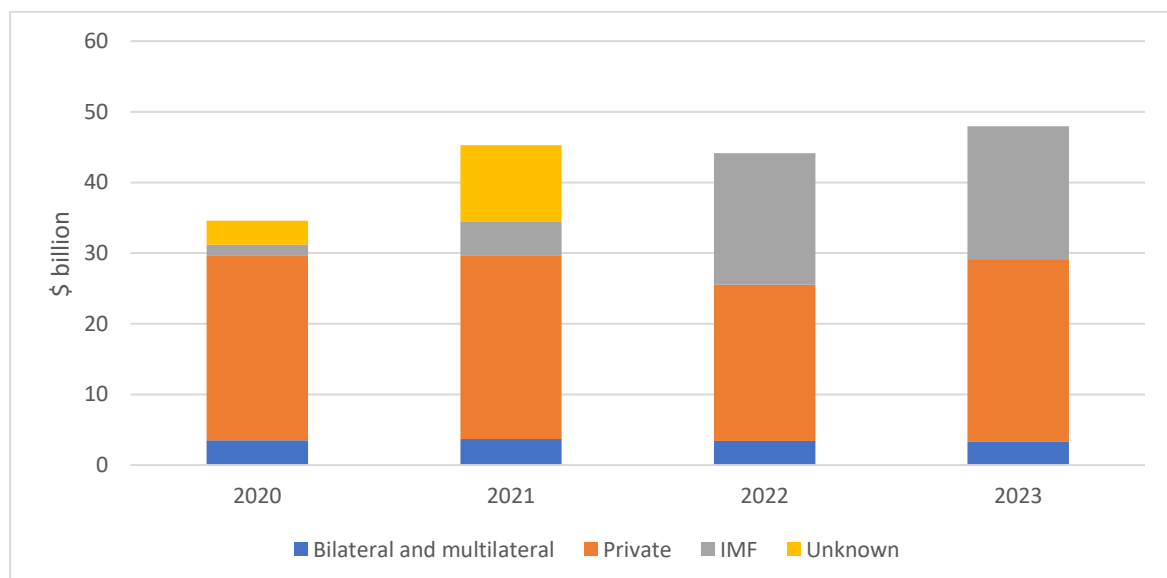
In 2014 the Argentinian government agreed to start repaying the debt to the Paris Club in full, plus an interest rate of 3%, which represented a huge return for the UK and other western governments over the reduction accepted by the private sector. Furthermore, the Paris Club insisted on a new clause in the debt payment agreement that if Argentina defaults on the Paris Club debt again, they will be charged a penalty 9% interest rate.

In 2014 almost \$10 billion was still owed to the Paris Club, but debt repayments mean this has now fallen to \$3.8 billion as of end-2018. \$41 million was owed to the UK as of end-2018.¹⁸ The rest of the debt is due to be paid in the next couple of years, though Argentina has requested rescheduling of payments and reduction of interest rates, as part of a comprehensive debt restructuring with other creditors. Loans to prop-up a despotic regime over 40 years ago still to this day contribute to Argentina’s debt crisis.

6. When payments are due

According to the IMF July 2019 loan documents, Argentina’s debt interest and principal payments due in 2020 are \$34.6 billion, rising to \$45.3 billion in 2021. The IMF does not provide figures for later years, but we have estimated them based on data from the IMF on payments due to it, and data from the World Bank International Debt Statistics. Overall, payments to the private sector are the most significant in 2020 and 2021, but large payments to the IMF are then due in 2022 and 2023.

Graph 4. Estimate of government of Argentina external debt payments by creditor, 2020 – 2023, \$ billion¹⁹



¹⁸ HM Treasury. Response to FOI request 2018/22277 08/01/2019

¹⁹ Estimated by Jubilee Debt Campaign from <https://www.imf.org/en/Publications/CR/Issues/2019/07/15/Argentina-Fourth-Review-under-the-Stand-By-Arrangement-Request-for-Waivers-of-Applicability-47116>, IMF website data on payments to the IMF, and World Bank International Debt Statistics

Table 1. Estimate of Argentina government external debt service, 2020 to 2023

	2020	2021	2022	2023
Government external debt service (\$ billion)	\$34.6 billion	\$45.3 billion	\$44.1 billion	\$48 billion
% of government revenue ²⁰	23%	28%	25%	25%
% of exports ²¹	50%	62%	58%	59%

7. Argentina's debt restructuring proposal

Argentina has proposed a debt restructuring with bondholders which would halt payments for three years, reduce interest rates on the debt from an average of 6.6% to 2.3%,²² and extend maturities.²³ Some private sector analysts have said this would reduce the present value of the debt to 30-35% of the face value. While they argue this is far too much for the private sector to accept, it is in line with the price Argentina's bonds are currently being bought and sold for.²⁴

8. Our position

We warned in 2016 that Argentina taking on more debt to repay the vulture funds risked another debt crisis. The creditors who participated in the 2016-2018 high interest lending boom must now take responsibility for their role in the current debt crisis. Furthermore, the Argentinian people should not have to face cuts in public spending and public services because of the irresponsible actions of the Macri government, the IMF and international lenders. Argentina's duty to meet its human rights obligations to its citizens, and accountability for the role of private creditors in the debt crisis trump any right the creditors have to be paid in full. They should accept Argentina's debt restructuring offer.

The IMF broke their own rules in effectively bailing out previous lenders and enabling capital flight through their loan programme. They should acknowledge the mistakes they made in the Argentina loan programme, accept that this means they also need to write-down in Argentina's debt owed to them, and adopt clear guidelines to ensure they implement their own policy of only lending to countries in debt crisis if a debt restructuring or default takes place.

The Paris Club were given a hugely beneficial debt repayment deal in 2014, and at least some of the debt owed to Paris Club members is odious. The Paris Club should accept Argentina's debt restructuring proposal, and should also cancel in full any debt which originally comes from loans for arms sales to the military dictatorship in the 1970s and 1980s.

²⁰ This is based on IMF World Economic Outlook projections for government revenue, which assume considerable growth from 2021 to 2023.

²¹ This is based on IMF projections in its July 2019 programme review, which assume considerable growth from 2021 to 2023.

²² <https://www.ft.com/content/bb1000b3-966d-4b4c-95c7-a6a3aeddc749>

²³ <https://www.reuters.com/article/us-argentina-debt/argentina-extends-65-billion-debt-deadline-as-hardball-talks-stoke-risk-of-default-idUSKBN22N1TN>

²⁴ <https://www.ft.com/content/2a46472b-7fb4-4fb0-ad3e-91ca980c7217>