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Guest post: why Argentina's behaviour must not be allowed to stand

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By Hans Humes and Diego Ferro of Greylock Capital Management

A decade-long battle stemming from Argentina's epic 2001 default has reached a critical stage. Courts recently required Argentina to uphold a promise in its bond contract to rank its debts equally, following years of orchestrated repudiation. The so-called pari passu case in New York is being closely watched across the world for the possible implications it could have for future sovereign debt restructurings.

Argentina and its defenders claim that if recent US court rulings against it are upheld, then other sovereign debt disputes cannot be resolved. They argue that an unfavourable court ruling will in effect prevent countries from tackling unsustainable debt burdens in the future.

But this argument misunderstands the fundamental issues raised by this case.

This case is not about sovereign restructurings in general. It is about the uniquely intransigent behaviour of one sovereign, and why that behaviour must not be allowed to stand.

The Institute for International Finance has identified four principles necessary for a successful sovereign debt restructuring: transparency, close debtor-creditor dialogue, good-faith negotiations, and fair treatment of all creditors. Since its \$80bn debt default in 2001, Argentina's leaders have consistently violated all of these principles.

After years of stalling, Argentina gave creditors a unilateral, "take-it-or-leave-it" offer that, despite Argentina's threats and ultimatums, only reached a 76 per cent acceptance rate. This was considerably lower than any restructuring where internationally accepted restructuring principles have been followed.

Some creditors, including official-sector creditors like the Paris Club, continue to reject Argentina's inadequate unilateral offers. Others, especially those without deep pockets, have had no choice but to accept. But to this day, repeated requests by Argentina's creditors to sit down and negotiate in good faith to reach an appropriate middle ground on the remainder of its defaulted debt have been met with either silence or insults.

Argentina's unique brand of intransigence is what led a US district court to rule last

February that Argentina violated its promise to rank creditors equally. Through subsequent appeals, including a Circuit Court affirmation of the district court, Argentina's president, Cristina Fernandez, has continually thundered that the country would not pay "one dollar" to the holdouts.

Argentina and its defenders argue that upholding and enforcing these rulings would embolden creditors to reject offers, making future restructurings more difficult. But in fact, there is no evidence that the recent court decisions against Argentina, which itself never made a good faith offer, will impede any ongoing or future sovereign-debt restructurings. Quite the opposite.

Late last year Greece negotiated a successful voluntary tender offer with its creditors. This year Belize reached a deal in principle with its bondholders. In both cases, IIF principles were followed, creditors agreed to take significant haircuts, and there was no discussion of using the recent US court rulings to "hold out". No other country has ever acted with the obstinacy of Argentina, and the current system for sovereign debt restructurings work.

The real concern raised by this case is what it might mean for other developing nations. If the courts were to vindicate Argentina's continued intransigence, then other nations would undoubtedly face scarcer credit and higher interest rates, imperilling economic growth and living standards. Creditors would be forced to adjust for the risk that these nations would emulate Argentina's behaviour.

Argentina itself has suffered the dire consequences that can occur when creditors do not believe that a sovereign will comply with – or that a court will enforce – its bond contract. The country has been locked out of international capital markets for over a decade, and its borrowing costs are four times higher than those of other nations with similar – or even worse – fiscal profiles. Worse, the inflexibility of Argentina's government has made it nearly impossible for local businesses, provinces, and individuals to access capital from external sources.

Far from being cause for alarm, the recent US court rulings against Argentina are a necessary line in the sand. By defining the outer boundaries of sovereign behaviour, they will encourage adherence to the IIF's principles for speedy and successful debt resolutions.

That alone would do a lot of good. But if the rulings also prompt the Argentine government to finally get its act together and start healing its self-inflicted wounds, then the biggest group of beneficiaries could be the Argentines themselves.

Hans Humes is chief executive officer of Greylock Capital, a firm that currently holds Argentine bonds. Mr Humes sat on Argentina's creditors committee. Diego Ferro is co-CIO of Greylock Capital.

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