PART IV

The Great Default: Argentina (1999–2005)

TWELVE

The Exception That Proves the Rule

On December 23, 2001, Argentina declared a unilateral suspension of payments on $82 billion in public debt, triggering the largest sovereign default in history. The sheer scale of the episode was staggering: as Latin America's biggest debtor, Argentina's bonds made up nearly a quarter of all emerging market debt traded globally.[1] The dramatic outcome of its crisis constitutes a remarkable contrast to the widespread debtor compliance of the 1980s and 1990s, and thus poses an interesting new research puzzle: if the trend after 1982 was for countries *not* to default on their external debts, then why did Argentina go against this historical dynamic by declaring a moratorium on its debt service? The observation seems all the more puzzling since, at the time, many observers were just beginning to argue that globalization had greatly increased the power of multinational corporations—and of global finance in particular.[2] Argentina's unilateral default, followed by its coercive debt restructuring and President Kirchner's scathing rhetoric against foreign creditors and the IMF, seemed to challenge some of these presumptions. Suddenly the dreaded and supposedly all-powerful "bond vigilantes" did not appear to be so omnipotent after all; apparently even a crisis-ridden peripheral debtor like Argentina was capable of challenging its foreign creditors and reneging on its external obligations. Noting this apparent discrepancy, some scholars have even explicitly posited the Argentine case as a challenge to the structural power hypothesis.[3]

Such narratives, however, largely pass over a crucial observation: Argentina's striking *over*-compliance in the months and years leading up to the default. In fact, right up until mid-2001, Argentina was widely considered to be a model debtor, resembling Mexico in terms of its commitment to repay. During the 1990s the country even became known as an IMF "poster child" and a darling of global capital markets. Presidents Menem (1989–1999) and De la Rúa (1999–2001) firmly insisted on full repayment and adherence to the Washington Consensus throughout their terms, also when the economy entered into stormy waters following the Mexican peso crisis of 1995, the East-Asian financial crisis of 1997–1998, the Russian default of 1998 and the Brazilian devaluation of 1999. Despite the fact that Argentina experienced a deep economic depression

that saw unemployment rates climb sharply from 14 percent to over 25 percent between 1999 and 2001, De la Rúa steadfastly refused to pursue a unilateral default strategy even as his opponents openly called for it, his approval rates fell to historic lows, and Wall Street, the IMF and the U.S. government all pressed him to face up to the inevitable and simply suspend payments and renegotiate the outstanding obligations.

Finally, in December 2001, there was a historic rupture. After De la Rúa was forced from office following a massive popular uprising and a wave of deadly riots, his interim successor immediately declared a moratorium on all public debt payments.[4] What explains this sudden switch from compliance to defiance? Clearly, a convincing explanation of the Argentine financial crisis should be able to account not only for the default itself but also the earlier *refusal* to default; in other words, it should account for both the country's over-compliance in the first three years of the crisis and for the ways in which this over-compliance finally gave way to noncompliance at the end of 2001. This chapter demonstrates how the process leading up to the largest default in history, far from challenging the structural power hypothesis developed in this book, actually confirms it. Argentina, in short, is the exception that proves the rule. To understand why, we have to take a closer look at what happened to the three enforcement mechanisms of debtor compliance over the course of the crisis. Initially fully effective, we will see in the next three chapters how each of them gradually broke down over the course of 2001, making a disorderly Argentine default not only possible but increasingly unavoidable. The fourth and final chapter of the case study then considers the consequences of these exceptional dynamics for the outcomes of the crisis, leading up to the highly coercive debt restructuring that was concluded by President Néstor Kirchner in 2005.

International Lending in the Lead-Up to the Crisis

The first crucial difference between the Argentine case and the Mexican case discussed in the previous section has to do with the structure of international lending. The resolution of the Latin American debt crisis of the 1980s by means of the Brady deal had allowed the commercial banks to swap their outstanding loans for bonds, which could subsequently be sold on secondary markets. The Brady restructurings thus contributed to the demise of syndicated bank lending and the return of securitized bond finance as the principal form of cross-border lending from the early 1990s onwards (see figure 12.1). Governments in Latin America and across the Global South still mostly interacted with the major Wall Street banks, but these banks no longer served as the principal creditors themselves. Instead, they acted as loan underwriters and financial intermediaries between the borrowing governments and international investors—often major financial institutions in the rich countries like hedge funds, pension funds,

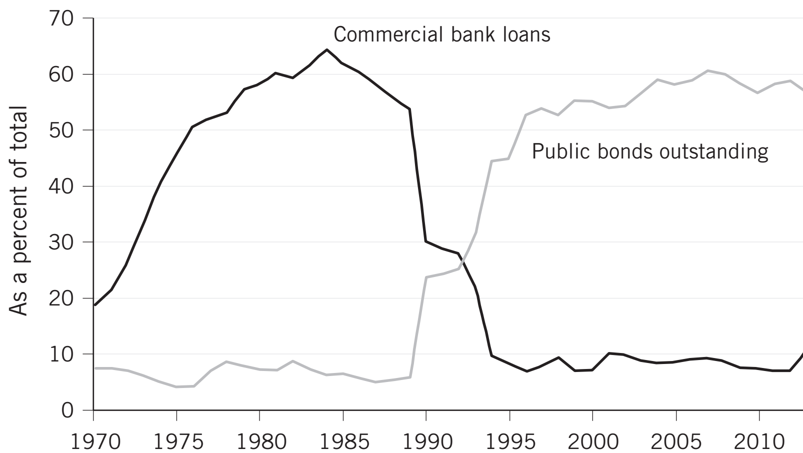

FIGURE 12.1. Bond issuance supplants bank lending, 1970–2013. *Source*: Kaplan and Thomsson (2017).
Note: Aggregate data for sixteen Latin American countries.

and mutual funds, but sometimes also retail investors, small savers, and individual pensioners.

The return to bond finance did not stop the steady growth in external indebtedness of developing countries (see figure 12.2). Argentina, in particular, began to attract large amounts of foreign credit and investment over the course of the 1990s (see figure 12.3). Even though the country had defaulted many times in the past and had been by far the most defiant debtor under Alfolsín in the 1980s, briefly suspending payments following the transition to democracy, it still managed to rapidly establish itself as an investor favorite under Alfolsín's successor Carlos Menem in the 1990s, attracting more international loans than any other developing country. As always, however, the boom was bound to turn to bust. Just like in the 1980s, Mexico was the first domino to fall, with a sudden fall in the value in the peso in 1994 rendering the country's external debts unsustainable, once more reviving the specter of a Mexican default. U.S. treasury secretary and former Goldman Sachs executive Robert Rubin responded to the Mexican peso crisis of 1994–1995 by orchestrating a record international bailout under strict policy conditionality.[5] Barely five years after the Brady deal had brought the last great developing country debt crisis to an end, the next one was already rearing its ugly head.

The repercussions of Mexico's debt troubles immediately threatened to spill over to other developing countries in Latin America and East Asia. Between 1995 and 1998, Argentina's financing needs doubled to $20 billion.[6] "With hindsight," economists Dominguez and Tesar would later note, "it is easy to see that

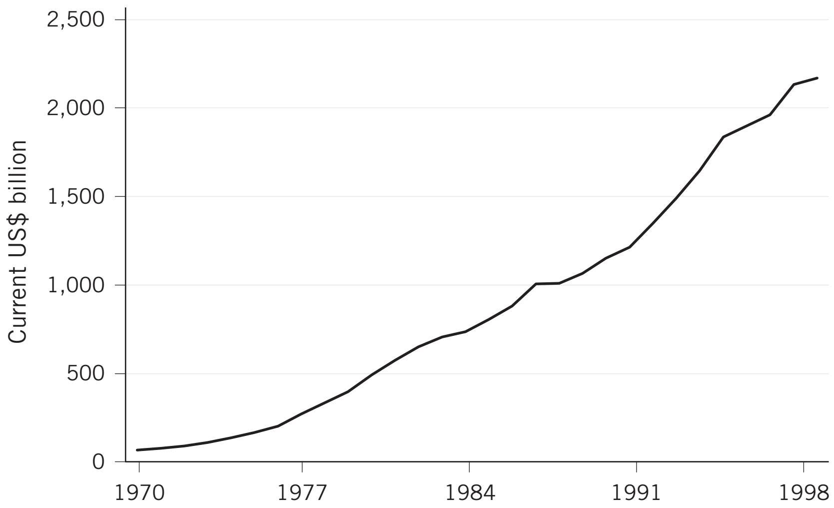

FIGURE 12.2. Total external debt of low- and middle-income countries, 1970–1999. *Source*: World Bank (2017).

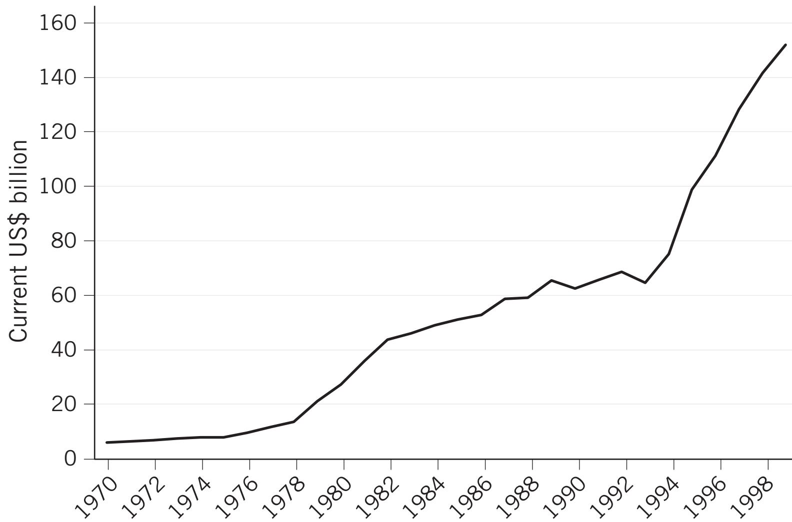

FIGURE 12.3. Argentina's total external debt, 1970–1999. *Source*: World Bank (2017).

Argentina's boom in the early 1990s . . . was in fact on precarious footing."[7] By 1998, the peso—whose value was tied to the dollar through the so-called Convertibility Plan, established by Menem's economy minister Domingo Cavallo in 1991—had become dangerously overvalued in real terms, undermining the competitive position of Argentine exporters, reducing export earnings, and depleting the foreign-exchange reserves that the country needed to service its dollar-denominated debts. These internal problems were further compounded by a sharp rise in interest rates as international investors panicked and lost their appetite for emerging market bonds in the wake of the East-Asian crisis of 1997–1998 and the subsequent Russian default. Meanwhile Argentina's total national debt, which had stood at $60 billion in 1989 when President Menem first came to power at the tail end of the previous crisis, reached $145 billion by the end of his second term in 1999. As a result, interest payments came to take up an ever-larger share of total public expenditure, reaching over a third by the time of the default (see figure 12.4). Unsurprisingly, this burden was starting to look increasingly unsustainable to the country's foreign lenders.[8]

After the presidential elections of 1999, Argentina's new president, Fernando De la Rúa, rose to power inside a monetary and fiscal straitjacket. Not unlike Greece's position inside the Eurozone today, the nature of the dollar-peso convertibility regime meant that Argentina was unable to adjust its exchange rate or print pesos to stimulate the economy or inflate away its debts. As a result, the growing interest rate spreads forced the government to choose between

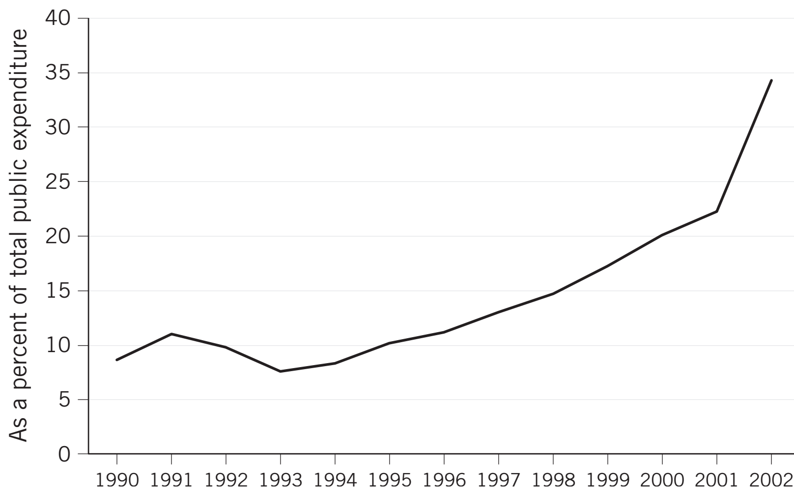

FIGURE 12.4. Argentina's interest payments as a share of total public expenditures, 1990–2002. *Source*: World Bank (2017); IMF, Government Finance Statistics Yearbook and data files.

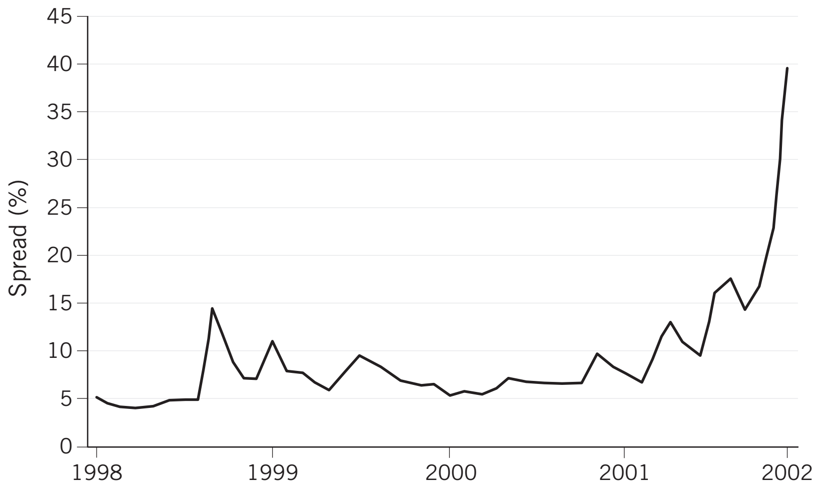

FIGURE 12.5. Argentine bonds' risk-spread (*riesgo país*) over U.S. Treasuries, 1998–2002. *Source*: Economist (2005); derived from Thomson Datastream, J.P. Morgan EMBI+ Argentina index.

Scylla and Charybdis: either it responded to the emerging fiscal crisis by halting payments on its external debt and suspending convertibility, or it pursued an internal devaluation to avoid a disorderly default and external devaluation of the peso, requiring a severe fiscal contraction and sharp wage reductions that in turn risked undermining aggregate demand and domestic welfare, further deepening the social and economic crisis in the process.

As investor confidence sapped and the so-called *riesgo país*—the risk premium Argentina had to pay on its bonds—rose sharply in the wake of the Russian default and Brazilian devaluation (see figure 12.5), De la Rúa found himself pushed towards the latter option, imposing ever more stringent austerity measures to reassure investors that the Argentine budget was under control.[9] As in the 1980s, market discipline effectively compelled the government to comply with investor demands for austerity and debt repayment even in the absence of a formal IMF program. Like their Mexican counterparts before, Argentine policymakers feared that noncompliance would cause foreign creditors to stop all loans, with crippling short-term consequences for the domestic economy.[10] Cavallo explicitly expressed a concern that "seeking meaningful debt relief meant losing access to domestic and external credit and immediately moving into fiscal and external balance."[11]

But in the context of the return to bond finance, this observation does raise an important question: why did the Argentine government express similar fears of a credit cutoff as the Mexican government, if the dominant form of international

lending in the 1990s occurred through bond finance? If bondholders are really so much more difficult to organize than international bank syndicates—which was, after all, one of the key lessons from the comparison between the 1930s and the 1980s—then why did the bond market turmoil of the late 1990s not lead to more widespread sovereign default? During the Mexican peso crisis of 1995 and the East-Asian financial crisis of 1997–1998, developing countries and international financial institutions largely pursued the same orthodox policy response as they had in the 1980s; indeed, in many respects the austerity measures and structural reforms imposed in the 1990s were even harsher.[12] Like most developing countries, Argentina itself was—at least in the first years of its crisis—extremely subservient to the expectations of foreign investors and the prescriptions of the Washington Consensus. What explains this initial compliance in a context of bond finance? Why did Argentina and other emerging market borrowers not simply defy foreign bondholders as they had in the 1930s?

Again, a big part of the answer appears to lie with the key players dominating the international lending game in the 1990s, especially the big U.S. investment banks managing emerging market bond sales, and the institutional investors—like pension and mutual funds in the United States and Europe—that ended up buying these securities. In fact, contrary to widespread perceptions about the decentralized nature of bond finance, global capital markets in the 1990s still retained an important degree of hierarchy and centralization, with Wall Street giants like Goldman Sachs, Morgan Stanley, and Crédit Suisse–First Boston playing a key intermediary role in the marketing of emerging market bonds. In his authoritative account of the crisis, investigative journalist Paul Blustein notes that a small number of brokerage firms

> competed fiercely for "mandates" to be lead managers of government bond sales, especially in Argentina. . . . They found plenty of customers for the bonds in the United States and other wealthy countries among professional investors managing the hundreds of billions of dollars held in mutual funds, pension funds, insurance companies, foundations, and other large institutions.[13]

As long as emerging market borrowers continued to depend on a handful of U.S. investment banks to furnish them with access to institutional buyers of their government bonds, this hierarchical and centralized nature of international bond finance tended to ease creditor coordination and served to impose a degree of discipline on the debtors. After all, in the event of noncompliance, not only would institutional investors have had an incentive to divest from their high-risk bonds, but most importantly the powerful Wall Street investment banks would also have refused to continue marketing new bonds as a safe and lucrative investment, causing government borrowing costs to shoot up and robbing the country of its primary source of foreign financing. In this respect, at least, the centralized and investment-bank-dominated bond finance of the

1990s resembled the syndicated bank lending of the 1970s and early 1980s; the key difference being that sovereign bonds can easily be sold on secondary markets, providing institutional investors with an exit option and the ability to reduce their exposure in anticipation of a potential sovereign default.

This exit option proved to be particularly important in Argentina, once it became increasingly clear over the course of 2001 that the country would never be able to honor its towering debt load in full. As the government's creditworthiness began to be called into question, foreign pension and mutual funds grew increasingly wary of holding Argentine bonds as part of their portfolios. The result, Anna Gelpern notes, was that "the identity of Argentina's creditors . . . changed over time. . . . In the mid-1990s, Argentina borrowed chiefly from foreign institutional investors. As the recession wore on and institutional interest wore thin, Argentina tapped unprecedented numbers of European, and to a lesser extent Asian, retail investors."[14] The result was a stark change in the ownership structure of Argentina's external debt, the importance of which—as we will see in greater detail later—is difficult to overstate.

The Return of the Collective Action Problem

By mid-2001, it was clear to most Wall Street financiers that Argentina would soon have to declare itself incapable of servicing its towering foreign debt load. As this realization finally dawned, the U.S. investment banks moved in to orchestrate an obscure debt rescheduling deal aimed at buying the country's government and its big bondholders some much-needed time before the inevitable default. In May that year, Crédit Suisse–First Boston and seven other international banks joined together in a consortium that took the initiative to present Economy Minister Domingo Cavallo with a notorious refinancing scheme that became known as the *megacanje*, or "megaswap"—a deal that would exchange Argentina's maturing bonds with new ones carrying longer maturities but also much higher interest rates.[15] The megaswap thus postponed $15 billion in bond payments falling due in 2001, buying the De la Rúa administration some much-needed fiscal breathing room and pushing the moment of reckoning back until after the next presidential elections.

But in the process, the same deal also loaded the country with much higher interest payments and a growing debt burden in the long run. According to Blustein, the swap "ranks among the most infamous deals that Wall Street has ever peddled to a government—and with good reason: for [Crédit Suisse] and a half dozen other Wall Street firms, the megaswap would be a bonanza. . . . For Argentina, it would be a bust, rendering the country's solvency even more questionable than it was already."[16] The successful conclusion of the megaswap, however, raises a crucial question. In the words of political scientist Paul Lewis, "Why would the big international bankers agree to such a deal, knowing in

advance that Argentina would never pay up?" The answer, he suggests, has to do with the ongoing shift in the ownership structure of Argentina's debt:

> The composition of Argentina's creditors had changed. Back in the early 1990s, when Cavallo first became economics minister, he had had to deal with only a handful of powerful financiers to get what he wanted . . . , while big mutual fund and pension fund managers in the United States were eager to buy. By the end of the Menem period, however, those fund managers were becoming leery of Argentina's prospects, so the big brokerage houses turned to Europe, where regulations protecting small investors were less strict. There, most individual investors bought stocks and bonds through their local banks. . . . Thus, the big international brokerage houses succeeded in "atomizing" the risk of default by spreading it among literally hundreds of thousands of small investors in Italy, Germany, and the rest of Europe (and Japan), who bought into high-interest-bearing "emerging market" mutual funds through their pension plans. "That's what kept Argentina going," said an emerging market bond manager at Metropolitan Life Insurance Company. "Those poor suckers didn't have a clue as to what they were buying."[17]

By atomizing Argentina's creditor base, the megaswap had far-reaching consequences for the ability of the new bondholders to organize collective action among themselves. While the syndicated bank lending of the 1980s and Argentina's hierarchical and centralized bond finance of the 1990s had interlocked creditor interests by concentrating foreign government debt in the hands of a few systemically important repeat players, thereby easing the internal coordination of a coherent creditors' cartel, the dispersion of Argentina's bondholders over the course of 2001 brought back painful memories of the 1930s, when disorganized and geographically scattered small investors failed to walk the fine line between disciplining sovereign borrowers through the credible threat of a credit cutoff while simultaneously keeping them in the lending game through coordinated debt roll-overs. Anne Krueger, who served as the IMF's deputy managing director during the Argentine crisis, observed a stark contrast between the "generally orderly" crisis management of the 1980s, and the chaotic and unpredictable crises at the turn of the century, in which investors "were increasingly numerous, anonymous, and difficult to coordinate," just as they had been in the interwar period.[18] Miguel Teubal, an economist at the University of Buenos Aires, confirms this observation:

> Through this mechanism [of selling government bonds on the secondary market] the foreign banks were divested of their exposure to Argentina's foreign debt, [which] was now transferred to individual bondholders, thus atomizing the foreign (and local) creditor universe. For this reason when default of foreign private debt was declared in early 2002, the main creditors affected were the retired and pensioners mostly of Europe and Japan that had been (ill-)advised by the banks to purchase Argentine government bonds due to their very high profitability.[19]

The breakdown of the international creditors' cartel—or rather, the existing cartel's success in passing on the risks and losses of a future Argentine default to an unorganized body of scattered retail investors—in turn helped to disarm the first enforcement mechanism of market discipline that had been so effective in the 1980s and that had, up to that point, served to enforce the compliance of the De la Rúa government. After the megaswap, however, Argentina was for all practical purposes excluded from international capital markets, and was now sending abroad more money in interest service than it was receiving back in further private financing (see figures 12.6 and 12.7). The Wall Street banks did not want to burn their fingers on further loans to a country that now seemed destined to default, and so they refused to float Argentine bonds until the government faced up to the necessity of a debt restructuring to render the country's enormous debt load sustainable. Meanwhile Wall Street started hedging its bets. By September 2001, it was clear to most of the international financial community that the Argentine government was on "the brink of default."[20] Anticipating a major credit event, the U.S. investment banks doubled down on their bets, not only embracing the inevitability of default but starting to aggressively push for a major debt restructuring. This is also the point at which the banks' hedge fund departments began swooping in on secondary markets to buy up the country's depreciated debt at mere cents on the dollar, hoping to land handsome profits from a widely anticipated future settlement—a point to which we will return in chapter 15 on the outcomes of the crisis.

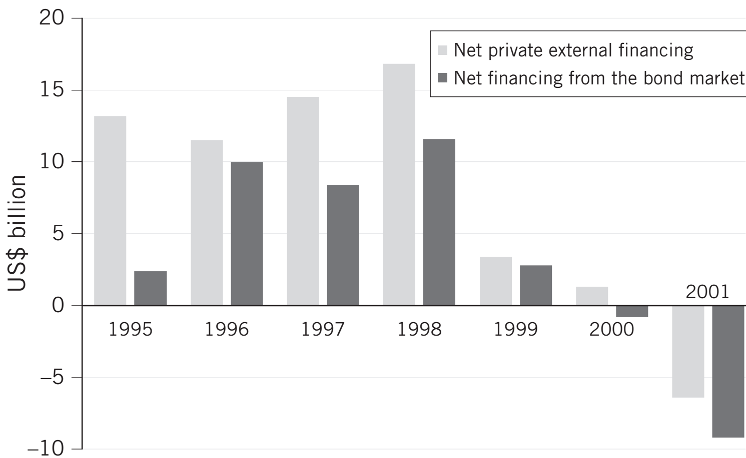

FIGURE 12.6. Argentina's access to private sources of financing, 1995–2001. *Source*: Setser and Gelpern (2006); Government of Argentina (external debt statistics); and BCRA.

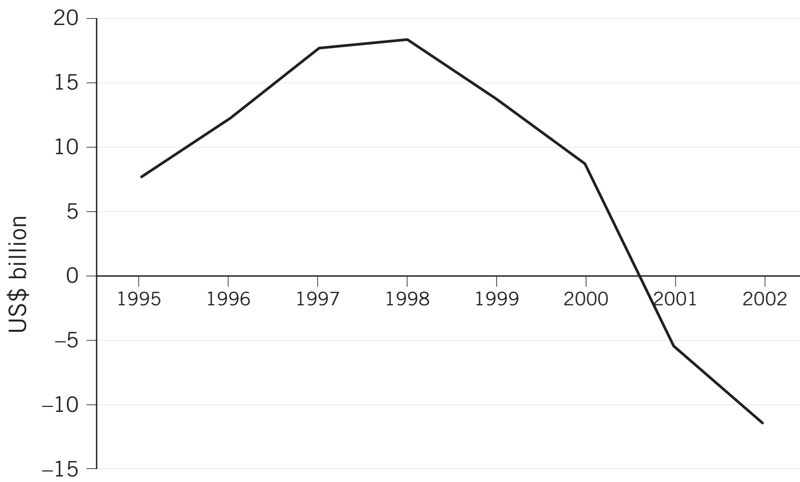

FIGURE 12.7. Argentina's net capital flows, 1995–2002. *Source*: Baer, Margot, and Montes-Rojas (2010).

In October 2001, a key meeting took place between IMF Managing Director Horst Köhler and the senior executives from some of the leading investment banks and institutional investors, including J. P. Morgan, Goldman Sachs, Citigroup, Crédit Suisse–First Boston, and AIG. According to one observer, the private financiers assembled at the meeting concluded that "Argentina was going to collapse and that nothing could be done to save it. A default was inevitable, and the best that the creditors could do would be to approve a restructuring under which they would voluntarily accept less than the face value of their claims."[21] As Paul Blustein emphasizes, "this was a remarkable moment. The major creditors of a country were effectively saying that the government should pay them less than they were owed, on involuntary terms."[22] But while the bankers' position may seem puzzling at first sight, their insistence on the necessity of an Argentine default had little to do with altruism: the lenders were simply hoping to restore Argentina's long-term creditworthiness, keep the country in the lending game and thus allow its government to come crawling back to the banks for further high interest loans after the anticipated debt restructuring. The losses from a haircut on the outstanding bonds, even in the form of a record-breaking and involuntary sovereign default, would be acceptable. After all, the principal institutional investors had already written down the remaining securities they still held on to; as long as Argentina could be prevented from repudiating its debts outright, they were unlikely to incur significant losses in any post-default debt restructuring. Indeed, their hedge fund departments might profit

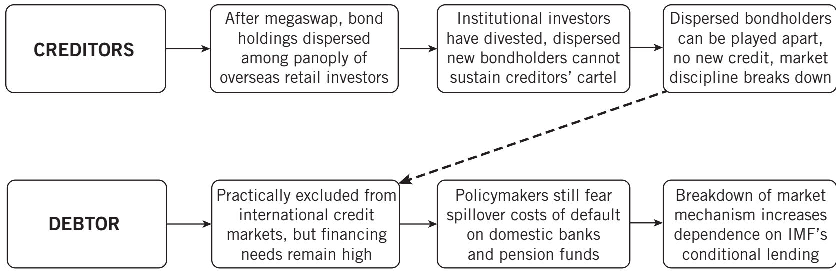

FIGURE 12.8. The first enforcement mechanism in Argentina.

handsomely from such a renegotiation, since they were now buying up the country's debts on secondary markets at sizable discounts.

By October 2001, Wall Street had not just reconciled itself with the impending default; it was actively pushing for it. The first enforcement mechanism of market discipline had broken down.

THIRTEEN

From IMF Poster Child to Wayward Student

The shift in Argentina's creditor composition over the course of 2001 was reflected in a comparable shift in the international financial community's stance towards Argentina. The role of the IMF was particularly important in this respect, and presents a second major contrast to the management of the Mexican debt crisis. As we saw in previous chapters, the Fund had played a crucial role in cementing the creditors' cartel and preventing a series of sovereign defaults in the 1980s debt crisis by disbursing credit facilities of last resort under strict policy conditionality. Together with the U.S. Treasury Department and the U.S. Federal Reserve, the IMF played an even more important role in the crises of the late 1990s, disbursing ever-larger international bailout loans and demanding even-stricter structural adjustments and austerity measures than before. Echoing the lessons from the 1980s, economists at the Center for Economic and Policy Research pointed out that "the role of the IMF is important, not so much because of its own resources or expertise, but because of its power—together with the U.S. Treasury Department—as head of a creditors' cartel that can deny Argentina access to sources of credit."[1] But if the International Monetary Fund had previously been so successful in wielding this threat of a credit withdrawal, then why did it not prevent Argentina's record default of 2001? Was it unable to stop it? Or did it not want to?

The answer, we will see in this chapter, was a combination of both. While the second enforcement mechanism of conditional IMF lending was initially fully operative, helping to enforce Argentina's compliance in the first years of the crisis, the outcome of the megaswap greatly reduced the risk of an Argentine default to the international financial system. Combined with mounting domestic opposition in the United States to further international bailout loans, this greatly weakened the IMF's capacity to impose fiscal discipline on Argentina, eventually leading the Fund to pull the plug on its own bailout program, causing the second enforcement mechanism to break down altogether. The following pages will recount the process through which this breakdown occurred.

The IMF's Evolving Role in the Crisis

The first thing to note about the IMF's role in Argentina is the fact that the Fund was severely weakened by the time the crisis came around at the turn of the century. Having greatly overextended itself during the developing country debt crises of the 1990s (see figure 13.1), the IMF not only faced scathing criticism and growing opposition from across the political spectrum—especially in the United States, the Fund's main contributor and its most powerful board member—but also carried sizable exposures to Argentina and several other emerging markets. The second thing to note is that, after the inauguration of George W. Bush in 2001, the U.S. government grew increasingly preoccupied with the War on Terror and increasingly hostile to the massive bailouts that had been pursued by the Clinton administration, leading to an isolationist stance with respect to international crisis management that was enabled by the convenient fact that U.S. financial institutions no longer had a dog in the fight. As we will see, the first development led to a growing *inability* of the IMF in the period leading up to mid-2001 to compel De la Rúa to stick to his fiscal targets, while the second led to a growing *unwillingness* among the IMF's main sponsors in Congress and the White House to keep Argentina afloat in the face of a default that was now widely considered to be unavoidable. The two dynamics conspired in November 2001 to lead to the withholding of a critical IMF credit

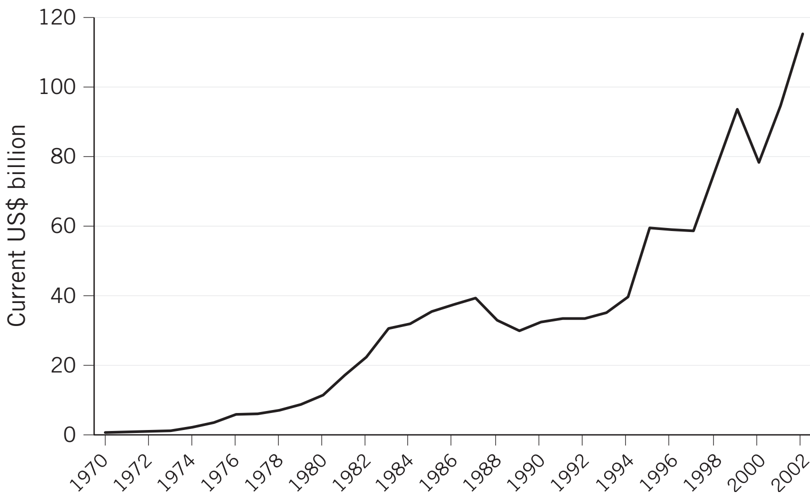

FIGURE 13.1. Low- and middle-income countries' use of IMF credit, 1970–2002. *Source*: World Bank (2017).

tranche on the grounds that Argentina had failed to live up to the conditions of its IMF Stand-By Arrangement. The severing of the Fund's official credit line set in motion a sequence of events that three weeks later finally ended in default.

The IMF's approach to Argentina thus underwent a change at least as dramatic as—and very much in line with—the simultaneous change in debt concentration and creditor composition. We can identify three distinct phases in this trajectory. The first, which covered Menem's presidency from 1989 until 1999, was marked by very close and cooperative relations between Argentina and the Fund. Throughout the 1990s, the international financial community enthusiastically sponsored the neoliberal agenda pursued by Menem and Cavallo, which "matched perfectly with the reigning economic ideology" of the IMF, World Bank, and U.S. Treasury.[2] As late as 1998, Menem was invited to address the IMF annual meeting in Washington, D.C., to share his views on responsible fiscal and monetary policy—a particularly ironic twist, since Menem's policies and Cavallo's convertibility regime largely laid the foundations for the subsequent debt crisis.[3] At this point, the representatives of Argentina's financial establishment resembled the technocratic allies of Mexico's bankers' alliance, working closely with U.S. and IMF officials to establish "a high degree of agreement on the economic policies to be implemented."[4] The IMF's managing director Michel Camdessus exclaimed that "in many respects the experience of Argentina in recent years has been exemplary . . . clearly, Argentina has a story to tell the world: a story which is about the importance of fiscal discipline, of structural change, and of monetary policy rigorously maintained."[5] As late as May 1999, when the contours of the impending crisis had already begun to emerge, the IMF Board of Directors declared that "Argentina is to be commended for its continued prudent policies," noting that "the sound macroeconomic management, the strengthening of the banking system and the other structural reforms carried out in recent years in the context of the currency board arrangement, have had beneficial effects on confidence."[6] Argentina, in short, was celebrated as an IMF poster child.

The second phase, which covered the first part of De la Rúa's presidency from 1999 onwards and the lame duck phase of the Clinton administration, was marked by a deepening of the recession, the escalation of fiscal pressures, and increasingly forceful attempts to stave off an Argentine default. At the same time, however, this phase was also marked by the waning influence of the IMF and its growing inability to enforce its loan conditionality on the Argentine government. In the United States, Republican opposition to the unprecedented U.S.-led rescue operations in Mexico, East Asia, Russia, Turkey, and Brazil (see figure 13.2) had begun to gather steam. From 1998 onwards, influential voices inside the U.S. political establishment began to call for the wholesale abolition of the Fund, and the Clinton administration struggled to convince Congress to increase the IMF quota.[7] As a result, the Fund became severely overexposed to emerging market debt, with Turkey, Brazil, and Argentina accounting for

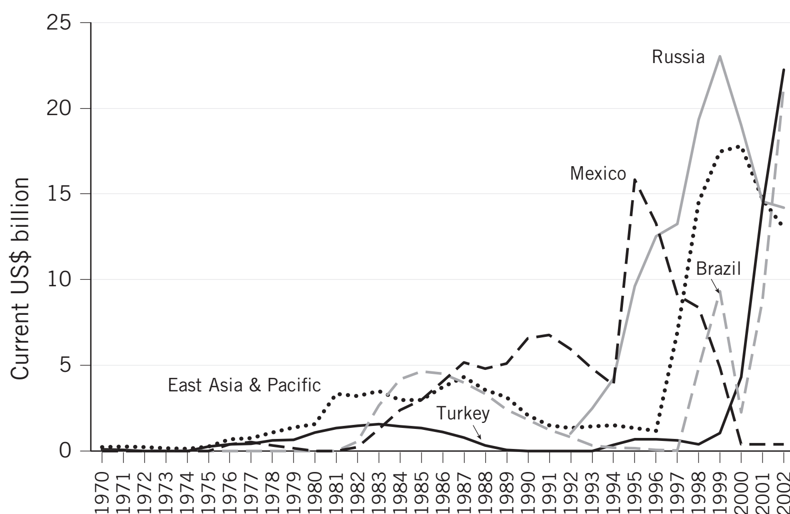

FIGURE 13.2. Use of IMF credit by selected countries, 1990–2002. *Source*: World Bank (2017).

73 percent of its outstanding liabilities at the end of the decade, and the IMF's reserves of $8.7 billion paling in comparison to the $16 billion in exposure it carried to Argentina alone.[8] All of this gave the Fund considerably less leverage over the Argentine government than it had enjoyed over the other developing country borrowers of the 1980s and 1990s.

Throughout this phase, however, the IMF nevertheless remained determined to avoid an Argentine default, working closely with the increasingly embattled economy minister Domingo Cavallo to keep the country in the lending game. Brad Setser and Anna Gelpern write that "Cavallo's core accomplishment was to draw on his considerable reputation [as a friend of the international financial establishment] to secure a series of additional injections of IMF liquidity to finance what turned out to be a classic gamble for resurrection."[9] In 2000 and 2001, the IMF disbursed several of the largest credit augmentations in its history (see figure 13.3), but even this failed to bring a halt to the investor stampede. Meanwhile, the IMF's top officials, who had not received advance notice of Cavallo's momentous megaswap, grew increasingly frustrated with the De la Rúa administration. Cooper and Momani note that the relationship "soured during this time as the Fund watched Argentina continue to announce policies that the IMF deemed 'misguided,' although these initiatives were overtly approved out of fear of a systemic collapse."[10] In September 2001, the IMF came to the rescue once again by adding another $8 billion lifeline to its Stand-By Arrangement from 2000; the third such augmentation in less than a year, bringing

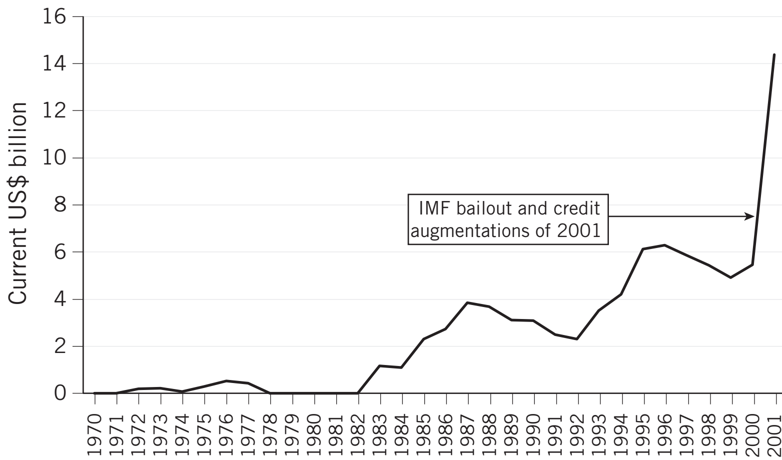

FIGURE 13.3. Argentina's use of IMF credit, 1970–2001. *Source*: World Bank (2017).

the total of extra credit to $22 billion. There now appears to be a broad consensus, including among the IMF's top economists, that these loan extensions constituted "the most contentious decisions regarding the IMF's involvement in the Argentine crisis."[11] Not only did the augmentations triple the Fund's exposure to Argentina and turn the IMF into the country's single biggest creditor; the Fund's own economists also held them responsible for "delaying the inevitable, postponing the default and amplifying the dislocation caused by the crisis."[12]

This period of muddling through finally gave way to the third phase, which covered the first years of the Bush administration and the final months of De la Rúa's presidency. At this point, the Fund's pent-up frustrations with Argentina turned to outright, full-blown hostility. First, as the economic performance of its former poster child grew from bad to worse, the IMF notably shifted its narrative. Whereas it had previously praised the fiscal discipline of the profligate Menem, it now began to blame the relatively compliant and technocratic De la Rúa for his fiscal ineptitude. This in turn reflected a change at the helm of the IMF and the U.S. Treasury. When the Mexican, East-Asian, Russian, and Brazilian crises struck during the Clinton administration in the 1990s, the Treasury and the IMF had prioritized firefighting over all other priorities—disbursing record international bailout loans under strict policy conditionality to keep the debtors solvent and servicing their debts. However, from Clinton's last treasury secretary Larry Summers on, the United States' interventionist role in international financial crises was gradually undermined from within by isolationist forces in U.S. Congress. In 1998, Republicans lawmakers had put up stiff resistance to a proposed $18 billion increase in IMF reserves to

protest Clinton's East Asian bailouts. The increase eventually passed—but only on the condition that Congress establish a commission to review the IMF's role in international crisis management. This gave rise to the Meltzer commission, chaired by the right-wing libertarian economist Allan Meltzer, an influential advocate for the abolition of the Fund.[13] In its final report, the commission urged a radical downsizing of the IMF. Given this context, it is perhaps no surprise that Bush's response to the Argentine crisis amounted to little more than "a placeholder with relatively modest upfront financial commitments that deferred hard decisions."[14]

Embracing the Inevitability of Default

After a new management took over at the Treasury and the IMF following the inauguration of George W. Bush, the international stance towards the Argentine government hardened. The new treasury secretary, Paul O'Neill, expressed his opposition to further bailouts while his undersecretary for international affairs, John Taylor, even argued for doing away with the IMF altogether.[15] Bush's chief economic advisor, Lawrence Lindsey, was also on record for his staunch free-market convictions; views that weighed heavily on the administration's response to the Argentine crisis, which on the one hand became ever more *laissez-faire* in its approach to emergency lending and on the other much tougher in terms of the conditionality it imposed on the debtor.[16] Javier Corrales writes that "the first sign of hard-line posturing came when Secretary of the Treasury O'Neill, shortly after taking office in 2001, chided Argentina publicly for getting in trouble because it never did its homework, essentially ignoring Argentina's reform record of the past decade and the role of external crises."[17]

Moreover, after the megaswap of mid-2001, the Fund decided that "the fire in Argentina would not spread, mostly because bondholders had protected themselves (more specifically, most U.S. bondholders had already sold much of their Argentine debt)."[18] Indeed, figure 13.4 shows how the holdings of U.S. investors accounted for only around 9 percent of Argentina's total outstanding privately held bonds at the time of the default in December 2001, much of which had already been written down or sold on to Wall Street hedge funds. Carmen Reinhart, the Fund's deputy chief economist at the time, tried to ease the contagion fears of her colleagues by reassuring them that an Argentine default would probably have only limited repercussions for other developing countries or the world economy more generally. As she co-wrote in a staff memo of the IMF research department on August 15, "a 'credit event' in Argentina is widely anticipated and has been (partly) discounted by the markets for some time. The possibility that a default by Argentina triggers a sharp reversal of capital flows to other countries in South America is therefore relatively small."[19] Another internal IMF report showed that, while a few Spanish banks might take a hit, the

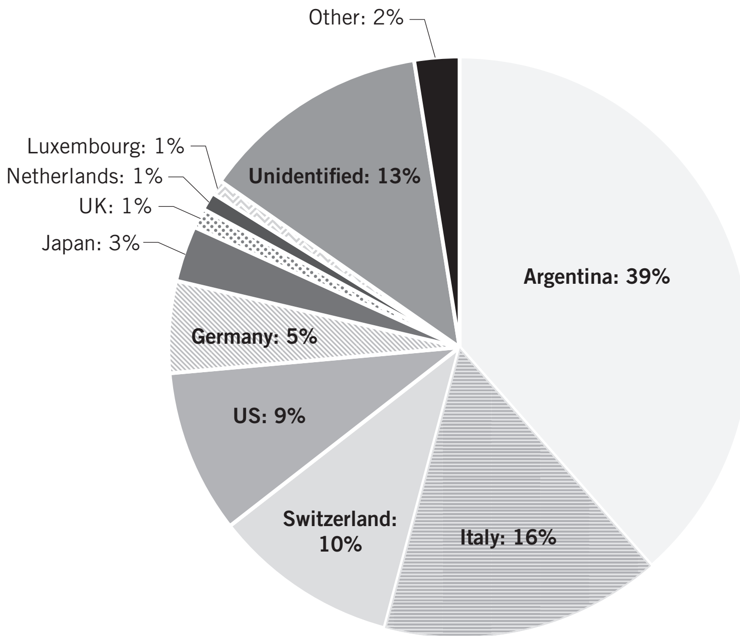

FIGURE 13.4. Ownership of Argentina's $82 billion privately held debt at time of default in late 2001. *Source*: Shapiro and Pham (2006).

risk of contagion and the threat to the international financial system were low.[20] At the same time, drawing on its past experience with currency devaluations in East Asia, the IMF had become convinced that Argentina's inflexible exchange rate had to go, which would in turn necessitate a sizable restructuring of the country's dollar-denominated external debt. None of this meant that Argentina would be granted any leeway, however; as the stance of the U.S. government and the IMF hardened, loan conditionality was only further ramped up.[21]

By now, influential economic commentators and leading figures in the U.S. financial establishment had already been openly expressing the inevitability and necessity of a default for quite some time. Back in March 2001, Columbia University economist Charles Calomiris and a group of Wall Street bankers had proposed that "Argentina declare itself bankrupt, request debt forgiveness, and start over with new policies intended to reward creditors only if its economy improved."[22] Calomiris was by no means a leftwing populist or Jubilee campaigner. Well-known in policymaking circles as a long-time champion of financial deregulation who kept the interests of Wall Street close at heart, Calomiris was convinced that there was only one way to keep Argentina in the lending game: by writing off a significant chunk of the debt. At this stage, "devaluation

and default were openly discussed (particularly in financial and academic settings in the United States) and there was a widespread opinion that the debt and the convertibility regime were not sustainable."[23] With the IMF itself heavily overexposed to Argentine debt, Horst Köhler, the Fund's new managing director, began to investigate the possibility of private sector involvement in the burden sharing. Paul Blustein reports that Köhler "raised the possibility that the IMF and the Argentine authorities should consider something like Calomiris's 'haircut' proposal for forcing creditors to accept reduced payment of their claims."[24] And so the IMF's economists began to prepare various default scenarios—"Plan Gamma"—as a possible resolution to the crisis.

In April 2001, Calomiris went public with his default proposal in a *Wall Street Journal* article entitled "Argentina Can't Pay What It Owes." In the piece, he specifically argued that most U.S. institutional investors had already sold off their Argentine bonds and therefore U.S. policymakers did not need to fear the consequences of even a disorderly Argentine default. Highlighting the fact that "US institutions are already 'underweight' on Argentine debt," Calomiris pointed out that, while Argentina accounted for some 25 percent of emerging market bonds in circulation worldwide, it only made up 10–15 percent of the portfolios of the large U.S.-based mutual funds and pension funds (note that this was before the megaswap; these ratios were even further reduced as institutional investors offloaded their Argentine bonds in the swap). The opinion piece elicited a strong rebuke from Economy Minister Domingo Cavallo, who shot back that "I have thought a lot as to why honest people may dare to write a recommendation as to how Argentina may default. Who could conceive such a destructive idea for a country, and be bold enough to propose it? . . . There is a complete misunderstanding (almost omission) of the costs that a compulsory restructuring of our debt would have."[25]

By October 2001, Héctor Schamis writes, "it was obvious to most analysts that Argentina would have to default on its debt, but Cavallo—some said with an eye on his ties to Wall Street—stubbornly refused to admit it."[26] The perceived inevitability of a default, however, was already turning into a self-fulfilling prophecy. On December 5, the IMF announced that it would be withholding its next $1.24 billion loan installment out of frustration with the government's failure to keep its budget under control. With the lender of last resort pulling the plug on Argentina's financial lifeline, there was little the government could do to prevent the downward spiral that, three weeks later, would force the country to declare the largest unilateral default in world history. In a final act of desperation, Cavallo seized the country's pension funds and transferred the proceeds to the national treasury, allowing the government to keep paying its bills and to once more extend the moment of reckoning. In a meeting with IMF officials on December 7, when it was clear to everyone in the room that Argentina had no other option but to suspend payments and exit the convertibility regime, Cavallo refused to even discuss the option with Fund officials.[27] And so

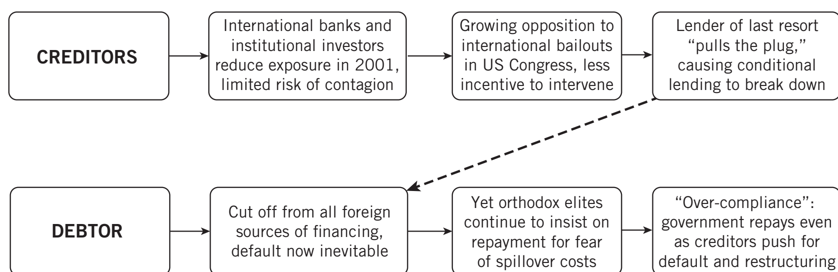

FIGURE 13.5. The second enforcement mechanism in Argentina.

the United States simply kept pushing Argentina further towards the abyss. “As if the message was not clear enough,” Cavallo later fumed in indignation, “Allan Meltzer visited Buenos Aires to tell [opposition leader] Eduardo Duhalde and most of the senators that the debt restructuring process which the Argentinian government was engaged in would not generate enough of a haircut and Argentina should simply default on all its debt.”[28] But Cavallo and De la Rúa would have none of it. In one of the most remarkable cases of overcompliance in recent financial history, the two men continued to defy the global financial community precisely by *not* defaulting. Both the first and second enforcement mechanisms had now broken down—but debtor discipline was so firmly internalized that the Argentine government continued to try everything in its power to repay a debt that everyone else now agreed was unpayable.

FOURTEEN

The Rise and Fall of the *Patria Financiera*

By the end of 2001, Argentina's external debt compliance had become a case of *incredible commitment*, in both senses of the term: in the sense that creditors no longer considered the government's commitment to honor its financial obligations credible, and in the sense that the government nevertheless continued to display an extraordinary commitment to continued debt servicing. After the dispersal of Argentina's bondholders in the megaswap and the IMF's decision to pull the plug on its own financial lifeline, the first two enforcement mechanisms had effectively broken down—yet De la Rúa and Cavallo continued to insist on full repayment. If Wall Street, the U.S. government, and the IMF were now all actively pushing for Argentina to suspend its debt service, why did the country's leaders not just get it over with and default? What drove De la Rúa and Cavallo to repay? And what was it that eventually produced the shift from overcompliance to default—and from there to Kirchner's outright defiance of foreign lenders? So far, we have merely explored the gradual breakdown of the *international* enforcement mechanisms of market discipline and policy conditionality; to answer the above questions, we will now need to take a closer look at the redistributive implications and the contentious politics of sovereign debt repayment inside Argentina itself.

This chapter traces the rise and fall of Argentina's version of the "bankers' alliance" over the course of the crisis. It shows how the state's growing dependence on credit over the course of the 1990s initially strengthened the position of those considered to be most capable of attracting foreign credit and investment, and fulfilling a bridging role to foreign lenders. As the crisis began to bite, however, the social costs of austerity and structural adjustment gradually eroded the legitimacy of the political establishment and the country's democratic institutions more generally, leading to mass demonstrations and a demonstrable shift in popular preferences from repayment to default. It was not until the end of December, however, that a citizens' revolt finally forced De la Rúa and Cavallo from office, causing the third enforcement mechanism of internalized discipline to break down. At that point, the interim government declared a unilateral suspension of payments in a desperate attempt to restore

a degree of legitimacy to the state apparatus by deflecting part of the costs of adjustment onto foreign bondholders. The popular uprising was therefore the final push that eventually made the inevitable unstoppable.

The Privileged Position of the *Patria Financiera*

Like most other countries, Argentina's political economy underwent a profound transformation in the last three decades of the twentieth century. In the early 1970s, the most important political faultline—apart from the divide between the authoritarian military and prodemocratic forces—had been the split between the leftwing and rightwing factions of the Peronist movement. The former advocated a *patria socialista*, a socialist homeland, while the latter advocated a nationalist and corporatist *patria Peronista*. The military coup of 1976 dramatically changed this situation. As in neighboring Chile, the left suffered bloody persecution at the hands of the *junta*, which killed, tortured, and imprisoned thousands while beginning to liberalize the economy.[1] But the end of import substitution and financial repression went hand in hand with the state's growing dependence on private credit and the rising indebtedness of the government to an increasingly concentrated domestic financial system. Schamis writes that "Argentines came up with the term *patria financiera* to refer to the main beneficiary of the liberalization process": the major banks and financial institutions of Buenos Aires.[2]

As in Mexico and other Latin American countries, financial elites grew increasingly influential during the debt crisis of the 1980s, as the state's dependence on credit increased. Their power arguably reached its peak under Menem and Cavallo in the 1990s. When the crisis of 1999 struck and the state's dependence on credit grew even more acute, the political advocates of the *patria financiera*—who shared foreign investors' interests and belief in fiscal stabilization, financial deregulation, the privatization of state assets, trade and capital account liberalization, deep economic integration into the world market, and the "soundness of money" guaranteed by the convertibility of the peso into the U.S. dollar—effectively monopolized economic policymaking, especially in the wake of the reappointment of Domingo Cavallo as economy minister. In this respect, Argentina's political trajectory in the first years of its crisis strongly resembled that of Mexico. Unlike in Mexico, however, the rise of the *patria financiera* and Cavallo's controversial policy response to the deepening financial crisis did not go uncontested by the general citizenry.

While the labor unions had been largely co-opted by the Peronist establishment and did not put up a very strong resistance to painful reforms and austerity measures, there was significant social mobilization and popular pressure from below to reverse Menem's neoliberal reforms and fight skyrocketing poverty and unemployment levels. The rise of the *patria financiera* in the 1990s

TABLE 14.1.
Consolidation and internationalization of banking system

	Dec. 1994	Dec. 1998	Dec. 2000
Total no. banks	166	104	89
No. foreign banks	31	39	39
No. foreign bank branches	391	1,535	1,863
Foreign share of total assets	15%	55%	73%
No. public banks	32	16	15

Source: Perry and Servén (2003); Central Bank of Argentina.

thus closely corresponded to the growing dependence of the Argentine state and economy on increasingly concentrated, centralized, and internationalized credit markets (see table 14.1), while its eventual demise was a direct outcome of both the severing of the IMF's financial lifeline and the deepening legitimation crisis that grabbed hold of Argentine society as the social costs of the crisis made themselves felt. As we will see, the economic depression that began in 1999 led to a complete loss of public trust in the political establishment and the post-1983 democratic order more generally, culminating into a dramatic popular uprising that finally forced out the *patria financiera* and paved the way for Argentina's historic default.

Just as in Mexico, the crisis started out with two conflicting positions on the debt question. Unlike under Mexico's one-party regime, however, these conflicting positions could be openly expressed in competitive democratic elections, with the Peronist candidate Eduardo Duhalde of the Justicialist Party calling for default in his 1999 campaign and Fernando De la Rúa, who led a coalition between his centrist Radical Civic Union and the center-left Frepaso, pledging "to pay the debt under all circumstances."[3] But as international financial pressures grew stronger in the wake of the elections, the victorious De la Rúa found himself stuck between a rock and a hard place. On the one hand, the markets and the IMF demanded far-reaching fiscal stabilization efforts, while on the other popular opposition to such austerity measures was growing stronger by the day. As the country entered into a vicious cycle of rising risk premiums, deeper budget cuts, a worsening economic downturn, and widening social unrest, there seemed to be little the president could do to rectify the situation: pleasing investors angered voters, and pleasing voters scared away investors. Still, investors clearly had the upper hand, compelling the government to pursue painful austerity measures that gradually eroded De la Rúa's standing at home. By 2000, even fellow party members began to openly air their opposition to the president's policies. De la Rúa's predecessor and party leader

Raúl Alfolsín, for one, lambasted the government for its fiscal orthodoxy and called for a unilateral moratorium, just as he had done following the transition to democracy in 1983.

Increasingly incapable of sticking to the IMF's fiscal targets and desperate to strengthen his weakening grip on power in the wake of a corruption scandal that had led to the resignation of the vice-president and left him politically isolated, De la Rúa decided in March 2001 to replace his economy minister with Ricardo López Murphy, a fiscal hawk and former IMF economist who, he hoped, could help restore private sector confidence. But when the $4.45 billion austerity package López Murphy announced upon taking office triggered a wave of student protests, the Bulldog, as the press liked to call him, was forced to retreat with his tail between his legs. As a result, research staff at the IMF began to lose faith in Argentina's ability to repay its debt.[4] Chief economist Michael Mussa believed López Murphy was the only person who could have credibly reined in government spending—and he had just been mowed down by popular protest.[5] Meanwhile, as wealthy citizens started withdrawing and expatriating their savings and a slow-motion bank run quietly gained pace, it began to dawn on people that "default was only a matter of time."[6] But De la Rúa, determined to avoid that outcome, pledged once more that he would honor Argentina's obligations in full. To add force to that commitment, the president did something remarkable: he turned to his political opponent Domingo Cavallo, against whom he had squared off in the presidential elections of 1999, and reappointed the controversial former economy minister to the position he had previously held under De la Rúa's rival and predecessor Carlos Menem.

The economic motivations behind Cavallo's appointment were clear. With his close relationship to domestic and international finance as well as the U.S. government and the IMF, the Wizard, as Cavallo was known, was the man deemed most capable of providing a bridging role towards foreign creditors. In fact, Cavallo was so beloved by investors that when President Menem had announced on January 29, 1991, that he would be appointing him as economy minister the first time around, the Buenos Aires stock exchange instantly shot up 30 percent in a single day.[7] As one commentator noted, the main reason why De la Rúa now reinstated his one-time rival was because "he was hoping thereby to gather political support from economic and financial elites, as well as to put in place a man whom he could trust to attack the deficit aggressively, foster growth, and service the debt."[8] As had been the case with Silva Herzog in Mexico before, the combination of Cavallo's reputation as a financial savior and his bridging role to foreign creditors provided the economy minister with immense political leverage, which he wielded to near-autocratic effect.[9] As Cavallo himself put it, with remarkable frankness about the purpose behind his second coming, "it was perfectly clear that President De la Rúa intended to appoint me as his economy minister in order to avert a default on the debt and to preserve the convertibility regime."[10]

Why, then, were De la Rúa and Cavallo so adamant to avoid default? One important reason is that, since a significant share of the country's massive debt load was in the hands of domestic investors and financial institutions, a default "would reduce the financial wealth of those Argentines who had invested in the debt—banks and pension funds as well as wealthy Argentines with offshore accounts."[11] It would also have led to the collapse of the country's financial system and would have forced the government to come to the rescue of the country's banks and large pension and insurance funds. The vast capital injections this would have required were impossible to undertake in the fiscal and monetary straitjacket of the convertibility regime. A default would therefore have forced the government to abandon the convertibility regime—a situation not unlike Greece's precarious footing inside the Eurozone today. This in turn risked reviving the specter of devaluation and inflation that so haunted not only the lower and middle classes—who always bore the brunt of price increases—but also the investor class, since inflation cancels out real interest. Moreover, the convertibility regime cemented Argentina's integration into the world economy and into the U.S. financial system in particular, enabling wealthy Argentines to invest and safely deposit their savings abroad. A default was therefore clearly not in the interest of the Argentine elite—and De la Rúa and Cavallo, as solemn representatives of the embattled *patria financiera*, were determined to avoid harming this key constituency at all costs.

As the crisis deepened, the health of the domestic financial system became a particularly important concern for De la Rúa's government.[12] Cavallo's chief economic advisor, Guillermo Mondino, points out that "the population was very much aware of the exposure the banks had to government securities," and hence even the slightest hint of a default would risk triggering a bank run.[13] Cavallo himself stated that he was deeply concerned about the adverse consequences a default would have had on the domestic economy: "I made it clear that I would by no means join the government to devalue the peso and to declare default on the debt because I considered that such measures would create chaos."[14] Specifying the kind of chaos he expected, Cavallo explicitly identified the spillover costs that would have rippled out through the transmission channel of the country's fragile and overleveraged financial system:

> Defaulting on loan repayments would temporarily ease the burden of public debt interests on budgets; however, it would automatically bring about the collapse of the financial system, cause the destruction of pension funds, and adversely affect savers and workers, because over 50 percent of the bonds issued by the national state and the provincial governments represented the assets of those institutions.[15]

In sum, the growing dependence of the state on foreign loans and investment, combined with policymakers' fears of the domestic spillover costs of default, tended to strengthen the hand of orthodox and creditor-friendly elites who

were seen to be capable of attracting sufficiently affordable credit, endowing them with a privileged position in economic policymaking and contributing to a gradual internalization of debtor discipline. The reason for Argentina's continued compliance, then, even after the first and second enforcement mechanisms had broken down, must be sought in its domestic political economy—in particular in the attempt by financial policymakers to shield domestic companies and wealthy elites from the consequences of a government default.

Legitimation Crisis and Antiausterity Protest

The problem for the government, however, was that three years of economic crisis and over a decade of relentless austerity and neoliberal restructuring had left an indelible mark on the already fraught relationship between the government and its own electoral base, and between the political establishment and the citizenry more generally. De la Rúa's failure to do anything about the economic collapse, combined with his embarrassing corruption scandals and his seeming indifference to the suffering of the Argentine people, caused presidential approval ratings to drop to unprecedented lows. While the president's popularity had stood at 70 percent when he had taken office in 1999, by October 2000 it had dropped to 32 percent and by June 2001 it had was down to 15 percent, easily making De la Rúa the country's most widely despised democratically elected president ever.[16] In fact, a Gallup poll in November 2000 found that only 11 percent of voters believed that the government was doing a good job economically, while nearly half saw no difference between the policies of De la Rúa and those of the thoroughly corrupt and deeply unpopular *caudillo* Carlos Menem, from whom the president had so desperately tried to distance himself all these years.[17]

But it was no longer just the government that people despised. The anger ran deeper: citizens had begun to question the very legitimacy of the post-*junta* democratic order as a whole. As one observer put it, "there was a widespread feeling, if an ill-defined one, that the people had been let down by the entire political class."[18] As the government grew ever more committed to its obligations towards foreign bondholders and ever less responsive to its own citizenry, a deep crisis of representation took hold that saw public trust in the political establishment and in democratic institutions whither and eventually collapse. Several Graciela Römer polls during Menem's presidency had already indicated a slide in public confidence in political parties: while only 24 percent of those questioned expressed some or much confidence in 1993, this fell to a mere 10 percent in 1999, while confidence in Congress as an institution fell from 31 percent to 13 percent.[19] These dynamics were further aggravated by the economic crisis, and in particular by Domingo Cavallo's often erratic and increasingly autocratic approach to crisis management.

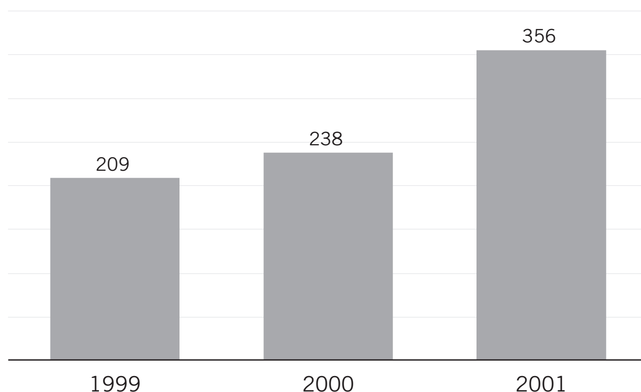

FIGURE 14.1. Frequency of strikes in Argentina, 1999–2001. *Source*: Tomz (2002).

Put simply, the majority of Argentinians simply lost faith in the established democratic process. Protests, strikes, and occupations took off across the country (see figure 14.1), and incensed citizens spontaneously began to attack government officials spotted in public. Social tensions reached a point where most politicians were too afraid to even go out for dinner or cross the street on foot. Senator Eduardo Menem, the former president's brother, was assaulted on an airplane; others were yelled and spat at in restaurants. According to another Graciela Römer poll taken around the congressional elections of October 2001, 70 percent of respondents were dissatisfied with political institutions.[20] The elections themselves were widely seen as a referendum on the government's economic policies. As Tomz points out, "all major parties addressed the default in their manifestoes, with some clinging to the status quo policy of payment and others seeking an immediate suspension of payments."[21] Eduardo Duhalde, representing the national-popular wing of the Peronist movement, restated the same default pledge he had made in the 1999 elections, and members of De la Rúa's Radical Party—including ex-president Raúl Alfolsín and De la Rúa's former cabinet chief, Rodolfo Terragno—publicly distanced themselves from the president by pledging a default on the external debt. Terragno even claimed to have made default "the leitmotif of my campaign."[22]

The outcome of the midterm elections (see table 14.2) was the clearest manifestation of the deepening legitimation crisis to date. Despite the fact that voting was obligatory, nearly a quarter of the electorate did not show up at the polls. Of those who did, an unprecedented 18 percent cast blank or spoiled ballots (the so-called *voto bronca*) in protest against the entire political class. Popular anger had now reached boiling point. One observer noted that "the cumulative social disillusionment with the [Radical Party] of Alfolsín, the [Justicialist Party] of Menem and the Alliance of De la Rúa gave rise to the idea that

Table 14.2
Outcome of 2001 midterm elections compared to 1997

	1997	2001	Change
Positive vote	72.51%	57.37%	-15.14%
Abstention	21.53%	24.54%	+3.01%
Blank vote	4.65%	8.11%	+3.46%
Spoiled vote	1.31%	9.98%	+8.67%

Source: Epstein and Pion-Berlin (2006).

there was no place within the structure of the Argentine political system for the representation of broad and diverse social demands."[23] The leading newspaper *La Nación* simply headlined that "the people do not feel represented." In addition to the widespread abstention and the large *voto bronca*, Tomz shows that those who did cast a positive vote "overwhelmingly favored candidates who did not want to repay the foreign debt."[24] Thus the prodefault Peronists (the Justicialist Party) became the biggest grouping in the Lower House, while retaining their control over the Senate. Federico Storani, a leading figure in the ruling anti-default Radical Civic Union, admitted defeat and called it a "plebiscite against the government's economic policy."[25]

Meanwhile, polls revealed that public opinion had largely turned in favor of a unilateral suspension of payments. According to one poll in the city and greater metropolitan area of Buenos Aires, only 28 percent of Argentines wanted their government to stay current on its debt obligations, while 63 preferred to declare a unilateral moratorium. Another found that only 5 percent considered repayment to be a priority, while support for a total repudiation of the debt more than doubled from 11 to 27 percent compared to the last elections of 1999.[26] But De la Rúa still refused to give in. In fact, he decided to swim right against the current of public opinion by insisting on even more austerity to prevent what he considered to be a "catastrophic" default. The president declared, "I am going to give over my life to this struggle. We discard the idea of a devaluation or default." Despite losing his Congressional majority and witnessing his party disintegrate before his eyes, De la Rúa stood firm in his insistence on the full and timely repayment of the national debt. In a televised address, he euphemistically stated, "I know that many are not content with the government or with the form of my management and style, [but] it is time to face reality. . . . Argentina will not fall into a cessation of payments."[27]

The president's obstinacy, and the complete disqualification of the political class as a whole, left many Argentines hungry for political change. Strikes and protests became not only more frequent but also more militant. In the period

between July and December 2001, the number of strikes per month tripled compared to the same months of the previous year. Tomz remarks that "the jump, sparked by a major new round of budget cuts and a 'zero deficit' plan . . . confirms that workers were becoming less tolerant of the austerity needed to continue servicing the debt."[28] Meanwhile, protesters blocked highways and major intersections, attacked government buildings, and on a number of occasions temporarily took officials "hostage" to demand public-sector jobs or unemployment benefits. As the government continued to lay off civil servants and cut salaries, pensions, and social security benefits, powerful social movements emerged across the country. Harvard economists Hausman and Velasco recount that "the new poor realized that their social collapse was unstoppable. They were going to carry on falling. It was at that point that new political actors appeared." Notably, these were "not the historical leaders of the working class because, when the labor market collapsed, the unions, as the political representatives of the working class, went with it."[29] Instead, the "new forms of political construction [were] built from within society rather than the political system, [and] emerged on the Argentine scene with unusual force."[30]

Emphasizing radical democratic principles and stressing their horizontal nature and their autonomy from political parties, trade unions, and the state apparatus more generally, these "new social protagonists" began to craft alternative forms of popular self-organization that touched upon the lives of millions. Given their widespread appeal and innovative grassroots practices—which included neighborhood assemblies, road blocks and the recuperation of closed factories and other workplaces—the traditional political actors largely failed to connect to these burgeoning social movements, let alone come up with a convincing political response.[31]

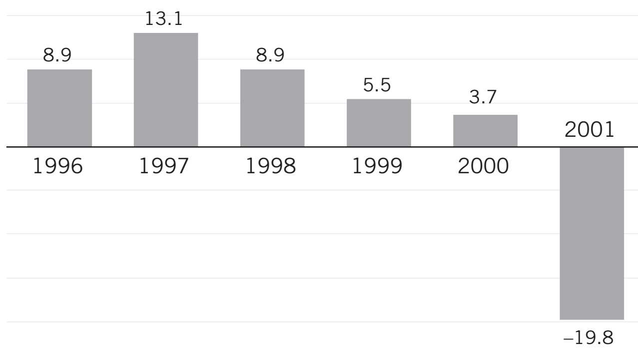

FIGURE 14.2. Change in bank deposits (%) in Argentina, 1996–2001. *Source*: Setser and Gelpern (2006).

At the end of November 2001, these dramatic social mobilizations from below coincided with equally dramatic political and economic developments from above: the *riesgo país* shot up to 5,000 basis points, leaving Argentina without any affordable external sources of financing. Worried that the impending default would lead to a collapse of the banking system and that a breakdown of the convertibility regime and a subsequent currency devaluation would eat up their peso-denominated savings, depositors began to withdraw over $1 billion per day.[32] This came on top of the $10 billion that had already fled the country in the wake of an earlier debt rescheduling in June that year, rapidly depleting the banks' reserves in the process (see figure 14.2). On December 1, Cavallo announced a set of draconian measures to halt the full-blown bank run: he shut down the country's private banks and declared his fateful *corralito*, or "ring fence"—freezing bank deposits, outlawing deposit transfers abroad, and imposing a withdrawal limit of 1,000 pesos per week. As one banker put it, "the *corralito* trapped the *perejiles,*" the little guys. "The big players already knew what was going to happen and got out ahead of time."[33]

As was to be expected in the highly combustible social context of late 2001, the *corralito* failed spectacularly in its stated objective of restoring calm, prompting mass protests and setting in motion a series of events that would eventually culminate in Cavallo's political demise. A few days later, on December 5, against the backdrop of intensifying opposition in the streets, the IMF announced its equally fateful decision to withhold the next installment of its bailout program in response to the government's inability to stick to the loan conditions. From there on out, Argentina was on a one-way street to default, and the government found itself under immense pressure from all sides to simply get it over with and formalize what was by now widely considered a *fait accompli*.

"¡Que Se Vayan Todos!"

On December 19, after weeks of simmering tensions, the popular anger that had been building up all throughout the crisis finally came to a head when the streets exploded in furious anger. Food riots and looting first broke out in the central city of Rosario and rapidly spread to Santa Fe, Córdoba, La Plata, and Mendoza, and from there via the suburbs of Buenos Aires to the heart of the capital.[34] Within hours, violent clashes between protesters and police had erupted across the country. In a poorly calculated attempt to quell the uprising, De la Rúa went on national television to announce a suspension of constitutional rights and declare a 30-day state of emergency, deploying the federal police, the border guard, and the naval prefecture to restore order. Given the severity of the social unrest and the speed at which the riots spread across the country, the president briefly entertained the idea of shutting down all private radio and TV stations and mobilizing the army to put down the rebellion—but

both options were roundly rejected by his cabinet. With the experience of the military *junta* still fresh in the country's mind, even the army leadership turned out to be unwilling to leave the barracks without express approval from Congress and so long as there remained a chance, however slim, that conventional political solutions might save the day.

Like Cavallo's *corralito*, the president's televised address backfired in the worst way imaginable. It was widely noted that "De la Rúa looked distant and insensitive to what was taking place. Some of his aides even qualified his speech as 'autistic.'"[35] Citizens felt that their legitimate expressions of indignation were not being taken seriously, and so they defied the curfew and descended from their homes in the hundreds of thousands. As protesters marched on the Plaza de Mayo, clashes broke out, and police violently cracked down on the impromptu demonstrations, killing seventeen people nationwide, five of them right in front of the presidential palace.[36] That night, De la Rúa, looking for a scapegoat, forced a publicly humiliated Cavallo to resign. Under judicial orders not to leave the country, in fear of being lynched by the multitude outside, and with his wife reportedly on the verge of a nervous breakdown, Cavallo holed himself up inside his apartment on the Avenida Libertador while a private security detail fended off angry protesters down below.[37] The curtain, it seemed, had finally fallen on the Wizard.

The rage, however, could no longer be contained so easily. On the morning of the next day, December 20, renewed protests broke out as thousands returned to the Plaza de Mayo to defy the curfew once more. Again, at least a dozen protesters were killed in the resultant clashes—but the demonstrations continued. When it finally dawned on the president that violent repression would not break the people's resolve, he again went on national television to invite the Peronists to join him in a "government of national salvation" and help restore "peace and order" to the country. The Peronist leadership roundly refused. Even De la Rúa's own cabinet members later declared that, watching the president's performance on TV, they could not escape the feeling that he was on another planet, far removed from what was truly going on "out there."[38] As his ministers and senators began to abandon him and the protesters only seemed to grow stronger in numbers and resolve, the politically isolated De la Rúa finally tendered his resignation. But security forces considered it too dangerous to evacuate the now ex-president from the *Casa Rosada* by car, so—in an image that would come to define Argentina's deepest political crisis since the return to democracy—De la Rúa was forced to escape the palace by helicopter. As he was airlifted from the rooftop of the building, the crowds below roared: *¡que se vayan todos!*—"all of them must go!" As Tomz puts it, the people "had just removed from power the most significant obstacle to default."[39] The third enforcement mechanism of debtor compliance had finally broken down.

Since the vacant position of vice-president had never been filled following an earlier corruption scandal that had forced De la Rúa's coalition partner to

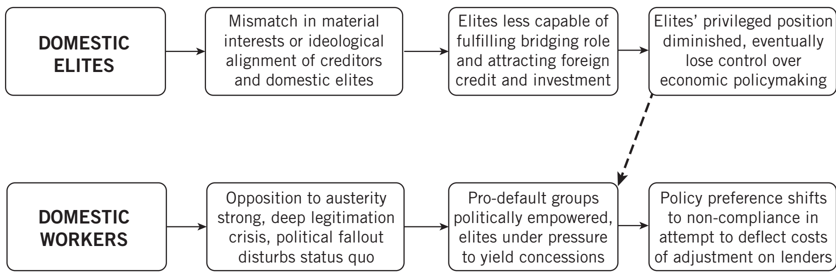

FIGURE 14.3. The third enforcement mechanism in Argentina.

step down, the role of interim-president fell to Ramón Puerta, the Peronist leader of the Senate, until Congress elected Adolfo Rodríguez Saá as the new head of state. The first thing Rodríquez Saá did upon taking office was to declare a unilateral moratorium on the service of Argentina's entire outstanding debt. In his inaugural address on December 24, he declared that "I believe in an Argentina without unemployment, without misery. I will govern for the most humble and for those who suffer. I call for the suspension of payments on the foreign debt until all Argentines have jobs." The interim-president lamented that "the gravest thing that has happened here is that priority has been given to foreign debt while the state has an internal obligation with its own people."[40]

But while Argentina thus entered into default on over $82 billion in privately held public debt, roughly two-thirds of which was in the hands of foreign investors, the new president almost immediately fell afoul of all his other pledges. As fresh protests took off, the most powerful Peronist governors came together and decided that Rodríguez Saá had to go. On December 30, Congress voted to replace him with Ramón Puerta, who resigned immediately. From there, the hot potato of the presidency passed to Eduardo Oscar Camaño, chairman of the Chamber of Deputies, who was a known supporter of Eduardo Duhalde, the former vice-president under Menem who had been De la Rúa's main opponent in the 1999 elections. On January 1, 2002, the power vacuum was finally filled when Camaño arranged for Duhalde to take over and complete the remainder of De la Rúa's term, with new elections set for December 2003. Duhalde, who had been the sole presidential candidate calling for a suspension of payments in 1999, would become the country's fifth head of state in just ten days' time. Now he was to preside over the dramatic fallout of the largest sovereign default in world history.

FIFTEEN

"Even in a Default There Is Money to Be Made"

The economic consequences of Argentina's default were immediate and traumatic. Foreign investors and international financial institutions immediately withheld all further loans and refused to deal with the new government unless it agreed to negotiate "in good faith" with its private creditors for an orderly restructuring of the defaulted debt—something that was politically unpalatable in the social environment that had given rise to the default. Beside the wholesale credit cutoff, international capital flight also accelerated dramatically, rapidly depleting the central bank's dollar reserves and leading to a breakdown of the convertibility regime at the start of January 2002, followed by an official devaluation of 30 percent and a government-decreed "pesification" of domestic bank deposits. After the abandonment of its fixed exchange rate with the dollar, the peso began to slide and would eventually lose 300 percent of its value.[1] Locked out of international capital markets and with the IMF refusing to provide any further emergency loans, Argentina effectively found itself in a state of financial autarky.[2] Credit markets froze up, and the economy fell into a deep depression.

As the interbank payment system ground to a halt (see figure 15.1), firms could no longer access the financing they needed to sustain their everyday activities. Sales dropped by 40 percent, and over 100,000 companies went bankrupt, leading to at least 280,000 layoffs.[3] In the first quarter of 2002, Argentina's GDP contracted by 16 percent and manufacturing output by 20 percent, while an investor strike undermined any hopes of an immediate recovery. The rate of investment to GDP, which had stood at 19.1 percent in 1999, fell to 11.3 percent.[4] Meanwhile, firms struggled to obtain export credits—a development about which the foreign ministry and Argentina's chamber of exports, as well as leading economists at the World Bank, repeatedly expressed their concern.[5] The ongoing bank run also intensified after the despised *corralito* was lifted. Total bank deposits collapsed from $70 billion at the start of 2002 to a mere $2.9 billion by October. Their capital base depleted, the banks closed 210 branches and fired 9,500 workers.[6] The social consequences of all this were devastating. Unemployment hit nearly one-quarter of the country's economically active pop-

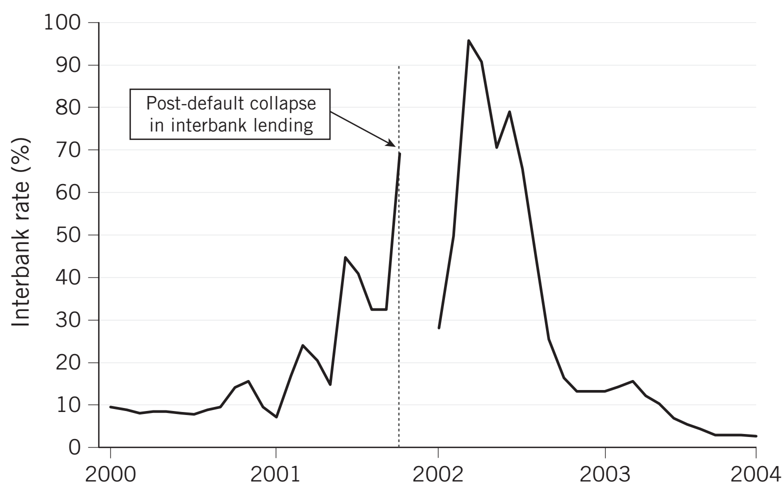

FIGURE 15.1. Interbank rate in Argentina, 2000–2004. *Source*: Miller, Garcia Fronti, and Zhang (2006).

ulation, the percentage of people living in poverty reached 57.5 percent, and extreme poverty doubled to 27 percent.[7] Observers noted that, when he took power in early 2002, "the Argentine economy threatened to disintegrate before Duhalde's eyes."[8] The collapse in output and the sharp increase in poverty and unemployment were the worst to hit a capitalist economy since World War II; in a country that less than a century ago had ranked among the ten richest in the world, one in four now "could no longer afford sufficient food."[9]

Nevertheless, despite their intensity, these spillover costs of default turned out to be relatively short-lived, and the trauma quickly began to subside once Argentina returned to very high levels of growth from late 2002 onwards. Figure 15.1 shows how the interbank rate spiked dramatically following the default (indeed, interbank lending collapsed altogether for some time), but quickly fell back to below its crisis levels. Figure 15.2 shows Argentina's postdefault return to growth, while figures 15.3 and 15.4 clearly demonstrate how poverty and unemployment rates steadily declined after the initial economic shock of the default, devaluation and depression. These observations are fully in line with the structural power hypothesis, which stresses the *immediate* consequences of a default on domestic credit circulation and its painful knock-on effects on economic performance, but which also emphasizes the *short-lived* nature of these spillover effects.

This chapter presents the main outcomes of the Argentine crisis—from the realignment of the domestic balance of forces in the wake of the default, to the aggressive debt restructuring concluded by President Kirchner in 2005. It seeks to

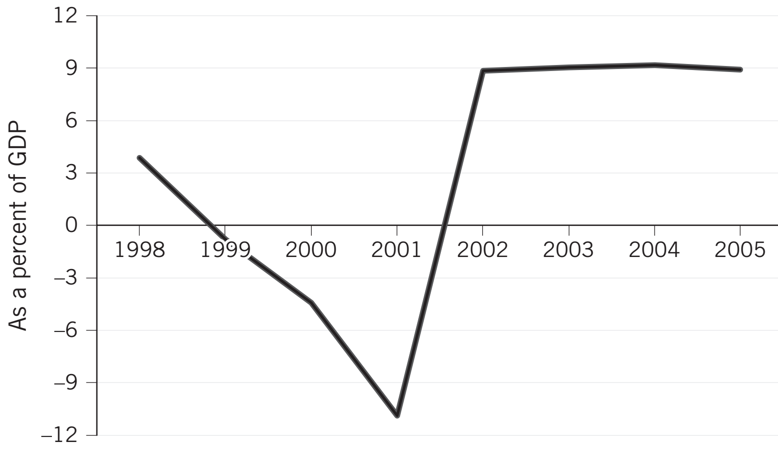

FIGURE 15.2. Argentina's GDP growth, 1998–2005. *Source*: Baer, Margot, and Montes-Rojas (2006).

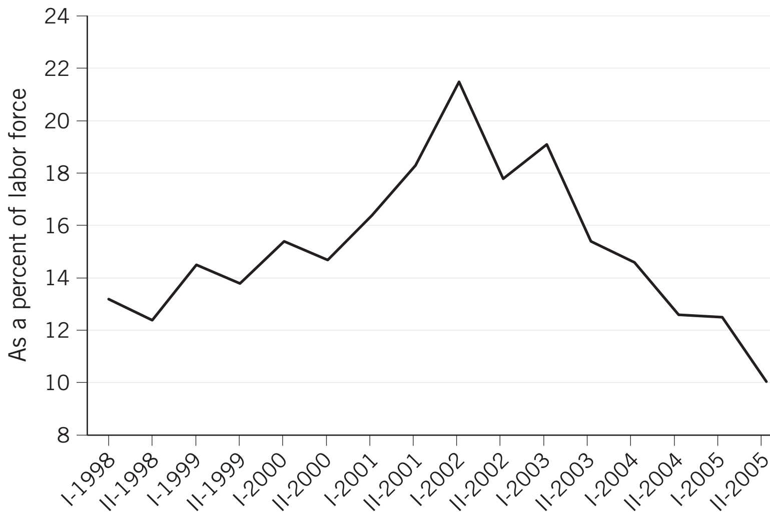

FIGURE 15.3. Argentina's unemployment rate, 1998–2005. *Source*: Mercado (2007); INDEC–Ministry of Economy.

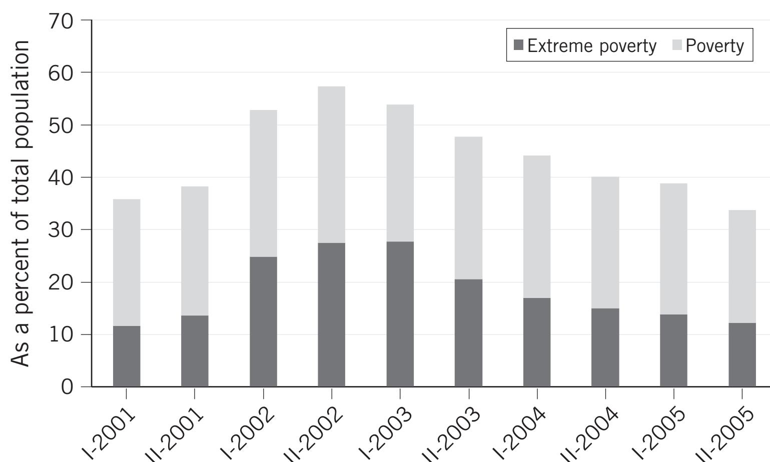

FIGURE 15.4. Poverty levels in Argentina, 2001–2005. *Source*: Mercado (2007); INDEC–Ministry of Economy.

explain why Kirchner was both willing and able to pursue such a confrontational stance towards the IMF and foreign bondholders, and presents the counterintuitive conclusion that—far from being harmed by the Argentine default—Wall Street actually managed to find innovative ways to turn it to its own advantage.

Opening an Unimagined Space for Politics

The first important outcome to note was a profound realignment in the domestic balance of forces in the wake of the popular uprising. As the economy briefly went into free fall in the first half of 2002, the widespread social dislocation wrought by the spillover effects of the default fed into further protests and strikes. The sheer power of popular mobilization eventually forced the political establishment to make a number of concessions to the domestic population, including a new set of redistributive social policies and antipoverty measures.[10] As the Argentine historian Ezequiel Adamovsky puts it, "it was the constant threat of looting, targeting of politicians, of rebellion, of occupations, of roadblocks, and assemblies that disciplined both management and local and international financial sectors, opening an unimagined space for politics."[11]

In the immediate wake of the December uprising, President Duhalde struggled to restore a degree of political stability and was constantly forced onto the defensive by the powerful social mobilizations and an increasingly restive population. Upon taking office, the president's approval rating stood at a mere

10 percent, and the initial wave of protests had "grown into a massive civic rebellion against the entire political elite."[12] A Gallup poll showed that 84 percent of respondents did not feel represented, while 87 percent rejected all parties outright.[13] Duhalde was therefore acutely aware of the need for some kind of shift in policy and rhetoric to outmaneuver the country's burgeoning social movements and restore at least a semblance of democratic legitimacy to the political system. He embarked upon a populist campaign to shore up support for the government and the wider state apparatus by pursuing a somewhat more equitable distribution of adjustment costs. Publicly railing against "the destructive alliance of 'political power and financial might' that had sold the nation out to foreign creditors and international financial institutions at the expense of internal production and consumption," the president tried to portray himself as a real man of the people.[14] He restored the yearly extra month's pay for public sector workers and earmarked $350 million for soup kitchens. In an address to Congress in March 2002, he for the first time publicly recognized the "formidable crisis of representation" that had undermined the public's trust in democratic institutions. Despite the acute fiscal crisis, he announced the implementation of the *Plan Jefes y Jefas de Hogar Desocupados*, a $1 billion household support program targeted at the unemployed, in a move that was widely seen as an attempt "to combat militant opposition by the *piquetero* movement."[15]

But these relatively superficial moves failed to subdue the rage people felt towards the authorities. The government remained trapped between the popular pressure for a redistribution of wealth and power from below and the total absence of foreign credit and investment from abroad. Duhalde, in a word, struggled to bridge the contradiction between the state's structural dependence on capital on the one hand, and its need to restore democratic legitimacy on the other. One observer identified the president's approach as profoundly "schizophrenic": while he embraced the radical rhetoric of the movements, Duhalde "began (gradually and almost secretly) to do as the IMF advised, not only devaluing the currency, but also securing an agreement with the provinces to cut spending, unifying the exchange rate, and changing a bankruptcy law to match international standards."[16] While at home he complained endlessly about the crimes and betrayals of the *patria financiera*, he simultaneously sought to placate his other audience—international investors—by exuding a market-friendly pragmatism abroad. As he failed to reconcile the two, street protests resumed and Duhalde was forced by intensifying social unrest to call early elections for April 2003.

These were the conditions that Néstor Kirchner inherited when he assumed the presidency in May 2003, having won the elections with just 22 percent of the vote in the first round, after his leading contender—the widely despised former president Carlos Menem, of all people—withdrew from the race when it became clear that he would suffer a humiliating defeat in the second round. To boost his standing, Kirchner, then known as a moderate and pragmatic

center-left Peronist, immediately announced an economic program that prioritized growth and job creation and refused to resume payment of the external debt at the expense of social and economic recovery. In a return to the classical populist blend of left-Peronism, Kirchner praised the virtues of "national capitalism" as an alternative to the Washington Consensus that had led to the country's economic collapse. "It's not that we want not to comply, not to pay," he declared, echoing the words of his predecessor Raúl Alfolsín in the 1980s, "but neither can we pay at the expense of seeing more and more Argentines postponing their access to proper housing, a safe job, education for the children, and health services."[17]

In an attempt to restore the legitimacy of the political system and the dominant position of the traditional Peronist establishment, Kirchner set out to build a corporatist coalition consisting of an alliance between large-scale farmers, oil exporters, industrial capitalists, and leaders of the labor unions and the unemployed workers' movement. In a meeting with a group of Buenos Aires bankers on September 29, 2003, Kirchner declared that "it is crucial that national capital partakes in the process of the reconstruction of society. It is impossible to build a national project if we do not consolidate a national bourgeoisie." This followed an earlier statement by Alberto Alvarez Gaiani, head of the Industrial Union, who had argued that—with Argentina now cut off from foreign credit—the only way to see to the state's dependence on capital would be to resume domestic investment by strengthening the government's ties to Argentine firms. "There is a need for a national bourgeoisie," he declared. "A country is stronger when you have the owners of the most important companies in the country sitting around the decision-making table. Nobody is going to invest a single penny in this country for a long time."[18]

At the same time as opening up the government to domestic business, Kirchner pursued a classical Peronist strategy of co-optation with regard to labor and the popular sector. Now that the trade unions had practically imploded, the most militant opposition to the political establishment came from the various factions of the *piquetero* movement of unemployed workers. By incorporating the leaders of some of its more traditional and hierarchically organized groups into his government, Kirchner hoped to isolate the more radical autonomous wing of the movement, demobilize the grassroots resistance and at the same time obtain a strong ally in his political maneuvers against opponents.[19] Luis D'Elia, leader of the Federación Tierra y Vivienda, one of the more visible *piquetero* groups, was appointed undersecretary for land and housing. His followers, called *piqueteros-K*, became a crucial support base for Kirchner and a powerful weapon in the government's public confrontations with foreign companies.[20]

This rearrangement of the dominant class coalition—away from Menem's neoliberal alliance between national capital and the *patria financiera* and toward a classical Peronist alliance between national capital and elements of the popular sector—went hand in hand with the embrace of an alternative economic

model that has often been referred to as "neodevelopmentalist" or "neo-extractivist." This transition was made possible by the advantageous external conditions in the postdefault period, including ample liquidity and the Chinese-driven commodity boom of the 2000s, which conspired to bring about a major transformation of Argentina's economy and agricultural sector, with commodity exports surging and a soy boom changing the face of the countryside. The dramatic events of 2001–2002 were therefore about much more than a just change in government; they marked a political-economic rupture in the development of Argentine capitalism and a transformation, however partial and contradictory, in the relationship between business and the state. The reduced state dependence on credit weakened the *patria financiera* and allowed for the emergence of a new balance of power that subordinated financial interests to the interests of extractive and exporting industries on the one hand, and of co-opted elements of the popular sector on the other. Kirchner's confrontational stance in the subsequent debt negotiations with foreign bondholders should be considered in light of this new political reality on the ground.

Néstor Kirchner and the 2005 Debt Restructuring

Under the first Kirchner government, the realignment of social and political forces at home combined with a crucial transformation in the political and economic opportunity structure internationally, providing Kirchner with exceptional room for maneuver. While Eduardo Duhalde had struggled throughout his term to balance the contradictory needs to restart economic activity on the one hand and restore popular legitimacy on the other, Néstor Kirchner upon assuming office in 2003 found himself presented with ample space for much more confrontational action, creating the preconditions for the unusually aggressive postdefault debt restructuring. In early 2005, after a long and arduous negotiation process, Argentina reached a deal with its creditors that saw 76 percent of bondholders accept new bonds worth 25 percent of the original defaulted ones. The claims of the remaining 24 percent, a Baptist-Bootlegger coalition of European pensioners and U.S. hedge funds, were repudiated.[21] When Argentina briefly reopened the restructuring deal in 2010, more bondholders subscribed, reducing the remaining share of "holdout" creditors to a mere 9 percent (who were finally compensated for their losses by President Macri in 2016).

Ninety-one percent is a remarkably high degree of participation given the size of the haircut and the defiant posturing of the Argentine government. How was Kirchner able to get his way? As it turns out, there were a number of factors that played to Argentina's advantage. First, as we saw before, the country's bondholders were greatly atomized after the creditor-led megaswap of mid-2001, and mostly made up of so-called financially illiterate small savers and pensioners.

This had important consequences for creditors' bargaining power vis-à-vis the Argentine government. As Paul Lewis puts it, "most of the bondholders were 'small fry' and scattered geographically, making it difficult for them to coordinate any strategy."[22] The collective action problem of 1930s bond finance returned with a vengeance. "True to atomistic stereotype," Anna Gelpern observes, "bondholders could not hold a coalition. Each acted in its own self-interest." Moreover, "these [small] investors generally were not repeat players and knew little about emerging-market debt."[23] Others who have studied Argentina's debt negotiations confirm that "the lack of cohesion among the different organizations representing the creditors worked to the advantage of the government."[24] Kirchner made strategic use of these factors to play his creditors apart. When the representatives of the small lenders set up the Global Committee of Argentina Bondholders in an attempt to present a united front at the debt negotiations, he simply refused to talk to the group or even to recognize its existence.[25] Kirchner was able to do this because he did not depend on these dispersed bondholders for future credit; even if he restructured the debt on extraordinarily good terms for the creditors, most of the small bondholders had made a one-off investment and were unlikely to ever lend to Argentina again, so there was little incentive to cut them a break.

Argentina's unilateral suspension of payments also contributed to reversing the debtor-creditor power dynamic, just as it had done in the wake of the defaults of the 1930s.[26] Before Argentina's moratorium, bondholders had been receiving 100 cents on the dollar, and any reduction in the face value of these claims would have undoubtedly been considered an unacceptable loss. Now, some two years after the default, creditors were receiving 0 cents on the dollar, and—barring moral concerns over the violation of creditor rights—some form of debt restructuring, even an unusually harsh one, would at least allow them to mark their holdings to market and recover some profit from the restructured bonds. The moratorium, in other words, restored the initiative to the debtor and allowed it to wield the prospect of a restructuring as a carrot instead of a stick, creating an incentive structure for bondholders to sign up to a deal that they would otherwise never have agreed to. As Giselle Datz succinctly put it, "investors were not looking at losses taken in 2001, but at a scenario of gains in 2005."[27] Economy Minister Roberto Lavagna seemed to be under a similar impression when, just a month before the conclusion of the deal, he rhetorically asked why, despite the destruction of numerous debt contracts in 2001, investors were still so eager to buy Argentine bonds. His simple answer: "because today clearly they can get a very good rate of return."[28]

The benefits of Argentina's debt restructuring accrued especially to the financially literate repeat players: the Wall Street investment banks and the U.S.-based institutional investors that had a direct interest in keeping Argentina in the lending game. But these same benefits were not immediately clear to the small

European retail investors, who were unlikely to lend to Argentina again and who would have preferred a higher payout on their one-off investment. Kirchner was acutely aware of these conflicting interests among different groups of investors and exploited the fissure within the creditor base to full effect. By insisting on separate negotiations with the big international banks, while at the same time denying the very existence of the small bondholders and their formal representatives, he successfully drove a wedge in the (nonexistent) creditors' cartel—to the detriment of the pensioners and other small investors in Europe.

The second factor playing to Argentina's advantage was that its dispersed lenders received little or no support from their own governments, the IMF or the United States.[29] In its negotiations with private bondholders, Eric Helleiner notes, "the USA was . . . quite sympathetic to the position taken by the Argentine government."[30] When Bush met Kirchner at the Summit of the Americas on January 13, 2004, Bush "quite significantly did not echo Koehler's request that he consider paying more than just 25 percent to holders of bonds." As Assistant Treasury Secretary Randal Quarles put it: "it's not the IMF's role to impose any particular terms of the deal. . . . How much can Argentina repay? . . . I think that's something that the IMF and the U.S., as a shareholder in the IMF, should not have a view on." Treasury Secretary Taylor echoed the same sentiment: "the idea here is to allow negotiations but not to be in the middle, or choose sides. That's for the creditors and Argentina to work out."[31] The IMF's decision not to intervene and the lack of a unified creditor front clearly benefited the Argentine government.[32] It also greatly frustrated the small bondholders. As an Italian lawyer representing a group of pensioners who lost their life's savings in the default put it: "Argentina doesn't want to pay its debt, and Washington doesn't want to force it to pay. So the easiest thing is to send the bill to the bondholders in Europe, little people no one will ever see."[33] Another Italian lawyer pointed out to the *Wall Street Journal* that "with what's happening in Iraq and Afghanistan, you can be sure that Mr. Bush didn't want to start a battle with Argentina, just to defend some retirees in Europe."[34]

But the role of the U.S. government was not just characterized by lack of interest; the administration took an active stance in favor of Argentina's aggressive approach to private bondholders and the IMF. When Kirchner missed a $2.9 billion payment to the IMF on September 9, 2003, President Bush personally supported the move, further reducing the IMF's ability to defend bondholder interests in the debt negotiations.[35] A group of Argentine economists has noted that, "because there was a real risk of Argentina defaulting on its large obligations to international financial institutions, the Fund's leverage to influence the outcome of the private debt restructuring was much weakened all through the post-default phase of the crisis."[36] When Kirchner finally reached an agreement with the IMF that was uncharacteristically beneficial to the debtor country, the U.S. president personally called up his Argentine counterpart to congratulate him and express his satisfaction with the deal. Assistant Treasury

Secretary Quarles claimed that the administration had "deliberately pushed for the budget surplus targets [in the IMF Stand-By Arrangement] to be left undefined in the second and third years—over IMF objections—because it wanted the IMF not to take a stance in the debt negotiations with private creditors," stating that "it's not the IMF's role to take a stance to impose any particular terms of a deal."[37]

This active support from the Bush administration in turn allowed Argentina to segment not just its small bondholders and large institutional investors, but also its official and private creditors. By negotiating on two different tables at once, Kirchner effectively removed IMF conditionality from the equation when it came to his government's arm-twisting with private bondholders. And, indeed, when Kirchner finally offered his "take it or leave it" deal to foreign bondholders, the U.S. government "raised no objections to the Argentine offer."[38] In fact, the day after the final offer was made, Bush briefly met Kirchner at the sidelines of the UN General Assembly where the U.S. President "seemed to endorse" the deal. According to Kirchner's spokesperson, Bush told him the following words: "congratulations again for the agreement with the IMF; now you must keep negotiating firmly with private creditors." When Kirchner approached him later that day, Bush even had the wit to crack a joke about the deal to a group of assembled world leaders: "here comes the conqueror of the IMF!"[39]

The third factor playing to Argentina's advantage were the "extraordinarily good international conditions" it found itself faced with postdefault, most importantly the global commodity boom generated by rapid Chinese growth and the wave of liquidity sloshing through international financial markets thanks to the Fed's low interest rates in the wake of 9/11 and the collapse of the dotcom bubble.[40] These beneficial external conditions then combined with Argentina's own relative resilience in financial and economic terms. A study by the Center for Economic and Policy Research noted that "one of the great advantages that Argentina has over other countries confronting the creditors' cartel . . . in terms of recovering on its own is that the country is running large surpluses on both its trade and current accounts" (see figures 15.5, 15.6, and 15.7).[41] Between 1999 and 2002, the government managed to maintain a sizable primary budget surplus, leaving it much less dependent on external financing than most other peripheral countries facing balance-of-payments crises.[42] Unlike Mexico, Argentina was also self-sufficient in food production and a net exporter of commodities, while its large current account surplus greatly reduced its dependence on hard currency for the import of basic necessities. As a result, Argentina's foreign-exchange reserves never fell below four months' worth of imports, compared to two weeks' in Mexico in 1982 (see figure 15.8).[43]

Meanwhile, Argentina could count on the support of an important regional ally, Hugo Chávez, who came to Kirchner's aid by reinvesting part of Venezuela's oil revenues in special Argentine bonds. In 2005, the Venezuelan government lent a total of $3.1 billion, and the two countries even set up a special

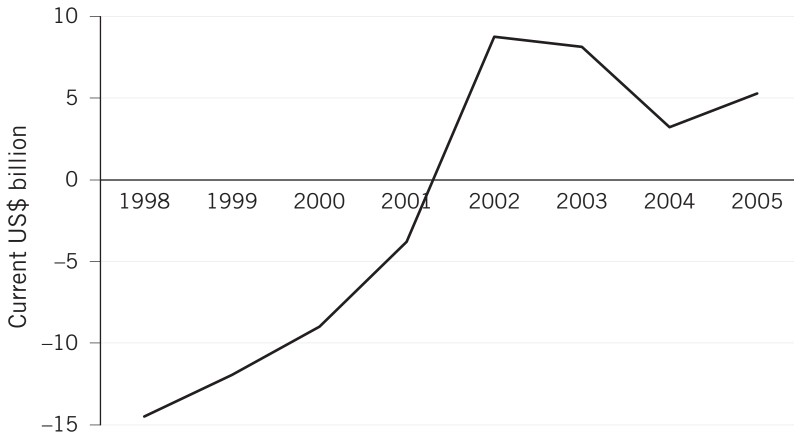

FIGURE 15.5. Argentina's current account balance, 1998–2005. *Source*: World Bank (2017).

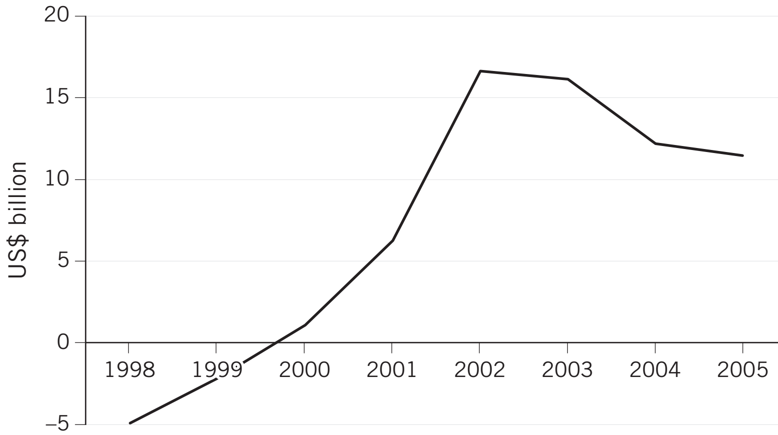

FIGURE 15.6. Argentina's trade balance, 1998–2005. *Source*: Baer, Margot, and Montes-Rojas (2006).

investment fund, the Fund for the South, whose official mission "was to free South America from dependence on the United States and the IMF."[44] The following year, Chávez purchased another $3.6 billion in bonds in 2006, adding a further $1 billion in 2007. Venezuela's loans thus provided Argentina with a helpful "outside option" for external financing that contributed to the country's relative autonomy from international finance and its insulation from the two

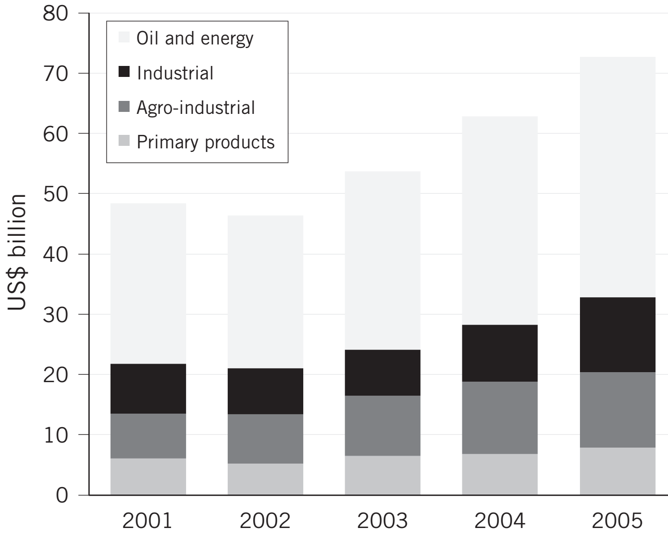

FIGURE 15.7. Argentina's exports by sector, 2001–2005. *Source*: Grugel and Riggirozzi (2007).

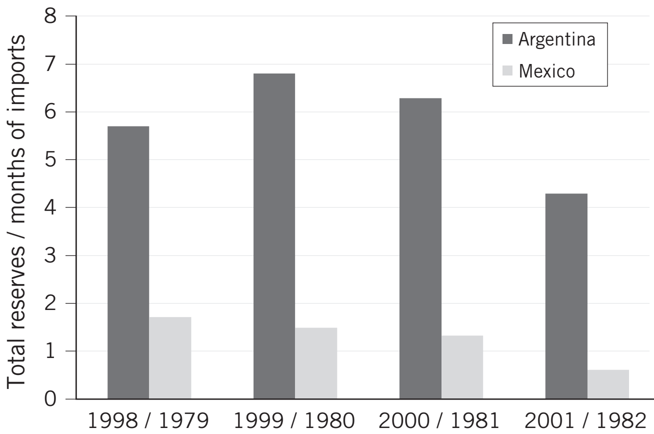

FIGURE 15.8. Total reserves in months of imports, Argentina (1998–2001) vs. Mexico (1979–1982). *Source*: World Bank (2017).

enforcement mechanisms of market discipline and conditional IMF lending.[45] All of these factors combined to boost Kirchner's standing at home and his self-confidence abroad, feeding his fiery anticreditor rhetoric. As Mortimore and Stanley emphasize, "the short-term cost [of Kirchner's defiance] to the country was minimal, since Argentina clearly had no possibility of obtaining external financing in the international financial markets anyway."[46]

With the prospect of continued high growth and the option to raise funds through domestic bond auctions, confrontation with powerless small bondholders overseas and the extremely unpopular IMF in Washington seemed like a sensible path to pursue—especially in light of the need to deflect attention away from the profound legitimation crisis at home. All of this goes to show how the prevailing international conditions endowed the government with considerably more room for maneuver after 2002 than it had enjoyed under Alfolsín in the 1980s. At the same time, the constant threat of a resumption of mass protests continued to exert pressure on the government from below, precluding any overt strategy of reconciliation with foreign creditors.

Still, it would be overly simplistic to conclude on the basis of Argentina's defiant stance that the structural power hypothesis somehow does not hold up in practice. Argentina's international opportunity structure in the wake of the December revolt and the subsequent default was highly idiosyncratic—a fact that is clearly confirmed by the observation that the country's unilateral moratorium and aggressive debt restructuring remain isolated and extremely rare occurrences. As Nouriel Roubini has pointed out, "the lesson of Argentina is that crisis and default are very costly and painful, not that they are costless. Otherwise, if default is so costless, how come we do not see dozens of highly indebted countries following Argentina and defaulting?"[47]

The Brazilian experience presents an interesting counterfactual in this respect. In 2002, as Argentina's northern neighbor prepared for presidential elections, it found itself facing similar pressures as Argentina itself had since 1999; pressures that were exacerbated by the prospect of a victory for Lula's Workers' Party. During the 1980s debt crisis, Lula, then still a devout leftwing activist and outspoken labor leader, had gained a degree of notoriety among investors for his vocal advocacy of a unilateral debt moratorium and an outright repudiation of the foreign obligations incurred by the military dictatorship. In its December 2001 electoral program, the Workers' Party still "spoke of denouncing the existing agreement with the IMF and auditing and renegotiating the external debt," pledging "a complete revision of the policy of giving priority to the payment of the debt service."[48] Unlike Argentina, Wall Street still carried significant exposure to Brazil in 2002, so when Lula began to advance in the polls, investors unsurprisingly took fright. Every time a new poll indicated a Lula lead, the "Brazil risk" shot up.[49] As the banks withheld further loans in fear of a default, Brazil's spreads skyrocketed, widening from 7 percent in March 2002 to 20 percent in September, as Lula rose from 30 to 40 percent.[50]

In response to this market pressure, and in an attempt to calm both foreign investors and potential voters at home, Lula decided to tone down his rhetoric over the course of the campaign. By January 2003, *The Economist* reported that, "since the final weeks of the election campaign, Lula has worked hard to turn investor panic into mere wariness. He has stressed that Brazil means to pay its debt and has chosen ministers who seem ready to carry that promise through."[51] After Lula's victory, economist Arminio Fraga, who had served as central bank director under the previous conservative government, noted that "the biggest event when Lula came to office in 2003 is that nothing happened."[52] Roubini writes that "Lula, as soon as he was elected, looked across the border and saw what default—even an unavoidable one like Argentina's—causes as its by-product, i.e., massive crisis and pain."[53] And so he eventually decided to appoint an orthodox finance minister and avoid default.

"Even in a Default There Is Money to Be Made"

Argentina's payment suspension, then, should by no means be construed as a challenge to the structural power hypothesis. Not only does its moratorium remain an exceptional event in international finance, but its social and economic costs even became a cautionary tale for left-leaning leaders elsewhere. The remarkable developments in Argentina between 1999 and 2005 therefore show how the structural power of finance was fully operative throughout the crisis, initially leading to a case of unprecedented overcompliance and eventually producing devastating short-term spillover costs in the wake of the default—even if these spillover costs turned out to be relatively short-lived. Crucially, as we have seen in this chapter, the country only suspended payments *after* the three enforcement mechanisms had broken down: after the structurally powerful institutional investors had dumped their Argentine bonds on a dispersed body of small bondholders overseas and refused to loan further money; after the IMF had withheld its crucial financial lifeline, leaving the country without any sources of foreign financing; and after the *patria financiera* had been ousted following a mass antiausterity revolt.

Despite the breakdown of these three enforcement mechanisms, however, the substantive outcome of the Argentine default was not all that different from the outcome of the Mexican debt crisis of the 1980s. For one thing, as in Mexico, the burden of adjustment in Argentina was initially largely borne by workers and the poor. The imposition of the *corralito* in December 2001 was perhaps the clearest expression of this inherent pro-elite bias in the government's policy response. When he found himself compelled to shut down the banks, Cavallo had deliberately left a loophole in his deposit withdrawal scheme that allowed wealthy Argentines to pull billions of pesos out of the banking system anyway. Through a mechanism very similar the one used by Mexicans elites in the

wake of López Portillo's bank nationalization, wealthy depositors were able to move their savings and investments to the stock exchange. Economists Kathryn Dominguez and Linda Tesar explain that "restrictions in the *corralito* . . . allowed investors to use their frozen bank deposits to purchase Argentine stocks, and, in so doing, provided a legal mechanism for transferring funds abroad."[54] The few lucky Argentines who still had real savings in the bank could simply buy stocks that were cross-listed in the United States to legally convert their Argentine shares (purchased with pesos) into American Depository Receipts (ADR), which could subsequently be sold for dollars and deposited in a U.S. bank account. Only this loophole in the *corralito* can explain the idiosyncratic 50 percent rise in Argentine stock exchange valuations in December 2001, at a time when the national economy was effectively in a state of meltdown: the local elite was simply pouring its money into shares to get it out of the country ahead of a default and devaluation. While the wealthy upper class had to contend with a very different political-economic environment after the inauguration of Néstor Kirchner in 2003, the latter's insistence on giving the "national bourgeoisie" a seat at the table ensured that the privileged position of domestic elites would never be fully eroded.

In the end, however, the main beneficiaries of the crisis were not Argentine elites but the speculative foreign investors who managed to find fresh profit opportunities in the country's debt troubles. While Argentina's policy choices may have been diametrically opposed to those of the debtors of the 1980s, the outcome was more or less the same from Wall Street's perspective; if not more favorable. As we saw before, by the time of the default in 2001, U.S. institutional investors had already dumped most of their bonds on a scattered group of European retail investors, meaning they largely emerged from the initial payment suspension unscathed. But by the time of the 2005 restructuring, some of these same dispersed retail investors—including many Italian pensioners who were terrified at the prospect of losing their life savings—despaired at Argentina's refusal to recognize their representatives in the debt negotiations and began to sell back their bonds, for mere cents on the dollar, to an eager army of traders at the Wall Street hedge funds. The opposition to the eventual deal came mostly from European pensioners who were understandably less than enthusiastic about taking such a big hit on their retirement schemes. The leading hedge funds, by contrast, hardly put up a fight and signed up to the restructuring deal by an overwhelming 90 percent—the remaining 10 percent being made up of so-called vulture funds that successfully held out for full repayment.[55]

This raises an important question: why would the hedge funds be so eager to jump on Kirchner's offer if they thought they were receiving such a bad deal? The answer is that they were, in fact, not receiving a bad deal at all. As Giselle Datz has shown, "some hedge funds bought these bonds at 17 cents [on the dollar] in 2002 and were happy to swap them for nearly double that amount in 2005." This, in turn, greatly eased the restructuring process for the government,

"because instead of dealing with private international creditors who bought the bonds at 90 cents on the dollar, the government was dealing with those who paid around 20 cents."[56] In short, when the debt restructuring finally came around, the structurally powerful financial players had already won the battle by dumping most of their worthless bonds on powerless European pensioners and then *buying them back up* at greatly discounted prices to subsequently restructure them at a profit. Although the opaque nature of bond finance means that exact numbers are hard to come by, the *Wall Street Journal* reported that by the time of the 2005 debt restructuring, about half a million European and Japanese retail investors (including 450,000 Italians, 35,000 Japanese and 15,000 Germans and Central Europeans) held around 44 percent of Argentina's defaulted debt, with Argentine citizens, companies and financial institutions like banks and pension funds holding another 38 percent.[57] Small bondholders in Europe and Argentina thus ended up as the main losers in this game of financial arbitrage, while Wall Street emerged as the big winner.

Moreover, it turns out that the eventual debt reduction for Argentina was nowhere near as large as the 75 percent nominal haircut would seem to suggest. The reason is that the government added an obscure and rare "sweetener bonus" to the deal—a so-called GDP warrant—which paid bondholders an annual dividend in case Argentina's growth rates were to exceed a certain threshold. Since its GDP had contracted by almost 20 percent between 1998 and 2002, and since the country encountered such a favorable external environment after its default, it was to be expected that the Argentine economy would rebound rapidly and that investors stood to gain extensively from the GDP warrant. Because Argentina's average annual growth rates shot up to 9 percent after the default, the government actually found itself confronted with greater debt servicing costs as it emerged from the crisis. At the same time, the banks made significant profits from the intermediation fees they could charge for the restructuring itself. In fact, it was reported that "almost all the investment arms of leading Wall Street firms made lucrative deals" with the Argentine government.[58] In the end, it is therefore clear that Kirchner's scathing rhetoric against global finance was just that: rhetoric. His restructuring managed to impose severe losses on hapless foreign pensioners, but allowed Wall Street to continue to prosper. As the *Economist* dryly noted after the conclusion of the restructuring deal: "even in a default, there is money to be made."[59]

TABLE 15.1.
Comparison between the Mexican and Argentine crises

Mexico in 1980s	**Argentina in 2001**
Syndicated bank lending:	**Decentralized bond finance:**
Debt concentration high	Debt concentration low
Interlocked lending structure	Bondholders atomized/dispersed
Creditor coordination easy	Creditor coordination difficult
Credible threat of credit cut-off	No new credit forthcoming
Market discipline strong	***Market discipline weak***
Active US/IMF intervention:	**No US/IMF intervention:**
Sizeable international bailout loans	IMF pulls plug on Argentina's bailout program
Coordinated roll-overs to keep debtors solvent	No official coordination of small bondholders
IMF monitoring/supervision of debtor policies	U.S. isolationists push for reduced IMF role abroad
Policy conditionality enforces discipline	Policy conditionality breaks down
Effective conditional lending	***No more conditional lending***
Limited debtor autonomy:	**Relative debtor autonomy:**
Growing dependence on foreign credit and capital	Lenient int'l conditions, relative self-sufficiency
Bridging role for domestic elites and technocrats	Sidelining of domestic elites and technocrats
Popular opposition forestalled through cooptation	Legitimation crisis leads to antiausterity revolt
Strengthened bankers' alliance	Strengthened national-popular coalition
Internalization of debtor discipline	***Breakdown of debtor discipline***
OUTCOME:	**OUTCOME:**
No unilateral default	***Unilateral default***
Room for maneuver constrained	Exceptional room for maneuver postdefault
Mexico develops into "model debtor"	Argentina becomes most defiant debtor by far
Creditors only restructure debt after divesting	Debtor initiates aggressive debt restructuring
Highly unequal distribution of adjustment costs	Move towards more equitable redistribution