

# Negotiating Out of Argentina's Financial Crisis: Segmenting the International Creditors

ANDREW F. COOPER & BESSMA MOMANI

Developing countries restructuring their debts with international creditors are generally assumed to have little leverage in negotiations. This view of a weakened state mirrors an analysis of the changing architecture of power that highlights the influence of globalised finance at the expense of national autonomy. Stephen Gill, most notably, privileges this changed power relationship as a component of the 'new constitutionalism' of global capitalism.<sup>1</sup> Such a pattern of systemic oversight and international surveillance implies that states can no longer act in an unconstrained manner. Unorthodox state behaviour is not only disapproved of, it faces severe punishment. The strength of these pressures, coined the 'reach of coercion',<sup>2</sup> in tandem with the shift of states towards a 'defective' condition,<sup>3</sup> leads inevitably to the subordination of national priorities to the interests of external forces.

When assessing the interaction between international creditors and the state, therefore, it is most often assumed that structure trumps agency. Moreover, rather than depicting the international financial system as being full of discrete, and disconnected parts, a seamless quality is commonly attributed to the structure in place. Outcomes are understood to be (pre)-determined by the actions of a close-knit (and closed) network of international creditors. As agents with their room to manoeuvre constrained, states become, in effect, prisoners to the dictates of an integrated set of international financial actors. Political space is severely compressed through the need to adhere to internationally-imposed disciplinary measures.

This article probes these assumptions about the pattern of the relationship between states and international creditors through a close study of one high profile but underresearched case of debt restructuring. In terms of process, via this illustrative example, it examines how different actors in the international financial system conduct their negotiations with states. In terms of outcomes, through the lens of the same case, it explores the extent to which states are powerless (or not) with regard to international creditors.

Andrew F. Cooper and Bessma Momani, The Centre for International Governance Innovation (CIGI), 57 Erb Street West, Waterloo, Ontario N2L 6C2, Canada.

Because of its form, scope and intensity, the recent Argentinean crisis offers a valuable test of the power of international creditors. Not only did Argentina create the largest sovereign default in history, but the range and weight of attendant creditors was unsurpassed.<sup>4</sup> If the room for manoeuvre for states has indeed been bounded by external forces, then the upshot of the case examined should be a foregone conclusion. However, looking specifically at Argentinean President Néstor Kirchner's negotiation tactics from April 2003 to February 2005, this article reveals a very different picture of debt negotiations from those commonly described. At the core of this re-appraisal is a narrative of an indebted state managing to segment its international institutional and private creditors. At odds with the image of structural rigidity, what stands out about the case of Argentina is the pattern of diffuseness in both the manner in which discipline was applied by divergent components of the international financial system and the room for agency at the state level. Argentina's international creditors did not act as parts of a monolithic whole and the Argentine government was thus able to adopt various negotiation strategies towards different actors. Most significantly, the International Monetary Fund (IMF) and private international creditors revealed significant differences in their reaction to Argentinean behaviour and in their distinctive roles *vis-à-vis* the international financial system.

### **The IMF and private international creditors**

The international financial system is composed of various multilateral or official creditors, namely the IMF, the World Bank, the Paris Club and various regional development banks such as the Inter-American Development Bank. If a strong argument can be made that the Group of 7 (G7) states, with the largest share of world capital, dominate these organisations and groups, the one agency that has effectively managed and coordinated these official creditors has been the IMF. The Fund 'links the entire nexus'<sup>5</sup> of the international financial system and provides the largest source of multilateral credit to developing countries.

Although multilateral creditors, particularly the IMF and to a lesser extent the World Bank, are significant sources of capital for developing countries, they have become secondary to private international creditors. This group of private international creditors includes commercial banks, bondholders, portfolio investors and multinational corporations investing in foreign direct investments. International private creditors are interconnected and often act in unison, particularly banks and bondholders because they are often mutually exposed and have bonds underwritten together.<sup>6</sup> Since the influx of petrodollars into the international financial system in the 1970s, private international creditors have provided more credit to most developing countries (and even more to emerging market economies) than the IMF provides.<sup>7</sup> Still, the Fund retains a unique role: part watchdog and part enforcer of debtors' fiscal responsibility, with benefits to the private international creditors.<sup>8</sup>

While there is no international organisation that has legal control over private international creditors, historically the IMF has had both the institutional capacity and the moral authority to assert itself over these actors.<sup>9</sup> Consequently, the Fund

has most recently been identified by proponents of international financial system reform as the principal institution with jurisdiction over the management of private debt restructuring.<sup>10</sup> Generally, private creditors give deference to Fund leadership over debt negotiations because private creditors assume that the Fund will be tough, technocratic and politically effective at getting the best concessions possible.<sup>11</sup> Overpowering the debtor state, the Fund leads the 'creditor coalition' to achieve state discipline and acquiescence.<sup>12</sup> Thus, international private creditors tend ultimately to defer to the Fund's assessment of debtors' economic capacity to repay their creditors.<sup>13</sup>

After a country demonstrates that it is in financial trouble, the Fund reschedules its debt or provides financing first before private international creditors, in order to create 'borrower credibility'. Ideally, IMF lending is meant to enhance investor confidence, establish a catalyst for added financing and minimise market losses.<sup>14</sup> It must be acknowledged that this role has drawn considerable criticism, as some critics have argued that the IMF 'bails out' private creditors, giving countries added liquidity that private creditors deplete when exiting a crisis-stricken country.<sup>15</sup>

Nevertheless, the Fund claims that it supports 'comparability of treatment': the devising of a burden-sharing arrangement between private international creditors, official creditors and the debtor state. Or, more simply put, the Fund attempts to ensure that all parties absorb some losses when restructuring a country's debt in an effort to prevent 'moral hazard'.<sup>16</sup> Furthermore, the Fund has historically refused to lend to countries that are in default to private creditors. Following the 1980s debt crisis, the Fund backed the interests of commercial banks by not providing debt relief to those countries in poor standing with private international creditors. In 1999 the Fund expanded this ambit to include bondholders, arguing that countries must be in 'good faith' with all private international creditors – banks and bondholders alike – before it would approve any loan package.<sup>17</sup> It has often been suggested that, amidst the turbulent financial crises of the 1990s, the Fund and private international creditors, in particular exposed banks and bondholders, were able to outmanoeuvre debtors. Yet the Argentinean case, as analysed below, suggests that this outcome could vary according both to the capabilities of a debtor state and its relationship with its creditors.

### **What went wrong in Argentina, 1991–2003?**

Throughout the 1990s President Carlos Menem and his Economic Minister Domingo Cavallo ushered in broad economic and structural reforms intended to liberalise the Argentinean economy. Argentina's initial successes included a drastic taming of inflation, the improvement of economic growth, the entrance of large capital inflows into the country and a substantial increase in foreign exchange reserves. These marked economic improvements were initially attributed to the successes of Argentina's Convertibility Plan which rested on a currency board that pegged the peso at parity with the US dollar.

Menem's Convertibility Plan started showing signs of fatigue in 1994, as domestic producers faced strong competition from less expensive imports.<sup>18</sup>

To maintain political confidence and support from the Peronist governors in the Congress, Menem kept federal–provincial transfers at unsustainable levels while continuing to add to the public debt.<sup>19</sup> Meanwhile, he privatised a series of state-owned enterprises under far from transparent conditions and borrowed heavily from the Fund – signing four agreements with IMF in 1991, 1992, 1996 and 1998 – to finance continued federal–provincial transfers.<sup>20</sup> Consequently, when Argentina started showing signs of economic malaise, many laid the blame on the IMF which had been ‘approving’ and financing Argentina’s economic policies.<sup>21</sup>

President Fernando de la Rúa came to power in 1999 with promises of reviving Argentina’s economy and cleaning up the corruption of his predecessor’s government. In March 2000 de la Rúa’s government signed an IMF Standby Agreement (SBA) for US\$7.2 billion that was initially meant to be a precautionary fund (not to be drawn from) to help signal a positive IMF endorsement to creditors. In August 2000 the then Economy Minister Jose Luis Machinea announced that the budget would exceed projected targets by 10 per cent. Argentina had failed to get sufficient international credit – in common with many other emerging market economies at the time – and this circumstance, combined with the trapings of a convertibility regime during a time of dollar appreciation, meant that Argentina was draining its foreign exchange reserves and was compelled to turn to the Fund.<sup>22</sup> In November 2000 Argentina asked for an extra US\$13.7 billion under the 2000 SBA that it now intended to use. A few months later, the Fund’s Executive Board approved the request to augment the funds of the 2000 SBA, assessing that the liquidity crisis Argentina faced could be perhaps mitigated through additional finding.<sup>23</sup>

Argentina’s worsening economic and political situation moved to a different stage in March 2001, when Minister Machinea resigned. Minister Lopez Murphy, Machinea’s replacement, failed to last in his post for three weeks after announcing a US\$4.45 billion austerity programme which created great discord within the government. President de la Rúa brought back Domingo Cavallo in an attempt to return the economy to order. The IMF internally recognised that Argentina’s debt and pegged exchange rate was unsustainable, but it continued with the May review and *de facto* endorsement of the SBA for ‘non-economic’ or political reasons.<sup>24</sup>

In a position of considerable power and enhanced control, Minister Cavallo announced in June 2001 that Argentina had completed a debt-swap of government bonds of almost US\$30 billion by extending bond maturity dates. The Fund was not consulted on the debt-swap and quietly held that this move would further erode investor confidence in Argentina.<sup>25</sup> Amid rumours that President de la Rúa might resign, domestic investor confidence dipped along with stock exchange prices and international credit agencies lowered Argentina’s credit rating. IMF–Argentinean relations 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.<sup>26</sup>

Because of this fear of failure, the IMF came to Argentina’s rescue again in September, adding another US\$8 billion to Argentina’s existing 2000 SBA. After the three augmentation decisions, the IMF had now promised Argentina

nearly US\$22 billion in access to credit. Cavallo again announced another debt restructuring plan in November, causing individual depositors fearful of domestic bank collapses to withdraw US\$1.3 billion in their savings. Capital flight increased as international confidence decreased, marked by high spikes in interest rate spreads on Argentinean bonds.<sup>27</sup> The government reacted by restricting individual bank withdrawals. The Fund in turn expressed mounting displeasure with Argentinean measures. On 5 December 2001 the IMF announced that it would not approve a requested waiver on an unmet loan condition nor would it complete its scheduled review of the 2000 SBA. The Fund, in effect, had cut Argentina off from any further access to the loan package in place. These restrictions meant that Argentina would soon be in technical default, as it began to fail to service its international debts.

Throughout late December 2001 Argentineans demonstrated against restricted access to savings and, despite the government's state of emergency, protests and popular pressure brought down de la Rúa and Cavallo. Their resignations on 20 December 2001 were then followed by charges of treason against the two for their roles in renegotiating Argentinean debt. In these turbulent circumstances finding a replacement for de la Rúa was difficult, and the caretaker government of President Rodríguez Saa lasted only 10 days before itself resigning.

In January 2002 Eduardo Duhalde, former Vice President under Menem, was appointed as President by the Peronist-led Congress. One of Duhalde's first policies was to abandon the 10-year convertibility regime, while continuing to control currency trading and banking, causing a *de facto* peso devaluation of 30 per cent. Duhalde made Roberto Lavagna the new Economy Minister in April 2002, although both were unable to create political confidence either in the government or on Argentinean streets. In July 2002 Duhalde called for elections earlier than had been mandated. In the long interim period, Lavagna's continued requests for funds from the IMF were unsuccessful as the Fund declared that the reform programme was incomplete. Without access to money and blaming the IMF, Argentina defaulted on its payments to the World Bank (in November 2002) and to the Inter-American Development Bank (in January 2003). After the default to these two other financial institutions, the IMF came in with a US\$6.78 billion rescue package to help Argentina meet immediate payment needs. The January 2003 agreement gave Argentina economic breathing space in the midst of political campaigns for a new president.

The April 2003 election constituted a heated battle between fellow Peronists – former President Carlos Menem and Santa Cruz Governor Néstor Kirchner. Menem had promised to make amends with the IMF and pay back the Fund and its creditors and he placed these actions as top priorities; Kirchner campaigned on the promise that the defence of the domestic interests of the Argentinean populace must come first. After Menem conceded in the second round, Kirchner succeeded in winning the election, ushering in a new administration which endeavoured to fulfill his campaign promise to put the interests of the Argentinean people ahead of those of the international creditors. Politically, Kirchner's promise to stand up to the international creditors won considerable public support. Conceptually, the resistant stance also challenged conventional thinking about the powerlessness of an indebted state and the dominant position of international creditors.

### **Kirchner segments international creditors: April 2003–February 2005**

#### *The Kirchner government's protracted negotiations with the IMF*

Kirchner's approach with regard to the multilateral or official creditors was made up of different layers, with a hard declaratory outer shell and a softer operational interior. The Kirchner government in its public statements had said at the outset of its dealings with the IMF that it would pay what it could but not at the expense of its management of the 'social debt'. The quality of life of Argentine citizens would take priority over the financial debt of the nation's creditors. Yet, at least in comparison to the robust language used against the private international creditors, its criticism of the Fund was more muted, with the initial focus being on the IMF's culpability in overlooking Menem's deeply ingrained corruption. The strategy of the Kirchner government was to deploy these tough words in order to procure the best arrangement possible for Argentina as part of a long-term approach to dealing with its creditors.

One device in Kirchner's wider approach was to play for time with the IMF. From the original default in December 2001, the government took until September 2003 to sign an agreement with the Fund for the rescheduling of its debt. Although a good portion of the waiting period was a result of acute political and economic turmoil surrounding the Argentine crisis, part of the Kirchner government's tactic became the buying of time to allow for political breathing space and an economic recovery (with enhanced tax receipts). To strengthen its bargaining position the Economy Minister Roberto Lavagna released on 4 February 2004 a report detailing how the international financial institutions had continued to receive a greater proportion of payment via the collection of old debt (US\$16.6 billion) than the funds they had lent (US\$9.3 billion) through 2002 and 2003.

The protracted process allowed Argentina to gain concessions from the Fund. In parallel with delaying tactics came negotiating brinkmanship. In September 2003 Argentina fell into technical default for 24 hours in the pursuit of more lenient terms (only making the US\$2.9 billion payment it owed after the Fund had committed to a new loan accord). When an agreement was ultimately due with the IMF the Kirchner government still tried to extract as much as it could up to the deadline. The hallmark of this process remained not symbolic posturing but instrumental haggling.

Right up to the last moment in March 2004, Argentina again threatened to withhold its scheduled loan payment if IMF officials did not give a clear indication that they would approve another review of the stand-by credit package established in September 2003. The Kirchner government also stood up to the IMF's proposal that Argentina aim for a primary budget surplus (before interest payments) of around 4.5 per cent. Lavagna was particularly adamant that growth, not austerity, would restore solvency and that any requirement of a primary surplus above 3 per cent would jeopardise growth and force him either to cut spending or raise taxes.

In the week leading up to the March 2004 loan payment, frantic negotiations took place between the IMF and the Kirchner government with at least four draft revisions being sent between Washington DC and Buenos Aires. On 5 March – just days before the payment was due – the IMF put forward four additional conditions besides the fiscal one needed for approval of the loan

review. However, the Argentine government deemed these conditions 'unacceptable' and Lavagna replied with four counter-proposals.<sup>28</sup>

The four conditions wired by the IMF to the Kirchner government were all related to the linking of its negotiations with a renewal of negotiations with the private international creditors – namely, bondholders, banks and portfolio investments – in an attempt to meet its obligations to private creditors. The first condition concerned the issue of identifying with whom the negotiations were to occur. The second related to the level of support needed to put into effect a rescheduling procedure. The third dealt with the procedures to be used by the banks that would represent Argentina in the negotiations with the private creditors. The fourth focused on the time-line of the negotiations.

Despite all this pressure, the Kirchner government held firm with the IMF on the matter of the separation of the two procedures. The IMF did not get its way on any of the issues it advanced. Instead of continuing to push hard for the acceptance of its conditions it backed off and allowed a very different process to take place. As Senator Cristina Fernandez de Kirchner – the spouse of the President – noted in an interview: 'Argentina hasn't signed up for anything that we cannot fulfil'.<sup>29</sup>

The strongest argument rests not so much on what the agreement did, but what it did not do. Despite enormous IMF pressure, Argentina separated its negotiations with the Fund from those with the private international creditors (which were in effect non-negotiations). The Argentinean government succeeded in taking the issue of resolving disputes with the private international creditors off the table in its dealings with the Fund. This was a considerable break from the Fund's historical role as the effective coordinator and enforcer of private international debt restructuring. Consequently, in an unusual move of dissent, eight members of the 24-member IMF Executive Board abstained from giving their approval of Argentina's September 2003 standby package.<sup>30</sup>

#### *The Kirchner government's non-negotiating approach to the private international creditors*

In its approach to the private international creditors the Kirchner government displayed a resistant stance with none of the subtlety that had been attached to its IMF negotiations. On the margins of the IMF's September 2003 meeting in Dubai, it presented the private creditors with a minimalist offer: a repayment with a 75 per cent face value cut on the defaulted bonds, no recognition of past due interest and an extension of some of the bonds' maturity dates to a period of over 40 years.

The Argentine government's approach of non-negotiating with the private international creditors included refusing to contemplate any kind of engagement beyond 'discussions' with this sector, allowing little or no room for any form of compromise. Semantics aside, the Kirchner government simply made the write-off a take-it or leave-it offer. Going on the offensive, it adopted the position that this was a one-time offer that would not be repeated or replaced by other offers, if declined. Faced with what they considered an unacceptable arrangement, many bondholders felt that they were being 'bullied into taking the most aggressive action to defend our claims'.<sup>31</sup>

The Argentine government's declaratory approach targeting the private creditors was couched in adversarial terms. Questions of legitimacy came to dominate the struggle between the government and the bondholders. The latter talked of the need to uphold the sanctity of contracts. Kirchner contrasted the negativism of the private creditors with the positive future he envisaged for Argentina: 'If they want to squeeze, let them. Here we have Argentines ready to build a new destiny, a new reality.'<sup>32</sup>

Moreover, the Kirchner government repeatedly contrasted its own sense of authentic and constructive purpose with the speculative instincts central to the practices of bondholders. In the past these bondholders had received up to 30 per cent in annual returns. Under current conditions, as Kirchner constantly told his audiences, these players had to accept the consequences of their actions. Bonds implied risk and Argentine bonds implied huge risks. Instead of a 'moral hazard' problem arising from the failure of Argentina to pay, the crisis revealed a distorted incentive structure based on the greed of the traders who continued to sell the bonds to investors without revealing their implied risks.<sup>33</sup> The Argentine government thus attempted to redirect a good deal of its rhetoric at specific debtors such as hedge funds and so-called 'Vulture Funds'.<sup>34</sup>

Guillermo Nielsen, the Argentine Finance Secretary, and the government's principal negotiator within this process, made it clear that the bondholders would not be allowed to substitute their vision for the restructuring of Argentina's debt, stating that the country was not 'a mere Excel computer spreadsheet'.<sup>35</sup> Even so, Argentina's combative stance held considerable risks. On the one hand, scenarios were mooted of capital flight. On the other hand, the spectre was raised of Argentina moving toward the status of an international financial 'pariah' suffering from an investment strike.

The Argentine government started its process of non-negotiation with the assumption that there would no preferential treatment for any one group. The main candidate for such treatment was the Global Committee of Argentine Bond Holders (GCAB). In April 2004, however, it opened up the prospect of one-on-one discussions with the GCAB, although it still maintained that it could not give more than 25 per cent on the dollar. Moreover, after originally saying that only half of the private creditors had to accept the provisions of the rollover to make the terms acceptable, the government moved to allow this number to increase to 66 per cent.

At odds with the temptation to make a quick deal the Argentine government waited for almost two years after the default even to enter 'discussions' (or, as the language evolved during the process, 'consultations', 'talks' or 'meetings') with its private creditors and continued to take a hard line on what it was willing to offer.<sup>36</sup> Viewing these meetings as a battle that had to be waged, Kirchner suggested that any capitulation to these forces in terms of a higher offer would be paid for 'with the sweat of the Argentine people, with the faces of suffering Argentines, with the faces of those who gradually fell by the wayside'.<sup>37</sup>

The final offer made to the private international creditors in January 2005 reflected Kirchner's steadfast position: old bonds would be cut by 70 per cent of the face value and bondholders had 6 weeks to decide. Kirchner declared that the bondholders could 'take it or leave it. We are not going to change. This



is Argentina's final offer'.<sup>38</sup> Indeed, approximately 76 per cent of bondholder took the offer, swapping debts in the very last few days before the 25 February 2005 deadline.

### **Analysing how Argentina segmented its negotiations with the international creditors**

The Argentinean leadership's ability to segment negotiations with the IMF from negotiations with the private international creditors can be attributed to three inter-related factors. First, Argentinean leaders were able to exploit the differences in the goals of the multilateral and private international creditors to their advantage. Second, they used their domestic political situation to further segment the country's creditors by playing a 'two-level game'. Third, in the absence of international political interference, namely from the United States, they were able to take advantage of both the IMF and the private creditors' inherent weaknesses. These interrelated factors are discussed in turn.

First, the IMF and bondholders had competing goals in their approach to negotiations with Argentina. The IMF was concerned with long-term systemic stability, while the bondholders were concerned with short-term material gain. The Argentinean leaders took full advantage of these divergent differences. The IMF's major goal is the preservation of its institutional prerogatives and status, as well as ensuring the stability of the multilateral financial order. This is not to say that the IMF did not have its own short-term interests; after all, the Fund was already highly exposed, the US Congress was not prepared to infuse additional liquidity into the Fund and Argentina was the third largest Fund borrower.<sup>39</sup> But the signal of a potential Argentinean default to other Fund creditors was a real concern. Indeed, if the Fund was effectively 'yielding to blackmail', the hostage was not just Argentinean debt (accounting for 16 per cent of the Fund's outstanding credit) but also other emerging market economies' debt (the combined debt of Brazil, Turkey and Argentina accounted for 72 per cent of outstanding credit).<sup>40</sup> While willing to use disciplinary measures to impose the rules of the game as it saw fit, there was also a decided recognition on the part of the the Fund that some flexibility was needed if the whole system was not to be significantly damaged. With such huge stakes attached to the performance of the international financial system, the maintenance and long-term health of the system remained the essential priority. This willingness to recognise the need to nurture as well as compel introduced an element of adaptability into the Fund's negotiating approach that the Argentinean government was able to play on in order to gain added concessions from the IMF.

Private international creditors were less concerned with system maintenance and more concerned with their short-term interests, confirming Geoffrey Underhill's appraisal that private sector interests in times of crisis have a strong set of 'particularistic' objectives.<sup>41</sup> Rather than being concerned with the systemic legitimacy and on-going credibility of the financial system, private international creditors wanted simply to extract profit (or, at least, minimise loss) from the system. Short-term material self-interest outweighed any longer-term institutional objectives concerning systemic order.

These gaps between the IMF's and the bondholders' goals created space for the Argentinean state authorities as these officials did not thus face a 'creditor coalition'. By skilfully segmenting their negotiations, the authorities offset their own vulnerability. On the one hand, in dealing with the Fund Argentina was open to negotiation and was patient. On the other hand, with the bondholders it was tough, uncompromising and effectively non-negotiating. Kirchner was able to play off the two sides against each other to an unanticipated extent by adopting the dual diplomatic styles of negotiating/non-negotiating, thereby maximising the limited bargaining capacity his government possessed. By leveraging advantage in this fashion the Argentinean authorities were able to shift the debt burden disproportionately to the bondholders.

The second interrelated factor that explains how the Argentinean government segmented the international creditors concerns the advantageous 'two-level' game played by the state.<sup>42</sup> Argentina effectively portrayed a strong political message to its creditors: stability of the Argentinean sociopolitical situation had to be the top priority or else the Argentinean state could collapse. When a concerted populist movement was mounted within Argentina, the threat it posed was used by state officials as a persistent bargaining chip in dealing with its creditors. The so-called 'Piqueteros', an organised and energised lower-class movement for social and political change, were especially militant and convincing in their actions to nudge the Kirchner government to break off negotiations with the IMF. If there were risks in terms of business confidence in the Argentinean state listening to populist sentiments – including popular assemblies, cooperatives, alternative currencies, workers seizing and running factories, together with a vast array of self-help local arrangements that became embedded in the society – there were also advantages to be gained. Immediate political rewards were reaped by playing the populist card *vis-à-vis* the creditors. In defying its creditors, the government could declare that it had chosen to prioritise investment in public infrastructure, such as improvements to the road and rail systems, scholarships to university students and welfare payments, together with increases in wages and pensions. In the midst of the December 2001 protests, the popular slogan on the streets been that of '*que se vayan todos*' ('let's get rid of all [politicians]'). In an impressively short time Kirchner restored legitimacy to the Argentine state, generating a huge surge of personal and political popularity.

In operational terms, the two-level approach was played out by attempting to tilt the burden of a settlement away from the Argentinean public and on to creditors, proportionally more so on the bondholders. Given the status of the IMF as the preferred creditor, in procedural terms the negotiations with the IMF took precedence.<sup>43</sup> Substantively, the Kirchner government asserted that it could not pay both types of creditors – or at least could not do so at the same time with the same flexibility. As Lavagna explicitly put it, 'there is only one pocket and, if you have to pay the IFIs [international financial institutions] what remains is a smaller portion for the private sector'.<sup>44</sup>

The success of this two-level approach was magnified by the third and final interrelated factor in the story of how the Argentinean government segmented its international creditors – the absence of external political interference exposed inherent weaknesses and contradictions in the international financial

system. What stood out here is how little the United States involved itself in Argentina's negotiations with both the IMF and the bondholders.<sup>45</sup> Despite a few diplomatic flare-ups the US adopted a 'hands-off' position.<sup>46</sup> A number of reasons contribute to an explanation as to why the Bush administration adopted this position. One is that the US was distracted by homeland security after 9/11 and its mobilisation for the Iraq war. Another more strategic argument highlights the US concern with keeping Argentina 'on side' with the initiatives on the negotiation of the Free Trade Area of the Americas and the Doha trade round – and thus away from the tighter embrace of Brazil and Mercosur. Still another emphasises the balance presented in the Argentine government's efforts: the charm offensive conducted by Kirchner with the US (with these efforts replicated in Europe with a particular focus on Spain), his reluctance to get too deeply involved in the Group of 20 championed in global trade negotiation by Brazil, South Africa and India, as well as a reward for his tangible offers of help (on Haiti, for example). Finally, the Bush administration's non-involvement in the Argentinean debt situation was in keeping with the unilateralist, isolationist, and conservative ideology prosecuted by the Bush administration.<sup>47</sup> Simply put, Argentina's collapse was an intentional signal from the United States to world investors that it would not 'bail out' creditors and countries.<sup>48</sup>

The point is that the United States did not defend the 'Washington Consensus' or make threatening overtures indicating that defaulting on either multilateral or private creditors would be met with international or bilateral condemnation.<sup>49</sup> Consequently, in contrast to structuralist arguments that international power has moved away from states to markets,<sup>50</sup> we see here a reiteration of the relational power of the US *vis-à-vis* the international financial system.<sup>51</sup> With its reluctance to get involved in Argentina's debt situation, the Kirchner government could effectively exploit weaknesses in the international financial system itself: eroding IMF confidence in its own prescriptive policies and playing off the divisions amongst the bondholders.

Concerning the IMF, if the Argentine crisis did not expose an outright crisis of confidence, it certainly accentuated a loss of arrogance. Having built up Argentina as the 'star pupil' in the front row of emerging markets, the Fund's standing was linked to some extent to this image of success.<sup>52</sup> This reputational stake was especially salient because, unlike the Asian crisis, the IMF had a 10-year-old relationship with Argentina. Again, simply put, the Fund should have done a better job of predicting the crisis. According to its own Independent Evaluation Office (IEO) study on what went wrong, 'the IMF on its part erred in the *precrisis period by supporting the country's weak policies too long*, even after it had become evident in the late 1990s that the political ability to deliver the necessary fiscal discipline and structural reforms was lacking'.<sup>53</sup> For its part, the Kirchner government drew attention to the fact that the Fund should have known better. In declaratory terms, an element of this approach was to try to shame the Fund because, as Nielsen argued, there has been a key 'decision by multilateral institutions to sustain convertibility' (and increase its own proportion of the debt load) through 2001. This in turn led to a 'rather skewed relationship between IFI debt and defaulted debt, which led to an unavoidable squeeze of the private debt subject to restructuring'.<sup>54</sup>

Nor did the United States try to rally the bondholders or uphold their legitimacy, thereby exposing the high degree of fragmentation of personnel and practices among the bondholders. Unlike earlier crises – most notably, the Mexican peso crisis in 1994–5 – there was no international (namely, US) appetite or capacity for a major ‘bail out’ involving a wider number of governments and private interests. Nor with the shift to the secondary market was there the same prospect that banks could simply wait the crisis out by building up their capital assets and absorbing the losses. While some creditors grudgingly accepted this approach the majority kept up the pressure by utilising various tactics of collective action. Nevertheless, the clubbishness of the established banking order (manifested through a continuity of personnel and informal institutions such as the Bank Advisory Committee and the London Club) had manifestly eroded somewhat under the weight of new, complex and inherently risky forms of competition and business dealings. For example, Anne Krueger, the Deputy Managing Director of the Fund, contrasted the ‘generally orderly’ world she operated in during the 1980s with the world at the turn of the twenty-first century, with private investors who ‘were increasingly numerous, anonymous, and difficult to coordinate’.<sup>55</sup> Huge divisions existed between the investment banks which sold bonds and the ‘buy side’ that catered to emerging markets.<sup>56</sup> Most of the investment funds lacked any skill-set which would allow them to negotiate with an effective government, as became apparent with the resort to hired hands (most notably, the eventual turn by European and Japanese bondholders to such experienced hands as Adam Lerrick, a Carnegie Mellon University economist and lead negotiator for the Argentine Bond Restructuring Agency, and Angel Gurria, the former Mexican Finance Minister).

Exploiting the weakened and fragmented bondholders, the Kirchner government treated categories of creditors quite differently from – and against – each other. It effectively delegitimised the private creditors. As Nielsen remarked:

On one side of the table you have a nation; it’s easily identifiable; it’s a clear-cut situation. On the other side of the table . . . there are thousands of individuals and firms, with widely divergent objectives and priorities. Some so-called creditors include institutions that placed the bonds among depositors, and in many cases are being sued by those former customers, with clear conflict of interests. They also include representatives that are really concerned on making huge fees on the way, but with little knowledge of their clients’ situations and goals.<sup>57</sup>

As noted, the Argentine government took a consistently hard line against the GCAB, the biggest creditor group, questioning its credibility as a representative body and its authority to conduct negotiations. In a clear attempt to dilute still further the GCAB’s legitimacy, it took a far more conciliatory approach to other groups, most notably the Argentine Bond Restructuring Agency (ABRA). This segmentation in turn reinforced severe contrasts in negotiating styles between the bondholder groups. The GCAB boycotted the first planned meetings between creditor groups and the Argentine government in June 2004, because the

site chosen was Buenos Aires (not New York) and the meetings were not preceded by technical pre-talks. In marked contrast, the ABRA took part in these discussions. As regards location, the Argentinean state simply refused to concede to any suggestion that they should be held in New York (or even London or Paris). In terms of actors, the Kirchner government also took the initiative – albeit with some considerable hesitations and tensions – to establish a Bank Advisory Committee of its own choice. By February 2004 it had designated three banks – Merrill Lynch, Barclays Capital and UBS – along with three domestic institutions – Galicia, Frances and Nación – to initiate this process.<sup>58</sup>

Given these geographical and institutional limitations, the bondholders could not work in a coordinated or decisive fashion to apply sanctions on the Argentinean state. Throughout the crisis these creditors mooted a number of disciplinary options, either directly (the seizure of overseas Argentine state property) or indirectly (putting obstacles in the way of the trade negotiations between the European Union and Mercosur). But, notwithstanding a great deal of press speculation (ranging from stories about the fate of President Kirchner's plane – Tango One – on foreign travel to attempts by some hedge funds to litigate the full face value of the debt or seize Argentina's defaulted assets), these tactics gathered no sustained traction. Taking a hard line with bondholders at the outset of the process allowed the Kirchner government to build confidence and a momentum that it never conceded. Those holding out against the February 2005 debt exchange offer were told in no uncertain terms by Roberto Lavagna, the Economy Minister, that they would 'get absolutely nothing today, not tomorrow nor in a month'.<sup>59</sup>

## **Conclusion**

From this analysis of the Argentinean crisis, the power of international creditors' discipline appears to be far more elusive in practice than might be expected. With such high stakes involved, and the risk of a demonstration effect, it would appear that both the IMF and international private creditors possessed the will and the capacity to rein in the Argentine government. Indeed, a claim exists that this protracted process is still in train, with a tightening degree of pressure being exerted via the IMF and the G7.<sup>60</sup> Yet even this longer-term scenario, the limitations on the reach and the delayed response of the forces of coercion – as much as their impact – deserves attention. The notion of structural discipline sets the 'reach of coercion' at a level that, at least in the Argentine case, failed to match realities. The IMF and bondholders operate in different if overlapping worlds and their sense of purpose and interests, far from being monolithic, continues to be distinctive and competitive in flavour.

As in other areas of international political economy, moreover, the domestic political context cannot be excluded from consideration by means of an exclusively 'outside-in' prism of analysis.<sup>61</sup> The Kirchner government revealed that it could do much to gain and retain momentum, modifying the direction of discourse and policy innovation. Albeit under enormous stress, it found ways to create room for manoeuvre *vis-à-vis* its creditors by a combination of technical acumen and diplomatic skill. In no way did this segmented approach – prying open space within the international financial system – guarantee complete

success. But it helped ward off the full force of coercive control at the key moment of crisis and subsequently adjusted both its pace and degree. The overall impression generated is thus one of great nuance and equipoise in the contest between the power of international creditors and the reassertion of state control.

## Notes

We benefited from the comments and advice of Eric Helleiner, three reviewers, and the editors of *New Political Economy*. Kelly Jackson and Andrew Schrumm assisted on research. CIGI and the Social Sciences Research Council provided financial support.

1. Stephen Gill, *Power and Resistance in the New World Order* (Palgrave, 2003).
2. Randall Germain, 'Global financial governance and the problem of accountability: the role of the public sphere', unpublished paper delivered to the annual conference of the International Studies Association, Portland, Oregon, 2003. See also Susanne Soederberg, 'The Emperor's New Suit: The New International Financial Architecture as a Reinvention of the Washington Consensus', *Global Governance*, Vol. 7, No. 4 (2001), pp. 453–67.
3. Susan Strange, 'The Defective State', *Daedalus*, Vol. 124, No. 2 (1995), pp. 55–74.
4. The most complete study of this case is Eugenio Andrea Bruno, *El default y la Reestructuración de la deuda* (Nueva Mayoría, 2004).
5. Randall Germain, 'Reforming the international financial architecture: the new political agenda', in: Rorden Wilkinson and Stephen Hughes (eds), *Global Governance: Critical Perspectives* (Routledge, 2002), p. 22.
6. Charles Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (University of California Press, 1985); and Benjamin Cohen, 'Balance of payments financing', in: Stephen Krasner (ed.), *International Regimes* (Cornell University Press, 1981), p. 175. Lipson adds that foreign direct investors tend to be more competitive with each other and act unilaterally, but that financial institutions and bondholder groups have more shared investments and interests.
7. Cohen, 'Balance of payments financing', p. 327.
8. See Erica Gould, 'Money Talks: Supplementary Financiers and International Monetary Fund Conditionality', *International Organization*, Vol. 57, No. 3 (2003), pp. 551–86.
9. Lipson, *Standing Guard*, pp. 170–75; and Cohen, 'Balance of payments financing', p. 332.
10. Arguments to give the Fund added control over sovereign debt restructuring akin to the US bankruptcy rules of Chapter 11 have been debated and then rejected principally by major creditor states. IMF Deputy Manager Director Anne Krueger supported the establishment of a Sovereign Debt Restructuring Mechanism to help the rescheduling of bond debt. See Anne Krueger, *A New Approach to Sovereign Debt Rescheduling* (International Monetary Fund, 2002). Critics of the proposal, however, argued that the IMF would be in a conflict of interest as a principal lender and an arbiter of debt restructuring. See Yilmaz Akyuz, *Reforming the Global Financial Architecture* (UNCTAD, 2002).
11. Lipson, *Standing Guard*, pp. 170–71.
12. Miles Kahler, 'Bargaining with the IMF: Two level strategies and developing countries' in: Peter Evans *et al.* (eds), *Double-Edged Diplomacy International Bargaining and Domestic Politics* (University of California Press, 1993), p. 363.
13. Lipson, *Standing Guard*, pp. 170–71.
14. *Ibid.*, p. 176. Also see Pierre Dhonte, 'Conditionality as an Instrument of Borrower Credibility', *IMF Paper on Policy Analysis and Assessment* (International Monetary Fund, 1997).
15. Fund critics further charge that this induces moral hazards in the financial system. See Ralph Bryant, *Turbulent Waters: Cross-border Finance and International Governance* (Brookings Institution, 2003), pp. 325–9. Moreover, others have negated the catalytic effect of Fund loans. See Graham Bird & Dane Rowlands, 'Catalytic Effect of Lending by the International Financial Institutions', *World Economy*, Vol. 20, No. 7 (1997), pp. 967–91.
16. Akyuz, *Reforming the Global Financial Architecture*, p. 129.
17. See IMF, *Fund Policy on Lending to Arrears to Private Creditors—Further Consideration of the Good Faith Criterion* (IMF, 2002).
18. Pamela Starr, 'Argentina: Anatomy of a Crisis Foretold', *Current History*, February 2003, p. 67. Cavallo adds that this is when Argentina should have switched to pegging its currency to a basket of foreign currencies. See Domingo Cavallo, 'Argentina and the IMF during the Two Bush Administrations',

- International Finance*, Vol. 7, No. 1 (2004), p. 143. Those blaming the exchange rate regime include Martin Feldstein in 'Argentina's Fall: Lessons from the Latest Financial Crisis', *Foreign Affairs*, Vol. 81, No. 2 (2002), pp. 8–14.
19. Starr, 'Argentina'. See also Michael Mussa, *Argentina and the Fund: From Triumph to Tragedy*, Policy Analysis in International Economics, No. 67, Institute for International Economics, Washington DC, 2002.
  20. Many have blamed the federal structure of Argentinean politics as a prime reason for excessive borrowing and eventual financial collapse. See Cavallo, 'Argentina and the IMF during the Two Bush Administrations'.
  21. According to the Fund's own Independent Evaluation Office, IMF staff failure to stop funding Argentina despite predicting policy failures was a pre-crisis mistake. See Independent Evaluation Office (IEO), *The IMF and Argentina. 1991–2001* (IMF, 2004), p. 3.
  22. According to Calvo *et al.*, the combination of adverse external shocks and the reversal of capital flows in Latin America best explains the Argentinean crisis. See Guillermo Calvo *et al.*, 'Sudden Stops, the Real Exchange Rate and Fiscal Sustainability: Argentina's Lessons', Inter-American Development Bank, Washington DC, 2002.
  23. IEO, *The IMF and Argentina, 1991–2001*, p. 5.
  24. *Ibid.*, p. 5.
  25. *Ibid.*, p. 13.
  26. *Ibid.*, p. 5.
  27. *Ibid.*, p. 13; moreover, Cavallo added that Krueger's call for an SDRM at the time of Argentina's planned debt swap made investors more fidgety, compromising the process further. See Cavallo, 'Argentina and the IMF during the Two Bush Administrations', p. 147.
  28. The deadlock was finally broken by a 30-minute telephone conversation between Kirchner and Krueger.
  29. Quoted in Paul Blustein, 'Argentina agrees to pay IMF', *Washington Post*, 10 March 2004. Similarly, a number of points can be made in support of Senator Kirchner's view. In comparative terms, the 3 per cent figure compared favourably with the 4.5 per cent to which Brazil—after its own debt crisis—had been held. In terms of a *quid pro quo* the debt payment made to the IMF by the Kirchner government was contingent on an equal sum being released to Argentina in the form of the loan. There was also the consideration that the debt payment constituted only about 20 per cent of Argentina's US\$15 billion of foreign reserves.
  30. At the head of this group of objectors were the representatives of three G7 states – Italy, Japan, where many individuals holding Argentine bonds live, and Britain. The finance ministers of the influential G7 countries who met in Miami in February 2004 urged that the Kirchner government 'be more flexible' in its dealings with private bondholders.
  31. Hans Humes, portfolio manager of US mutual fund Van Eck Global, quoted in Paivi Munter & Jenny Wiggins, 'Bond prices fall as rules are rewritten', *Financial Times*, 23 September 2003. Interestingly, however, Humes sounded a far more positive note about the introduction of the set of restrictions imposed in June 2003, requiring investors to keep their money in the country for at least 180 days. See *Brady Net Forum*, 26 June 2003.
  32. Quoted in Jon Jeter, 'Most Argentines back their president, not debt', *Washington Post*, 28 February 2004.
  33. This was a classic case of what Susan Strange captured in her memorable phrases 'Casino Capitalism' and 'Mad Money'. See Susan Strange, *Mad Money* (Manchester University Press, 1998).
  34. Although these actors were certainly on the scene in Argentina, their presence was still overshadowed by other forms of investors. Within the secondary market the institutional bondholders included asset managers and institutional investors such as mutual fund and insurance companies.
  35. Observer, 'Cry for him', *Financial Times*, 8 December 2003.
  36. Some divisions within the state apparatus appeared as the process dragged on, most notably when Cabinet chief Alberto Fernandez in comments to a local radio programme in May 2004 floated the idea of investors being able to recover some of the accrued interest which the bondholders argued was owed to them. See 'Lavagna, Fernandez disagree', *Buenos Aires Herald*, 28 May 2004.
  37. Quoted in Adam Thompson, 'Argentina sees growth outstrip even optimists' best estimates', *Financial Times*, 23 January 2004.
  38. Quoted in Bryan Brynes, 'Argentina plays chicken with foreign investors', *The Christian Science Monitor*, 9 February 2005.
  39. Eric Helleiner, 'The Strange Story of Bush and the Argentine Debt Crisis', *Third World Quarterly*, Vol. 26, No. 5 (2005), pp. 25–6.
  40. Martin Wolf, 'The IMF should stand firm against Argentine blackmail', *Financial Times*, 8 March 2004.

41. Geoffrey Underhill, 'Private markets and public responsibility: conflict and co-operation in transnational banking and securities regulation', in: Geoffrey Underhill (ed.), *The New World Order in International Finance* (St. Martin's Press, 1997), p. 43.
42. For a similar argument, see Howard P. Lehman & Jennifer L. McCoy, 'The Dynamics of Two-Level Bargaining Games', *World Politics*, Vol. 44, No. 4 (1991), pp. 600–44. For the origins of the two-level games argument in International Relations theory, see Robert D. Putnam, 'Diplomacy and Domestic Politics: The Logic of Two-Level Games', *International Organization*, Vol. 42, No. 3 (1988), pp. 427–60.
43. For a neoliberal criticism of this bias, see Desmond Lachman, *The Argentine Debt Charade*, American Enterprise Institute for Public Policy Research, 23 April 2004.
44. Quoted in Adam Thompson, 'Argentina on the edge: what are the consequences of another default?' *Financial Times*, 8 March 2004.
45. Cavallo goes as far as to blame the United States' lack of leadership, under President George W. Bush, in international finance as being one of the main factors that led to Argentina's economic problems. See Cavallo, 'Argentina and the IMF during the Two Bush Administrations', p. 148.
46. On US Treasury Secretary Paul O'Neil's experience with Argentina, see Ron Suskind, *The Price of Loyalty: George W. Bush, the White House, and the Education of Paul O'Neil* (Simon Schuster, 2004). For different assessments, see Steve H. Hanke, 'Argentine "bank robbery": US looks the other way', *A Cato Commentary, Wall Street Journal*, 21 March 2003; 'Kirchner seeks Bush's backing in talks with IMF', *Washington Times*, 22 July 2003; and Miguel Diaz, 'Argentina Alert; Welcome to Washington President Kirchner', *CSIS Hemisphere Alert*, Vol. X1, Issue 26, 21 July 2003.
47. Helleiner, 'The Strange Story of Bush and the Argentine Debt Crisis'.
48. See Cavallo, 'Argentina and the IMF during the Two Bush Administrations', p. 148.
49. The US was far from practising 'dollar diplomacy'—a history of defending US private and multilateral economic interests in the developing world to uphold the capitalist system.
50. See Susan Strange, *The Retreat of the State* (Cambridge University Press, 1996).
51. For a strong version of the structuralist–realist argument about US supremacy in relation to international institutions, such as the IMF, see John Mearsheimer, 'The False Promise of International Institutions', *International Security*, Vol. 19, No. 3 (1994), pp. 5–49.
52. See for example, 'Argentina and the IMF: which is the victim?', *The Economist*, 4 March 2004; and Economist Intelligence Unit, 'Argentina: finance, government sidesteps new default', *EIU views wire*, 10 March 2004. For the most complete treatment of the IMF–Argentina relationship, see Michael Mussa, *Argentina and the Fund: From Triumph to Tragedy*, Policy Analyses in International Economics, Institute for International Economics, Washington DC, July 2002.
53. IEO, *The IMF and Argentina, 1991–2001*, p. 3. Emphasis added. Specifically, the IEO claimed that staff failed to raise concerns regarding the exchange rate policy, enforce fiscal conditionality and prescribe sufficient structural reforms.
54. Merrill Lynch, 'An update on Argentina by Guillermo Nielsen, Secretary of Finance, Argentina', presentation to Latin American Investor Conference, 27 March 2004, p. 2.
55. Quoted in Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery* (Brookings Institution Press, 2003).
56. *Ibid.*
57. *Ibid.*
58. Merrill Lynch, 'An update on Argentina'. A debate persisted whether Merrill Lynch was drawn into this process because of a desire for corporate profile or the prospect of selling more Argentine bonds.
59. Adam Thompson, 'Argentina rejects talks with hold-out creditors', *Financial Times*, 12 April 2005.
60. Marcus Miller & Javier Garcia Fronti, *Argentina in Default: The Renegotiation Game*, Centre for the Study of Globalisation and Regionalisation Working Paper, University of Warwick, 19 December 2003.
61. On this point, see Philip Cerny, 'Politicizing the global', in: James Busumtwi-Sam & Laurent Dobuzinskis (eds), *Turbulence and New Directions in Global Political Economy* (Palgrave, 2003), pp. 24–6; and Geoffrey Garrett, 'Shrinking states? Globalization and national autonomy', in: Ngaire Woods (ed.), *The Political Economy of Globalization* (Macmillan, 2000), pp. 107–22.