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# ***DEBTCOM CONFERENCE***

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## ***FROM MEXICO TO ARGENTINA :***
## ***WHAT HAVE WE LEARNED ?***

Among the many sovereign debt crises that the world has experienced over the last 35 years, let me focus on Mexico (1982) and Argentina (2000). I shall try to draw a few lessons that seem still valid today.

***I – The causes of the crises were similar in both cases.*** They were related to overindebtedness, macro-economic imbalances, loose fiscal and monetary conditions.

- To many observers of the time, the increased indebtedness seemed sustainable as long as nominal prices and export revenues were continuing to rise.

- But in both cases, this "gentle assessment" by international financial markets ended abruptly :

  a) In the Mexican case, the hike in Fed interest rates (1979-1980) and the subsequent recession, interrupted the basic conditions on which the country had thrived.

  b) In the case of Argentina, the mastering of inflation by Minister Cavallo's monetary regime was defeated by the slippage of fiscal policies in the mid 1990s (public accounts deteriorated by an amount of 20% of GDP in 5 years). Under such conditions, Argentina heavily borrowed on external markets which started to hurt market confidence in the country's credit standing.

## ***II – The handling of the crisis was completely different.***

a) In the case of Mexico in 1982 a true "collaborative" strategy was enforced :

- A strong adjustment program was negotiated by the IMF
- Negociations between creditors and Mexico on "new money" and debt rescheduling were engaged to avoid a unilateral default (grace periods, roll over of maturities).

b) The case of Argentina was more difficult to handle because of the nature of the debt incurred (bonds sold to the market instead of commercial bank loans to Mexico). The negociations with creditors did not take off.

Besides, no meaningful discussion with the IMF took place at the time and the default was officially declared in 2001. Half-hearted IMF programs appeared weak and, in fact, were more a way to help Argentina avoid a default vis-à-vis the Fund than a meaningful adjustment program that would have reassured the markets.

Eventually, President Kirchner – who took office in 2003 – decided unilaterally a debt restructuring whereby Argentina was prepared to pay 25% of its debt to creditors (but if one takes into account the interest owed by Argentina since the default, the "haircut" imposed amounted, in fact, to 92% in net present value terms). The approach was thus different from Mexico :

Indeed, 30% of Argentine debt was due to IFIs who were entitled to full repayment. This, consequently, implied very heavy haircuts for private creditors.

## ***III – The lessons.***

a) In the case of Mexico a virtuous circle was triggered :

- No unilateral actions but
- Negociations of debt relief with creditors
- Strong Fund programmes
- And eventually, as Mexico regained balance of payments stability and as banks had engaged in significant writedowns and provisions, the Brady Plan (1989) could encourage the negociation of a reduction of Mexican public debt. Besides, through the securitization of discounted debt instruments, Mexico could buy back part of its debt at depreciated prices.

To sum up, bank creditors granted debt relief in exchange for greater assurance of repayment in the form of an appropriate collateral. The exchange of bank loans could take the form of Par or discounted 30 years Bonds (at the choice of creditors) :

- Par (with lower interest rates) or
- Discounted capital (30-50% discount with a market interest rate)

The principal was secured at final maturity by a pledge of 0 coupon US Treasury securities.

b) In the case of Argentina, the unilateral nature of the decisions taken by the Government on debt restructuring trigerred a negative reaction by financial markets. Many litigations were carried out. In fact, Argentina was cut off, for more than a decade, from external capital inflows. This impacted severely investment in the country.

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The lessons are straightforward :

- One should always focus on surveillance and prevention of crises,
- discourage short-term foreign borrowing,
- and when debt is not sustainable, insist on the negociation of debt restructuring between creditors and the borrower.

As the “statutory” solution proposed by the IMF in 2002 (Special Debt Restructuring Mechanism - SDRM - ) did not take off, “market” solutions seem definitely better.

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