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Marcus Miller

Argentina, Debt Relief, and Vultures What are the lessons for Europe?

Sovereign debt continues to hang over the Eurozone. Debt burdens have limited the fiscal options of member states. Debt and default, actual and feared, have embittered the relations among them.

The legacy of Argentina's 2001 default provides a cautionary tale for the Eurozone.

In a final settlement, Argentina's long-term holdout creditors – so-called vulture funds - have secured full compensation for the bonds they acquired for a fraction of their face value, and more in other charges and penalties.

Professor Marcus Miller from the University of **Warwick's Centre for Competitive Advantage in the Global Economy (CAGE)** will discuss the implications for Europe. He will propose a reform in the way sovereign debt is issued, replacing standard debt contract with state-contingent debt – so-called GDP bonds.

The lecture will be followed by a policy dialogue moderated by **Mr Richard Tuffs, Director of the European Regions Research and Innovation Network (ERRIN)** including:

- **Mr Ernest Urtasun** - MEP, Vice-President of the Euro-Latin American Parliamentary Assembly European Parliament
- **Mr Christian Engelen** – Team Leader for Stability Mechanisms in the Directorate Treasury and Financial Operations DG ECFIN (Economic and Financial Affairs) - European Commission

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Argentina, the vultures and the future of sovereign debt restructuring

Sovereigns who borrow with bonds are uniquely vulnerable, but they are also uniquely shielded. They are *vulnerable* because there is no bankruptcy court where they can 'file for protection' against creditors. They are *shielded* because sovereigns typically do not own many assets in their own name outside of their borders; and the few assets that are frequently held abroad, such as embassies and consulates, are clothed with special immunity from creditor seizure.

So said Lee Buccheit, the doyen of sovereign debt restructuring, in 2014. But that was before the final victory of long-term holdout creditors against the Republic of Argentina , where the principal holdouts involved – so-called vulture funds - have not only secured full compensation for the bonds they acquired for a fraction of their face value, but have secured more, much more, in interest charges, penalty clauses and legal costs.

What brought the vulture funds their stunning victory? It was no magical sword that shattered the sovereign's shield of protection, it was the legal doctrine *pari passu*. This doctrine, created it seems by Judge Griesa in the second circuit court of NY, puts settling the exorbitant claims of vulture funds on the same footing as paying coupons to those creditors who have earlier taken a write-down. By invoking this doctrine, holdout creditors can threaten to unravel the entire process of debt restructuring that has gone before. So armed, they can get pretty much what they ask for.

With this judgement, it has been shown that being a holdout is a way to riches – "it may take time but it is a true path to prosperity", as Buccheit puts it. What does this imply for sovereign debt restructuring in future? If the case of Argentina is taken as a precedent, it could spell the end of voluntary debt restructuring. Only suckers should accept haircuts: why give up some of your claim if those who give nothing are given equal treatment? It could also mean that vultures get their exorbitant claims quicker: why will sovereigns stay and fight if this just adds penalty costs and legal fees to the face value they will have to pay?

Perhaps Argentina was a special case? The sovereign debtor's challenge - that she would never pay the vultures a cent – meant the Judge had to assert the superiority of the court; which he did by invoking the doctrine of *pari passu* and giving judgement to the holdouts. In future, with suitably well–behaved sovereigns, the doctrine will not be invoked.

Well maybe, just possibly. But note that the US Treasury briefed in favour of Argentina and against *pari passu* in their submissions to the US court involved. So official US saw the doctrine as a threat to sovereign debt restructuring. So did the IMF, as they hastened to recommend changes in collective action clauses (CACs) which would give a super-majority of the other creditors the power to 'cram down' their terms and to block the claims of the holdouts. (It is also noticeable that the big international banks recently showed willing to help Argentina achieve a settlement – albeit painful – and so to avoid an unravelling of the entire debt restructuring process.)

What about Europe, where sovereign debt problems abound? There has been no promulgation of *pari passu* in the sense of Judge Griesa: but debt restructuring is surely under threat. Holdouts were promptly paid in full in the case of Greece, for example, so as to make sure they did not block restructuring.

Steps have been taken to strengthen existing CACs by adding aggregation features; and there has been talk of statutory protection of sovereigns by Treaty amendment.

But fiddling with existing contracts and half-hearted statutory moves lack conviction: what they promise is a paradise for lawyers rather than efficient risk-sharing procedures.

The best response surely lies in a switch away from plain vanilla debt to what economists call state-contingent contracts. *GDP bonds* are an example; Robert Shiller has long argued that these offer an attractive bet on the future prospects of whole economies rather than simply quoted companies. Olivier Blanchard has recently added his voice to the case for such debt as a way to create more fiscal space in recession and to reduce the tail risk of sovereign default. Pooling of sovereign debt in Europe could add extra chance of diversification. Banks are now issuing CoCo (contingent convertible) bonds that convert to equity in case of need: *Sovereign CoCos* might be another mechanism for introducing flexibility into debt contracts.

Sovereigns both in emerging markets and in Europe face the prospect that holdouts pursuing private profit will prevent socially desirable debt restructuring. Fear that public debts cannot be restructured in turn gives succour to the proponents of austerity, who advocate spending cuts so as to avoid issuing debt; but in a liquidity trap austerity leads to recession.

Some financial innovations proved dangerous and led to crisis. But those we propose could help avoid the debt crisis spiralling into recession and unemployment.

SPEAKER BIOGRAPHIES

Professor Marcus Miller

Marcus Miller is a professor of economics at the University of Warwick, currently teaching macroeconomics to undergraduates and international macro to Masters students. He is a research associate of CAGE and a research Fellow at CEPR, London. He was educated at Oxford University (PPE) and Yale University (PhD). His previous academic positions were at the London

School of Economics & Manchester University, with visiting teaching positions at Chicago University Business School and Princeton University.

Miller has worked as an economist at the Bank of England (and later held Houblon-Norman Fellowships there); acted as advisor to the Treasury Committee of the House of Commons; was member and chair of academic panel of the Treasury and joint director of international macroeconomics programme at CEPR from1986 to 1991. Over the years he has been visiting fellow/economic consultant at the OECD, TACIS (Technical Assistance to the CIS, on Macroeconomic Policy in the Ukraine), IMF, World Bank, ECB; and recently at the Inter-American Development Bank.

Miller was a contributing editor to Exchange Rate Targets and Currency Bands (with Paul Krugman), CUP (1992) and the Asian Financial Crisis (with Pierre-Richard Agénor and others), CUP (1999), among other books published. His recent co-authored papers include “QE and Tobin’s Q” and “When bigger isn’t better: bailouts and bank reform” in Oxford Economic Papers; and “Eurozone Sovereign Debt Restructuring” in Oxford Review of Economic Policy.

His current research topics involve endogenous financial crises; sovereign debt restructuring; fiscal consolidation in Europe; and imprisonment as worker-discipline in Stalin’s Russia.

Mr Ernest Urtasun

Ernest Urtasum is a Spanish MEP for the Group of the Greens/European Free Alliance. Having previously worked in the Parliament as an

MEP assistant, and then in the Spanish Diplomatic Service, he was elected an MEP in 2014. He is a member of the Parliamentary Committees on Economic and Monetary Affairs, on Women's Rights and Gender Equality and is a substitute member of the Foreign Affairs Committee. He is also Vice-President of the Euro-Latin American Parliamentary Assembly and member of the Delegation for relations with Central America.

Mr Christian Engelen

Christian Engelen is working for the European Commission as Team Leader for Stability Mechanisms in the Directorate Treasury and Financial Operations of DG ECFIN. The topics he is dealing with include a broad range of institutional and legal issues related to sovereign debt markets and the European framework for financial assistance for Member States. Previous to his current position, he has worked in different positions in DG ECFIN and DG FISMA on topics related to financial stability, financial regulation and macro-prudential policy. Before joining the Commission he has worked for more than six years in the financial stability department of Deutsche Bundesbank in Frankfurt on topics related to global financial stability and international monetary policy. In that capacity he has also followed closely the international discussions in the area of sovereign debt restructuring and the work of the IMF in that context. He holds a PhD in Economics from University of Passau and a LL.M. in Finance from the Institute for Law and Finance (ILF) at Goethe-University Frankfurt.

Mr Richard Tuffs

Richard Tuffs has been working in the regional dimension of European policy in cohesion and research for many years and worked for the Kent and the West Midlands offices in Brussels before

joining ERRIN. He has been involved in numerous EU projects and is also a member of the Smart Specialisation Mirror Group established by the European Commission. Richard has a degree in geography and social sciences and master's degrees in town planning, applied linguistics and business administration. His career spans town planning language and management training, university lecturing and research and education administration.

About CAGE

CAGE is a research centre in the Department of Economics at the University of Warwick. Funded by the UK Economic and Social Research Council (ESRC), CAGE is carrying out a 5 year programme of innovative research. The centre's research programme is focused on how countries succeed in achieving key economic objectives such as improving living standards, raising productivity, and maintaining international competitiveness, which are central to the economic wellbeing of their citizens. Our research analyses the reasons for economic outcomes both in developed economies like the UK and emerging economies such as China and India. We aim to develop a better understanding of how to promote institutions and policies which are conducive to successful economic performance and endeavour to draw lessons for policy makers from economic history as well as the contemporary world.

Research is organised under four themes:

- What explains comparative long-run growth performance?
- How do culture and institutions help to explain development and divergence in a globalising world?
- How can the measurement of wellbeing be improved and what are the implications for policy?
- What are the implications of globalisation and global crises for policymaking and for economic and political outcomes in western democracies?