



**Argentina's 2001 Debt Default and 2005 Debt Restructuring:
An Update on the Costs to Bondholders, Taxpayers, and Investors**

Robert J. Shapiro and Nam D. Pham

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American Task Force Argentina

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Introduction

In 2001, the Argentine government defaulted on \$81.2 billion of sovereign debt, the largest such default in history. Over the following three years, the Argentine government refused to negotiate terms for restructuring the debt with its bondholders. In 2005, the government issued a take-it-or-leave-it plan with the worst terms ever offered in a sovereign debt restructuring – a bond swap worth less than 25-cents on the dollar and repudiation of all past due interest payments. When nearly one-quarter of its lenders holding \$19.4 billion in Argentine bonds declined the offer, including U.S. lenders holding \$2.1 billion in Argentine debt, the Argentine government repudiated its obligations to those lenders, an unprecedented act in sovereign finance.

In October 2006, we assessed the economic costs of this default, the restructuring plan and the repudiation for the bondholders and for taxpayers and investors in the United States and worldwide, from the default in December 2001 to the restructuring plan in January 2005.¹ We found that these events cost U.S. bondholders \$7.9 billion in capital losses, past due interest payments and foregone investment returns, net of their tax benefits for their capital losses. Further, the default's indirect economic effects cost U.S. taxpayers and equity investors another \$10.4 billion. The default and its restructuring cost bondholders worldwide \$73.6 billion, and worldwide taxpayers and equity investors lost \$63.4 billion. (Table A, Appendix)

The costs to those lenders who accepted the terms of the restructuring ended in January 2005, but the repudiation of the debts owed to foreign lenders who declined the terms of the restructuring imposed additional costs of those lenders from January 2005 to the present.

- We estimate that from January 2005 to December 2007, the losses to U.S. bondholders who declined the restructuring plan continued to rise by an additional \$1.4 billion beyond their estimated \$2.2 billion in net losses from December 2001 to January 2005. The net losses to U.S. bondholders who declined the restructuring total \$3.6 billion from the default in December 2001 to December 2007.
- The net losses to U.S. bondholders who accepted the January 2005 restructuring plan totaled \$5.8 billion, producing net losses for all U.S. lenders to Argentina of \$9.4 billion.

¹ Robert J. Shapiro and Nam D. Pham, "Discredited – The Impact of Argentina's Sovereign Debt Default and Debt Restructuring on U.S. Taxpayers and Investors," American Task Force Argentina, October 2006.

- We estimate that the additional costs from January 2005 to December 2007 to bondholders worldwide who declined the restructuring offer total \$13.3 billion, on top of \$20.7 billion in costs borne by them from December 2001 to January 2005. The total net costs to bondholders worldwide who declined the restructuring is \$34 billion.
- The costs to bondholders worldwide who accepted the January 2005 restructuring plan total \$52.9 billion, producing net losses for all lenders to Argentina of \$86.9 billion.
- In addition, taxpayers incurred indirect costs as the default and restructuring reduced the revenues which bondholders would otherwise have paid on capital income, interest income, an investment returns.
 - These U.S. taxpayer costs for the period January 2005 to December 2007 total an estimated \$515 million, on top of taxpayer costs of \$2.6 billion for the period December 2001-January 2005.
 - The taxpayer costs worldwide for January 2005 to December 2007 total \$4.8 billion, on top of taxpayer costs of \$24.2 billion for December 2001-January 2005.
- U.S. shareholders also incurred indirect costs of \$7.8 billion when the peso devaluation triggered by the default reduced the value of shares in companies with large direct investments in Argentina. These losses are confined to December 2001-January 2005. Those indirect costs for worldwide shareholders were an estimated \$39.2 billion.
- Over the entire period, December 2001- December 2007, the Argentine default and restructuring cost U.S. bondholders, taxpayers and investors an estimated \$20.3 billion, and cost bondholders, taxpayers and investors worldwide an estimated \$155 billion.

The Total Costs for U.S. and Worldwide Bondholders Who Rejected the Restructuring Plan, December 2001-December 2007

The costs to investors who rejected the January 2005 restructuring include three components: direct capital losses; foregone interest payments; and foregone investment returns. Since capital losses generate tax deductions, the net capital losses to these investors are their total direct losses minus the tax benefits from claiming those capital losses.

Capital Losses. The capital losses did not change from January 2005 to December 2007. In our previous analysis, we found that in the three years preceding the default, foreign investors purchased Argentine bonds at an average price of 75-cents per-dollar of face value (that is, an average discount of 25 percent). Therefore, we calculated that American lenders who declined the restructuring had purchased \$2.1 billion in bonds (face value) for nearly \$1.6 billion, and the \$19.4 billion in bonds held by all worldwide investors who rejected the restructuring had been purchased for \$14.5 billion. These losses generated tax benefits of \$355 million for those U.S. bondholders and \$3.3 billion for those bondholders worldwide.

- The repudiation of these obligations by the Argentine government, therefore, generated net capital losses to U.S. lenders who declined the terms of the restructuring of \$1.2 billion (\$1.6 billion minus \$0.4 billion), while investors worldwide suffered net capital losses of \$11.2 billion (\$14.5 billion minus \$3.3 billion). These losses did not change from January 2005 to December 2007.

Foregone Interest Payments. The restructuring did not include any provision for interest owed to bondholders from the time of the default in December 2001 to the restructuring offer in January 2005. For U.S. lenders who declined the terms of that offer, this past due interest totaled \$638 million, and these foregone interest payments for investors worldwide totaled almost \$6 billion. The average annual interest rate for the defaulted bonds was 10.3 percent.

- Applying this implicit annual interest rate to the defaulted holdings of those who declined the restructuring, for the period from January 2005 to December 2007, we estimate that the additional foregone interest, accrued and compounded, totaled \$923 million for U.S. lenders and more than \$8.6 billion for lenders worldwide. The total foregone interest from December 2001 to December 2007 for U.S. lenders who declined the restructuring offer is nearly \$1.6 billion (\$638 million plus \$923 million), and nearly \$14.6 billion for lenders worldwide (\$5.96 billion plus \$8.6 billion).

Foregone Investment Returns. Argentina's lenders also forfeited investment returns when the Argentine government defaulted on their holdings, based on the increased value of other Latin American sovereign debt which tracked Argentina's sovereign bond market until the default. For that calculation, we used the J. P. Morgan Emerging Markets Bond Index Plus (EMBI+) to calculate the returns for emerging markets' external debt instruments, as the proxy for the foregone investment returns for Argentine bond holders in the absence of a default. We found that the foregone investment returns for U.S. investors who declined the restructuring totaled \$373 million from the December 2001 default to the restructuring in January 2005, while those losses for investors worldwide who declined the restructuring offer came to nearly \$3.5 billion.

These foregone returns continue to accumulate for those lenders who declined the restructuring offer. The returns on the J. P. Morgan EMBI+ for Latin America from January 2005 to December 2007 were 32 percent, while the returns for the J. P. Morgan Emerging Markets Bond Index Plus for Argentine bonds over this period were 38 percent. The Argentine returns may be elevated by the low base reflecting the default. Therefore, we use the more conservative 32 percent returns for the Latin American region to calculate additional foregone investment returns from January 2005 to December 2007 for investors who declined the restructuring offer.

Our previous analysis estimated that the foregone investment returns from December 2001 to January 2005 on the principal, based on the average purchase price of the bonds, were \$373 million for U.S. bondholders who declined the restructuring offer and nearly \$3.5 billion for those bondholders worldwide.

- Applying the investment return of the EMBI+ (Latin America) for the period of January 2005 to December 2007 to the purchase costs of the defaulted bonds, we estimate that U.S. bondholders who declined the restructuring absorbed additional losses in foregone

investment returns of \$497 million on their principal. These foregone investment returns from January 2005 to December 2007, combined with foregone investment returns of \$373 million from December 2001 to January 2005, produce total foregone returns for U.S. bondholders from December 2001 to December 2007 of \$870 million.

- Using the same approach, we estimate that the investors worldwide who declined the restructuring absorbed additional losses in foregone investment returns from January 2005 to December 2007 of more than \$4.6 billion on their principal in addition to the \$3.5 billion cost for foregone investment returns on their principal from December 2001 to January 2005. The total foregone investment returns from December 2001 to December 2007 for lenders worldwide who declined the restructuring offer are more than \$8.1 billion.

Total Direct Costs and Net Losses.

- The direct costs for U.S. bondholders who declined the restructuring offer, including their capital losses, foregone interest income and foregone investment returns, from December 2001 to December 2007, total nearly \$4 billion. These investors also could claim an estimated \$355 million in tax benefits from their capital losses, producing total net costs of approximately \$3.6 billion for U.S investors who declined the restructuring.
- The direct costs for bondholders worldwide who declined the restructuring offer, including their capital losses, foregone interest income and foregone investment returns, from December 2001 to December 2007, total \$37.2 billion. Again, since these investors might be able to claim an estimated \$3.3 billion in tax benefits from their capital losses, their total net costs are an estimated \$34 billion.

Table 1. Total Net Losses for Bondholders Who Declined the Restructuring Offer, U.S. and Worldwide, December 2001 to December 2007 (\$ millions)

| | Worldwide | U.S. |
|--|------------------|----------------|
| Gross Capital Losses | \$14,525 | \$1,554 |
| Tax Benefits | -\$ 3,315 | -\$ 355 |
| Net Capital Losses | \$11,210 | \$1,199 |
| Total Foregone Interest Payments | \$14,589 | \$1,561 |
| December 2001- January 2005 | \$ 5,963 | \$ 638 |
| January 2005 – December 2007 (accrued and compounded) | \$ 8,626 | \$ 923 |
| Total Foregone Investment Returns | \$8,134 | \$ 870 |
| On Capital Losses, December 2001 - January 2005 | \$ 3,486 | \$ 373 |
| On Capital Losses, January 2005 – December 2007 | \$ 4,648 | \$ 497 |
| Total Net Losses | \$33,933 | \$3,630 |

Costs to Lenders Who Accepted the Restructuring Plan and Total Costs to All Lenders

In our previous analysis, we estimated that the December 2001 default and January 2005 restructuring produced losses for those U.S. bondholders who accepted the terms of the

restructuring of some \$5.8 billion: \$3.2 billion in direct capital losses, \$2.0 billion in foregone interest payments from December 2001 to January 2005, and foregone investment returns of \$1.2 billion over the same period, less \$700 million in tax benefits for their direct capital losses. (Table A, Appendix)

In our previous analysis, we also estimated that the default and restructuring plan produced losses for bondholders worldwide who accepted the terms of the restructuring of some \$52.9 billion: \$29.5 billion in direct capital losses, \$19.0 billion in foregone interest payments from December 2001 to January 2005, and foregone investment returns of \$11.1 billion over the same period, less an estimated \$6.7 billion in tax benefits for their direct capital losses.

- From December 2001 to December 2007, Argentina's debt default and restructuring plan cost all U.S. bondholders a total of \$9.4 billion (\$3.6 billion + \$5.8 billion).
- From December 2001 to December 2007, the Argentine default and restructuring cost all bondholders worldwide a total of \$86.9 billion (\$52.9 billion + \$34 billion).

Costs to Taxpayers and Investors

In our previous analysis, we also estimated two substantial indirect costs from the default and restructuring: Costs to foreign investors in companies with Argentine operations on their holdings in those companies arising from the sharp devaluation of the peso which accompanied the default, and its effect on the value of their Argentine operations; and revenue losses from the capital losses and the lost interest and investment income, which other taxpayers had to offset. We estimated that the U.S. shareholder losses totaled \$7.8 billion and that those losses for shareholders worldwide were \$39.2 billion. We further calculated that the revenue losses cost U.S. taxpayers \$2.6 billion and taxpayers worldwide \$24.2 billion. (Table A, Appendix)

We do not estimate any additional indirect costs to foreign shareholders in companies with Argentine operations for the period from the January 2005 restructuring to December 2007, because the peso has generally maintained its value since the sharp devaluation at the time of the default. The additional costs to U.S. and worldwide bondholders from foregone interest income and foregone investment returns in this latter period, however, do entail additional costs for taxpayers: Foregone interest and foregone investment income in this period cannot be taxed, so in principle taxpayers have to offset these implied lost revenues. Using the same methodology as our previous analysis, we estimate U.S. tax revenue losses in this period of \$335 million from foregone interest income and \$180 million from foregone investment returns, or a total additional cost of \$515 million for U.S. taxpayers (Table 2, below). The costs to taxpayers worldwide over this period are an estimated \$3.1 billion from uncollected revenues on foregone interest payments and \$1.7 billion in uncollected tax revenues on foregone investment returns, or a total cost of \$4.8 billion for worldwide taxpayers over this latter period. Over the entire period from the default in December 2001 to December 2007, the revenue losses that taxpayers would have to offset total an estimated \$3.5 billion for U.S. taxpayers and \$32.5 billion for taxpayers worldwide.

Table 2: Revenues Losses from the Argentine Default and Restructuring, to be Offset By Taxpayers, U.S. and Worldwide, December 2001-January 2007, (\$ billion)

| Source of Revenue Losses | Worldwide | U.S. |
|---|---------------|----------------|
| Capital Losses | \$10.0 | \$1.1 |
| Foregone Interest Payments (Dec. 01-Dec. 07) | \$5.3 | \$0.566 |
| December 2001-January 2005 | \$2.2 | \$0.231 |
| January 2005-December 2007 (accrued and compounded) | \$3.1 | \$0.335 |
| Foregone Investment Returns (Dec. 01-Dec. 07) | \$3.0 | \$0.315 |
| On Capital Losses, December 2001-January 2005 | \$1.3 | \$0.135 |
| On Capital Losses, January 2005-December 2007 | \$1.7 | \$0.180 |
| Currency Effects on Equity Values (Dec. 01-Jan.05) | \$14.2 | \$1.5 |
| Total Revenues Losses for Taxpayers to Offset | \$32.5 | \$3.5 |

Total Costs

Based on these additional estimates, we find that the Argentine default and restructuring:

- Cost U.S. bondholders, taxpayers, and investors an estimated \$20.3 billion (\$9.4 billion + \$7.8 billion + \$2.6 billion + \$515 million); and
- Cost bondholders, taxpayers, and investors worldwide an estimated \$155 billion (\$86.8 billion + \$39.2 billion + \$24.2 billion + \$4.8 billion).

Appendix

**Table A: The Argentine Sovereign Debt Default and Restructuring:
U.S. and Worldwide Direct and Indirect Costs, December 2001 – January 2005 (\$ billions)²**

| | Worldwide | U.S. |
|--|---------------|---------------|
| Defaulted Debt Eligible for Restructuring, January 2005 | | |
| Principal (face value) restructured to new securities | \$61.8 | \$6.6 |
| Principal (face value) still outstanding | \$19.4 | \$2.1 |
| Total | \$81.2 | \$8.7 |
| Past Due Interest at Restructuring, January 2005 | | |
| Interest owed on securities that were restructured | \$19.0 | \$2.0 |
| Interest owed on securities that have not been restructured | \$ 6.0 | \$0.6 |
| Total | \$25.0 | \$2.7 |
| Direct Costs for Investors Accepting the Restructuring | | |
| Capital losses | \$29.5 | \$3.2 |
| Past due interest payments, December 2001-January 2005 | \$19.0 | \$2.0 |
| Foregone investment returns | \$11.1 | \$1.2 |
| Total Direct Costs | \$59.6 | \$6.4 |
| Tax benefits for capital losses | - \$6.7 * | - \$0.7 |
| Total Net Losses | \$52.9 | \$5.8 |
| Direct Costs for Investors Rejecting the Restructuring | | |
| Capital losses | \$14.5 | \$1.6 |
| Past due interest payments, December 2001-January 2005 | \$ 6.0 | \$0.6 |
| Foregone investment returns | \$ 3.5 | \$0.4 |
| Total Direct Costs | \$24.0 | \$2.6 |
| Tax benefits for capital losses | - \$ 3.3 * | - \$0.4 |
| Total Net Losses | \$20.7 | \$2.2 |
| Direct Costs for All Bond Investors | | |
| Capital losses | \$44.0 | \$4.7 |
| Past due interest payments, December 2001–January 2005 | \$25.0 | \$2.7 |
| Foregone investment returns | \$14.6 | \$1.6 |
| Total Direct Costs | \$83.6 | \$9.0 |
| Tax benefits for capital losses | - \$10.0 * | - \$1.1 |
| Total Net Costs | \$73.6 | \$7.9 |
| Indirect Costs for Equity Investors and Taxpayers | | |
| Shareholder losses - currency effects on foreign investment | \$39.2 | \$7.8 |
| Revenues losses for other taxpayers to offset | \$24.2 * | \$2.6 |
| Total | \$63.4 | \$10.4 |
| Taxpayer Funds At Risk in IMF Bailouts of Argentina | \$23.2 | \$4.0 |

* Global estimates of foregone investment returns, tax benefits for capital losses, and total revenue losses calculated by applying American returns and tax treatment globally, and therefore can provide only a rough estimate.

² Robert J. Shapiro and Nam D. Pham, “Discredited – The Impact of Argentina’s Sovereign Debt Default and Debt Restructuring on U.S. Taxpayers and Investors,” American Task Force Argentina, October 2006.

About the Authors

Robert J. Shapiro is the co-founder and chairman of Sonecon, LLC, a private firm that advises U.S. and foreign businesses, governments and non-profit organizations. Dr. Shapiro has advised, among others, U.S. President Bill Clinton, British Prime Minister Tony Blair, Vice President Albert Gore, Jr., and Senators Hillary Clinton and Evan Bayh; private firms such as AT&T, Amgen, Gilead Sciences, Google, MCI, Inc., Exxon-Mobil, Nordstjernan of Sweden, and Fujitsu of Japan, and non-profit organizations including the American Public Transportation Association and the U.S. Chamber of Commerce. He is also a Senior Policy Fellow of the Georgetown University Center for Business and Public Policy, Fellow of the Progressive Policy Institute, director of the Globalization Initiative of the NDN, co-chair of American Task Force Argentina, and a director of the Ax:son-Johnson Foundation in Sweden. From 1997 to 2001, Dr. Shapiro was U.S. Under Secretary of Commerce for Economic Affairs. In that position, he directed economic policy for the Department of Commerce and oversaw the nation's major statistical agencies. Prior to that appointment, he was co-founder and vice president of the Progressive Policy Institute and the Progressive Foundation. He also was the principal economic advisor to Governor Bill Clinton in his 1991-1992 presidential campaign and an economic advisor to the presidential campaigns of Vice President Albert Gore, Senator John Kerry, and Senator Barack Obama. Dr. Shapiro also served as Legislative Director for Senator Daniel P. Moynihan and Associate Editor of *U.S. News & World Report*. He has been a fellow of Harvard University, the Brookings Institution, and the National Bureau of Economic Research. He holds a Ph.D. and M.A. from Harvard University, a M.Sc. from the London School of Economics, and an A.B. from the University of Chicago. Dr. Shapiro is widely published, and his most recent book is *Futurecast: How Superpowers, Populations and Globalization Will Change the Way You Live and Work* (St. Martin's Press, April 2008).

Nam D. Pham is an economic consultant of NDP Group, LLC, where he specializes in international trade, finance and economic development issues. Prior to founding NDP Group in 2000, Dr. Pham was a vice president at Scudder Kemper Investments, Boston, where he was responsible for research, asset allocation and currency hedges for Scudder's global and international bond funds. Before that he was chief economist of the Asia Region for Standard & Poor's DRI in Boston. Dr. Pham has over a decade of experience in multinational organizations and government agencies in Washington, DC. This tenure includes time as an economist at the World Bank, as well as a consultant to the Department of Commerce and the Federal Trade Commission. In addition, Dr. Pham has been a visiting lecturer at George Washington University, where he has taught undergraduate and graduate courses in monetary economics, international trade and finance, macroeconomics and microeconomics. Dr. Pham earned a Ph.D. in economics from George Washington University with concentrations in international trade and finance, economic development and applied microeconomics, an M.A. from Georgetown University, and a B.A. from the University of Maryland.