

EMTA

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Ladies and gentlemen,

Let me start by thanking the organizers for their kind invitation. I am really honored to be the keynote speaker this year, at a time in which the attention of the members of EMTA and of the international financial community are focused on what will happen with the restructuring of the Argentinean debt.

Unfortunately, the Argentinean case brings together many of the worst examples of wrongdoing that can be found to this day. I doubt we are going to find something this bad in the future. I hope we don't and that the lessons from Argentina be well understood.

In the mid 1990s, it was clear that the "Convertibility regime" was increasingly compounding the problems of the Argentine economy. "Convertibility" became "the problem", rather than the solution to the task of laying the foundations for robust and stable growth. The social and economic tensions that were building up inside Argentina reached unsustainable proportions by the year 2000, with grave consequences in human life in 2001. The fate of Convertibility was set much earlier, however.

Understanding how we got there is crucial to grasp the enormity of the Argentinean debt restructuring challenge that lies ahead. Because structural reforms and a sound fiscal stance were absent from the thrust of economic policies of the 1990's, Argentina borrowed heavily from international capital markets to close growing fiscal imbalances. Remarkably, Argentina's ability to borrow was not impaired by its large fiscal imbalances, thriving in fact on global growth and financial markets exuberance. The picture changed in 1998 when the Russian crisis shocked global capital markets, sending them into a tailspin. The US Federal Reserve stepped in and credit conditions recovered in the US. But the international financing picture had already changed for Argentina and for the rest of the emerging world.

Once external savings dried up, the Argentinean authorities turned to domestic savings, missing yet again another opportunity to address the

massive fiscal imbalances. As Argentinean savings were tapped, lending to private investment was replaced by lending to the government. Indeed, the decline in bank loans to the Argentinean business sector was exactly mirrored by the rise in bank loans to the government. The squeeze on the private sector was exacerbated by tax policies that kept Argentina with no growth.

Once voluntary domestic financing dried out, temporary multilateral financing followed. In January 2001, Argentina signed a Standby Agreement with the IMF that provided around US\$ 14 billion, as part of an international support package of nearly \$40 billion. About US\$ 3 billion were made available immediately, and three additional tranches of \$ 1.3 billion were to be released with the completion of future reviews. In early September, the IMF again provided a new program disbursing US\$ 5 billion immediately, and more important for what we are engaged in now, the IMF pledged another US\$ 3 billion in support of future debt restructuring operations. From our experience in negotiating two agreements with the IMF in the past eighteen months, these amounts seem incredible today. Despite promises from the government for fiscal austerity, once again, the opportunity to address fiscal imbalances was missed. Effectively multilateral financing was used as a substitute for voluntary domestic financing.

Even worse, the authorities implemented a disastrous Mega debt swap of US\$ 29.5 billion in face value. In this operation, US\$ 12.6 billion in debt obligations falling due in 2001-2005 were swapped for longer maturities at an implicit interest rate of approximately 16 % per year. In NPV terms, this meant that US\$ 12.6 billion of debt service obligations were postponed at a cost of US\$ 22.1 billion. At the time, many people chose to disregard the mounting evidence of unsustainability of debt.

When presenting the “Guidelines” for restructuring Argentina’s debt in Dubai, we were aware that the write-off implicit in our work exceeds those in recent restructurings, such as the 42 % suffered by the Russian bonds, or the 27% of the Ecuadorian debt. Unfortunately, these are not useful comparisons. The Russian default was centered on domestic-law debt held by a few international hedge funds and by Russians banks, after capital flight had eased somewhat. The authorities, however, took advantage of the more limited scope of the domestic debt problem and avoided a default on euro bonds. In the case of Ecuador’s debt restructuring it remains to be seen whether the country’s write-off will be large enough to ensure a sustainable debt repayment capacity. In terms of size and specially on macroeconomic effort the Argentine case resembles more the post-war

German case. It took until the London Conference of 1952 to advance Germany's debt restructuring, with a write-off of more than 77% as well as a flexible repayment schedule.

One of the reasons that explain the foreseeable level of losses of Argentine bondholders is the structure of Argentina's sovereign indebtedness. Indeed, save for Turkey, Argentina has one of the highest ratios of debt from official multilateral creditors to total debt of any sovereign borrower. Argentina's current bondholders are within a capital structure in which "preferred creditors" weigh heavily. We have said repeatedly that we are not dogmatic followers of the "preferred creditor" theory but it is the reality we face. We are not in a position to modify such a central tenet of the current international financial architecture.

In the past, the cost of default were pretty much distributed across the entire population. Today, capital markets distribute those costs among those taking the investment risks. It is therefore understandable that the evident size of the losses has outraged individual investors in Italy, Germany, Japan and Argentina. We sincerely think that Argentina lost the possibility of sorting out its debt problems with a write-off in the range of other recent experiences once it opted for the Mega swap and the IMF bailout of 2001, rather than pursuing the needed corrections, and facing up to the debt restructuring reality. A reality that we must face today.

In 2001, it was clear to any sharp observer that Argentina's debt problem was not one of liquidity, or simply a mismatch of long term assets and short term liabilities, but one of a fairly evident solvency crisis, in which the debt was too high to be supported by reasonable growth prospects. Unfortunately, the response of the De la Rúa government to the crisis was to increase the debt burden even further, as if it was indeed a manageable liquidity crisis. The apparent aim of this policy was to sustain Convertibility at all costs. By doing so, Convertibility defeated its purpose to act as a reliable foundation for growth and, in turn, to serve the Argentinean people.

Unfortunately, the 2001 IMF package only served to finance capital flight out of Argentina, just as Russia witnessed three years earlier. Equally serious was the depletion of the Argentinean pension funds, privatized years earlier with high hopes for the development of domestic capital markets and for a brighter future at the time of retirement. Those funds were irresponsibly used to sustain an economic model, even as it fell apart. By end 2001 the Argentine pension funds (AFJPs) had a portfolio with an average 70% of sovereign bonds, an absurd level when the purpose of

portfolio management is diversification of risk. The interests of the contributors to the pension system—more than 9 million people—were disregarded in favor of “giving time” to an unsustainable economic policy.

In its early days, convertibility served the useful purpose of building credibility and anchoring inflation. More importantly, however, convertibility stressed the structural flaws of the Argentine economy, especially in the government finances, while instigating a sense of urgency through its steep penalty: rising unemployment costs. In doing so, it demanded that reforms be pursued quickly and that a sound fiscal stance be consistently in place. Two things that never happened. The evident costs included rising debt expenses and growing unemployment that rendered unachievable any serious possibility of economic recovery.

The lost wealth and opportunities have hit Argentines hard. In all, Argentines lost over USD 12 billion in pension savings alone, banks lost another USD 9 billion, while thousands of firms went bankrupt. Unemployment reached historical highs of above 21% similar to the Great Depression of the United States or in the aftermath of World War II in Germany. Argentina lost two-thirds of its GDP in US dollar terms, becoming only a US\$ 100 billion economy after the peso devaluation. The most important costs, however, are the historical costs to a nation that is now being rebuilt, including the loss of opportunities and wealth for generations to come.

The costs to the citizens of the world have also been great. These are costs that were postponed for too long and that now need to be faced and shared by Argentines and by investors. Undoubtedly, Argentines have paid dearly and will continue to pay for the past failure to face these formidable problems.

Many thought that the financing decisions made in 2001 were the right decisions, but tensions inside the country were mounting. On October 14, 2001 on the occasion of the vote for the renewal of Congress, four out of ten citizens decided not to vote or chose to spoil their ballot, leading to an unprecedented low turnout and high null votes by Argentine history. Weeks later, the people of the City of Buenos Aires were to provoke one of the sharpest political changes of modern times on their own, outside the means that stable democracies use when certain limits for governmental mistakes are surpassed.

In a mature democracy, a President like De la Rúa should have been ousted by an impeachment. In fact, some impeachment ideas were discussed in the

corridors of Parliament in late 2001; but all speculation about the continuity or not of de la Rúa and of the economic policies of the decade were put off on the evening of December 19th. After a nationally broadcasted speech where the President appeared to be out of touch with reality, the middle and upper class voters that had made him a political figure since 1973 spontaneously took to the streets in huge numbers, demonstrating against the government's economic policy. President De la Rúa resigned after 20 people died in riots.

De la Rúa was elected in 1999 to solve the most pressing problems of Menem's decade: corruption, recession and rising poverty and unemployment. Not only did he not solve those problems, but in fact compounded most of them.

When Minister Lavagna's Economic Team began working at the end of April 2002, it took a great deal of effort to be loyal to our own convictions; to be resilient and disregard apparently experienced advice, if not resisting blatant pressure, to go ahead with our own policy, in the terms that could help Argentina and its people. We understood that Argentines had to lead their own destiny. And we are now leading a destiny that seeks to be part of the international community in a way that allows Argentina to respond to its people as well as to the rest of the world. *This is why I'm here.*

We understand that shaping a new destiny requires normalizing our relations with the international financial community. Argentina is ready to work with investors in finding a lasting solution to the Argentinean default. But investors should be aware that Argentina is alone in this. Of course, we do not expect US\$ 14 billion, nor any other big financing packages as our predecessors were offered. In fact, our experience is totally the opposite: the US\$ 3 billion to support debt restructuring has long been withdrawn. The US\$ 1.5 billion of funding that was to be used to rescue quasi-monies, and was part of our the initial negotiations with the Fund, was withdrawn from the negotiating table in September 2002. The same happened with an offer of a syndicate loan for US\$ 2 billion for export finance led by the IFC. We have overcome these setbacks and shown an unyielding commitment to low inflation, as a foundation to economic stability and future growth. A sharp fiscal turnaround built on spending restraint was the cornerstone of this achievement. Argentina has now a primary fiscal surplus that is reaching 3% of GDP, higher than at any time during the last decade.

Arguably, returning to solvency by means of sound fiscal policy, sustained growth and the accomplishment of the debt restructuring calls for

compelling IMF and World Bank support. Despite no new financial support, we managed to stabilize the economy and to restart growth. For the past year and a half, both under President Duhalde and currently under President Kirchner we have been putting together the pieces of a broken country, and also of a broken people. Half of Argentines live today at or below the poverty line. We will face up to our duty but not at the expense of the further suffering of the Argentine people. We are gearing towards a recovery, but there is absolutely no way Argentina can pay beyond its capacity to ensure a sustainable debt profile.

Unfortunately, some market participants are not interested in either *debt sustainability* or the coherence of the proposal, but only on maximizing short term market value. We believe that this would not serve the best interests of most investors as it would lead to a new crisis and yet another restructuring. Market perception would immediately focus on the need for further restructuring if the write-off is not of the magnitude needed.

We are working towards a coherent, sustainable solution. We want Argentina to become an attractive place for private investment in a balanced society that offers opportunities to all Argentines and foreign investors alike. Solid, sustained fiscal performance, as much as steady growth, are key to get us there. But we also need to dissipate the fiscal uncertainty posed by the existing contractual debt levels; to get rid of the debt overhang. This is the main reason in pursuing a restructuring. We will also need decades of sound, responsible economic policy

We will finish this year with a growth level superior to 7%, and 2004 also looks promising. But we are certainly faced with many difficult challenges ahead to attain the needed growth levels that would allow us to simultaneously achieve a debt repayment capacity and sustainable social improvements. The real side of the economy reacted well to our policies, they are discounting a level of tax pressure consistent with the proposed primary surplus. The technological changes incorporated by our agricultural sector would take a disproportionate time of my speech, they are simply amazing. The import substituting industries are doing well, as well as those that are contributing to develop Argentina's export capacity. These dynamic sectors, in turn, are counting on the new relative prices.

In terms of policymaking the most important challenges concern both the improvement of financial intermediation and of tax collection. Attaining steady higher rates of GDP growth will require lending. The recovery of the last year and a half is based primarily in self financing. To move forward, banks will need to speedily resume credit, something for which

they are preparing themselves. Years before the crisis, the banking system was managerially oriented towards lending to the central government and to the provinces, limiting managerial capabilities to lend to the private sector. The same happens in other areas of financial intermediation. Perhaps the most difficult challenge in terms of financial infrastructure development is to invigorate those few financial institutions capable of evaluating and funding small and medium size businesses. What we have, in fact, is a segmented financial system, with most institutions focused on financing few corporations, few traditional export industries and a very small fraction of ABC1 consumer credit. At the same time, the vast majority of Argentinean businesses are ignored.

One of the shocking features of the current situation is the evident misuse of resources on an unprecedented scale. Argentina piled up massive amounts of debt, but where is the counterpart of that debt? Where are the infrastructure: schools, hospitals, roads that were built with those resources? It's simply not there. This says a lot about the deterioration of the quality of international and multilateral lending and the need to go back to the traditional, old fashioned rigorously evaluated project financing needed by the Republic and the private sector.

Let me briefly reflect on the Guidelines presented in Dubai. Few have challenged the macroeconomic assumptions that underlie them. At the same time, too much of the discussion has been focused on primary surplus, while a country's capacity to pay is the result of the interaction between primary surplus, growth, exchange and interest rates. Of these variables, the most important one is growth. Any debt restructuring can only be considered successful if the restructured liabilities can be matched by the repayment capacity of the debtor. As a result, we are bound to commit to running a fiscal primary surplus that, while allowing to service debt, also fosters an incipient economic recovery, and indeed a path to sustained growth. We come from a vicious cycle of more than four years of rising debt and recession, and currency overvaluation. We cannot afford to commit to a higher fiscal primary surplus than we can sustain without jeopardizing growth and, more importantly, that it can be sustained into the foreseeable future by governments to come.

We will ensure that a higher primary surplus helps foster growth. Similarly, with the exchange rate. Argentina's growth was hampered by an overvalued real exchange rate through the 1990s and previously between 1976 and 1981. A stronger peso could facilitate repayment of the debt, but as with high tax pressure, would slow down growth. We have to attain a delicate equilibrium.

Our commitment is a long term commitment, for the indefinite foreseeable future. As such, we have the responsibility of being realistic as to how much can be delivered in a credible way. We have to remember that few countries in the world have primary surpluses above 1 or 2% and that the effort implied by our debt restructuring proposal is indeed an extraordinary one.

We believe that the debt restructuring guidelines should be discussed in a consistent framework, based on realistic assumptions. We should leave aside the temptation of thinking of a country as a mere Excel computer spreadsheet.

Investors should have the opportunity to share in any repayment capacity enhancements that would follow stronger than envisaged growth. The balance of risk in this debt restructuring, if any, needs to be tilted towards the upside, not the downside. We therefore invite investors to share in that upside and, as you know, we are analyzing the inclusion of GDP indexed instruments as part of the debt restructuring options. We are willing to include these, or other instruments that would help to better align our repayment capacity with the servicing of our obligations in a way that ensures a sustainable path that gives our creditors the opportunity to benefit from Argentina's growth.

Our priority is credibility: Argentina will not promise what it cannot honor. There were too many broken promises in the past; we are not going back there. Rebuilding Argentina's credibility will be the arduous task of many years to come. It will take time to rebuild it. But we are determined to rebuilding it.

Some years ago, in view of the dangers in international financial markets, the international community began to look at ways to facilitate crisis resolution. The SDRM failed to gain acceptance. The recommendation to use CACs was, to a certain extent, the outcome of the SDRM proposal, but would only benefit future restructurings. Of course some of our existing debt instruments—most notably our UK Law governed instruments—contain CAC's, but such clauses are conspicuously absent in most of our bonds. CAC's certainly don't help us deal with our past. We can't change our past, but we can change where we go from here.

World authorities are currently working in developing a "Code of Conduct". Theory is fine, but *we* are the ones that are left to move forward with its practical application. The Code of Conduct calls for good faith

negotiations with representative creditors, as well as for equitable and fair treatment for all creditors. It also calls for fair information sharing, fair burden sharing, and restoration of debt sustainability. Argentina fully subscribes to these principles of the Code of Conduct.

This market structure is very different from the one in the 1980s, when the whole universe of creditors was a small group of banks with similar interests, whose representatives could be gathered around a table. With today's diverse and sparsely distributed creditor composition, we cannot create steering committees and have a meaningful two-party negotiation as in the 1980s. This is why debt restructuring operations in the 1990s followed a different framework than those in the 1980s. But the implications of this issue should not be misunderstood. We are strongly committed to maintaining a meaningful dialogue with all the different creditor groups, and we are willing to pursue every viable option. We do not intend to impose a unilateral offer.

Earlier this year we put together Consultative Working Groups in Frankfurt, Rome, Zurich, Tokyo and New York. The most difficult problem when setting up the CWG is that of representation. How do you attain representation when you have more than four hundred thousand bondholders as we have in Italy, or even forty thousand as we have both in Japan and in Germany?

At the other extreme, how do we get a unified view on the CWG of Institutional Investors, a place to hear the views of long-term holders of bonds as well as short-term, speculative holders? How do you get legitimate representatives when the bonds trade and change hands every day in global capital markets?

In a restructuring as difficult as this one, equitable treatment is key; we made several announcements and claimed adherence to this basic principle, but admittedly, this is not enough in the face of the lack of credibility that Argentina suffers as a consequence of the debt default. This lack of credibility has been exacerbated by the marketing efforts of an initiative to group together retail bondholders. Admittedly, many predominantly retail held bonds trade less than bond issues predominantly held in the hands of institutions. But that reflects market conditions that underscore liquidity and depth of the markets. Still, Argentina was depicted as wanting to take advantage of retail bondholders. Contrary to that, we stand behind treating equally all bondholders, retail as well as institutional. And we repeat again that retail investors do not need to pay fees to advisors to ensure fair and equal treatment.

Regaining credibility for our policies and commitments has been the point of departure for every one of our actions. The Argentinean crisis was one of despair and confrontation, but its final solution should be one of trust and partnership. There are a few things one can do to regain trust. It takes time, effort, and conduct. It takes transparency, including sharing information. I say today that all of our efforts are directed toward achieving a successful debt restructuring that entails the broad participation of creditors and that is, at the same time, within the feasible bounds of Argentina's repayment capacity in the way I just outlined.

We said we were to announce the guidelines of the restructuring right after the approval of the IMF program. On the Saturday before the IMF-World Bank Annual Meetings the agreement was approved; and on the following Monday, we announced the debt restructuring guidelines. We visited the Consultative working groups afterwards, launching the CWG in Argentina, where roughly 50 % of the debt is held. We also posted on our website the contents of each of the presentations we made, as well as our model. The projections involve many assumptions and we are prepared to discuss these. For example, various assumptions can be made on reaccessing international capital markets, even if prudence suggest a limited assumption, and we are prepare to discuss that. But what we can not do is to repeat the mistakes of the past. Any future new access would have to be made responsibly.

Our aim is progress through dialogue. We are committed to giving every possible opportunity for creditors to voice their views and will give consideration to any serious and feasible suggestions.

Parallel to these consultative efforts, we invited the top international banks to submit proposals for becoming Regional Managing Banks of the debt restructuring. We met in Buenos Aires with the top management and the team proposed to work in the transaction for each bank.

With the Regional Managing Banks we have a two-track program. On the one hand, we will work out the details of the proposal with them. The contents of the proposal should be ready by end of January, or early in February at which time we will be prepared for an enhanced interaction with our creditors. Moreover, we think that the regional managing banks can provide an useful additional conduit to maintain fluid communications with our private creditors. On the other hand, we will have to put together the syndicate that will implement the transaction.

Regardless of the difficulties, we are moving forward, and we are committed to implementing the exchange as soon as possible, as we recognize that performing bonds would give investors the most value for their past investments. The market has no precedent for a transaction this difficult due to the size of the write-off, the magnitude of the amounts involved, the diversity of investors' goals and the variety of applicable laws.

To reinvigorate the Emerging Markets asset class, to make it evolve to new highs, the market needs to constructively solve Argentina's debt restructuring. You can certainly count on us for doing our part of the job. We look forward to counting on you.

Thank you.