



**Statement of
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**Prepared for the
New York State Senate Standing Committee on Banks
Regarding a Public Hearing on
The Argentine Bond Default and Its Impact on New York State**

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Introduction

Chairman Foley and Members of the Committee, on behalf of the National Taxpayers Union's (NTU's) 362,000 members across the United States and our 18,000 members in New York, I am honored to submit comments for your hearing today on an issue of great importance to taxpayers as well as the overall well-being of our economy: Argentina's continued flouting of the rule of law in its international financial practices.

Since its founding in 1969, NTU's work for lower taxes, limited government, and accountability from public officials has often focused on international lending and monetary policies. In 1977, for example, NTU initiated a public education campaign, chaired by experts in finance, to warn that the mounting debts of the developing world and (then) Iron Curtain countries could not be readily repaid. We opposed the Carter and Reagan Administration's attempts to vastly increase International Monetary Fund (IMF) quotas, and thereby burden U.S. taxpayers with shaky liabilities.

In 1983, NTU's research affiliate sponsored a symposium, "Constructive Approaches to the Foreign Debt Dilemma," featuring such luminaries as Milton Friedman, Anna Schwartz, and Allan Meltzer. Using econometric and historical evidence, participants posited that urgent "end of the world" calls for infusions of cash to bad actors in international borrowing were "designed more for the emotions of policymakers than for their intellects." In testimony before Congress that year, then-NTU Chairman James Dale Davidson argued that:

The best way for the IMF to serve a positive role in resolving world financial difficulties is for it to serve as a monitoring agency only. The more the allocation of credit is left on a market basis, the sounder will be the resulting policies. ... Rather than dealing out yet another hand to be stacked on international banking's house of cards, we should take care, and look to the long run, to the real sources of economic growth and prosperity. **These lie in policy adjustments by the borrowing countries, and not in subsidized lending** (emphasis added).

In subsequent years, NTU has continued its efforts on behalf of transparent and accountable international financial behavior. My organization is a founding member of the World Taxpayers Associations (www.worldtaxpayers.org), a united front for lower taxes, less waste, accountable government, and taxpayers' rights across the globe.

Mr. Chairman, I provide this rather lengthy background not as a recitation of NTU's credentials in discussing the topic at hand today, but rather to show that for decades, Argentina's internal and external policies have been directly or peripherally involved in most of the larger controversies surrounding global finance. For this reason, your hearing is all the more critical in pointing out the need for urgent action that will open new, less ominous chapters for taxpayers in the future history of Argentine-U.S. fiscal relations.

I. Effect on Taxpayers

The National Taxpayers Union often finds itself on opposite sides of opinion with the federal and state governments when it comes to taxation. However, the case of Argentine debt repayment appears to be a "win-win scenario" for all U.S. entities – tax collectors and taxpayers alike.

Argentina's pattern of fiscal irresponsibility and economic mismanagement has left U.S. taxpayers to shoulder the burden of such recklessness, and has exacerbated the already battered and fragile state of our own economy. Repayment of Argentine debt in full is the only option to relieve the misery caused by Argentina's negligence.

Since Argentina's 2001 default, U.S. taxpayers have continually felt the effects of Argentina's refusal to meet its debt obligations. In the U.S. alone, taxpayers have incurred large indirect costs as a result of reduced revenues that bondholders otherwise would have paid – including capital gains, interest income, and investment returns. Altogether, these costs total \$3.2 billion from the default to December 2008.

While this number is quite startling, New York's inhabitants have been subjected to the worst of the costs. New York residents held Argentine bonds totaling over \$830 million, or 9.6 percent of all U.S. holdings and the largest amount of any locality, at the time of the default. Due to the sheer volume of bonds New York citizens held, taxpayers have been responsible for \$329 million in indirect costs resulting from Argentina's default and restructuring.

As far as investors are concerned, the devaluation of Argentina's peso that followed the default has affected their holdings in companies with large Argentine operations. Revenue losses associated with these investments stem indirectly from capital losses and foregone interest and investment income. Nationwide, this amounts to almost \$3.2 billion in unrealized revenue, while New York encountered higher-than-average costs, totaling almost \$329 million. As time goes by and Argentina continues its refusal to repay, taxpayers are on the hook for offsetting progressively larger costs. In turn, Argentina's debt spiral continues to trap hard-working Americans.

To clarify, NTU opposes higher tax burdens on investments, and in fact supports reduced tax rates on capital gains and dividends of all kinds. Furthermore, we do not subscribe to the notion – fashionable among some policymakers – that every dollar of foregone revenue is somehow a "loss" to the government that must be "made up for" by

taxing some other unfortunate class of taxpayer. In the case of New York in particular, we noted in a January 25, 2010 letter to the Legislature that the state's deficit woes are heavily linked to excessive expenditures:

New York state government spending has skyrocketed by \$35 billion over the past decade, outstripping inflation by \$21 billion and personal income growth by \$17 billion. When including the \$6.6 billion of federal bailout money in last year's budget, spending jumped roughly 8 percent from the previous fiscal year. The result of this binge, under Gov. Paterson and his predecessors, is that government is unable to balance its books with any ease or predictability.

Nonetheless, we are sympathetic to the argument that without the additional problem of Argentina's default, the severity of federal and state budget shortfalls would be lessened. As a result, the task of reducing expenditures would be less daunting, and the political pressure to consciously raise tax rates (as opposed to allowing current laws to generate anticipated revenues) would be diminished somewhat.

II. Effect on U.S. Economy

Following its debt default and restructuring, Argentina claimed that it could not repay its debts due to economic insolvency. Since that time, Argentina has been nursed back to health, in large part by the investments of U.S. creditors. These individuals are already deterred from lending and new investments by the economic recession – and Argentina's outstanding debt has further discouraged them from placing their hard-earned funds in a position to be managed poorly. Argentina has also repeatedly declared its economic insolvency over the years, even though its Central Bank reserves are reportedly more than enough to cover its outstanding debts, further causing mistrust from lenders in the international community.

In addition to the direct impact on individuals, institutional bondholders such as pension and mutual funds have suffered losses that affect fiscal balances. These carry with them the potential for further long-term liabilities to taxpayers in the case of public employee pensions, which are already facing massive shortfalls. Furthermore, depending upon the ultimate resolution of this situation, investors of all kinds may very well be required to expend precious resources on legal and other actions to recover what is by all points of law their own money. This certainly cannot help a struggling U.S. economy that badly needs the most efficient allocation of private funds in order to get a nascent recovery into full gear.

Through its fiscal negligence, Argentina has placed an enormous financial load on U.S. taxpayers. These individuals have the right to lawfully reclaim their investments, which were issued (and should be honored) contractually. After years of denying its responsibilities, the Argentine government must recognize the effect this negligence has had on the American people and remedy the problem by paying its debts.

III. Effect on Future U.S. and World Stability

While Argentina's actions have jeopardized investment relations between our two countries, Argentina has also set a dangerous precedent in the international community. In 2008, Ecuador followed Argentina's irresponsible lead and defaulted on billions of dollars in

sovereign debt that it claimed to be “illegitimate.” Ecuador then promptly bought the debt back at 35 cents on the dollar – a number so paltry that only Argentina’s painfully low offering of 27 cents on the dollar could rival. If Argentina and Ecuador can default on debt without exhibiting economic hardship, which country is next?

Such a problem is not idle speculation for U.S. taxpayers. Although this statement has discussed the revenue implications of Argentina’s default policies, there are effects on the spending side of our government’s ledger as well. Last year, NTU and its ally Citizens Against Government Waste contacted Treasury Secretary Tim Geithner to urge that he “defend American taxpayers by persuading multilateral institutions to hold Argentina’s and Ecuador’s governments accountable for their own fiscal choices.” The letter noted:

As the primary source of financial support to the IMF, U.S. taxpayers should not be asked to foot the bill while the Argentine government willfully mismanages its finances. From nationalizing its private pension system to issuing dubious inflation figures, Argentina has engaged in counterproductive behavior. Multilateral institutions such as the IMF and IDB [Inter-American Development Bank] must not encourage such harmful practices by allowing the Argentine government to tap additional lines of credit.

The Argentine publication *Clarín* recently reported on an IMF technical cooperation program to reform Argentina’s national statistics reporting agency. While the IMF’s efforts should be commended as a step in the right direction, Argentina should not be rewarded with new loans until it repays its existing debt obligations.

Thus, it is quite conceivable that without a timely course correction, other nations beyond South America with similar government-heavy, state-owned enterprise models could begin emulating Argentina’s reckless decisionmaking. The consequences for U.S. taxpayers, who significantly back international lending institutions, would be harsh. Just as we saw in 2008 with the introduction of the Troubled Asset Relief Program (TARP), a crisis of confidence in the stability of financial markets can lead to large and costly government interventions. While NTU opposed the TARP legislation as an overbearing, anti-taxpayer response to such problems, hopefully all policymakers – regardless of their views on the wisdom of TARP – would agree that such conditions should be studiously avoided in the future. They have the perfect opportunity to do so now with Argentina’s debts.

Conclusion

For many years NTU has pointed out the dangers of irresponsible borrowing policies that sovereign nations sanction. Admittedly, the United States has in the past several years become more susceptible to such proclivities. The White House’s Fiscal Year 2010 budget projected that the Gross Federal Debt of the United States would hit the equivalent of 100 percent of Gross Domestic Product (GDP) in 2017. The most recent budget, for Fiscal Year 2011, now predicts the mark will be reached in 2012. Such debt-to-GDP levels, unheard of in our country since World War II, are a portent of difficult times ahead for the U.S. economy and for its image as a source of stability among other nations.

Yet, even this situation does not rise to the Argentinean debacle. NTU continues to pursue debt-reduction solutions based on structural spending reform. State and local governments generally (though not always) approach their constitutional fiscal duties in

earnest, and a healthy debate over federal fiscal policy continues to take place in Washington. So far the evidence of such trends in Buenos Aires is tentative at best, unconvincing at worst.

Argentina's pattern of disappointing the international community and consistently making poor economic decisions that affect more than its own people is far from over. Argentina's mistakes are being felt worldwide and international investing has been deterred. Argentine debt repayment will be the first step in restoring its stature among nations.

Accordingly, we would urge policymakers on all levels to carefully craft measures that would achieve the following ends.

- 1) Government-backed development enterprises as well as direct foreign aid are rarely appropriate venues for U.S. tax dollars. Taxpayers should be protected from defaults on loans they directly subsidize.
- 2) Removal of tax and trade barriers for private firms doing business abroad is a far better long-run strategy for helping free-market economies to flourish around the world.
- 3) In the near-term, the U.S. and state governments can and should take steps to ensure that judgment-evading countries and their state-owned enterprises are denied access to credit markets that taxpayers implicitly or explicitly underwrite.

Until the Argentine government learns to responsibly manage its economy, prioritize its obligations and repay its debts, U.S. taxpayers will continue to feel the pain. This injury is not only unwarranted, but also unnecessary and unjustifiable. U.S. taxpayers should never be charged for another country's poor decisions – especially a country that has so blatantly tossed its creditors aside.

In closing, Mr. Chairman and Members of the Committee, NTU and its members look forward to working with you and your colleagues on all levels to ensure that your state's – and our nation's – taxpayers obtain the fiscal justice they deserve. Please feel free to contact me in this regard.