



Argentina has fallen from having the 10th-highest per capita income in the world early in the 20th century to just 68th today. Sovereign countries that print their own currency normally "inflate" away much of the value of their debt by excessive money issuance when the debt is in their own currency. However, Argentina's debt was U.S. dollar-denominated and subject to New York commercial law, which is why the court battle is in New York. Argentina issued U.S. dollar-denominated bonds subject to U.S. law because most international bond buyers would not have been willing to buy Argentine currency bonds subject to the Argentine courts. What has been particularly galling to those who have held Argentine bonds is that the country has many state-owned assets and considerable foreign exchange that it could have used to pay the bondholders but, for domestic political purposes, chose not to.

Those who buy the discounted bonds of countries in default in the secondary market do so to make a profit, but they often need to hold the debt for many years and engage in long and expensive court battles with an uncertain outcome. Many do-gooders from around the world disparage those bond buyers by claiming they are saddling the people in relatively poor countries with large debt payments. What such do-gooders ignore is that it was the governments of those debtor countries that issued the debt in the first place and benefited from the funds received, and those who buy them do not get paid more than the government originally offered.

As with individuals or businesses, those who earn a reputation for being deadbeats will find it much more difficult to sell debt in the future and normally will be required to pay a higher price. The World Bank, the International Monetary Fund and foreign governments frequently come in to provide the irresponsible debtor government with debt relief, often at the expense of the private bondholders and the world's taxpayers. The late Nobel laureate Lord Peter Bauer said it best when he quipped that foreign aid is far too often a process by which "poor people in rich countries give to rich people in poor countries."

The Greek case is somewhat different and nowhere near as blatant as Argentina's. Greece, being part of the eurozone, also cannot print its way out of the debt dilemma. It must cut expenditures, sell assets, such as islands, or talk creditors into taking less than full value for the bonds, which Greece has been doing.

Several of the often disparaged vulture funds have track records of helping to bring corrupt government leaders to heel by insisting that governments pay what they promised. By creating precedents, they have reduced risk and borrowing costs for all. They illustrate Adam Smith's concept of the "invisible hand" of the entrepreneur, who, by operating in his own self-interest, unintentionally benefits many.

When you buy a government bond, you are taking the risk that the government might inflate the currency by printing too much or default on the debt. Some will claim that the buyers of Argentine and Greek debt have nobody to blame but themselves because both countries were known to have high levels of corruption and many irresponsible politicians.

Here is where the "vulture funds" come in. They are run by entrepreneurs who are willing to take very high risks by buying the defaulted debt of the corrupt or mismanaged country at deep discounts (usually after the original bondholders have fled) and, at times, use the court systems around the world to seize assets of the deadbeat countries as a way of pressuring them to pay their debts. Last month, one of the Argentine creditors managed to legally hold an Argentine naval training vessel (a large, beautiful, classic, four-masted sailing ship) that had docked in Ghana.

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## In Defense of "Vulture Funds"

by Richard W. Rahn

### RISK-TAKERS FORCE CORRUPT NATIONS TO PAY THEIR DEBTS

If you lend money at 5 percent interest for 10 years and then suddenly the borrower announces that he is only going to repay you at 30 cents on the dollar, would you think you have been cheated?

The Argentine government defaulted on its debt a little more than a decade ago, and some of the creditors are still in court trying to get paid. A New York court ruled against Argentina last week, which made headlines. The story is important to everyone because even though the Argentine case is unique, the final resolution likely will have some effect on government bond prices for decades to come -- and, in turn, on tax burdens and growth rates worldwide. If Argentina gets away with not paying the full amount it contracted to pay when it sold the original bonds, other countries will be encouraged also to default on their bonds, as several already have.

Argentina has had destructive economic interventionist and socialist policies for more than 80 years. The result is that