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DON'T CRY FOR ME ARGENTINA: ECONOMIC CRISES AND THE RESTRUCTURING OF FINANCIAL PROPERTY

*Horacio Spector**

I. INTRODUCTION

Property rights are a prerequisite for economic growth. Indeed, economists and legal scholars stress the ability of property rights to solve collective action problems, such as the tragedy of the commons and the tragedy of the anti-commons.¹ More direct contributions have also been noted. For instance, it has been argued that formal land ownership plays a central role in economic development, and that formal property titles are correlated with an increase in social well-being.²

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1. This literature really started in the Scottish Enlightenment. See DAVID HUME, *A TREATISE OF HUMAN NATURE*, bk. III, pt. II, § II (Dolphin Books ed. 1961) (1740). Among contemporary works, see, e.g., YORAM BARZEL, *ECONOMIC ANALYSIS OF PROPERTY RIGHTS* (1989), Stephen R. Munzer, *The Commons and the Anticommons in the Law and Theory of Property*, in 10 *THE BLACKWELL GUIDE TO PHILOSOPHY OF LAW AND LEGAL THEORY* (Martin P. Golding & William A. Edmundson ed., 2005), David Schmitz, *The Institution of Property*, in *ENVIRONMENTAL ETHICS: WHAT REALLY MATTERS, WHAT REALLY WORKS* (D. Schmitz & E. Willott eds., 2002), Harold Demsetz, *Toward a Theory of Property Rights*, 57 *AM. ECON. REV.* 347 (1967), Robert C. Ellickson, *Property in Land*, 102 *YALE L. J.* 1315, (1993), Garrett Hardin, *The Tragedy of the Commons*, 162 *SCIENCE* 1243 (1968), Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 *HARV. L. REV.* 621 (1998), and Carol Rose, *The Comedy of the Commons: Custom, Commerce, and Inherently Public Property*, 53 *U. CHI. L. REV.* 711 (1986).

2. HERNANDO DE SOTO, *THE MYSTERY OF CAPITAL: WHY CAPITALISM TRIUMPHS IN THE WEST AND FAILS EVERYWHERE ELSE* (2000). For an excellent “natural

When assessing the economic functions of property, it is generally assumed that financial property rights are as beneficial for economic growth as are property rights over tangible assets.³ The public policy recipe in this situation would be to respect property claims over financial assets to the greatest possible extent. However, perfect compliance with financial property raises special problems. While natural catastrophes (such as floods, earthquakes, or tsunamis) can damage land holdings and real estate, the working of a market economy by itself cannot annul or reshape real property. By contrast, financial property is subject to the vagaries of economic and political markets. In fact, the respect for financial property can become impossible in the event of a microeconomic (insolvency, bankruptcy, etc.) or macroeconomic crisis (bank run, stock market crash, financial fallout, etc.).

This Article will discuss five paradigms that can be used in order to restructure financial property under economic crises, particularly those affecting emerging market economies: the *emergency paradigm*, the *monetary paradigm*, the *valorist paradigm*, the *social justice paradigm*, and the *bankruptcy paradigm*. Both the *emergency* and *monetary paradigms* have been heavily influenced by decisions of the U.S. Supreme Court.⁴ The *valorist paradigm* is of German origin,⁵ and the *social justice paradigm* can be regarded as an application of the doctrine that private property has a social function, espoused by socialist and Catholic social thought.⁶ The last paradigm, the *bankruptcy paradigm*, is a theoretical construct that has never been used.

experiment” study that shows that land titling develops individualist and materialist beliefs, see Rafael Di Tella et al., *The Formation of Beliefs: Evidence from the Allocation of Land Titles to Squatters*, 122 Q. J. ECON. 209 (2007).

3. See Hardin, *supra* note 1, at 1244 (acknowledging flaws in theories that presuppose that individuals, when allowed to make their own decisions based on their property rights without government interference, will reach decisions that are optimal for society).

4. ROBERT HIGGS, *CRISIS AND LEVIATHAN, CRITICAL EPISODES IN THE GROWTH OF AMERICAN GOVERNMENT* (1987).

5. BERND RÜTHERS, *DIE UNBEGRENZTE AUSLEGUNG. ZUM WANDEL DER PRIVATRECHTSORDNUNG IM NATIONALSOZIALISMUS* (1997).

6. Leon Duguët, *Les Transformations Générales Du Droit Privé Depuis de Code Napoléon*, in *THE PROGRESS OF CONTINENTAL LAW IN THE NINETEENTH CENTURY* 129-36 (Alejandro Alvarez ed., 1969). For the Catholic Church’s doctrine about the social function of private property, see the following encyclicals: Pius XI, *Quadragesimo Anno* (1931), John XXIII, *Mater et Magistra* (1961), Paul VI, *Populorum Progressio* (1967), and John Paul II, *Centesimus Annus* (1991).

The Article will expose the inadequacies of the first four paradigms, both in light of doctrinal analysis and political economy. Finally, it will argue that the *bankruptcy paradigm* coheres with rule of law principles and minimizes costs in terms of long-term economic growth. More specifically, it will claim that the *bankruptcy paradigm* can maintain a separation of powers, reduce rent-seeking by small interest groups, and mitigate the overall damage to the financial system caused by a crisis. This paradigm is especially helpful to respond to bank runs in countries that have a currency board or formal dollarization.

Two methodological features are worth emphasizing. First, the kind of financial crisis on which the Article will focus takes place in countries where financial liabilities are mostly denominated by foreign currencies. The crisis starts with a bank run provoked by a drastic withdrawal of foreign and domestic capital, among other relevant factors. The bank run creates severe illiquidity in the banking system which, if not rapidly treated, will cause overall insolvency. Furthermore, there is no lender of last resort or other possible safeguards that could contain the fallout. Insurance deposit schemes or international financial assistance are either unavailable or insufficient. Though the analysis here will focus on this kind of crisis, many of its conclusions are also relevant for financial crises under other currency regimes.

Second, the Article will discuss decisions by the Argentine Supreme Court in 1986, 1990, and 2002 through 2006, and by the U.S. Supreme Court in the 1920s and 1930s. In Argentina, litigation as a result of the mega-crisis of 2001 was massive.⁷ By April 2002, the Attorney General confirmed that 210,188 injunctions [*amparos*] were filed in federal courts against the suspension of cash payments [*corralito*] and the freezing and pesification of deposits [*corralón*].⁸ In addition, provincial courts throughout the country ordered injunctions *in*

7. Catalina Smulovitz, *Judicialization of Protest in Argentina, The Case of Corralito*, in ENFORCING THE RULE OF LAW: SOCIAL ACCOUNTABILITY IN THE NEW LATIN AMERICAN DEMOCRACIES 55 (Enrique Peruzzotti & Catalina Smulovitz eds., 2006). Post-crisis litigation in Argentina was however of a much smaller scale than litigation in Germany after the hyperinflation of 1918-1923, which soared to several millions of cases. For an account of German litigation, see ARTHUR NUSSBAUM, MONEY IN THE LAW—NATIONAL AND INTERNATIONAL, A COMPARATIVE STUDY IN THE BORDERLINE OF LAW AND ECONOMICS 206-11 (1950).

8. Pesification is the compulsory conversion of U.S. dollar-denominated bank deposits into Argentine pesos at an official exchange rate.

*audita parte*⁹ that compelled banks to return deposited sums in U.S. dollars to plaintiffs, without adjudicating the substantive question of law.¹⁰ Some provincial courts were accused of unethical behavior.¹¹ Bank depositors also organized a widespread social and political mobilization that included banging pots and pans, assaults on banks, and popular assemblies.

While Argentina provides a fascinating case study, the problem addressed in this Article has arisen in other emerging market economies, as well. Similar situations have arisen in Mexico (1994-1995), Korea and Indonesia (1997), Russia (1998), Ecuador (1998-2000), and Uruguay (2002), resulting in financial debacles that led to bank runs, defaults, massive devaluations, and political instability.¹² Though a bank run is difficult to conceive today in developed countries that have easy access to domestic and international capital markets, bank runs may, in principle, occur in even the most developed economies. Recall the Savings & Loan crisis of the 1980s, which led the Ohio state government in March 1985 to declare a bank holiday to prevent a run on Home State Savings Bank.¹³ To this extent, the conclusions reached in this Article might also provide a point of reference for discussing responses to financial crises in the developed world.

II. LEGAL BACKGROUND

This Article will discuss the paradigms involving the reshaping of property rights against the background of the United States and Argentine Constitutions. Both Constitutions contain similar relevant clauses. First, the Due Process Clause of the Fifth Amendment of the U.S. Constitution provides that no persons shall be “deprived of . . . life, liberty, or property, without due process of law.”¹⁴ The Fifth Amend-

9. These injunctions were ordered without hearing the banks' defenses.

10. Héctor Mairal, *Argentina: El derecho en tiempos de cólera*, 3 ACTUALIDAD JURÍDICA 3, 20 (2002).

11. Horacio M. Lynch, *Emergencia, Derecho, Justicia y Seguridad Jurídica (Reflexiones Sobre la Crisis y las Libertades Económicas)*, REVISTA JURÍDICA ARG. – LA LEY [L.L.] (2002).

12. JEROME SGARD, L'ECONOMIE DE LA PANIQUE: FAIRE FACE AUX CRISES FINANCIERES (2002).

13. This Article was finished in March 2008, well before the financial meltdown in the U.S. and in Europe. For a useful report on the crisis in the thrift industry and its macro-economic origins, see *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

14. U.S. CONST. amend. V.

ment also adds, “nor shall private property be taken for public use, without just compensation.”¹⁵ Similarly, the Argentine Constitution, enacted in 1853 and put into full force in 1860, establishes in Article 17, “Property is inviolable and no inhabitant of the Nation shall be deprived of it but in virtue of a court judgment founded on law. Expropriation because of public utility must be so qualified by a law and previously indemnified.”¹⁶ The protection of private property in the Argentine Constitution is thus as robust as that afforded by the U.S. Constitution. Moreover, Article 14 of the Argentine Constitution guarantees inhabitants the right to “use and dispose of property.”¹⁷

In both U.S. and Argentine constitutional law, private property encompasses creditor rights arising out of contracts, such as bank deposits. Indeed, this is the case in the U.S. Constitution as a result of the Contracts Clause in Article I, Section 10.¹⁸ Moreover, the U.S. Supreme Court has held that reliance interests are included in property.¹⁹ The Argentine Constitution is much the same. The Argentine Supreme Court has declared that the term “property” covers “all interests a man can possess, outside himself, his life, and liberty, as well as all rights that have a recognized value, either emerging from private law relations or administrative acts.”²⁰ More specifically, the Court has stated “it is also true that the rights awarded by a contract to the creditor constitute his property, as all the goods that form his patrimony, all of which are protected by the constitutional guarantee of Article 17.”²¹

The current Argentine Constitution also lays down social and economic rights that could conflict with property rights. Thus, Article 14 *bis*²², added in 1957, as well as various human rights provisions introduced by the constitutional reform of 1994 through the incorporation of

15. *Id.*

16. CONST. ARG. art. 17.

17. *Id.* art. 14.

18. U.S. CONST. art. I, § 10.

19. *Nordlinger v. Hahn*, 505 U.S. 1 (1992); *Bd. of Regents of State Colls. v. Roth*, 408 U.S. 564 (1972); *Goldberg v. Kelly*, 397 U.S. 254 (1970).

20. Corte Suprema de Justicia de la Nación [CSJN], 14/12/1925, “Bourdieu, Pedro E. v. Municipalidad de la Capital Federal,” Fallos (1925-145-307) (Arg.).

21. Corte Suprema de Justicia de la Nación [CSJN], 7/12/1934, “Avico, Don Oscar Agustín v. de la Pesa, don Saúl G. / sobre consignación de intereses,” Fallos (1934-172-21) ¶5 (Arg.).

22. In Argentine legislative practice, the suffix “bis” serves to denominate a new article or clause when the lawmaker wants to avoid re-numbering all the subsequent articles or clauses.

international treaties, establish certain rights such as the right to decent housing and the right to basic welfare.²³ Such rights could arguably justify the curtailment of private property.²⁴ For instance, the American Convention on Human Rights provides: “Everyone has the right to the use and enjoyment of his property. *The law may subordinate such use and enjoyment to the interest of society.*”²⁵ Though such provisions are absent in the U.S. Constitution, Scholar Frank Michelman has tried to infer social and economic rights from the Equal Protection Clause.²⁶

The U.S. and the Argentine constitutions establish two other kinds of powers that are relevant for this inquiry. First, both the U.S. and the Argentine Constitutions afford Congress power over monetary policy. Article I, Section 8 of the U.S. Constitution provides that Congress is empowered “[t]o coin money, regulate the value thereof, and of foreign coin.”²⁷ Article 75, paragraph 11, of the Argentine Constitution contains an identical provision.²⁸ Second, in U.S. and Argentine constitutional law private property is consistent with bankruptcy law, as evidenced by Article I, Section 8’s declaration that Congress shall have the power to establish “uniform laws on the subject of bankruptcies throughout the United States.”²⁹ Moreover, the U.S. Supreme Court has construed the Contracts Clause as consistent with state power to pass bankruptcy legislation that modifies remedies for breach of contract.³⁰ The Argentine Constitution has a similar bankruptcy provision in Article 75, paragraph 12.³¹

23. CONST. ARG, art. 14 bis., art. 75, ¶ 22 (articles incorporate various international treaties on Human Rights, such as the American Convention of Human Rights).

24. Corte Suprema de Justicia de la Nación [CSJN], 15/3/2007, “Rinaldi, Francisco Augusto y otro c/ Guzman Toledo, Ronal Constante y otra s/ ejecución hipotecaria,” Fallos (2007-330-855) (Arg.).

25. AMERICAN CONVENTION ON HUMAN RIGHTS, art. 21, ¶ 1, 9 I.L.M. 673 (1970) (emphasis added).

26. Frank I. Michelman, *In Pursuit of Constitutional Welfare Rights: One View of Rawl’s Theory of Justice*, 121 U. PA. L. REV. 962, 1005 (1973); Frank I. Michelman, *The Supreme Court, 1968 Term-Foreword: On Protecting the Poor Through the Fourteenth Amendment*, 83 HARV. L. REV. 7, 11 (1969).

27. U.S. CONST. art. I.

28. CONST. ARG. art. 75.

29. U.S. CONST. art. I.

30. *Ogden v. Saunders*, 25 U.S. 213 (1827); *Sturges v. Crowninshield*, 17 U.S. 122 (1819).

31. CONST. ARG. art. 75.

III. THE GREAT DEPRESSION (1929) AND THE ARGENTINE CRISIS (2001)

The United States suffered bank runs in 1893, 1907, and during the Great Depression period. In 1893 and 1907, the situation was handled through a privately concerted restriction of convertibility of deposits into currency.³² In the 1930s, however, the Federal Reserve System operated in a different way.

The Emergency Banking Act of March 9, 1933 granted President Franklin Delano Roosevelt emergency powers over banking transactions, foreign exchange dealings, gold and currency movements.³³ The next day, on March 10, the President issued a decree prohibiting gold payments unless permitted by the Secretary of the Treasury.³⁴ On April 5, a subsequent decree forbade the hoarding of gold and required all holders of gold to deliver their gold coins, bullion, or certificates to Federal Reserve Banks on or before May 1 (excluding rare coins, reasonable amounts for use in industry and the arts, and a maximum of \$100 per person in gold coins and gold certificates).³⁵ On January 30, 1934, Congress passed the Gold Reserve Act, under which the President established a fixed buying and selling price of \$35 per ounce for gold, thereby devaluing the gold dollar to 59.06 percent.³⁶ According to the Gold Reserve Act, title to all gold coins and bullion was vested in the United States; all gold coins were withdrawn from circulation and melted into bullion; further gold coinage was to be discontinued; and the Secretary of the Treasury was to control all dealings in gold.³⁷

The model of crisis resolution established by the U.S. Federal Government during the Great Depression became very influential in Argentina. The Argentine debacle in 2001 unfolded much like the Great Depression had, resulting in catastrophic effects on the country's economy.³⁸ On November 30, fears of devaluation and deposit freeze

32. MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES, 1867-1960* 108-11, 156-63 (1963).

33. *Id.* at 421.

34. *Id.* at 422.

35. *Id.* at 462-63.

36. *Id.* at 469.

37. *Id.* at 469-70.

38. In fact, GDP fell 28%, and unemployment rose from 18.3% in 2001 to 23.6% in 2002. Poverty rate rose from 25.9% in 1998 to 38.3% in 2001 and 57.5% in 2002. JIM SAXTON, VICE CHAIRMAN JOINT ECON. COMM., U.S. CONG., *ARGENTINA'S ECONOMIC CRISIS: CAUSES AND CURES 1* (June 2003), available at <http://www.house.gov/jec/imf/06-13-03long.pdf>.

pushed interest rates in pesos to an average of 689% overnight, and the bank run accelerated at high speed.³⁹ On December 1, 2001, the Argentine government announced a freeze on bank deposits. Decree 1,570/2001, Article 2, prohibited cash withdrawals of more than two hundred and fifty pesos (\$250 pesos) or two hundred and fifty dollars (US\$250) per week, made by any holder or holders from the total balance of the bank accounts opened with each financial entity.⁴⁰ Minister Cavallo and President De la Rúa were forced to resign on December 19 in the midst of great social and political turmoil. Then, from December 20 through December 31, interim presidents Ramon Puerta, Adolfo Rodríguez Saa, and Eduardo Camaño took office. Finally, on January 1, 2002, the two Houses of Congress appointed Eduardo Duhalde as President and a series of measures were taken to address the disastrous situation. First, Congress enacted the Public Emergency and Exchange Regulations Reform Law 25,561 (called “the Emergency Law”), which ended the “convertibility” monetary system that had been in effect since 1991.⁴¹ This law also applied the exchange rate of one peso per US\$1 for a certain group of debts with financial entities, not exceeding the sum of US\$100,000, including mortgage and individual loans.⁴² Second, by Decree 71/2002, President Duhalde devalued the Argentine Peso to \$1.40 per dollar for certain transactions, and established a managed floating rate system for all other operations and transactions.⁴³ Later, on February 4, the President issued Decree 214/2002, pursuant to which all bank deposits were “pesified” at \$1.40 pesos per US\$1 and revalued at various time periods.⁴⁴ This order also provided for the application of an index of inflationary correction (“CER”) to all rescheduled bank deposits.⁴⁵ Because Decree 214/2002 “pesified” loans with the financial system at \$1.00 peso per US\$1 – a measure that greatly benefited local and foreign corporations – the overall system was known as “asymmetric pesification.”⁴⁶ The free exchange rate, on the other hand, which at the time was approximately \$2.80 pesos per US\$1,

39. *Id.* at 9.

40. Decree No. 1.570/2001 art. 2, Dec. 3, 2001, B.O. 29787 (Arg.).

41. Law No. 25.561, Jan. 6, 2002, B.O. 29810 (Arg.).

42. *Id.* art. 6.

43. Decree No. 71/2002 art. 1, Jan. 9, 2002, B.O. 29813 (Arg.).

44. Decree No. 214/2002 art. 2, Feb. 3, 2002, B.O. 29830 (Arg.).

45. *Id.* art. 4.

46. Gabriel Gómez-Giglio, *Emergency Law and Financial Entities in Argentina*, 10 J. INT’L BANKING L. & REG. 397, 401 (2003).

doubled the “pesification” rate for depositors; the difference was even larger for debtors.

Successive decrees and lower norms made it possible for depositors to obtain government bonds for the difference between the official and the free exchange rate. On May 31, Decree 905/2002 granted depositors the option to swap all rescheduled deposits for government bonds in U.S. dollars (“*Bodens*”); depositors who did not opt for the swap were given certificates of rescheduled deposits (“*Cedros*”).⁴⁷ Finally, Decree 1836/2002 granted depositors various options to swap all or part of their *Cedros* for government bonds.⁴⁸ The obvious goal of both decrees was to put 2001 depositors at a position no worse than those under the Bonex Plan, which is discussed further in Part IV of this Article.

IV. THE EMERGENCY PARADIGM

During the 1920s and 1930s, American constitutional jurisprudence analogized an economic and social emergency to war, thus justifying an encroachment of private property and freedom of contract as an exercise of Congress’s extraordinary powers during times of emergency.⁴⁹

It is common to regard emergency regulations – such as restriction or deferral of the convertibility of deposits into currency, as well as the compulsory currency conversion of bank deposits, bonds, and other creditor rights – as infringements of property rights and freedom of contract that are grounded on public interest reasons.⁵⁰ Indeed, resolving an emergency situation seems to be the paradigm of serving the public interest. The emergency paradigm allows individual rights to be sacrificed when necessary to avert a social or economic catastrophe. Emergency norms thus contradict ordinary norms. However, this does impede the coherent functioning of the legal system: emergency norms simply suspend, during a period of time, the application of ordinary

47. Decree No. 905/2002, June 1, 2002, B.O. 29911 (Arg.).

48. Decree No. 1836/2002, Sept. 16, 2002, B.O. 2995 (Arg.). A detailed account of all normative changes can be found in Gómez-Giglio, *supra* note 46, at 403, and Gabriel Gómez-Giglio, *Argentina and the Changing Nature of Financial Regulation*, 9 J. INT’L BANKING L. & REG. 317 (2004).

49. Higgs, *supra* note 4, at 159-72.

50. *Id.*

norms. During the state of emergency, ordinary norms are not rendered null, but rather their application is suspended.⁵¹

From a philosophical viewpoint, it is interesting to observe that even natural rights theories do not necessarily dismiss the possibility that, under catastrophic conditions, it might be morally permissible to infringe on individual rights.⁵² Thus, Argentine Judge and law professor, Martín Farrell, contends that utilitarian considerations outweigh rights-based decision making when respecting individual rights will lead to tragic consequences.⁵³ While a judge's moral obligation is to enforce rights, under conditions of political unrest or social emergency, a judge can allow the infringement of individual rights if necessary to prevent tragic consequences.⁵⁴

When emergency measures are analyzed in terms of the property/public interest matrix, two different normative stances are possible. Under a conservative-libertarian, *Lochner*-type approach, any infringement on private property that does not seek to prevent nuisance constitutes compensable government taking.⁵⁵ Alternatively, aligning with New Deal policy, Congressional legislation can legitimately curb private property rights in extenuating situations by simply alleging a public interest goal.⁵⁶ Compensation is then only applicable in cases of physi-

51. Ricardo Guarinoni, *La emergencia y los jueces*, in DERECHO, LENGUAJE Y LÓGICA 91 (2006).

52. See ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 29-30 (Basic Books, Inc. 1974). In one of the most important natural rights treatises of the twentieth century, Robert Nozick says: "The question of whether these side constraints [individual rights] are absolute, or whether they may be violated in order to avoid catastrophic moral horror, and if the latter, what the resulting structure might look like, is one I hope largely to avoid." *Id.* at 30.

53. Martín Diego Farrell, *Los planes económicos y la Corte Suprema*, in FILOSOFÍA DEL DERECHO Y ECONOMÍA 15-16 (2006).

54. *Id.* at 17.

55. RICHARD EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 35-41 (1985).

56. The so-called Constitutional "Revolution" of 1937, which abolished substantive due process, was completed in *United States v. Carolene Prods. Co.*, 304 U.S. 144, 147 (1938). Justification of encroachments on private property is often given in terms of fairness or mutual advantage. See, e.g., Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundation of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967); Joseph L. Sax, *Takings, Private Property and Public Rights*, 81 YALE L. J. 149, 160 (1971).

cal invasion or significant reduction of economic value.⁵⁷ Argentina followed the latter approach.

The Argentine Supreme Court was ready to catch up with U.S. emergency doctrines as appropriate interpretations of the Argentine Constitution.⁵⁸ The doctrine of Economic Emergency harks back to *Ercolano v. Lanteri*.⁵⁹ However, in *Horta v. Harguindeguy*⁶⁰ the Court declared that rights vested by fixed term contracts made before the emergency law could not be encroached on; in *Mango v. Traba*,⁶¹ the Court stressed that violations of the rights to use and dispose of property must not exceed the emergency period.⁶² Then, in the landmark decision of *Avico v. de la Pesa*, the Court upheld the constitutionality of a law passed in 1933 that established a three-year moratorium on mortgage payments and foreclosures and capped the interest rate at six percent.⁶³ This decision was influenced by the U.S. doctrines in *Nebbia v. New York*⁶⁴ and *Home Building and Loan Association v. Blaisdell*.⁶⁵ In *Blaisdell*, a Minnesota act imposed a limited moratorium on the foreclosure of mortgages. James W. Ely described the position of Chief Justice Hughes, who spoke for the Court:

57. See, e.g., Leif Wenar, *The Concept of Property and the Takings Clause*, 97 COLUM. L. REV. 1923, 1933 (1997).

58. For helpful works, see Alberto Garay, *Federalism, The Judiciary, and Constitutional Adjudication in Argentina: A Comparison with the U.S. Constitutional Model*, 22 INTER-AM. L. REV. 161, 173 (1991), William C. Banks & Alejandro D. Carrió, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 63. (1993), and Jonathan Miller, *Judicial Review and Constitutional Stability: A Sociology of the U.S. Model and its Collapse in Argentina*, 21 HASTINGS INT'L & COMP. L. REV. 77, 141 (1997).

59. Corte Suprema de Justicia de la Nación [CSJN], 28/4/1922, "Ercolano v. Lanteri," Fallos (1922-136-161) (Arg.).

60. Corte Suprema de Justicia de la Nación [CSJN], 21/8/1922, "Horta v. Harguindeguy," Fallos (1922-137-60) (Arg.).

61. Corte Suprema de Justicia de la Nación [CSJN], 26/8/1925, "Mango v. Traba," Fallos (1925-144-219) (Arg.).

62. *Id.*

63. Corte Suprema de Justicia de la Nación [CSJN], 7/12/1934, "Avico, Don Oscar Agustín v. de la Pesa, don Saúl G. / sobre consignación de intereses," Fallos (1934-172-21) ¶5 (Arg.).

64. 291 U.S. 502, 537 (1934).

65. 290 U.S. 398, 415 (1934).

Clearly influenced by the economic emergency, Chief Justice Charles Evans Hughes ruled that contracts were subject to the reasonable exercise of the state police power. The police power encompassed the authority to give temporary relief for extraordinary economic distress. Although susceptible to a narrow construction limiting valid impairments of contracts to emergency situations, Hughes's opinion also suggested in broad terms that the state's interest in regulating economic affairs could justify interference with contracts.⁶⁶

In *Avico*, by summarizing the requirements imposed in *Blaisdell* Attorney General Horacio L. Larreta submitted to the U.S. Supreme Court a four-prong test to determine the constitutionality of a moratorium. Specifically, (1) the conditions existing must have created an emergency situation; (2) the fundamental purpose of the measure, and of government acts in general, is to safeguard the public and promote general welfare to the people; (3) the postponement of mortgage foreclosure sales must be reasonable; and (4) the change in legislation must have been provided in a temporary manner.⁶⁷

Following *Blaisdell*, Larreta maintained that "a moratorium does not attack property, which is maintained with all its attributes, and only *delays* the application of the remedies that are available to the creditor."⁶⁸ The Court stressed the difference between the substance of property and the remedies for its protection by quoting the opinion delivered by Chief Justice Marshall in *Sturges v. Crownshield*. Marshall pointed to the distinction between an obligation and the remedy to enforce it:⁶⁹

The distinction between the obligation of a contract, and the remedy given by the legislature to enforce that obligation, has been taken at the bar, and exists in the nature of things. Without impairing the obligation of the contract, the remedy may certainly be modified as the wisdom of the nation shall direct.⁷⁰

Thus, the decisions of the U.S. Supreme Court and Argentine Supreme Court in *Blaisdell* and *Avico*, respectively, maintained that for emergency reasons, the federal government is allowed to modify the

66. JAMES W. ELY, JR., *THE GUARDIAN OF EVERY OTHER RIGHT, A CONSTITUTIONAL HISTORY OF PROPERTY RIGHTS* 121 (1998).

67. *Avico*, Fallos (1934-172-21) at 34-35.

68. *Id.* at 33.

69. 17 U.S. 122 (1819).

70. *Id.* at 200.

“time dimension” of property rights, provided this modification is reasonable.⁷¹

The Argentine Supreme Court’s borrowing of the emergency paradigm in *Avico* would prove useful many decades later in sustaining the constitutionality of emergency decrees in Argentine financial crises. The most important decision in this area came in the context of the economic crisis of 1989, in the early days of President Menem’s administration. The President issued Decree 36/90, which converted time deposits into public bonds (“Bonex 1989”).⁷² The publicized goal of this measure was to reduce the burden of the increasing internal public debt.⁷³ In the famous decision of *Peralta v. Nación Argentina*⁷⁴ the Argentine Supreme Court acknowledged the constitutional validity of Decree 36/90 by invoking the doctrine used by the U.S. Supreme Court in *Blaisdell*, already transplanted into Argentine law in *Avico*. The Court defined “emergency” in *Peralta* as “an extraordinary situation that hovers over the economic-social order, with its burden of accumulated troubles, in the form of scarcity, poverty, penury or indigence, and creates a state of necessity which must be put to an end.”⁷⁵

Importantly, *Peralta* stretched the emergency paradigm beyond that which had been set forth in *Blaisdell* and *Avico*. In essence, the Court in *Peralta* discussed two different issues: (1) whether the President possesses emergency powers of a legislative nature, and (2) whether the relevant authority (Congressional or Executive) can, in a state of emergency, defer the paying out of deposits by restructuring them into public bonds. Thus, *Peralta* introduces two possible sides to the doctrine of economic emergency: *functional emergency* and *regulatory emergency*.

A functional emergency occurs when the state of emergency can justify an alteration of the separation of powers established by the Constitution, so that the President can exercise, with or without Congress’s prior approval, powers ordinarily reserved to Congress. A regulatory emergency, on the other hand, refers to the government’s

71. LAURA S. UNDERKUFFLER, THE IDEA OF PROPERTY, ITS MEANING AND POWER 28 (2003) (a four-dimensional analysis of property in which time is the fourth dimension).

72. Decree No. 36/90, Jan. 5, 1990, B.O. 26795 (Arg.).

73. PABLO GERCHUNOFF & LUCAS LLACH, EL CICLO DE LA ILUSIÓN Y EL DESENCANTO 430 (2003)

74. Corte Suprema de Justicia de la Nación [CSJN], 27/12/1990, “Peralta, Luis Accenio v. Nación Argentina / acción de amparo,” Fallos (1990-313-513) (Arg.).

75. *Id.* at 571.

wider powers of regulatory interference with constitutional rights that are grounded on the need to protect fundamental public goals (e.g. the preservation of the whole constitutional order).

In its assessment of regulatory emergencies, the *Peralta* Court apparently rested on the doctrines used in *Blaisdell* and *Avico*:

In our law as well as in that of the United States of America, the laws dictated in emergency situations have not been taken to be outside the Federal Constitution in disregard of the right to property, when they either limited themselves to not suspending indefinitely the exercise of the creditor's rights, or did not make difficult the fulfillment of the obligations with excessively long terms.⁷⁶

However, *Peralta* equated a congressional moratorium (the measure challenged in *Blaisdell* and *Avico*) to a financial restructuring scheme introduced by Presidential decree, thus stretching the borrowed precedent from a regulatory emergency to a functional emergency. Moreover, *Peralta* lengthened a short-term moratorium in *Blaisdell* (just over two years) and *Avico* (three years) to a ten-year banking restructuring (the "Bonex Plan"). Therefore, by stretching the borrowed precedent in all these ways, the Court concluded that the President has an emergency power to postpone the lawful exercise of property rights for ten years. Further, in allowing such a postponement the Court did not require compensation.⁷⁷

Subsequently, in December 2001, when President de la Rúa suspended the convertibility of both demand and time deposits into cash by Decree 1,570/2001,⁷⁸ it may have seemed that the Court would follow *Peralta* in testing the constitutional validity of the decree. In fact, the Court rejected exceptional cautionary measures [*amparos*] in the so-called *Kiper* case because they violated procedural due process.⁷⁹ A few weeks later, however, the Court ruled in *Smith* that restrictions on bank withdrawals and the emergency measures described in Section III

76. *Id.*

77. *Id.*

78. Decree No. 1.570/2002 art. 2, Dec. 3, 2001, B.O. 29787 (Arg.).

79. Corte Suprema de Justicia de la Nación [CSJN], 28/12/01, "Banco de la Ciudad de Buenos Aires s/ solicita se declare estado de emergencia economica," Fallos (2001-324-4520) (Arg.).

amounted to confiscation of property.⁸⁰ *Smith* was a curious return to *Lochner*-style jurisprudence. The Court declared:

The right to freely dispose of the funds invested or deposited with banking and financial institutions is based on constitutional principles, regardless of any other legal standards acknowledging it. It is clear that any condition or restriction on such right will affect the intangibility of property and impair the goal of promoting justice. Such clashes with constitutional principles, given their seriousness and the absence of crucial reasons for them, cannot be understood as the result of reasonable regulations based on such principles, nor do they arise from Article 28 of the Constitution (Decisions 305:945, par. 8, last paragraph). This is clearly the case of the situation at stake in the case sub lite, in which successive regulations went too far, imposing conditions and restrictions on the free disposal of private property that flagrantly violated the said constitutional principles.⁸¹

The Court made an unconvincing attempt to distinguish the facts in *Smith* from those in *Peralta* by resorting to the doctrine of “vested rights”:

In the light of the case law criteria mentioned above [vested rights cases], the plaintiff’s property has been violated, given that the deposits had been made while a system guaranteeing their inviolability was in force. Furthermore, such guarantee had been recently strengthened by Law 25466, which had declared deposits intangible, with intangibility being defined as the impossibility by the State to alter the conditions agreed upon by deposit holders and the financial institution, as well as the prohibition to swap deposits for State bonds, postpone payments, or restructure their maturity (Sect. 1 to 4); these circumstances did, in fact, exceed those described in the *Peralta* case recorded in Fallos 313:1513.⁸²

Thus, one could argue that the Court considered the suspension of deposits’ intangibility by Emergency Law 25561,⁸³ passed in January 2002, as a new circumstance that was absent when it decided the *Kiper*

80. Corte Suprema de Justicia de la Nación [CSJN], 1/2/2002, “Smith, Carlos Antonio v. P.E.N. / medidas cautelares,” Fallos (2002-325-28) (Arg.).

81. *Id.* at 240.

82. *Id.*

83. Law No. 25.561, Jan. 6, 2002, B.O. 29810 (Arg.).

case. There is little doubt, however, that Menem's appointees in the Court were mainly guided by political considerations.⁸⁴

In *Smith*, the Argentine Supreme Court justices (usually called the "automatic majority" because they generally voted *en bloc* in favor of President Menem's policies) made an apparent preemptive strike to deter Duhalde's impeachment plans. Therefore, one could argue *Smith* must be given an *externalist* explanation, that is, an explanation that is not premised on judicial or doctrinal reasoning, but rather on political grounds.⁸⁵ Apart from the political background of the decision – which was widely documented in Argentine newspapers – two reasons support this claim. First, it is difficult to explain why the Court decided to adjudicate the substantive question of law in *Smith*, whereas it had declined to do so in *Kiper*. The Court's explanation was simply not persuasive: "[T]he injunction requested and granted matches the object of the appeal."⁸⁶ In fact, the plaintiffs in both *Kiper* and *Smith* claimed the same cautionary injunctions through *amparos*. Second, as Horacio M. Lynch observes, it was ironic that after decades of validating the most diverse invasions of private property and contractual freedom, such as minimum prices, rent control legislation, and freezing of deposits, the Argentine Supreme Court would suddenly return to a *Lochner*-type conception of private property and freedom of contract.⁸⁷

In *Provincia de San Luis*⁸⁸, the last case on pesification decided by the so-called "automatic majority," the Supreme Court restated the fundamental doctrines set forth in *Smith*. The Court held that pesification of bank deposits went beyond the emergency powers because it altered the substance of the depositors' property rights, instead of simply putting off the remedies available to depositors.⁸⁹ Justices Eduardo Moliné

84. Lynch, *supra* note 11, at 1298.

85. See Gretchen Helmke, *The Logic of Strategic Defection: Court-Executive Relations in Argentina Under Dictatorship and Democracy*, 96 AM. POL. SC. REV. 291 (2002) (an externalist explanation of doctrinal shifts in the Argentine Supreme Court). See generally Laura Kalman, *The Constitution, the Supreme Court, and the New Deal*, 110 AM. HIST. REV. 1052 (2005) (features a description of the internalist/externalist divide, and an internalist explanation of Supreme Court decisions during the New Deal that separates them from President Roosevelt's "Court-packing" plan).

86. Corte Suprema de Justicia de la Nación [CSJN], 1/2/2002, "Smith, Carlos Antonio v. P.E.N. / medidas cautelares," Fallos (2002-325-28) (Arg.).

87. Lynch, *supra* note 11, at 1287.

88. Corte Suprema de Justicia de la Nación [CSJN], 5/3/2003, "Provincia de San Luis v. Estado Nacional," Jurisprudencia Argentina [J.A.] (2003-I-188) (Arg.).

89. *Id.* at 29.

O'Connor and Guillermo A. F. López strongly emphasized Intangibility Law No. 25.466⁹⁰ because, they declared, this law strengthened the constitutional protection of depositors' vested rights. The justices found that "the energetic wording of those norms uncontroversially reveals the existence of an economic policy addressed to capture deposits, creating for such purpose a high degree of trust, which public power defrauded almost immediately with the passing of those norms here questioned."⁹¹ The Court ordered Banco de la Nación Argentina ("the Nation") to pay off the dollar deposits to Provincia de San Luis (the "Province"); it also instructed the Nation and the Province to agree on the method and dates of repayment within sixty days, without modifying the substance of the decision, under a penalty of the Court deciding the issues itself.⁹²

In 2004, a divided Court in *Bustos* overruled *Smith* and *Provincia de San Luis* and sustained the constitutionality of pesification.⁹³ In *Bustos*, the majority of the Court went back to the doctrines in *Avico* and *Blaisdell*, that is, to the emergency paradigm. According to *Bustos*, Congress or the President may establish pesification in a state of emergency.⁹⁴

Justices Augusto Belluscio and Juan Carlos Maqueda offered a critical assessment of the economic policies adopted in the 1990s:

[I]t is evident that the prolonged maintenance of an artificial value equivalence between the Argentine peso and the U.S. dollar, together with economic circumstances that the mentioned absence of evidence impedes to clarify, led to a process of worsening of the national productive apparatus – with its aftermath of unemployment, misery and hunger – to which the unusual interest rates offered for dollar deposits were relevant, to a threat of bank run that the Government tried to avert by means of these rates, and finally to a certain risk that that threat really should occur or start, which were the determinants of the measures adopted by the Executive Branch and the Congress with the goal of impeding the

90. Law No. 25.466, Sept. 25, 2001, B.O. 29739 (Arg.).

91. *Provincia de San Luis*, J.A. (2003-I-188) at 30.

92. *Id.* at 38.

93. Corte Suprema de Justicia de la Nación [CSJN], 10/26/2004, "Bustos, Alberto Roque v. E.N. / amparo," J.A. (2005-III-189) (Arg.) (concurring opinion of Judges Augusto C. Belluscio and Juan C. Maqueda, Antonio Boggiano, Eugenio R. Zaffaroni, and Elena Highton de Nolasco).

94. *Id.* at 29.

generalized insolvency of the banking system and the subsequent ruin of all depositors.⁹⁵

Belluscio and Maqueda availed themselves once again of Larreta's four-condition test and ruled that the test was met. They even advanced an explanation of Argentina's fall: "It is undisputable . . . that devaluation of national currency was an unavoidable measure in the face of the grave emergency resulting from the value disequilibrium vis-à-vis the U.S. dollar and the beginning of an important bank run."⁹⁶ Interestingly, Belluscio and Maqueda focused on real exchange overvaluation as the cause of the crisis, but did not mention fiscal sustainability and the stop of capital inflows. The explanation of the Argentine crisis remains controversial in economic literature, with real exchange overvaluation being only one of the factors cited.⁹⁷

Today, the Court adheres to this emergency paradigm, though most federal courts still follow the doctrines of *Smith* and *Provincia de San Luis*. In the recent *Massa* decision, the Court again applied the emergency paradigm.⁹⁸ It ruled that applying the conversion formula established by Decree 214/2002 – in an extended version that also covers the period of legal proceedings – plus an annual interest rate fixed at four percent, does not cause economic damage when restitution is made at

95. *Id.* at 8.

96. *Id.* at 9.

97. See, e.g., Guillermo A. Calvo et al., *Sudden Stops, the Real Exchange Rate, and Fiscal Sustainability: Argentina's Lessons*, in EMERGING CAPITAL MARKETS IN TURMOIL: BAD LUCK OR BAD POLICY? (Guillermo Calvo ed., 2005); Sebastián Etchemendy, *Old Actors in New Markets: Transforming the Populist/Industrial Coalition in Argentina, 1989-2001*, in ARGENTINE DEMOCRACY, THE POLITICS OF INSTITUTIONAL WEAKNESS (Steven Levitsky & María Victoria Murillo eds., 2005); Ricardo Hausmann & Andres Velasco, *Hard Money's Soft Underbelly: Understanding the Argentine Crisis*, in BROOKINGS TRADE FORUM: 2002 61 (Susan M. Collins & Dani Rodrik eds., 2003); Augusto de la Torre et al., *Living and Dying with Hard Pegs: The Rise and Fall of Argentina's Currency Board*, ECONOMIA 8 (2003), available at <http://siteresources.worldbank.org/DEC/Resources/Economia-DelaTorre-LevyYeyati-Schmukler.pdf>; Martin Feldstein, *Argentina's Fall: Lessons from the Latest Financial Crisis*, 81 FOREIGN AFF. 2 (2002).

98. Corte Suprema de Justicia de la Nación [CSJN], 27/12/2006, "Massa, Juan A. v. E.N.", Jurisprudencia Argentina [J.A.] (2007-II-185) at 13 (Arg.) (concurring opinion of Judges Elena Highton de Nolasco, E. Raúl Zaffaroni, Ricardo Luis Lorenzetti, and Carmen Argibay).

the time of the decision.⁹⁹ Justices Elena I. Highton de Nolasco, E. Raúl Zaffaroni, and Ricardo Luis Lorenzetti held:

[A]n interpretation contrary to this fundamental regime of economic working (the “emergency legislative bloc,” which includes the new exchange system), if adopted years after the implementation of this regime, would yield very grave institutional sequels, which is contrary to the interpretative standard that requires to ponder over the consequences that result from judicial decisions.¹⁰⁰

The Court declared in *Peralta*, *Bustos*, and *Massa* that it was following the doctrine in *Blaisdell*, and its Argentine analogue in *Avico*. In fact, however, the compulsory swap of deposits for public bonds in 1991 and the conversion of dollar deposits into rescheduled peso deposits in 2002 nevertheless altered the substance of the obligations, thus violating the right to property (even considering the option to swap deposits for dollar denominated Government bonds).¹⁰¹ As noted above, *Blaisdell* and *Avico* made a crucial distinction between the substance of an obligation (e.g., a creditor right) and the remedies available to obtain its execution. The emergency paradigm permits deferral of the available remedies when necessary to overcome the crisis, but it disallows even a temporary alteration of the nature of the underlying obligations. A compulsory swap for government bonds modifies the essence of an obligation because, among other things, it substitutes the government for the original obligor. The same principle applies to the conversion of bank deposits into pesos at an official rate, because this conversion modifies the economic value of the deposit.¹⁰²

V. THE MONETARY PARADIGM

During the Great Depression, the U.S. Supreme Court did not return to *Blaisdell* in order to review gold dollar contracts after the abandonment of the gold standard. Though the Court discussed the abrogation of gold clauses under the rhetoric of emergency, its approach in these

99. *Id.* at 5.

100. *Id.* at 6.

101. Marta Macías, *Revisión del fallo Bustos según la doctrina de sus precedentes. Análisis de la jurisprudencia citada en el voto de los Dres. Belluscio y Maqueda*, S.J.A. (2005).

102. Justice Carmen Argibay expressed this opinion in her concurring opinion in *Massa*.

cases forms a different paradigm, the *monetary paradigm*. President Roosevelt forbade, with certain exceptions, the commerce of gold throughout the entire nation; Congress redefined obligations fixed in gold dollars into obligations in unconvertible dollars.¹⁰³ Chief Justice Hughes, speaking for the majority, distinguished between private and public contracts in five decisions usually known as the “Gold Clause Cases,” yet reaffirmed in all these cases comprehensive congressional power over monetary policy. As Robert Higgs explains: “By validating the abandonment of the gold standard, [these decisions] released the federal government from a powerful restraint on its expansion of the money stock. Not by coincidence has the subsequent half-century been an age of inflation.”¹⁰⁴

It is important to realize that the Supreme Court’s reasoning was quite different in the three private-contract and the two public-contract cases.¹⁰⁵ In *U.S. v. Bankers’ Trust Co.*,¹⁰⁶ and *Norman v. Baltimore & Ohio Railroad Co.*,¹⁰⁷ the Court addressed the validity of the Joint Resolution of June 5, 1933¹⁰⁸ with respect to the “gold clauses” of private contracts for the payment of money:

Contracts, however express, cannot fetter the constitutional authority of the Congress. Contracts may create rights of property, but, when contracts deal with a subject-matter which lies within the control of the congress, they have a congenital infirmity. Parties cannot remove their transactions from the reach of dominant constitutional power by making contracts about them.¹⁰⁹

Further, the majority opinion explained that it was neither a state of emergency, nor the consequences arising thereof, that mattered in its decision:

We are not concerned with consequences, in the sense that consequences, however serious, may excuse an invasion of constitutional right. We are concerned with the constitutional power of the Congress over the monetary system of the country and its attempted frustration. . . . The contention that these gold clauses are valid

103. H.R.J. 192, 73d Cong. (1st Sess. 1933).

104. HIGGS, *supra* note 4, at 186.

105. See John P. Dawson, *The Gold Clause Decisions*, 33 MICH. L. REV. 647 (1935).

106. 294 U.S. 240 (1935).

107. 293 U.S. 548 (1934).

108. H.R.J. 192.

109. 294 U.S. at 307-08.

contracts and cannot be struck down proceeds upon the assumption that private parties, and states and municipalities, may make and enforce contracts which may limit that authority.¹¹⁰

The Supreme Court addressed the issue of Government bonds in *Nortz v. United States*¹¹¹ and *Perry v. United States*¹¹², striking down the Joint Resolution of June 5, 1933. This resolution had provided that clauses requiring payment in gold or a particular kind of coin or currency were against public policy, and that every obligation, theretofore or thereafter incurred, “shall be discharged upon payment, dollar for dollar, in any coin or currency which at the time of payment is legal tender for public or private debts.”¹¹³ Government bonds fell under this resolution because they provided that the principal and interest would be payable “in United States gold coin of the present standard of value.”¹¹⁴ The Court declared in *Perry* that the Joint Resolution went beyond the Congressional power because it attempted to override the obligation created by the bond in suit. “The Congress cannot invoke the sovereign power of the people to override their will as thus declared.”¹¹⁵ Moreover, the *Perry* court held, “[t]he action is for breach of contract. As a remedy for breach, plaintiff can recover no more than the loss he has suffered and of which he may rightfully complain. *He is not entitled to be enriched.*”¹¹⁶

As to the issue of how to establish the baseline for assessing compensable damages, the Court said: “The question of actual loss cannot fairly be determined without considering the economic situation at the time the government offered to pay him the \$10,000, the face of his bond, in legal tender currency. The case is not the same as if gold coin had remained in circulation.”¹¹⁷ The Court did not consider the mere impossibility of converting the nominal amount of dollars into gold at the previous exchange rate as a compensable damage. As Higgs says,

110. *Id.* at 316.

111. 294 U.S. 317 (1935).

112. 294 U.S. 330 (1935).

113. H.R.J. 192.

114. *Id.*

115. *Perry*, 294 U.S. at 353.

116. *Id.* at 354 (emphasis added).

117. *Id.* at 355.

[the court] reached this conclusion by assuming that during 1933-1934 the government could and did legitimately deny Americans recourse to foreign markets for gold and foreign currency linked to gold. In other words, the government's (unconstitutional) abrogation of its obligation to pay gold to bondholders has caused them no determinate harm because access to the markets wherein the value of the damages could have been established had been foreclosed by other (constitutional) governmental restrictions.¹¹⁸

Chief Justice Hughes, writing for the majority, emphasized this point by asserting:

Plaintiff demands the 'equivalent' in currency of the gold coin promised. But 'equivalent' cannot mean more than the amount of money which the promised gold coin would be worth to the bondholder for the purposes for which it could legally be used. That equivalence or worth could not properly be ascertained save in the light of the domestic and restricted market which the Congress had lawfully established.¹¹⁹

A logical conclusion, therefore, is that the monetary paradigm is relevant when denomination of liabilities in gold currency or foreign exchange (e.g., U.S. dollar) is a central component in a banking crisis. In fact, liability dollarization played a key role in the Argentine crisis, because the devaluation and abandonment of the currency board caused a severe balance-sheet mismatch in non-tradable sectors.¹²⁰ However, the monetary paradigm does not really apply to the Argentine crisis. The Argentine Supreme Court adopted divergent stances on this issue. While *Bustos* generally adopted the emergency paradigm, Justices Belluscio and Maqueda invoked the monetary paradigm in their opinion by citing *Perry*.¹²¹ Their argument merits careful scrutiny. The justices argued that "the supposed property of dollars was nothing more than a great fallacy."¹²² They asserted this bold claim as follows:

118. HIGGS, *supra* note 4, at 187.

119. *Perry*, 294 U.S. at 357.

120. Calvo et al., *supra* note 97, at 144-45 (noting that liability dollarization was also important in the crises of Korea and Indonesia (1997) and Turkey (2001)).

121. Corte Suprema de Justicia de la Nación [CSJN], 10/26/2004, "Bustos, Alberto Roque v. E.N. / amparo," *Jurisprudencia Argentina* [J.A.] (2005-III-189) at 10 (Arg.).

122. *Id.* at 29.

In Argentina no one earned in American dollars, hence it follows that denominating bank deposits in that currency was either a way of using it simply as an accounting unit – no one is unaware that to a great extent pesos were deposited and that these were converted to an equal amount of dollars, an equivalence whose falsity became notorious if the impossible task was attempted to convert pesos for dollars abroad (except in some neighboring countries), and whose fictitious nature is now very clearly seen – or of preparing the purchase of dollars at a low and base price – that of exchange rate¹²³

Thus, Justices Belluscio and Maqueda assumed that a currency board is a delusion because it maintains a convertible national currency (in which salaries, for instance, are still being denominated). This is meaningless: it is like saying that the currency board is delusional because it is a currency board.

The Argentine currency board lasted 10 years. It is debatable whether it could have lasted longer under different fiscal conditions. But the important issue is that sustainability of an exchange system is quite different from its “ontological” status (as real or delusive). For example, Hong Kong’s currency board has been operating since 1983 with the Hong Kong dollar pegged at a fixed exchange rate to the U.S. dollar. Is this fictitious? A currency board is probably not the best exchange system for coping with the deflationary rigidities of modern democratic and unionized politics, as the Great Depression and Argentine crises have tragically shown.¹²⁴ Yet a currency board is no less real than any other exchange system. On the contrary, if “artificial” has any clear meaning in this context, it is evident that inconvertible paper money is more artificial than convertible paper money. In the Court’s opinion, financial contracts denominated in U.S. dollars are always fictitious or fallacious under any exchange rate system except dollarization. This is an unsupported claim. The justices also failed to explain why bonds issued by a government in default (for which bank deposits could be swapped) were less “artificial” than dollar deposits under convertibility.

After criticizing the currency board, Justices Belluscio and Maqueda held that depositors (at least those who do not prove that they need U.S. dollars for operations abroad) cannot claim damages against

123. *Id.*

124. *Cf.* Barry Eichengreen & Peter Temin, *The Gold Standard and the Great Depression* 15-16, 24-26, 37-38 (Nat’l Bureau of Econ. Research, Working Paper No. 6060, 1997).

the State as a result of the compulsory pesification of bank contracts. Borrowing an argument from *Perry*, Belluscio and Maqueda stated: “pesification presents itself as reasonable as long as the amount to be returned has the same or greater purchasing power than the original deposit, because this does not cause damage to the creditor.”¹²⁵ Additionally, “in the absence of damage produced by the State, there is no action.”¹²⁶

The application of *Perry* to the Argentine pesification is flawed. *Perry* is not founded on the monetary paradigm, but rather on the principle that a plaintiff must be compensated for breach of contract with expectation damages, in an amount not to exceed his expectation value. Therefore, *Perry* does not apply to the Argentine crisis for two reasons. First, Argentine law is a civil law system and the creditor always has recourse to specific performance as a remedy for breach of contract. This is strikingly different from the common law, where specific performance is the exception rather than the rule.¹²⁷ For example, the French Civil Code declares that contracts must be performed in good faith,¹²⁸ and stipulates that an obligation to give implies an obligation to deliver the thing, and to preserve it until delivery.¹²⁹ Similarly, the Argentine Code stipulates that the creditor, in case of non-performance of a contract, has the right to choose from among the following measures: (1) force performance of the obligation, (2) obtain performance by a third party at the debtor’s expense, or (3) obtain appropriate damages.¹³⁰

How is the specific performance of a money obligation to be determined? In the civil law tradition, *nominalism* maintains that monetary obligations should be discharged at the numerical sum of the currency established in the contract.¹³¹ Traditionally, the French Civil Code¹³² and most Latin American codes embraced nominalism. The Argentine Civil Code established nominalism in regards to money obligations in national currency (Article 619), but Article 617, under its original wording,

125. *Bustos, Alberto Roque*, J.A. (2005-III-189) at 29.

126. *Id.*

127. Horacio Spector, *Fairness and Welfare from a Comparative Law Perspective*, 79 CHI.-KENT L. REV. 521, 528-30 (2004).

128. CODE CIVIL [C. CIV.] art. 1134 (Fr.).

129. In civil law, obligations are traditionally classified into three categories: obligations to give, obligations to do, and obligations not to do. See SAUL LITVINOFF, *THE LAW OF OBLIGATIONS* (1992).

130. CODIGO CIVIL [CÓD. CIV.] art. 505 (Arg.).

131. KENNETH L. KARST & KEITH S. ROSENN, *LAW AND DEVELOPMENT IN LATIN AMERICA* 443 (1975).

132. C. CIV. art. 1895.

considered obligations to give money that lacked legal tender quality as an obligation to give goods (as opposed to money).¹³³ Convertibility Law No. 23928 modified Article 617 by providing that obligations denominated in foreign currency were money obligations.¹³⁴ It also amended Article 610 to apply nominalism to obligations denominated in foreign currency: "If the debtor's obligation is to deliver a certain quantity of a certain kind of money, the debtor fulfills his obligation by giving the designated kind of money on the maturity's day."¹³⁵ Therefore, in the case of contracts denominated in dollars, the specified kind of money is dollars, and so the creditor can obtain specific performance of the obligation to give dollars.¹³⁶

Furthermore, unlike New Deal measures, Argentine Decree 260/2002 allowed free circulation of the U.S. dollar and established a free exchange market.¹³⁷ The Argentine government did not suppress the circulation of U.S. dollars, but rather substituted a dirty float¹³⁸ for the currency board. Pesification of bank deposits at the rate of \$1.40 pesos to US\$1, unlike the repayment of private bonds in non-convertible dollars, implied high opportunity costs for dollar depositors; these costs remained under the new exchange rate system. Therefore, even if expectation damages were applied, pesification caused real damage to depositors at the moment of its passage.¹³⁹ Moreover, as Justice Argibay rightly pointed out in *Massa*, there was no evidence that the economic value fixed by Decree 214/2002 was equivalent to the capital deposited,

133. *Id.* art. 619.

134. Law No. 23.928, Mar. 28, 1991 [Art. 11] B.O. No. 27104 (Arg.).

135. *Id.*

136. This is a literal application of the Argentine Civil Code. If the debtor is unable to give the designated kind at the maturity of the obligation, he defaults on it, but the obligation is not extinguished. See Horacio Tomás Liendo (h.), *Los pesificadores reniegan de su tempestad (genus nunquam perit)*, La Ley [L.L.] 1299, 1300-01 (2002-F) (Arg.), available at <http://www.liendo.com.ar/html/sitio/publicaciones/casopesificacion2.pdf>. Yet Congress could have modified Article 505 of the Civil Code laying down expectation damages as the only remedy for breach of financial contracts during the state of emergency.

137. See *id.* at 1305.

138. Dirty float (or managed floating rate system) is "[a] system in which a country's currency is allowed to float freely in the foreign exchange market within certain bounds; drastic changes in the value of the currency are mitigated by central bank intervention in the foreign exchange market." ROBERT B. EKELUND, JR. & ROBERT D. TOLLISON, *ECONOMICS* 853 (1986).

139. Macías, *supra* note 101.

because: (1) it is dogmatic to assume that the depositor intended to employ this capital for purchasing services and goods in the internal market; and (2) even within the internal market, some goods (i.e., real estate) increased in the same proportion as the U.S. dollar in the free exchange market.¹⁴⁰

Thus, it is not *Perry* or its brethren, but rather *U.S. v. Bankers' Trust Co.*, *Norman v. Baltimore & Ohio Railroad Co.*, and *United States et al. v. Bankers' Trust Co. et al.*, that became relevant for sustaining pesification. As former Justices Moliné O'Connor and López held in *Provincia de San Luis*, *Perry* addressed the case of Government bonds, where the key statement was that Congress cannot exercise its monetary powers as a way of unilaterally modifying its own freely assumed obligations:

The Constitution gives to the Congress the power to borrow money on the credit of the United States, an unqualified power, a power vital to the government, upon which in an extremity its very life may depend. The binding quality of the promise of the United States is of the essence of the credit which is so pledged.¹⁴¹

Given that this factual condition was absent in the Argentine cases, why did the Court get into trouble by invoking *Perry* instead of simply resorting to *Norman*, where the sovereign power of Congress freely reigns?¹⁴²

In the author's view, unlike Justices Belluscio and Maqueda, Justice Highton de Nolasco correctly cited *U.S. v. Bankers' Trust Co* in her opinion in *Bustos*, thus properly applying the monetary paradigm. She explained that Convertibility Law 23928 "established the . . . convertibility with the U.S. dollar, a new and full-fledged nominalism, desindexation, and the inclusion of foreign currency under the obligations to give

140. Corte Suprema de Justicia de la Nación [CSJN], 27/12/2006, "Massa, Juan A. v. E.N.," *Jurisprudencia Argentina* [J.A.] (2007-II-185) at 20 (Arg.).

141. Corte Suprema de Justicia de la Nación [CSJN], 5/3/2003, "Provincia de San Luis v. Estado Nacional," *Jurisprudencia Argentina* [J.A.] (2003-I-188) at 29 (Arg.).

142. Julio C. Crivelli, *Se acerca un gravísimo error: la redolarización. Enseñanzas del fallo "Perry" v. Estados Unidos*, *Jurisprudencia Argentina* [J.A.] (2002-IV-1404) (stating that the relevance of *Perry* had been wrongly stressed); see Eduardo Conesa, *El caos monetario argentino de 2002 y su resolución (Ad impossibilia nemo tenetur)*, *La Ley* [L.L.] (2002-D-1201) (Arg.) (advocate of pesification mentions *Norman*).

sums of money as if it were national currency.”¹⁴³ Echoing Arthur Nussbaum, Justice Highton drew a distinction between “legal tender” [*curso legal*] and “compulsory tender” [*curso forzoso*].

For Nussbaum, legal tender denotes the quality of non-refusable money, that is, the rule that the payee cannot refuse a payment in lawful money made by the payor.¹⁴⁴ In contrast, compulsory tender is the inconvertibility of paper money established by law; in other words, compulsory tender likewise denotes an aspect of the relationship between the issuer and the holder of paper currency.¹⁴⁵ In American history, the expression “legal tender” is associated with the Acts of 1862 and 1863, which made U.S. notes – i.e., nonconvertible paper money – a legal tender in payment of all debts, public and private.¹⁴⁶ In Argentine history, the expression “compulsory tender” was used to the same effect: to denote the quality of legal tender as applied to paper money that has become inconvertible. Like “legal tender” in the American sense, “compulsory tender” in the Argentine sense tends to signify the quality of legal tender of irredeemable paper money with respect to debts and taxes.¹⁴⁷ Legal tender, as distinct from compulsory tender, can also exist in a convertibility regime. “Legal tender” in this sense is much the same as national currency or lawful money. Thus, pesos were not compulsory tender under the peg, but they certainly were legal tender, because only pesos had releasing power with respect to taxes and other State-related obligations.

Highton claims that when Congress declares “compulsory tender”, it can also fix the exchange rate of the new inconvertible money.¹⁴⁸ Accordingly, Congress could follow three different variants: paper money could be established as compulsory tender (a) at par or face value, (b) at the market value, or (c) at some intermediate value between the nominal value and the market value. Highton implied that Congress is empowered to opt for any of these alternatives, which means that it can fix a rate of \$1.40 pesos for US\$1.00, even when the free exchange

143. Corte Suprema de Justicia de la Nación [CSJN], 10/26/2004, “Bustos, Alberto Roque v. E.N. / amparo,” J.A. (2005-III-189) at 61 (Arg.).

144. NUSSBAUM, *supra* note 7, at 55-58.

145. *Id.*

146. Knox v. Lee & Parker v. Davis, 79 U.S. 457 (1871); Hepburn v. Griswold, 75 U.S. 603 (1870); *see also* John Dawson & Frank Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879*, 33 MICH. L. REV. 852, 898-922 (1935).

147. PABLO GERCHUNOFF ET AL., DESORDEN Y PROGRESO 50 n.46 (2008).

148. *Bustos, Alberto Roque*, J.A. (2005-III-189) at 63.

rate is much higher. This opinion overruled the doctrine in *Gowland v. Mallmann*, decided in 1886, according to which the establishment of paper money as legal tender does not mean that it must be accepted at par value or any other value lower than its market value.¹⁴⁹ Therefore, the monetary argument, presumably embraced by Highton, states: (1) Emergency Law 25445¹⁵⁰ changed the monetary system by establishing Argentine paper currency as compulsory tender by substituting the irredeemable peso for the convertible peso; (2) in passing this law, Congress exercised its sovereign powers to fix the exchange value of currency, and private contractors must accept compulsory tender at the parity fixed by Congress in cancellation of their dollar-denominated credits; and (3) this would mean that banks are entitled to pay off deposits in irredeemable pesos at the rate fixed by Congress.

Though pesos became compulsory tender when the currency board was abolished, this did not establish pesification as a way of exercising congressional power to fix the exchange rate of inconvertible pesos. In effect, in establishing nominalism, Articles 617 and 619, as amended by Convertibility Law 23.928, provided that payment in dollars was the adequate form of paying off dollar-denominated obligations. Under convertibility's nominalism, neither dollars nor inconvertible pesos were compulsory tender simply because, by definition, there is no compulsory tender in a convertibility regime. Though dollar convertibility can misleadingly be assimilated to the classic currency board under the gold standard, the author contends that *Norman* is not applicable to the pesification of dollar-denominated contracts.

From 1899 to 1914 Argentina maintained a regime of gold convertibility administered by a currency board. Conversion Law No 3.871, passed on October 31, 1899, established gold convertibility of paper pesos.¹⁵¹ According to this regime – which would extend over a period of fifteen years – the currency board was to exchange paper pesos for gold pesos at the rate of 2.27 paper pesos to one gold peso.¹⁵²

The obvious difference between a gold standard currency board and a dollar currency board is that metal currency is coined by the govern-

149. Corte Suprema de Justicia de la Nación [CSJN], 6/10/1985, "Gowland v. Mallmann," Fallos (1985-29-304) (Arg.).

150. Law No. 25.445, June 25, 2001, B.O. 29675 (Arg.).

151. GERARDO DELLA PAOLERA & ALAN M. TAYLOR, STRAINING AT THE ANCHOR: THE ARGENTINE CURRENCY BOARD AND THE SEARCH FOR MACROECONOMIC STABILITY, 1880-1935 120 (2001).

152. *Id.* at 119.

ment, while U.S. dollars are issued by a foreign government. Consequently, when contracts are denominated in the national currency, Congress's power to coin or issue national currency and to regulate the value thereof can affect those contracts. Congress can exercise this power either by introducing a new national currency or by varying the gold or dollar parity of the old currency. This feature of the monetary paradigm can be described as Congress having the power to change the *internal denomination* of contracts. In contrast, when contracts are lawfully denominated in a foreign currency (*external denomination*), the Government cannot modify the economic value of those contracts by simply exercising monetary powers. Private contracts in the gold clause cases were denominated in gold *dollars* and therefore, bond holders' attempt to maintain the gold clauses after Congress had established legal tender and prohibited the circulation of gold, were incompatible with Congress's power to change the monetary system and establish legal tender.

Still, bank deposits in the pesification cases were typically denominated in U.S. dollars, and the U.S. Government had already declared that paper dollars were legal tender in 1933. As Justice Adolfo R. Vázquez wrote in *Provincia de San Luis, Norman* would have been relevant in the Argentine cases if bank deposits had been denominated in convertible pesos.¹⁵³ The Court then could have truly argued that Congress's "monetary sovereignty" implied that depositors could not claim convertible pesos (or the amount of inconvertible pesos needed to purchase convertible pesos) in the free exchange. Pesification of bank deposits denominated in U.S. dollars, however, was neither a monetary decision nor a necessary consequence thereof.

VI. THE VALORIST PARADIGM

The previous section of this Article concluded that the conversion of dollar deposits into peso deposits at an official rate lower than the free exchange rate was not a necessary consequence of Congress exercising its sovereign attributions over legal tender. This is not to say that Argentine law disallows adaptations of the economic value of contracts when unforeseeable economic circumstances (i.e., different from those existing or foreseeable at the moment of the contract formation) break

153. Corte Suprema de Justicia de la Nación [CSJN], 5/3/2003, "Provincia de San Luis v. Estado Nacional," *Jurisprudencia Argentina* [J.A.] (2003-I-188) at 93 (Arg.).

the equilibrium of the contract, making its performance too onerous for one of the parties and therefore, inconsistent with equity. Instead of contractual adjustment by changing the baseline for estimating expectation damages (for example, the strategy pursued in *Perry v. United States*), the traditional form of adjusting the value of contracts in civilian countries applies the revaluation principle, the theory of unforeseeability (“imprevisión”), or related doctrines that adopt a *valorist paradigm* of monetary obligations.¹⁵⁴ Valorism holds that debts must be discharged at their real economic value.¹⁵⁵ This position was introduced by German jurisprudence. The German hyperinflation of 1918 to 1923 depreciated all debts to an extreme degree, which made fulfillment at the nominal amount inconsistent with the civilian principles of *bona fides* and *rebus sic stantibus* (things thus standing).¹⁵⁶ On November 28, 1923, the Fifth Senate of the *Reichsgericht* reversed its previous doctrine and issued the famous *Aufwertungsurteil*, which ordered the revaluation of a mortgage debt, thus adopting a position held by the Court of Appeals of Darmstadt in decisions of March 29 and May 18, 1923.¹⁵⁷ The valorist paradigm became widely used in Latin America in order to readjust contract values that were affected by inflation.¹⁵⁸

Argentine civil courts, in effect, applied the valorist paradigm under the heading of “theory of imprevisión” to uphold revaluation of depreciated debts as a result of inflationary processes. In the 1960s, courts abandoned nominalism by leveling up the nominal sums set in contracts, fixing periodic performances or postponed execution with a view to neutralize the distorting effects of inflation on the economic bases of those contracts.¹⁵⁹ Thus, courts held that all contracts must be presumed to contain an implicit *rebus sic stantibus*¹⁶⁰ clause. On the basis of this principle, courts ruled that values set in contracts can be judicially recast

154. KARST & ROSENN, *supra* note 131, at 443-93.

155. *Id.*

156. RÜTHERS, *supra* note 5, at 64.

157. NUSSBAUM, *supra* note 7, at 206; RÜTHERS, *supra* note 5, at 64-69.

158. KARST & ROSENN, *supra* note 131, at 443-93.

159. See, e.g., Corte Suprema de Justicia de la Nación [CSJN], 26/2/1964, “Felix Sola v. Colonies and Farmhouses El Rodeo,” *Jurisprudencia Argentina* [J.A.] (1964-III-600) (Arg.).

160. “A tacit condition attached to all treaties to the effect that they will no longer be binding as soon as the state of facts and conditions upon which they were based changes to a substantial degree.” ENotes.com - West’s Encyclopedia of American Law - Rebus Sic Stantibus, <http://www.enotes.com/wests-law-encyclopedia/rebus-sic-stantibus> (last visited Mar. 30, 2009).

if new circumstances emerge that were not foreseeable and that substantially alter the financial equation of the bargain. Applying this doctrine, courts increased the nominal value of obligations fixed in contracts when this value was depreciated by inflation, or decreased it when performance became excessively burdensome for one of the parties as a consequence of the dollar denomination of the contract obligations or the application of an index clause. The Argentine Supreme Court upheld revaluation in *Pribluda de Hurevich v. Hernández*¹⁶¹ and *Provincia de Sante Fe v. Carlos Aurelio Nicchi*¹⁶². Justice José Francisco Bidau explained that “in the face of the persistence of this phenomenon [inflation] and the extremes it reaches at present, it is not possible to maintain legal principles that have become fictitious.”¹⁶³ Following *Hernández* and *Nicchi*, various rulings held that revaluation was a way to protect the right to property and to maintain the economic value of debts.¹⁶⁴ The 1968 reform of the Civil Code expressly laid down the theory of imprevision.¹⁶⁵ The Supreme Court later endorsed the valorist paradigm in three 1976 decisions, declaring that failure to update the amounts of defaulted obligations would amount to a violation of the right to property.¹⁶⁶

Then, in the 1990s Argentina returned to nominalism in an attempt to stop a long process of inflation and currency depreciation. Convertibility Law No. 23928¹⁶⁷ established nominalism with respect to contracts in foreign currency by amending Articles 610 and 617 of the

161. Corte Suprema de Justicia de la Nación [CSJN], 30/11/1966, “Pribluda de Hurevich v. Hernández,” Fallos (1966-266-223) (Arg.).

162. Corte Suprema de Justicia de la Nación [CSJN], 26/6/1967, “Provincia de Sante Fe v. Carlos Aurelio Nicchi,” Fallos (1967-268-112) (Arg.).

163. *Id.* at 116.

164. For a helpful list of cases asserting that the revaluation of the original amount does not make the debt more onerous but just maintains its economic value, see NARCISO J. LUGONES ET AL., *LEYES DE EMERGENCIA, DECRETOS DE NECESIDAD Y URGENCIA* 164 nn.199 & 202 (1992).

165. Cód. Civ. art. 1198 (Arg.).

166. Corte Suprema de Justicia de la Nación [CSJN], 9/9/1977, “La Amistad SRL v. Iriarte Roberto Co.,” *Jurisprudencia Argentina* [J.A.] (1977-IV-3) (ARG.); Corte Suprema de Justicia de la Nación [CSJN], 23/9/1976, “Jose Raquel Valdez v. Nacion Argentina,” Fallos (1976-295-937) (Arg); Corte Suprema de Justicia de la Nación [CSJN], 21/5/1976, “Amalia Camusso Vda. de Marino v. S.A. Perkins,” Fallos (1976-294-434) (Arg.); *see also* Genaro R. Carrió, *Judge Made Law Under a Civil Code*, 41 *LA. L. REV.* 993 (1981).

167. *See* Law No. 23.928, Mar. 28, 1991, [Art. 11] B.O. No. 27104 (Arg.).

Civil Code.¹⁶⁸ Argentine courts were not allowed – and indeed had no need – to go back to the valorist paradigm during the convertibility decade (1991-2001). In January 2001, amidst the crisis, Article 5 of Emergency Law No. 25561¹⁶⁹ maintained the wording of Articles 610 and 617 of the Civil Code established by the Convertibility Law.¹⁷⁰

As explained above, imprevision theory indicates a leveling up of nominal amounts as the natural response to depreciation of the currency in which contracts are denominated. In contrast, leveling down of nominal amounts would seem to be the natural response for the converse problem, when the economic value of contracts increases due to strong deflation or appreciation of the currency in which contracts are denominated.¹⁷¹ Though downward adjustment was never applied in such a pure form in Argentina, there was a case of scaling down when President Alfonsín issued the emergency Decree No. 1096/1985. This decree created a new currency (“Australés”) and converted all indexed debts denominated in the old currency (“Argentine Pesos”) into Australes at a rate that periodically increased the value of Australes to make up for Argentine Pesos indexation.¹⁷² The Supreme Court upheld the constitutionality of this decree. In *Provincia de la Pampa v. Esteban Albano*, the Court ruled that striking down Decree 1096/1985 for violating the right to property would have required a demonstration that the purchasing value on the maturity date was less than the value of the nominal capital would have been if inflation remained at a similar level as at the time of contract formation.¹⁷³

The valorist paradigm is thus one possible strategy to deal with U.S. dollar denominated contracts when the depreciation of the national currency causes an increase in the domestic purchasing power of the dollar. In other words, when the national currency is unforeseeably devalued and, as a result, the economic basis of U.S. dollar denominated contracts is seriously altered, Congress or courts could apply the valorist paradigm in such a way as to reduce the nominal sum of dollars owed by

168. Cód. Civ. arts. 610, 617.

169. Law No. 25.561, Jan. 6, 2002, B.O. 29810, art. 5 (Arg.).

170. C. CIV. art. 1895 (Fr.).

171. CHARLES PROCTOR, MANN ON THE LEGAL ASPECT OF MONEY 281 (1982).

172. Decree No. 1096/1985, June 17, 1985, B.O. 24/VI/1985 (Arg.).

173. Corte Suprema de Justicia de la Nación [CSJN], 28/6/1988, “Provincia de la Pampa v. Esteban Albano S.A.,” Fallos (1988-311-1155) ¶ 5 (Arg.). The same position is maintained in Corte Suprema de Justicia de la Nación [CSJN], 20/4/1989, “Luis A. Porcelli v. Banco de la Nacion Argentina,” Fallos (1989-312-555) (Arg.).

debtors to banks, and by banks to savers. Under the valorist paradigm, however, Congress or courts could not vary the currency denomination of contractual sums. The valorist paradigm allows only a variation of nominal amounts and not a change in currency denomination.

As already noted, the valorist paradigm is well rooted in the Argentine civil law tradition. It is easier for civilian courts to apply the valorist paradigm than to utilize the emergency and the monetary paradigms, which are both ultimately borrowed from U.S. sources. Emergency Law No. 25561, however, did not apply the valorist paradigm for restructuring deposits and loans within the banking system in the Argentine crisis.¹⁷⁴ On the contrary, that law explicitly maintained nominalism.¹⁷⁵ The obvious question then, is why was the valorist alternative not invoked? Initially, it is important to note that the pure form of applying the valorist paradigm would have been to reduce the nominal amount of dollar denominated deposits to match the deposit pre-devaluation real value. If depositors are perfectly rational, this might have exacerbated the existing demonstrations against the restructuring of financial contracts.

Suppose, hypothetically, a deposit of US\$1,000 before the crisis at a parity of US \$1 per \$1, the peso is devalued up to a rate of \$2 per US \$1; it is certain that the Government can only take one of the following options: (i) pesify the deposit and nominally increase it by 20%, or (ii) maintain the deposit in dollars but nominally decrease it by 40%. The former case yields \$1,200; the latter yields US\$600. Which option is less attractive? Despite a lack of experimental studies on this issue, a substantial majority would likely answer that they dislike the second option more, because this option vividly conveys a subjective feeling of loss.¹⁷⁶ Of course, a perfectly rational agent would answer the question on the basis of an *ex ante* estimation of the probability of devaluation or revaluation of the peso until maturity of the obligation.

Article Eleven of Emergency Law No. 25561, however, did apply an *impure* variant of the valorist paradigm – called “burden sharing” – to

174. Law No. 25.561 art. 7, Jan. 6, 2002, B.O. 29810 (Arg.).

175. *Id.*

176. This is probably related to an asymmetry noted by Kahneman and Tversky: people have greater aversion to losses than to objectively equivalent foregone gains. Cf. Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990); Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979).

mortgage loans outside the financial system.¹⁷⁷ This variant allows pesification and therefore bypasses the problem of imperfect rationality indicated above. Article Eleven awarded the parties to such contracts a period no longer than 180 days to reach an agreement on the readjustment of the contract in such a way as to equitably share the burdens of the devaluation.¹⁷⁸ In the absence of agreement, the norm allowed the parties to have recourse to the official system of mediation and to start legal proceedings; the Executive Branch was empowered to issue executive orders readjusting the obligations on the grounds of the theory of imprevision (Article 1198 of the Civil Code) and the principle of “burden sharing.”¹⁷⁹ Decree 214/2002 then pesified and indexed these loans (by consumer product prices or wages, depending on the amount and nature of the loan).¹⁸⁰ The decree also provided that judges should proceed to a fair revision of loans if the adjusted debt was disproportionately lower or higher than the value of the thing purchased at the moment of payment.¹⁸¹

On the basis of Article Eleven of Law No. 25561 and Decree 214/2002, a prevailing trend of doctrinal opinion in Argentina defended judicial revision of the value of contracts denominated in dollars, in the form of conversion into pesos at an intermediate rate resulting from splitting the difference between \$1 and the free market exchange rate.¹⁸²

177. Law No. 25.561 art. 11, Jan. 6, 2002, B.O. 29810.

178. *Id.*

179. *Id.*

180. Decree No. 214/2002, Feb. 3, 2002, B.O. 29830, art. 2 (Arg.).

181. *Id.* art. 8.

182. See, e.g., Ariel Ariza, *Revisión judicial de los contratos en la emergencia económica*, Jurisprudencia Argentina [J.A.] 9 Número especial (2002) (Arg.); Juan José Casiello, *El impacto de las normas de emergencia en el derecho monetario. La ‘pesificación’*, La Ley [L.L.] 19 (2002) (Arg.); Gabriel B. Chausovsky & Ángel L. Moia, *Un caso de equitativa recomposición de la obligación de dar moneda extranjera entre privados alcanzado por la legislación de emergencia*, Jurisprudencia Argentina [J.A.] (2003-IV-590) (Arg.); Andrés Gil Domínguez, *La teoría del esfuerzo compartido y los depósitos bancarios*, La Ley [L.L.] (2004-1) (Arg.); Alejandro Gaido, *La naturaleza jurídica del esfuerzo compartido*, El Derecho [E.D.] (2004-209-793) (Arg.); Carlos G Gerscovich, *Discordancias de la pesificación en el marco de la crisis y la emergencia*, Jurisprudencia Argentina [J.A.] (2003-34) (Arg.); Lilian N. Gurfinkel de Wendy, *Algo más sobre la teoría del esfuerzo compartido: estado actual de la jurisprudencia*, Jurisprudencia Argentina [J.A.] (2003-III-674) (Arg.); Francisco Junyent Bas, *Pesificación. Los contratos privados, las deudas en mora y la teoría de la imprevisión y el esfuerzo compartido*, El Derecho [E.D.] (2003-202-779) (Arg.); Jorge W. Peyrano, *La pretensión distributiva del esfuerzo compartido. Análisis provisorio de*

While doctrinal commentators widely endorsed an equal splitting of the difference, civilian courts were divided between equal splitting and a strong debtor-relief splitting of thirty percent to seventy percent.¹⁸³ In all cases, judicial revision of loans was defended on the grounds of contractual equity and good faith.

Law 25798 (modified by Law 25908 and regulated by Decree 1284/2003) created a system of mortgage restructuring by which *Banco de la Nación Argentina* reimburses the original debtor for the difference between the pesified debt and the readjusted debt.¹⁸⁴ This system sought to relieve debtors who took loans of under \$100,000 to purchase residential property. Finally, Article Six of Law 26167 established that judges should make the equitable readjustment of contract under the doctrines of unforeseeability, unfair enrichment, abuse of rights, and unconscionability, as well as the constitutional rights of access to decent housing and the protection of family.¹⁸⁵ It also established that judges could not readjust debts so that the revised amount exceeded the pesified debt at a rate of US\$1 to \$1 peso plus thirty percent of the difference between this rate and the free exchange rate.¹⁸⁶

In *Rinaldi*, decided on March 15, 2007, the Supreme Court sustained the constitutionality of this regime and overturned a Civil Court of Appeals decision that had split the difference by fifty percent.¹⁸⁷ The Court ruled that the conflict between creditors and debtors must be resolved by restoring the economic equilibrium lost by the great

aspectos procesales de la 'pesificación', Jurisprudencia Argentina [J.A.] Tomo (2002-I-1078) (Arg.); Jorge W Peyrano, *Una nueva pretensión: la distributiva del esfuerzo compartido. Comentarios procesales sobre el régimen de 'pesificación' forzosa de obligaciones en moneda extranjera no vinculadas al sistema financiero*, El Derecho [E.D.] (2002-196-861) (Arg.); Ramón Daniel Pizarro, *La Degradación del Derecho de crédito en la Argentina*, La Ley [L.L.] (2002-50) (Arg.); Roberto A. Vázquez Ferreira, *Cambio de circunstancias y distribución del riesgo contractual*, La Ley [L.L.] (2002-40) (Arg.).

183. Ethel Humphreys, *La hipoteca: pesificación, dolarización y esfuerzo compartido. Panorama jurisprudencial de la C. Nac. Civ. de la Capital Federal*, Jurisprudencia Argentina [J.A.] (2003-IV-1555) (Arg.).

184. Law No. 25.798, Nov. 7, 2003, B.O. 30272 (Arg.).

185. Law No. 26.167, Nov. 29, 2006, B.O. 31043 (Arg.).

186. *Id.*

187. Corte Suprema de Justicia de la Nación [CSJN], 15/3/2007, "Rinaldi, Francisco Augusto y otro v. Guzman Toledo, Ronal Constante y otra s/ ejecución hipotecaria," Fallos (2007-330-855) (Arg.).

devaluation of the peso.¹⁸⁸ Of course, this is essentially the theory of imprevision laid down in Article 1198 of the Civil Code. The Court thus defended the constitutionality of a legislative scheme based on the idea of burden sharing.

Burden sharing is a morally attractive notion – more so than the idea that individual rights may be sacrificed for the sake of the collective good. It is central to the emergency paradigm. On the basis of burden sharing, pesification at an intermediate rate could have been applied to all financial contracts, without recourse to the emergency and the monetary paradigms. The question remains: why was this paradigm not used?

The explanation is not doctrinal, but rather political. First, in Argentina and elsewhere, banks are not regarded as contributors to social welfare but rather as powerful and greedy organizations, in defense of which it would have been only grotesque to wield the theory of imprevision and moral arguments grounded on equity. This is particularly important in a country like Argentina, where public discourse is largely insensitive to the propositions of economic theory and the results of experimental economics.¹⁸⁹ It would have been politically impracticable for the Government to apply the theory of imprevision, especially under the burden sharing variant, to defend banks and curtail savers' rights.

Rent seeking also explains why the valorist paradigm was not an attractive option for restructuring banking deposits and loans. “Asymmetrical pesification” at a \$1 to US \$1 rate was more profitable for rent seekers (i.e., politically connected corporate debtors) than burden sharing. The upshot of “asymmetric pesification” was that, while large tradable sector corporations enjoyed a pre-devaluation exchange rate for paying off their debts to banks, individual debtors who took mortgage loans in notaries' bureaus to buy their homes had to pay \$1.40 pesos for each U.S. dollar borrowed.¹⁹⁰ Thus, while the valorist paradigm and equity guided the restructuring of small mortgage loans in the informal financial sector, *realpolitik* led the way for liquefying corporations' dollarized debts.

188. *Id.*

189. See GUIDO PINCIONE & FERNANDO R. TESÓN, RATIONAL CHOICE AND DEMOCRATIC DELIBERATION, A THEORY OF DISCOURSE FAILURE (2006) (a path-breaking theory of public discourse in democratic regimes).

190. Decree No. 214/2002 of Feb. 3, 2002, B.O. 29830, art. 3 (Arg.).

VII. THE SOCIAL JUSTICE PARADIGM

The *social justice paradigm* derives from a doctrine concerning the social function of property, embraced by socialist thought and the Catholic Church.¹⁹¹ This paradigm maintains that the reshaping of property in financial crises must be accomplished by assigning priority to the worst off.¹⁹² The Government and courts should therefore ensure that as a result of such reshaping, the greater burdens befall the best off, and the lesser ones fall on the worst off. Under this scheme, small debtors and depositors are prioritized, particularly when information about the overall economic condition of each debtor or depositor is difficult to obtain.

Though the social justice paradigm did not guide the reshaping of property rights in Argentina, it played a role in a number of “exceptions” laid down by Presidential or Ministerial regulations. For example, Resolution Number 46, issued by the Ministry of Economy on February 6, 2002, allowed all individuals or corporations to exclude deposited amounts from the rescheduling if such amounts were applied to the payment of salaries and wages, payments related to social security, severance payments, compensation for death or accident, disability insurance, and payment of social security benefits, under certain conditions.¹⁹³ Similarly, Decree 905/02 gave an option to swap rescheduled deposits for Bodens in U.S. dollars to: (1) holders of deposits of amounts up to US\$10,000; (2) depositors over 75 years of age; and (3) individuals with severe health afflictions or severance payments beneficiaries.¹⁹⁴ Such exceptions are justified on social justice or humanitarian grounds and have little economic impact. Rather than an independent paradigm, they are indispensable qualifications to any of the other paradigms.

Nevertheless, the social justice paradigm found articulate expression as an independent paradigm in two judicial opinions: *Bustos* and *Rinaldi*. Though these opinions did not constitute the holding of the majority decisions, they indicate that the social justice paradigm was starting to have a hold over the Supreme Court. Thus, in a minority

191. See encyclicals of Pius XI, John XXIII, Paul VI and John Paul II mentioned *supra* note 6.

192. See JOHN RAWLS, A THEORY OF JUSTICE, Revised Edition (1999); Derek Partit, *Equality and Priority*, in IDEALS OF EQUALITY (Andrew Mason ed., 1998) (The social justice paradigm comes close to Rawls's theory of justice).

193. Resolution No. 46 art. 2, Feb. 7, 2002, B.O. 29833 (Arg.).

194. Decree No. 905/2002, June 1, 2002, B.O. 29911 (Arg.).

opinion in *Bustos*, Justice Eugenio R. Zaffaroni differentiated three groups of depositors in terms of their economic capacity: (a) holders of deposits exceeding US\$140,000, (b) holders of deposits in the US\$70,000-140,000 range, and (c) holders of deposits of less than US\$70,000.¹⁹⁵ Zaffaroni proposed a different solution for each group. He opined that the largest burdens deriving from the state of necessity should fall on group (a), to which pesification at the \$1.40 peso per dollar rate, plus correction by “CER”, was constitutionally applicable.¹⁹⁶ Group (c), which Zaffaroni presumed as the worst off, was entitled to receive the amount of pesos needed to purchase the original amount of deposited dollars in the free exchange market.¹⁹⁷ A mixed solution was suitable for group (b): for deposits up to US\$70,000 they would be treated like group (c) and, for the amount ranging between US\$70,000 and US\$140,000, they would be treated like group (a).¹⁹⁸ Notably, Justice Zaffaroni invoked no constitutional text in support of his redistributive scheme; he simply stated that it is “fair” to allocate burdens in proportion to the amount of the deposits.¹⁹⁹

In *Rinaldi*, Justices Maqueda and Highton de Nolasco declared that the restructuring mechanism established by Law 26167 is coherent with Article Fourteen *bis* of the Constitution and various international treaties incorporated into the Argentine Constitution in 1994, which protect family and the access to decent housing.²⁰⁰ Maqueda and Highton de Nolasco also stated that this decision resolves the conflict between creditors’ constitutional right to property and debtors’ constitutional right to housing, because the law makes both parties share the burden of re-adjustment.²⁰¹ In his dissent, Justice Carmen Argibay said:

[T]here is a serious internal contradiction in the view that finds a conflict or tension between the creditor’s right to foreclose the mortgage and the debtor’s right to decent housing. The thing that works as housing is also an economic good that can be used by his owner to obtain money, be it through its sale, or through its being used as collateral Therefore, if the thing is an economic good at

195. Corte Suprema de Justicia de la Nación [CSJN], 10/26/2004, “*Bustos*, Alberto Roque v. E.N. / amparo,” J.A. (2005-III-189) at 49 (Arg.).

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. “*Rinaldi*,” Fallos (2007-330-855) at ¶45 (Arg.).

201. *Id.* ¶46.

the moment of its sale or being affected as collateral, it also must be an economic good at the moment of its delivery to the buyer or to the creditor who forecloses the mortgage.²⁰²

The social justice paradigm has two obvious shortcomings. First, the assumption that by differentiating groups of depositors by the amounts deposited, the Court can achieve social justice is a something of a fiction. For example, the rich could have large deposits in off shore banks, thus eluding their justice-based obligations. They could also invest in real property, luxury goods, or paintings. Taxation and a redistributive scheme based on universal criteria, like a basic minimum income, are far more efficacious ways of achieving social equality. Second, differentiating property protection in terms of the amount deposited, if generalized, would produce a stunted banking system in Argentina; it would encourage depositors of amounts exceeding US\$70,000 to run away from the local banking system. Curiously, Justice Zaffaroni said in *Bustos*, “[I]t is important that small and medium depositors preserve their trust in the banking system, both to promote those sectors’ savings and to avoid the holding of money and titles outside the banking system, with the resulting dangers of victimization in moments of social conflict.”²⁰³ Justice Zaffaroni failed to mention the importance of maintaining the trust of *large* depositors. Perhaps Zaffaroni thought that large depositors would not remain in the Argentine banking system. But, of course, the Court’s decisions are not exogenous to this expected event. Large depositors could maintain a greater degree of trust if the Court acknowledged their claims. Justice Highton de Nolasco’s doctrine that the protection of creditors’ rights can in principle be qualified by debtors’ rights to housing would, in cases of conflict between these two kinds of rights, also reduce the size of domestic financial markets. Because the right to housing could systematically threaten mortgage credits, this doctrine would deter lenders from supplying mortgage credits in Argentina.

Social justice doctrines that create legal uncertainty in savers and investors are typically counter-productive: they hurt the group that they seek to defend, namely, the worst off. The lack of a large banking system generally yields deleterious effects on undercapitalized individuals. For instance, the undersupply of mortgage creditors deprives many individuals from a decentralized form of access to decent housing. Of

202. *Id.* ¶32.

203. *Bustos*, Alberto Roque, J.A. (2005-III-189) at 49.

course, Argentina already has stunted financial markets as a result of repetitive waves of macroeconomic collapses and emergency decrees. By discouraging sizable bank deposits and mortgage credits, Zaffaroni's and Highton de Nolasco's doctrines would only exacerbate this problem. However, the Court could still endorse these doctrines on moral grounds, regardless of their consequences. On the one hand, Justice Zaffaroni was concerned about *some* consequences ("dangers of victimization").²⁰⁴ On the other hand, as Guido Pincione and Fernando Tesón have shown, counterproductive public discourse (within which some judicial opinions might be included) could hardly become *transparent* moral discourse.²⁰⁵ If a judge acknowledged that the moral doctrine she defends would damage the worst off, her discourse would be pragmatically self-defeating and morally counter-productive, because by this acknowledgement she would cancel the persuasive force of her doctrine. Because moral language has a persuasive function, counter-productive public discourse presents an ineradicable tension between transparency and pragmatic effectiveness.²⁰⁶

VIII. THE BANKRUPTCY PARADIGM

The application of the emergency and monetary paradigms to deal with the Argentine crisis was beset by doctrinal difficulties. The Argentine Government and courts failed to discuss alternative constitutional paradigms for designing the reshaping of property rights.

This Article suggests, in particular, that an important paradigm has been ignored, called the *bankruptcy paradigm*. This paradigm is wholly consistent with the property and contract structure of liberal constitutional regimes. More generally, this Article asserts that it is important to analyze the benefits of implementing a standing scheme of crisis resolution under a new paradigm that could minimize the damage to the property and contract structure. This is necessary to develop a financial and banking system, capable of fostering citizens' well being and of financing innovative entrepreneurial initiatives. Emerging market countries, where new crises cannot be discarded off hand, would be well

204. Bustos, *Alberto Roque*, J.A. (2005-III-189) at 49.

205. See PINCIONE & TESÓN, *supra* note 189, at 142-75 (an excellent analysis of the "moral turn" in counter-productive public discourse).

206. The form in which this point is expressed owes much to Ezequiel Spector's thoughtful comments on Pincione and Tesón's theory. *Id.*

advised in investigating the economic and legal underpinnings of this proposed scheme.

The emergency view of government takings in the midst of financial crises is strengthened by the fact that the public is unaware of the technicalities of the banking system. For instance, many small depositors are unaware that even solvent banks cannot pay a majority of their liabilities on demand. Milton Friedman illuminates this point:

It is easy to see why a run would cause an insolvent bank to fail sooner than it otherwise might. But why should a run cause a responsible and solvent bank trouble? The answer is linked to the one of the most misleading words in the English language – the word “deposit,” when used to refer to a claim against a bank. If you “deposit” currency in a bank, it is tempting to suppose that the bank takes your greenbacks and “deposits” them in a bank vault for safekeeping until you ask for them. It does nothing of the kind. If it did, where would the bank get income to pay its expenses, let alone to pay interest on deposits? The bank may take a few of the greenbacks and put them in a vault as a “reserve.” The rest it lends to someone else, charging the borrower interest, or uses to buy an interest-bearing security.

If, as is the typical case, you deposit not currency but checks on other banks, your bank does not even have currency in hand to deposit in a vault. It has only a claim on another bank for currency, which it typically will not exercise because other banks have matching claims on it. For every \$100 of deposits, all the banks together have only a few dollars of cash in their vaults. We have a “fractional reserve banking system.” The system works very well, so long as everyone is confident that he can always get cash for his deposits and therefore only tries to get cash when he really needs it. Usually, new deposits of cash roughly equal withdrawals, so that the small amount in reserve is sufficient to meet temporary discrepancies. However, if everyone tries to get cash at once, the situation is very different – a panic is likely to occur, just as it does when someone cries “fire” in a crowded theatre and everyone rushes to get out.²⁰⁷

The bankruptcy paradigm arises from the recognition that bankruptcy legislation must be understood as consistent with protection of private property. True, it has been held that bankruptcy law is inconsistent with a libertarian system of property rights because it allows the

207. MILTON FRIEDMAN & ROSE FRIEDMAN, *FREE TO CHOOSE* 72-73 (1990).

non-contractual extinction of the insolvent debtor's debts and, in doing so, legitimizes the non-voluntary transfer of creditor rights.²⁰⁸ As Robert Nozick himself admits, it is always problematic for the natural-rights tradition to accommodate risk-spreading schemes in a principled way.²⁰⁹ The author concedes that Nozick's point can be extended to the reshaping of property rights under a bankruptcy regime. However, bankruptcy procedures are consistent with the right to property as established in a classical liberal constitution. In fact, as discussed in Part II of this Article, both the United States and Argentine constitutions empower Congress to pass bankruptcy legislation. Today, bankruptcy legislation enjoys widespread acceptance in liberal democratic countries and, therefore, any theory about property rights should accommodate this fact.

Instead of passing emergency legislation when there is a crisis in the banking system, a more adequate solution, the author contends, is to enact standing legislation to take effect during bank runs and financial crises that differentiates insolvent from solvent banks, and saves the latter from being eventually driven into bankruptcy. Just as bankruptcy legislation seeks to avoid an inefficient race for the debtors' assets, the central function of a bank restructuring mechanism should be to avoid panicky cash withdrawals and the fire selling of bank assets, with the associated loss in value. Coupled together, bankruptcy law and a bank restructuring mechanism allow the temporary suspension of property rights as the only possible means of maximizing the observance of property rights. In order to maximize the net worth of the depositors' rights, the bank restructuring mechanism would allow the suspension and reorganization of remedies. Functionally, this mechanism could be regarded as a bankruptcy-like process. Therefore, the Constitution allows Congress to pass legislation for restructuring bank debts, especially in the context of bank runs and illiquidity crises. Because this type of legislation is a variety of bankruptcy legislation, its constitutionality could be sustained without recourse to the emergency or monetary paradigms. Even if Congress failed to establish a standing bank restructuring piece of legislation, it should be understood that Congress retains its power to do so once a crisis has started. Naturally, Congres-

208. Peter Morriss, *How Capitalism Infringes Property Rights*, 31 POL. STUD. 656 (1983); see also Chandran Kukathas, *Does Capitalism Infringe Property Rights? A Reply to Peter Morriss*, 32 POL. STUD. 611 (1984).

209. NOZICK, *supra* note 52, at 75.

sional powers do not diminish in the face of a crisis. A bank run is a market failure, due in part to a lack of coordination, which diminishes the net worth of banks' assets.²¹⁰ Congressional power to pass bankruptcy legislation covers all forms of state-regulated mechanisms for collecting creditor rights when consensual renegotiations are subject to high transaction costs. An emergency declaration is simply not a prerequisite for Congress to exercise this power.

It is beyond the scope of this Article to espouse the bankruptcy paradigm in detail. Nevertheless, it will be helpful to explain how this paradigm might be brought to bear in practice. One possible conception of this paradigm consists of three complementary strategies, all of which are designed to solve banking illiquidity and insolvency in countries that have a hard peg, formal dollarization, or extended de facto dollarization. In all cases, the Central Bank cannot act as a lender of last resort and therefore, a dollar liquidity run has a great propensity to become a bank run. The background monetary policy of these strategies is to preserve financial dollarization of stock and to adopt the margin conversion of contracts into the national currency (pesos). This means that the Government consolidates all pesos in circulation (as well as quasi-monies) into a new national currency: the "nonconvertible peso." In this way, the function of the U.S. dollar as preserver of value is maintained because existing financial contracts are *not* "pesified"; at the same time, the nonconvertible peso is established as a unit of denomination and a means of payment of new financial contracts and all non-financial contracts. This consolidation of the national currency solves the problems of the nominal flexibility of public spending and the sticky nature of salaries in the unionized sectors because depreciation of the floating national currency automatically deflates public and private salaries, which are denominated in the nonconvertible currency.²¹¹

The first "nonconvertible peso" strategy ("Strategy I") corrects balance-sheet mismatches arising from maintenance of dollarization of the national currency. The goal of Strategy I is achieved by establishing a "two-pole circuit breaker." The "positive pole," proposed by Eduardo

210. See Douglas Diamond & Philip Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 3, 401-19 (1983).

211. Augusto De la Torre et al., *Living and Dying with Hard Pegs: The Rise and Fall of Argentina's Currency Board* (World Bank Policy Research, Working Paper No. 2980, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=352380.

Levy Yeyati²¹², is to automatically suspend the convertibility of deposits into currency (“internal convertibility”) when the liquidity of banks falls below a certain threshold as a result of a systemic crisis. In this proposal, the suspension of convertibility clause is *ex ante* included in financial contracts, so that suspension of convertibility in the given conditions does not constitute a breach of contract.

Thus, in the author’s view, the “negative pole” of the “circuit breaker” is to shorten the average length of loans in the tradables and other high-profit sectors. Just as many bank credits are awarded on a variable interest rate, all credits given to large domestic or multinational corporations should include a variable maturity period. It is conceded that this form of pre-cancellation of credits may only be applicable in a limited scale, basically to large corporations that obtain liquidity through exports. The usefulness of this mechanism, however, cannot be summarily discarded. For instance, when systemic illiquidity exceeds a certain limit, the regulator authorizes banks to call in their loans to oil corporations by anticipating the maturity of those loans. Even when this double pole circuit breaker is not explicitly provided for *ex ante* in financial contracts, the bankruptcy paradigm constitutionally allows its imposition by *ex post facto* legislation. This is because all contracts are subject to an “implicit bankruptcy clause”; if repayments become impossible, the government is empowered to establish procedures that maximize the expected repayment for all creditors by maximizing the net worth of the debtors’ assets.

The second strategy (“Strategy II”) allows banks confronted with a systemic crisis to issue freely negotiable notes in order to repay time deposits. These notes would not be redeemable in paper currency on demand, but rather after a variable period of months with an annual interest payable at the end of this period. These bank notes would have the same qualities attributed to bank notes in regimes of private money:

212. Eduardo Levy Yeyati, *Liquidity Insurance in a Financially Dollarized Economy* (Nat’l Bureau of Econ. Research, Working Paper No. 12345, 2006), available at <http://www.nber.org/papers/w12345>.

[T]he name or denomination a bank chooses for its issue will be protected like a brand name or trade mark against unauthorized use, and . . . there will be the same protection against forgery as against that of any other document. These banks will then be vying for the use of their issue by the public by making them as convenient to use as possible.²¹³

“Private money” regimes are not a theoretical fiction. In fact, the experience of free banking was documented in Scotland during the period of 1695-1845.²¹⁴ In 1704, facing a bank run, the Bank of Scotland suspended payments for four months and announced that it would pay five percent annual interest for the period of the delay. Some years later, this option was inserted onto the currency.²¹⁵

In a banking crisis, solvent banks could issue notes that could work as well as the Bank of Scotland’s notes in 1730. In fact, Argentina had an experience with bank notes in 2002, when the Government awarded certificates of rescheduled deposits (CEDROs) to depositors who did not opt for the swap of deposits for bonds.²¹⁶ CEDROs were publicly traded and negotiable through the secondary market.²¹⁷ Unlike CEDROs, bank notes under Strategy II would be denominated in the same currency as original deposits, and their circulation would be unrestricted. One virtue of this scheme is that it would discriminate between solvent and insolvent banks instead of lumping them together under the umbrella of the systemic crisis. This would mitigate moral hazard problems.

These first two strategies address the problem of systemic illiquidity. The third strategy (“Strategy III”) provides a procedural resolution for banks that become insolvent. This procedure assumes that banks have a corporate structure that includes a bank holding company and two distinct subsidiaries: a *payments bank* and a *financial subsidiary*. The liabilities of the payments bank consist of demand accounts and small deposits, which are typically insured; the bank’s assets are only prime-quality. The financial subsidiary handles all remaining operations and is subject to regulatory requirements similar to those of commercial banks. The procedure works as follows: when

213. F. A. HAYEK, DENATIONALISATION OF MONEY, AN ANALYSIS OF THE THEORY AND PRACTICE OF CONCURRENT CURRENCIES 38 (1976).

214. LAWRENCE H. WHITE, FREE BANKING IN BRITAIN, THEORY, EXPERIENCE, AND DEBATE, 1800-1845 (1984).

215. *Id.* at 26.

216. Gómez-Giglio, *supra* note 46.

217. *Id.* at 403.

illiquidity is so serious that the bank's solvency is threatened, the regulator proceeds (by his own decision or at the bank's request) to freeze all the operations of the financial subsidiary (i.e., a sort of permanent "circuit-breaker"). Equity is written off to zero and the remaining liabilities and assets are set to constitute a mutual fund, where deposits are exchanged into senior shares and other liabilities are transformed into junior shares. The payments bank continues its operations in nonconvertible currency until liquidation.²¹⁸

IX. THE EMERGENCY PARADIGM AND THE BANKRUPTCY PARADIGM COMPARED

Figure 1 summarizes the doctrinal features of the paradigms for property reshaping. Both the emergency and the bankruptcy paradigms allow putting off the maturity of contracts, or the remedies for their breach. This feature allows them to confront panicky withdrawals during a bank run when the affected banks are solvent. By contrast, the monetary and the valorist paradigms lack this feature, which is crucial for dealing with bank runs. In endorsing vast redistributive powers, the social justice paradigm can modify both time and nominal quantity of deposits, but it can seriously alter the structure of incentives on which any robust financial system relies.

Figure 1: Features of Property Reshaping Paradigms

Variations Paradigms	Time	Quantity (Nominal)	Denomination	
			Internal	External
Emergency	Yes	No	No	No
Monetary	No	No	Yes	No
Valorist	No	Yes	No	No
Social Justice	Yes	Yes	No	No
Bankruptcy	Yes	Yes*	No	No

* In cases of insolvency.

Given the doctrinal features, the emergency and the bankruptcy paradigms are the most effective in coping with a financial debacle,

218. Pablo E. Guidotti, *Toward a Liquidity Risk Management Strategy for Emerging Market Economies*, in *LATIN AMERICAN MACROECONOMIC REFORM, THE SECOND STAGE* § 8.2.3 (José Antonio González et al. eds., 2003).

particularly when the banking system is healthy. While both paradigms have similar doctrinal features, they critically differ in their institutional implications.

Primarily, the bankruptcy paradigm has three fundamental advantages. The first advantage is a corollary of Mancur Olson's famous theory of groups.²¹⁹ The core postulate of this theory is that "*the larger the group, the farther it will fall short of providing an optimal amount of a collective good,*" where the collective good can be distributional gains at the expense of the welfare of society.²²⁰ The explanation of this postulate is that "an individual member . . . gets only part of the benefit of any expenditure he makes to obtain more of the collective good," which means that "he will discontinue his purchase of the collective good before the optimal amount for the group as a whole has been obtained."²²¹ Olson draws nine second-level implications from his theory, namely, propositions that follow from the theory together with basic facts and microeconomic assumptions.²²² Among these implications, which serve to explain political phenomena in a democratic polity, the third implication is relevant to explain the rent seeking function of much of the legislation passed within the emergency paradigm: "members of small groups have disproportionate organizational power for collective action, and this disproportion diminishes but does not disappear over time in stable society."²²³ Therefore, "oligopolies and other small groups have a greater likelihood of being able to organize for collective action, and *can usually organize with less delay,* than large groups."²²⁴ Though Olson himself failed to place great emphasis on organizational speed, the author contends that this factor is critical for understanding the particular shape that emergency measures often take in financial debacles.²²⁵

219. MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION, PUBLIC GOODS AND THE THEORY OF GROUPS* 33-36 (1971).

220. *Id.* at 35.

221. *Id.* at 35.

222. MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS, ECONOMIC GROWTH, STAGFLATION, AND SOCIAL RIGIDITIES* 74 (1982).

223. *Id.* at 41.

224. *Id.* (emphasis added).

225. One clarification is in order. Olson concedes that "encompassing" labor organizations (i.e., organizations that represent a large percentage of the work force) can self-regulate their demands, and Lange and Garrett have shown that this variable is positively associated with rent-seeking reduction and economic growth only if accompanied by political control of government. *See* Peter Lange & Geoffrey Garrett,

The idea of an emergency suggests that action must not be delayed, and therefore that much deliberation and discussion is self-defeating. Thus, because of time constraints, emergency powers are typically exerted with greater discretion and less accountability than normal powers. Typically, when a state of emergency is declared, a sort of rent-seeking festival simultaneously opens to small redistributive coalitions. Small interest groups who tend to have a successful rent-seeking apparatus already in operation act quickly to obtain wealth redistributions in their favor. Because large unorganized groups work at a much lower speed (if at all), small highly organized groups have the greatest chance to get the greatest redistributive stakes. Faster decision-making speed, implicated by a state of emergency, only exacerbates the organizational constraints of large groups, who for this reason are more exposed to “exploitation” by small groups. This process reverses the natural result of democratic decision-making. Furthermore, it violates the second condition in Larreta’s four-condition test,²²⁶ because rent-seeking, by definition, does not promote the general welfare of the people.²²⁷

Emergency legislation in the United States highlights interesting examples. There are helpful rent-seeking analyses of the labor legislation backed in *Lochner*²²⁸ and of the regulatory legislation endorsed in *Carolene Products*.²²⁹ Rent-seeking interpretation of

The Politics of Growth: Strategic Interaction and Economic Performance in the Advanced Industrial Democracies, 1974-1980, 47 J. POL. 792, 792-827 (1985). However, emergency situations offer such short-term opportunities for massive rent-seeking that self-regulation cannot be rationally expected, even if the relevant groups are encompassing, which in addition is not generally the case. For the list of the one hundred most indebted corporations in Argentina on December 31, 2001, see ALEJANDRO RODRÍGUEZ DIEZ, DEVALUACIÓN Y PESIFICACIÓN 230-33 (2003).

226. Corte Suprema de Justicia de la Nación [CSJN], 7/12/1934, “Avico v. de la Pesa,” Fallos (1934-172-21) (Arg.).

227. EKELUND & TOLLISON, *supra* note 138 (rent-seeking is “[t]he activity of individuals who spend resources in the pursuit of monopoly rights granted by government; the process of spending resources in an effort to obtain an economic transfer”); see also Anne O. Krueger, *The Political Economy of the Rent- Seeking Society*, 64 AM. ECON. REV. 3, 291-303 (1974).

228. David E. Bernstein, *Lochner v. New York: A Centennial Retrospective*, 85 WASH. L. REV. 5, 1469-1528 (2005).

229. Geoffrey Miller, *The True Story of Carolene Products*, SUP. CT. REV. 397 (1987).

Argentine emergency legislation in the same period is also available.²³⁰ Emergency legislation in financial crises is amenable to a similar analysis. For instance, the Great Depression was a great occasion for rent-seeking. It is well known that with the abandonment of the gold standard, President Roosevelt sought to raise the price of farm products, which had been affected by the preceding period of deflation. According to author Murray Rothbard, the reflationist program was agitated by agricultural and industrial lobbyists gathered in the Committee for the Nation to Rebuild Prices and Purchasing Power. Rothbard explains:

The Committee for the Nation at first included several hundred industrial and agricultural leaders, and within a year its membership reached over two thousand. Its recommendations, beginning with going off gold and embargoing gold exports, and continuing through devaluing the dollar and raising the price of gold, were fairly closely followed by the Roosevelt administration.²³¹

In recent financial crises in emerging economies, various redistributive transfers have been empirically studied: transfers to the financial sector; transfers to large and foreign depositors; transfers to large, bank-related borrowers; and benefits for high-income households.²³² In the Argentine crisis, in particular, it is well documented now that transfers to large, bank-related borrowers were dominant in the “asymmetric pesification” implemented by Decree 214/2002.²³³ It is likewise well

230. Horacio Spector & Sergio Berensztein, *Business, Government, and Law, in A NEW ECONOMIC HISTORY OF ARGENTINA* 339-48 (Gerardo della Paolera & Alan M. Taylor eds., 2004).

231. Murray N. Rothbard, *The New Deal and the International Monetary System, in THE GREAT DEPRESSION AND NEW DEAL MONETARY POLICY* 94 (Garet Garrett & Murray N. Rothbard eds., 1980).

232. Marina Halac & Sergio L. Schmukler, *Distributional Effects of Crises: The Role of Financial Transfers*, (World Bank Policy Research, Working Paper No. 3173, 2003), available at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2004/01/20/000160016_20040120172705/Rendered/PDF/wps3173.pdf.

233. The currency board itself was probably a rent seeking institution. In fact, it may be argued that Convertibility Plan institutions (central bank independence, privatization of public utilities under a monopoly regime, etc.) were established to allow Government and its business allies to maximize rent seeking in the 1990s. Many Argentines make a similar point by saying that convertibility was an “exchange rate insurance.” See Sebastián Etchemendy, *Constructing Reform Coalitions: The Politics of Compensations in Argentina’s Economic Liberalization*, 43 *LATIN AM. POL. & SOC’Y* 1, 1-35 (2002) (an illuminating discussion of the political economy of Argentina’s

known in Argentina that the former president of the powerful Argentine Industrial Union (UIA), José Ignacio de Mendiguren, who was appointed Minister of Production in early 2002, was a strong supporter of asymmetric pesification.²³⁴ In fact, lobbyists' actions in favor of the measure were revealed by Jorge Remes Lenicov, advisor and Minister of Economy to President Duhalde, in an e-mail addressed to journalist Joaquín Morales Solá and many other figures.²³⁵ Remes Lenicov affirmed that the decision was taken as a result of pressures from industrialists and bankers.²³⁶ After this e-mail was widely diffused in the media, banker Carlos Heller, from *Asociación de Bancos Públicos y Privados de la República Argentina (ABAPPRA.)*, confirmed UIA's intervention. Heller denied, however, that the bankers supported pesification.²³⁷ Speaking about a key meeting at the *Palacio de Hacienda* (Palace of the Treasury), Heller said: "This is not true. I was in that meeting and argued with Jorge Todesca, second in hierarchy to Remes Lenicov, and the people from UIA, who encouraged the decision to pesify." He added:

I publicly promoted the proposal of creating a trust with what could be cashed from the main 1,200 major debtors of the system, who concentrated 50% of credits. These loans should not have been pesified and so creditors could have been guaranteed restitution in the original currency up to the amount cashed. But they told me that this was not possible and that debts would be pesified. There was a political decision to liquefy debts.²³⁸

In contrast, bankruptcy-like legislation should ideally be discussed and decided before the crisis hits and when there is uncertainty about how different details in the proposal will benefit or harm various interest

"liberalization" reforms in the 1990s); Geoffrey P. Miller, *An Interest-Group Theory of Central Bank Independence*, 27 J. LEGAL STUD. 433 (1998).

234. Mendiguren resigned in April 2002 and is now one of UIA's Vice Presidents.

235. Julio Nudler, *Cuando Remes desembucha*, PÁGINA/12, Aug. 17, 2002, available at <http://www.pagina12.com.ar/imprimir/diario/economia/2-9007-2002-08-17.html>.

236. *Id.*

237. However, some commentators persuasively note that banks agreed to asymmetric pesification because they were assured sufficient compensation through Government's bonds. See, e.g., Rodríguez Diez, *supra* note 225, at 111.

238. *Remes Lenicov declaró que cuando propuso pesificar los bancos dijeron que sí*, LA NACIÓN, Aug. 18, 2002, available at http://www.lanacion.com.ar/nota.asp?nota_id=423350.

groups. This uncertainty reduces the expected value of all rent seeking investments, even those made by highly concentrated groups.

Second, emergency measures treat all banks and financial entities alike, irrespective of their liabilities and assets. This causes a serious moral hazard problem in the banking system. On the one hand, depositors anticipating that emergency measures will give them equal odds of recovery in the face of a crisis will not rationally invest resources in obtaining information regarding an entity's financial solidity. On the other hand (and related to consumers' behavior), banks will not rationally invest in maintaining liquid assets. The latter effect is dramatic in exchange regimes that lack a lender of last resort (hard pegs and formal dollarization). If the banking system is subject to periodic emergencies, there is little chance to develop a sizable local market of capital sources, which means that social welfare and GDP growth will be lower than they could be otherwise.

Finally, emergency powers represent an anomaly within the liberal system of political power. It is true that emergency powers have been often recognized in both the United States and Argentina in great national emergencies.²³⁹ In the last few decades, however, various Argentine governments have abused emergency powers whose justification rests on emergencies that usually have strong fiscal components and that therefore, are under government control.²⁴⁰ More fundamentally, Negretto and Aguilar Rivera claim that "liberalism – the political theory that informed Spanish American constitution makers – traditionally lacked an adequate theoretical framework to address the problem of emergencies in political life."²⁴¹ Typically, "regulatory emergencies" lead to "functional emergencies"; these, in turn, lead to a permanent alteration of the separation of powers. Because emergencies tend to alter the separation of powers by delegating congressional powers in the executive branch, the real upshot of the theory of emergency is to increase the President's power at the expense of the legislative and judicial branches. A good example is *Peralta*, which recognized the President's power to enact legislative orders under a state of emergency.²⁴² Three

239. Banks & Carrió, *supra* note 58.

240. Mairal, *supra* note 10.

241. Gabriel L. Negretto & José Antonio Aguilar Rivera, *Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797-98 (2000).

242. Corte Suprema de Justicia de la Nación [CSJN], 27/12/1990, "Peralta, Luis Arcenio v. Nación Argentina / acción de amparo," Fallos (1990-313-513) (Arg.).

years later, the Constitutional Reform of 1994 introduced decrees of necessity and urgency, thus permanently altering the system of checks and balances originally established in the Argentine constitution.

X. CONCLUSION

The restructuring of financial property after macro-economic debacles has often proceeded in accordance with four different paradigms: the emergency paradigm, the monetary paradigm, the valorist paradigm, and the social justice paradigm. The emergency paradigm has been the prevailing paradigm to resolve legal controversies arising from bank runs and economic crises. The monetary paradigm has traditionally been used to ground legal tender legislation, which establishes the inconvertibility of the national currency and economic liquefaction of public debts denominated in the national currency. The valorist paradigm has also been used for redistributing gains and burdens in macro-economic debacles (i.e., hyperinflations). All these paradigms show important doctrinal differences. The emergency paradigm can serve to modify the time dimension of obligations (i.e., maturity), but not their nature (i.e., their currency denomination, or nominal quantity). The valorist paradigm can serve to modify the nominal amount of obligations, but not their time dimension. The monetary paradigm can ground a modification of the currency denomination of contracts (and the value thereof) when contracts are denominated in the national currency (internal denomination), but not when contracts are denominated in a foreign currency (external denomination). Therefore, this paradigm cannot be applied to countries that have formal or *de facto* dollarization.²⁴³ The social justice paradigm is unnecessarily costly in terms of prosperity and welfare, because it can destroy the incentive structure of the banking system; egalitarian wealth redistribution can be less costly achieved through taxation and the recognition of a basic income entitlement.

Finally, the bankruptcy paradigm suggested in this Article can include a variety of restructuring measures. Three examples have been mentioned in this paper: a “double pole circuit breaker,” a scheme of freely negotiable bank notes issued by solvent entities, and the creation

243. This was the case of Argentina in 2001. However, this paradigm could be applied in countries that require financial contracts to be denominated in the national currency (e.g., Brazil).

of a mutual fund encompassing the assets and liabilities of insolvent banks.²⁴⁴ None of these strategies require utilizing the emergency, the monetary, the valorist, or the social justice paradigms. Moreover, there are political economic reasons that favor the bankruptcy paradigm as compared with the emergency paradigm. Political and economic factors predict that the emergency paradigm will systematically be wielded to legitimize exploitation of large, unorganized groups. The emergency paradigm also creates constitutional threats for the separation of powers, as well as moral hazard problems in bank operations.

244. *Peralta, Luis Arcenio*, Fallos (1990-313-513); *see supra* Part IX.