Of Course Argentina Defaulted

And you would have done the same thing too, if you had been in their shoes.

BY SHANNON O'NEIL

On July 30, Argentina defaulted on its outstanding debt. The technical default ends a long saga. It began in 2001 when the country failed to continue payments on nearly $100 billion worth of obligations, continued through its 2005 and 2010 restructurings of over 90 percent of these bonds, bled into ongoing lawsuits with "holdout creditors" including Elliott Management and Aurelius Capital Management, and culminated in the June 16 decision by the U.S. Supreme Court to not hear Argentina's appeal of a 2012 ruling by New York Judge Thomas P. Griesa. This left in place a decision that not only bolstered the holdouts' rights to repayment, but also blocked Argentina and its U.S.-based banks from disbursing the next $539 million round of interest due on the restructured debt. Negotiations over the last month ended fruitlessly, leading to Wednesday's selective default, as defined by Standard & Poor's.

Many are bewildered as to why Argentina wouldn't come to some agreement in the eleventh hour, given the seemingly manageable amounts of debt in play. But the truth is that Argentina acted sensibly, especially given the limited maneuvering room it had to work with.

For starters, the effects of default at home, at least in the short term, are minimal. Argentina hasn't had access to international capital markets for well over a decade. This has made foreign currency often hard to come by, has led to big disparities between the official exchange rate and the unofficial "blue" market rate, and has more generally limited productive investment throughout the economy. But banks, companies, and consumers are now accustomed to this reality. So while the default keeps Argentina from re-entering international credit markets, it doesn't change day-to-day life for most Argentines -- ATMs still work, stores are still open, and business continues as usual.

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the plaintiffs the more than $1 billion it owed, it would have opened itself up to the demands of other remaining outside creditors, which hold somewhere between $10 billion and $15 billion in debt. Further, some argue that the "rights upon future offers" (RUFO) clause in the restructured debt would enable those holders to ask for similar terms, reopening all of the $100 billion to new and better terms.

Having defaulted, Argentina can pursue other potentially profitable strategies. Finance journalist Felix Salmon argues that Argentina could now buy back the newly defaulted exchange bonds at a bargain on the secondary market. Or it could replace those bonds with locally issued debt, getting around U.S. courts and their jurisdiction. In fact, the exchange bondholders could earn more due to the accumulating interest on the defaulted bonds (assuming they are paid in the end).

Moreover, it was in Argentine politicians' and policymakers' self-interest to not settle. In 2005, Argentina passed a law forbidding policymakers from renegotiating with the holdouts. Part bravado, part politics, this law meant that Economy Minister Axel Kicillof and Finance Secretary Pablo Lopez had good reason to shy away from the negotiating table, if only to protect themselves. President Cristina Fernández de Kirchner is in her second (and last) term, and she is already looking toward her December 2015 exit. Breaking domestic laws, even for the greater good of the nation, can't be an enticing alternative, especially given the history of prosecuting former presidents and their cabinet ministers for controversial policy choices.

This doesn't mean Argentina will remain in arrears for long. In recent months it has made several market-friendly moves. It allowed the peso to devalue by roughly one-third early this year, working to make exports, and by extension the larger economy, more competitive. In May, it finally renegotiated its $9.7 billion outstanding Paris Club debt, some 13 years in the making. It also paid the Spanish-led oil giant Repsol for its expropriated majority share of YPF, Argentina's national energy company. And it designed a new inflation index in line with IMF

standards, ending its censure from the multilateral agency.

A resolution to this ongoing battle, however, will depend on both personal and market incentives aligning. Talk of the Argentine banking association buying out the plaintiffs continues, which could satisfy the holdouts, permit interest payments for the rest, and bring Argentina back from financial exile. The government, too, could step forward, particularly if its Congress repeals the criminalization of negotiations, which would give officials legal cover to resolve the debt crisis.

Until then, the Kirchner government will try to make political hay of its defiance. In his remarks to the press, Kicillof defiantly blamed the "vulture funds" for their recalcitrance and promised to defend "the future of the Argentine people." This bluster positions him -- when the debt is resolved -- as both the defender and then savior of the nation, which incidentally might be a strong platform from which to launch his 2015 presidential bid.

Photo by Maxi Failla/AFP/Getty Images

Zawahiri's Revenge

Why al Qaeda, not the Islamic State, is still the most dangerous terrorist organization on Earth.

BY DAVEED GARTENSTEIN-ROSS , THOMAS JOSCELYN

The Islamic State of Iraq and al-Sham -- which has now rebranded itself "the Islamic State" (IS) -- is trying to position itself as the new leader of the global jihadist movement. After being expelled from al Qaeda's network in February, it released several blistering critiques of al Qaeda emir Ayman al-Zawahiri's leadership -- then launched a stunning offensive against the Iraqi government, and subsequently declared that it had re-established the caliphate.

IS has continued its headline-grabbing exploits even after its initial explosive territorial gains, expanding its holdings in both Iraq and Syria. As the Iraqi government pushed to retake Tikrit from IS and other Sunni insurgents, the jihadist group rallied a counteroffensive that

temporarily captured an airfield at Camp Speicher, a former U.S. military base that supported the Iraqi government operation. Other IS advances were accompanied by the group's characteristic over-the-top brutality, for example its capture of the Shaar gas field in Syria's Homs province, after which the group killed an estimated 270 people. In a departure from its previous tendency to target rival rebel groups, IS has also recently begun taking the fight to Assad: On July 25, its fighters ambushed and killed over 50 Syrian soldiers in northern Syria -- several were beheaded, and IS proudly displayed its grisly trophies on social media.

The success of IS has led to a widespread belief among Western observers that the group has eclipsed al Qaeda. In *Newsweek*, writer Kurt Eichenwald described IS as "the biggest threat" to al Qaeda, and wrote that al Qaeda "faces a growing risk of irrelevance" because of it. In *Foreign Affairs,* Barak Mendelsohn argued that IS's success "could be a harbinger of a tectonic shift" in which IS "could supplant al Qaeda as the [jihadist] movement's leader"; others have claimed that the shift has already occurred.

IS's blood-soaked gains represent a real transnational challenge. It is currently a more formidable force than al Qaeda in both Iraq and Syria -- the latter being a theater that will fundamentally shape a new generation of jihadists. That alone will make the group a force to reckon with for years to come.

Nevertheless, commentators appear to be overestimating IS's strengths and underestimating al Qaeda's. It is Zawahiri's organization, not the Islamic State, that will most likely pose the top jihadist threat to the United States and other Western countries in three to five years. Despite its rapid gains, the Islamic State is already showing its weaknesses -- notably in its failure to attract a deep network outside Iraq and Syria and its propensity to alienate potential partners through its brutality and refusal to compromise.

Al Qaeda's network is still intact

IS has tried on

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caliph, Abu Bakr al-Baghdadi. Its attempts failed every time.

In November 2013, Baghdadi began to quietly feel out whether these branches would be willing to switch their oaths of loyalty to him, according to al Qaeda sharia official Abu Sulayman al-Muhajir. In May 2014, IS spokesman Abu Muhammad al-Adnani publicly made the call for defections, asking for all of al Qaeda's branches to issue "an official statement" about the group and its approach to jihad. No public affirmations of IS were forthcoming -- and the Caucasus Emirate, a jihadist group opposed to the Russian government, went even further, publicly declaring Zawahiri to be its emir for the first time.

IS's June announcement of the caliphate was the most explicit challenge to al Qaeda yet. Resurrecting the caliphate is a goal shared by most jihadists -- it is a concept not only about projecting power, but is also about establishing a legitimate ruling authority. Sayyid Qutb, one of the intellectual forefathers of jihadist thought, believed that Islam could not truly be practiced without a caliphate unifying the Muslim world and implementing Islamic law. Because this imagined caliphate would usurp the authority of all other bodies, IS's caliphate announcement was a bold attempt to claim unilateral authority over the entire Muslim world, including other jihadist groups. Its official statement announcing the caliphate made this clear, declaring that "the legality of all emirates, groups, states, and organizations becomes null by the expansion of the caliphate's authority."

However, not one of al Qaeda's official branches elected to join Baghdadi's caliphate. While the Islamic State certainly has supporters within all of al Qaeda's branches -- particularly among disgruntled elements or lower-level foot soldiers -- this support hasn't translated into a shifting of loyalties or widespread personnel defections.

The branches of al Qaeda's international network responded to IS's announcement of the caliphate in different ways - but none of them came close to pledging loyalty to Baghdadi. On July 1, al Qaeda in the Islamic Maghreb (AQIM) released a statement praising the Sunni advances in Iraq and calling for IS to reconcile with its jihadist rivals in Syria -- a message that echoes that of Zawahiri and al Qaeda's central leadership. When that announcement was widely misinterpreted as a signal that the group was on its way to defection, AQIM released a new statement on July 14 declaring that it remained loyal to al Qaeda and that it rejected the Islamic State's caliphate. In Tunisia, Ansar al-Sharia first publicly denied rumors that it had joined IS's enterprise, then reposted on its official Facebook page AQIM's statement condemning the caliphate announcement.

Though al Qaeda in the Arabian Peninsula (AQAP), which is often considered the jihadist group's most dangerous branch, hasn't directly addressed IS's caliphate announcement, its recent messages have hardly been subtle. In early July, the jihadist group released a poem from Nasir al-Wuhayshi, who serves as both AQAP's emir and also al Qaeda's general manager, praising Zawahiri, whom he described as the "sheikh father" and the "apple of the eyes of jihadists of this time." Shortly afterward, AQAP released a video from two of its most prominent ideologues rebuking those who "slander" veteran jihadists. The video was clearly aimed at IS's officials and supporters, who have become increasingly hostile toward Zawahiri.

The Islamic State's problems in expanding its network will likely continue, as the group has already alienated the most influential jihadist ideologues. For example, two of the most credible jihadist authorities, Abu Muhammad al-Maqdisi and Abu Qatada, are both highly critical of IS and Baghdadi's caliphate. In late May, while still in a Jordanian prison, Maqdisi released a stinging assessment calling IS a "deviant organization" -- and then reiterated that criticism in another statement in June, following his release, in which he wondered aloud if Baghdadi would use the caliphate declaration as a pretext to kill jihadists who refused to offer their allegiance.

Abu Qatada, who has been imprisoned in Jordan since 2013, has reinforced Maqdisi's criticisms. A pamphlet containing Abu Qatada's denunciation of IS has been circulating online,

arguing that the caliphate announcement is "void and meaningless because it was not approved by jihadists in other parts of the world." Abu Qatada's critique resonates in the jihadist community, and has been echoed by prominent clerics.

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With its network still intact, al Qaeda maintains a deeper and more capable global organization than IS. Baghdadi and IS have attracted a large number of followers, but the A-list jihadist talent remains in al Qaeda's camp. Not only have they failed to grab the reins of the global jihad, but they are now in the process of repeating Iraqi jihadists' prior strategic errors, which will further hamper their ability to become the movement's new leader.

A tale of two strategies

This isn't the first time observers believed an Iraq-based jihadist group had eclipsed al Qaeda.

From 2005 to 2007, some argued that IS's predecessor, al Qaeda in Iraq (AQI), and its emir, Abu Musab al-Zarqawi, had eclipsed Osama bin Laden's al Qaeda. Zarqawi, after all, was extraordinarily popular with young jihadists. He reveled in the brutality he inflicted, releasing videos of his victims being beheaded, and slaughtering Shiite Muslims, whom he called "a sect of treachery and betrayal." And like IS, Zarqawi succeeded in controlling territory in one of the region's critical countries: An assessment written by Col. Peter Devlin in August 2006 found that AQI had become the "dominant organization of in?uence" in Anbar province.

But al Qaeda was not happy with Zarqawi's approach. Zawahiri, who was then al Qaeda's deputy emir, reprimanded AQI's leader in a letter urging him not to "be deceived by the praise of some of the zealous young men and their description of you as the sheikh of the slaughterers." He warned that these fanatics "do not express the general view of the admirer and the supporter of the resistance in Iraq."

Zawahiri was right, and Zarqawi was wrong. Although Zarqawi captured the imagination of young zealots who romanticized his violence, AQI not only met defeat but also weakened the broader al Qaeda organization by diminishing its brand. An academic review of how AQI lost Iraq provides a lengthy account of the group's failings: It wrongly assumed that other insurgent groups would accept its primacy, employed brutality that earned it the enmity of the region's tribal groups, and implemented its extreme version of Islamic law, thereby alienating local groups. These mistakes are all strikingly familiar in light of IS's recent conduct.

AQI's rise and fall aren't perfectly analogous to the case of IS. For starters, the United States invested much blood and treasure in a "surge" of forces that buttressed local uprisings against AQI. America is less invested in the fight for Iraq today, and Baghdad is in disarray. Prime Minister Nouri al-Maliki is widely despised outside of his corrupt patronage network, which nurtures cronyism at the expense of a truly representative government -- his failures, coupled with the poor performance of Iraq's military, make IS's job considerably easier.

While the Islamic State appears to be making the same mistakes all over again, AQI's high-profile collapse -- and the revolutions of the Arab Spring -- caused al Qaeda to significantly shift its approach. Al Qaeda ideologues began to emphasize that the old regimes had kept citizens from knowing true Islam, and thus argued that it was important to reintroduce people to the faith relatively slowly rather than by simply exerting their will through force. Groups associated with al Qaeda in Egypt, Libya, and Tunisia began to expand their *dawa* (proselytism) efforts, which were intended to win popular support for jihadist ideology. Even some of the most hard-line parts of al Qaeda's international network have recognized that they need to implement their version of Islamic law gradually. AQIM emir Abu Musab Abdel Wadoud (aka Abdelmalek Droukdel), for example, wrote a letter to his fighters in northern Mali after they captured territory there, warning that one of their "wrong policies" was "the extreme speed with which you applied *sharia*, not taking into consideration the gradual evolution that should be applied in an environment that is ignorant of religion."

Al Qaeda's base is back

There's no denying that IS has a number of significant strengths, especially its military prowess in Iraq and Syria. Its exploits, however, are sometimes overstated -- or made up out of whole cloth. For example, after IS overran Mosul, media outlets reported that the group had captured over $400 million from the city's central bank, making it the richest terrorist group on the planet. Less noticed was a careful follow-up report in the *Financial Times* revealing that, according to Iraqi officials and bankers, there was no evidence that any bank robbery had occurred at all.

Similarly, the Islamic State is reportedly making $1 million a day from the sale of crude oil from fields it controls. The reality, however, is more complex: Though $1 million changes hands from these transactions, the claim that IS reaps all the benefit is misleading because the group does not control all the proceeds, which are shared with tribes and other rebel groups. And while IS has an impressive amount of income, it is also spending a great deal of money holding the territory that it has come to control. The group lacks skilled professionals to maintain even basic governance functions, such as electricity, trash collection, and pre-existing social services, so it has to spend money to ensure that those functions continue.

The Islamic State's present might be bright, but its future looks dim. It has done nothing but make enemies in Syria, and the coalition of Sunni groups it managed to cobble together in Iraq is quickly descending into infighting. Further, while IS's brutality may yield some advantages in the region - namely, increasing Sunni-Shiite sectarian tensions, which plays to IS's advantage -- its brand, like AQI's before it, is bound to take a hit internationally.

In contrast, al Qaeda can expect a significant boost in the near term. Though the group's senior leadership in Pakistan has been disrupted by drone strikes for several years, the U.S. drone campaign has already been significantly reduced. And as the United States pulls out from Afghanistan, al Qaeda will find new safe havens in the country. The remote provinces of Kunar and Nuristan are home to significant cadres of al Qaeda fighters, and al Qaeda continues to operate side by side with its allies in other parts of the country. This provides al Qaeda's senior leadership, which has in the past proven quite resilient to the loss of personnel, an opportunity

to increase its international reach in the coming years.

While the Islamic State has antagonized would-be allies, al Qaeda has long operated in South Asia as part of what former Defense Secretary Robert Gates has called a jihadist "syndicate." It has long-standing and close ties to groups such as the Afghan Taliban, the Haqqani network, Harkat-ul-Jihad-al-Islami, the Islamic Movement of Uzbekistan, Jaish-e-Mohammed, Lashkar-e-Taiba, and the Pakistani Taliban, among others. And al Qaeda-aligned factions in South Asia have grown over the past two months with the public announcements of loyalty to Zawahiri from Junud al-Fida and Ansar ut-Tawheed, both of which are active in Afghanistan. The increasing strength of these groups will redound to al Qaeda's benefit: As Gates put it, "What we see is that the success of any one of these groups leads to new capabilities and a new reputation for all."

It's tempting to write off Afghanistan as largely irrelevant to the dispute between IS and al Qaeda. But just as IS has gained momentum from its gains in Iraq, al Qaeda and its allies are likely to do the same in Afghanistan in the coming months. Al Qaeda recently reaffirmed its loyalty to Mullah Omar, the Taliban's reclusive emir. This may be an attempt to undermine Baghdadi's claim to be the caliph by portraying Mullah Omar as the jihadists' rightful leader, as well as an effort to cement al Qaeda's place in a Taliban-dominated Afghanistan should Mullah Omar's forces conquer parts of the country once again.

Furthermore, there is a very real risk that IS's brutality, even toward its fellow jihadists, will help al Qaeda gain the upper hand. In Syria, the population and other rebel groups have deemed al Qaeda's local branch, the Nusra Front, to be a more moderate alternative to IS. In the short run this hasn't stopped IS from achieving tactical victories over Nusra -- but over the longer term, the Nusra Front may have the more viable strategy.

But even if al Qaeda can't best the Islamic State in Syria, it will likely remain the top jihadist threat globally. As with AQI during its heyday, the Islamic State is comprised of brilliant tacticians with no strategic vision -- they are seemingly unable to envision where the group will

be next year, let alone five years down the line. Al Qaeda's vision, on the other hand, promises to keep counterterrorism analysts up at night for years to come.

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