

UNCTAD Conference on “Legal Framework for Debt Restructuring Process: Options and Elements”

Venue: Columbia University

Date: March 31, 2015

Panel on “Principles for a Multilateral Debt Restructuring Process”

Intervention by Martin Guzman (Columbia University)

Ladies and Gentleman, Organizers, Mr. Chairman,

Thanks for the invitation.

The frameworks for sovereign debt restructuring are not working well. They don't facilitate restructurings. Instead, they make them very difficult, delaying their initiation and finalization. Besides, restructurings are in many occasions not deep enough to restore the conditions for sustained economic growth. Overall, the existing frameworks create severe inefficiencies and inequities. This is costly for the global society, and especially so for the societies of countries that are more prone to debt crises. It's a pleasure to participate in this very important discussion on how to fix the frameworks for sovereign debt restructuring.

In general, lack of clarity for resolving debt crises can lead to chaos. There would be potentially extended periods of time during which the claims are not resolved, giving persistence to crises, and making them more severe.

Examples abound. We are witnessing this phenomenon right now in Argentina—where finalizing a restructuring is taking too long—and in Greece—where bailouts do not address the real problems, are where the former restructuring came in a “too little, too late” form.

Bankruptcy laws are designed to prevent this chaos, ensuring an orderly discharge of debts. They establish how restructuring will proceed, who will get paid first, what plans the debtor will implement, etc. But as we all know, we don't have such a framework for resolving sovereign debt crises.

Modification of collective action clauses (as providing a formula for aggregation) and clarification of *pari passu*—as established in the proposal of ICMA supported by the IMF—are improvements over the old terms, but they leave a variety of important deficiencies unresolved—issues that will be addressed by our keynote speaker Joe Stiglitz in the next session.

I will instead focus on the principles that should guide a multilateral framework for sovereign debt restructuring—and in particular on economic aspects.

First, the framework should recognize the limitations of the private contractual approach. It needs to solve the “too little, too late, and too long” syndrome. It also needs to ensure a reasonably fair treatment of all parties.

Although there are differences between sovereign debt and corporate debt restructurings, there are also important analogies. Thus, some of the provisions of chapters 9 and 11 of the US Bankruptcy Code should be considered.

The sovereign should be encouraged to initiate the restructuring in a timely way. Delays in finalization should also be discouraged. The implications are the following:

- (i) The framework must set specific deadlines for the different stages of the process. This would make the whole process more predictable.
- (ii) The framework must recognize the macroeconomic externalities associated with debt crises resolution. Thus, it should facilitate countercyclical macroeconomic policies providing easier access to credit in crises times when it's mostly needed. Then, the framework should contemplate provisions of lending into arrears, according to which creditors who lend while the restructuring process is being carried on would receive senior treatment.
- (iii) The framework should incorporate clauses of stays for litigation, which would prohibit litigation in courts between the initiation and the finalization of the restructuring process—preventing disruptive behavior that leads to some of the large inefficiencies already noted.

The design of the framework must also consider what is the set of principles over which all the parties involved would agree on. We could think of the possibility of following a hard law approach, where countries adhere to an International Bankruptcy Court. But if the rulings of the Court were enforceable, countries would be giving up on sovereign immunity, and this might be unacceptable for many countries. Besides, geopolitical problems would be intense: How would the members of the international court be appointed? What interests would they represent?

Alternatively, we could think of a soft law approach, where a framework that would facilitate restructurings is created and at the same time sovereign immunity is respected. The creation of an **Oversight Commission** with the mission of mediating and supervising the restructuring process would be an example of such an approach. The Commission would also maintain a registry of the debt stocks. The members of the Commission would be countries that endorse the

multinational framework. The Commission would not rule over different alternatives. Instead, the sovereign would finalize the process with a final proposal and the Commission would produce statements about the reasonability of the process and the final proposal. This approach would serve to legitimate the restructuring, or alternatively, to legitimate positions that speak of illegitimate restructurings. This is the approach that seems feasible and convenient at least in the short-run—and it's the one I advocate for.

To conclude, let me point out that restructuring is not a zero sum game. The mechanisms in place can have large effects on the overall economic performance. The existing institutional arrangements are making the sum too negative, as they delay restructurings, and lead to so-called "solutions" that do not promote economic recovery. Improvements to contracts are possible but not enough to solve the current problems. I believe a "soft law" approach that entails a more active role for a quasi-judiciary can mitigate some, perhaps many, of the current inefficiencies and inequities in sovereign debt restructurings. On the other hand, the absence of these mechanisms would still imply further problems for sovereign debt restructuring, and further barriers for recoveries of countries in recessions. I hope we don't let this happen.

Thank you for your attention.