INTRODUCTION

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Sovereign debt crises are becoming, once again, frequent. In some cases, the costs to the citizens of those countries facing such crises have been enormous. Deficiencies in the mechanisms for resolving such crises cast a pallor over countries that are not yet in a crisis but worry that they might become so; and indeed, the high costs and uncertainties associated with debt restructuring dampen cross-border capital flows and force especially developing countries and emerging markets to pay higher interest rates than might be the case if there were better ways of resolving these debt problems.

A fresh start for distressed debtors is a basic principle of a well-functioning market economy. The absence of a fresh start may lead to large inefficiencies, wherein both the debtor and the creditors lose. This principle is well recognized in domestic bankruptcy laws. But there is no international bankruptcy framework that similarly governs sovereign debts. We refer to such a broad framework as a "framework for sovereign debt restructuring."

This lacuna is creating serious problems for nations facing sovereign debt crises. The issue has been brought to the fore especially by the difficulties recently faced by several countries attempting reasonable debt restructurings—most notably Argentina and Greece.

Sovereign debt restructuring has suffered from "too little, too late." The current system discourages incumbent governments from initiating debt restructurings. And when a restructuring is undertaken, it is often not deep enough to provide the conditions for an economic recovery, as the Greek debt restructuring of 2012 illustrates. And if the debtor decides to play hardball and not accept the terms demanded by the creditors, finalizing a

restructuring can take a long time and, as the case of Argentina illustrates, be beset with legal challenges, especially from small groups of noncooperative agents (holdout creditors) that have earned the epithet "vulture funds." Under the current non-system, the gaps in the international legal architecture make possible the emergence of these vulture funds, who buy defaulted debt in secondary markets at very low prices and then litigate against the issuer for the payment of the full amount of the liabilities. This destabilizing speculative behavior, together with the favorable treatment these agents have been receiving from the U.S. courts, creates serious problems, as it encourages all creditors to hold out in debt restructuring negotiations—making debt restructurings de facto impossible.

Delays in debt restructurings have been costly for sovereigns and for good faith investors. These dysfunctions have ramifications for the entire sovereign debt market. They may lead to a reluctance on the part of countries to borrow, even when doing so might make sense; and they may lead to higher interest rates in sovereign debt markets.

These problems are not new. They have been plaguing the functioning of sovereign debt markets for decades. Over the past fifteen years discussions have explored many alternative ways of dealing with both situations in which sovereigns have difficulties in meeting their debt obligations and the subsequent economic, political, and social consequences. Each has to be evaluated in terms of ex ante incentives. Is there, in some sense, too much or too little lending? How is lending distributed across countries? Is lending done on the right terms? To the right countries? Do the lenders have the right incentives for due diligence? And do the borrowers have the incentives for prudent borrowing?

An assessment of alternative frameworks for resolving sovereign debt crises must also consider the ex post incentives: When a problem occurs, are there incentives for a timely resolution? Are there incentives for a fair and efficient resolution, one that enables the indebted country to return to growth quickly, that does not impose undue hardship on the debtor's citizens, and provides fair compensation to the creditors? Does it provide appropriate treatment for "implicit" creditors, such as old-age pensioners?

Some have suggested that simple modifications of the current contractual approach are all that are required. Others claim that some sovereign debt restructuring mechanism would be desirable; this is known as the "statutory approach." Others aver that at the very least, there is a need for an international agreement on the set of acceptable debt contracts—for instance, that countries cannot sign away their sovereign immunities.

At the time of publication of this book, the issue of fixing the frameworks for sovereign debt restructuring is in the center of the global debate. It has been explicitly addressed by the United Nations (in resolutions overwhelmingly passed by the General Assembly in September 2014 and in September 2015 over the opposition of some developed countries and the abstention of others), the International Capital Market Association (ICMA), the International Monetary Fund (IMF), and the G20, which made explicit reference to the need of resolving the current deficiencies in the final communiqué of the leaders' summit in November 2014.

There have been several important academic studies addressing various aspects of frameworks for sovereign debt restructuring and the advantages and disadvantages of these mechanisms relative to the private contractual approach. In light of the recent events and progress in our understanding of the issues, these studies need to be updated.

This book fills in this gap by providing a collection of essays from top academic economists, lawyers, and practitioners in the field, providing guidance on the most critical questions. (Many of these ideas were presented as part of an ongoing series of conferences held at Columbia University on frameworks for sovereign debt restructuring.)

Part I focuses on general issues of sovereign debt restructuring, with an emphasis on the goals of debt restructuring and the challenges imposed by the deficiencies in the current non-system, as well as the implications of recent events for the functioning of sovereign lending markets.

In chapter 1, Martin Guzman and Joseph E. Stiglitz review the existing problems in the world of sovereign debt restructuring, contrast how well existing structures and proposed alternatives fulfill the objectives of debt restructuring, and propose solutions. They argue that improvements in the language of contracts, although beneficial, cannot provide a comprehensive, efficient, and equitable solution to the problems faced in restructurings, but they note there are improvements within the contractual approach that should be implemented. They claim that ultimately the contractual approach must be complemented by a multinational legal framework that facilitates restructurings based on principles of efficiency and equity. Given the current geopolitical constraints, in the short run they advocate for the implementation of a "soft law" approach, one built on the recognition of the limitations of the private contractual approach and on a set of principles over which there may be consensus, as the restoration of sovereign immunity.

In chapter 2, Marilou Uy and Shichao Zhou provide an overview of the broadly favorable public debt trends in developing countries over the past decade. They also note that while the increased access to international debt markets provides more opportunities for investments that stimulate growth, it may also bring with it new sources of risk that could seriously affect some sovereign borrowers. They also highlight the unique challenges that some groups of countries face in managing sustainable levels of debt. Their paper further acknowledges countries' responsibility for managing their debt but also recognizes that the global community has a role in strengthening the system of sovereign debt resolution. Yet a global consensus on how to move forward on this has been elusive. In this context, their chapter documents the evolution of highly divergent views on how to reform the global system for sovereign debt in intergovernmental forums and the potential approaches that could pave the way for a wider consensus.

In chapter 3, Skylar Brooks and Domenico Lombardi examine two cases that help to explain why an international framework to facilitate sovereign debt restructuring has not been created yet: first, the IMF's attempt to establish a sovereign debt restructuring mechanism (SDRM) in 2001–2003; second, the creation of the European stability mechanism (ESM) in 2012. In the former case, they ask why the SDRM failed despite growing recognition of the need for such a mechanism. In the latter case, they analyze why eurozone countries responded to the European debt crisis by creating the ESM—a sovereign bailout rather than a debt restructuring mechanism. They argue that private creditor opposition best explains the failure to create a sovereign debt restructuring framework and advance the hypothesis that private creditor preferences shape outcomes through two distinct but intersecting forms of power: instrumental and structural. Instrumentally, private creditors engage in lobbying and "strategic reform" to preempt more far-reaching measures. Structurally, private creditor preferences are internalized by states with systemically important financial markets and states that rely on international markets for their borrowing.

Part II offers an analysis of two recent major cases—the resolution of Argentina's and Greece's debt crises. These cases illustrate the problems that the lack of mechanisms for sovereign debt restructuring may create.

In chapter 4, Sergio Chodos explores in depth Argentina's debt restructuring saga after its 2001 default. In his ruling in the country's dispute with vulture funds, Judge Thomas Griesa of the District of New York

decided that Argentina breached a boilerplate pari passu clause included in sovereign bond issuances, and he created a novel "equitable remedy" that in effect prohibited Argentina from continuing to service its restructured debt until the vulture funds had been paid in advance in full. This decision, which was confirmed by the Court of Appeals of the Second Circuit in October 2012, became operational after the U.S. Supreme Court denied a petition for review in June 2014. The chapter describes the details of the case and argues that the decision constituted a game changer that affected the nature of restructurings to a point where the problems generated by the absence of a fair, effective, and efficient mechanism to deal with sovereign debt restructuring can no longer be neglected. Chodos also argues that one of the main consequences of such decision is to render untenable the marked-based approach for sovereign debt restructuring.

In chapter 5, Yanis Varoufakis presents the proposals from the Greek government during his appointment as Finance Minister of Tsipras's government. He argues that his ministry's priority was an ex-ante debt restructuring, because it would provide the "optimism shock" necessary to energize investment in Greece's private sector. He claims that in contrast, the troika program they inherited was always going to fail, because its logic was deeply flawed and, for this reason, guaranteed to deter investment. It was a logic based on incoherent backward induction, reflecting political expediency's triumph over sound macroeconomic thinking.

The case of Greek debt is fascinating because it is one of those curious situations in which creditors extend new loans under conditions that guarantee they will not get their money back. Why do Greece's creditors refuse to move on debt restructuring before any new loans are negotiated? And why did they ignore the Greek government's proposals? What is the reason for preferring a much larger new loan package than necessary? Varoufakis claims that the answers to these questions cannot be found by discussing sound finance, public or private, for they reside firmly in the realm of power politics. If Tsipras's government were to conclude a viable, mutually advantageous agreement with the troika of creditors, after having opposed its "program," its "success" would have seriously jeopardized the electoral prospects of troika-friendly governing parties in Portugal, Spain, and Ireland. But although these considerations were important factors in the perpetuation of the "Greek debt denial," he claims there is a more powerful explanation buried deep in the architectural faults of the eurozone and in the manner in which a significant European politician,

the German finance minister Wolfgang Schäuble, (1) understands these faults and (2) is planning to resolve them.

He concludes that behind the Eurogroup rhetoric and decisions a war is waging between Berlin and Paris over the form of political union that must be introduced to bolster Europe's monetary union. Greek debt will not be restructured until this conflict is resolved.

Part III focuses on a set of possible improvements within the contractual approach, extending the set of measures proposed by Guzman and Stiglitz in chapter 1.

In chapter 6, Anna Gelpern, Ben Heller, and Brad Setser provide a comprehensive description of the recent reforms proposed by the International Capital Market Association (ICMA) for sovereign debt contracts (a process in which the three experts have been involved), i.e. the changes that would allow a supermajority of creditors to approve a debtor's restructuring proposal in one vote across multiple bond series. They start by reviewing the introduction of series-by-series voting to amend financial terms into New York–law bonds in 2003. Then, they look at the factors that helped create broad consensus on the need to move beyond series-by-series voting in 2012. Most of the essay is devoted to analyzing the key features of the new generation of aggregated CACs and the considerations that shaped decisions about these features. They conclude with observations on contract reform in sovereign debt restructuring and their views of the challenges ahead.

In chapter 7, Richard Gitlin and Brett House lay out a work program to reduce the ex ante costs of sovereign debt restructuring that is complemented by additional measures to mitigate the costs of restructuring. Among other measures, they propose the creation of a sovereign debt forum that would provide a standing, independent venue (outside of existing institutions like the IMF) in which creditors and debtors could meet on an ongoing basis to address incipient sovereign debt distress in a proactive fashion, and they suggest the implementation of state-contingent debt in the form of sovereign "cocos," which consists of bonds that automatically extend their maturity upon realization of a prespecified trigger linked to a liquidity crisis.

In chapter 8, James Haley makes three points regarding recent improvements for sovereign debt contracts suggested by the ICMA and later endorsed by the IMF. First, he argues that the new clauses are a useful and potentially important instrument to deal with the problem of holdout creditors. Second, he claims the new clauses are not a panacea.

This assessment reflects the fact that it will take some time for these clauses to be embedded in the stock of outstanding bonds and that whatever their merits the new clauses do not fully address the issues of unenforceability and discharge of sovereign debts. Third, he notes that the debate between voluntary/contractual and statutory approaches is a false dichotomy. Contractual approaches will necessarily be incomplete and the design of "institutions," whether bankruptcy provisions embodied in formal treaty or the responses of existing international financial institutions, will influence the outcome of sovereign debt restructurings.

In chapter 9, Timothy DeSieno points to the importance of creditor committees for achieving successful sovereign debt restructurings. He claims that a more widespread utilization of creditor committees would minimize the holdout problems and facilitate inter-creditor consensus, as most creditors will usually feel they can trust "a group of their own" more readily than they can trust the issuer.

Part IV turns to the specific proposals for the implementation of a multinational formal framework for sovereign debt restructuring. The chapters in this section lay out a set of principles, elements, and forms for institutionalizing such a framework.

In chapter 10, José Antonio Ocampo provides a history of debt crises resolution and the rise of the current non-system, which mixes the Paris Club for official debts, voluntary renegotiations with private creditors, and occasional ad hoc debt relief initiatives (the Brady Plan and the Highly Indebted Poor Countries and later Multilateral Debt Relief Initiatives). This system, he argues, not only provides inadequate solutions but also does not guarantee equitable treatment of different debtors or different creditors. He then proposes a multilateral mechanism for sovereign debt restructuring that offers a sequence of voluntary negotiations, mediation, and eventual arbitration with preestablished deadlines, similar in a sense to the World Trade Organization's dispute settlement mechanism.

In chapter 11, Barry Herman proposes that the UN General Assembly should formulate a set of principles to guide governments and international institution creditors when restructuring sovereign debt and as the representative of the international community should guide the IMF in assessing restructuring needs. The principles would also guide national courts, which would oversee restructuring of sovereign bonds and bank loans issued under national law. The UN Commission on International Trade Law (UNCITRAL) would prepare a model law for national

governments that would provide common guidance across jurisdictions for court supervision of restructuring of private claims. While sovereigns would continue to negotiate restructurings separately with each class of creditors, the indebted government or creditor groups could appeal the workout to the Permanent Court of Arbitration in The Hague when either party believes there has been a violation of the principles.

In chapter 12, Jürgen Kaiser discusses the "institutionalization" of a multinational framework for sovereign debt restructuring. In Kaiser's view, the institutionalization should comply to three basic principles: first, it needs to restructure debt in a single comprehensive process, with no payment obligations being exempted from the process; second, it needs to allow for impartial decision making about the terms of any debt restructuring; and third, this decision must be based on an impartial assessment of the debtor's situation. Kaiser claims that there are not many historical precedents for a sovereign debt restructuring that complies with these conditions, but the case of Indonesia in 1969 may be inspiring. He argues that a "sovereign debt restructuring liaison office" mandated by the United Nations and run independently from any debtor or creditor interference could be a catalytic element with the potential to overcome the shortcomings of existing procedures. In this view, it could facilitate a comprehensive negotiation format with all stakeholders around the table; it could provide an impartial and thus realistic assessment of the need for debt relief; and it could suggest an unbiased solution. Such an "office" could be established immediately as an outcome of the present UN General Assembly consultation process and then develop its rules, regulations, and infrastructure over time.

In chapter 13, Richard Conn argues that the creation of an agreed-upon framework that interacts with private party contracts or restricts contractual options ex ante is a logical alternative to the status quo. This approach can provide greater stability and efficiency in the restructuring process while allowing for sufficient flexibility and certainty for market participants. He claims that there are procedural frameworks that could add value to the restructuring process with less risk of treading on the political terrain of sovereigns. This chapter discusses the catalyst for recent efforts to create a framework and context for evaluating sovereign debt restructuring; outlines a strategy to successfully adopt a framework that deals with problems that require resolution; highlights the deficiencies of relying solely upon private party contractual revisions; discusses practical impediments to a substantive-law approach to sovereign debt

restructuring; and finally puts forward specific proposals for a consensual, procedural framework designed to earn broad political support.

In chapter 14, Robert Howse analyzes some of the possible elements of an international-law approach to a multilateral framework for sovereign debt restructuring. This chapter draws extensively from the deliberations and publications of the UN Conference on Trade and Development (UNCTAD) Working Group. He proposes the creation of a "counter-framework" using soft-law instruments of a kind generated by various UN processes and institutions, including the International Law Commission, UNCITRAL, and UNCTAD. The "counter-framework" would offer different norms, fora, legal mechanisms, expertise, and analyses to those that dominate the existing informal framework (IMF, Paris Club, U.S. Treasury, financial industry associations, private law firms, creditors' groups, etc.). It would offer alternatives for borrower-lender relationships and the restructuring of debt, alternatives that if the analysis in this chapter (and the other chapters of this book) is correct, would benefit both sovereign debtors and creditors. This proposal might be of particular interest to states that could be sources of new finance and do not want to keep within the existing informal framework (like perhaps China).

In chapter 15, Kunibert Raffer analyzes which elements are indispensable for any model to be rightly called insolvency: equality of parties instead of creditor diktat, debtor protection, fairness, and a solution in the best interest of all creditors. This chapter presents a model that fulfills all these requirements. It concludes by showing that since the 1980s there has been progress in moving toward such a model, although at snail speed.

Overall, the chapters in this book depict an overwhelming consensus among those who are well informed about sovereign debt markets but do not have a vested interest on either the creditor or debtor side on the need to reform the non-system that governs sovereign debt restructuring. Doing so requires the political willingness from both of debtor and creditor countries. Debtor countries have raised their voice at the United Nations, calling for an end to the suffering that debt crises bring under the current arrangements. But creditor countries, led by the United States, are reluctant to engage in reforms. The political reasons are clear: the reforms would lead to a redefinition of the balance of power between debtors and creditors—a redefinition that is necessary if we are to create a better-functioning sovereign debt market. But as this book explains, those concerns miss the point. A better system for debt restructuring may be a win-win, that is, a situation in which everyone—with the exception

of the vulture funds—wins. The size of the pie distributed among debtors and creditors would be larger with a better system. The suffering of societies in debt crises would be lessened, and creditors would also benefit from the faster economic recoveries that better resolutions of debt crises would entail. And as this book emphasizes, if there is a better framework for debt restructuring, debt markets will function better.