

Fixing Sovereign Debt Restructuring

United Nations

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Legal Framework for Sovereign Debt Restructuring

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- Joseph E. Stiglitz, Martin Guzman, Domenico Lombardi, José Antonio Ocampo, and Jan Svejnar; *“Frameworks for Sovereign Debt Restructuring”*, IPD-CIGI-CGEG Policy Brief, January 2015
- Skylar Brooks, Martin Guzman, Domenico Lombardi, and Joseph E. Stiglitz; *“Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring”*, CIGI Policy Brief No.53, January 2015

- ① The role and importance of sovereign debt restructuring
- ② The current situation
- ③ The Contractual Approach response and its limitations
 - Possible improvements
- ④ The guidelines for a Framework for Sovereign Debt Restructuring

- Analogies with private bankruptcies
 - Limited liability ensures a lower bound to expected utility
 - Efficiency requires a rapid fresh start
 - The design of the system affects its functioning (incentives for screening, monitoring) → Determines efficiency ex-ante

- “Too little, too late” syndrome
- Judge Thomas Griesa ruling makes debt restructuring *de facto* impossible
 - Creates both inefficiencies and inequities in global financial markets
- Policy questions:
 - Are there quick fixes within the private contractual approach?
 - To what extent will they solve the problems?
 - What are the principles that should guide the design of a FSDR?

- CAC and Pari Passu
 - Improvements over the old terms
 - But not sufficient to solve the current problems
- Limitations:
 - Do not solve the problem for the existing debt stock
 - Multiple inter-creditor equity problems
 - Coordination problems

- Problems for determining priority with debt issued in different jurisdictions
- Problems of determining valuations with debt issued in different currencies

- The backgrounds of the negotiations are biased against the “implicit creditors” (workers, pensioners)
- IMF bailout policies favor short-term creditors and hurt long-term creditors, including the implicit creditors

- With heterogeneous debtors and imperfect information, the market solution leads to a suboptimal signaling equilibrium
- Makes demand for “tough” jurisdictions inelastic

- Full disclosure of SCDSs
- Variants of champerty into contracts
- GDP indexed bonds

- Must recognize the limitations of the market-based approach
- Must provide the conditions for timely restructurings
- Must be aware of the minimum set of principles over which the parties involved would agree on

- 1 Sovereign initiates the restructuring
- 2 System should incentivize no delays
 - Stays for litigation
 - Lending into arrears
- 3 Stage of possible objections by other parties
 - Alternative proposals must justify how they recreate the conditions for sustained growth (instead of just re-creating conditions for repayment in the short-term)
 - Proposal should describe the impacts on all stakeholders

- ④ End of the process depends on type of mechanism: Hard law vs. Soft law
 - **Hard law:** An International Bankruptcy Court would require that countries that adhere to the mechanism sacrifice sovereign immunity
 - And would be associated with complex geopolitical problems
 - **Soft law:** An Oversight Commission (composed by other States that endorse the Multilateral Framework) would act as a supervisor and mediator
 - It would not have the capacity to rule over the final proposal, but could make statements on its reasonableness
 - Therefore, it would legitimate the outcome of the restructuring process

- SDR nowadays featured by lengthy and intricate negotiations
- Conditions apt for emergence of destabilizing vulture funds, with systemic implications
- Recent evolution of legal frameworks played in favor of the vultures business, not in favor of global social welfare
- There is space for improving contracts, legal frameworks, and IMF bailout policies

- But with incomplete contracts the private contractual approach will not suffice
- A formal framework for SDR is necessary
- A more efficient restructuring process could lead to lower interest rates
- Its absence would imply still further problems in SDR of the type described in this presentation