10th UNCTAD DEBT MANAGEMENT CONFERENCE

Geneva, 23th – 25th November 2015

Debt Issues of the Trade and Development Report

by

Mr. Alfredo Calcagno

Head, Macroeconomic and Development Policies Branch
Division on Globalization and Development Strategies
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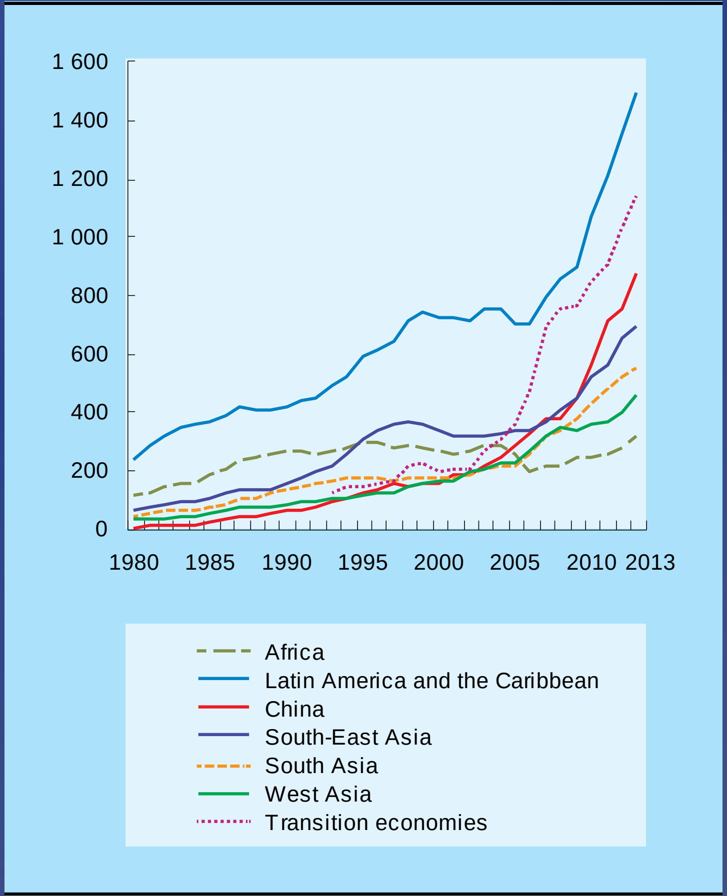
External debt crises, a recurrent problem

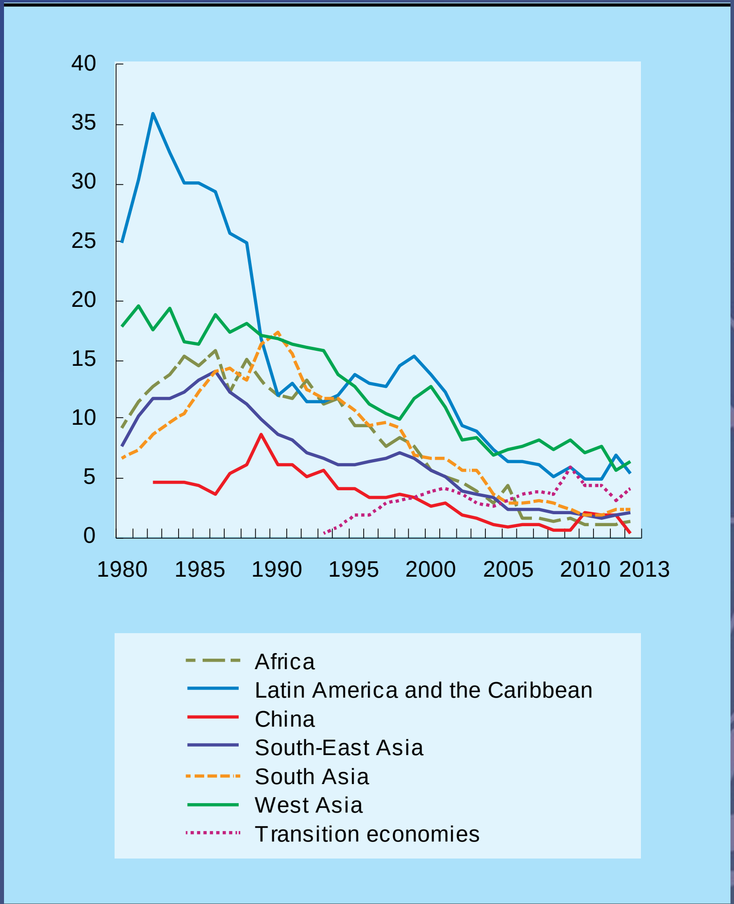
- Global financial cycles and instability, pro-cyclical biases and insufficient regulation lead to recurrent external debt crises, particularly in developing countries
- External debt specificities increase vulnerability associated to financial cycles and complicate external debt management (residence, currency, jurisdiction).
- Cost of debt crises extremely high, not only for debtors, also for the global economy

External debt in developing and transition economies becoming a threat despite reassuring debt indicators

External debt, selected country groups and China, 1980–2013, billion $



Interest payments on external debt as a proportion of exports, selected country groups and China, 1980–2013, in %



The International Financial System lacks a coherent and effective legal framework to manage sovereign external debt crises.

- Sovereign debt problems cannot be handled as private debts problems
- The present framework is fragmented with different kind of creditors, different jurisdictions and a multitude of private bondholders with different interests and behaviours
- Debt crisis management tends to increase and socialize costs
  - "Too little, too late" is not neutral: liquidity vs. solvency, revolving door
  - Substitution of debtors and creditors, emergency loans not used for growth
  - Asymmetric and pro-cyclical adjustment, role of IMF
  - Debt sustainability further undermined
- Holdouts litigation makes restructuring more difficult and may put in jeopardy a successful restructuration. It shows the limits of a commercial logic that ignores economic and social conditions to debt sustainability

Which alternatives?

- Improving contractual approaches: Collective Action Clauses, clear wording in contracts (*pari passu*), etc.
  - No guarantee of rapid consensus and good result
  - Vulture funds are not totally excluded
  - Do not apply to existing debt stock
- Adopting a statutory approach: a mechanism to reduce costs, facilitate an agreement (or settle an arbitrage).
  - Appropriate measures to stop deterioration: temporary standstill decided by the debtor country, stay on litigation, exchange controls, debtor-in-possession financing and IMF lending into arrears
  - Major jurisdictions in which external debt is mostly issued may not sign
  - Debt restructuring (rescheduling, lowering interest rates, haircuts) to restore debt sustainability
  - Major jurisdictions in which external debt is mostly issued may not sign

Which alternatives?

- Incremental strategy: principles, soft law
  - Principles based on international public law to orient sovereign debt restructuring. The GA approved 9 principles:
    - The right to restructure sovereign debt
    - Good faith by creditors and debtors for re-establishing debt sustainability and service
    - Transparency
    - Impartiality
    - Equitable treatment
    - Sovereign immunity
    - Legitimacy
    - Sustainability
    - Majority restructuring (anti-vulture funds)
  - They could be integrated into national legal systems or applied by international tribunals ("soft law")
  - Principles are not mandatory; it may be difficult to reach a critical mass of countries approving them; it may take many years and maintain fragmentation. But they are an important step in the right direction