Fixing Sovereign Debt Restructuring

United Nations

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References

- 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) \( \rightarrow \) 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
ICMA’s response and inter-creditor equity problems

- Problems for determining priority with debt issued in different jurisdictions
- Problems of determining valuations with debt issued in different currencies
ICMA’s response and inter-creditor equity problems

- 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
Coordination problems

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

- 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
Guidelines for a Framework for Sovereign Debt Restructuring
A possible framework

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
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
Conclusions

- 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