

**ECOSOC special meeting on
“External debt sustainability and development: Lessons learned from debt crises and
ongoing work on sovereign debt restructuring and debt resolution mechanisms”
(New York, 23 April 2013)**

Executive summary

Pursuant to General Assembly resolution 67/198, the Economic and Social Council held, on 23 April 2013, a special one-day meeting on “External debt sustainability and development: Lessons learned from debt crises and ongoing work on sovereign debt restructuring and debt resolution mechanisms.” The main substantive points of the meeting are summarized below.

Opening of the meeting

President of the ECOSOC, H.E. Mr. Nestor Osorio (Colombia)

The meeting was opened by the President of ECOSOC, H.E. Mr. Nestor Osorio (Colombia), who emphasized the importance of the meeting in exchanging practical ideas for an enhanced and durable solution for sovereign debt restructuring given the high cost sovereign debt distress and sovereign debt restructuring imposed on the populations of affected countries. Unlike past crises, the current debt crisis has not been confined to poor or emerging economies. The ongoing debt crisis in the Euro zone has had a far reaching effect on the world economy as a whole, which has made the resolution of debt problems a global concern. There is a need for a global solution for debt restructuring from the perspective of both developed and developing countries.

The current debate on sovereign debt restructuring has a direct impact on financing sustainable development and the post-2015 development agenda, as countries with unsustainable debt burdens spend a large proportion of public resources on debt servicing, which diverts resources from expenditures necessary for sustainable development. Therefore, the need for a durable solution to the current debt crisis is an important aspect of the global governance agenda. The international community must come together to promote sustainable and responsible borrowing and lending, design an architecture for sovereign debt restructurings which ensures speedy and predictable solutions to debt distress with fair burden sharing between debtors and creditors, and implement improved debt management.

Mr. Supachai Panitchpakdi, Secretary General, UNCTAD

Mr. Panitchpakdi argued that the issue of sovereign debt distress should be brought back to the centre of the international debate, and called for a predictable mechanism to allow for orderly sovereign debt restructurings. He also emphasized that the sovereign debt crisis was no longer confined to developing countries, and that the current sovereign debt crisis in developed countries threatened to derail the already fragile global economy. Given the frequency and severity of crises, he called for a global timely and equitable solution to debt crises. As much as debt financing can spur investment and economic growth, if it's not well managed it can be a source of financial and economic instability. According to him, debt

problems need to be monitored to prevent them from growing into major financial crises with the potential to halt a country's development agenda or even erode gains already made.

Mr. Panitchpakdi further commented on the global and systemic nature of today's sovereign debt crises with the cross-holding of sovereign debt instruments in a globalized economy. He pointed out that the uncertainty surrounding the debt restructuring process had caused unnecessary delays and high costs. He invited the international community to work towards a more predictable mechanism that would facilitate more orderly sovereign debt restructurings and allow space for collaborative and constructive dialogue between the debtor and all creditors.

In addition, he emphasized the importance of finding ways to minimize negative externalities arising from crises. He reported on progress made by his own institution, UNCTAD, in crisis prevention with the establishment of international norms and principles for responsible borrowing and lending. These principles cover all types of sovereign debt contracts, as a first step towards preventing crises generated by irresponsible, imprudent or opportunist behaviour by debtors and creditors. According to him, these "soft law" guidelines have gained support from a range of countries, and their growing acceptance can make a contribution to debt sustainability and global financial stability.

Ms. Shamshad Akhtar, Assistant Secretary General for Economic Development, UN-DESA

Ms. Akhtar emphasized the need for a structured framework to deal with sovereign debt. The recent global financial crisis has shown the limitation of the international financial architecture in solving debt crises. She pointed out that because defaults were costly in political terms and carried the risk of domestic banking system collapse, politicians and policymakers almost always postponed calling default, which made the ultimate cost higher. At the same time, she said that market-based, or voluntary, solutions did not generally provide enough debt relief for the debtor, often leaving the debtor country financially vulnerable to yet another debt crisis in the near future. She argued that improvements to the market-based approach, such as through collective action clauses (CACs), were not sufficient for several reasons. In particular, CACs leave open questions on how to aggregate votes across bond issues, as well as across different types of debt. The voluntary code of conduct and the principles of stable private capital flows and fair debt restructuring have not resulted in more efficient outcomes either. In addition, the lack of a sovereign bankruptcy regime has led to moral hazard for both creditors and debtors and created perverse incentives, which ultimately affects both the cost and extent of borrowing.

Ms. Akhtar was of the view that a more structured process for debt restructuring could help reduce inefficiencies, ensure a more equitable solution for all parties, and put countries back on a debt sustainability path without sacrificing their potential for economic growth. Such an orderly mechanism, she said, could provide an early response to debt distress and provide a space for dispute resolutions, and for collective action amongst creditors. Ms. Akhtar concluded by urging continued discussion amongst the international community for ex-ante solutions for a more stable, fair, and efficient system fit for today's global economy. She advised setting up a working group to examine various perspectives on the practicality of alternative proposals to build consensus on the way forward.

Lessons learned from the history of debt crisis

Mr. Jeffrey Lewis, Director of the Economic Policy, Debt and Trade Department, Poverty Reduction and Economic Management Network (PREM), World Bank.

Mr. Lewis focused on the debt relief provided under the Highly Indebted Poor Country (HIPC) Initiative and assessed it as a successful effort to recognize and partially solve a systemic debt crisis in low-income countries. According to Mr. Lewis, the reduction in the debt stock has opened the space for contracting new debt, including non-concessional debt. The increase in debt relief has been accompanied by rising expenditure on poverty reduction, though the causality between debt relief and the increase in expenditures has been harder to demonstrate. He noted that the HIPC Initiative responded flexibly to challenges but noted that another World Bank program (in the form of a trust fund hosted by the World Bank) aiming to reduce sovereign commercial debt has found it much harder to find consensus among private lenders to reduce debt. He noted that challenges remain in that there are countries that have been unable to avail themselves of HIPC debt relief.

Mr. Lewis highlighted the debt problems of small states in the Caribbean, ECCU and Latin America, which had high public debt levels and slow growth. These countries are highly vulnerable to external shocks and fiscal deficits and have limited fiscal space for counter-cyclical spending and financial capacity to cope with disasters. He emphasized that the face of global finance is changing and that there is the need to reduce the chances of debt crisis spreading to other sectors, such as the banking sector, which tends to hold sovereign debt on its balance sheet. Moreover, the focus of debt management strategies should be on risk management and on addressing underlying links between fiscal policy, debt sustainability and growth.

Mr. Christoph Paulus, Professor, Humboldt University, Berlin, Germany

Mr. Paulus noted that there was a broad consensus on the need to establish a legal framework for debt restructuring, but that, despite the ongoing sovereign debt crisis in the Euro zone, no progress has been made in recent years. According to him, the time is right for a debt restructuring mechanism. He stressed that the decision by the U.S. Second Circuit Court of Appeals against Argentina, as well as proceedings at the International Centre for Settlement of Investment Disputes, will make pre-default debt restructuring negotiations more difficult in the future.

Mr. Paulus stressed that there was a need for debt restructuring procedures, as the absence of pre-determined rules increased the costs of a restructuring. A legal procedure would make negotiations in the shadow of a court house possible and/or give guidance on how to proceed when a sovereign defaults. Collective Action Clauses (CACs) are helpful but they do not address the underlying structural problems that led to debt distress in the first place. He argued that in the case of debt distress, the issuing sovereign should have the option to activate a resolvency proceeding by filing a respective petition with a to-be-established court.

Ongoing work on sovereign debt restructuring and debt resolution mechanisms

Ms. Yuefen Li, Head, Debt and Development Finance Branch, Division on Globalization and Development Strategies, UNCTAD

Ms. Li briefly described the schemes used in dealing with debt crises in the past, as well as current discussions on debt restructuring mechanisms and the concerns they have generated among different stakeholders. She pointed out that there was a misconception that new debt restructuring mechanisms might make it easier for debtors to seek debt restructuring, thereby introducing debtor moral hazard and increasing the probability of defaults. Ms. Li argued that the new mechanisms would not make it easier to recourse to debt restructuring but, rather, would make the process timelier, fairer, and less costly. The objective would be to avoid a debt crisis if both creditors and debtors are willing to consider the possibility of debt restructuring when needed.

Ms. Li also talked about several action-oriented activities undertaken by UNCTAD with debtor countries. UNCTAD is currently assisting up to sixty countries in debt management. In particular, it is active in three areas: analytical work, bilateral consensus building, and technical assistance activities. The analytical work includes technical reports such as the Secretary-General's report to the General Assembly on debt sustainability and development and the principles for responsible sovereign borrowing and lending. On consensus building, UNCTAD has organized several meetings and participated in others at international and national levels. Ms. Li argued that the recent developments in the European debt crisis, along with the ruling in New York City court on Argentina's debt, have led many experts to reflect on the need for more orderly debt workout procedures that would allow ex-ante "spelling out of rules and procedures," which would make the mechanisms more efficient, less unpredictable, and less costly. Ms. Li also suggested that UNCTAD's work on consensus building may have helped contribute to the changing perceptions on debt mechanisms.

Ms. Benu Schneider, Senior Economic Affairs Officer, Financing for Development Office, UN-DESA

Ms Schneider reported on the ongoing work carried out by the Financing for Development Office to improve the architecture for sovereign debt restructuring. The Office has organised a number of panel discussions and expert group meetings to garner ideas and proposals, both under the voluntary and statutory approaches, to improve the architecture for debt restructuring. She provided the rationale for improving the architecture for sovereign debt restructuring in that the IMF's tools in dealing with the recent debt crisis were no longer suited to the current structure of the global economy when capital accounts were open, while at the same time restructurings became larger and more complex with more and different creditors. The way forward, she said, would be to find a balance between new lending, restructuring, standstills, and adjustment. In addition, effective debt management policy and responsible borrowing and lending are important tools of crisis prevention.

Going forward, she reported on some of the concrete proposals that emerge from the expert group meetings which include:

(1) A proposal to set up ex ante structures and frameworks for creditor committees to ensure creditors' coordination with oversight and governance structure;

- (2) Proposals for standstills both under the voluntary and statutory approach to provide financial stability and prevent cross-border default and acceleration;
- (3) The need for debtor-in-possession financing by the private sector to complement official resources;
- (4) Setting up an international debt registry which is needed for complete and timely data;
- (5) The need for harmonization of regulatory, accounting, and tax incentives/disincentives with a framework for debt restructuring;
- (6) Three possible structures for a sovereign debt restructuring mechanism:
 - (a) The framework for debt restructuring which is similar to the WTO dispute resolution mechanism in which the IMF or another institution could have the convening power. This proposal has the advantage of combining the voluntary with the statutory approach.
 - (b) A proposal for the creation of a neutral organization, a Sovereign Debt Forum, with broad participation and permanent and neutral staff seconded from debtors, private creditors and multilateral organisations, which could foster timely and orderly restructuring by improving information flows between debtors and creditors, providing a template for negotiations and facilitating a frank discussion of debt sustainability and the feasibility of required efforts.
 - (c) A proposal for a resolvency proceeding in a resolvency court presided by one permanent judge and a limited pool of judges to be appointed when cases arise. The procedures of the resolvency court would resemble the procedures of Chapter 11 bankruptcy procedures.

Interactive discussion

During the discussion the following points were raised:

- The negative impact of the global economic and financial crisis on many developing countries whose economic policies has been threatened by turbulence in global financial markets remains an area of concern. Concerns were also raised about financial sustainability risks in developed countries, calling for measures to address sovereign risks.
- Continued debt distress in some post-HIPC countries remains a concern. Problems in the inclusion of countries, such as Sudan, to the HIPC Initiative were highlighted. Further, external shocks had impacted many countries' abilities to service their debt obligations.
- Concern was raised about the methods used by credit ratings agencies, as they did not always reflect the solvency of the debtor. Standard-setting bodies should reduce their reliance on credit rating agencies and develop objective criteria for assessing credit risks.
- No path to growth could be travelled with debt overhang. Debt restructuring should address countries' "real repayment" capacity.
- Concerns were raised about "vulture fund litigation". A fair, human-centered and development-oriented mechanism to help ensure that Governments fulfill their peoples' aspirations was needed.
- A Debtor Forum was proposed. Another proposal highlighted was to form a standing committee of the private sector and organize a series of round table meetings with the official sector to reach consensus on the way forward.
- Debt has been an important source of financing for sustainable development. Voluntary approaches to debt distress have not worked well in times of crisis. The

next step should be to discuss the “incentive and disincentive structure” so that responsible borrowing and lending could take place, and that high debt burdens did not deter growth.

- Consensus had been reached on the fact there was a problem, there were gaps in the architecture for debt restructuring, and that there is a need to work towards improving the architecture for debt restructuring.

**Keynote Address by Professor Joseph Stiglitz of Columbia University:
“Gaps in legal and institutional structures for debt restructuring”**

Mr. Stiglitz argued that the goal of a bankruptcy regime is to provide for a fair and efficient restructuring that provides a sufficient write-down in debt to allow countries to resume growth. Both the objectives of efficiency and equity dictate that a fresh start for sovereign debtors is needed. The ultimate objective should be to promote economic growth and to protect the economic interests of citizens, who are made to bear the costs of the banking sector and politician’s mistakes.

According to Mr. Stiglitz, the current system does not meet any of these goals: restructurings have not treated all parties fairly, delays and prolonged negotiations have led to the destruction of assets during the restructuring process, and countries generally have not received sufficient write-downs. He argued that existing market-based mechanisms, such as collective action clauses, do not address the full spectrum of gaps and perverse incentives in the system. For example, he suggested that the lack of a fair bankruptcy regime has created incentives that have contributed to excessive lending, poor credit screening, and debt overhangs. Mr. Stiglitz also argued that a restructuring is particularly helpful when a country has a fiscal deficit but a primary surplus (i.e. its tax revenues exceed its spending, excluding interest on outstanding debt), which implies that the only reason the fiscal position is at a loss due to debt servicing. He advised for deep restructurings, as shallow restructurings often leads to further turmoil at a later stage. Given that bankruptcy has large externalities and conflicts of interest among different claimants, Mr. Stiglitz concludes that market solutions by themselves will neither be efficient nor fair. Turning to the example of Argentina, Mr. Stiglitz argued that there is life after debt, and that even though the restructuring was costly, not having restructured the debt would likely have been even more costly.

Keeping in mind that a new wave of restructuring appears in the offing, Mr. Stiglitz argued that discussions on a sovereign debt restructuring mechanism (SDRM) need to be re-opened. He raised the question of what kind of system we should try to work towards, and argued for a World Bankruptcy Organization. The sovereign would initiate a restructuring and propose the terms. Those believing that the proposed restructuring treats them unfairly may submit counterproposals. Ultimately, an arbitration panel would rule on the alternative resolution proposals. Acknowledging that such an organization is a long-term solution, Mr. Stiglitz proposed some short and medium term solutions, such as the imposition of capital controls/exit taxes in the event of crisis, mutual recognition of bankruptcy laws, and an international bankruptcy evaluation/mediation service, which would help evaluate the consequences of different proposed resolutions on different parties.

Panel discussion: The architecture of debt restructuring

Mr. Sergio Chodos, Executive Director, IMF

In his intervention, Mr. Chodos reflected on some of key questions posed by Professor Stiglitz, particularly on why the market structure is not a fit framework for sovereign debt restructuring. In Mr. Chodos' view, market solutions did not work in large part because the diverse and often divergent interests of different creditors. He pointed out the lack of logical common interest and therefore incentive for creditors to align their positions. A hedge fund that bought in the secondary market, for example, was not a lender. It was a claimant and would not behave like a primary buyer or a direct lender, or even like a vulture fund that purchased debt after the default (and then pushed for default). According to Mr. Chodos, any solution to the debt problem has to address the core question of incentive for all type of stakeholders.

Mr. Chodos also addressed what he believes is an over-emphasis on maintaining "market access" when dealing with debt problems and debt restructuring. He said that "we have this mantra that financial markets are the only thing that can save us" and therefore in any restructuring exercise the focus becomes on how the market is going to react. From his perspective, this is not the proper way to address the problem and he advised, rather, to look for a solution that will address the future repayment capacity of the debtor country. He also suggested that any solution should first identify the desired outcome and search for the appropriate institution to attain such an outcome.

Mr. Hans Humes, Chairman & CEO, Greylock Capital Management, LLC

Mr. Humes provided a view on sovereign debt restructuring from the perspective of a creditor. In his view, the big problem was the delay in getting all the parties to the negotiating table. Back in 2001, it was apparent that Argentina's debt was unsustainable, yet for a time both policy makers and creditors were in denial of the problem. Regarding the assessment of the debt problem, he said it is important not just to focus on the debt to GDP ratio in assessing a debt problem, but to pay more attention to the cost of debt servicing to the economy.

Concerning the proposal to set up a SDRM, Mr. Humes opined that conceptually it would address a lot of problems identifiable in the debt restructuring process, but in practice it could be more difficult to implement. He said that since the last attempt to set up a SDRM, the ad hoc approach had been improving and the turnaround time getting shorter. The problem of holdouts that was prevalent in the ad hoc process now, he said, was not just an issue of holdouts by private creditors, but also holdouts by the official sector such as the holdout of bonds issued under UK law held by the official sector in the case of the Greek debt restructuring. He agreed with the objectives of setting up an SDRM but cautioned not to focus on just things that did not work but also focus on the things that are working. In his view, the meetings organized under the UN umbrella were a good way to identify problems and seek consensus.

Ms. Deborah Zandstra, Partner, Sovereign Debt Restructuring Group, Clifford Chance

Ms. Zandstra focused on the issue of standstills during sovereign debt restructuring. One possibility was a standstill under the statutory approach which could be achieved by an amendment of Article VIII 2 (b) of the IMF. Under the contractual approach, English and New York law bonds typically include events of default with some variation. In fact, bond

documents often contain grace periods to address technical or short-term problems, but are not meant to operate either as a standstill period or as a restructuring tool. In short, they do not alter the obligation to pay or provide the sovereign debtor with sufficient time to negotiate with its lender. While standstills in the sovereign context could take on many different forms, Ms. Zandstra pointed to their benefits as providing the sovereign and its creditors with some financial stability in which to decide a restructuring plan. Further, a standstill could prevent cross-default and acceleration of obligations and might diminish uncertainty and contagion in the market.

Elements to consider for inclusion in respect of a voluntary standstill would be among others whether a deferral of interest payments is sufficient or broader cessation of payments is required, waiver of acceleration rights, proposed length of the standstill, and any triggers for termination of standstill. Potential challenges are, inter alia, the danger of spill-over effects, whether creditors would agree to voluntary standstill agreements and contractual mechanisms. Ms. Zandstra then presented mechanics for accepting a standstill and concluded that the severity of the recent Euro crisis indicates that discussions about standstills are crucial, but pointed out that standstills typically come into play after an event of default but may be needed even prior to that event, thus asking how this could be accommodated.

Mr. Lee Buchheit, Partner, Cleary Gottlieb Steen & Hamilton

Mr. Buchheit's presentation focused on holdout creditors in sovereign debt restructuring (SDR). He stated that unless and until there is something like a transnational bankruptcy regime, the sovereign debtor has no ability to command that creditors accept a restructuring proposal, even a shallow one.

In order to increase the likelihood of creditors accepting a sovereign debt restructuring, the architects of the restructuring can try to accommodate individual and regulatory preferences of creditors. Alternatively, creditors may be threatened by the sovereign with the prospect that if they hold out they will not be paid, and will have to avail to litigation. As the sovereign generally holds little assets outside of its jurisdiction, holdout creditors find it notoriously difficult to enforce against the sovereign, even if they have a judgment from court. Mr. Buchheit then outlined a case of Iraq in which the debtor's position was strengthened against seizure of assets for debt payments. This was through the UN Security Council Resolution 1483 of 2003, which, among other things, immunized Iraqi assets from litigation by creditors. He then argued for an amendment of the Treaty Establishing the European Stability Mechanism to immunize within the confines of the Euro zone the assets of a country receiving ESM bailout assistance from attachment by holdout creditors. Lastly, Mr. Buchheit explained that a SDRM, if established, will have to replicate the principal features of corporate bankruptcy procedures to decide whether a restructuring is necessary, allow for automatic stays, and achieve a fair allocation of burden on various creditor groups by a supermajority of creditors.

Mr. James Haley, Executive Director, Inter-American Development Bank

Mr. Haley noted that the global financial system has changed but that the architecture to support it has not changed enough. With closed capital accounts, balance of payments problems were inherently due to current account problems, denoting a flow problem. Adjustment generally took place over a long period of time. Today, with more and more crises emanating from the capital account, the debt problem is increasingly a stock problem,

which has turned into financial sector crises. The resulting burden of adjustment on the debtor is thus much larger and over a shorter period of time. The IMF is not designed to deal with such crisis and in the absence of a rules-based system, it has no other option but to come in with bail in financing and adjustments over short periods. Mr. Haley's proposal was to firstly endow the IMF or another international organization with powers to become a de facto international central bank. Another option was to design a SDRM to promote timely and orderly debt restructuring, which takes into account broader societal claims.

Even though voluntary approaches have been developed within the last decade, they have drawbacks, especially with the respect to the issue of aggregation in collective action clauses. Some of the problems in the voluntary approach were attempted to be resolved with the design of exit consents which created a credible threat of coercion to bring about a debt restructuring. The reasons why it is sensible to explore a more formal approach is that in its absence there are deadweight losses for debtors, creditors and international financial stability. A legal framework of how to deal with SDR would reduce uncertainty at the domestic level. Mr. Haley concluded that the time might be right to continue to explore formal debt restructuring.

Interactive discussion

The participants raised the following points:

- Concern was raised about some multilateral institution programmes that appear to be designed as a “one size fits all”. The IMF and the World Bank were called to give more attention to small and fragile economies and the need for tailored solutions and increased voice for them.
- Concerns were raised about IMF programmes often made in conjunction with debt restructurings, and the scale of austerity often required in these programmes.
- The IMF programmes in the euro zone countries show a decline in allocation to the health sector. Health and well-being of a population should be more of a priority for Governments than paying back a creditor.
- Debt audits could play a useful role but dealing with odious debt was a grey area.
- The lending to Iraq in the Saddam Hussain era represented a clear case of irresponsible lending as the creditors were aware what the money was being used for. The turn of events proved disastrous for the region and the Iraqi people. More emphasis has to be placed on the principles of responsible lending and borrowing.
- Although progress had been made with the voluntary approach, it is clear that more needs to be done. As a first step maybe recognition of creditor committees and disclosure could be embedded in bond contracts.
- The structure of the proposed frameworks should have the ability to return countries to growth and debt sustainability.
- There is merit in supporting the reform of the international architecture for debt restructuring which is dynamic and flexible. This would lower the cost of debt distress and restructuring and provide an orderly predictable process. The IMF's role in assessing the scale of adjustment will remain crucial.
- There is a broad spectrum of proposals already on the table for further discussion and debate: the IMF's SDRM , mediation and arbitration, adopting the WTO kind of dispute resolution mechanism, improving the contractual approach, and setting up a neutral organization, the Sovereign Debt Forum. Further work and consultations were encouraged to find the best way forward.