The Economics of Sovereign Debt Restructuring

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Based on "Fixing Sovereign Debt Restructuring", by M. Guzman and Joseph E. Stiglitz

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Any good framework for sovereign debt restructuring should be conducive to the following objectives:

- Ex-post efficiency

- Ex-ante efficiency (credit assessment, risk-taking)

- Efficiency in the restructuring process

Corollary: The system should solve the "too little, too late" and possibly "too long" syndrome

(and should do more than that)

- The current non-system doesn't work

- Remedies on the table:
  - Improvements within the private contractual approach (ICMA-IMF)
  - UN Principles for sovereign debt restructuring
  - A multinational framework for sovereign debt restructuring (United Nations)

- CAC and Pari Passu

  - Improvements over the old terms

- But not sufficient to solve the current problems

  - It doesn't solve the problem for the existing debt stock

  - Multiple inter-creditor equity problems

  - Coordination problems when debts are issued under multiple jurisdictions, in multiple currencies, and with different maturities

  - It doesn't resolve the problem of inequitable treatment of "implicit creditors"

  - It doesn't solve political economy problems both on the debtor's and creditors' side

  - It can even facilitate strategic defaults

- Full disclosure of SCDSs

- Variants of *champerty* into contracts

- GDP indexed bonds

- Sovereign's right to design macro policy including right to initiate restructuring
- Good faith
- Transparency
- Impartiality
- Equitable treatment of creditors
- Sovereign Immunity
- Legitimacy
- Sustainability
- (Super)-Majority Restructuring

They have not been respected in recent restructurings, which led to inefficient and inequitable outcomes

- 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

1. 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

- Current non-system doesn't achieve the objectives of sovereign debt restructuring

- ICMA-IMF proposal will improve some aspects but will not provide a comprehensive solution

- Space for improving contracts, legal frameworks, and IMF bailout policies

- But with incomplete contracts the private contractual approach will not suffice (and contracts will always be incomplete)

- Calls for a statutory approach that complements the contractual approach

  - A more efficient restructuring process could lead to lower interest rates

- UN principles are a step in the right direction