Domestic bankruptcy frameworks evolved because punishing insolvent debtors with prison was counterproductive — a prisoner cannot repay his debts. Likewise, kicking debtor countries when they’re down only makes their problems worse: Countries in economic free-fall can’t repay their debts, either.

FOREIGN VIEWS

Joseph E Stiglitz and Martin Guzman

A big step forward for sovereign debt

ELECTED TO define the world economic order, the IMF and the World Bank are permanent players in shaping countries’ participation in the world market. But the world’s largest institution, the International Monetary Fund (IMF), and its principal partner, the World Bank, are both lacking a proper legal framework for sovereign debt restructuring.

The extensive discussion in the September meeting of the International Monetary Fund’s Executive Board on the need for a “legal framework for sovereign debt restructuring” reflects the growing recognition that the world has been operating for decades on a legal vacuum.

When a country defaults on its debt, and creditors cannot get their money back, one billion people, the poor and vulnerable, are impacted. This presents a huge challenge for those who work to reduce global poverty.

The current situation is counterproductive for all, and it burdens the world’s most vulnerable countries, the very ones it is supposed to help.

Insolvent but unremorseful

What is needed, therefore, is an international legal framework for sovereign debt restructuring, which would encompass the entire range of forms of sovereign debt, including sovereign bonds, contingent debt, private sector claims, and public-private partnerships.

Too many countries — Argentina, for example — have been victimized by the absence of a robust legal framework to protect them from insolvent debtors.

In September, the United Nations took a big step toward filling the void, approving a set of principles for sovereign-debt restructuring.

The nine precepts — namely, a sovereign’s right to initiate a debt restructur- ing, sovereign immunity, equitable treatment of creditors, (super) majority restructuring, transparency, predictability, legitimacy, sustainability, and good faith in negotiations — form the rudiments of an effective international rule of law.

Recent events underscore the importance of this framework for sovereign debt restructuring.

In the case of Argentina, a US court recently ordered the country to seize about $1 billion from the property of the Argentine government’s holding company in order to pay bondholders. 

In Greece, the absence of an international legal framework was an important reason why its creditors — the troika of the European Commission, the European Central Bank, and the International Mon- etary Fund — could impose policies that inflicted enormous harm.

But some powerful actors would stop well short of establishing an international legal framework.

The International Capital Market Association (ICMA), supported by the IMF and the US Treasury, suggests changing the language of debt contracts.

One precept of such proposals is the implementation of collective action clauses (CACs), which would make restructuring proposals approved by a super majority of creditors binding on all others.

There is the challenge to define FDI’s sustainability characteristics. An international organization or a non-gov- ernmental organization could establish a working group to prepare, in a multi- stakeholder process, an indicative list of FDI sustainability characteristics.

A FDI support program would complement the World Trade Organization (WTO)-led Aid-for-Trade Initiative and the WTO Trade Facilitation Agreement.

An institutional roadmap to sustainable investment

Karl P. Sauvant

FOREIGN VIEWS

TRANSITIONING to a carbon-free world economy and meeting the Sustainable Development Goals by 2030 requires, annually, trillions of dollars. Massive private investment, including foreign direct investment (FDI), has to be mobilized for this purpose.

However, developing countries, especially the least developed countries, simply lack the capacity to compete suc- cessfully in the highly competitive FDI world market.

What is needed, therefore, is an inter- national support program for sustainable investment facilitation. It would focus on practical ways of encouraging sustainable FDI flows to developing countries: commerci- ally viable investment that makes a maximum contribution to the economic, social and environmental development of host countries and takes place in the context of fair governance mechanisms, as defined by host countries and reflected in their incentive programs.

For example, serious questions remain unaddressed by the ICMA proposal about how to resolve conflicts that arise when bonds are issued in different jurisdictions with different legal frameworks. Contract law might work well when there is only one class of bondholders, but when it comes to bonds issued in different jurisdictions and currencies, as it is often the case, the ICMA proposal fails to solve the dif- ficult “aggregation” problem.

Moreover, the ICMA’s proposal promotes collusive behavior among the major financial centers: The only creditors whose votes would count for the activation of CACs would be those who own bonds issued under a restricted set of jurisdictions. And it does nothing to address the severe irreality between formal creditors and implicit ones (namely, the pensioners and workers to whom sovereign debtors also owe obligations) who would have no say in a restructuring proposal.

All six countries that voted against the UN resolution (the US, Canada, Germany, Japan, the UK) have domestic bankruptcy legislation, because they recognize that CACs are not enough. They are not in favor of a domestic rule of law — including provisions to protect weak borrowers from powerful and abusive creditors — at the international level as well.

Perhaps that is because all are leading creditor countries, with no desire to embrace restrictions on their powers.

What’s been missing

Respect for the nine principles approved by the UN is precisely what’s been missing in recent decades.

The 2012 Greek debt restructuring, for example, did not restore sustain- ability, as the desperate need for a new restructuring only three years later demon- strated. And it has become almost the norm to violate the principles of sover- eign immunity and equitable treatment of creditors, evidenced so clearly in the New York court’s decision on Argentine debt. The market for credit default swaps has led to non-transparent processes of debt restructuring that create no incen- tive for parties to bargain in good faith.

The irony is that countries like the US object to an international legal framework because it interferes with their national sovereignty. Yet, the most important principle to which the international community has given its assent is respect for sovereign immunity: There are limits beyond which markets and governments cannot go.

Incumbent governments may be tempted to exchange sovereign immunity for better financing conditions in the short term, but that’s the wrong equation, because the costs that will be paid by their successors. No government should have the right to give up sovereign immunity, just as no person can sell himself into slavery.

Debt restructuring is not a zero-sum game. By helping to define it, determine not just how the pie is divided among formal creditors and between formal and informal claimants, but also the size of the pie.

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Likewise, kicking debtor countries when they’re down only makes their problems worse: Countries in economic free-fall can’t repay their debts, either.

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Karl P. Sauvant is President Senior Fellow at the Colum- bia Center on Sustainable Investment, a joint center of Columbia Law School and the Earth Institute at Columbia University, Shanghai Daily condensed the article.