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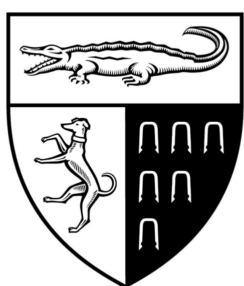

ONLINE

SPECIAL EDITION ON SOVEREIGN DEBT

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Stephanie Blackenburg & Richard Kozul Wright

Guest Editors' Forword
Juan Pablo Bohoslavsky & Matthias Goldmann

An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability
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Legitimacy and Impartiality as Basic Principles for Sovereign Debt Restructuring
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Putting Your Faith in Good Faith: A Principled Strategy for Smoother Debt Workouts
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Preface

Sovereign Debt Restructurings in the Contemporary Global Economy: The UNCTAD Approach

Stephanie Blankenburg* and Richard Kozul-Wright**

This Special Issue on *Principles for Sovereign Debt Restructuring: An Incremental Strategy* brings together core contributions from international legal experts to on-going debates about how best to ensure that sovereign debt can remain a viable financing tool for growth, prosperity and development, in particular in today's challenging global economic environment. This means, in the first place, building a convincing case for what constitutes a sustainable national debt, as well as engaging with legal and policy debates about how best to deal with sovereign debt that clearly has become unsustainable and requires restructuring.

For many years, UNCTAD has taken a proactive and forward-looking stance on the need to confront increasingly pressing issues of sovereign debt crisis prevention and resolution, with a primary but not exclusive focus on developing economies. Some of the contributions to this Special Issue go back to work originally advanced by UNCTAD; other contributions comment on and further develop UNCTAD's work in this area. This is a highly welcome initiative to situate UNCTAD's work and role in this field in wider scholarly contexts and to encourage further productive debate.

In this preface we comment on the growing relevance of UNCTAD's long-standing concern with sovereign debt crisis prevention and resolution in the context of recent trends and events in the global economy, as well as provide a brief overview of UNCTAD's main contributions in these areas and their rationale. We hope this will serve readers of this Special Issue as a useful entry to the manifold important issues raised in the contributions to this Special Issue.

DEBT, DAMN'D DEBT: NEW AND OLD CHALLENGES TO SOVEREIGN DEBT SUSTAINABILITY IN THE CONTEMPORARY GLOBAL ECONOMY

Credit, and by implication debt, is the lifeblood of resource mobilization in modern economies. In the words of J.M. Keynes, "credit is the pavement along which production travels; and the bankers, if they knew their duty, would provide the transport facilities to just the extent that is required in order that the

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productive powers of the community can be employed to full capacity."[1] Debt also is a social and institutional relationship that builds on trust and on shared information, expectations and objectives between debtors and creditors. If the 'bankers' do *not* know their duty – if they overextend the 'transport facilities' for the sake of reckless quick profit, or if they curtail them unnecessarily for fear of longer-term uncertainties – things can quickly go wrong. Instead of the 'productive powers of the community' being fully employed, debtors and creditors alike can end up in a vicious circle of strangulated economic activity and growing mountains of debt turned toxic.

While this applies to both public and private debt, public or sovereign debt is inherently different from private debt, in the same way in which a private sector bank is different from a central bank: Only the latter can act as a lender of last resort when a crisis threatens to affect the welfare of all citizens. Similarly, while it is broadly recognized that sovereign borrowing is often required to facilitate the financing of long-term investment programs that are too expensive and risky to attract sufficient private sector finance, it is also the only instrument that can prevent unsustainable private sector liabilities in decentralized market economies from turning into a deflationary debt spiral. By implication, how sovereign debt is managed, in both the short and longer-term, *directly* affects the wider welfare and 'the productive powers of the community' as a whole. This includes its restructuring, if and when this becomes an obvious necessity.

Concerns about the sustainability of sovereign debt are again on the rise, this time focusing on emerging and developing economies. For many observers, the 'third wave' of a debt saga, that began in 2007 in the US and subsequently engulfed European economies, is only a matter of time[2]. At the global level, growth remains driven by an unhealthy dependence on debt. During the years of the (inappropriately termed) 'great moderation' (1985–2005), global debt levels rose from around $21 trillion in 1984 to $87 trillion by 2000, and to a staggering $142 trillion at the onset of the global financial crisis. Since 2008, another $57 trillion has been piled on top. This growing mountain of debt, has had both public and private components, but in both respects its accumulation has been driven by short-term expediency: It has not provided the 'transport facilities' required to ensure full use of productive resources and powers, instead merely propping up an otherwise stagnant and crumbling world economy.

Following several years of counterproductive austerity programs in Europe, haphazard and insufficient fiscal expansion in the US and an over-reliance by both on 'unconventional' but largely ineffective monetary expansion (aka quantitative easing), emerging and developing countries are now paying the price for the inevitable slowdown of already sluggish global growth in trade and real investment. The current downturn of the latest

1. JOHN MAYNARD KEYNES, A TREATISE ON MONEY, vol. II, *The Applied Theory of Money* 219-220 (1930).

2. See, e.g., *The never-ending story*, THE ECONOMIST (Nov. 14, 2015). http://www.economist.com/news/leaders/21678220-first-america-then-europe-now-debt-crisis-has-reached-emerging-markets-never-ending.

commodity super-cycle – itself at least in part a consequence of and deepened by – stagnant aggregate demand worldwide, has meant that highly commodity-dependent developing economies have been hit particularly hard.

But the sheer size and pace of global indebtedness is only the manifestation of a deeper malaise that affects sovereign debt. This is the unprecedented expansion, over the past three or so decades, of private over public control of the issuance of debt or credit, what is more commonly referred to as 'financial deregulation'. Financial deregulation was part and parcel of the return to free-market policies since the end of the post-WWII global economic order, the Bretton Woods System, in the 1970s. Yet, it quickly took on a life of its own, not unlike a malicious virus. Freed of the shackles of public 'safety' controls, the financial industry grew beyond all (or most) expectations, endlessly mutating to add new financial instruments to its toolbox for short-term speculative profit-making, and forever expanding its lobbying powers to fend off any efforts at reregulation, in a mutually reinforcing spiral of expansion, growing lobbying powers, further deregulation and further expansion. This, in turn, is often referred to as 'financialization'.

In the process, many advanced economy governments became the handmaidens of a financial industry that 'globalized' faster than they did. By now, many developing and emerging economies are being caught up in the inevitable fall-out: At stake is not simply sovereign debt that has grown too fast relative to their productive powers, although this, too, is the case for some such economies. Of equal or higher concern is the manner in which much of this debt has been contracted: With their access to multilateral loans and grants dwindling fast, many developing economies have undergone a rapid and often premature integration into deregulated international financial markets, before they had the chance and time to engage properly with 'financial deepening' in their own backyards. As a result, much of sovereign debt has been issued in domestic bond markets dominated by large foreign bondholders and in international financial markets, awash with cheap credit but also with highly complex contractual arrangements, usually under advanced economies' laws and jurisdiction. In addition, public balance sheets in these economies are riddled with explicit and implicit contingent liabilities, ranging from formal guarantees of privately contracted debt, often in foreign currency, to the *de facto* obligation to bail out the private sector in the case of an economy-wide financial crisis.

In this brave new world of advanced 'financialization', in which central banks become marginalized as the 'bankers of government' and public debt is increasingly contracted from transnational financial institutions operating in a regulatory vacuum, conventional lines of demarcation between sovereign and private debt are hard to maintain in practice. At the extreme end of market-driven profiteering on the back of sovereign debt, the potentially disastrous consequences for sovereigns of this kind of 'financial integration' have become most obvious in the (in)famous case of Argentina v. NML Capital and three other US-based hedge funds.[3] Following a protracted legal battle fought under

3. For detail see Martin Guzman and Joseph Stiglitz, *How Hedge Funds Held Argentina For*

New York law, these four vulture funds secured profits of up to 1180% from having held out for repayment at full face value of Argentine debt they originally bought at steep discounts. The Argentine legislators recently ratified this deal under pressure to re-open Argentina's access to international capital markets and, in particular, to ensure that an injunction, issued by the New York district judge in charge of this trial, could be lifted. This injunction made any payment by Argentina to its cooperative creditors conditional on its first paying the holdouts in full, thereby ensuring that Argentina would remain excluded from international capital markets until it had ceded to the demands of the four vulture funds.

Beyond the high price paid by the Argentine people to a handful of financial speculators with the lobbying power to leverage legal argument in their favor, this deal sets an unfortunate precedent for all private creditors to nations to hold these for ransom in future. After all, what is the point of being co-operative, when holdouts get their way at much higher rates of profit? Importantly, the basis for the 'vulture' type of financial speculation is not even the 'conventional' approach to such speculation – that of beating the markets and of taking risks on bets about the future economic performance of an economy or a sector - but rather, and from the outset, that of exploiting existing legislation and the lack of a multilateral framework for sovereign debt restructurings for exorbitant profit.

In such conditions, it is difficult to see how credit can provide the 'transport facilities' required for the full use of the productive capacities of a community. Or how public debt can serve its core purposes of smoothing over short-term fluctuations in private economic activity and of ensuring that initially high-risk and high-cost but transformational real investment is financed appropriately, in advanced and developing economies alike.

UNCTAD ON SOVEREIGN LENDING, BORROWING AND DEBT RESTRUCTURING

UNCTAD has been an active advocate of orderly workout procedures for sovereign debt since the late 1970s when, with the rise of free-market policies and a shift to monetarism in advanced economies, problems of sovereign debt sustainability became a major concern again, at the time in particular in Latin America. In 1977, UNCTAD called for explicit principles for debt rescheduling and in 1980, its Governing Body endorsed Detailed Features for Future Operations Relating to the Debt Problems of Interested Developing Countries. Throughout the past three decades, UNCTAD has continued to highlight the need for a coordinated international effort to establish fair and efficient ground rules for sovereign debt restructuring, in its flagship annual Trade and Development Reports[4] and in numerous reports to the UN General Assembly on external debt sustainability and development since 2001.

Ransom, NEW YORK TIMES (April 1, 2016), http://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html?_r=0; and Mario Blejer, *Argentina's deal with the holdouts is a mixed blessing*, FIN. TIMES (March 31, 2016), http://www.ft.com/cms/s/0/db6779d6-f729-11e5-96db-fc683b5e52db.html.

4. See, e.g., the Trade and Development Reports of 1986, 1998, 2001, 2009 and 2015, *available at* http://unctad.org/en/Pages/Publications/TradeandDevelopmentReport.aspx.

Existing processes to deal with sovereign debt crises and their resolution are fragmented, slow and often result in unfair burden sharing and high economic, social and political costs for the sovereign debtor.[5] Incentives, for debtors and creditors alike, are such that delaying any official declaration of insolvency as opposed to illiquidity is paramount: Debtor states will be reluctant to declare themselves insolvent for fear of triggering a financial crisis at home. Cooperative creditors will also have an interest to avoid any such havoc in order to preserve the market value of their assets. The collectively sub-optimal outcome is "too little, too late". But equally importantly, once sovereign debt restructurings do get under way, a debtor has to negotiate separately with different types of creditors (bilateral, multilateral, private) for different types of debt contracts (bonds, loans, etc.). Different courts will have different interpretations of the same contractual clause and can impose a wide array of rulings, as evidenced in the case of Argentina vs NML Capital and other vulture funds.

In view of this unsatisfactory situation, UNCTAD has argued that orderly workout procedures for sovereign debt should meet two objectives. On the one hand, they should help prevent financial meltdown in countries facing difficulties servicing their external obligations, which often results in a loss of market confidence, currency collapse and drastic interest rates hikes, inflicting serious damage on public and private balance sheets and leading to large losses in output and employment and a sharp increase in poverty. On the other hand, they should provide mechanisms to facilitate an equitable restructuring of debt that can no longer be serviced according to the original contract. Although, in the wake of the debt crises of the early 1980s, UNCTAD insisted that meeting these goals would be best served by fully fledged international bankruptcy procedures. there was an understanding that behind the institutional and judicial challenges this implied, moving forward would depend on taking a few basic steps:

(a) A temporary standstill, whether debt is public or private, and regardless of whether the servicing difficulties are due to solvency or liquidity problems (a distinction which is not always clear-cut). In order to avoid conflicts of interest, the standstill should be decided unilaterally by the debtor country and sanctioned by an independent panel, rather than by the IMF, since the countries affected are among the shareholders of the Fund, which is itself also a creditor. Sanction should provide an automatic stay on creditor litigation.

(b) Standstills should be accompanied by exchange controls, including the suspension of convertibility for foreign currency deposits and other assets held by residents as well as non-residents.

(c) Provision should be made for debtor-in-possession financing, automatically granting seniority status to debt contracted after the imposition of the standstill. The IMF should lend into arrears for financing imports and other vital current account transactions.

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5. UNCTAD. *Trade and Development Report: Making the international financial architecture work for development* 119 et seq. (2015), http://unctad.org/en/PublicationsLibrary/tdr2015_en.pdf.

(d) Debt restructuring including rollovers and write-offs should take place based on negotiations between the debtor and creditors,.

This core position has been informed by UNCTAD's ongoing work on the international monetary and financial system, as this has evolved, its impact on global economic imbalances and on developing economies' prospects for successful structural transformation, as well as by UNCTAD's proposals for substantive wider reforms of this system.[6]

With the advent of the global financial crisis in 2007/08, UNCTAD's long-standing concern with sovereign debt crisis prevention and resolution, in particular, took on a new and obvious urgency. In response, UNCTAD established a more detailed set of 15 Principles on Promoting Responsible Sovereign Lending and Borrowing (PRSLB) between 2009 and 2012.[7] These were the result of an inclusive and transparent multi-stakeholder process including governments, civil society organization, academia, the private sector, observers from international financial institutions (IFIs) and the Paris Club Secretariat. The PRSLB focus on sovereign debt crisis prevention and specify key responsibilities of lenders and borrowers, including due diligence, fiduciary duties, proper approval, transparency and disclosure, alongside alternatives for sovereign debt restructuring. In view of the heterogeneity of national conditions, these principles do not include specific thresholds or quantitative targets. However, they offer economic, legal and ethical guidelines for sovereign lending and borrowing. Their adoption has been encouraged by the UN General Assembly[8] and they are noted in the Addis Ababa Action Agenda of 2015.[9]

In April 2015, UNCTAD published a Roadmap and Guide on Sovereign Debt Workouts (Roadmap, for short).[10] By then, the need to re-focus on efficient and fair frameworks for sovereign debt resolution had become very clear and urgent. Not only had the European Monetary Union been embroiled in protracted attempts to negotiate a politically and economically sustainable outcome to the Greek debt crisis (as well as public finance crises elsewhere in the EMU), but Argentina had also entered into legal dispute with uncooperative holdouts on some of its sovereign debt.

The Roadmap draws together much of the legal and economic work UNCTAD developed and advanced over the years in this area. In particular, it appeals to

five general legal principles – legitimacy, impartiality, transparency, good faith and sustainability – that provide the foundation and interpretative legal framework for a step-by-step guide to a more constructive, fairer and more efficient sovereign debt workout procedure, covering all stages from the

6. *Supra* note 4.

7. UNCTAD, *Principles on Promoting Responsible Sovereign Lending and Borrowing* (2012), http://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf.

8. G.A. Res. 65/144 (Dec. 20, 2010).

9. United Nations, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development*, para. 97 (2015), http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

10. UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (2015), http://unctad.org/en/Pages/GDS/Sovereign-Debt-Portal/Sovereign-Lending-and-Borrowing.aspx.

decision to restructure to preparing negotiations, the negotiations themselves and post-restructuring issues.

The five general principles of law to guide the practice of sovereign debt restructurings as detailed in the Roadmap have, in the meanwhile, been included in a resolution on Basic Principles for Sovereign Debt Restructuring Processes, adopted by the UN General Assembly in September 2015.[11] Some of the contributions to this Special Issue, earlier versions of which directly contributed to some of UNCTAD's work on sovereign debt crisis prevention and resolution, provide detailed legal argument on the potential, validity and relevance of some of these principles. Others, as mentioned, further develop and discuss UNCTAD's work and initiatives in this respect.

If and how the UN General Assembly and its member states will take forward its resolution on Basic Principles for Sovereign Debt Restructuring Processes remains to be seen at the time of writing. As its title suggests, this Special Issue advocates an incremental approach to sovereign debt restructurings, largely in recognition of the political realities of opposition to a fully-fledged binding multilateral framework for sovereign debt resolution, in particular by advanced economies that are home to leading financial centers. This incremental strategy welcomes some advances in market-based contractual tools, insofar as these help to facilitate sovereign debt sustainability and—to some extent—implement the majority rule. At its heart, however, is precisely a set of legal principles—such as those proposed in the Roadmap though of course not limited to these—that can be used to gradually influence legal and policy practice, both nationally as well as internationally, to promote sovereign debt sustainability.

UNCTAD fully supports this approach as the most constructive and sustainable way forward under current circumstances. This should, however, not distract from the fact that a multilateral legal framework remains the only truly effective and fair—since the only truly collective—solution for sovereign debt restructuring processes.

11. G.A. Res. 69/319 (Sept. 29, 2015).

Guest Editors' Foreword

The present special issue is a cooperation of the *Yale Journal of International Law* and the United Nations Conference on Trade and Development (UNCTAD). It emerged from UNCTAD's work on sovereign debt workouts, specifically from its Working Group on a Sovereign Debt Workout Mechanism (2013 to 2015). Both editors were involved in this working group; Juan Pablo Bohoslavsky as a staff member of UNCTAD and Matthias Goldmann as an external expert. The working group developed a Roadmap and Guide for Sovereign Debt Workouts, published in 2015.[1] It proposes an incremental approach to sovereign debt workouts that relies on the continuous, progressive development of sovereign debt restructuring practice. This work has inspired the adoption of Basic Principles for Sovereign Debt Restructuring by the United Nations General Assembly in September 2015.[2]

The special issue assembles papers that elaborate, reflect on, and critically scrutinize the incremental approach to sovereign debt restructuring. The foreword by UNCTAD's Stephanie Blankenburg and Richard Kozul-Wright explains the political and economic rationale behind this approach and how it was inspired by the work that UNCTAD has undertaken in this field for decades. The paper by Juan Pablo Bohoslavsky and Matthias Goldmann sets out the legal foundations of the incremental approach. As the political momentum that would be necessary to adopt an international treaty governing sovereign debt workouts is currently lacking, the incremental approach explores the possibility of further developing current practice in line with legal principles that have emerged from progressive developments in debt restructuring practice in reaction to the crises of the last decades.

Key among them is the principle of sovereign debt sustainability. Debt sustainability is a global concern today. This is evidenced by significant institutional, procedural and substantive innovations in the way in which sovereign debt is treated. Among them is the generalized conviction that debt sustainability cannot come at the expense of human rights enjoyment. The rise in holdout litigation does not contradict this finding, as it has been countered by a strong policy response. The incremental approach is not only unique because it overcomes the binary structure of a debate juxtaposing statutory, institutional and contractual, market-based approaches to improve the current debt restructuring framework. Rather, the incremental approach puts law and legal theory right at the center of the debate about sovereign debt that in the last decades has been dominated by economic thinking. It thereby claims that markets, including markets for sovereign debt, must be embedded in other social fields and therefore require regulation. The incremental approach is thus opposed to the idea of markets as spontaneous orders. However, given that our

1. UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (2015), http://unctad.org/en/Pages/GDS/Sovereign-Debt-Portal/Sovereign-Lending-and-Borrowing.aspx.

2. G.A. Res. 69/319 (Sept. 29, 2015).

knowledge is limited, market regulation that proceeds continuously and in small steps does not need to be less successful in its effort to avoid crises and solve collective action problems than grand proposals for institutional design.

Hence, the incremental approach does not imply that there is no need for further reform. Rather, reform is a continuous process. Things will not take a turn for the better without intervention. In a meticulous autopsy of the recent Argentinean, Greek, and Ukrainian debt crises, Anna Gelpern's contribution, carves out the need for reform and develops policy proposals to that end.

A number of contributions analyse the potential of the incremental approach by exploring improvements that might be made in current practice in line with specific legal principles. Odette Lienau argues that international debt deals need to be legitimate. This presupposes, among other things, a high level of acceptance of the legal framework of debt restructuring processes, the inclusion of relevant stakeholders in the negotiations, and a set of accepted substantive standards. The impartiality of institutions charged with the debt sustainability analysis or dispute resolution is also crucial. Matthias Goldmann explores the potential of good faith—a well-established general principle of law—to guide debt resolution negotiations. He argues that debtor states and creditors are under a good faith duty to enter into negotiations in case of a crisis, and that good faith further prevents the arbitrary exercise of voting rights, as well as abusive holdout litigation. Michael Riegner studies the intricate issue of the indicators used for debt sustainability analyses. What appears to be a very technical issue at first sight turns out to be highly political. He therefore holds that the selection and application of indicators needs to respect principles like sustainability, transparency, ownership, as well as human rights and social protection.

Two further articles are devoted to the issue of human rights. Juan Pablo Bohoslavsky argues that economic inequality is both a result of, and contributor to, economic crises. A vicious spiral involving economic inequality and financial crises that puts human rights at great risk. Debt management and debt restructuring practices therefore need to take inequality into account. Daniel Bradlow proposes a mechanism for holding private creditors accountable for human rights violations in the context of debt restructurings. He analyses how various international soft law instruments, especially the United Nations' Guiding Principles on Business and Human Rights, might contribute to improving the practice of sovereign debt restructuring.

The special issue concludes with a sobering analysis of the institutional framework by Jan Klabbers. He offers an explanation of why there is no international organization for the resolution of sovereign debt crises. International organizations usually draw their legitimacy and appeal from their functional, supposedly apolitical character. The distributive effects of sovereign debt restructuring make a functional justification of a hypothetical international restructuring organization less credible. In his view, it therefore seems unlikely that an international institution will be charged with the task of sovereign debt restructuring, as their democratic legitimacy is notoriously under-developed.

The guest editors would like to warmly thank the Volume 41 editorial team of the *Yale Journal of International Law*, especially the editors-in-chief,

Britta Redwood and Jayoung Jeon, and the editors in charge of the special issue, Daniel Hessel and Tasnim Motala. We are deeply indebted to them for their extraordinary and hard work on the articles. The special issue would not be the same without their extremely helpful and critical readership and editorial work. We are also grateful to UNCTAD for lending its support to this special issue, its cooperation in the process of its creation, and its permission to publish some of the research papers that inspired the work of the UNCTAD Working Group. Last but not least, we thank the authors for their time and ideas.

This special issue is intended to present a space for dissemination and discussion of ideas related to sovereign debt. The *Yale Journal of International Law* has hosted the forum to provide a venue for this important discussion at a time in which policy-makers, academics and citizens are grappling with these issues first-hand. While the Journal has provided some editorial insight, the Articles contained herein represent the stylistic proclivities of the authors, and diligence surrounding the accuracy of the sources they rely upon has been entrusted to them. The special issue reflects the timeliness and importance of sovereign debt sustainability and the *Yale Journal of International Law* seeks primarily, with this special issue, to provide a discussion space for the authors in these pages and a resource for those around the world interested in their exchange.

Viedma and London, May 2016
Juan Pablo Bohoslavsky and Matthias Goldmann

An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law

Juan Pablo Bohoslavsky & Matthias Goldmann*

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I. INTRODUCTION: LOOKING BEYOND STATUTORY AND CONTRACTUAL APPROACHES

Current sovereign debt restructuring practice does not always provide timely and effective solutions for troubled states. Restructuring is tedious and causes economic hardship; this makes it unattractive for leaders of debtor states with increasingly unsustainable debt burdens to enter the process in time.[1] Once

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1. From the rich literature: Lee C. Buchheit, et al., *Revisiting Sovereign Bankruptcy* (Brookings Committee on International Economic Policy and Reform, 2013), *available at* http://www.brookings.edu/~/media/research/files/reports/2013/10/sovereign-

states decide to restructure, overly optimistic growth expectations might lead to inadequate restructuring terms.[2] Once the debtor state makes an exchange offer to its bondholders, holdout strategies might lead to further delays.[3]

To improve this economically and politically unsatisfactory situation, two types of solutions dominate the discussion: contractual proposals (such as improved aggregated Collective Actions Clauses – CACs)[4] and statutory proposals (e.g., a treaty establishing an international bankruptcy court).[5] The relative practical advantages and disadvantages of each set of proposals are the subject of a rich debate. What is less often discussed is whether they satisfy the normative demands towards sovereign debt restructuring that emanate from the international legal order and its practices. The goal of this Article is therefore to reconstruct the normative implications of current sovereign debt restructuring practice and measure contractual and statutory proposals in their light.

The normative implications of current sovereign debt restructuring practice find expression in principles of international law (reflecting the main structures of the international legal order), to be distinguished from general principles of law (reflecting overlapping consensus among domestic legal orders). We explain this difference in Section II.

In Section III we argue that changes in sovereign debt restructuring practices over the last decades reflect an increasing recognition of sovereign debt sustainability as a principle of public international law. This principle expresses the now widely shared conviction that states need healthy financial conditions for economic development, as well as the provision of welfare. It therefore also implies concern for the protection of human rights in sovereign debt crises, including of internationally guaranteed economic, social and cultural rights. We track down the emergence of this principle in the practice of sovereign debt restructuring. While a private law paradigm prevailed up to the end of the First World War that left the resolution of sovereign debt crises to unregulated, *ad-hoc* negotiations between debtor states and their creditors, first traces of the recognition of sovereign debt sustainability as a public interest can be found in the aftermath of the First World War. They coincided with institutional arrangements that were vertical rather than horizontal, reflecting an emerging public law regime, This regime was consolidated after the demise of

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bankruptcy/ciepr_2013_revisitingsovereignbankruptcyreport.pdf; Christoph Trebesch, *Delays in Sovereign Debt Restructurings* (working paper, 2010), *available at* https://sites.google.com/site/christophtrebesch/research/Trebesch-RestructuringDelays.pdf?attredirects=0.

2. Olivier Blanchard & Daniel Leigh, *Growth Forecast Errors and Fiscal Multipliers* (IMF Working Paper WP/13/1, 2013).

3. Julian Schumacher, et al., *Sovereign Defaults in Court* (SSRN working paper, 2014), *available at* http://ssrn.com/abstract=2189997.

4. E.g. International Capital Markets Association, *Standard Aggregated Collective Action Clauses ("CACs") for the Terms and Conditions of Sovereign Notes* (2014), *available at* http://www.icmagroup.org/resources/Sovereign-Debt-Information.

5. E.g. ANNE O. KRUEGER, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING (2002); José A. Ocampo, *A Brief History of Sovereign Debt Resolution and a Proposal for a Mutilateral Instrument*, *in* TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 189 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds., 2016); comprehensive overview in Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001*, 49 IMF STAFF PAPERS 470 (2002).

the Bretton Woods system in the early 1970s and the ensuing debt crises that have afflicted the developing world since then. In the course of this development, sovereign debt sustainability gained recognition as the objective of international debt restructuring efforts. Thus, sovereign debt restructurings are not an issue of concern only for the debtor state and its creditors, but for the entire international community.

Subsequently, Section IV explores the challenge to sovereign debt sustainability constituted by the rise in holdout litigation, a development that has serious legal and factual consequences for debt sustainability. Nevertheless, in reaction to this development, a wide array of stakeholders has strongly rejected holdout litigation and taken measures to prevent it, thereby confirming the principle of sovereign debt sustainability.

Section V assesses current proposals by this standard. As valuable as contractual proposals are from a practical standpoint, taking them as the sole response to debt crises appears normatively unsatisfactory. Sovereign debt sustainability as a global concern implies that sovereign debt restructurings cannot depend on the mercy of the creditors alone. By contrast, statutory proposals would satisfy this requirement. But for the time being, they seem to be politically unavailable. We therefore propose a third avenue: an incremental approach. It complements current practice, including contractual approaches, with a set of legal principles, both principles of international law and general principles of law, with the principle of sovereign debt sustainability as the normative center. They should help remedy the shortcomings of current practice. Section IV concludes.

II. Principles in International Law

We understand principles in international law to be abstract, general norms, which express an important structural element of the present international legal order. Broadly speaking, principles in international law can take two forms. First, there are general principles of law, which are original sources of international law derived from domestic law.[6] Although general principles of law play an important role for the incremental build-up of a sovereign debt restructuring mechanism, this Article concentrates instead on the second, less widely known form of principles: principles *of* public international law.[7] Unlike general principles of law, principles of international law do not have a basis in domestic law. Rather, they reflect the main structures of the international legal order.[8] At first sight, the international legal order is a chaotic, amorphous arrangement consisting of myriad rules and practices with different normative status, ranging from treaty law to soft law, which often

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6. Cf. Art. 38(1)(c), Statute of the International Court of Justice.

7. For a focus on general principles, see Matthias Goldmann, *Putting your Faith in Good Faith: A Principled Strategy against Holdouts in Sovereign Debt Workouts*, 41 YALE J. INT'L L. ONLINE (2016), in this special issue.

8. WOLFGANG G. FRIEDMANN, THE CHANGING STRUCTURE OF INTERNATIONAL LAW 196 et seq. (1964); RÜDIGER WOLFRUM, *General International Law (Principles, Rules, and Standards), in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW ¶ et seq. (Rüdiger Wolfrum ed., 2010); Matthias Goldmann, *Principles in International Law as Rational Reconstructions. A Taxonomy* (working paper, 2013), *available at* http://ssrn.com/abstract=2442027.

appear incomplete and contradictory.[9] Like in any legal order,[10] principles give structure to this amorphous arrangement, ensuring consistency and providing orientation to those applying the law. It is the foremost task of legal practice and scholarship to make sense of this chaos and create a fairly consistent order by identifying and, where possible, codifying principles.[11]

Of course, the existence of principles of public international law presupposes that one understands international law as an order, albeit a fragmented one that does not emanate from one centralized power, rather than as inherently chaotic and incomplete. Today, one cannot presume that public international law is not an order.[12] Its development since the Second World War has given rise to the presumption that the rules of international law do not contradict each other[13] and form a legal order that is by and large coherent.[14] Principles are the backbone of that order. They ensure consistency in the application of specific international legal rules and serve the interpretation and further development of the law.[15] Moreover, as any seasoned lawyer can attest, even legal orders that emanate from one central power are often no less chaotic and fragmented than international law as they result from political compromises made by different people at different times.[16]

The formation of principles of public international law thus requires a constructive, interpretative effort. They emerge as abstractions from the rules and practice of international law. One may establish a principle by showing that practice follows a fairly consistent normative pattern in a certain field of international law, which is consistent with other rules and principles of international law. This implies that practice will hardly ever follow a principle to the fullest extent. Rather, establishing a principle implies almost by definition that there are certain specific rules that deviate from the principle, as long as the principle prevails. Principles might also reflect a trend or a tendency in practice that is not yet fully prevailing. In that case, one might speak of an emerging principle.[17]

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9. *Id*.

10. Seminal: RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 22 (1977); JÜRGEN HABERMAS, BETWEEN FACTS AND NORMS ch. 5.1.3 and 5.2.1 (Repr. ed. 2008).

11. This has been called "doctrinal constructivism." *See* Armin von Bogdandy, *The Past and Promise of Doctrinal Constructivism: A Strategy for Responding to the Challenges Facing Constitutional Scholarship in Europe*, 7 INT'L J. CONST. L. 364 (2009).

12. Cf, by contrast, the Case of the S.S. "Lotus" (France v. Turkey), 1927 P.C.I.J. (ser. A/B) No. 9, at 16-7 (Sept. 7), which puts "principles of international law" on a par with contractual or customary obligations.

13. Right of Passage over Indian Territory (Portugal v. India), 1957 I.C.J. 142 (Nov. 26).

14. A first-rate example for this approach is the understanding of jurisdiction in Prosecutor v. Tadic, Case No. IT-94-1-I, Decision on Defence Motion for Interlocutory Appeal on Jurisdiction (Int'l Crim. Trib. For the Former Yugoslavia Oct. 2, 1995).

15. Koskenniemi calls them "descriptive principles". *See* Martti Koskenniemi, *General Principles: Reflexions on Constructivist thinking in International Law*, *in* SOURCES OF INTERNATIONAL LAW 365-6 (Martti Koskenniemi ed. 2000). Herdegen prefers calling them "values", see Matthias Herdegen, *Interpretation in International Law*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW ¶ 64 (Rüdiger Wolfrum ed. 2010). *See also* Samantha Besson, *General Principles in International Law – Whose Principles?*, *in* PRINCIPLES IN EUROPEAN LAW 48-51 (Samantha Besson & Pascal Pichonnaz eds., 2011).

16. *Cf. supra* note 10 — both Dworkin and Habermas developed their theories with respect to domestic law.

17. On the formation and taxonomy of principles, see Matthias Goldmann, *On the*

III. THE EMERGENCE OF SOVEREIGN DEBT SUSTAINABILITY AS PRINCIPLE OF PUBLIC INTERNATIONAL LAW

This Section tracks the emergence of debt sustainability as a principle in international law. While international legal practice had long turned a blind eye to issues of debt sustainability, the period from the end of the First World War to the end of the Bretton Woods system marks signs of a paradigm change. But it was only after the end of the Cold War that sovereign debt sustainability came to be broadly recognized in the practice of international law. As will be explained in the following, the concept of sovereign debt sustainability implicates a concern for economic development as well as for human rights.

A. Before the End of WWI: The Prevalence of the Private Law Paradigm

Since the formation of statehood in Europe during early modernity, states have assumed domestic and external debt[18] in order to finance their activities. Before 1800, this led to occasional and sometimes even serial sovereign defaults.[19] But it was only in the 19th century that the volume of sovereign debt and the number of defaults skyrocketed.[20] This period marked the beginning of the development of international sovereign bond markets.[21] Newly independent states — particularly those in Latin America and later Japan, Central European, and North African states — took out loans from banks located in the United States, Great Britain, and a few other Western European countries like Switzerland.[22] This fueled several cycles of credit expansion and sovereign default in various countries. Sometimes this resulted from unstable political development and wars of independence, and sometimes in reaction to economic development that turned out to be slower than the providers of highly mobile capital had wished.[23]

Throughout that period, the international legal order was dominated by the idea of sovereign equality.[24] Hence, debt restructurings were a matter to be dealt between the debtor and the creditor only.[25] This is what we call the private law paradigm. It rests on the idea of a relative equality of arms. On the

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Comparative Foundations of Principles in International Law: The Move Towards Rules and Transparency in Fiscal Policy as Examples, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW 113 (Carlos Esposito et al. eds., 2013).

18. The terms domestic and external debt refer to the legal regime governing the debt instrument. *See* Ugo Panizza, *Domestic and External Debt in Developing Countries* (UNCTAD Working Paper, 2008).

19. CARMEN M. REINHART & KENNETH S. ROGOFF, THIS TIME IS DIFFERENT. EIGHT CENTURIES OF FINANCIAL FOLLY 87 (2009).

20. *Id.,* at 90.

21. Barry Eichengreen & Richard Portes, *Debt and default in the 1930s: Causes and consequences* 30 EUROPEAN ECONOMIC REVIEW 599, 601-2 (1986); HORST FELDMANN, INTERNATIONALE UMSCHULDUNGEN IM 19. UND 20. JAHRHUNDERT. EINE ANALYSE IHRER URSACHEN, TECHNIKEN UND GRUNDPRINZIPIEN 20 et seq. (1991).

22. *Id*.

23. The Baring crisis of 1890 provides a textbook example of such crises. *See* Kris James Mitchener & Marc D. Weidenmier, *The Baring Crisis and the Great Latin American Meltdown of the 1890s*, 68 JOURNAL OF ECONOMIC HISTORY 462 (2008).

24. S.S. Lotus case (France v. Turkey), 1927 PCIJ (Ser. A) No. 10.

25. Feldmann, *supra* note 21, 200 et seq., 368 et seq.

one hand, states could repudiate their debt and remain protected against foreign law enforcement authorities by their sovereign immunities. On the other hand, creditors could capitalize on the desire of debtor states to regain access to credit markets. Even if the debt had been issued in the debtor state's currency, currency devaluation was not an option since debt instruments frequently included gold clauses, obliging the debtor state to make payments in gold or the equivalent thereof.[26] This delicate balance was often threatened in the one or the other way, triggering government action to reinstate it. On the one hand, creditors for a long time lacked organizations for their effective coordination.[27] This led to the formation of the British Corporation of Foreign Bondholders and later the Foreign Bondholders Protective Council.[28] Even though the American and British governments had midwifed these entities, they did so only to establish an equality of arms, not to actively enforce claims of their nationals.[29] On the other hand, in a few cases, governments of creditors exercised "gunboat diplomacy" in order to corroborate the claims of their nationals.[30] This gave rise to the Drago-Porter Convention of 1907, which established the universal principle that states may not use force in order to collect claims arising from sovereign debt of the attacked state held by their nationals.[31] As these developments demonstrate, crisis resolution was not always swift and smooth. But reform proposals aimed to reinstate an equality of arms between the parties, in accordance with the private law paradigm.[32] Debt restructurings were hardly seen as problems requiring the intervention of international institutions representing some form of common global interest.

B. Before the End of Bretton Woods: A Public Law Regime in the Making

The situation changed slightly after the First World War. Sovereign debt issues acquired a new dynamic, as Europe's war-ridden economies, as well as China and other states, required funds for reconstruction and development, which they mainly found in the United States.[33] The activities of the League of Nations in relation to sovereign debt issues constituted a decisive step forward and a sign of a changing perception of sovereign debt issues in international legal practice. The League made the prevention and resolution of debt crises an

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26. Feldmann, *supra* note 21, 20 et seq.

27. Eichengreen & Portes, *supra* note 22, 621-22.

28. Feldmann, *supra* note 21, 261 et seq.; Michael R. Adamson, *The Failure of the Foreign Bondholders Protective Council Experiment, 1934-1940*, 76 BUSINESS HISTORY REVIEW 479 (2002).

29. Eichengreen & Portes, *supra* note 22, 619; Feldmann, *supra* note 21, 30-1, 100-1.

30. A prominent example is the blockade of Venezuelan ports in 1902 by Great Britain, Germany and Italy. British occupation of Egypt in 1882 had the objective to control the Suez channel. *See* Wolfgang Benedek, *Drago-Porter Convention*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW (Rüdiger Wolfrum ed. 2007).

31. Convention Respecting the Limitation of the Employment of Force for the Recovery of Contract Debts, 18 October 1907, 36 Stat. 2241.

32. This includes Meili's remarkable proposal for an international bankruptcy court, see FRIEDRICH MEILI, DER STAATSBANKEROTT UND DIE MODERNE RECHTSWISSENSCHAFT: VORTRAG GEHALTEN IN DER INTERNATIONALEN VEREINIGUNG FÜR VERGLEICHENDE RECHTSWISSENSCHAFT UND VOLKSWIRTHSCHAFTSLEHRE ZU BERLIN (1895).

33. Barry Eichengreen, *The US Capital Market and Foreign Lending, 1920-1955*, *in* DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY 239-40 (Jeffrey D. Sachs ed. 1989); Eichengreen & Portes, *supra* note 22, 605-6.

issue of international concern for the first time. It carefully scrutinized the development of contractual provisions used for sovereign bonds, such as gold clauses and the relevant case law.[34] The League did not have funds to provide financial support to troubled debtor states.[35] However, it advised member states on economic reform and monitored the implementation of its recommendations.[36] This generated trust in those states' economic viability and helped them regain access to capital markets.[37] During the interwar period, bond settlements in Latin American countries led to substantial debt forgiveness in the longer run, ranging from fifteen to forty-eight percent.[38] International agreements like the Young Plan for the restructuring of German post-war debt concerned reparations, not sovereign debt, but they also improved the situation of debtor states.[39] In addition, inflation reduced their debt issued in domestic currency.[40] Nevertheless, inflation also gave rise to the first interventions of international tribunals in debt matters. The Permanent Court of International Justice (PCIJ) helped French creditors to enforce contractual rights to be repaid in gold against Brazil and Serbia.[41] In the *Serbian Loans* case, the court rejected Serbia's invocation of *force majeure* because of economic deteriorations after the First World War.[42] One might therefore conclude that the pre-war equilibrium was re-established under different terms. While the League of Nations and certain generous restructuring agreements improved the lot of the debtor states, elevating debt sustainability to the level of a global concern for the first time, creditors' trust in the validity of contracts was re-established by the court.

This new equilibrium underwent a stress test during the massive debt market troubles of the 1930s. The Great Depression saw many debtor states default on their external debt, especially in Latin America and the eastern Mediterranean area.[43] Restructurings largely maintained their consensual and horizontal structure, consisting of negotiations between debtor states and creditors' committees, although the need of debtor states to quickly return to capital markets seems to have accelerated restructurings compared to earlier

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34. *See Report of the Committee for the Study of International Loan Contracts*, League of Nations Doc. C.145.M.93.1939. II. A. (1939).

35. Juan H. Flores & Yann Decorzant, *Public borrowing in harsh times: The League of Nations Loans revisited* (University of Geneva Working Paper Series No. 12091, 2012); Margaret G. Myers, *The League Loans*, 60 POLITICAL SCIENCE QUARTERLY 492 (1945).

36. *Id*.

37. *Id*.

38. E. Joergensen & Jeffrey D. Sachs, *Default and Renegotiation of Latin American Foreign Bonds in the Interwar Period*, *in* THE INTERNATIONAL DEBT CRISIS IN HISTORICAL PERSPECTIVE 74 (Barry Eichengreen & Peter H. Lindert eds., 1989).

39. Dieter Fleck, *Dawes Plan (1924) and Young Plan (1930), in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW ¶ 7 et seq. (Rüdiger Wolfrum ed. 2015).

40. Carmen M. Reinhart & M. Belen Sbrancia, *The Liquidation of Government Debt* (NBER Working Paper Series No. 16893, 2011), *available at* http://www.nber.org/papers/w16893.

41. *Cf.* MICHAEL WAIBEL, SOVEREIGN DEFAULTS BEFORE INTERNATIONAL COURTS AND TRIBUNALS 84 et seq. (2011).

42. Case Concerning the Payment of Various Serbian Loans Issued in France (France v. Serbia), 1029 P.C.I.J. (ser. A) No. 20, at 3 (July 12).

43. Reinhart & Rogoff, *supra* note 19, 96; Peter H. Lindert & Peter J. Morton, *How Sovereign Debt Has Worked*, *in* DEVELOPING COUNTRY DEBT AND THE WORLD ECONOMY 227 (Jeffrey D. Sachs ed. 1989).

periods.[44] Debt repudiation remained the exception.[45] In a few cases, the United States State Department had to exert pressure on creditors' committees.[46] Nevertheless, most countries had a hard time regaining access to capital markets due to the protracted economic crisis, which should soon develop into political disaster.[47] For this reason, the League Committee for the Study of International Loan Contracts recommended the adoption of contractual restructuring clauses, as well as recourse to arbitration.[48] However, the outbreak of the Second World War prevented these proposals from gaining traction.[49]

After the Second World War, a more elaborate international economic order came into existence that provided for greater capacity to deal with sovereign debt issues. In particular, international institutions began extending credit. The International Monetary Fund (IMF) supplied developed economies with funds in case of capital account difficulties.[50] Developing and emerging economies benefited from credit extended by multilateral institutions and bilateral lenders.[51] While some countries, like the United States and the United Kingdom, inflated away their mostly domestic debt,[52] other restructurings became a concern for international law. The London Agreement (a debt relief treaty between the Federal Republic of Germany and some of its creditor states) restructured German debt from the interwar period.[53] It underlined the significance of stable debt for economic prosperity, but also for peace. For developing and emerging economies requiring a restructuring of their bilateral debt, the Paris Club has provided a fairly comprehensive forum for negotiations since the mid-1950s. However, sovereign debt sustainability did not seem to be a prevailing concern for the Paris Club at the time. It was largely focused on safeguarding bilateral creditors' interests. For examples, restructurings did not include debt relief at the time.[54] Thus, on the whole, the private law paradigm still prevailed, although a nascent global public concern for sovereign debt sustainability had become discernible.

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44. Feldmann, *supra* note 21, 261 et seq., 383 et seq.

45. For a discussion of the Soviet and Costa Rican examples, see ODETTE LIENAU, RETHINKING SOVEREIGN DEBT. POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE 57 et seq., 100 et seq. (2014).

46. Adamson, *supra* note 28, 485, 499 et seq.

47. Feldmann, *supra* note 21, 420 et seq.

48. In 1935, the Netherlands sponsored a resolution of the League of Nations creating a Committee for the Study of International Loan Contracts with the goal of improving contracts relating to international loans issued by governments and model provisions. *See Report of the Committee for the Study of International Loan Contracts*, League of Nations Doc. C.145.M.93.1939. II. A. (1939).

49. Mark C. Weidemaier, *Reforming Sovereign Lending Practices: Modern Initiatives in Historical Context*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW 329 et seq. (Carlos Esposito et al. eds., 2013).

50. ANDREAS LOWENFELD, INTERNATIONAL ECONOMIC LAW 597 et seq. (2nd edn. 2007).

51. *Id*.

52. Cf. Herschel I. Grossman, *The Political Economy of War Debts and Inflation* (NBER Working Paper Series No. 2743, 1988) 18.

53. Agreement on German External Debts, Feb. 27, 1953, 333 U.N.T.S. 4764.

54. William N. Eskridge Jr., *Les Jeux Sont Faits: Structural Origins of the International Debt Problem*, 25 VA. J. INT'L L. 281, 328 et seq. (1985).

C. After Bretton Woods: The Emergence of Sovereign Debt Sustainability

After the demise of the Bretton Woods system, the structure of sovereign debt changed dramatically. As a consequence, and with some delay, debt-restructuring practice changed, too. In a fairly consistent pattern, debt sustainability is today reflected in international legal practice and may be considered a principle of public international law. It recognizes two important public interests, namely a concern for economic development and growth, and increasingly also for the protection of human rights.

In the 1970s, due to a massive recycling of petrodollars held by commercial banks in Europe and the United States, and to bank regulation that encouraged loans to emerging and developing economies in the absence of global prudential standards,[55] new possibilities for commercial lending in the sovereign debt market emerged. To diversify risks, banks formed consortiums that extended huge amounts of loans to emerging and developing states well beyond their repayment capacity. Loans were extended to developing countries by commercial banks that actively and systematically pushed these loans in violation of basic principles of prudential risk management, leading to a huge credit bubble.[56]

At the beginning of the 1980s, the abrupt and significant increase in interest rates for loans caused by the United States Federal Reserve's effort to fight inflation with high interest rates and the continuous deterioration in the terms of trade for the debtor states due to falling commodity prices rendered them unable to repay those loans.[57] As a consequence, the banks faced a high risk of collapse due to the failure of their sovereign debtors to repay their debts.[58] This led multilateral financial institutions to intervene by granting even more loans (under the premise that the problem was one of short-term liquidity only) and by promoting the implementation of adjustment programs.[59] The Paris Club engaged in restructurings of bilateral debt, but it still categorically excluded debt relief.[60] Whatever the merits of this approach, the fact that it deserved the attention and intervention of multilateral institutions shows the growing concern of the international level for debt sustainability, if only for the sake of stabilizing the banking system in developed economies.

Gradually, the new situation led to the emergence and consolidation of debt sustainability as a principle in international law that recognizes a public interest in debt practices that foster economic development and growth. Towards the end of the 1980s it became clear that there was an unavoidable

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55. Cynthia C. Lichtenstein, *The US Response to the International Debt Crisis: The International Lending Supervision Act of 1983*, 25 VA. J. INT'L L. 401 (1984).

56. WILLIAM A. DARITY & BOBBIE L. HORN, THE LOAN PUSHERS: THE ROLE OF COMMERCIAL BANKS IN THE INTERNATIONAL DEBT CRISIS (1988).

57. KUNIBERT RAFFER & HANS WOLFGANG SINGER, THE ECONOMIC NORTH-SOUTH DIVIDE. SIX DECADES OF UNEQUAL DEVELOPMENT 13 (2001).

58. Lichtenstein, *supra* note 55; Manuel Monteagudo, *The debt problem: The Baker Plan (1985) and the Brady initiative (1989) – History, experience, practice and prospects, in* LA DETTE EXTÉRIEURE – THE EXTERNAL DEBT 139 (Dominique Carreau & Malcolm Shaw eds., 1995).

59. Raffer & Singer, *supra* note 57, 164 et seq.

60. MARTIN WEISS, CONG. RESEARCH SERV, RS21482, THE PARIS CLUB AND INTERNATIONAL DEBT RELIEF (2013), *available at* https://www.fas.org/sgp/crs/misc/RS21482.pdf.

need to actually reduce the debt. The Brady Plan, an initiative of the U.S. government, aimed at alleviating the debt burden by converting the "hot" loans (i.e. loans with low chances of being fully and timely repaid) into tradeable bonds that could be sold to other private investors and allow creditors to better diversify risks.[61] At the same time, the "Washington Consensus" foresaw that debtor states should adopt incisive, radical economic reforms including measures facilitating trade and investment in order to bring them back on track.[62] Again, the need for international coordination to at least channel the crisis tells volumes about international concern for debt sustainability. In line with this policy change, the Paris Club adopted its Naples terms in 1994, which for the first time granted debt relief.[63] In addition, the IMF liberalized its lending practice and opened its facilities for states in default against their private creditors ("lending into arrears").

However, the initial optimism generated by these plans was soon revealed to be unfounded. The 1990s saw increased financial indebtedness of sovereign debtors that received a significant amount of speculative short-term investment, mainly through sovereign bonds. New defaults were confronted by the IMF with adjustment policies and rescue packages. It was not until the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative that debt sustainability became recognized in the context of multilateral debt, leading to a significant policy change.[64] During the same period, the Paris Club further extended the possibility of debt relief, notably through the introduction of the Evian terms in 2003.[65] These measures were based on the conviction that debt sustainability is a precondition for economic development and growth.[66] This shift in perspective finally led to the discarding of the traditional private law paradigm and entrenched debt sustainability as a global public concern in international law. It is the reason why contemporary, internationally orchestrated debt restructurings may be considered as exercises of international public authority.[67]

The conviction underlying this shift found expression in other international documents that corroborate the idea of debt sustainability as a principle in international law. The Monterrey Consensus of 2002, the outcome of a United Nations conference on financing for development, highlighted the

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61. Lowenfeld, *supra* note 50, 683 et seq.

62. John Williamson, *Democracy and the "Washington consensus"*, 21 WORLD DEVELOPMENT 1329 (1993).

63. These are the Paris Club's terms for cancelling and rescheduling the debts of very poor countries, see Weiss, *supra* note 60.

64. On these initiatives and their implementation see https://www.imf.org/external/np/exr/facts/hipc.htm and http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20634753~menuPK:4876270~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html

65. Weiss, *supra* note 60.

66. Barry Herman, José Antonio Ocampo & Shari Spiegel, *Introduction: The Case for a New International Reform Effort, in* OVERCOMING DEVELOPING COUNTRY DEBT CRISES 18 (Barry Herman, José Antonio Ocampo & Shari Spiegel eds., 2010).

67. Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of Public Authority: Towards a Decentralized Sovereign Insolvency Law*, *in* RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE SEARCH FOR COMMON PRINCIPLES 39 (Carlos Esposito et al. eds., 2012).

broad international consensus around the relevance of sustainable debt financing in order to mobilize resources for public and private investment:

"While recognizing that a flexible mix of instruments is needed to respond appropriately to countries' different economic circumstances and capacities, we emphasize the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors."[68]

In the same direction, the Doha Declaration on Financing for Development of 2008 (a Follow-up Conference to review the implementation of the Monterrey Consensus) enhanced the importance of debt sustainability:

"While welcoming the Evian approach, we emphasize the importance of sustained efforts by all towards achieving sustainable debt of middle-income countries, including by improving their sustainable debt management and through debt relief based on current debt mechanisms and debt swap mechanisms on a voluntary basis."[69]

The annual United Nations General Assembly resolutions on external debt from 2010 to 2013[70] stressed the importance of responsible lending and borrowing. The United Nations Conference of Trade and Development (UNCTAD) also addressed the issue on its 6th, 7th and 8th Debt Management Conferences in November 2007, November 2009 and November 2011, respectively.[71] The two UNCTAD initiatives in this area, one on Principles on Responsible Sovereign Lending and Borrowing of 2012, and the Roadmap and Guide on Sovereign Debt Workouts of 2015,[72] extensively elaborate why and how debt sustainability needs to be observed in sovereign debt management and restructuring. The Roadmap lists debt sustainability as one of five key principles.

The IMF, for its part, has recognized debt sustainability as a goal at several occasions. It defines debt sustainability as "a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure".[73] Similarly, the IMF-World Bank Joint Sustainability Framework

68. Report of the International Conference on Financing for Development ¶ 56, Monterrey, Mexico, 18-22 March 2002, UN Doc. A/CONF.198/11, *available at* http://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf.

69. Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus ¶ 56, Doha, Qatar, 29 November – 2 December 2008, available at http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf.

70. G.A. Res. 65/144 (Dec. 20, 2010); G.A. Res. 66/189 (Dec. 22, 2011); G.A. Res. 67/198 (Dec. 21, 2012); G.A. Res. 68/202 (Dec. 20, 2013), each one addressing external debt sustainability and development.

71. UNCTAD, Sixth International Debt Management Conference, Geneva, Nov. 19-21, 2007; UNCTAD, Seventh International Debt Management Conference, Geneva, Nov 9-11 2009; UNCTAD, Eighth International Debt Management Conference, Nov 14-16, 2011.

72. UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (2015), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf.

73. International Monetary Fund, *Assessing Sustainability,* IMF Policy Paper 4 (May 28, 2002). In equivalent terms, the IMF has defined unsustainable debt as follows: "[T]he fiscal policy stance can be regarded as unsustainable if, in the absence of adjustment, sooner or later the government would not be able to service its debt", International Monetary Fund, *Modernizing the Framework for*

for Low-Income Countries defines debt sustainability as "the condition that this debt can be serviced without resort to exceptional financing or a major future correction in the balance of income and expenditure"[74] In order to pursue this goal, the IMF has not only made its lending more generous, especially in the aftermath of financial crises. It has also led initiatives pursuing a more preventive objective, such as the Code of Good Practices on Fiscal Transparency.[75] The fact that IMF-led efforts to establish a Sovereign Debt Restructuring Mechanism failed in 2003 does not defeat the emergence of debt sustainability as a principle of international law. Rather, the project was abandoned because contractual solutions were deemed sufficient for reaching debt sustainability by major stakeholders at the time.[76] The IMF has promoted the contractual approach ever since.[77]

Dissatisfied with the current situation, the UN General Assembly passed Resolution 68/304 on 9 September 2014. The resolution established an ad hoc committee to elaborate a multilateral legal framework for sovereign debt restructuring processes to increase the efficiency, stability and predictability of the international financial system and achieve sustained, inclusive and equitable economic growth and sustainable development. The process so far culminated in UN General Assembly Resolution 69/319 of 10 September 2015. Rather than proposing an international treaty, the resolution follows in the footsteps of the UNCTAD Roadmap and Guide[78] and stipulates a set of "Basic Principles on Sovereign Debt Restructuring Processes".[79] They comprise the principles of sovereignty, good faith, transparency, impartiality, equitable treatment, immunity, legitimacy, sustainability, and majority restructuring. It defines sustainability in the following terms:

"Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights."[80]

The latter definition of sustainability highlights a further aspect of

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Fiscal Policy and Public Debt Sustainability Analysis 5-6 (IMF Staff Paper, 2011). On the legitimacy of debt sustainability assessments and the indicators used for that purpose, see Michael Riegner, *Legal frameworks and general principles for indicators in sovereign debt restructuring*, 41 YALE J. INT'L L. ONLINE (2016), in this special issue.

74. International Monetary Fund & International Development Association, *Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications* 7 (Staff Paper, 2004).

75. International Monetary Fund, Code of Good Practices on Fiscal Transparency (2007), available at https://www.imf.org/external/np/pp/2007/eng/051507c.pdf.

76. Randall Quarles, *Herding Cats: Collective-Action Clauses in Sovereign Debt - The Genesis of the Project to Change the Market Practice in 2001 through 2003*, 73 L. & CONTEMP. PROBS. 29 (2010).

77. International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF Policy Paper (2013); International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring*, IMF Policy Paper (2014).

78. *Supra* note 72.

79. G.A. Res. 69/319 (Sept. 29, 2015).

80. *Id*.

sustainability that has gained traction more recently. While the IMF and the World Bank define debt sustainability in purely financial terms, other stakeholders adopt a broader approach that looks at the social and economic implications of adjustment policies, in particular their impact on human rights. In this vein, many resolutions of the UN General Assembly, the Committee on Economic, Social and Cultural Rights, the Commission on Human Rights and then the Human Rights Council have periodically stressed that structural adjustment programs have serious implications for the ability of developing countries to abide by the Declaration on the Right to Development and to formulate national development policies that effectively improve the economic, social and cultural rights enjoyment of their citizens.[81]

The aftermath of the last financial crisis has affirmed this trend. In 2011, the UN Human Rights Council endorsed the UN Guiding Principles on Foreign Debt and Human Rights.[82] They establish that "[i]nternational financial organizations and private corporations have an obligation to respect international human rights. This implies a duty to refrain from formulating, adopting, funding and implementing policies and programs which directly or indirectly contravene the enjoyment of human rights."[83] While human rights are often held to oblige only the state exercising jurisdiction over the citizens holding these rights, the resolution also specifies that "[c]reditors and debtors share responsibility for preventing and resolving unsustainable debt situations."[84] This is in line with the recognition of extraterritorial effects of economic and social rights as set out by an expert committee in the Maastricht Principles.[85] This includes calls for holding private creditors accountable.[86] Thus, on October 3, 2014, the UN Human Rights Council condemned the activities of vulture funds for the direct negative effects of debt repayment to those funds on the capacity of governments to fulfill their human rights obligations.[87] It also invited States participating in the General Assembly negotiations to ensure that such a multilateral legal framework will be compatible with existing international human rights obligations and

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81. E.g. U.N. Commission on Human Rights Res. 1999/22, Effects on the full enjoyment of human rights of the economic adjustment policies arising from foreign debt and, in particular, on the implementation of the Declaration on the Right to Development, E/CN.4/RES/1991/13 (April 23, 1999). For a list of relevant human rights related resolutions, see http://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/Resolutions.aspx (April 25, 2016, 10:40AM).

82. Human Rights Council Res. 20/10, The effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, A/HRC/RES/20/10 (July 18, 2012).

83. *Id.*, ¶ 9.

84. *Id.*, ¶ 23.

85. Cf. Olivier De Schutter, *Commentary to the Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights*, 34 HUM. RTS. Q. 1084 (2012).

86. For a doctrinal analysis of the human rights responsibilities of private creditors, see Matthias Goldmann, *Human Rights and Sovereign Debt Workouts*, *in* MAKING SOVEREIGN FINANCING AND HUMAN RIGHTS WORK 98-9 (Juan Pablo Bohoslavsky & Jernej L. Cernic eds., 2014).

87. Human Rights Council Res. 27/30, Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds, A/HRC/RES/27/30 (Oct. 3, 2014).

standards.[88] Moreover, the European Committee of Social Rights, responsible for complaints against violations of the European Social Charter, specified that adjustment measures must respect a minimum level of social rights enjoyment and need to be proportionate,[89]and domestic courts have scrutinized the compatibility of adjustment measures with constitutional guarantees.[90] Only the European Court of Justice denied the application of the Charter of Fundamental Rights to the European Union to the European Stability Mechanism, albeit on the basis of a highly formalistic reading of the Charter.[91]

In conclusion, sovereign debt sustainability is today widely recognized in international legal practice. It guides the policies of all major multilateral institutions dealing with sovereign debt, including informal organizations like the Paris Club, and should therefore be considered a principle of public international law. It signifies a shift in sovereign debt restructuring practice away from an almost exclusive focus on creditors' rights towards a global public interest in both the financial well being of a debtor state, and in mitigating the impact of debt crises on the broader economic, social and human rights situation in the country.[92] Its emergence resonates with the coincidental rise of solidarity as a principle in international law that has elevated issues formerly belonging to states' *domaine reservé* to the level of global concerns.[93] This does not mean that private interests of creditors can no longer play a role in debt restructurings. Rather, they need to be balanced against the public interests reflected in sovereign debt sustainability. Whether sovereign debt sustainability also constitutes a general principle of law (i.e. a source proper of international law) is a different question—one that would require an in-depth analysis of *domestic* legal practice.[94] As welcome and useful as such an analysis would be, it is not necessary for the thesis advanced in this paper in the

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88. *Id*.

89. Complaints No. 65/2011 and 66/2011, Decisions on the merits (European Committee of Social Rights May 23, 2012).

90. Overview: Claire Kilpatrick, *Constitutions, social rights and sovereign debt states in Europe: a challenging new area of constitutional inquiry* (EUI Working Paper EUI LAW 2015/34, 2015), *available at* http://hdl.handle.net/1814/36097; Federico Fabbrini, *The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective*, 32 BERKELEY J. INT'L L. 65 (2014). Most domestic courts did not hold that rights had been violated, though. But the fact that they examined certain adjustment measures thoroughly confirms the relevance of human rights for debt sustainability.

91. Case C-370/12, Thomas Pringle v. Government of Ireland, Ireland and The Attorney General ¶ 179-80, EUR-Lex 62012CJ0370 (Nov. 27, 2012). However, Advocate General Kokott had argued that the European Commission was bound by the Charter of Fundamental Rights of the EU when acting in the frame of the European Stability Mechanism, see *id*., View of Advocate General Kokott ¶ 176, EUR-Lex 62012CP0370 (Oct. 26, 2012). On the human rights obligations of the ESM, see Margot E. Salomon, *Of austerity, human rights and international institutions*, 21 EUROPEAN LAW JOURNAL 521, 537-40 (2015).

92. On comparable shifts in domestic bankruptcy law: Joseph Spooner, *Long Overdue: What the Belated Reform of Irish Personal Insolvency Law tells us about Comparative Consumer Bankruptcy*, 86 AM. BANKR. L.J. 243 (2012).

93. E.g. SOLIDARITY: A STRUCTURAL PRINCIPLE OF INTERNATIONAL LAW (Rüdiger Wolfrum & Chie Kojima eds., 2010); Markus T. Kotzur & Kirsten Schmalenbach, *Solidarity Among Nations*, 52 ARCHIV DES VÖLKERRECHTS 68 (2014), listing disaster relief and development cooperation as relevant fields.

94. *See* Matthias Goldmann, *Responsible Sovereign Lending and Borrowing: The View from Domestic Jurisdictions. A Comparative Survey* (UNCTAD Working Paper, 2012), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2012misc3_en.pdf.

following, as we focus here on the significance of sovereign debt sustainability for debt restructuring practice in general rather than on the specific legal consequences of this principle.

IV. HOLDOUT LITIGATION: A LITMUS TEST FOR DEBT SUSTAINABILITY

Sovereign debt sustainability as a principle of international law has no basis other than current debt restructuring practice. It therefore needs to be examined whether the rise in holdout litigation is in a position to dilute sovereign debt sustainability as a principle of international law by watering down its normative status or content.

Sovereign debt restructurings today face a high chance to be inflicted by holdout litigation. Vulture funds buy bonds of troubled states at a significant discount from the nominal value. As participation in debt restructurings is voluntary, they refuse to exchange their old bonds into new ones. Instead, they sue very aggressively for repayment of their debts at face value plus interest, arrears and litigation costs, amounting to rates of return of between 200 percent and 3.000 per cent.[95] As explained by Schumacher, Trebesch and Enderlein,[96] holdout litigation constitutes by now a widespread an increasing practice in debt restructurings. Between 1976 and 2010 there have been about 120 lawsuits by commercial creditors against 26 defaulting Governments in the United States and the United Kingdom alone, the two jurisdictions where most sovereign bonds are issued. While in the 1980s only about 5 per cent of debt restructurings were accompanied by legal disputes, this figure has rocketed high to almost 50 per cent and the total volume of principal under litigation reached USD 3 billion by 2010.[97] The trend has since continued with suits being filed, among others, against Ecuador,[98] Grenada,[99] and several ones against Greece.[100]

Holdout litigation causes serious legal risks for the recognition of debt sustainability as a principle. It also has severe negative factual effects on debt restructurings. However, as we will explain, recent developments affirming debt sustainability as a principle might offset these countercurrents. This demonstrates the operation of the incremental approach and confirms its viability.

A. Holdout Litigation as a Legal Challenge to Debt Sustainability

Holdout litigation challenges the principle of debt sustainability on a

95. Data from the African Development Bank (AfDB), *available at* http://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/ (April 25, 2016, 10:38AM).

96. *Supra* note 3.

97. *Id*.

98. GMO Trust v. The Republic of Ecuador, No. 1:14-cv-09844 (S.D.N.Y. March 23, 2015). The case was settled in March 2015.

99. *See*, *i.a*., Export-Import Bank of China v. Grenada, No. 13 Civ. 1450 (HB), 2013 WL 4414876 (S.D.N.Y. Sept. 19, 2013).

100. *See*, *i.a*., Case C-226/13, Fahnenbrock v. Greece, EUR-Lex 62013CJ0226 (June 11, 2015); Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic, ICSID Case No. ARB/13/8, Award (April 9, 2015).

normative level. Given the increase in holdout litigation, sovereign debt restructuring practice might not be focused as much on sustainability as we claim. We identify three major legal challenges in this respect. They are related to the debtor state's legal defenses, enforcement, and conflicts of jurisdiction.

First, courts around the world faced with holdout litigation have given relatively little consideration to various defenses raised by debtor states that invoked sovereign debt sustainability as a goal. Courts in the United States have persistently ruled that, in the absence of contractual clauses providing for majority vote, the sanctity of contracts prevails so that unanimity of creditors is needed to make a restructuring agreement binding for every creditor.[101] Invoking sovereign immunity has mostly been unsuccessful since the deliberate turn to sovereign debt litigation and the regular inclusion of waivers of immunities in the terms of debt instruments since the 1990s.[102] Debtor states have often claimed a state of necessity, but this has also been rejected by many courts around the world, demonstrating their unawareness of developments in debt restructuring practice and the emergence of the principle of debt sustainability. Courts refused to recognize a state of necessity as a defense because they thought this defense would only apply between states (overlooking that, as a general principle, it might also apply to private parties),[103] or because they believed that necessity could not be invoked if the debtor state had contributed to the state of necessity (rendering the defense toothless for sovereign debt litigation without providing for compensation).[104] In 2015, the German Federal Court of Justice rejected not only the view that there was a rule of customary international law making majority restructurings binding even for the dissenting minority. It also held that good faith did not constitute a defense against holdout litigation.[105]

Second, on top of rejecting debtor states' defenses, New York courts provided holdout creditors with a new, indirect way of enforcement through injunctions by giving an unexpected interpretation to the *pari passu* clause.[106] This clause is widely used in sovereign debt contracts.[107] According to a traditional reading, it is supposed to ensure that all unsecured creditors have the same rank with no priority among themselves.[108] NML Capital, a seasoned vulture fund, holds bonds issued prior to Argentina's 2001 default. It did not

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101. *See* Allied Bank International v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985); Pravin Banker Associates v. Banco Popular del Peru, 109 F. 3d 850, 854 (2d Cir. 1997); Elliot Associates v. Banco de la Nacion and the Republic of Peru, 12 F.Supp. 2d 328 (S.D.N.Y. 1998).

102. For the U.S.: Argentina v. Weltover, Inc., 504 U.S. 607 (1992); for the U.K.: NML Capital Limited (Appellant) v Republic of Argentina (Respondent) [2011] UKSC 31, [2011] 2 A.C. 495 (U.K.).

103. Bundesverfassungsgericht [Federal Constitutional Court], May 8, 2007, 118 BVerfGE 124 (Ger.).

104. On the diverging case law of ICSID tribunals see Michael Waibel, *Two Worlds of Necessity in ICSID Arbitration:CMS and LG&E*, 20 LEIDEN JOURNAL OF INTERNATIONAL LAW 637 (2007).

105. Bundesgerichtshof [Federal Court of Justice], Feb 2, 2015, Neue Juristische Wochenschrift 2328, 2015 (Ger.).

106. NML Capital et al. v. Argentina, 699 F.3d 246, 263 (2d Cir. 2012).

107. Lee C. Buchheit & Jeremiah S. Pam, *The pari passu clause in sovereign debt instruments*, 53 EMORY L.J. 869 (2004).

108. *Id*.

accept Argentina's 2005 and 2010 exchange offers, but decided to litigate. In 2012, following an earlier Belgian case,[109] the United States federal District Court for the Southern District of New York saw in the *pari passu* clause an obligation of Argentina to make ratable payments to NML each time it pays its restructured bondholders.[110] More specifically, the District Court's injunctions forbid any financial intermediary, including Euroclear and Clearstream, to collaborate with Argentina in paying exchange bondholders unless they are notified that holdouts have received ratable payment.[111] As a consequence, the ruling effectively prohibits Argentina from complying with its obligations towards holders of restructured bonds without paying on the bonds held by NML, irrespective of the law applicable to the restructured bonds and their location.

A third legal risk associated with holdout litigation consists in protracted conflicts of jurisdiction that find no easy solution. Three cases demonstrate the risk. First, Argentina complained that the injunctions based on the ratable payment interpretation of the *pari passu* clause profoundly disrupted Argentina's financial relations and threatened its economic and financial development. In 2014, it therefore filed a lawsuit against the United States before the International Court of Justice, arguing that the judgment violated her sovereignty.[112] The lawsuit did not get anywhere for lack of jurisdiction.[113] Second, in another lawsuit filed by holders of restructured Argentine Eurobonds who wish to receive their payments even after NML Capital, the High Court of England and Wales ruled in February 2015 that the trusteeship established with the Bank of New York Mellon (BNYM) for the purpose of processing Argentina's payments on bonds issued under English law was governed by English law.[114] But it refrained from deciding whether the injunctions of the U.S. District Court might constitute a defense of BNYM under English law.[115] Third, a ruling by the European Court of Justice paved the way for the judicial authorities of any EU member state to serve a writ to Greece that will trigger holdout litigation.[116] This means that an array of domestic courts of different member states might have to decide about the

109. Elliott Assocs., L.P., General Docket No. 2000/QR/92, Cour d'Appel [Court of Appeal] Bruxelles, 8éme ch., Sept. 26, 2000 (Belg.).

110. NML Capital, Ltd. v. Republic of Argentina, No. 08 Civ. 6978 (TPG), 2012 WL 5895784 (S.D.N.Y. Nov. 21, 2012): "Whenever the Republic pays any amount due under […] the [Exchange Bonds]… the Republic shall concurrently or in advance make a 'Ratable Payment' to NML […]. Such 'Ratable Payment' shall be an amount equal to the 'Payment Percentage' […] multiplied by the total amount currently due to NML in respect of the bonds at issue in these cases [...]. Such 'Payment Percentage' shall be the fraction calculated by dividing the amount actually paid or which the Republic intends to pay under the terms of the Exchange Bonds by the total amount then due under the terms of such Exchange Bonds."

111. *Id*.

112. I.C.J., Press Release No. 2014/25 (Aug. 7, 2014), *available at http://www.icj-cij.org/presscom/files/4/18354.pdf*.

113. Joseph Ax & Andrew Chung, UPDATE 4–Argentina threatened with contempt order by U.S. judge, Reuters (Aug. 8, 2014), *available at* http://www.reuters.com/article/argentina-debt-idUSL2N0QE12D20140809.

114. Knighthead Master Fund LP v. The Bank of New York Mellon (2014), HC-2014-000704, [2015] EWHC (Ch) 270 (Eng.).

115. *Id.,* ¶ 49.

116. Fahnenbrock v. Greece, *supra* note 100.

constitutionality under Greek law of Greek legislation facilitating the restructuring of its domestic debt.[117]

B. Holdout Litigation as a Factual Challenge to Debt Sustainability

While some argue on the basis of highly theoretical models that vulture litigation would improve the functioning of sovereign debt markets in accordance with the efficient capital market hypothesis,[118] reality looks quite different. In fact, holdout litigation under present circumstances threatens debt sustainability in more factual, practical ways. First, as has been said, the injunctions against Argentina's banks seriously disrupt Argentina's financial relations and thereby threaten its economic and financial development. Every financial intermediary of Argentina with business in the United States is affected. Given the global scope of many financial intermediaries, the judgment potentially has universal reach. The same applies to Argentina's cooperative creditors who are cut off their legitimate proceeds.[119]

Second, the expansive interpretation of the *pari passu* clause makes future restructurings of other countries' debt much more difficult than they are already, as it provides stronger incentives to creditors no to give their consent to debt restructuring agreements. The amplification of this judgment to other debt restructurings would have disruptive implications for global debt sustainability. This is a concrete possibility.[120]

Third, holdout litigation makes restructuring more costly. For example, right before the Greek haircut, vulture funds bought Greek bonds issued under English law that did not allow Greece to activate CACs.[121] The government decided to pay 435 million euros to investors who had refused to participate in the restructuring one month after the completion of the haircut. The vulture funds took advantage of the financial turmoil engulfing the country at that moment. In June and July 2013 the Greek government made two additional and higher payments of 790 and 540 million euros each to holdout creditors. The same applies to Argentina now that the new government found agreement with her creditors. The price to be paid is high indeed.[122]

Fourth, as concerns the broader financial repercussions, holdout litigation

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117. Nomos 4050/12 Kanones tropopoieseos titlon, ekdoseos e eggyeseos tou Ellenikou Demosiou me symphonia ton Omologiouchon [Rules for the amendment of bonds, issued or guaranteed by the Greek government by virtue of a bondholder agreement], EPHEMERIS TES KYVERNESEOS TES HELLENIKES DEMOKRATIAS [E.K.E.D.] 2012, A:36 (Greece).

118. Robert W. Kolb, *The Virtue of Vultures: Distressed Debt Investors in the Sovereign Debt Market*, 40 THE JOURNAL OF SOCIAL, POLITICAL AND ECONOMIC STUDIES 368 (2015).

119. Cf. W. Marc C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189 (2014).

120. Cf. the cases listed in notes 98 to 100. *But see* Natalie Wong, *NML Capital, Ltd. v. Republic of Argentina and the Changing Roles of the Pari Passu and Collective Action Clauses in Sovereign Debt Agreements*, 53 COLUM. J. TRANSNAT'L L. 396 (2015), pointing out the more cautious approach in cases against Granada.

121. Stratos D. Kamenis, *Vulture Funds and the Sovereign Debt Market: Lessons from Argentina and Greece* 15 (Crisis Observatory Research Paper No. 13/2014, 2014).

122. Anna Gelpern, *Sovereign Debt. Now What?,* 41 YALE J. INT'L L. ONLINE (2016), in this special issue; Martin Guzman & Joseph Stiglitz, *How Hedge Funds Held Argentina for Ransom*, N.Y. Times, April 1, 2016, *available at* http://www.nytimes.com/2016/04/01/opinion/how-hedge-funds-held-argentina-for-ransom.html?_r=0.

has been particularly disruptive with respect to the realization of economic, social and cultural rights in the context of multilateral efforts to relieve heavily indebted poor countries of their external debt burden.[123] In practice, such litigation has significantly eroded the (limited) fiscal space created by debt relief initiatives for resources to alleviate poverty and foster economic development in these countries. At least eighteen heavily indebted poor countries have been threatened with or have been subjected to legal actions by these creditors since 1999, giving rise to an estimated number of more than 50 lawsuits by commercial creditors of such a kind.[124] Most lawsuits were filed in the US, the United Kingdom, and France. For example, in a case against Zambia, Donegal International, a vulture fund based in the British Virgin Islands, having bought debt instruments for USD 3.28 million, sued the debtor for their nominal value of USD 55 million. The High Court of England and Wales, with notable political and moral disapproval, ruled that the government pay the vulture fund USD 15.4 million,[125]which represented 65 percent of what Zambia had saved in debt relief delivered through the Multilateral Debt Relief Initiative (MDRI) in 2006.

Summing up, holdout litigation has become a serious challenge for debt restructurings both in quantity and in quality, legally and factually, for debtors and cooperative creditors. Notwithstanding the fact that many debt restructurings do not give rise to litigation,[126] it potentially threatens debt sustainability.

C. Recent Affirmations of Debt Sustainability

One might ask whether the observed challenges to debt sustainability might defeat debt sustainability as a principle in international law. As has been set out above, principles of international law are rooted in practice so that a dramatic change in practice will change the principle.[127] Certainly, principles are always to some extent counterfactual as they also reflect trends. But this must not become their dominant trait. In this respect, it must be recognized that holdout litigation transforms the character of debt restructurings to some extent. While it does not lead to a relapse into the private law paradigm, it gives rise to an unprecedented asymmetry that benefits some investors who strive towards extracting a benefit from a fragmented legal order governing the global public interest in sovereign debt sustainability.

Nevertheless, there are strong signals that confirm debt sustainability as a principle despite the increase of holdout litigation. Thus, on many of the above-

123. Human Rights Council, Promotion and Protection of All Human Rights, Civil, Political, Economic, Social and Cultural Rights, Including the Right to Development, Report of the independent expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephas Lumina, A/HRC/14/21 (April 29, 2010).

124. Dem. Rep. of Congo, Rep. of Congo, Ethiopia, Honduras, Niger, Sierra Leone, Sudan, Tanzania, Uganda, Cote d'Ivoire, Burkina Faso, Angola, ,Cameroon, Liberia, Madagascar, Mozambique, Niger, and Sao Tome and Principe.

125. Donegal International Ltd. v. Zambia, [2007] EWHC 197 (Comm.) (Eng.).

126. *See* Schumacher, Trebesch & Enderlein, *supra* note 3.

127. *See supra* section B.

cited cases, the last word has not yet been spoken. Courts in EU member states with pending holdout suits might decide that they do not have jurisdiction as the case involves questions regarding the constitutionality of another member states' legislation, which in many member states only the highest courts may decide. Encouraging in this respect is the decision of the ICSID tribunal in the *Poštová banka* case. In its decision on jurisdiction, it concluded that

"sovereign debt is an instrument of government monetary and economic policy and its impact at the local and international levels makes it an important tool for the handling of social and economic policies of a State. It cannot, thus, be equated to private indebtedness or corporate debt."[128]

The German Federal Court of Justice's decision is now pending before the Federal Constitutional Court.[129] Argentina claims that the former court violated its constitutional right to a legally assigned judge by not referring the case to the Federal Constitutional Court – the sole authority competent for deciding questions relating to the existence of customary international law or general principles in the German legal order. Should the Federal Constitutional Court decide in favor of Argentina, there is a high chance that the outcome will be different. In fact, the Federal Court of Justice did not specifically investigate the issue whether good faith as a general principle might constitute a defense against holdout litigation. It only relied on the Federal Constitutional Court's previous judgment rejecting the application of the necessity defense in relations involving private parties[130] – a very weak basis for an argument relating to good faith. Ironically, the Federal Court of Justice chose this avenue in order to avoid a referral to the Federal Constitutional Court.

Further, there have been some rare cases where courts recognized sustainability concerns. Because of the potential global effects of the restructuring at stake, US courts acknowledged at times a legitimate interest in debt restructurings in order to safeguard financial stability.[131] In other jurisdictions, courts have given broader recognition to the interests reflected in the principle of debt sustainability, by granting immunity to debt repudiation aimed at safeguarding the basic human rights of citizens in the debtor states.[132]

Besides these encouraging signals from the judiciary, holdout litigation has received strong negative responses and explicit disapproval on the part of governments and in many decisions of international organizations. Regarding the former, the United States government's *amicus* brief in NML Capital before the Court of Appeals for the Second Circuit, as well as of other governments before the US Supreme Court, are testament to their concern for debt

128. Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic, ICSID Case No. ARB/13/8, Award ¶ 324 (April 9, 2015).

129. *See supra* note 105.

130. *Supra* note 103.

131. Crédit francais, s.A. v. Sociedad financier de comercio, C.A., 128 Misc.2d 564 (S.C.N.Y. 1985); EM Ltd. v. Argentina, No. 05-1525-cv, Summary Order (May 13, 2005), 2d Cir. R. 32.1. (obiter dictum lacking precedential value).

132. *See, e.g.*, the case about judicial immunity of Argentina in Italy: Corte di Cassazione, Sezione Unite Civile, n. 11225 (May 27, 2005), 88 RIVISTA DI DIRITTO INTERNAZIONALE (2005) 856 (Ital.); or the holdout litigation cases before Argentinean courts: Juzgado Nacional en lo Contencioso Administrativo Federal N° 1 [Lower National Court for Administrative Matter No. 1], 12/10/ 2006, La Ley [L.L.], Suplemento Derecho Constitucional L.L., Feb. 27, 2007.

sustainability in the light of holdout litigation.[133] The United Kingdom and Belgium adopted anti-vulture legislation,[134] the latter in reaction to the Donegall case. It prevents claims against heavily indebted poor countries that exceed the amount that a holdout creditor would have received had he accepted the restructuring.[135] International organizations' rejection of holdout litigation is reflected, among others, in proposals by the IMF for strengthening contractual clauses:[136] in GA Resolution 69/319, which affirms the need for equitable treatment and good faith in sovereign debt restructurings and in the 2014 resolution of the Human Rights Council condemning holdout litigation.[137]

Above all, citizens in debtor states have voiced concerns over the effects of structural adjustment programs that might compromise their social and economic rights enjoyment.[138] In debtor states, there is a notable backlash against the structural adjustment programs related to debt restructurings, which are perceived as deeply illegitimate.[139] This sentiment has found support in decisions of domestic and international judicial bodies that have critically scrutinized their conformity with various fundamental rights guarantees.[140] It remains to be hoped that human rights impact assessments will become a standard step in the procedure in the design of structural adjustment.[141]

Thus, while it cannot be excluded that the principle of debt sustainability will be modified, attenuated, or even fade someday, the challenges constituted by holdout litigation do not give reason to doubt its existence at present. Rather, litigation strategies viewed as problematic under the principle of debt sustainability have been met with strong responses. This confirms the incremental approach, and it also illustrates its operation. The incremental approach cannot be as straightforward as a treaty or a grand legislative project. Rather, it moves ahead in tiny steps, from action to reaction, by and by forming consensus among stakeholders.

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133. NML v. Republic of Argentina, Brief for the United States of America as Amicus Curiae in Support of Reversal, 6 et seq., case 12-105-cv(L) (2nd Cir.) (April 4, 2012); for briefs of other states and interested parties, see http://www.scotusblog.com/case-files/cases/republic-of-argentina-v-nml-capital-ltd/. (April 25, 2016, 11:00AM).

134. *Supra* note 169 and accompanying text.

135. United Kingdom Debt Relief (Developing Countries) Act, 2009-2010, H.C. Bill [22], *available at* http://www.legislation.gov.uk/ukpga/ 2010/22/contents.

136. E.g. International Monetary Fund, *supra* note 77); see also the list of UN General Assembly resolutions in note 70.

137. Human Rights Council Res. 27/33, Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds, UN Doc. A/HRC/RES/27/33 (Oct. 3, 2014).

138. Sigrun Skogly, *Structural Adjustment and Development: Human Rights--An Agenda for Change*, 15 HUM. RTS. Q. 751 (1993); Daniel D. Bradlow, *The World Bank, the IMF, and Human Rights*, 6 TRANSNAT'L L. CONTEMP. PROBS. 47 (1996); ECONOMIC AND SOCIAL RIGHTS AFTER THE GLOBAL FINANCIAL CRISIS (Aoife Nolan ed., 2014); Goldmann, *supra* note 86.

139. Comprehensively: von Bogdandy & Goldmann, *supra* note 67.

140. *Supra* note 89.

141. James Harrison & M.-A. Stephenson, *Assessing the Impact of the Public Spending Cuts: Taking Human Rights and Equality Seriously*, *in* HUMAN RIGHTS AND PUBLIC FINANCE 234 et seq., (Aoife Nolan, et al. eds., 2013); see also Human Rights Council, Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights on his mission to Greece, UN Doc. A/HRC/31/60/Add.2 (Feb. 29, 2016).

V. SAFEGUARDING DEBT SUSTAINABILITY: AN INCREMENTAL APPROACH TO SOVEREIGN DEBT RESTRUCTURING

This Section assesses current reform proposals for sovereign debt restructuring in light of sovereign debt sustainability's status as a principle of public international law. Contractual approaches appear normatively insufficient. With statutory solutions being politically unavailable, we propose an incremental strategy that relies on sovereign debt sustainability and other legal principles.

A. Contractual and Other Bilateral Approaches

A first set of reform proposals for sovereign debt restructuring advocates innovations in contractual clauses.[142] Improved CACs, which allow a supermajority of bondholders to agree to changes in bond payment terms binding for all bondholders, might facilitate debt restructurings on a practical level and thereby contribute to debt sustainability. Nevertheless, they have well-known loopholes, which differ from one generation of CACs to another. Traditional single-series CACs, which require a qualified majority of bondholders of each single issue to give their consent,[143] can easily be disabled by holdout creditors who buy a blocking minority. In the case of the 2012 Greek private sector involvement, holdouts amounted to € 6.4bn, or twenty-nine percent of the outstanding face value, dispersed over twenty-four bonds governed by English law with single-series CACs, as well as one bond governed by Greek law.[144]

More promising are second-generation CACs with so-called aggregation clauses. They require a lower qualified majority of the holders of each single issue (usually 66 2/3%) as well as of the holders of all covered issues (usually 75%).[145] They reduce the risk of holdouts of single issues as they make it more difficult for holdouts to acquire a blocking minority. Being a recent innovation, aggregation clauses have not yet had to pass many practice tests. They worked fairly well in the case of Greece where legislation had introduced them retroactively into bonds governed by domestic law. As far as we can see, only one bond with second-generation aggregation clauses was not restructured.[146]

A third generation of so-called single-limb CACs does not require voting by issue, but the participation of 75 percent of all covered categories of outstanding debt.[147] One might doubt whether such clauses will be superior to second-generation aggregation clauses on a practical level. While it might be

142. For many: International Monetary Fund (2014), *supra* note 77.

143. On the difference between the quorum approach and the outstanding principal approach, see Sergio J. Galvis & Angel L. Saad, *Collective action clauses: recent progress and challenges ahead*, 35 GEO. J. INT'L L. 713 (2003).

144. Jeromin Zettelmeyer, et al., *The Greek debt restructuring: an autopsy*, 28 ECONOMIC POLICY 513, 527 (2013).

145. International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF Policy Paper 29 (April 26, 2013).

146. Zettelmeyer, *supra* note 144, 538.

147. This reflects the model proposed by the International Capital Markets Association, *supra* note 4. On pre-war examples, see W. Marc C. Weidemaier & G. Mitu Gulati, *A People's History of Collective Actions Clauses*, 54 VA. J. INT'L L. 51, 70 et seq. (2013).

difficult even for very large investors to acquire a blocking minority in case of single-limb CACs, the operation of such clauses – which are yet to stand the test of practice – requires that all creditors are offered identical conditions under the restructuring agreement, regardless of the conditions of their old bonds.[148] Without this condition, there would be a huge risk that the restructuring is carried out at the expense of some bond series whose volume does not amount to a blocking minority. However, this condition at the same time provides a basis for inter-creditor discrimination. One-size-fits-all restructuring agreements will necessarily disadvantage the holders of bonds with higher yields than those of the majority. To ensure a majority for the restructuring, debtor states might exempt such bond issues from restructurings under the clause. This would reduce the reach of single-limb clauses, making its aggregating effect not so aggregate any more. A further practical obstacle with single-limb CACs is that they might require legislative amendments in some jurisdictions in order to protect them against standard terms review by courts:[149] Many legal orders protect contractual parties against boilerplate terms used by one party which unduly compromise the rights of the former. To be on the safe side, legislation would have to determine that certain CACs do not fall in that category.

But apart from these more practical difficulties, contractual approaches raise a number of normative concerns from the perspective of the principle of sovereign debt sustainability that are not easy to overcome. First, contractual approaches have a very narrow focus that misses important features necessary for ensuring debt sustainability effectively. They only apply to bonds and do not include other classes of creditors. Also, they do not ensure a fair burden-sharing among different creditor group, and these features of the contractual approach might delay debt restructuring. Further, the contractual approach is only loosely connected to the provision of interim financing to a debtor during a restructuring.[150] By definition, these tasks pertain to the international community of states by virtue of the global *public* interests recognized by the principle of debt sustainability.

Second, contractual approaches continue considering debt restructurings as a matter to be figured out between the debtor state and its creditors alone. The principle of sovereign debt sustainability demonstrates this is no longer a viable position. Leaving the debtor state ultimately at the mercy of the majority of the creditors, no matter which thresholds apply, does not seem to do justice to the role assigned to states as protectors of their citizens and providers of welfare, including their responsibility to ensure the progressive enjoyment of economic, social and human rights. As has been shown, this dimension is today a component of the principle of sovereign debt sustainability. It needs to be ensured even against the wishes of private creditors, ideally by way of a

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148. International Capital Markets Association, *supra* note .

149. Cf. Gesetz über Schuldverschreibungen aus Gesamtemissionen (Schuldverschreibungsgesetz) [SchVG] [Bond Issuance Act], July 31, 2009, BGBL. I at 2512, last amended by Gesetz [G], Sept. 13, 2012, BGBL. I at 1914, art. 2, § 5 (Ger.).

150. Anne O. Krueger & Sean Hagan, *Sovereign workouts: an IMF perspective*, 6 CHI. J. INT'L L. 203, 214-5 (2005).

crackdown provision or similarly effective instruments. The global public interest in the resolution of debt crises expressed in the principle of debt sustainability requires putting strings on the powers of creditors, including private bondholders. This means that the private law paradigm prevailing during the 19th and most of the 20th century needs to be effectively laid to rest, but CACs do not go far enough in that respect.

It is for these reasons that we think that arbitration, such as investor-state dispute settlement under the aegis of the International Centre for Settlement of Investment Disputes (ICSID), cannot by itself provide a solution to sovereign debt disputes that would respect debt sustainability. This would simply reproduce the private law paradigm that essentially requires the consent of the parties for restructurings, whether they are governed by domestic private law or by bilateral treaty relations. It is for its disregard of public interests that ICSID has been under strong criticism over the last decade that focused mainly on its lack of transparency and accountability. This criticism has led a number of countries discontinuing their membership. As an institutional forum that solves debt disputes needs to be based on a broad international consensus, it is hard to believe that stakeholders involved in debt restructurings see the ICSID as a proper forum to settle debt disputes. Besides, the expansive interpretation of investors' rights against host states that arbitrators often apply in investment disputes significantly reduces the fiscal and regulatory space required for economic development.[151] Investment arbitration therefore seems inadequate as a means for achieving debt sustainability. A radical change in the institutional design of ICSID tribunals would be required in order for them to become good candidates for the sustainable solution of sovereign debt crises.

B. The Difficulty with a Treaty Option

Others favor a treaty-based sovereign debt restructuring organization.[152] A widely-ratified international treaty establishing a predictable, effective, fair and independent debt workout mechanism with the option of enforcing the terms of the agreement if needed would most likely create proper incentives for debtors and creditors to reach acceptable debt restructuring agreements within a reasonable amount of time. Compared to contractual approaches, a comprehensive treaty option could in principle comprise all debt, irrespective of its type, creditor, or specific contractual clauses.[153] Moreover, a treaty option would potentially overcome the bilateralism of contractual approaches. It could include a standstill provision that would make holdout litigation impossible, except for legal review explicitly provided by the treaty.[154] Such treaty

151. *See generally* UNCTAD, TRADE AND DEVELOPMENT REPORT (2014).

152. Cf. Krueger & Hagan (note 150); Mathias Audit, *Ingénierie juridique pour la création d'un centre international pour la sauvegarde financière des états*, 142 JOURNAL DU DROIT INTERNATIONAL 1057 (2015); for a de-politicized resolvency court on a contractual or treaty basis: Christoph G. Paulus, *Should Politics be Replaced by a Legal Proceeding?*, *in* A DEBT RESTRUCTURING MECHANISM FOR SOVEREIGNS: DO WE NEED A LEGAL PROCEDURE? 191 (Christoph G. Paulus ed. 2014).

153. Note, however, that not all proposals for a treaty mechanism are comprehensive in this way. The proposal by Audit, *supra* note 152, seems to cover bonds only.

154. On the controversies regarding the inclusion of a standstill clause in the SDRM proposal, see International Monetary Fund, *Proposed Features of Sovereign Debt Restructuring Mechanisms*, IMF

provisions, as well as any agreement on debt restructuring reached under their terms, would be enforceable in any jurisdiction. This would satisfy the requirements of the principle of sovereign debt sustainability.

However, this is not a highly realistic option in the current political landscape. UN General Assembly Resolution 68/34 of 2014 received 124votes in favor, 11votes against[155] and 41abstentions.[156] A year later, UN General Assembly Resolution 69/319, which does not even call for a treaty, still received 136 votes in favor, 6 votes against,[157] and 41 abstentions.[158] There is thus considerable support for a multilateral solution in large parts of the community of states. The voting pattern suggests, however, a number of influential developed countries are not willing to go in this direction, even if it is only because they favor the International Monetary Fund (IMF) as a venue.[159] Any proposal of an international treaty is at present unlikely to become binding for the jurisdictions in which most external debt of developing and emerging economies is usually issued. Certainly, an international agreement signed by only a limited number of countries might still create an area for smooth debt restructurings. Debtor states might prefer such a jurisdiction for issuing sovereign debt because it adheres to rules for debt restructurings. This may be an attractive option for an existing or rising financial center to strengthen its position on the sovereign debt market. Nevertheless, a limited geographic reach would come at the price of limited effectiveness.

The multilateral treaty option brings further complexities: Treaties are rigid legal instruments. Their ratification as well as potential amendments take time and are politically difficult to achieve. In a rapidly changing field like the sovereign debt market, the legal framework needs to be able to react quickly to unforeseen changes. Beyond such practicalities, an international debt workout mechanism would have to take decisions concerning the allocation of money that have serious distributive consequences. Decisions of that kind call for a mechanism that enjoys a high level of democratic legitimacy, which is notoriously difficult to achieve on the international level.[160] This calls for an

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Policy Paper (2003). The standstill clause was ultimately removed from the proposal. However, this happened while the rise of holdout litigation was still very much at the beginning. Contractual clauses were deemed sufficient to bring it under control. *See* Matthias Goldmann, *Necessity and Feasibility of a Standstill Rule for Sovereign Debt Workouts* 2-4 (UNCTAD Working Paper, 2014). For a concise argument why standstill is necessary, see HOLGER SCHIER, TOWARDS A REORGANISATION SYSTEM FOR SOVEREIGN DEBT AN INTERNATIONAL LAW PERSPECTIVE 183-7 (2007).

155. Australia, Canada, Czech Republic, Finland, Germany, Hungary, Ireland, Israel, Japan, United Kingdom, United States of America.

156. Albania, Andorra, Armenia, Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Denmark, Estonia, France, Georgia, Greece, Iceland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Monaco, Montenegro, Netherlands, New Zealand, Norway, Papua New Guinea, Poland, Portugal, Republic of Korea, Republic of Moldova, Romania, San Marino, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Ukraine.

157. Canada, Germany, Israel, Japan, United Kingdom, United States.

158. G.A. Res. 69/319 (Sept. 29, 2015).

159. *See* European Union, EU Explanation of Vote – United Nations General Assembly: Sovereign Debt Restructuring Process, Statement on behalf of the Member States of the European Union, EUUN14-112EN (Sept. 9, 2014).

160. Cf. Jan Klabbers, *On Functions and Finance: Sovereign Debt Workouts and Equality in International Organizations Law*, 41 YALE J. INT'L L. ONLINE (2016), in this issue.

approach that goes beyond the contractual and statutory ones.

C. An Incremental Approach Based on Legal Principles

In the following we propose an incremental approach to sovereign debt restructuring that would promote debt sustainability in the absence of an international treaty. This approach takes sovereign debt sustainability seriously as a global public interest, i.e. a matter of concern for the international community, not only for the debtor state and its creditors. It tries to overcome the private law paradigm by making any decision relating to debt restructuring – whether on the domestic or international levels, whether taken on the political level, in the frame of debt restructuring negotiations, or by courts – subject to a set of legal principles promoting debt sustainability. The approach requires consolidating legal principles, both principles of public international law and general principles of law, which reflect progressive trends in current practice that corroborate the principle of sovereign debt sustainability.[161] Such principles complement, rather than replace, existing mechanisms, including contractual approaches and the activities of the International Financial Institutions or the Paris Club, and guide their operation. The principles give, where necessary, a new reading to existing practice in line with the global public interest in sovereign debt sustainability. They use the interpretative space between the factual and the normative, between apology and utopia, in order to highlight and strengthen trends in current practice that support debt sustainability.

The incremental strategy has inspired the 2015 UNCTAD Roadmap and Guide.[162] The UN General Assembly followed this approach in its 2015 resolution.[163] The incremental strategy follows what emerged as a possible compromise between those advocating statutory solutions in the frame of UN and those strictly opposed to such a bold endeavor, at least in the frame of the UN. Thus, in 2014, when taking the floor in the process that led to the adoption of GA Resolution 69/319, Italy, on behalf of the EU, expressed that

"[t]he ad-hoc committee must be limited to the elaboration of a non-binding 'set of principles' which builds upon a market-based voluntary contractual approach to sovereign debt restructuring and aims at furthering its implementation and use. Neither the EU nor Member States will participate in discussions aiming at the establishment of a binding multilateral legal framework for sovereign debt restructuring processes."[164]

What is the purpose of the envisaged 'set of principles'? Such principles might help establish consensus among decision-makers about sovereign debt

161. For a list of necessary economic principles, *see* Martin Guzman & Joseph Stiglitz, *Creating a Framework for Sovereign Debt Restructuring That Works, in* TOO LITTLE, TOO LATE. THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 20 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds., 2016). For a similar proposal based on general principles of law, see Schier, *supra* note 154, 109 et seq. However, Schier might have been too optimistic in deriving a fully-fledged insolvency regime from general principles, instead of a number of broad guidelines that allow improving current practice.

162. *Supra* note 72.

163. *Supra* note 79.

164. *Supra* note 159~~159~~.

restructuring practices that foster sovereign debt sustainability. Certainly, the emergence of such consensus does not immediately improve debt-restructuring practice. Principles do not have the same legal quality as international treaties. Compared to treaty law, they tend to be less precise in scope and more contested regarding their legal status and content, as one might disagree to some extent about the state and direction of current sovereign debt restructuring practice.

One might therefore doubt whether the incremental approach will be effective and meet the expectation to further develop current practice towards debt sustainability. A particularly hard case is holdout litigation, as explained in Section D. Some deem the incremental approach insufficient to fight it effectively. Accordingly, principles of international law are not widespread and clear enough to provide an effective remedy against such litigation.[165] Yet, as we showed, holdout litigation triggered a series of unambiguous signals confirming debt sustainability as a principle of international law, manifested in the overwhelming rejection to abusive vulture funds litigation.[166]

In any case, there are several avenues by which debt sustainability, including the concern for human rights, might gain traction and make sovereign debt restructurings more sustainable. First, as Robert Howse has recently pointed it out,[167] informal norms have been actually ruling the management of sovereign debt crises. While it is true that most of these standards do not have the binding force of public international law, the point to make here is that soft law should not *a priori* be ruled out as an instrument to effectively deal with debt issues. It has the capacity to set out standards of fairness that might exert a "compliance pull" on debtors and creditors.[168]

Second, states could choose to endorse such principles unilaterally, like a limited, non-binding treaty option. For states as debtors, adherence to the principles might tilt competition for sovereign debt market shares in their favor. For states as creditors, adherence to the principles might secure better outcomes for debt restructurings of other states in which they participate, as this will help to mitigate the "too little, too late" problem. States might even choose to adopt legislation that implements such principles in their domestic legal order, like the UK 2010 Debt Relief (Developing Countries) Act or the analogous Belgian legislation.[169] In the long run, such domestic legislation might corroborate the respective principles of international law through the incremental formation of corresponding general principles of law. This solution would have the advantage of allowing states greater discretion in the concretization of internationally agreed principles.

165. With respect to the 2012 UNCTAD Principles on Responsible Sovereign Lending and Borrowing: Mauro Megliani, *Vultures in Courts: Why the UNCTAD Principles on Responsible Financing Cannot Stop Litigation*, 28 LEIDEN JOURNAL OF INTERNATIONAL LAW 849 (2015).

166. *Supra,* section D.III.

167. Robert Howse, *Toward a Framework for Sovereign Debt Restructuring: What Can Public International Law Contribute?, in* TOO LITTLE, TOO LATE. THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 241 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds., 2016).

168. THOMAS M. FRANCK, THE POWER OF LEGITIMACY AMONG NATIONS 43 (1990).

169. Projet de loi relative à la lutte contre les activités des fonds vautours art. 2, Chambre des represéntants de Belgique, Doc. 54 1057/005 (July 1, 2015).

Third, courts might implement such principles when they interpret and apply the law relating to a sovereign debt case brought before them, whether the case turns on a question of contractual law, domestic private law, or international law. In principle, judges may interpret any provision relevant to a case in light of the principles, though some types of legal provisions might provide better gateways for such principles than others. For example, in civil law jurisdictions, general clauses like good faith lend themselves for the application of principles to give meaning and content to their broad scopes of application.[170] In common law jurisdictions, comity or equity might lead to equivalent results.[171] Further, to the extent that the principles constitute general principles of law, they might be directly applicable in some legal orders by virtue of legislative or constitutional incorporation.[172]

But the drawback of principles is that they require activist governments and courts for their implementation. There are plenty of examples where courts have used principles or general clauses to advance the law decisively.[173] However, their focus on individual cases might tilt courts structurally towards taking a more narrow perspective on policy issues. The need to achieve justice in a specific case comes at the risk of losing the grand picture out of sight and ignoring the development of sovereign debt restructuring practice over the last decades epitomized by the principle of sovereign debt sustainability. The codification of principles in soft law instruments might mitigate this bias to some extent and remind governments and courts of the grand picture. This seems the purpose behind the adoption of principles by the UN General Assembly's "Basic Principles on Sovereign Debt Restructuring Processes" and the UNCTAD Roadmap and Guide.[174] Courts can refer to such principles as they interpret the applicable law, in accordance with the rules of interpretation applicable to their legal order. In international law, the use of principles for interpretative purposes, though frequent practice,[175] is not clearly regulated by Arts. 31 and 32 of the 1969 Vienna Convention on the Law of Treaties (VCLT).[176] In any event, international courts may refer to soft law instruments by considering them as subsequent agreements (Art. 31(3)(a) VCLT),[177] subsequent practice (Art. 31(3)(b) VCLT),[178] relevant rules of international law

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170. On good faith, see Goldmann, *supra* note 7.

171. Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253 (2003).

172. E.g. Art. 25, Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [Basic Law], May 23, 1949, BGBl. I (Ger.).

173. Thus, the German Reichsgericht developed and applied the *clausula rebus sic stantibus* doctrine in cases of hardship deriving from the effects of the First World War, see Reichsgericht [RG] [Imperial Court] Sept. 21, 1920, 100 RGZ 129, *English translation available at* https://law.utexas.edu/transnational/foreign-law-translations/german/case.php?id=955.

174. *Supra* notes 72 and 79.

175. For many: Monetary Gold Case (Italy v. France, U.K., and U.S.A.), 1954 I.C.J. 19, 32 (June 15): "To adjudicate upon the international responsibility of Albania without her consent would run counter to a well-established principle of international law embodied in the Court's Statute, namely, that the Court can only exercise jurisdiction over a State with its consent."

176. Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331.

177. *Id*.

178. *Id*.

(Art. 31(3)(c) VCLT),[179] or as supplementary means of interpretation (Art. 32 VCLT).[180]

In addition to soft law codifications, the incremental approach would benefit from "soft" means of enforcement. By that we think in particular of a debt workout institution facilitating the implementation of the principles through recommendations and technical assistance. A debt workout institution does not need to be based on a treaty. It could also be conceived as a soft institution like a universal version of the Paris Club. Such an institution could help debtors and creditors to ensure that debt restructuring negotiations contribute to sovereign debt sustainability, in particular that they are legitimate, transparent, assisted by independent institutions, respect good faith and creditor equality. Optionally, the institution could maintain a list of uncooperative holdout creditors and their parent companies. This list, provided it respects due process rights, would incentivize individuals, companies and public entities not to make business with them. It would also guide domestic and international courts when called upon to decide whether certain creditors acted abusively in violation of good faith.

On the whole, given that a multilateral, coordinated solution appears politically unavailable, the present decentralized restructuring practice would be brought further in line with the principle of debt sustainability by an incremental approach that uses a set of principles as brackets that bend practice further towards debt sustainability. Even when there is presently no agreement as to how the principles should be further developed and implemented, it seems that the process in the General Assembly has so far broadened international consensus around a global set of principles guiding debt restructurings. This consensus becomes all the more apparent if one looks at the substance of the principles instead of their number, the scope of each principle, or the way they are called. Thus, while the UNCTAD Roadmap and Guide list five principles, the UN General Assembly has extended the list to nine. But on substance, both sets of principles broadly overlap. The General Assembly only added two principles which stress state sovereignty: principle1 emphasizes states' sovereign powers with respect to macroeconomic policy-making; principle6 with respect to sovereign immunities. These principles are compatible with the UNCTAD proposal as both are well established in international law. Apart from that, the UN General Assembly only rephrased the UNCTAD proposal or emphasized certain aspects, such as equitable treatment, which the UNCTAD proposal had included under the heading of the principle of good faith. This broad consensus is remarkable as the principles emerge from a complex pattern of practice that can be assessed and structured in different ways. To achieve consensus on substance is also important for the legitimacy of such principles. In fact, while legal scholarship and expert advice can provide input into a consensus building process, consensus in international law ultimately hinges on the establishment of agreement among states, international organizations, and

179. *Id.*

180. *Id.* The extent to which references to soft law are permissible under the mentioned provisions is controversial. *See* ANTHONY AUST, MODERN TREATY LAW AND PRACTICE 212 et seq. (3rd ed. 2013).

other actors with the capacity to make international law. This dynamic demonstrates how the complex politics of deformalization in international law[181] might ultimately turn out to strengthen the international legal order through principles of international law.

VI. CONCLUSION: CHALLENGES AHEAD

Since the beginning of the 20th century, debt-restructuring practice has come a long way. The recognition of debt sustainability as a principle in international law marks an important step ahead which takes into account the global nature of financial, economic and social relations in today's world and the ensuing interconnections. Debt sustainability demands expedient restructurings, and provides a gateway to the application of human rights provisions, including to non-state actors.[182] It opens the door towards an incremental approach to sovereign debt restructuring, of which it constitutes the normative center. Other principles, both principles of international law and general principles of law, such as good faith, transparency, and impartiality, further corroborate this process.[183] Certainly, an international treaty's binding force would greatly advance the potential of debt restructurings to achieve debt sustainability. For the time being, however, the incremental approach, which comprises and complements contractual strategies, appears to be the best available option to strengthen debt sustainability as a global public interest, and to overcome the structural bias in court decisions about holdout litigation. The principles may play the role of a social architect more than that of a policeman.[184]

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181. Sceptical about the politics of deformalization: Jean d'Aspremont, *The Politics of Deformalization in International Law*, 3 GOETTINGEN JOURNAL OF INTERNATIONAL LAW 528 (2011).

182. *See* Daniel D. Bradlow, *Can Parallel Lines Ever Meet? The Strange Case of the International Standards on Sovereign Debt and Business and Human Rights*, 41 YALE J. INT'L L. ONLINE (2016), in this issue.

183. On good faith, see Goldmann, *supra* note 7; on transparency, see Goldmann, *supra* note 17; on legitimacy and impartiality, see Odette Lienau, *Principles of Legitimacy and Impartiality for a Sovereign Debt Workout Mechanism,* 41 YALE J. INT'L L. ONLINE (2016), in this issue.

184. Georges Abi-Saab, *Eloge du "droit assourdi". Quelques réflexions sur le role de la soft law en droit international, in* NOVEAUX ITINERARIES EN DROIT: HOMMAGE A FRANÇOIS RIGAUX 68 (Bibliothèque de la Faculté de Droit de l'Université Catholique de Louvain 1993).

Sovereign Debt: Now What?

Anna Gelpern*

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INTRODUCTION

The sovereign debt restructuring regime looks like it is coming apart. The regime, such as it is, emerged in the late twentieth century, anchored in institutions dominated by the Group of Seven (G-7) wealthy nations,[1] and has shaped responses to dozens of international financial crises. All along, it drew criticism for failing to deliver enough relief or fair distribution; it prevailed nonetheless in good part because "[f]or 30 years sovereign debt restructurings have gotten done."[2] Changing patterns of capital flows, old creditors'

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1. The Group of Seven (G-7) comprises Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.

2. Lee C. Buchheit, *Sovereign Debt Restructurings: The Legal Context*, in SOVEREIGN RISK: A WORLD WITHOUT RISK-FREE ASSETS? BIS PAPERS NO. 72 107, 110 (July 2013), http://www.bis.org/publ/bppdf/bispap72.pdf. For evidence that debt relief comes too late and delivers

weakening commitment to past practices, and other stakeholders' inability to take over or coalesce behind a viable alternative, have challenged the regime from the moment it came together in the mid-1990s, so that by 2016, its survival cannot be taken for granted. Crises in Argentina, Greece, and Ukraine since 2010 exposed the regime's perennial failures and new shortcomings. Until an alternative emerges, there may be messier, more protracted restructurings, more demands on public resources, and more pressure on national courts to intervene in disputes that they are ill-suited to resolve.

Lengthy debt crises bring deadweight losses, but they also disproportionately hurt the poorest, least sophisticated debtors and creditors.[3] These ultimate stakeholders of any sovereign debt restructuring regime—citizens, taxpayers, bank depositors and pensioners—lose their livelihoods along with their faith in domestic and international institutions.[4] Governments lose their capacity to meet the basic human needs of their citizens and to safeguard their human rights.

Initiatives emanating from places as different as the United Nations General Assembly (UNGA), the International Monetary Fund (IMF), and the International Capital Market Association (ICMA)[5] reveal broad-based demand for reform. The regime's apparent decline presents an opportunity to reconsider the institutional architecture of sovereign debt restructuring, along with the norms and alliances it reflects. I argue that reform should have three objectives, addressing the old flaws and the new challenges. First, the reformed regime should achieve sustainable outcomes generally accepted as fair. It should deliver a fresh start for debtors and finality for creditors, and treat similarly situated debtors and creditors alike. Second, to that end, the restructuring process should be comprehensive and collective. Third, this regime should be intelligible and accountable to all stakeholders. While overnight transformation is not in the cards, even partial and incremental reforms should be evaluated

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too little relief, *see* Rodrigo Mariscal et al., *Sovereign Defaults: Has the Current System Resulted in Lasting (Re)Solutions?* (Escuela de Negocios: Universidad Torcuato Di Tella, Working Paper 03/2015, 2015), http://econpapers.repec.org/paper/udtwpbsdt/2015-03.htm; LEE C. BUCHHEIT ET AL., BROOKINGS INST., COMM. ON INT'L ECON. POL'Y & REFORM, REVISITING SOVEREIGN BANKRUPTCY 5-14 (2013), http://www.brookings.edu/research/reports/2013/10/sovereign-debt (follow "Download the full report" hyperlink under "Download") [hereinafter REVISITING SOVEREIGN BANKRUPTCY]; Elena Duggar, *Sovereign Defaults Series: The Aftermath of Sovereign Defaults*, Moody's (Oct. 2013); Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* (IMF, Working Paper No. WP/12/203, 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf.

3. *See, e.g.*, FEDERICO STURZENEGGER & JEROMIN ZETTELMEYER, DEBT DEFAULTS AND LESSONS FROM A DECADE OF CRISES 50-53 (2006) (summarizing economic literature on deadweight losses from sovereign debt default); Peter Fallon & Robert Lucas, *The Impact of Financial Crises on Labor Markets, Household Incomes, and Poverty: A Review of Evidence*, 17 WORLD BANK RES. OBSERVER 21, 21-45 (2002); 2 Jeffrey D. Sachs, *Introduction* to DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE: COUNTRY STUDIES—ARGENTINA, BOLIVIA, BRAZIL, MEXICO 19-24 (Jeffrey D. Sachs ed., 1990) (describing the distributional effect of debt crises).

4. *Cf.* Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of International Public Authority: Towards a Decentralized Sovereign Insolvency Law*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 39 (Carlos Espósito, Yuefen Li & Juan Pablo Bohoslavsky eds., 2013) (arguing that the effects of sovereign debt restructuring fall on the public and should be governed by public law).

5. *See infra* notes 211-213 and the accompanying text.

based on how well they advance the three objectives.

This essay proceeds as follows: Parts I and II review existing institutions for sovereign debt restructuring and the trends that have destabilized them. Part III considers three recent shocks—Argentina, Greece, and Ukraine—and what they reveal about the regime. Part IV outlines a set of contractual, statutory, and institutional measures to promote sustainable and fair outcomes, a comprehensive, collective, intelligible institutional framework, and an accountable process. I argue for more robust links among restructuring fora to deter free-riding, improve enforcement and generate shared norms, for stronger industry governance, including more contract standardization, and for richer, more standardized and accessible disclosure to promote accountability. The thrust of the argument is that any new regime, much like the old, is more likely to take hold and endure if it solves concrete problems for its diverse constituents, who understand it and have a stake in its success. On their own, each of the proposed reforms might look like a small-bore; this is misleading. The reform package as a whole is designed to build an infrastructure for repeated collaboration, and to infuse big ideas like sustainability and fairness with consensus meaning and normative pull from shared practice. It is consistent with the 2015 UNGA Resolution establishing basic principles for sovereign debt restructuring,[6] and harnesses existing institutions—the IMF, national courts, industry and civil society groups, and market infrastructure—to advance them.

I. *FIN DE* SOMETHING: SOVEREIGN DEBT RESTRUCTURING *CIRCA* 2000

Any sovereign debt restructuring regime must account for two distinctive features of sovereign debt that are so well-rehearsed in the academic literature that they no longer strike anyone as weird.[7] First, the debt contracts are unenforceable in any conventional sense.[8] Short of gunboats, there are few ways for creditors to make governments pay. Despite the dramatic erosion of sovereign immunity over the course of the twentieth century, foreign courts normally cannot seize public property, liquidate a country, or compel public officials to do their bidding.[9] Second, the debt does not go away. Governments have no access to bankruptcy relief, partly because none would submit to a binding process beyond their control.[10] While occasional default and

6. G.A. Res. 69/319 (Sept. 10, 2015).

7. I elaborate on the peculiar nature of unenforceable-yet-nondischargeable debt in Anna Gelpern, *Policy Brief 13-21: Sovereign Damage Control*, PETERSON INST. INT'L ECON. (May 2013).

8. For canonical accounts, *see* Jonathan Eaton & Mark Gersovitz, *Debt with Potential Repudiation: Theoretical and Empirical Analysis*, 48 REV. ECON. STUDIES 289 (1981) (reputation); Jeremy Bulow & Kenneth Rogoff, *Sovereign Debt: Is to Forgive to Forget*, 79 AM. ECON. REV. 43 (1989) and Jeremy Bulow & Kenneth Rogoff, *A Constant Recontracting Model of Sovereign Debt*, 97 J. POLIT. ECON. 155 (1989) (enforcement); MICHAEL TOMZ, REPUTATION AND INTERNATIONAL COOPERATION: SOVEREIGN DEBT ACROSS THREE CENTURIES (2007) (reputation).

9. W. Mark C. Weidemaier, *Sovereign Immunity and Sovereign Debt*, 2014 U. ILL. L. REV. 67 (2014); Pierre-Hugues Verdier & Erik Voeten, *How Does Customary International Law Change? The Case of State Immunity*, 59 INT'L STUD. Q. 209 (2014).

10. *See, e.g.,* Sean Hagan, *Designing a Legal Framework to Restructure Sovereign Debt,* 36 GEO. J. INT'L L. 299, 346-47, 352, 391 n. 250 (2005); Jérôme Sgard, *How the IMF Did It—Sovereign Debt Restructuring Between 1970 and 1989*, 11 CAP. MKTS. L.J. 103 (2016).

restructuring inhere in sovereign commitment, there is no debt discharge, no fresh start as a matter of right; as a result, debt relief has come from bargaining between a government and its creditors.[11] This tension between weak enforcement and no discharge frames sovereign borrowing *ex ante* and sovereign debt restructuring *ex post*.

Twentieth century restructuring institutions partly overcame the enforcement constraint by controlling borrowing governments' access to external financing.[12] More than asset seizures, debtors had to worry about getting cut off from public and private sources of foreign exchange.[13] To recover from an immune debtor, creditors had to stick together. A mix of regulatory, reputational, and contract tools to promote inter-creditor cooperation emerged in response to particular historical problems.

Changes in international trade and capital flows, the decline of absolute sovereign immunity, post-colonial and post-Soviet upheavals each periodically called for new debt management and restructuring tools, and forced the old ones to adapt. Growth in bilateral trade finance from the rubble of World War II created demand for coordination among government-to-government creditors. The Paris Club, a regular informal gathering of official bilateral creditors, was born in the 1950s.[14] The 1970s saw a spike in syndicated loans to poor and middle-income countries, made by banks in major financial centers. The crises and restructurings that followed in the 1980s required a mechanism to coordinate commercial banks. Bank advisory committees, or the London Club process, emerged in response.[15] G-7 finance officials were just backstage with moral suasion, funding and regulatory incentives, because the health of their financial systems depended on the success of the process: banks took nearly a decade to build up enough capital and reserves to absorb losses from debt reduction.[16] Meanwhile, sovereign debt kept growing.[17]

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11. Even in his advocacy of debt repayment, Alexander Hamilton acknowledged that repayment in full and on time is sometimes impossible and inadvisable. *See* ALEXANDER HAMILTON, FIRST REPORT ON PUBLIC CREDIT (1790) ("Every breach of the public engagements, whether from choice or necessity, is, in different degrees, hurtful to public credit. When such a necessity does truly exist, the evils of it are only to be palliated by a scrupulous attention, on the part of the Government, to carry the violation no further than the necessity absolutely requires, and to manifest, if the nature of the case admit of it, a sincere disposition to make reparation whenever circumstances shall permit.").

12. *See infra* notes 39-43 and accompanying text [*Cross-Conditionality and Inter-Group Discipline*]; *see also*, REVISITING SOVEREIGN BANKRUPTCY, *supra* note 2.

13. The mechanism could be either reputation (no new lending) or enforcement (blocked payments). In either case, defaulting sovereigns face disruptions in cross-border trade and financial flows, *supra* note 8; *see, e.g.*, Willem Buiter & Ebrahim Rahbari, *Why do Governments Default, and Why Don't They Default More Often?* 28, CEPR Discussion Paper No. 9492 (May 2013) (discussing liquidity shocks in countries with debt denominated in foreign currency).

14. THOMAS M. CALLAGHY, THE MISUNDERSTOOD ORIGINS OF THE PARIS CLUB (2008) (unpublished manuscript) (on file with author).

15. José Antonio Ocampo traces some of the same history, with an emphasis on the booms and busts in different forms of lending to sovereigns, but argues that the accretion of institutions to restructure sovereign debt to different creditors resulted in a "non-system." José Antonio Ocampo, *A Brief History of Sovereign Debt Resolution and a Proposal for a Multilateral Instrument*, in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 189-195 (Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz, eds., 2016). *See also*, LEX RIEFFEL, RESTRUCTURING SOVEREIGN DEBT: THE CASE FOR AD-HOC MACHINERY 95-131 (2003) (describing the London Club process).

16. WILLIAM R. CLINE, INTERNATIONAL DEBT REEXAMINED 72-73 (1995) (describing changes in the financial position of banks and developing country debt stocks throughout the 1980s); Ocampo, *supra* note 15; RIEFFEL, *supra* note 15. *See also*, JOSEPH KRAFT, THE MEXICAN RESCUE

Starting in 1989, banks exchanged unpayable loans for tradable bonds at a discount. Developing countries reduced their debt to foreign banks by a third or more.[18] Bonds quickly eclipsed loans as the funding instrument of choice for sovereigns, as they had been in the late nineteenth and early twentieth centuries.[19] Defaults returned to the sovereign bond market in the late 1990s, and called for bondholder coordination.[20] Designing the right coordination machinery was a challenge because late twentieth-century bonds traded more widely and actively than their ancestors, and because modern-day bondholders did not normally have enduring ties to governments. Creditor committees, which had led bond restructuring negotiations a century earlier and commercial bank negotiations a decade earlier, have played a limited role in contemporary bond exchanges. For the most part in the late 1990s and early 2000s, debtors and their advisers drove distressed sovereign bond exchanges, which resembled new securities offerings more than the deals brokered by bank advisory committees or bondholder councils of yore.[21]

Chronically poor countries cut off from private markets borrowed instead from governments and multilateral institutions such as the IMF, the World Bank, and regional development banks. Many of the economic reform and development programs financed with foreign official credits failed to deliver thanks to some combination of bad design, bad implementation, and bad luck. By the late 1990s, some countries' debts had grown and their economies had deteriorated so much that stretching out repayments (rescheduling) and even substantial debt reduction by Paris Club creditors could not put them on a sustainable path: their debts would keep growing in perpetuity. In response to a global civil society campaign, the G-7 unveiled newly dedicated debt relief programs, the Heavily Indebted Poor Countries (HIPC) initiative in 1996 and the Multilateral Debt Relief Initiative (MDRI) in 2005. Throughout the 1990s and into the 2000s, a mix of outside pressure, creditor country politics, new

(1984) (a journalistic account of the early days of the Third World Debt Crisis and the bank coordination process). For a description of sovereign debt restructuring as a three-party negotiation including the debtor, the creditor, and creditors' governments, *see* Jeremy Bulow & Kenneth Rogoff, *Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining-Theoretic Framework*, 35 IMF STAFF PAPERS 644 (1988).

17. CLINE, *supra* note 16.

18. *See, e.g.*, Serkan Arslanalp & Peter Blair Henry, *Is Debt Relief Efficient?*, 60 J. Fin. 1017 (2005).

19. Ross Buckley, *The Facilitation of the Brady Plan: Emerging Markets Debt Trading From 1989 to 1993*, 21 FORDHAM INT'L L.J. 1802, 1804-18, 1820-22 (1997).

20. Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Restructuring Sovereign Debt: Lessons from Recent History, in* FINANCIAL CRISES: CAUSES, CONSEQUENCES, AND POLICY RESPONSES 593 (Stijn Claessens et al. eds., 2014).

21. For accounts of bondholder committees in the nineteenth and early twentieth centuries, see Marc Flandreau, *Sovereign States, Bondholders Committees, and the London Stock Exchange in the Nineteenth Century (1827–68): New Facts and Old Fictions*, 29 OXFORD REV. ECON. POL. 668 (2013); and Rory Macmillan, *Towards a Sovereign Debt Work-out System*, 16 NW. J. INT'L L. & BUS. 57 (1995). On the development of contemporary sovereign bond restructuring practices, see NOURIEL ROUBINI & BRAD SETSER, BAILOUTS OR BAIL-INS? RESPONDING TO FINANCIAL CRISES IN EMERGING ECONOMIES (2004); STURZENEGGER & ZETTELMEYER, *supra* note 3; Ran Bi, Marcos Chamon & Jeromin Zettelmeyer, *The Problem that Wasn't: Coordination Failures in Sovereign Debt Restructurings* (IMF, Working Paper No. WP/11/265, 2011), https://www.imf.org/external/pubs/ft/wp/2011/wp11265.pdf; Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default*, 47 J. ECON. LIT. 651 (2009).

research and policy experience prompted a succession of program changes to deliver more relief in exchange for more reform. Multilateral debt of the world's poorest countries eventually would be cut for the first time alongside bilateral debt, with relief tied to policy and governance conditionality.[22]

Different fora, practices, and techniques—the Paris and London Clubs, bond exchanges, HIPC and MDRI—could be mixed and matched to suit particular debtors, creditors, and debt stocks. By the late 1990s, sovereign debt restructuring was the work of a reasonably integrated regime, even if it was not recognized as such.

The IMF established itself as the foundation of this restructuring regime beginning in the 1980s.[23] It delivered temporary liquidity for the debtor and used its lending instruments and policies to nudge disparate creditor groups to coordinate. By the turn of the century, this role was well-understood by a small core of repeat players: finance officials in debtor and creditor countries, staff and management at multilateral institutions, experts at credit rating agencies, big law and financial firms, and smaller, specialized investors.[24] A country that could not pay its debt first turned to the IMF, which typically offered financial support for up to three years, conditioned on economic reform.[25] The IMF indicated what budget savings the country could achieve, which implied a "financing gap" to be filled by new lending and debt relief from other creditors. By default, the IMF also became a gatekeeper: if the gap could not be filled, the program could not go forward. Without IMF funding, the country and its creditors faced the prospect of disorderly default.[26]

For debtors and creditors, there were few good alternatives to negotiation. Throughout the 1980s and 1990s, national courts chipped away at sovereign

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22. Technically, the debt was paid off on the debtors' behalf by donor countries. Martin A. Weiss, *The Multilateral Debt Relief Initiative*, CRS Report No. 22534 (Jun. 11, 2012), Martin A Weiss, *Debt Relief for Heavily Indebted Poor Countries: Issues for Congress*, CRS Report No. RL33073 (Apr. 18, 2006); NANCY BIRDSALL & JOHN WILLIAMSON, DELIVERING ON DEBT RELIEF: FROM IMF GOLD TO A NEW AID ARCHITECTURE (2002); IMF, *Factsheet: The Multilateral Debt Relief Initiative* (updated Sep. 17, 2015), https://www.imf.org/external/np/exr/facts/mdri.htm; IMF, *Factsheet: Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative* (updated Sept. 17, 2015), http://www.imf.org/external/np/exr/facts/hipc.htm; Joshua Busby, *Is There a Constituency for Global Poverty? Jubilee 2000 and the Future of Development Advocacy*, *in* GLOBAL DEVELOPMENT 2.0: CAN PHILANTHROPISTS, THE PUBLIC AND THE POOR MAKE POVERTY HISTORY? 85 (Lael Brainard & Derek Chollet eds., 2008).

23. Sgard puts the start of this role for the IMF in the 1970s; it developed more fully during the Third World Debt Crisis in the 1980s. Sgard, *supra* note 10.

24. *See* Anna Gelpern & Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 84 WASH. U. L. REV. 1627 (2006) (an interview-based study of sovereign bond contract reform, describing different parts of the sovereign debt restructuring community); MITU GULATI & ROBERT E. SCOTT, THE 3 1/2 MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (2012) (describing and interviewing lawyers in New York and London); *cf.* YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER 10 (1996) (describing the tightly-knit international arbitration community).

25. Lee Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHI. J. INT'L L. 333 (2005).

26. *Id*. at 341-42. Buchheit points out that this IMF role was not well understood by the private sector. While this may have been true of the private sector in general or investor groups new to the sovereign debt restructuring scene, it was not true of insiders like him, who numbered in the dozens. *Supra* note 25. Ocampo argues that outright defaults in the interwar periods led to better economic outcomes for the borrowing countries than the managed restructuring process described here. Ocampo, *supra* note 15.

borrowers' defenses to paying their debts.[27] Yet most government property remained beyond creditors' reach, either safe inside debtors' borders or covered by still-potent central bank, military and diplomatic immunities.[28] Governments that could not or would not pay their foreign creditors had to choose between compromise and a lifetime of hiding assets and rerouting payments, which made it hard to pursue international trade and finance.[29] Meanwhile, creditors with judgments against sovereigns could spend years scouring the world for morsels of attachable property and hassling debtors into settlement. A scant few could play this game; hardly anyone else found it appealing.[30]

The old regime as described so far had three key features that helped it manage sovereign debt distress just well enough to survive in a world without statutory, court-supervised bankruptcy, robust contract enforcement, or strong shared norms. It was modular, relied on cross-conditionality among creditor groups, and featured repeat players invested in its practices. I discuss them in turn below.

A. Modularity and Intra-Group Discipline

Creditors with common interests and similar claims restructured together, in more-or-less self-contained groups, which could be assembled in a modular fashion to produce a mix of reform and relief—like a building out of Lego blocks (Figure 1).

Paris Club and London Club lenders, foreign bondholders, multilateral institutions, and domestic residents each had distinct motives for lending, and distinct sources of legal, political, and economic leverage over the sovereign. For example, bilateral and multilateral creditors lent above all to advance policy objectives; they relied on diplomatic and institutional pressure to collect. Foreign commercial banks generally lent for profit, but often had a complex web of dealings with a sovereign borrower, and optimized returns across the relationship. A bank might arrange loans for a sovereign to gain regulatory favors for its branch network in the country, even if it lost money on the loans.[31] Banks could take their contracts to court, or draw on ties with

27. For U.S. jurisprudence, see, for example, *Argentina v. Weltover, Inc*., 504 U.S. 607 (1992) (U.S. courts have jurisdiction over domestic-law bonds payable in New York; debt issuance is commercial activity outside the scope of sovereign immunity); *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 757 F.2d 516 (2d Cir. 1985) (eliminating the Act of State Doctrine as a defense to sovereign default); and *Elliott Assocs*. *v*. *Banco de la Nacion*, 194 F.3d 363 (2d Cir. 1999) (effectively eliminating the champerty defense in sovereign debt).

28. The "ARA Libertad" Case (Argentina v. Ghana), Case No. 20, Order of Dec. 15, 2012, 12 ITLOS Rep. 332, https://www.itlos.org/fileadmin/itlos/documents/cases/case_no.20/C20_Order_15.12 .2012.corr.pdf.

29. *Compare* stylized description of enforcement in Bulow & Rogoff, *Is to Forgive to Forget* and *A Constant Recontracting Model*, *supra* note 8.

30. For game-theoretic analysis of sovereign debt restructuring episodes, see, for example, VINOD K. AGGARWAL, DEBT GAMES: STRATEGIC INTERACTION IN INTERNATIONAL DEBT RESCHEDULING (1996).

31. *See, e.g*., RIEFFEL, *supra* note 15 at 38 ("Accordingly, banks have a 'relationship' interest in sovereign borrowers that is totally absent among bond investors. Banks may participate in a loan to a sovereign borrower, even when the prospective return is not commensurate with the risk, if they can gain a business advantage by doing so"); *see also*, Charles Lipson, *Bankers' Dilemmas: Private*

regulators in their own and debtor countries to boost recovery. Non-bank bondholders as a rule sought to profit from the bonds, not the relationships. They had fewer non-contractual means to recover, and correspondingly fewer inhibitions about suing sovereigns. This did not necessarily make litigation the default option. In distress, bondholders tended to sell or settle, not sue, because suing immune sovereigns was time-consuming, uncertain, expensive, and inconsistent with most funds' investment strategies.[32] Lastly, domestic banks, pension funds and insurance firms sometimes lent to the sovereign under direct or implicit pressure.[33] In crisis, they bargained over their share of pain from austerity ("adjustment") policies alongside other domestic interest groups; their fate would depend in important part on domestic politics.

Creditor groups also operated under distinct regulatory, tax and accounting constraints. At one extreme, sovereign debtors could simply change their own regulations to make local banks and pension funds buy their debt. Foreign governments and banks (foreign and domestic) could keep distressed sovereign loans on their books at full value under financial reporting rules applicable to them. Government accounting let some official bilateral creditors reschedule payments and reduce interest rates without booking losses or getting new legislative authority.[34] This created a bias against principal reduction. Regulatory accounting created a similar bias for banks.[35] In contrast, investment funds typically had to value cash flows and report the market value of their assets; when they "marked to market," funds felt the impact of sovereign distress in real time. These and similar background constraints affected creditor groups' willingness to restructure, as well as their preferences for restructuring terms.

Similarly situated creditors bargained together and exerted a measure of intra-group discipline.[36] They insisted on high or total participation among

Cooperation in Rescheduling Sovereign Debts, in COOPERATION UNDER ANARCHY 200, 207 (Kenneth A. Oye ed., 1986); Jill Fisch & Caroline Gentile, *Vultures or Vanguards: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1058-59 (2004).

32. *See* ROSS BUCKLEY, EMERGING MARKETS DEBT: AN ANALYSIS OF THE SECONDARY MARKET 294-95 (J.J. Norton & Christos Hadjiemmanuil eds., 1999).

33. *See, e.g.*, Carmen M. Reinhart & M. Belen Sbrancia, *The Liquidation of Government Debt* (IMF, Working Paper No. WP/15/7, 2015), https://www.imf.org/external/pubs/ft/wp/2015/wp1507.pdf. Of course, so-called financial repression is not the only or even the dominant reason domestic actors lend to their governments—they can make bad credit judgments just as well as foreign creditors.

34. RIEFFEL, *supra* note 15, at 278-79 (describing legislative constraints on principal reduction by the U.S. government).

35. *See, e.g.*, Jonathan Hay & Nirmaljit Paul, *Regulation and Taxation of International Commercial Banks During Debt Crisis* (World Bank Technical Paper No. 158), http://www-wds .worldbank.org/external/default/WDSContentServer/WDSP/IB/1999/09/23/000178830_9810190414145 7/Rendered/PDF/multi_page.pdf.

36. The Paris Club is the most obvious example of a "creditor cartel." Member governments negotiate together and police compliance through regular meetings and monitoring within the group. *See Historical Development*, CLUB DE PARIS, http://www.clubdeparis.org/en/communications/page /historical-development (last visited Apr. 27, 2016). Group discipline became a challenge in bank syndicates when small banks refused to grant repeated concessions on par with larger banks that had higher exposure and a broader set of equities at stake in a sovereign crisis. Buckley, *supra* note 19, at 1802; *see also* 3 Robert S. Dohner & Ponciano Intal, Jr., *Debt Crisis and Adjustment*, *in* DEVELOPING COUNTRY DEBT AND ECONOMIC PERFORMANCE: COUNTRY STUDIES—INDONESIA, KOREA, PHILIPPINES, TURKEY 544 (Jeffrey D. Sachs & Susan M. Collins eds., 1989). Bond exchanges presented the biggest challenge, since the creditors were not necessarily repeat players and were not subject to regulatory suasion. Transactional techniques such as exit consents and minimum participation thresholds

members as a condition for restructuring, and devised ways to make freeriding unattractive.[37] When holdouts were small, the group might move on and settle with the debtor. This would deprive the holdout of group negotiating power; however, it also freed the debtor to pay off the holdouts quietly once the other creditors were out of the way. On occasion, large creditors paid off small holdouts in secret, so as not to encourage imitators.[38]

In sum, the existence of reasonably cohesive modules, or groups of creditors with shared motives and constraints facilitated collective action among individual creditors, and negotiations between all creditors and the sovereign debtor, so that "deals got done."

B. Cross-Conditionality and Inter-Group Discipline

A regime capable of brokering agreements within creditor modules still had to manage the problem of burden-sharing among them, and had to secure enough relief overall to revive the sovereign. With no ability to consolidate diverse claims in a single bankruptcy-style proceeding, sovereign debt restructuring fora used cross-conditionality to achieve more comprehensive, collective workouts.

IMF policies put pressure on debtors and creditors to settle, and on creditor groups to coordinate. As noted earlier, the IMF would not approve a program without assurances from the sovereign or directly from its creditors that there would be enough financing to meet the country's expected needs during the program period. IMF-supported program conditions also secured contributions from domestic creditors as part of the sovereign's adjustment program, whether or not they participated in debt restructuring alongside the foreign creditors. The IMF's avowed role was to ensure that a comprehensive combination of reform, relief, and new money was in place, and that it was workable. The Fund supplied the analytical frame, assessed performance, and enforced it with its own lending.

The Paris Club required the debtor to seek "comparability of treatment" from its other public and private foreign creditors.[39] As the term suggests, comparability was not equality—it was burden-sharing adequate to allay economic and political concerns about free riding on Paris Club countries' taxpayers. A sovereign that failed to get "comparable" terms from other creditors risked derailing its Paris Club agreement. While comparability was interpreted flexibly, few debtors or creditors were willing to sacrifice an IMF program or Paris Club relief.

Cross-conditionality could be tightened or relaxed to adjust negotiating incentives. For example, until 1989, the IMF would not finance countries in

reduced the number of dissenters. Bi et al., *supra* note 21.

37. *See* Bi et al., *supra* note 21 (describing exit consents and minimum participation thresholds, as well as majority amendment clauses in sovereign bonds, to explain the brisk pace of bond restructurings)

38. Lee C. Buchheit, *Making Amends for Amendments*, 10 INT'L FIN. L. REV. 11 (1991) (describing the rise of small bank holdouts in syndicated loan restructuring in the late 1980s).

39. *What does Comparability of Treatment Mean?*, CLUB DE PARIS, http://www.clubdeparis.org/en/communications/page/what-does-comparability-of-treatment-mean (last visited Feb. 29, 2016).

arrears to other foreign creditors.[40] This policy put pressure on sovereign debtors to stay current on their payments. When the IMF first decided to "lend into arrears"—finance governments in default on their bank loans—it loosened the ties with the London Club process, and gave debtors more negotiating leverage. The arrears policy was extended to bonds a decade later. Banks and bondholders that would not compromise now ran a higher risk of default; however, debtors still had to comply with IMF economic reform conditions and collaborate with creditors in good faith to receive IMF funds. The good faith criterion slightly offset debtors' gains from the arrears policy, and implicitly inserted the IMF as an arbiter into the negotiation process.[41]

Negotiation sequencing worked as a form of cross-conditionality. The Paris Club did not agree to grant relief until the debtor secured an IMF program. Private creditors were expected to finalize their terms after the IMF and the Paris Club.[42] This way, they would know what official creditors had done, and what everyone else was expected to deliver for the program to go forward. Although the sequencing practice began to break down with the advent of bond restructuring in the late 1990s, the underlying principle survived well into the 2000s: private creditors were free to maximize recovery so long as the IMF got its financing assurances and the Paris Club its comparability.

Different forms of cross-conditionality worked well enough together to assure creditor groups that the others were not free-riding on their concessions. Cross-conditionality was flexible enough to accommodate diverse stakeholders and diverse visions of inter-creditor equity. Each group negotiated within its unique parameters, so long as the others did not walk away or revolt over the result. Some contributed debt stock relief, others settled for reduced payment flows, yet others lent new money. Each creditor group could judge the fairness of the outcome for itself.

The modular sovereign debt restructuring regime did not reflect a general consensus on priorities and distribution. If a deal stood, it was "fair enough" for all practical purposes, though not necessarily fair or just by any shared standard. This attribute of the sovereign restructuring regime stands in contrast to domestic statutory bankruptcy. Although people find plenty to fight about in corporate and personal debt restructuring, the mere existence of a statutory framework and a judiciary to enforce it reflects a measure of agreement within a political system about distributing losses from a member's insolvency. Not so in sovereign debt.[43]

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40. JAMES M. BOUGHTON, THE SILENT REVOLUTION: THE INTERNATIONAL MONETARY FUND 1979-1989, at 477-537 (2001) (describing the context for the emergence of the IMF's arrears policy); *see also* IMF Executive Board, *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors* 6-11 (Oct. 15, 2015) (describing the process by which IMF staff obtained financing assurances from government creditors).

41. IMF, *Fund Policy on Lending into Arrears to Private Creditors—Further Considerations of the Good Faith Criterion* 3–9 (July 30, 2002), http://www.imf.org/external/pubs/ft/privcred/073002.pdf (reviewing the development of IMF policy on arrears) [hereinafter *IMF Lending into Arrears 2002*]; BOUGHTON, *supra* note 40; *see also* Lee C. Buchheit & Rosa M. Lastra, *Lending into Arrears—A Policy Adrift*, 41 INT'L LAW. 939 (2007).

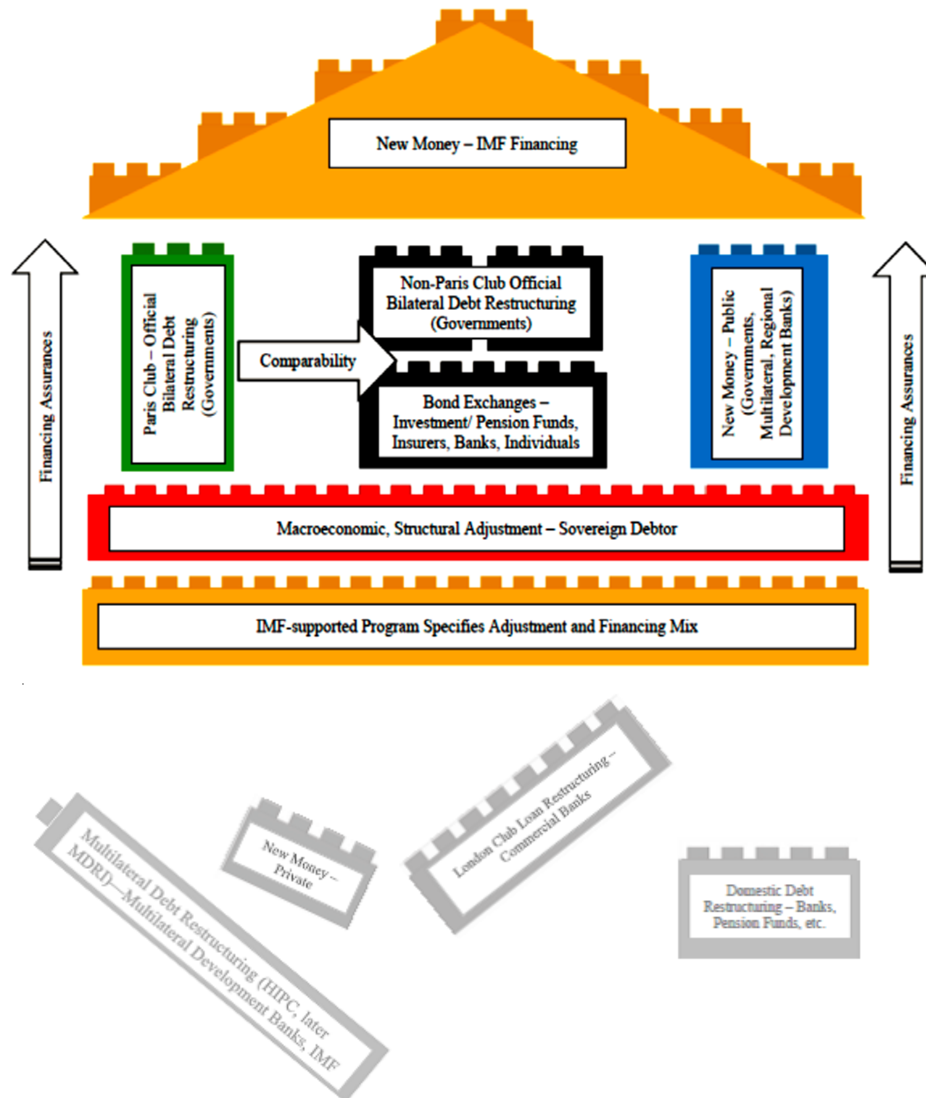
42. *See, e.g.*, JEFFREY A. FRANKEL & NOURIEL ROUBINI, ECONOMIC AND FINANCIAL CRISES IN EMERGING MARKET ECONOMIES 213 (Martin Feldstein ed., 2003).

43. *See e.g.*, Daniel K. Tarullo, *Rules, Discretion, and Authority in International Financial*

Figure 1 is a stylized depiction of the modular, cross-conditional sovereign debt restructuring regime that emerged in the mid-1990s and survived into the new century. Different building blocks representing creditor groups could be assembled based on an IMF-supported program design. The precise mix of blocks would depend on the sovereign's debt composition, and its political and financial constraints. For example, the hypothetical debtor in Figure 1 avoids London Club, domestic, and multilateral debt restructuring either because it has no debt in these categories, or because restructuring it is judged undesirable. These blocks, greyed out in Figure 1, might be indispensable for another debtor.

Reform, J. INT'L ECON. L. 613 (2001) (describing an authority gap in sovereign debt), Patrick Bolton & David A. Skeel, Jr., *Inside the Black Box: How Should a Sovereign Bankruptcy Framework Be Structured?*, 53 EMORY L.J. 763 (2004) (on the consequences of having no system of priorities in sovereign debt).

Figure 1: A Modular Sovereign Debt Restructuring Regime *circa* 2000



C. Repeat Players and Routines

The old sovereign restructuring regime depicted in Figure 1 might have been informal, but it was far from chaotic. It delivered a measure of relief for debtors and impressive returns for creditors with no treaty, no statute, and no court in charge.[44] It was flexible enough to adapt to massive shifts in global

44. Carmen M. Reinhart & Christoph Trebesch, *A Distant Mirror of Debt, Default, and Relief* (Univ. of Munich, Dep't of Econ., Discussion Paper No. 2014-49, 2014), https://epub.ub.uni-muenchen.de/21832/1/Distant_Mirror_October_27_2014.pdf; Carmen Reinhart & Christoph Trebesch, *Sovereign Debt Relief and its Aftermath*, 14 J. EUR. ECON. ASS'N 215 (2016) (debt relief figures); Michael Tomz & Mark Wright, *Empirical Research on Sovereign Debt and Default,* 2013 ANN. REV. ECON. 247; Christoph Klingen et al., *How Private Creditors Fared in Emerging Debt Markets, 1970-*

politics and economics. It was also effective enough, and accepted generally enough—just enough—to preempt far-reaching alternatives that periodically sprouted up at the United Nations, at the IMF, and among civil society groups.[45]

Nonetheless, it is hard to explain the regime's durability by its outcomes alone. Restructurings came late, and often took a long time to complete.[46] They delivered short-term liquidity relief, but often did not address the underlying solvency problems.[47] Re-defaults followed within a few years of sovereign debt restructurings in nearly forty percent of the cases.[48] While causation is open to debate, some mix of ill-conceived and ill-timed relief, and bad policy, likely played a part.

The dominance of repeat players and institutions shaped by long-term political alliances may help make sense of the regime survival puzzle. Late twentieth century sovereign debt restructurings involved a relatively small and tight cohort of officials from a handful of countries and international organizations, a dozen or so big financial firms, and half a dozen law firms.[49] They had developed the practices described earlier through trial and error, reacting to crises. They were also invested in these practices and controlled the institutions charged with their operation. Knowing the composition of and relationships among the restructuring modules, the customary sequence of negotiations, the range of terms Paris Club creditors had accepted as "comparable," the habitual exclusion of certain informally "preferred" claims from burden-sharing[50] was (and still is) invaluable in a world without statutory bankruptcy. Such knowledge can confer status, gain a seat at the negotiating table, and even help fashion arguments for reform. Long-term investment in the regime and a measure of social cohesion among those "in the know" helped sustain it.[51]

2000, at 37 (IMF, Working Paper No. WP/04/13, 2004), https://www.imf.org/external/pubs/ft/wp/2004/wp0413.pdf (observing "sizable ex post premiums" for creditors of emerging market countries in the 1990s).

45. *See, e.g*., Sgard, *supra* note 10; RIEFFEL, *supra* note 15, at 132-48 (describing the North-South Dialogue and the defeat of the International Debt Commission proposal in the 1970s); Hagan, *supra* note 10 (describing the rise and fall of the IMF's proposal for the Sovereign Debt Restructuring Mechanism (SDRM)); *see also infra* notes 84-85 and accompanying text (discussing SDRM).

46. *See, e.g*., *supra* note 2 (multiple sources citing evidence of the "too little-too late" problem in sovereign debt restructuring).

47. *See, e.g*., IMF Lending Framework Annexes, *infra* note 154.

48. Duggar, *supra* note 2; *see also* Martin Guzman & Joseph Stiglitz, *Toward a Framework for Sovereign Debt Restructuring: What Can Public International Law Contribute?, in* TOO LITTLE, TOO LATE. THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 241 (Martin Guzman, José Antonio Ocampo & Joseph Stiglitz eds. 2016).

49. GULATI & SCOTT, *supra* note 24, at 59-61; Gelpern & Gulati, *supra* note 24, at 1634-36 (2006).

50. Exclusion from comparability and other burden-sharing mechanisms was tantamount to a grant of seniority ("preferred creditor status") for claims of identical legal rank. Short-term trade credits, interbank loans, and, until recently, multilateral debt, have enjoyed such informal preference—presumably based on other participants' collective judgment that it was in their interest to consent to informal subordination. *See* RUTSEL SILVESTRE J. MARTHA, *Ranking of Obligations, in* THE FINANCIAL OBLIGATION IN INTERNATIONAL LAW 479 (2015).

51. *Compare* this depiction and Pierre-Hugues Verdier, *The Political Economy of International Financial Regulation*, 88 Ind. L. Rev. 1405 (2013) (arguing that soft law and informal network governance in international financial regulation has empowered certain political actors to the detriment of financial stability).

On the other hand, the modules, the web of cross-conditionality, and the many negotiating practices—let alone the logic behind them—were unintelligible to ordinary people, the ultimate debtors and creditors. Public debt appeared as a matter for private ordering, both in the legal sense (contract) and in the practical sense (behind closed doors). The regime as a whole could hardly claim to be effective, fair, or legitimate in absolute terms, if only because so few saw it as a regime, and because there was no shared standard by which to judge it.[52] It might have delivered serviceable outcomes on occasion, but it was not worth fighting for.

II. SOVEREIGN DEBT RESTRUCTURING *CIRCA* 2010

Three trends undermined the modular sovereign debt restructuring regime described in Part I. First, new creditors grew in importance. Countries such as China and Russia, as well as distressed bond funds and sovereign wealth funds,[53] among others, were not necessarily invested in the old restructuring processes and institutions. Second, cross-border capital mobility and government creditors' participation in the private capital markets eroded the boundaries of the restructuring modules, undermining internal discipline and cross-conditionality. Third, individual creditor lawsuits filled the enforcement gap left by the weakening modules. Some of these trends were already under way in the mid-1990s, but they intensified and combined to alter the landscape during the first decade of the twenty-first century.

A. New Players

In the 1980s, G-7 finance officials and the world's biggest commercial bankers, many of whom were on first-name basis, comprised the bulk of foreign creditors in sovereign debt restructurings.[54] By the early 2000s, new private and public players took center stage. Investment funds, pension funds, and hedge funds took over from banks as borrowers switched from loans to bonds in the 1990s. In the 2000s, governments that had been on the periphery of global finance ran large trade surpluses and expanded bilateral lending, while the G-7 wound theirs down. Sovereign wealth funds from surplus

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52. Legitimacy here does not look solely or primarily to the authority of the parties or the restructuring forum, but rather to the terms of the debt and the restructuring process that produce it. *See* Marie Sudreau & Juan Pablo Bohoslavsky, *Sovereign Debt Governance, Legitimacy, and the Sustainable Development Goals: Examining the Principles on Responsible Sovereign Lending and Borrowing*, 24 WASH. INT'L L.J. 613 (2015); *cf.* the discussion of legitimacy above and in the text to ODETTE LIENAU, RETHINKING SOVEREIGN DEBT: POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE (2014) (considering the function of sovereignty in sovereign debt).

53. "Sovereign wealth funds (SWFs) are special purpose investment funds or arrangements, owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage or administer assets to achieve financial objectives, and … [invest] in foreign financial assets." International Working Group of Sovereign Wealth Funds (IWG-SWF), *Generally Accepted Principles and Practices—Santiago Principles,* at 3 (Oct. 2008) http://www.iwg-swf.org/pubs /eng/santiagoprinciples.pdf.

54. KRAFT, *supra* note 16 (describing coordination among bilateral and multilateral officials and money center banks in the Mexican crisis of 1982); *see also* PAUL BLUSTEIN, THE CHASTENING: INSIDE THE CRISIS THAT ROCKED THE GLOBAL FINANCIAL SYSTEM AND HUMBLED THE IMF 175-205 (2003) (describing G-7 governments' engagement with their financial institutions to roll over interbank loans to Korea in late 1997).

countries invested in a growing range of international assets, including sovereign debt. Meanwhile, the G-20—a group that included both wealthy and middle-income countries—was taking over global economic and regulatory coordination from the G-7.[55]

The rise of sovereign bonds in the hands of atomistic creditors, presumptively unconnected to finance officials and uninterested in the public good, has drawn the bulk of critical attention in sovereign debt literature and policy since the mid-1990s.[56] When foreign bonds were a small part of the debt stock—as late as Russia's 1998 crisis—they could be paid in full without putting overall program financing or other creditors' participation at risk.[57] However, "bond exceptionalism" did not last: within two years of Russia's crisis, Pakistan, Ecuador, and Ukraine each launched a distressed bond exchange.[58]

The advent of tradable bonds has had a mixed impact on crisis resolution overall. Despite predictions of mass holdouts, bonds took less time to restructure than loans thanks to a mix of creditor incentives and transactional techniques.[59] Unlike banks, mark-to-market investors could not carry distressed debt on their balance sheets at face value, and did not benefit from delay as such.[60] They had every incentive to buy bonds for fifteen cents on the dollar and quickly settle for thirty cents, pocketing a 100 percent return on investment while delivering 70 percent principal reduction to the debtor. On the other hand, funds specializing in distressed sovereign debt collection also grew along with bond finance. Although they were a minority of sovereign bond holders, these funds sued much more often.[61]

New official bilateral lenders have received much less attention in the

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55. The G-20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom, United States, and European Union. The grouping originated in the policy coordination efforts after the Asian Financial Crisis of the 1997-1999, but did not assume its leadership role until 2008. *See, e.g.,* China's G-20 website, http://www.g20.org/English/Dynamic/201606/t20160601_2291 .html. China hosts the G-20 in the 2016 cycle.

56. *See, e.g.*, Anne Krueger, First Deputy Managing Dir., IMF, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring, Speech at the National Economists' Club Annual Members' Dinner (Nov 26, 2001) (transcript available at http://www.imf.org /external/np/speeches/2001/112601.htm).

57. *See, e.g.*, STURZENEGGER & ZETTELMEYER, *supra* note 3, at 104. Russia spared only a subset of its foreign bonds, those issued after the fall of the Soviet Union. By exempting post-Soviet Eurobonds from restructuring, it sought to signal both that the current government would pay its debts and that bonds were a privileged instrument. Russia's attempt to distinguish between Soviet and post-Soviet-era debt was a reputational gambit. *Cf.* LIENAU, *supra* note 52 (regime change implies new sovereignty).

58. STURZENEGGER & ZETTELMEYER, *supra* note 3 (case studies of early bond restructurings); *see also* Michael Peterson, *Emerging Market Bonds: A Crash Course in Default*, EUROMONEY, Oct. 1999, at 47-50 (describing some of the features that made bonds hard to modify, and led to their exclusion from restructurings).

59. Bi et al., *supra* note 21 (theoretical model for lack of coordination problems); Duggar, *supra* note 2, at 33 (citing 10 months on average between a government's bond restructuring announcement and completion, compared to loan restructurings that typically took years to negotiate).

60. *Supra* notes 34-35 and accompanying text.

61. Julian Schumacher, Christoph Trebesch & Henrik Enderlein, *Sovereign Defaults in Court* 10-11 (Working Paper, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2189997 (showing that lawsuits abroad accompanied only five percent of sovereign defaults in the 1980s, compared to fifty percent in the 2000s, and attributing the spike in lawsuits to the growth of specialized funds).

academic and policy debates, although they quickly became very important in some countries. In the 2000s, manufacturing and commodity exporters with large stores of government savings, most notably China and the Gulf states, began investing more of their foreign currency reserves in the emerging markets.[62] This trend accelerated after 2009, when interest rates dropped near zero in Europe and the United States post-crisis, and sent investors looking for higher returns elsewhere.[63] In parallel, China expanded its official bilateral lending to poor and middle income governments so dramatically that it eclipsed the original Paris Club lenders in some countries within a few years.[64]

New creditors contributed to the rise in complex forms of government-to-government lending that did not quite fit Paris Club reporting conventions. For example, Venezuela began borrowing from China against future oil sales in 2007; by 2015, oil payment advances from China reportedly were among the scant few sources of external financing it had left. By mid-2016, Venezuela sought a debt restructuring by another name as more and more of its oil exports effectively functioned as debt repayments.[65] Angola was even worse off, with no spare export capacity left after making its debt payments in oil.[66]

Lending that combined features of trade, investment, development aid, and strategic alliance-building was not new, but the scale and the players were.[67] In the past, such complex, mixed-motive arrangements might have

62. *See* IMF, *Market Developments and Issues,* Global Financial Stability Report 99 (April 2006), [hereinafter IMF GFSR April 2006]; *see, e.g.*, *Portfolio Overview*, ABU DHABI INV. AUTHORITY (ADIA), www.adia.ae/En/Investment/Portfolio.aspx (specifies 10-20% for government bonds and 15-25% for emerging markets). ADIA's total assets under management were estimated at $773 billion. Andrew Torchia, *Abu Dhabi fund ADIA Manages More of its Billions In-House*, REUTERS (June 2, 2015), http://www.reuters.com/article/emirates-sovereign-funds-idUSL5N0YN3LC20150602.

63. Serkan Arslanalp & Takahiro Tsuda, *Tracking Global Demand for Emerging Market Sovereign Debt* (IMF, Working Paper No. WP/14/39, 2014), https://www.imf.org/external/pubs/ft/wp/2014/wp1439.pdf.

64. For example, China became Angola's largest creditor by 2014, holding 41% of its debt, followed by the United Kingdom with 27%. IMF, *Angola Staff Report for the 2014 Article IV Consultation*, Country Report No. 14/274, at 9 (Aug. 14, 2014) https://www.imf.org/external/pubs/ft/scr/2014/cr14274.pdf. Some of China's exposure is secured by oil. Yun Sun, *China's Aid to Africa: Monster or Messiah?*, BROOKINGS (Feb. 2014), http://www.brookings.edu/research/opinions/2014/02/07-china-aid-to-africa-sun. China's lending to Congo has grown rapidly since 2006, much of it effectively secured by oil proceeds that Congo is required to keep on deposit in China. China became the dominant creditor after Congo secured HIPC and MDRI relief from wealthy countries and multilateral institutions. IMF, *Republic of Congo Staff Report For the 2014 Article IV Consultation*, Country Report No. 14/272, at 9 (July 7, 2014) https://www.imf.org/external/pubs/ft/scr/2014/cr14272.pdf; *see also* IMF, *Republic of Congo Staff Report for The 2014 Article IV Consultation—Debt Sustainability Analysis,* Country Report No. 14/272, at 2 (July 7, 2014), https://www.imf.org/external/pubs/ft/scr/2014/cr14272.pdf (China accounted for 63% of Congo's official bilateral debt and 15% of its overall external debt in 2010).

65. Corina Pons, Alexandra Ulmer & Marianna Parraga, *Venezuela in Talks with China for Grace Period in Oil-for-Loans Deal*, REUTERS (Jun. 15, 2016), http://www.reuters.com/article/us-venezuela-china-idUSKCN0Z01VH.

66. Libby George, *Growing Chinese Debt Leaves Angola with Little Spare Oil*, REUTERS (Mar. 14, 2016), http://www.reuters.com/article/angola-oil-finance-idUSL5N16H3EV.

67. The phenomenon of deliberately ambiguous financing forms is not new. For example, the United States financed South Vietnam's military with disguised agricultural credits during the Vietnam War. *See, e.g.*, Agreement between the Government of the United States of America and the Government of the Republic of Viet-Nam for Sales of Agricultural Commodities, 22 U.S.T. 1459, Sec. II.A.2 (June 28, 1971); Marian Nash (Leich), *Contemporary Practice of the United States Relating to International Law*, 91 AM. J. INT'L. L. 697, 705–06 (1997). Vietnam refused to repay the credits when it came to the Paris Club to restructure its debt in 1993. The difference is that the new creditors are not fully part of the institutions within which creditors negotiated how to deal with these ambiguities. For

been settled quietly on the margins of Paris Club negotiations. Classifying the debt and finding a forum to renegotiate it is more of a challenge when both debtors and creditors view the prevailing regime with suspicion, and are grossly underrepresented in its institutions.[68]

B. No More Modules?

After governments relaxed restrictions on cross-border capital flows, domestic and foreign investors gained access to debt instruments that had been beyond their reach.[69] Foreign creditors could buy local currency and local-law bonds in the domestic markets of poor and middle income countries.[70] Domestic banks and pension funds could participate in foreign bond offerings side by side with foreign investors.[71] Government creditors could take advantage of bigger, deeper, more liquid international markets to sell their bilateral loans.[72] As bond investors, central banks, reserve managers, and sovereign wealth funds were not uniformly risk-averse; some made bets on the bonds of troubled countries and actively managed their sovereign debt portfolios.[73] Active trading moreover meant that the mix of creditors behind a debt stock could change at any time, so that not even the debtor could ever know for sure who held what debt.[74]

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example, after the fall of Saddam Hussein, Iraq claimed that much of its "debt" to its Gulf neighbors was supposed to have been a grant, to help support Iraq in its war against Iran. Negotiations with Gulf countries, which were not part of the Paris Club, lasted for years after the Paris Club had agreed on near-total relief. MARTIN A. WEISS, CONG. RESEARCH SERV., RL33376, IRAQ'S DEBT RELIEF: PROCEDURE AND POTENTIAL IMPLICATIONS FOR INTERNATIONAL DEBT RELIEF 6 (2009).

68. *See, e.g.*, MARTIN A. WEISS, CONG. RESEARCH SERV., RS21482, THE PARIS CLUB AND INTERNATIONAL DEBT RELIEF 1 (2013) (China and Gulf states are not part of the Paris Club); NGAIRE WOODS, GOVERNING THE GLOBAL ECONOMY: STRENGTHENING MULTILATERAL INSTITUTIONS 2 (2008) (observing that China and Gulf states are underrepresented in the multilateral organizations, including the IMF and the World Bank).

69. In practice, the pace of financial liberalization and integration increased dramatically for wealthy and emerging market economies like in the late 1990s. Many formal restrictions had been lifted in the 1980s. *See e.g.*, M. Ayhan Kose, Eswar Prasad, Kenneth Rogoff & Shang-Jin Wei, *Financial Globalization and Economic Policies*, Chapter 5 in DEVELOPMENT ECONOMICS, Handbooks in Economics, vol. 5 (Dani Rodrik & Mark Rosenzweig, eds., 2010) at 4291 (Fig. 2).

70. Wenxin Du & Jesse Schreger, *Local Currency Sovereign Risk* 2, 44 (Bd. of Governors of the Fed. Reserve Sys., International Finance Discussion Papers No. 1094, 2013), https://www.federalreserve.gov/pubs/ifdp/2013/1094/ifdp1094.pdf.

71. Anna Gelpern & Brad Setser, *Domestic and External Debt: The Doomed Quest for Equal Treatment*, 35 GEO. J. INT'L L. 795 (2004); *see also* Arslanalp & Tsuda, *supra* note 63.

72. *See, e.g.*, Thomas Laryea, Donegal v. Zambia *and the Persistent Debt Problems of Low-Income Countries*, 73 L. AND CONTEMP. PROBS. 193-200 (2010) (analyzing a lawsuit brought in English courts by a private offshore fund on contracts that originated with Romania's bilateral agricultural credits to Zambia. Romania sold the loans to a private investor and avoided restructuring them in the Paris Club); *see also*, Felipe Ossa, *Woolly Outcome for Aries*, ASSET SECURITIZATION REPORT (July 3, 2006), http://www.asreport.com/issues/2006_27/176657-1.html (reporting Germany's securitization of its export credit loans to the Russian government).

73. *See, e.g.*, IMF GFSR April 2006, *supra* note 62; Brad Setser, *Norway was against Iceland before it was for Iceland*, FOLLOW THE MONEY BLOG (May 17, 2008), http://blogs.cfr.org/setser/2008/05/17/norway-was-against-iceland-before-it-was-for-iceland; Andres R. Martinez, *CIC Stops Buying Europe Government Debt on Crisis Concern*, BLOOMBERG (May 10, 2012), http://www.bloomberg.com/news/articles/2012-05-09/china-investment-stops-buying-europe-debt-on-crisis-concern-1-.

74. While their effect in sovereign debt markets is the subject of a heated debate, at least in theory, the rise of credit derivatives can further exacerbate the divergence between creditor incentives and their contractual claims. *See* Patrick Bolton & Martin Oehmke, *Credit Default Swaps and The Empty Creditor Problem*, 24 REV. FIN. STUD. 8 (2011); David Mengle, *The Empty Creditor Hypothesis*,

The trends just described were fundamentally inconsistent with a modular regime based on similar creditors holding similar legal claims. The advent of bonds already raised questions about the modules' viability—bondholders were a diverse and dynamic lot—but debtors and their advisers seized coordination initiative in the late 1990s in a way that initially made bond exchanges look like just another module.[75] They conducted informal "soundings" of key bondholders before making exchange offers, and used contract modification procedures to make holding out unattractive.[76] However, as the 2000s wore on, it was no longer safe to assume that the building blocks depicted in Figure 1 represented creditors with common interests and constraints, common accounting conventions, and more-or-less identical contracts. By 2010, a single bond exchange potentially had to sweep in Latin American pension funds, U.K. banks, euro area insurers, Asian governments, Italian pensioners, and Cayman Island hedge funds managed from Connecticut, holding bonds denominated in half a dozen currencies and governed by the laws of as many jurisdictions. Some creditors might have been susceptible to informal regulatory pressure, others driven by geopolitical imperatives, yet others committed to litigate for full repayment.[77] Reputational considerations and intra-group discipline weakened.

Changes in the composition and direction of international capital flows made some modules irrelevant, disrupted sequencing, and undermined cross-conditionality. London Club bankers' committees atrophied as syndicated loans shrank. Bondholder committees failed to take over as the default coordination mechanism, although they played important roles in some crises.[78] Bond exchanges now sometimes preceded Paris Club agreements, but cross-conditionality failed to adapt.[79] Official lenders rebuffed debtor and

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ISDA RES. NOTES (2009); Skylar Brooks et al., *Identifying and Resolving Inter-Creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring*, CENTRE FOR INT'L GOVERNANCE INNOVATION (Jan. 12, 2015), https://www.cigionline.org/sites/default/files/pb_no53.pdf; Nikki Tait & David Oakley, *Brussels Gives Sovereign CDS Trading All-Clear*, FIN. TIMES (Dec. 6, 2010), http://www.ft.com/intl/cms/s/0/5be55b2a-016a-11e0-9b29-00144feab49a.html#axzz42Ye94mRb (reporting the results of a European Union inquiry into credit default swaps as a potential source of speculative pressure on sovereign debt prices).

75. *See, e.g.*, Bi et al., *supra* note 21.

76. Researchers identified exit consents and minimum participation thresholds as particularly effective. *Id*. Exit consents are amendments to the old bonds approved by creditors just before "exiting" them for new ones. Participating creditors rarely could change the old bonds' financial terms (such changes often required unanimous consent and carried a higher risk of court challenge), but could and did strip away sovereign immunity waivers, exchange listing requirements, ranking, and other important nonfinancial terms. The old bonds became practically unenforceable, or, at best, illiquid. When sovereigns announced minimum participation thresholds in a bond exchange (typically above 90 percent), they committed not to proceed unless nearly all bondholders went along. This reassured creditors that a successful exchange would improve the debtor's finances and achieve a measure of burden-sharing, while also raising the specter of generalized default if participation fell short. *Id*.

77. Argentina's debt exchanges in 2005 and 2010 included bonds denominated in at least six currencies, governed by the laws of eight different jurisdictions. *See, e.g.*, *A Victory by Default?* ECONOMIST (Mar. 3, 2005), http://www.economist.com/node/3715779; *see also infra* Part III.

78. For different views on creditor committees, *see* Lee C. Buchheit, *Use of Creditor Committees in Sovereign Debt Workouts,* 10 BUS. L. INT'L 205 (2009) (skeptical) and Timothy B. DeSieno, *Creditor Committees in Sovereign Debt Restructurings: Understanding the Benefits and Addressing Concerns*, *in* TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, José Antonio Ocampo, & Joseph E. Stiglitz eds., 2016) 175-186 (favorable).

79. *See, e.g.*, Jorge Gallardo, *Cracks in the New Financial Architecture*, EUROMONEY, Apr. 1,

bondholder demands for "reverse comparability," apparently convinced that the point of comparability was to protect their taxpayers, not to let the first mover shape the overall debt restructuring terms.[80]

However, The Paris Club's ability to dictate terms was eroding. The trend that began with granting countries present value debt relief in the late 1980s and debt stock reduction in the mid-1990s, culminated in agreements to write off the debts of the poorest countries at the turn of the century.[81] By 2010, the club looked too small to influence other creditors, public or private. Its members had delivered near-total debt relief for some countries, such as Iraq and the poorest countries in Sub-Saharan Africa, and got full repayment from others, such as Russia. The G-7 now favored grants over loans in development aid.[82] China and the Gulf states seemed to be in no hurry to join.[83]

C. Gaps and Gap-filling

Disappearing modules and weakening cross-conditionality left gaps in the debt restructuring architecture. As described in Part I of this essay, the old regime tried to compensate for weak enforcement and the absence of bankruptcy discharge, and secured just barely enough relief for the debtor and burden-sharing among creditors to keep going. Its continued ability to deliver was now in serious doubt.

The IMF's role at the heart of the restructuring regime came to look awkward in the 2000s. In response to the rise of bonded debt, IMF management proposed a treaty-based sovereign debt restructuring mechanism (SDRM), just as Argentina careened to the largest foreign bond default on record in late 2001.[84] Despite support from European governments among others, SDRM suffered a humiliating defeat in 2003, blocked by the United States and large emerging markets, including Mexico and Brazil.[85] The intervening debate was

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2001, at 50 (describing Ecuador's failed attempt to get Paris Club creditors to grant relief comparable to its bond restructuring terms).

80. *Id*.

81. On the evolution of Paris Club terms in the 1980s and 1990s, *see, e.g.*, Christina Daseking & Robert Powell, *From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries* (IMF, Working Paper No. WP/99/142, 1999), https://www.imf.org/external/pubs/ft/wp/1999/wp99142.pdf.

82. The World Bank, *Global Development Finance: The Development Potential of Surging Capital Flows* 79-103 (2006) (documenting the wholesale shift to grants in development aid, and the trend to deeper debt forgiveness in the Paris Club); Benedict Clements et al., *Foreign Aid: Grants versus Loans*, 41 FIN. & DEV. 46, 46 (2004); OECD, *Measuring Aid: 50 Years of DAC Statistics—1961-2011*, at 14 fig.8 (2011) (grants eclipse loans in official development assistance as measured by the Organization for Economic Co-operation and Development).

83. Enda Curran, *China's Growing Clout Catches Eye of the Paris Club of Lenders*, BLOOMBERG (Feb. 27, 2016, 8:31 AM), http://www.bloomberg.com/news/articles/2016-02-27/china-s-growing-clout-catches-eye-of-the-paris-club-of-lenders. Another prominent surplus country, the Republic of Korea, did join the Paris Club in June of 2016. *The Paris Club Welcomes the Republic of Korea's Decision to Become its 21st Member*, Paris Club News Release (Jun. 6, 2016), at http://www.clubdeparis.org/en/communications/article/the-paris-club-welcomes-the-republic-of-korea-s-decision-to-become-its-21st.

84. *See* Anne Krueger, First Deputy Managing Dir., Int'l Monetary Fund, International Financial Architecture for 2002: New Approach to Sovereign Debt Restructuring, Speech at the National Economists' Club Annual Members' Dinner (Nov. 26, 2001). For the authoritative legal account by an insider, see Hagan, *supra* note 10.

85. *See, e.g.,* Hagan, *supra* note 10, at 327; Brad Setser, *The Political Economy of the SDRM*,

often bitter, with some members, private creditors and civil society groups accusing the IMF of engaging in a power grab.[86] After the SDRM trauma, IMF staff and Executive Board members were inclined to tread gingerly in the sovereign debt space. Besides, the urgency had passed—not many mainstream policy makers could justify obsessing about debt restructuring institutions in the mid-2000s, when memories of financial crises grew faint, and the fund's coffers grew flush from countries repaying their debts.[87]

Apart from such political sensitivities, the IMF's ability to anchor still-hypothetical crisis response[88] suffered from the growing gap between its resources and the scale of global capital flows, reflecting potential balance of payments vulnerabilities. Figure 2 shows IMF lending capacity against the background of capital flows in and out of the euro area and developing countries between 1999 and 2006. At the end of 1999, with much of Asia, Brazil, and Russia still in crisis, the IMF could lend up to $86 billion of its own resources, and borrow an additional $47 billion from wealthy member governments.[89] Even after disbursing nearly $10 billion to Brazil, $5.6 billion to Russia, and $6.3 billion to Indonesia during its 1998-1999 financial year,[90] the IMF could backstop a respectable 35 percent of gross capital outflows from the developing world. By 2006, with large emerging market economies borrowing from the capital markets and repaying the IMF, it could lend up to $189 billion of its own resources—but that was only eleven percent of the $1,723.8 billion in outflows from the developing world.[91] Including $1,941.4 billion from the euro area in 2006 would put available IMF resources at five percent of the relevant capital outflows. Then again, no one had imagined in 2006 that the IMF would be disbursing $20.6 billion to Greece and $8.1 billion

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in OVERCOMING DEVELOPING COUNTRY DEBT CRISIS (Barry Herman et al. eds., 2010); Gelpern & Gulati, *supra* note 24.

86. Hagan, *supra* note 10, at 345.

87. *One-Year Forward Commitment Capacity*, http://www.imf.org/external/np/tre/liquid/fccchart/052903.pdf.

88. PAUL BLUSTEIN, OFF BALANCE: THE TRAVAILS OF INSTITUTIONS THAT GOVERN THE GLOBAL FINANCIAL SYSTEM 1 (2013) (describing the IMF during this period of relative calm, and its efforts to prepare for a potential crisis).

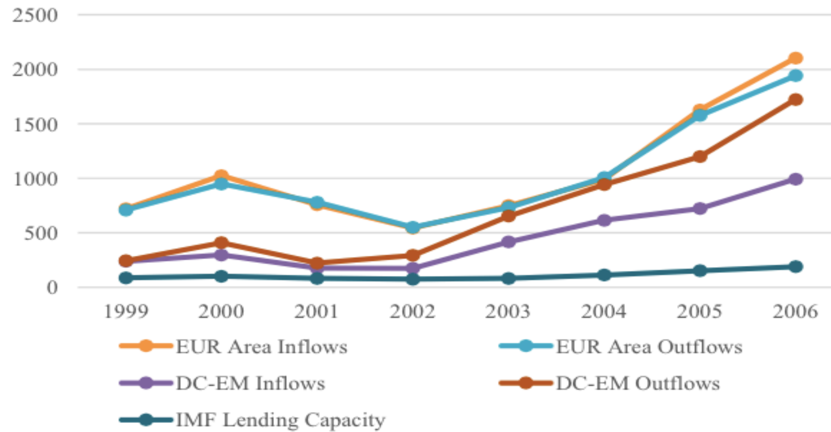
89. *IMF's Financial Resources and Liquidity Position, 1997-December 1999*, http://www.imf.org/external/np/tre/liquid/1999/1299.htm (Net Uncommitted Usable Resources).

90. IMF, *Report of the Executive Board for the Financial Year Ended April 30, 1999*, Annual Report 1999, at 100-101 (Apr. 1999), http://www.imf.org/external/pubs/ft/ar/1999/pdf/file5.pdf. U.S. dollar amounts are based on SDR1=USD1.37.

91. IMF resources were more impressive compared to portfolio flows. In 2006, the IMF could finance approximately 19 percent of combined euro area and developing country portfolio outflows. It could supplement this lending capacity in 2006 with $51 billion from borrowing arrangements with members. *IMF's Financial Resources and Liquidity Position, 2004 – December 2006*, http://www.imf.org/external/np/tre/liquid/2006/1206.htm (One-year Forward Commitment Capacity, memorandum items for General Arrangements to Borrow and New Arrangements to Borrow); IMF, *Financial Market Turbulence: Causes, Consequences, and Policies*, Global Financial Stability Report 2007, Stat. App. Table 1, 136-37 (Oct. 2007) [hereinafter IMF GFSR October 2007], http://www.imf.org/external/pubs/ft/gfsr/2007/02/pdf/text.pdf. Although portfolio flows are typically considered more volatile, the distinction between portfolio and other types of capital flows may be overblown. *See, e.g.*, UN Development Programme, Towards Human Resilience: Sustaining MDG Progress in an Age of Economic Uncertainty 86 (2011), http://www.undp.org/content/dam/undp/library/Poverty%20Reduction/Towards_SustainingMDG_Web1005.pdf.

to Ireland in just four years.[92]

Figure 2:
Total Capital Inflows and Outflows, IMF Lending Capacity
Euro Area, Developing Countries and Emerging Markets
(USD billions)



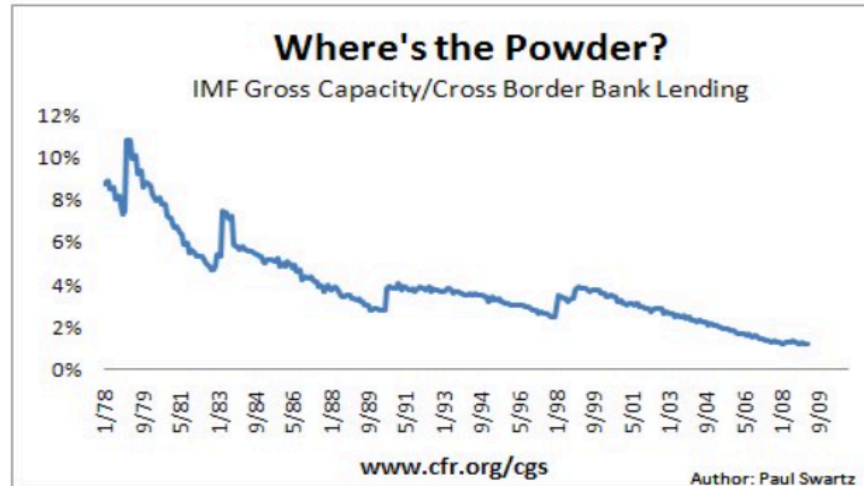
Source: IMF [93]

Long-term decline of IMF lending capacity relative to cross-border bank lending, which can be prone to runs, paints a similar picture in Figure 3.

92. IMF, *Financial Operations and Transactions*, Annual Report 2011 App. Table II.4 (2011), http://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/a2.pdf. U.S. dollar amounts are based on SDR1=USD1.62.

93. IMF GFSR October 2007, *supra* note 91; *IMF's Financial Resources and Liquidity Position, 1997-December 1999*, *supra* note 89; *IMF's Financial Resources and Liquidity Position, 2004 – December 2006*, *supra* note 91. Figures for IMF lending capacity exclude available borrowing arrangements, which stood at $47 billion in December 1999, and $51 billion in December 2006. *Id*. *See also*, *One-Year Forward Commitment Capacity*, *supra* note 87; MARKUS JAEGER, DEUTSCHE BANK RESEARCH, DOES THE IMF HAVE SUFFICIENT RESOURCES TO BAIL OUT THE EMERGING MARKETS? (2008) (market view of IMF capacity in light of the "explosion" in net private capital flows and potential future exposure).

Figure 3:



Source: Council on Foreign Relations[94]

To the extent the IMF's power to set restructuring parameters and nudge the process along depended on its unique ability to mobilize enough financing quickly to stop a run, stem contagion, and keep the distressed economy afloat during the workout, this power looked likely to diminish—for better or worse.[94]

The IMF's lopsided governance made matters worse. It reflected twentieth century compromises, with the G-7 and small European countries substantially overrepresented compared to the big emerging markets, whose voice and vote did not reflect the size and international importance of their economies.[95] Yet the incumbents showed few signs of either giving up control or investing in the IMF in the early and mid-2000s. As finance got bigger, powerful stakeholders spoke of the need to constrain the IMF as a source of "bailouts" and moral hazard.[96] Meanwhile, post-crisis countries, particularly in Asia, accumulated vast foreign exchange reserves and put in place regional arrangements that would allow them to bypass the IMF should misfortune strike again.[97]

Despite its outdated vote allocation, shrinking scale, self-insuring clients, and contested track record, the IMF remained indispensable in a debt crisis. It had the unique combination of institutional memory and analytical capacity, a

94. James M. Boughton, *The IMF as Just One Creditor: Who's in Charge When a Country Can't Pay?* CENTRE FOR INT'L GOVERNANCE INNOVATION 1 (Apr. 27, 2015); James M. Boughton et al., *IMF Lending Practices and Sovereign Debt Restructuring*, CENTRE FOR INT'L GOVERNANCE INNOVATION 4 (June 9, 2014).

95. *See, e.g.*, EDWIN M. TRUMAN, A STRATEGY FOR IMF REFORM (2006) (arguing for an overhaul in IMF governance and work program).

96. *See, e.g.*, JOHN B. TAYLOR, GLOBAL FINANCIAL WARRIORS: THE UNTOLD STORY OF INTERNATIONAL FINANCE IN THE POST-9/11 WORLD, at 98-110, 130-32 (2007), Hagan, *supra* note 10, at 345.

97. *See, e.g.*, Barry Eichengreen, *Commentary: A Blueprint for IMF Reform: More Than Just a Lender*, 10 INT'L FINANCE 153 (2007). The motives for reserve accumulation are a matter of debate, with authoritative commentary split between attributing it to self-insurance against crises and exchange rate management.

record of past practice, a global membership, and a formal governance structure prescribed by treaty—which made its actions at least somewhat accessible and predictable. The IMF's role as distressed countries' gateway to external financing long made it a valuable lever for other actors; it rose in importance as the modular regime faded and other levers disappeared. Public and private creditors sought to use IMF lending and arrears policies to gain leverage in restructuring negotiations. Sovereign borrowers cited IMF analysis and policy conditions to bolster their position *vis-à-vis* foreign and domestic constituents.[98] As it was called upon to fill more coordination gaps, the IMF was at risk of becoming both under-funded and overtaxed.

Foreign courts became another important gap-filler in the declining regime. Lawsuits accompanied only five percent of all restructurings in the 1980s, but this number climbed to 50 percent in the 2000s, with the poorest countries disproportionately represented among the defendants.[99] Sovereign debt literature generally attributes the rise of litigation since the 1990s to the rise of tradable bonds and unregulated investors in sovereign debt markets. However, bonds were but one element in the endemic weakening of the modular architecture.

The challenge by 2010 was not (or not just) the odd bondholder ready to go to court to bully countries into full repayment while they struggled to feed their people and pay cooperative creditors pennies on the dollar. Hardball negotiating tactics, free-riding, and litigious investors were part of the sovereign debt landscape in the bank loan days, when much of the law governing sovereign debt was made.[100] As the rest of the landscape changed, coordination became harder, and the courts assumed a more prominent role.

National courts sitting in contract cases are ill-suited to the coordination task. Unlike bankruptcy courts, they do not preside over a comprehensive, collective proceeding. They decide one-off disputes that happen to be brought before them, and have limited means and limited incentives to consider the sovereign's debt comprehensively. Having rejected substantive defenses to sovereign default in the 1990s, the courts left themselves no room to award creditors less than contract principal and past-due interest.[101] On the other

98. *See* IMF, *Access Policy in Capital Account Crises*, Policy Papers 18-26 (July 29, 2002); IMF, *The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations*, Policy Papers 8-21 (May 22, 2014). *See also* Buchheit & Lastra, *supra* note 41; BOUGHTON, *supra* note 40; NGAIRE WOODS, THE GLOBALIZERS: THE IMF, THE WORLD BANK AND THEIR BORROWERS (2006) (describing emerging markets officials using the IMF as a lever in domestic reform negotiations).

99. *See* Schumacher, Trebesch & Enderlein, *supra* note 61.

100. *See supra* note 27; CIBC Bank and Trust Co. (Cayman) v. Banco Cent. do Brasil, 886 F. Supp. 1105 (S.D.N.Y. 1995) (establishing the scope of permissible assignment of loan participations and inter-creditor duties in sovereign debt restructuring); Pravin Banker Assocs. v. Banco Popular Del Peru, 109 F.3d 850 (2d Cir. 1997) (applying the doctrine of comity to sovereign debt restructuring); Allied Bank Int'l v. Banco Credito Agricola de Cartago, 733 F.2d 23, 1984 U.S. App. LEXIS 23237 (2d Cir. 1984) (available on LEXIS but removed from bound Federal Reporter 2d), *vacated*, 757 F.2d 516 (2d Cir. 1985) (reversing the district court decision, limiting application of comity and act of state doctrines in sovereign debt); LNC Invs., Inc. v. Republic of Nicaragua, 115 F. Supp. 2d 358 (S.D.N.Y. 2000), *affirmed*, 228 F.3d 423 (2d Cir. 2000) (scope of sovereign immunity and effect of contractual waiver); Elliott Assocs. v. Republic of Peru, 948 F. Supp. 1203 (S.D.N.Y. 1996) (effectively eliminating the champerty defense in lawsuits on defaulted sovereign debt).

101. Cf. Marcus H. Miller & Dania Thomas, *Sovereign Debt Restructuring: The Judge, the Vultures and Creditor Rights*, 30 WORLD ECON. 1491, 1493 (2007) (arguing that the judge presiding

hand, they had no new way to force sovereigns to pay. They could make a government's life difficult and pressure it to settle, but they still had no property to seize or culprit to jail.

Policy makers, judges, and academics looked to another gap-filler—standardized contract reform—to help overcome emerging coordination gaps. "Collective Action Clauses" (CACs) in sovereign bonds allow a supermajority of creditors to approve restructuring terms and bind the dissenters. CACs had been the norm in the London market since the nineteenth century, but faced resistance in New York, where drafting custom required unanimous consent to amend financial terms. In 2002-2003, CACs became the most prominent market-friendly alternative to SDRM, and a subject of dogged advocacy by U.S. officials.[102] After Mexico issued a bond with CACs in February of 2003, New York custom shifted away from unanimity.[103]

The practical operation of CACs seemed secondary next to the goal of defeating SDRM.[104] Lost in the successful drive for contract change was the fact that CACs were simultaneously good at boosting creditor participation in an exchange offer, *and* bad at blocking committed free-riders. Since CACs had traditionally operated within individual bond issues, creditors who bought a blocking minority in a single small issue could reject the restructuring offer, see the rest of the debt stock swept into the restructuring, and then sue for preferential settlement.[105] This strategy works best if the free-rider is small: if everyone holds out, there is no restructuring and no side payment.[106] Perversely, CACs' transparent voting thresholds help the free-rider identify acquisition targets and clear the field of competitors.

Weaker discipline among creditors was not all bad for the debtors, even if it threatened to prolong the restructuring process. Without modules and cross-conditionality, sovereigns could play creditors off against one another. If private foreign investors would not lend or restructure, a government might turn to an oil-rich neighbor; if IMF conditions seemed too onerous, it could try borrowing from domestic banks, or from China; if Paris Club relief were slow in coming, foreign bondholders might be persuaded to move first.[107]

The upshot of these developments was a restructuring regime with limited

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over lawsuits against Argentina was fashioning a quasi-bankruptcy process within the framework of general civil procedure).

102. *See generally* Gelpern & Gulati, *supra* note 24.

103. *Id*.

104. *Id*. (arguing that SDRM adoption was improbable even before CACs took hold, and that few market participants or policy makers believed that CACs would help solve coordination problems).

105. Buying a blocking stake is easiest when the sovereign's bond stock is broken up into many small issues, which trade at a deep discount when the debtor is facing a crisis. For example, if the CAC in a $500 million bond issue requires a 75% majority to approve a restructuring, when the debt is trading at 20 cents on the dollar, would-be holdouts would have to pay just over $25 million to force the entire issue out of the restructuring. Minimum participation thresholds could change the incentives somewhat, by holding up the entire restructuring until a pre-announced portion of the debt (say, 90 percent of the debt stock) were bound. However, the remaining holdouts—however few—could still sue to block payments on the restructured bonds. *See infra* Part III.B.

106. Compare the position of the holdout with that of entire debt categories excluded from restructuring, described in *supra* note 57 and the accompanying text (on the exclusion of still-small Eurobonds from Russia's restructuring).

107. Argentina, Ecuador, Nigeria and Venezuela all successfully deployed such strategies.

sway over debtors or creditors. The London Club was history; the Paris Club at risk of becoming a side-show. The IMF was "just one creditor" among many—and far from the biggest—anchoring a regime where other creditors could not be counted upon to cooperate.[108] National courts presided over isolated claims with no mandate to consider the overall debt picture, and had no way to compel the sovereign to follow their orders. Such a regime might be able to nudge willing parties to compromise, but was not fit to host mortal combat to come.

III. SHOCKS IN 2010-2015

A series of shocks between 2010 and 2015 in Argentina, Greece, and Ukraine publicly exposed major flaws in the modular debt restructuring regime. U.S. federal court injunctions that blocked Argentina's access to international payment systems led to wildly unequal recoveries for similarly situated creditors, rewarding the most aggressive litigation strategies.[109] In Greece, the IMF repeatedly failed to shape debt restructuring outcomes, tainting public perceptions of its analysis and lending decisions. Greece also demonstrated the toxic politics of government-to-government debt—reviving ugly stereotypes and stoking historical resentments that threatened political compromises underpinning Europe's monetary union.[110] Both Argentina and Greece confirmed the weakness of then-standard bond contract terms against holdouts. Ukraine's debt to Russia, tangled up in the military conflict between them, showed how remnants of the old modular regime could be gamed by free-riders, prominently including official creditors.[111] The exposition below is brief, as I have written about these crises elsewhere.[112] I focus on their present implications for the sovereign debt restructuring regime.

A. Argentina

Argentina's crisis challenged the regime from the start. After the government defaulted on $82 billion in foreign bonds on December 24, 2001, it took three years to propose restructuring terms to its private bondholders—with no IMF program or Paris Club restructuring in sight.[113] The offer, initially

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108. Boughton, *supra* note 94.

109. For real-time commentary on the case, *see Pari Passu Saga,* FT ALPHAVILLE, http://ftalphaville.ft.com/tag/pari-passu-saga/ (last visited May 6, 2016).

110. IMF, *Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement*, Country Report No. 13 (June 2013) [hereinafter IMF Ex-Post Evaluation (Greece)].

111. ANNA GELPERN, POLICY BRIEF 14-20: DEBT SANCTIONS CAN HELP UKRAINE AND FILL A GAP IN THE INTERNATIONAL FINANCIAL SYSTEM 4 (Aug. 2014).

112. For the author's writings on Argentina, Ukraine, and Greece, see, for example, Brad Setser & Anna Gelpern, *Pathways Through Financial Crisis: Argentina*, 12 GLOBAL GOVERNANCE 465 (October 2006); W. Mark C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189 (2014); Gelpern, *Sovereign Damage Control*, *supra* note 7; Anna Gelpern, *Russia's Contract Arbitrage*, 9 CAP. MKTS. L. J. 308 (2014); Anna Gelpern & Mitu Gulati, *CDS Zombies*, 13 EUR. BUS. ORG. L. REV. 347 (2012).

113. REPUBLIC OF ARGENTINA, PRELIMINARY OFFERING MEMORANDUM DATED APRIL 11, 2016, at 158-163 (on file with author) [hereinafter Argentina Offering Memorandum]. Of the total, just under $80 billion represented principal outstanding; approximately $2 billion was accrued and unpaid interest. REPUBLIC OF ARGENTINA, GLOBAL OFFERING PROSPECTUS SUPPLEMENT (Reg. No. 333-117111) (Jan. 10, 2005), https://www.sec.gov/Archives/edgar/data/914021/000095012305000302/y04567e424b5.htm.

valued at approximately thirty cents on the dollar, swept in more than ninety-two percent of the defaulted debt in two bond exchanges, in 2005 and 2010.[114] Creditors who refused to go along sued in national courts around the world, and instituted arbitration proceedings before the International Center for the Settlement of Investment Disputes (ICSID).[115] For over a decade, successive governments refused to settle with holdouts on preferential terms, and paid them nothing.

Beginning in 2012, the U.S. federal judge presiding over multiple lawsuits brought against Argentina in New York blocked the government from servicing its restructured debt until it paid the holdouts in full.[116] Trial and appellate court opinions cited bond contract terms and the government's "uniquely recalcitrant" behavior to justify the equitable remedy.[117] Judges interpreted the *pari passu* (equal step) clause in Argentina's old defaulted bonds as a promise to pay all foreign debt in proportion to the current contract claim.[118] Argentina's steadfast refusal to pay the old bonds or honor court judgments, and the domestic measures it took to block holdouts from collecting, amounted to a breach, according to the courts. Ordering the government to pay money damages was useless under the circumstances, leaving injunctions as the only option in the judges' eyes. Enjoined, Argentina could no longer make interest payments to creditors who had forgiven two-thirds of their original claims in 2005 and 2010, until it paid full principal and past-due interest to creditors who had forgiven none.[119]

The injunctions operated entirely by targeting third parties who, unlike the immune sovereign, had a lot to lose in a fight with a U.S. federal court.[120] Trustees, paying agents, and clearing and payment systems around the world were mentioned by name, and risked sanctions if they tried to pass Argentina's funds to the holders of restructured bonds. When the government did try to pay in the summer of 2014, the money was frozen at the Bank of New York Mellon as trustee for the bondholders,[121] adding another $29 billion in principal to the

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114. Approximately three-quarters of the bonds were exchanged in 2005; many of the participating bondholders were regulated institutions in Argentina. Participation rate topped 92 percent when the offer was reopened in 2010. *Id*. *See, e.g*., ANNA GELPERN, POLICY BRIEF 05-2: AFTER ARGENTINA (Sep. 2005) (describing the 2005 exchange); Theresa A. Monteleone, *A Vulture's Gamble: High-Stakes Interpretation of Sovereign Debt Contracts in* NML Capital Ltd. v. Republic of Argentina, 8 CAP. MKTS. L.J. 149, 152-4 (2013).

115. A comprehensive summary of debt-related litigation around the world is in the Argentina Offering Memorandum, *supra* note 113, at 186-93. *See also*, Abaclat and Others v. Argentine Republic, ICSID Case No. ARB/07/5 (formerly Giovanna a Beccara and Others v. The Argentine Republic); Jessica Bees und Chrostin, *Sovereign Debt Restructuring and Mass Claims Arbitration before the ICSID, The* Abaclat *Case*, 53 HARV. INT'L L.J. 505, 505-07 (2012).

116. NML Capital, Ltd. v. Republic of Argentina, Nos. 08 Civ. 6978(TPG), 09 Civ. 1707(TPG), 09 Civ. 1708(TPG) (S.D.N.Y. Feb. 23, 2012). The injunctions were affirmed on appeal subject to clarification in NML Capital Ltd. v. Republic of Argentina, 699 F.3d 246 (2d Cir. 2012), and affirmed as clarified in NML Capital v. Republic of Argentina, 727 F.3d 230, 237-39 (2d Cir. 2013).

117. *Id*.

118. *Id*. at 241; NML Capital v. Republic of Argentina, No. 08 Civ. 6978, 2012 WL 5895784 (S.D.N.Y. Nov. 21, 2012).

119. *Id*. By giving up their defaulted bonds, the restructured bond holders had given up their right to accelerated principal repayment and penalty interest on the old bonds. Only periodic interest payments were due under the new bonds.

120. Weidemaier & Gelpern, *supra* note 112.

121. *See*, *e.g*., Judgment in Knighthead Master Fund LP et al. v. The Bank of New York Mellon

heap of Argentina's unpaid debt.[122] U.S. courts even blocked Argentina from issuing new local-law bonds in Buenos Aires, where Citibank's branch served as custodian, on the theory that such bonds would be sold to foreigners and constitute foreign debt covered by the "equal treatment" obligation.[123] The net effect was a court-imposed global financial boycott of the government.

The government of President Cristina Fernandez de Kirchner reacted to the boycott by digging in.[124] Officials continued to cast invective at the U.S. judge, placing him at the center of the country's domestic politics even after the appeals courts upheld his rulings,[125] after the U.S. Supreme Court refused to review the case,[126] and after Argentina was held in contempt. Meanwhile, holdout creditors fed U.S. judges a steady diet of juicy press clippings from Argentina, so that insults issued for domestic consumption in Buenos Aires might as well have been uttered in their Manhattan courtrooms.[127]

The conflict did not necessarily extend to the rest of the U.S. government: at the height of the court battle in 2014, Argentina quietly agreed to repay the Paris Club, including the United States, $9.7 billion over five years, with no links either to an IMF program, or to the treatment of private creditors. It was able to avoid the web of cross-conditionality by promising to pay in full.[128] The Paris Club deal was entirely beyond the purview of the contract litigation, where, fourteen years after the initial default, any trust that might have existed between the sovereign debtor and the U.S. courts was long gone. The conflict had become personal, political, and ugly.

Elections in the fall of 2015 brought a new government, which made settling the case and returning to the global financial markets a top priority.[129] The quick settlement brought a bizarre distribution of gains and losses, especially when considered in light of the courts' professed commitment to inter-creditor equity.[130] Argentina paid $9.3 billion in cash to settle the case,

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et al., Case No: HC-2014-000704, [2015] EWHC 270 (Ch) (February 13, 2015) (restructured English-law bond holders' attempt to recover the funds trapped at Bank of New York Mellon in London); Elaine Moore & Benedict Mander, *Argentina's Debt Battle Arrives in London with High Court Appeal*, FINANCIAL TIMES (Nov. 3, 2014, 8:53PM), http://www.ft.com/intl/cms/s/0/d84f3f5e-3f24-11e4-a861-00144feabdc0.html.

122. *See, e.g.*, Kathy Gilsinan, *65 Words Just Caused Argentina's $29 Billion Default*, ATLANTIC (July 31, 2014,), http://www.theatlantic.com/international/archive/2014/07/65-words-just-caused-argentinas-29-billion-default/375368/.

123. NML Capital v. Republic of Argentina, No. 08 Civ. 6978, 2015 WL 1087488 (S.D.N.Y. Mar. 12, 2015).

124. Nicholas Misculin & Eliana Raszewski, *Argentina's Debt Crisis Seen Rumbling On Until 2015 Election*, REUTERS (Dec. 30, 2014, 1:41PM), http://www.reuters.com/article/us-argentina-debt-analysis-idUSKBN0K81DL20141230.

125. NML Capital v. Republic of Argentina, 727 F.3d 230, 237-39 (2d Cir. 2013).

126. *Id.*, *cert. denied*, 82 U.S.L.W. 3515 (U.S. June 16, 2014) (No. 13-990).

127. NML Capital v. Republic of Argentina, No. 08 Civ. 6978 (Sept. 29, 2014) (holding Argentina in contempt of court). I am indebted to Martin Guzman for his insights into the government's rhetoric and its domestic political context.

128. Benedict Mander, *Argentina Reaches Landmark Deal with Paris Club Creditors*, THE FINANCIAL TIMES, (May 29, 2014), http://www.ft.com/intl/cms/s/0/212b0b1e-e722-11e3-aa93-00144feabdc0.html#axzz4ACwx9Qoq.

129. Benedict Mander, *Mauricio Marci Vows to End Argentina's Isolation*, FINANCIAL TIMES (Oct. 28, 2015), http://www.ft.com/intl/cms/s/0/c77cae92-7d6b-11e5-98fb-5a6d4728f74e.html.

130. *See, e.g.*, Matt Levine, *Argentina's Bond Fight Comes Down to Its Worst Bonds*, BLOOMBERG VIEW (Feb. 8, 2016,), https://www.bloomberg.com/view/articles/2016-02-08/argentina-s-

including $4.7 billion to four investment firms that had pursued it in courts around the world.[131] These were some of the most dogged and creative holdouts, the first to obtain the *pari passu* injunctions. Some of their contracts paid more than 100 percent annual interest, and ultimately returned more than 900 percent on principal in the litigation settlement, which also included reimbursement of their legal expenses.[132] Other creditors who obtained court judgments got a fifty percent return on principal.[133] By comparison, creditors who participated in the restructurings and had their bond payments frozen for nearly two years netted a relatively modest twenty to twenty-five percent return on principal, according to market estimates.[134] Creditors who neither exchanged their bonds, nor sued before the statute of limitations had run in New York got nothing at all.[135] Argentina paid the holdout claims and its restructured bond arrears from the proceeds of an oversubscribed $16.5 billion bond offering, completed on April 19, 2016.[136]

The closing chapters of Argentina's debt saga cast doubt on the ability of the prevailing restructuring regime to achieve anything close to a prompt, durable, or equitable outcome for anyone involved. After a decade of disruptive but feckless enforcement attempts (including temporary seizure of a tall ship[137]), national courts commandeered global payment intermediaries for the private benefit of a small minority of creditors. Bystanders were harmed to boost returns for the free-riders. Cross-conditionality, which had been used to promote burden-sharing among restructuring modules in the 1980s and 1990s,

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bond-fight-comes-down-to-its-worst-bonds; Supplemental Memorandum of Law in Support of the Republic of Argentina's Motion at Exhibit 1, NML Capital v. Republic of Argentina, No. 08 Civ. 6978 (S.D.N.Y. Feb. 29, 2016) [hereinafter Argentina Supplemental Exhibit].

131. Letter from Edward A. Friedman to Hon. Thomas P. Griesa, dated March 3, 2016, attaching Agreement in Principle dated February 29, 2016 (on file with author).

132. For an explanation of the Floating Rate Accrual Notes (FRANs) and their treatment in the settlement, see Levine, *supra* note 130 and Argentina Supplemental Exhibit, *supra* note 130.

133. Taos Turner, *Argentina Reaches Deal to Settle Bond Default Lawsuit*, WALL STREET JOURNAL (Feb. 16, 2016, 6:03PM), http://www.wsj.com/articles/argentina-reaches-deal-to-settle-bond -default-lawsuit-1455663817. Since the biggest holdout creditors acquired their claims at a deep discount off face value, their returns on investment were likely a multiple of the disclosed return on principal.

134. Katia Porzecanski, *Argentina's Forgotten Warrants Now a Buy at BofA as Election Bet*, BLOOMBERG BUS. (Sept. 16, 2015), http://www.bloomberg.com/news/articles/2015-09-17/argentina-s -forgotten-warrants-now-a-buy-at-bofa-as-election-bet; Charlie Devereux & Katia Porzecanski, *Argentine GDP Warrants Plunge as Growth Misses Trigger*, BLOOMBERG BUS. (Mar. 28, 2014), http://www.bloomberg.com/news/articles/2014-03-28/argentine-warrant-holders-seen-losing-out-as -gdp-misses-forecast.

135. Argentina Supplemental Exhibit, *supra* note 130, Argentina Offering Memorandum, *supra* note 113.

136. Declaration of Matthew Dukes in NML Capital v. Republic of Argentina, No. 08 Civ. 6978 (S.D.N.Y. Apr. 22, 2016), Exhibit A, Schedule 2 (listing settlement payments in the aggregate amount of $9,266,775,761); *see also*, Hugh Bronstein & Sarah Marsh, *Argentina Returns to Global Debt Markets after 15-Years*, REUTERS (Apr. 19, 2016), http://www.reuters.com/article/us-argentina-bonds-bids-idUSKCN0XG2W0 (citing offers of $68.5 billion, making the issue more than four times oversubscribed, and a litigation settlement amount of $9.3 billion); Andres D'Alessandro & Chris Kraul, *Argentina Pays Off 'Holdout' Bondholders, Elevating Hopes for Economy*, L.A. TIMES (Apr. 23, 2016), http://www.latimes.com/world/mexico-americas/la-fg-argentina-economy-20160424-story.html (confirming payment of $9.4 billion to holdout creditors from the proceeds of the $16.5 billion offering).

137. *See supra* note 28; *see also*, Jacob Goldstein, *Why A Hedge Fund Seized an Argentine Navy Ship in Ghana*, NPR (Oct. 22, 2012, 10:13AM), http://www.npr.org/sections/money/2012/10/22 /163384810/why-a-hedge-fund-seized-an-argentine-navy-ship-in-ghana.

had mutated into "equal treatment" injunctions in the hands of a national court, which produced fabulously unequal distribution. Judges got drawn into a dirty fight between a sovereign they could not control and a few sophisticated, well-resourced creditors, who took advantage of the common-law courts' narrow purview—in stark contrast to bankruptcy's comprehensive, collective process. In the end, it was domestic elections, not foreign courts, that made settlement possible.

The deal might have been good enough for Argentina, which had been hemorrhaging foreign exchange reserves, but it was not good not for the sovereign debt restructuring regime. As the fog clears, there is no consensus on what constitutes inter-creditor equity in sovereign debt. Argentina leaves behind a confused and contested jurisprudence, which will take years to sort out. On the other hand, the transactional precedent is clear: debt settlements favor the most aggressive litigants, incomplete restructurings can be hijacked by holdouts, and not suing is the one sure path for a creditor to be left out in the cold.

B. Greece

The Greek crisis that began in late 2009 tested multiple elements of the old modular regime, including the IMF's ability to establish overall parameters of reform and relief, its relationship with other official creditors, and the viability of existing contract tools for creditor coordination. The results were discouraging.

The IMF, the European Commission, and the European Central Bank (ECB) launched a €110 billion ($145 billion) financing program for Greece on May 9, 2010. The IMF's contribution of €30 billion ($40 billion) to this "troika" package was by far the largest program in its history.[138] The program went ahead despite IMF staff concerns about public debt sustainability, and based on heroic assumptions about tax collection, privatization, unemployment, economic growth, and a speedy return to the capital markets.[139] Figure 4, drawn from the IMF's own ex-post evaluation of the program, illustrates.

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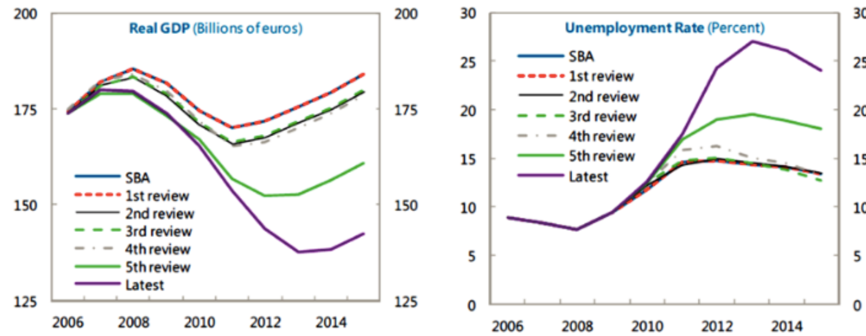
138. Press Release, IMF, IMF Executive Board Approves €30 Billion Stand-By Arrangement for Greece, No. 10/187 (May 9, 2010), https://www.imf.org/external/np/sec/pr/2010/pr10187.htm; IMF Ex-Post Evaluation (Greece) *supra* note 110, at 9.

139. IMF Ex-Post Evaluation (Greece) *supra* note 110, at 8; *see also* WILLIAM R. CLINE, MANAGING THE EURO AREA DEBT CRISIS 185 (2014); David Keohane, *Greek Government Acquires More Realistic Crystal Ball*, FT ALPHAVILLE (Nov. 1, 2012), http://ftalphaville.ft.com/2012/11/01/1241521/greek-government-acquires-more-realistic-crystal-ball/ (citing IMF and market analysis of IMF forecasts).

Figure 4:
Evolution of IMF Program Projections for Greek GDP and Unemployment[140]
("SBA" reflects projections in the May 2010 IMF stand-by arrangement)



Early baseline projections had the debt ratio rising from 115 percent of Gross Domestic Product (GDP) in May 2010 above 150 percent in 2013, potentially reaching 220 percent in some stress scenarios.[141] These projections meant that Greek debt could not be sustainable with "high probability" in the medium term, which posed a problem under the IMF's policy barring large-scale lending to over-indebted countries. As the staff saw it, the IMF had two choices: condition its participation in the troika on Greek debt relief, or ask its Executive Board to approve a policy change. Less than two years after the failure of Lehman Brothers had brought global finance to the brink, fear of Greece turning into "another Lehman-type event" took debt restructuring off the table.[142]

The Lehman reference underscores the challenge of managing debt crises in large economies integrated in regional and global financial systems (the euro area is an extreme example). Neither the IMF nor the European Union was prepared to address contagion in 2010 with liquidity support for its likely victims. Although IMF members had agreed in 2009 to lend the Fund up to $576 billion,[143] its resources remained visibly inadequate to rescue large euro area economies, certainly not two or three at the same time. The IMF's lending capacity in April 2010, on the eve of its first Greek program, was $255.5

140. IMF Ex-Post Evaluation (Greece), *supra* note 110, at 13, 17, 25.

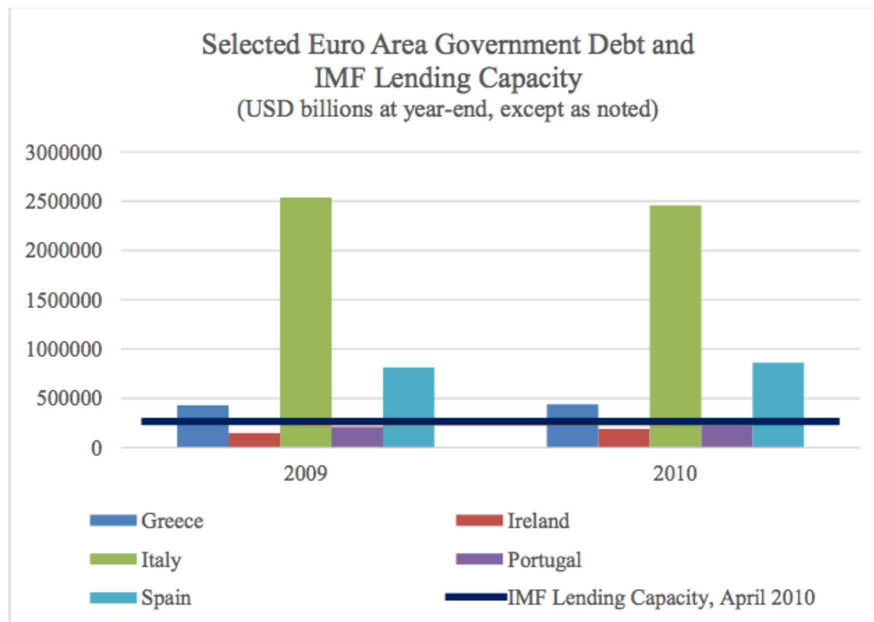
141. Paul Blustein, *Laid Low: The IMF, the Euro Zone and the First Rescue of Greece*, CENTRE FOR INT'L GOVERNANCE INNOVATION 2 (Apr. 7, 2015); IMF, *Greece: Preliminary Debt Sustainability Analysis—Updated Estimates and Further Considerations*, Country Report No. 16/130 1 (May 2016), http://www.imf.org/external/pubs/ft/scr/2016/cr16130.pdf [hereinafter IMF Preliminary Greek DSA May 2016] (citing public debt ratio of 115 percent of GDP, projected to top 150 percent despite policy adjustment); IMF Ex-Post Evaluation (Greece), *supra* note 110, at 16, 26-27 (citing initial projections for debt to peak at 154-156 percent of GDP in 2013, but continuing to rise above 220 percent under stress).

142. *Id.* at 27.

143. IMF ANNUAL REPORT FY2011 at 49 (tenfold expansion and activation of New Arrangements to Borrow (NAB) between November 2009 and April 2010), https://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/ch5.pdf; DOMENICO LOMBARDI & SARAH PURITZ MILSOM, THE BROOKINGS INSTITUTION, THE EURO-AREA CRISIS: WEIGHING OPTIONS FOR UNCONVENTIONAL IMF INTERVENTIONS 4 (Dec. 2011).

billion, counting supplemental borrowing of $253 billion.[144] In the next twelve months, it would approve nearly $210 billion in new commitments, including large, front-loaded programs for Greece and Ireland.[145] Spain and Italy, which looked shaky, were in a different category altogether. At the end of 2009, Spain had $815 billion in sovereign debt and Italy had $2.5 trillion, compared to Greece's $431 billion. In less than two years, foreign banks reduced their Italian government debt holdings by over $125 billion.[146]

Figure 5:



Sources: Eurostat, Board of Governors of the Federal Reserve System, IMF[147]

144. IMF's Financial Resources and Liquidity Position, 2008 – April 2010, http://www.imf.org/external/np/tre/liquid/2010/0410.htm (One-Year Forward Commitment Capacity).

145. IMF ANNUAL REPORT FY2011, *supra* note 143, Appendix Table II.1: Arrangements Approved during Financial Years Ended April 30, 2002-2011, and Appendix Table II.4: Purchases and Loans from the IMF, Financial Year Ended April 30, 2011, https://www.imf.org/external/pubs/ft/ar/2011/eng/pdf/a2.pdf. SDR=USD1.61967. IMF Financial Activities -- Update April 28, 2011, http://www.imf.org/external/np/tre/activity/2011/042811.htm.

146. Approximately half of Italian government debt was held by non-residents, mostly in the euro area. INT'L MONETARY FUND, ITALY: SELECTED ISSUES, IMF Country Report No. 12/168 87-88 (Jul. 2012), http://www.imf.org/external/pubs/ft/scr/2012/cr12168.pdf (detailing Italian debt composition); IMF, *The Quest for Lasting Stability*, Global Financial Stability Report 19 (Apr. 2012), http://www.imf.org/external/pubs/ft/gfsr/2012/01/pdf/text.pdf (Figure 2.6, showing a reduction of foreign bank holdings by €94 billion between Q1 2010 and Q3 2011). EUR=USD1.3449 at the end of Q3 2011. Board of Governors of the Federal Reserve System (US), U.S. / Euro Foreign Exchange Rate [DEXUSEU], (retrieved from FRED, Federal Reserve Bank of St. Louis https://research.stlouisfed.org/fred2/series/DEXUSEU, May 31, 2016); *see also* IMF, *Restoring Confidence and Progressing on Reforms*, Global Financial Stability Report 30 (Oct. 2012), http://www.imf.org/external/pubs/ft/gfsr/2012/02/pdf/text.pdf (Figure 2.9, showing the exit of foreign private investors in Italian and Spanish government debt).

147. Eurostat, Government Consolidated Gross Debt by Components - Annual Data [tipsgo11], http://ec.europa.eu/eurostat/tgm/table.do?tab=table&plugin=1&language=en&pcode=tipsgo11 ("Government debt is defined as total gross debt at nominal value outstanding at the end of the year and

If the crisis in Greece spread to Italy, contagion across the euro area, to the United Kingdom and the United States could bring back the darkest days of September 2008.[148] The euro area might have addressed the problem on its own—it had a powerful central bank, and strong economies at the core—but it was only beginning to develop the political consensus, legal and institutional tools against contagion.[149] When the risk of contagion topped the policy agenda, it was down to the IMF, which had crisis-fighting experience and resources on standby. In 2010, these resources were not enough to support new and potential IMF clients, which were vastly bigger than the old ones.

With no backstop in sight for large economies vulnerable to contagion from Greece, the IMF changed its lending policy. From May 2010, countries whose debts were not sustainable with high probability could avoid restructuring and still get large-scale IMF support, provided there was a high risk of "systemic international spillovers."[150] Greece then proceeded to borrow at least in part for the sake of broader financial stability—although Greece alone would be bound to repay.[151]

The IMF's failure to insist on debt relief for Greece in 2010 was not in itself a challenge to the old sovereign debt restructuring regime; it was the IMF's persistent inability well into 2011 to force a restructuring once it became convinced that one was necessary, and despite the risk to its own resources.[152] Finance officials had always been wary of debtor moral hazard, hurting banks, spending tax money, and, more recently, undermining the "catalytic" effect of IMF lending on the debtor's access to the private capital markets.[153] The

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consolidated between and within the sectors of general government."); Board of Governors of the Federal Reserve System (US), U.S. / Euro Foreign Exchange Rate [DEXUSEU], (retrieved from FRED, Federal Reserve Bank of St. Louis https://research.stlouisfed.org/fred2/series/DEXUSEU, May 31, 2016); *IMF's Financial Resources and Liquidity Position, 2008 – April 2010*, http://www.imf.org /external/np/tre/liquid/2010/0410.htm (One-Year Forward Commitment Capacity).

148. IMF, *Italy: 2012 Article IV Consultation*, Country Report No. 12/167, at 12 (2012), https://www.imf.org/external/pubs/ft/scr/2012/cr12167.pdf. (Box 2: Italy – Spillovers from a Potential Intensification of the Euro Area Crisis, showing cross-border borrowing by Italian banks exceeding €1.4 trillion, primarily from Germany, France, and Austria, as well as elsewhere in the euro area, Eastern Europe and the United States).

149. IMF, *Euro Area Policies: 2015 Article IV Consultation—Press Release, Staff Report, and Statement by the Executive Director*, Country Report No. 15/204, at 5 (July 2015), http://ec.europa.eu /justice/civil/files/insolvency/05a_imf_ea_art_iv_package_en.pdf (highlighting continuing risk of contagion from Greece despite new ECB tools).

150. *IMF Reforms Policy for Exceptional Access Lending*, IMF Survey, (Jan. 29, 2016), http:// www.imf.org/external/pubs/ft/survey/so/2016/POL012916A.htm.

151. *Supra* note 140-142, 149-150 and accompanying text; *compare* lending to Greece to avoid a crisis elsewhere in Europe and lending to developing countries in the 1980s to avoid a banking crisis in New York and London, *supra* note 16 and accompanying text. The argument that Greece borrowed for lack of better tools to avoid contagion broadly is distinct from the argument that troika loans bailed out French and German banks. *See, e.g.*, Dan Davies, *2010 and All That—Relitigating the Greek Bailout (Part 1)*, BULL MKT. (Jul. 21, 2015), https://medium.com/bull-market/2010-and-all-that-relitigating-the -greek-bailout-part-1-a889d468e8ae#.3z7p3pt8l (considering accusations that the Greek rescue benefited German and French financial institutions).

152. *See* Ashoka Mody, *In Bad Faith*, BRUEGEL (July 2, 2015), http://bruegel.org/2015/07/in-bad-faith/ (arguing that the IMF acted in bad faith by letting debt relief be deferred while insisting, along with euro area governments, on crippling adjustment conditions in Greece).

153. *The Fund's Lending Framework and Sovereign Debt – Annexes*, IMF 9-20 (June 2014), http://www.imf.org/external/np/pp/eng/2014/052214a.pdf [hereinafter IMF Lending Framework Annexes].

modular building in Figure 1 did not require debt reduction *per se*, only some combination of new money, debt restructuring, and adjustment to fill the financing gap during the program period. Countries avoided restructuring in 21 out of 53 emerging market sovereign debt distress episodes identified by the IMF between 1980 and 2012.[154] Debt stock sustainability became a formal condition for very large ("exceptional access") IMF programs in 2002, as part of a campaign to limit bailouts and moral hazard.[155]

There is no evidence that the 2002 policy made large programs any more exceptional, nor that it made debt restructuring more common. However, for as long as the IMF remained a source of some and the gatekeeper for most external financing in crisis, the 2002 reform raised the stakes for IMF staff analysis of borrowers' debt sustainability. At least in theory, large-scale IMF programs would mean debt restructuring, unless that analysis showed sovereign debt to be sustainable "with high probability."[156] Private creditors became big consumers of the analysis, and tough critics of the methodology.

The IMF's capacity to leverage its analytical and financial resources to shape a country's recovery program had anchored the old modular restructuring regime.[157] Greece exposed the limits of this capacity. IMF staff called for debt relief early in 2011; a bond restructuring came a year later, after more than $150 billion in private capital had fled the country and was replaced by public funds from the euro area and the IMF.[158] A new IMF program in March 2012 brought more loans and projections that Greek debt would fall below 120 percent of GDP by 2020—even as domestic politics deteriorated and support for the program sank.[159] In July 2015, the debt stock neared 180 percent of GDP and the Greek banking system was on life support from the ECB, rationing cash withdrawals. A new government was in a standoff with the troika over a third IMF program, and the IMF was at odds with its troika partners over government-to-government debt relief. In the middle of an acute political crisis, Greece threatened to abandon the euro and delayed repayment of €1.55 billion ($1.73 billion) to the IMF . . . causing new anxiety for being "the first developed country to default" on the multilateral lender.[160]

In May of 2016, Greek debt-to-GDP ratio malingered at 180 percent. Euro area governments agreed to disburse €10.3 billion ($11.5 billion) in new loans, but the IMF held back: it would wait for "a clear, detailed Greek debt

154. *Id*. at 28.

155. The new criterion was part of an effort to limit debtor and creditor moral hazard from IMF programs, instituted just as the global financial markets entered a period of relative calm. *Id*.; TAYLOR, *supra* note 96, at 119-21, 130-32 (2007).

156. IMF Lending Framework Annexes, *supra* note 153.

157. *See supra* notes 23-26 and accompanying text.

158. IMF Ex-Post Evaluation (Greece), *supra* note 110, at 27; *see also* Matthew Higgins & Thomas Klitgaard, *The Balance of Payments Crisis in the Euro Area Periphery*, 20 CURRENT ISSUES ECON. & FINANCE, no. 2, 2014, at 7, https://www.newyorkfed.org/medialibrary/media/research/current_issues/ci20-2.pdf.

159. IMF exposure would remain essentially unchanged. Press Release, IMF, IMF Executive Board Approves €28 Billion Arrangement under Extended Fund Facility for Greece, No. 12/85 (Mar. 15, 2012), https://www.imf.org/external/np/sec/pr/2012/pr1285.htm.

160. *See, e.g.*, Reuters, *Greece Becomes the First Developed Country to Default on IMF Loan*, NEWSWEEK (July 1, 2015), http://europe.newsweek.com/greece-becomes-first-developed-country-default-imf-loan-329602.

restructuring plan."[161] This was a principled position that might have produced better results had it come sooner.

IMF staff had a hard enough time negotiating Greek program parameters with euro area institutions when private investors' money was on the line; with euro area taxpayers as the dominant creditors, the political challenge was nearly insurmountable.[162] At the outset, program parameters had to be settled with euro area institutions first, leaving little room for Greek agency (or policy "ownership")[163] For their part, euro area leaders had left themselves limited scope to maneuver: after telling their citizens that EU treaties categorically barred public debt forgiveness, they had to choose between the prospect of outright default and a mix of transactional engineering, accounting gimmicks and wishful thinking about Greek citizens' tolerance for more austerity.[164] More bilateral financing was unpalatable, but default was still unthinkable for fear of financial and political contagion. The search for alternatives had produced six years of crippling economic decline and political upheaval.[165]

If the IMF proved to be a weak anchor, the Paris Club simply had no part of the Greek debt restructuring. While the Greek debt stock looked more and more like those of the poorest countries in the Paris Club, cut off from private markets, Europe insisted on handling Greece as a family affair.[166] To lighten its debt service burden, euro area governments quietly extended repayment term to between fifteen and forty years, and lowered interest rates to 1.2 percent on average; however, they stood firm against reducing principal claims.[167] This approach might have relieved near-term liquidity pressures, but was not enough to alter the debt trajectory, nor to stop government-to-government debt from fueling political fights that cast doubt over the viability

161. *Greece Bailout: IMF Queries Eurozone Debt Relief Deal*, BBC (May 25, 2016), http://www.bbc.com/news/world-europe-36382973.

162. IMF Ex-Post Evaluation (Greece), *supra* note 110, at 21, 30-32.

163. On Greek program "ownership," see IMF Ex-Post Evaluation (Greece), *supra* note 110. *Compare* BLUSTEIN, *supra* note 54, *with* WOODS, *supra* note 98 (on economic reform and power dynamics between emerging market and multilateral officials).

164. *See, e.g.*, Ashoka Mody, *Wolfgang Schäuble, Debt Relief, and the Future of the Eurozone*, BRUEGEL (August 6, 2015), http://bruegel.org/2015/08/wolfgang-schauble-debt-relief-and-the-future-of-the-eurozone/; Paul Carrel, *Legal Gray Areas Give Scope for Greek Debt Relief If Europe Wants It*, REUTERS (July 9, 2015), http://www.reuters.com/article/us-eurozone-greece-debt-idUSKCN0PJ28G20150709.

165. *See* Mody, *supra* note 164.

166. Both had triple-digit debt ratios and few private creditors. For example, at the end of 2012, after most of its privately held debt had been repaid or restructured, Greece had a debt-to-GDP ratio north of 150 percent and rising, while private creditors held approximately 20 percent of its debt; the rest was in the hands of other governments and the IMF. IMF Preliminary Greek DSA May 2016, *supra* note 141, at 4; *compare* debt composition figures cited in Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy*, 28 ECON. POL'Y 513 (2013) [hereinafter Greece Autopsy], *and* Liberia in 2007-2008, with 28 percent of the debt stock in the hands of commercial creditors, and an external debt-to-GDP ratio of 186 percent before debt relief. IMF, *Liberia: Enhanced Initiative for Heavily Indebted Poor Countries—Completion Point Document and Multilateral Debt Relief Initiative*, Country Report No. 10/192, at 32, 41 (July 2010) http://www.imf.org/external/pubs/ft/scr/2010/cr10192.pdf.

167. IMF Preliminary Greek DSA May 2016, *supra* note 141, at 4-5 (arguing that substantial official debt relief to date is not enough to achieve sustainability); *see also* William R. Cline, *Policy Brief 15-12: From Populist Destabilization to Reform and Possible Debt Relief in Greece*, PETERSON INST. INT'L ECON. (Aug. 2015).

of the monetary union.[168]

In contrast to the tortured path to official debt relief, the 2012 Greek bond restructuring was a brilliantly executed operation, at least on a technical level. Once it was launched, the deal was done, and done quickly. It covered a record-breaking stock of debt, approximately €200 billion ($260 billion), and reduced the private debt burden by over fifty percent.[169] The smooth execution was mostly attributable to the fact that more than ninety percent of the bonds were governed by Greek law and could be amended retroactively by statute.[170] The Greek Bondholder Act enabled the government to call a single vote of all its Greek-law bond holders, with quorum and voting thresholds set low at fifty percent and 66 2/3 percent, respectively, to ensure success.[171] The voting mechanism in Greek retroactive legislation was fundamentally unlike then-standard contractual CACs: the law was designed *ex post* to prevent individual bond series from dropping out and free-riding on the rest. CACs incorporated in contracts *ex ante* had always allowed some bonds to drop out. The single stock-wide vote legislated in Greece meant that either all or none of the bonds polled were bound to restructure.

Greece got much less benefit from the CACs already incorporated in its foreign-law bond contracts.[172] As noted in Part II, such CACs had been held up as a bulwark against free-riders in G-7 statements and G-10 reports since the mid-1990s.[173] As was customary at the time, CACs in Greek bond contracts governed by English and Swiss law applied only to individual bond series. Holdouts secured blocking positions in more than half of the series by number. The restructuring vote failed for approximately forty-four percent of foreign-law principal outstanding.[174] Private creditors holding €6.4 billion ($8.3 billion) in bonds kept their old bonds and have been paid on schedule since.[175]

The 2012 restructuring also caused controversy for excluding €56.7 billion ($73.7 billion) in bonds held by the ECB and national central banks in the euro area.[176] The ECB was Greece's largest bondholder and the biggest holdout. The exclusion of central bank holdings sent the signal that some official creditors would get paid first even when their contracts were identical to those of private creditors, and threatened to make official support

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168. *See, e.g.*, Jason Hovet, *Czech President Floats Idea of Greece Paying Debts by Hosting Migrant Centers*, REUTERS (Andrew Bolton ed., Mar. 6, 2016), http://www.reuters.com/article/us-europe-migrants-czech-president-idUSKCN0W80KJ; Yanis Varoufakis, *Germany Won't Spare Greek Pain—It Has an Interest in Breaking Us*, GUARDIAN (July 10, 2015), http://www.theguardian.com/commentisfree/2015/jul/10/germany-greek-pain-debt-relief-grexit.

169. Greece Autopsy, *supra* note 166, at 2.

170. Greece Autopsy, *supra* note 166. Retroactive legislation superimposed a majority voting mechanism on the entire stock of domestic-law bonds. Although it was enacted after consultations with creditors, it was in no way contractual – neither consensual nor market standard. The thresholds were designed to ensure that dissenting creditors would be outvoted by a combination of Greek and other euro area banks.

171. *Id.* at 11-12.

172. *Id.* at 42.

173. *See supra* Part II.

174. Greece Autopsy, *supra* note 166.

175. *Id*.

176. *Id*. at 15, 28.

synonymous with subordination in the eyes of such creditors.[177] To diffuse market fears that could undermine its emergency interventions, the ECB later promised that its new financing would be *pari passu* with the debt owed to private creditors.[178] This promise has not been tested.

In sum, the Greek experience implied that the IMF was weak, the Paris Club irrelevant, government creditors paralyzed by domestic politics, and CACs mostly futile. It highlighted a peculiar structure of accountability in crisis management institutions, which allowed Greece to accumulate unpayable debt at least in part thanks to their own inability to stop contagion and manage domestic politics in creditor countries. Echoing the experience of developing countries in the 1980s, Greece took on more and more debt at least in part because the international financial architecture was unequipped to process its default.

The IMF responded to the controversy surrounding its Greek programs, and to a lesser extent Argentina, with an effort to recapture policy initiative beginning in 2013.[179] Most importantly, in January 2016, the Executive Board did away with the systemic risk exception that had allowed the IMF to lend to Greece despite its questionable debt profile.[180] It also expressly broadened the range of restructuring outcomes IMF staff could seek when a country's debt sustainability was in doubt—effectively loosening the 2002 lending policy with its heavy emphasis on achieving sustainability.[181] This implied that in some cases, private creditors would be asked to maintain their exposure to the distressed country as a condition of IMF support for the country, as they had done on several occasions before 2002.

The revised policy also suggested that other governments—not the IMF—should finance a country like Greece on below-market terms to stem contagion.[182] Disclaiming responsibility for fighting contagion might help reduce political pressure on the IMF to lend to over-indebted countries.[183] However, unless other parts of the global financial system take on the task, the

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177. In addition to the Eurosystem holdings, €350 million in bonds held by the European Investment Bank (EIB) were excluded from restructuring. *Id*. On the other hand, Greek bonds held by the Norwegian sovereign wealth fund were treated alongside privately held bonds, and restructured over its objections. Richard Milne, *Norway State Fund Sells Eurozone Debt*, FIN. TIMES (May 4, 2012), http://www.ft.com/intl/cms/s/0/1c657afa-95e5-11e1-a163-00144feab49a.html#axzz42cmRohmK.

178. Press Release, European Central Bank, Technical Features of Outright Monetary Transactions (Sept. 6, 2012) ("The Eurosystem intends to clarify in the legal act concerning Outright Monetary Transactions that it accepts the same (pari passu) treatment as private or other creditors with respect to bonds issued by euro area countries and purchased by the Eurosystem through Outright Monetary Transactions, in accordance with the terms of such bonds.").

179. *See Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF (April 26, 2013), https://www.imf.org/external/np/pp/eng/2013 /042613.pdf [hereinafter IMF 2013 Sovereign Debt Review].

180. Press Release, IMF, IMF Executive Board Approves Exceptional Access Lending Framework Reforms, No. 16/31 (Jan. 29, 2016).

181. *Id*.

182. Press Release, IMF, IMF Executive Board Approves Exceptional Access Lending Framework Reforms, No. 16/31 (Jan. 29, 2016) (reporting Board approval of the policy); IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper (Apr. 9, 2015) (policy reform proposal). Going forward, this would mean a lot more bilateral rescue packages of the sort the United States had arranged for Mexico as a temporary measure to stem the 1990s Tequila crisis.

183. IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper 10-11 (Apr. 9, 2015).

pressure is likely to return in the next crisis.[184] As a membership organization with a crisis-fighting mandate, the IMF could find it hard to resist.

C. Ukraine

A political and economic crisis in Ukraine beginning in late 2013 again forced the IMF to deal with the breakdown of old debt restructuring modules. This time, the vanishing boundary between official and private debt presented the biggest problem.

The IMF approved a $17 billion lending program for Ukraine in April 2014, soon after the ouster of former President Viktor Yanukovych and Russia's annexation of Crimea, when the eastern part of the country erupted in conflict with Russian-backed rebels.[185] Unlike Greece, Ukraine presented little risk of contagion. Moreover, the IMF was by far the biggest source of financing for the program. The IMF did not ask for a debt restructuring this time because it judged Ukraine's debt, then less than 50 percent of its GDP, "sustainable with high probability" subject to "uncertainties that come from the geopolitics."[186] Less than a year later, Ukraine asked its creditors for forty percent debt reduction under a new IMF program that deemed its debt patently unsustainable.

The episode again underscored the risk of turning the IMF staff debt sustainability analysis (DSA) into a formal gateway for large-scale packages: it made complex, multi-factor calculations that mixed art and science[187] politically salient, and associated them with binary determinations (lend/not lend, restructure/not restructure).

The tendency to shape analysis to lending imperatives was hardly new, but the stakes were higher, and the process more visible with a mandatory, formal policy. The analysis itself grew more rigorous and elaborate; however, its most visible use was in the service of the lending policy. This fed suspicions of analytical bias especially in strategically important cases like Ukraine, or systemically important ones like Greece. It also anchored market expectations about IMF actions, and sent market participants off to construct matrices matching DSA profiles to likely IMF restructuring demands.[188] These efforts to map future IMF actions with precision in a world of uncertainty and discretion were bound to over-interpret, and likely to disappoint.

Having asked Ukraine to restructure its foreign bonds in 2015, the IMF became implicated in two fights: one with Ukraine's private creditors and

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184. IMF, *The Fund's Lending Framework and Sovereign Debt—Further Considerations*, Policy Paper (Apr. 9, 2015)

185. Ian Talley, *IMF Approves $17 Billion Emergency Aid for Ukraine's Economy*, WALL STREET J. (Apr. 30, 2014), http://www.wsj.com/articles/SB1000142405270230394810457953414046654 3308.

186. *Id*. (quoting IMF Deputy Managing Director David A. Lipton).

187. Julian Schumacher & Beatrice Weder di Mauro, *Debt Sustainability Puzzles: Implications for Greece*, VOX-EU (July 12, 2015), http://voxeu.org/article/debt-sustainability-puzzles-implications-greece.

188. Gregory D. Makoff, *Debt Reprofiling, Debt Restructuring and the Current Situation in Ukraine*, CENTRE FOR INT'L GOVERNANCE INNOVATION (Apr. 2015), https://www.cigionline.org/sites/default/files/cigi_paper_no.63.pdf.

another with Russia. If Ukraine complied with economic reform conditionality and engaged with its creditors in good faith, but the creditors refused to restructure, the IMF could "lend into arrears" and back the government's threat to stop paying.[189] But one of the biggest bondholders was Russia, an IMF member whose sovereign wealth fund had bought an entire $3 billion Ukrainian bond issue in late 2013 to support Yanukovych.[190] The bond was an ordinary tradable obligation governed by English law, albeit paying less than half the market interest rate at the time; it came due at the end of 2015 and represented the biggest debt payment during the IMF program.[191]

In a world of pristinely compartmentalized debt restructuring modules, private bondholders might have been offered a debt exchange, while Russia might have restructured its debt in the Paris Club as part of a grand political bargain. In today's world, Russia had initially refused to include the $3 billion Ukrainian bond in its Paris Club accounting—and also refused to participate in a bond exchange alongside private creditors. With any other recalcitrant bondholder, Ukraine could have taken advantage of the IMF's policy on lending into arrears.[192] However, this policy did not apply to government creditors, for whom the rule was "non-toleration" of arrears.[193] IMF had tried to align the two policies from the start in 1989, but bilateral creditors who dominate its Executive Board were loath to give up an enforcement channel. Russia's refusal to restructure and Ukraine's refusal to pay Russia in full thus threatened to undermine the program.

Backed by the IMF's threat to lend into arrears, Ukraine convinced most of its private bondholders to settle for approximately twenty percent debt reduction, along with an extension of maturities, in a September 2015 debt exchange.[194] Some creditors who held bonds coming due in the near term extracted a larger settlement after threatening to vote their blocking position against Ukraine's offer in selected bond series with CACs.[195] However, Russia was the bigger problem, since it held 100 percent of its bond issue and refused

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189. *See* Press Release, IMF, *IMF Executive Board Discusses reforming the Fund's Policy on Non-Toleration of Arrears to Official Credits*, No. 15/555 (Dec. 10, 2015); Reuters, *Ukraine Is On Track to Default on Its Russian Debt*, FORTUNE (Dec. 18, 2015, 12:50 PM), http://fortune.com/2015/12/18/ukraine-default-russian-debt/.

190. Laura Mills, *Ukraine Suspends Payment on $3 Billion Loan from Russia*, WALL STREET J. (Dec. 18, 2015, 10:44 AM), http://www.wsj.com/articles/ukraine-suspends-payment-on-3-billion-loan-from-russia-1450441229; *see also* GELPERN, *supra* note 111, at 4.

191. Natasha Doff & Marton Eder, *After Default to Putin, What's Next for Ukraine-Russia Bond Row*, BLOOMBERG (last updated Dec. 21, 2015, 12:19 PM), http://www.bloomberg.com/news/articles/2015-12-20/after-default-to-putin-what-s-next-for-ukraine-russia-bond-row; *see also* GELPERN, *supra* note 111, at 4.

192. *See* IMF, *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors*, Policy Paper (Dec. 2015) [hereinafter IMF Arrears 2015]; IMF Lending into Arrears 2002, *supra* note 41.

193. IMF, *Status of Ukraine's Eurobond held by the Russian Federation* (Dec. 11, 2015) http://www.imf.org/external/pubs/ft/scr/2015/cr15344.pdf.

194. Exchange Offer Memorandum Dated 23 September 2015 as Amended and Restated to Reflect the Changes Set out in the Supplements Dated 5 October and 9 October 2015, Ukraine (2015), http://sites.dfkingltd.com/DocumentDownload.ashx?item=nTeO_K91-UCRn3TCRM74NA.

195. Natasha Doff & Marton Eder, *Ukraine Bond Deal at Risk Again as Rebel Investors Demand Change*, BLOOMBERG (last updated Sept. 18, 2015, 12:23 PM), http://www.bloomberg.com/news/articles/2015-09-17/ukraine-dissenting-bondholders-have-blocking-stake-law-firm; compare with Greek foreign-law bonds in *supra* notes 172-175.

to participate altogether.[196]

In the standoff with Ukraine, Russia had the benefit of a private bond contract, which allowed it to sue Ukraine in English courts or bring a case against Ukraine before an arbitration tribunal. The contract itself had a number of unusual terms that gave bondholders more power over Ukraine than did any of the other Ukrainian Eurobonds. For as long as it held the bond, Russia also could take advantage of the IMF's non-toleration policy with respect to official arrears. In other words, the bond could be private or official debt, depending on the context and the argument that Russia chose to use on any given day.[197]

The IMF's Executive Board voted to revise the non-toleration policy on December 8, 2015, just before the $3 billion bond came due.[198] It was widely reported that the policy change was driven entirely by Russia's holdings of Ukraine's bonds. As noted earlier, IMF staff had tried to align the policies on official and private creditors back in 1989, and again in the spring of 2013 (six months before Russia bought the Eurobond from Ukraine),[199] but faced resistance from official bilateral creditors on its board. The fact that staff finally changed the policy more than a quarter century after the initial attempt speaks above all to the changing architecture of sovereign debt restructuring: the IMF could no longer count on the Paris Club to coordinate all the relevant official creditors.[200]

The revised policy transformed non-toleration into lending into arrears, but it also ended the implicit assumption that the Paris Club could deliver adequate official debt relief, either directly or through comparability. Going forward, the IMF would only rely on Paris Club restructuring assurances if the Club represented a substantial proportion of the creditors, and would seek assurances from non-members where Paris Club debt was small by comparison.[201] If non-member governments refused to restructure despite good-faith efforts on the part of the debtor, the IMF could lend into arrears, so long as doing so would not harm the IMF's ability to mobilize government financing in the future. The proviso on the need to mobilize official funds works as a safety valve; in a future crisis, it would allow the IMF to accommodate big non-Paris Club lenders such as China.[202]

196. Neil Buckley et al, *Legal Fight Looms over Ukraine's $3bn Debt to Russia*, FINANCIAL TIMES (Oct. 15, 2015, 6:57 PM), https://next.ft.com/content/f7a04f1e-7354-11e5-bdb1-e6e4767162cc.

197. Anna Gelpern, *Russia's Bond: It's Official! (... and Private ... and Anything Else It Wants to Be ...)*, CREDIT SLIPS (Apr. 17, 2015), http://www.creditslips.org/creditslips/2015/04/russias-ukraine-bond-its-official-and-private-and-anything-else-it-wants-to-be-.html.

198. *IMF Adjusts Its Policy on Arrears to Official Creditors*, IMF Survey (Dec. 10, 2015), https://www.imf.org/external/np/pp/eng/2015/101515.pdf.

199. *Id*. ("IMF staff first raised concerns about the risks inherent in the institution's policy on non-toleration of arrears to official bilateral creditors back in 1989, when IMF rules with regard to private creditors were amended. These concerns were reiterated in the May 2013 paper, before the Russian loan to Ukraine even existed. On both occasions, staff argued that protections under the policy should not automatically extend to non-contributing creditors and that the policy needed to be reformed to strengthen incentives for collective action among official bilateral creditors."). *See* IMF 2013 Sovereign Debt Review, *supra* note 179.

200. IMF Arrears 2015, *supra* note 192.

201. IMF, *Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors*, Policy Paper (Dec. 2015), https://www.imf.org/external/np/pp/eng/2015/101515.pdf.

202. *Id*.; Curran, *supra* note 83. In July 2016, IMF Managing Director Christine Lagarde shed further light on the IMF's expectations for the treatment of sovereign bonds held by governments. Bonds

The upshot of the change for Ukraine was simple: once the IMF staff determined that Ukraine complied with its reform conditions and had reached out to Russia in good faith, the government could stop paying the Eurobond without fearing for its IMF program disbursements.[203] Ukraine promptly defaulted on Russia three weeks later.[204] In February 2016, Russia sued Ukraine for full repayment in an English court, claiming among other things that Ukraine did not negotiate in good faith.[205]

The lawsuit continues at this writing. In Ukraine as in Argentina, national courts sitting in one-off contract disputes were effectively asked to referee a political conflict and a macroeconomic crisis, and, in the case of Ukraine, a military confrontation, all wrapped into one. Bankruptcy courts have much more elaborate toolkits, but are rarely asked to dabble in military conflict resolution. Ukraine's most morally intuitive defense is that it should not have to pay a creditor that invaded it, and that is at least arguably responsible for its dire economic condition. Such arguments can be refashioned into claims of duress and impracticability, grounded in common law contract doctrine—which is just what Ukraine tried to do in its answer to Russia's complaint.[206] Ukraine could also argue that the $3 billion bond was a tainted, illegitimate transaction to prop up a kleptocratic leader friendly to Russia.[207] In either case, judges interpreting a garden-variety Eurobond contract must implicitly rule on the legitimacy of Russia's annexation of Crimea and the extent of its military involvement in eastern Ukraine.[208] These are precisely the sorts of questions that judges sitting in commercial cases prefer to avoid by enforcing contracts as written, questions that are especially hard to answer in a regime that lacks a shared normative core.

In the old modular regime, where national courts played a relatively

held "for investment purposes" would not be restructured in the Paris Club—which she characterized as a forum for restructuring "official claims extended for public policy purposes" and entitled to (*de facto*) seniority. *Paris Club 60th Anniversary—Keynote Address by Christine Lagarde, Managing Director, International Monetary Fund* (Jul. 1, 2016) at www.clubdeparis.org. Apart from the fact that Paris Club debt seniority has been questioned and debated for decades, it is not clear whether the "investment purpose" approach is entirely workable: it can be difficult to disentangle government motives for lending or buying bonds, especially as they can change over time.

203. IMF, *Ukraine: Technical Assistance Report-Reforming the State Fiscal Service*, Country Report No. 16/48 (Feb. 2016), http://www.imf.org/external/pubs/ft/scr/2016/cr1648.pdf.

204. *Id*.

205. Anna Andrianova & Natasha Doff, *Russia Sues Ukraine in London Court Over $3 Billion Default*, BLOOMBERG (Feb. 17, 2016), http://www.bloomberg.com/news/articles/2016-02-17/russia-files-suit-against-ukraine-in-london-over-3-billion-debt.

206. Defence for Respondent, Law Debenture Trust Corp., v. Ukraine, [2016] EWHC FL-2016-000002 (QB) (May 26, 2016); Mark Weidemaier, *Ukraine's Defense: Russian Suit Part of a "Broader Strategy of Aggression,"* CREDIT SLIPS (May 29, 2016), http://www.creditslips.org/creditslips/2016/05/ukraine-russian-suit-part-of-a-broader-strategy-of-aggression.html#more.

207. Seema Jayachandran & Michael Kremer, *Odious Debt*, 96 AM. ECON. REV. 82 (2006) (arguing for odious debt as a financial sanctions regime); Tai-Heng Cheng, *Renegotiating the Odious Debt Doctrine*, 70 LAW & CONTEMP. PROBS. 7 (2007). *See* Lee C. Buchheit, G. Mitu Gulati & Robert B. Thompson *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201 (2007) (arguing for domestic law analogues); *but see* JEFF KING, THE DOCTRINE OF ODIOUS DEBT IN INTERNATIONAL LAW: A RESTATEMENT (2016) (arguing that odious debt is a doctrine of public international law); Robert Howse, *The Concept of Odious Debt in Public International Law*, UNCTAD/OSG/DP/2007/4 (July 2007) (surveying practice of state nonpayment of odious debt).

208. W. Mark C. Weidemaier, *Contract Law and Ukraine's $3 Billion Debt to Russia*, 11 CAP. MKTS. L.J. (Jan. 2016); Gelpern, *Russia's Contract Arbitrage*, *supra* note 112.

minor role compared to other institutional actors, such as the IMF, the Paris Club, and the London Club—and where governments did not sue each other on bond contracts—the dearth of shared norms might have been a manageable problem. Repeat players could resolve conflicts *ad hoc* in their respective modules, without explicitly invoking big ideas such as equality or good faith. The regime's failure to develop shared norms begins to bite when the informal institutional framework falls apart, and national courts take on a bigger role. In Argentina and Ukraine alike, courts could use guidance on the meaning of equality and good faith in sovereign debt practice, but such guidance is hard to come by because participants in the restructuring process often disagree on first principles.

IV. NOW WHAT?

Sovereign debt restructuring has always been a flawed enterprise. It would be wrong to describe the 1980s and the 1990s as the halcyon days of debt relief and burden-sharing. Agreements took years to negotiate and failed to secure a durable exit from debt crises. There were endless iterations of piecemeal relief and painful adjustment. But by the end of the twentieth century, debt crises unfolded in a regime that had its own structure and customs, and exerted a measure of discipline over its constituents within an IMF-centered analytical framework, thanks to cohesion within the restructuring modules and cross-conditionality among them. Modular structure and pragmatic focus made this regime resilient: creditors could come and go, but the overall framework would stay more-or-less as depicted in Figure 1. Yet it was unintelligible to all but a small core of specialists and often unaccountable to the lending and borrowing public.

Restructurings in Argentina, Greece, and Ukraine exposed a regime in disarray. Modules dissolved, cross-conditionality fell by the wayside, and public and private creditors showed little commitment to the old processes, practices, and institutions. Anyone could be a free-rider, and in the high-profile cases, free-riding demonstrably paid off.[209] The IMF and national courts had to manage the consequences of more coordination failures, although neither was fully equipped for the task. Debt fueled street protests and political crises. It was high time for reform.

Initiatives poured in from different corners of the sovereign debt universe. The IMF launched a comprehensive review of sovereign debt restructuring in 2013, including proposals to reform its analysis and lending policies.[210] The U.N. General Assembly called for a multilateral sovereign debt restructuring framework in September 2014, and endorsed a set of "Basic Principles" for sovereign debt restructuring a year later.[211] The resolutions built on a multi-year work program at the U.N. Conference on Trade and Development (UNCTAD), which also produced a restructuring "roadmap" for sovereign

209. *See supra* Part III (description of Argentina's litigation settlement).
210. IMF 2013 Sovereign Debt Review, *supra* note 179.
211. *See supra* note 6.

debtors.[212] ICMA proposed new contract reforms in August 2014, including stock-wide aggregated majority voting adapted from the 2012 Greek Bondholder Law. "Super-aggregated" CACs were a product of ICMA's collaboration with other industry bodies, large emerging market debtors, the IMF and official bilateral creditors.[213]

At least on their face, these initiatives were compatible, even complementary. Nonetheless, old rivalries threatened to block the emergence of a viable alternative to the old regime. The G-7 and a handful of other governments refused to engage in the U.N. debate for fear that it would create an opening for treaty-based bankruptcy and erode the IMF's role in sovereign debt restructuring. This was a plausible concern, since for some governments and civil society groups, treaty-based bankruptcy and formal institutions remain the only acceptable outcome.[214] However, arguments pitting contract against bankruptcy, market participants against officials, and the IMF against the United Nations have raged for decades. Meanwhile, sovereign debt restructuring has remained a pragmatic mix of contract, treaty, and politics. This is unlikely to change overnight.

Reform requires re-imagining the architecture of sovereign debt restructuring as a coherent whole, but one that need not reside in a single formal institution or legal process. For example, debt restructuring in the mid-1990s used modules and links among them to approximate elements of comprehensive and collective restructuring in bankruptcy, and to limit free-riding. The modular structure also made it easier to combine elements of treaty, contract, and institutional practice in a single process.[215] But it failed to deliver sustainable outcomes broadly accepted as fair by its constituents. A reformed regime should achieve better outcomes in a more accountable process, even as it works to make up for the loss of the old coordination tools. I sketch a series of contractual, statutory, and institutional reforms reflecting these objectives in the remainder of Part IV.

A. Sustainable and Fair Outcomes

The existing regime tends to approach debt sustainability as a fact, an ascertainable threshold: an economy's debt stock or debt service burden is either stable and payable, or doomed to keep growing. As noted earlier, this threshold can be hard to calculate with precision; however, the basic idea is relatively straightforward. It is generally understood, but less commonly

212. Report of UN Conf. on Trade and Dev., Sovereign Debt Workouts: Going Forward, Roadmap and Guide (Apr. 2015), http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf.

213. The U.S. Treasury convened a working group for two years, culminating in ICMA's model clause proposal. *Collective Action Clauses*, INT'L CAP. MKT. ASS'N (August 2014), http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/collective-action/; *see also* Anna Gelpern, Ben Heller & Brad Setser, *Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Debt Contracts* (forthcoming in TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz eds., 2016).

214. Sixty-ninth General Assembly, 102nd Meeting (PM), Discussion of Draft Resolution on "Basic Principles on Sovereign Debt Restructuring Processes" (document A/69/L.84), September 10, 2015, http://www.un.org/press/en/2015/ga11676.doc.htm.

215. For example, IMF participation was governed by treaty, banks and bondholders relied on contracts, and Paris Club creditors followed informal but regular practices.

discussed, that sustainability is also a political judgment about distribution of resources between debtors and creditors, and among different creditors with claims on the sovereign. A sovereign debtor allocates political capital, reform efforts and budget resources across a range of priorities that might include veterans' pensions, foreign bond payments, domestic bank bailouts, girls' education, and gold statues of military leaders. A government creditor chooses to lend its crisis-stricken neighbor billions of dollars to pay off its bonds, to reform, to restructure or some combination. In all cases, achieving sustainability requires political support from the government's domestic constituents and foreign creditors, since it implies distribution on a substantial scale.

Because they implicate sensitive political judgments, IMF staff should not be the sole source of debt sustainability determinations. It is risky and potentially counterproductive to put the entire weight of sustainability politics on the IMF, notwithstanding its analytical resources and experience. The crises in Greece and Ukraine illustrate how DSA politics can threaten the IMF's credibility, and cast doubt on its impartiality. Especially since it is no longer prudent to assume that all future restructurings would be anchored in the IMF, it is important to build consensus around debt sustainability methodology, including the range of assumptions that might go into a model, and to harness independent analytical capacity outside the Fund, which could be mobilized in crisis and be accepted by the relevant constituents.

For example, sustainability determinations could be made by standing or *ad hoc* expert panels, drawn from agreed lists including market, civil society, and public sector representatives. Such panels may consider data and other input from IMF staff, peer governments, market and academic experts. A representative working group under the auspices of the IMF or another multilateral body can develop and periodically review the substantive methodology, and agree on rules for constituting panels. Panel determinations of sustainability need not be binding. However, debtors and creditors may wish to incorporate them by reference in their contracts and policies, to reduce uncertainty in the event of a crisis.

IMF DSAs can and should continue to play an internal role at the Fund, for example, to assess the risk of a program to the IMF's own resources. This determination is distinct from whether a country should borrow or restructure, and on what terms—and would benefit from being made separately. Put differently, it is plausible for the IMF, the sovereign borrower, and its creditors to reach different conclusions about what is achievable and desirable, taking both politics and economics into account. Each may come to the table with different assessments and different normative priors. IMF staff may well decide that the sovereign's analysis does not add up. In that case, the IMF should not lend. If no other funding is available, the government may default or restructure; it may also continue to engage with the IMF to arrive at a consensus analysis. However, it is also possible that other financing sources would materialize, especially if the IMF is capacity constrained.[216] Abstaining

216. Boughton, *supra* note 94.

from a program that might strain its analytical credibility should bolster the IMF's position in a more diverse field of creditors, and preserve its resources—perhaps even to fight contagion.

Sovereigns should make greater use of contingent contracts with both private and official creditors. A substantial economic literature has advocated debt contracts that link repayment to macroeconomic factors.[217] For sovereign borrowers, such contracts might provide for standstills and predetermined relief in a financial crisis; creditors could also get higher payments in good times. Contingent contracts can function as a form of equity capital,[218] or as insurance against default, where the creditors may charge in advance for giving up payments when the government is in distress. Contracts with well-designed contingency triggers can reduce the overall risk of sovereign default, benefiting creditors as a group and reducing the cost of borrowing.[219]

A distinct advantage of contingent contracts in sovereign debt is that they secure a measure of *ex ante* political buy-in from foreign creditors, who can get an equity-like stake in a country's economy that is typically inaccessible to non-residents. At least for private creditors, contract design and price in this case could imply a view of sustainability (when a country needs relief), and an agreement on distribution of losses *ex post* (how much relief). The challenge is to design triggers that minimize incentives for the borrowing government to cheat (for example, by misreporting statistics), and a range of outcomes that would be accepted in a particular set of crisis circumstances that is hard to specify ahead of time.

Contingent sovereign debt contracts with official creditors can either mimic private contracts, or serve a different function altogether. As for the former, it may be politically difficult for a government to pre-commit its taxpayers to finance another government in crisis on a large scale. On the other hand, there is a distinct argument for tying a small portion of any policy-based loan to the achievement of the stated policy goals, or at least to the robustness of assumptions underlying the policy conditions. The role of contingency in this case is not so much to provide relief, but to promote accountability on the part of the lending government both to its own population, and to the borrower. In the current regime, the borrower bears the risk of poor policy design and implementation. Taking a lesson from Greece since 2010, contingent debt contracts could make it harder for an official creditor to lend on patently incredible assumptions about the borrower's ability to adjust, while telling its

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217. *See, e.g.*, Martin Brooke et al., *Financial Stability Paper No. 27: Sovereign Default and State-Contingent Debt*, BANK OF ENG. (2013); Olivier Blanchard, Giovanni Dell'Ariccia & Paolo Mauro, *Rethinking Macroeconomic Policy*, IMF Staff Position Note (Feb. 2010); Olivier Blanchard, Paolo Mauro & Julien Acalin, *The Case for Growth-Indexed Bonds in Advanced Economies Today*, VOX CEPR'S POL'Y PORTAL (Feb. 16, 2016), http://www.voxeu.org/article/case-growth-indexed-bonds; *see also* Olivier Blanchard, *Ten Takeaways From the 'Rethinking Macro Policy. Progress or Confusion?'*, VOX CEPR'S POL'Y PORTAL (May 25, 2015), http://www.voxeu.org/article/rethinking-macro-policy-ten-takeaways; Olivier Blanchard, Giovanni Dell'Ariccia & Paolo Mauro, *Rethinking Macroeconomic Policy: Getting Granular*, VOX CEPR'S POL'Y PORTAL (May 31, 2013), http://www.voxeu.org/article/rethinking-macroeconomic-policy-getting-granular.

218. Stephen Park & Tim R. Samples, *Towards Sovereign Equity*, STANFORD J. OF L. BUS. & FIN. (forthcoming 2016).

219. *See supra* note 217.

taxpayers that the debt was certain to be repaid. The contingent portion should be small, to minimize perverse incentives for the debtor to abandon reform to get debt relief—and so as not to discourage government-to-government lending altogether. However, even a small amount may be enough to get the attention of the lending government's constituents, and help hold it accountable.

Although academics heavily favor contingent contracts, they have been rare in practice. Countries have issued debt indexed to their export commodities, as well as debt with value recovery features, issued as part of a debt restructuring.[220] On the other hand, sovereign debt contracts that reduce payments in response to negative macroeconomic shocks are rare. In light of the strong theoretical case in favor, further research into the causes of market resistance is in order. In the meantime, policy measures to encourage contingent contracts can include exempting them from the IMF's lending into arrears policy and, where relevant, from Paris Club comparability requirements, provided they deliver relief broadly in line with the agreed program.[221]

Sovereigns and their creditors should invest in developing shared debt restructuring norms. The demise of modules and cross-conditionality revealed a normative gap at the heart of the sovereign debt restructuring regime. Creditors in their respective modules might have shared views on what constituted equitable treatment and good faith negotiation; however, there was no such consensus for the regime as a whole. As the modules weakened, this has led to dramatically disparate recoveries by creditors holding similar claims in Argentina, but also in Greece, and in Ukraine. To the extent the relationships among modules reflected an implicit priority structure in sovereign debt, it too was unraveling.[222] The rise of sovereign debt contract lawsuits in national courts exacerbated the problem: by mandate, courts pursue piecemeal resolution of contract disputes, not comprehensive resolution of financial crises. It is an inhospitable setting for the development of shared norms.

The Basic Principles for sovereign debt restructuring endorsed by the General Assembly are well-placed to fill the gap in the old regime, and to guide judicial discretion in sovereign debt lawsuits. In particular, Principles 5 and 8, along with the emphasis on majority restructuring in Principle 9, reflect substantial international consensus on equity and sustainability in restructuring. They begin to elaborate broadly-held values that should be uncontroversial, such as good faith and majority voting, inclusiveness, transparency and sustainability. They also include more specific guidance, for example, reiterating the imperative to construe exceptions to sovereign immunity narrowly.

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220. Argentina, Greece, and Ukraine each has issued GDP-indexed bonds in a debt restructuring.

221. The relevant policies would have to specify a range of acceptable relief parameters to discourage creditors from granting nominal concessions in advance in exchange for an exemption from restructuring. On the other hand, it would probably make sense to make the range generous enough to encourage creditors to opt into the contingent relief scheme ahead of time.

222. *Compare* criticisms of the missing priority structure in sovereign debt in Bolton & Skeel, *supra* note 43; Anna Gelpern, *Building a Better Seating Chart for Sovereign Restructurings*, 53 EMORY L.J. 1119 (2004); Jeromin Zettelmeyer, *The Case for an Explicit Seniority Structure in Sovereign Debt* (Int'l Monetary Fund, Research Dep't, Working Paper, Sept. 29, 2003).

If governments and their creditors use and invoke these principles when they restructure, they can infuse them with practical meaning and make them effectively binding. Over time, these principles can contribute to a richer understanding of equal treatment for similarly situated claims on the sovereign, and help develop a generally accepted priority structure, which could be incorporated in contracts or gradually become custom, binding on the courts. If they are used widely, invoked and elaborated in context, like elements of the old modular regime, the principles could begin exerting a compliance pull of their own: they would be useful to the stakeholders and compelling to the courts.

With its universal membership, the U.N. General Assembly is a familiar source of international legal norms. As a high-level political body, it is an unlikely place to hash out technical design particulars for a sovereign bankruptcy treaty. Governments that voted against or abstained from voting on the sovereign debt resolutions would benefit from more active engagement: it would give them a voice in norm elaboration, especially valuable since they can no longer count on remaining dominant among the creditors.

B. A Comprehensive, Collective Framework

The decline of modules and cross-conditionality has the biggest impact on creditor coordination. As noted earlier, it has opened new free-riding opportunities for public and private creditors alike, and has introduced more arbitrariness in enforcement against debtors—best illustrated by the court-imposed global boycott of Argentina for the benefit of a few holdout creditors. A new approach to inter-creditor discipline and enforcement is in order.

Financial industry groups should work with sovereign borrowers to advance contract reform and more robust standardization. There is already broad consensus in favor of ICMA proposals for stock-wide aggregated CACs, and for changing *pari passu* clauses in sovereign bonds so that they could not be used to impose drastic remedies of the sort seen in Argentina. The IMF, the G-20, and the U.N. General Assembly, in Principle 9 of the Basic Principles, have all endorsed these contract reforms, which can go a long way to eliminating free-riders if used stock-wide. While new clauses have been incorporated in more than half of the new foreign-law bonds issued since the ICMA proposal, a number of sovereigns have expressed reservations about changing their contracts. New issues with enhanced contracts also represent a tiny fraction of the more than $900 billion in foreign bonds outstanding, and nearly a third of the total do not mature for more than ten years.[223] Approximately 60 percent of all new issues in the year following ICMA's recommendations used the new clauses.[224] Moreover, sovereign debt contracts have never been entirely standardized. Idiosyncratic variations in both old and enhanced contracts raise the risk of interpretation error, which could undermine

223. *Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts,* 8-9 IMF, September 2015, http://www.imf.org/external/np/pp/eng/2015/091715.pdf.

224. *Id.*

the goals of contract reform.[225]

While debtors and creditors should have the ability to negotiate non-standard contract terms, inadvertent idiosyncratic variation presents a risk to the system. The risk is higher if judges follow in the steps of recent U.S. federal court decisions against Argentina, and impose injunctions targeting third parties in an effort to influence immune sovereign debtors. ICMA and other industry groups, perhaps with support from the official sector, should explore the scope for further standardization. For example, instead of issuing a handbook of model terms that are adopted piecemeal, ICMA could follow the derivatives industry model, and publish contracts for wholesale adoption, with non-standard variations contained in side documents. Since the 1980s, the International Swaps and Derivatives Association (ISDA) has published a growing suite of such agreements, which govern relationships among participants in derivatives markets.[226] In addition to creating a strong standard default option for contract design, where parties must make an effort to depart from ISDA texts, the derivatives industry approach makes it easier to deal with the outstanding debt stock. Instead of amending every contract separately, market participants can simply accede to a "protocol" issued by ISDA, which has the effect of incorporating the amendment contained in the protocol across their entire suite of ISDA documents.

An alternative approach to encouraging contract reform and standardization is to appeal to payment and clearing utilities, which have been repeatedly targeted in holdout litigation, including against Argentina. Systemically important payment and clearing institutions such as DTCC and Euroclear remain vulnerable to court injunctions from individual enforcement. They can protect themselves, for example, by charging more to clear bonds for sovereigns that do not use robust aggregated CACs or ICMA-style *pari passu* clauses. This would encourage sovereigns to turn over their debt stock more quickly by imposing transaction costs for failure to reform.

Private and official creditors should invest in developing best practices to promote inter-creditor coordination. In addition to standardizing contracts, industry groups should consider non-contractual reforms to promote inter-creditor coordination. In particular, they could develop best practices for the appointment and operation of creditor committees, in cooperation with sovereign debt issuers and their advisers. A "best practices" document would add more value than contract clauses providing for creditor committees, which have been controversial,[227] because it could address a broad range of contingencies, and evolve over time to address specific problems that come up in restructurings. Such a document also could serve as evidence of trade usage in the event of a court dispute involving committee operation.

225. GULATI & SCOTT, *supra* note 24 (agency problems in contract drafting, including inadvertent variation). Three of the earliest adopters of ICMA's model *pari passu* clause each introduced slight variations in the text. Anna Gelpern, *ICMA CACs, New York Edition - Vietnam! - and More Un-Boilerplate*, CreditSlips, Nov. 18, 2014, http://www.creditslips.org/creditslips/2014/11/icma-cacs-new-york-edition-vietnam-and-more-un-boilerplate.html.

226. Gelpern & Gulati, *supra* note 112.

227. *See supra* note 77 and the accompanying text.

Other norms and practices in need of elaboration concern bond trustees. In bonds issued under a trust indenture rather than fiscal agency agreement, the enforcement power rests with the trustee for the benefit of all bondholders. Individual bondholders cannot sue unless the trustee fails to do so after being offered adequate indemnification. As a result, sovereign bond trustees have worked well as barriers to lawsuits, but they have generally failed to facilitate engagement between the debtor and its creditors. Sovereign bond trustees have a long history of passivity that has prompted creditor complaints and official reform initiatives since the 1930s.[228] Investing trustees with more power and responsibility may contribute over time to the transformation of their role in sovereign debt and make them more expensive. In most cases, such insurance against individual enforcement would benefit the debtor and creditors as a group.

The rise of new creditors and forms of financing that mix trade, investment, and finance, elevates the importance of consistent accounting and reporting. If liberalization trends continue, it will get harder and harder to categorize a debt instrument as official, private, domestic, or external. Private financial industry groups, official creditors, including the IMF and the Paris Club, but also the International Forum of Sovereign Wealth Funds,[229] would benefit from comparing notes on their respective accounting conventions and reporting requirements. Unless such groups cooperate in this apparently mundane task, more creditors would try to replicate Russia's strategy in Ukraine, characterizing the same debt in multiple ways in order to free-ride on other creditors' concessions.

Because official and private creditors are now more likely to hold identical contract claims on a sovereign—as in the case of Russia's Ukrainian Eurobond and central bank holdings of Greek government debt—both sets of creditors should invest in developing a shared understanding of how such claims would be treated in a restructuring. The experience in Greece and Ukraine suggest that creditors with fundamentally different incentives should be discouraged from participating side by side in the same bond restructuring vote. To that end, all bonds held by official creditors should either be disenfranchised, or at a minimum segregated in their own voting pool.[230]

Market utilities should be insulated from free-riding by creditors, and should be off limits to debtors in extreme cases of abuse. Global injunctions

228. League of Nations Report of the Committee for the Study of International Loan Contracts, Geneva 1939, at 15-20; EDWIN BORCHARD, STATE INSOLVENCY AND FOREIGN BONDHOLDERS 42-63 (1951).

229. The International Forum of Sovereign Wealth Funds is a self-governing for sovereign wealth funds. http://www.ifswf.org/

230. In contrast, the ECB has publicly committed to vote against debt restructuring in the event CACs are invoked in any of the sovereign bonds in its portfolio, citing a treaty prohibition against financing euro area member governments. To ensure that it does not inadvertently block a restructuring, the ECB has also committed not to buy blocking positions in bond issues. However, by pre-committing to vote with the holdouts, the ECB reduces the cost holding out—they blocking stake they would have to buy is reduced by the amount of ECB holdings. Claire Jones, *Q&A: The ECJ Decision and QE*, The World Blog, The Financial Times, Jan. 14, 2015, http://blogs.ft.com/the-world/2015/01/qa-the-ecj-decision-and-qe/. As an alternative to separate classification or disenfranchisement, official creditors could also commit not to trade their debt, and not to enforce it in national courts. However, such a commitment may be politically hard for official creditors to make, and hard to enforce.

against Argentina have put market utilities at the center of sovereign debt enforcement, and at risk of disruption by holdout lawsuits. Treaties, regulatory norms, and national legislation should shield payment and clearing systems from being commandeered for the benefit of individual creditors or groups of creditors.[231] Regulatory coordination fora such as the Financial Stability Board (FSB) or the Committee on Financial Market Infrastructures can put forward standards for immunizing financial market infrastructure from disruption for private debt enforcement.[232] Such standards would address the risk of destabilizing systemically important market infrastructure for the sake of the free-rider, at the expense of creditors as a group and third parties.

However, in truly exceptional cases where a sovereign has engaged in abusive behavior or has defrauded creditors as a group, then treaty, legislative, or regulatory sanctions could put market infrastructure off limits to it—as they are off limits to illicit payment flows. Determinations of fraud and bad faith could be made by national courts or international bodies, provided, however, that they are made for the benefit of the entire body of creditors, not individual free-riders.

C. An Accountable Process

Sovereign debt restructuring experience must be accessible and intelligible to the public. This is entirely consistent with the principles of transparency and legitimacy endorsed by the U.N. General Assembly (Principles 3 and 7) and should be simple to implement in practice. Of all the proposals in this Part IV, this is the easiest to implement, and likely to have a significant long-term impact.[233] It is also unglamorous.

Any international organization, trade or civil society group can host a comprehensive, searchable public database of past restructurings, including financial and legal terms, the treatment of public, private, domestic and foreign claims, and any underlying assumptions—made available as soon as practicable after the agreement is finalized. The sovereign borrower should be responsible for supplying required information in standardized form within a prescribed period after a restructuring transaction is completed. At least basic summary terms should be available in English and in the language of the borrowing country. The requirement to disclose restructuring terms can be incorporated in standard form debt contracts, as well as IMF and other institutional lending policies. Failure to deliver information to the repository within a reasonable period without a compelling justification could give rise to sanctions, including claw backs of restructuring concessions in extreme cases, such as fraud.

Beyond *ex post* public disclosure of restructuring experience, borrowing governments should, as a rule, disclose in advance to their creditors the restructuring terms applicable to all of their external and domestic creditors.

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231. I have made this argument in more detail elsewhere, including in Gelpern, *Sovereign Damage Control*, *supra* note 7 and REVISITING SOVEREIGN BANKRUPTCY, *supra* note 2.

232. *See* Skylar Brooks & Domenico Lombardi, *Governing Sovereign Debt Restructuring through Regulatory Standards*, 6 J. of Globaliz'n & Dev. 287 (2015) (discussing a potential role for the FSB in sovereign debt restructuring).

233. This proposal is already part of the UNCTAD Roadmap, *supra* note 212.

Such disclosure is already required under the ICMA model, and would contribute to process transparency, consistent with Basic Principle 3 of the UNGA Resolution. The goal is to promote equity among the relevant stakeholders, judged by a shared standard. To foster adoption and compliance with all disclosure standards, the extent to which a sovereign abides by industry-norm contract and institutional commitments in this area should form part of the IMF's good faith determination in its policy on lending into arrears.

CONCLUSION

Sovereign debt crises are, by definition, systemic financial and political crises in the borrowing country. They could never be orderly or predictable in the strict sense. Sovereign debt restructurings in the late 20th and early 21st centuries have had a remarkable track record of operational success and substantive failure. Deals got done, but few debtors got timely and durable relief. The informal, modular regime with the IMF at the center, which has dominated sovereign debt restructuring since the 1980s, is now under stress as a result of changing patterns of international capital flows, the rise of new creditors, and old stakeholder disinvestment. Government, market, and civil society groups have put forward a slew of reform proposals.

Reforms must address both the perennial flaws of the old regime, and the gaps left by its demise. They should strive to achieve sustainable and fair distribution, a comprehensive and collective restructuring framework, and an intelligible, accountable process. The success of any new regime will depend in important part on its stakeholders' ability to develop shared norms, perhaps starting from the Basic Principles endorsed by the U.N. General Assembly in September 2015. The IMF likely will continue to anchor sovereign debt restructurings, but its role cannot be taken for granted given the size of its resources relative to global capital flows, and uncertainty about potential response to contagion.

For the foreseeable future, sovereign debt restructurings will happen in hybrid institutional arrangements, with some of the old restructuring modules potentially gaining a new lease on life, and others withering away. The regime will continue as part-statute, part-contract, guided by a mix of rules, principles, and constrained discretion. The challenge is to make the pieces add up to a reasonably coherent whole that meets the needs of its constituents—pensioners with their life savings in government bonds and workers whose taxes repay them—and convinces them to embrace its outcomes.

This essay has sketched several incremental steps to advance this goal. Among other things, I advocate creating independent capacity for debt sustainability analysis with input from and alongside the IMF, for much greater contract standardization on the derivatives industry model, for deep coordination among public and private creditor groups to discourage free-riders, for shielding market infrastructure from enforcement for the benefit of individual creditors, and, most immediately, for standardized and publicly accessible disclosure of restructuring experience. I also argue for elaborating a common set of norms to guide national court decisions, including a richer view of equity and priority, so that judges are more likely to rule for the benefit of a

broader set of stakeholders in sovereign debt restructuring, rather than an enterprising set of plaintiffs free-riding on the rest. Taken together, these proposals describe elements of a debt restructuring regime that should address concerns expressed by debtors and creditors, reflect changes in international finance and politics since 1990, and serve as a platform to develop shared values underpinning further reform of the regime and its institutions.

Legitimacy and Impartiality as Basic Principles for Sovereign Debt Restructuring

Odette Lienau*

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INTRODUCTION

The ongoing debt difficulties faced by multiple countries across the globe highlight the pressing need to improve sovereign debt restructuring practices. Major international institutions have recognized this need—the International Monetary Fund (IMF) has undertaken a review of its practices in this arena; the United Nations Conference on Trade and Development (UNCTAD) has engaged in extensive discussions with a view to bettering the current system; and the UN General Assembly addressed the topic through important resolutions in each of the last two years.

In light of this recent activity, this special issue of YJIL Online is especially timely, as it focuses on the applicability and ramifications of the "incremental approach" advocated by the UN General Assembly Resolutions and the UNCTAD Roadmap.[1] My contribution examines two of the Basic Principles on Sovereign Debt Restructuring Process adopted by the UN General

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1. See Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of International Law*, in this issue.

Assembly: legitimacy and impartiality.[2] It goes beyond the necessarily brief formulations of the GA-approved Principles themselves to ask several key background questions: How can these concepts be understood and why do they deserve greater consideration in future debt restructurings? To what degree are these principles already present in parallel domestic and transnational regimes in ways that might be useful for thinking through sovereign debt restructuring itself? Drawing from a recently published longer article, I contend that actors involved in sovereign debt should more deliberately attend to these principles in the future in order to improve restructuring outcomes and garner the stable and long-term adherence of global stakeholders.[3]

This paper will first point out the possible instrumental value of adhering to these principles, particularly in helping to minimize the disruption inherent to debt restructurings. It will then introduce more fully the concepts of legitimacy and impartiality, laying out different schools of thought on the characteristics of legitimate and impartial orders and briefly highlighting how these elements could inform current practice. Finally, it considers how national and transnational institutions analogous to debt restructuring have attempted to meet these standards, focusing on domestic insolvency procedures and investment treaty arbitration. This Essay concludes that, despite the variation in their institutional manifestations, both legitimacy and impartiality are cognizable as foundational principles for future restructurings. While complete attentiveness to all of these features might not be pragmatically feasible, the UN General Assembly Resolutions and the UNCTAD Roadmap are right to emphasize the centrality of these principles for the sovereign debt regime going forward.

I. THE INSTRUMENTAL VALUE OF LEGITIMACY AND IMPARTIALITY

While many global stakeholders no doubt consider legitimacy and impartiality to be important values or goals in their own right, not everyone will necessarily subscribe to this view. Why would it matter, on the ground, whether a sovereign state's debt restructuring is considered legitimate or impartial? What might perceptions of legitimacy or impartiality *do* for any given sovereign debt restructuring, such that these concepts deserve inclusion in an international statement of principles on the topic?

It is clear that a restructuring can be a fairly traumatic economic, social, and political event in the life of a country. While it should ideally offer financial relief in the form of extended payment schedules or a debt write-down, the process also can entail a fiscal consolidation that results in cuts to government programs and other austerity measures. Setting aside for now the

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2. UN General Assembly Resolution 69/319 of 10 September 2015, principles 4 and 7.

3. This contribution is based on and excerpts a much more extensive article recently published, Odette Lienau, *The Challenge of Legitimacy in Sovereign Debt Restructuring*, 57 HARV. INT'L L. J. 151-214 (Winter 2016). The longer piece extends the themes outlined here, applies them to historical debt practices and recent policy proposals, and considers the political tensions and distributional ramifications implicated in the discussion. I thank the guest editors of this YJIL Online issue for inviting me to contribute to this symposium, the YJIL Online editors for their excellent work on this essay, and the editors of the *Harvard International Law Journal* for their work on the earlier article.

question of when such measures can become counterproductive, these policies often have significant domestic distributional ramifications, and the resulting anger may erupt in economically and politically disruptive ways.[4] While entirely understandable, this second-order disruption can add to and extend the distress and sacrifice already generated by the restructuring itself.

How do legitimacy and impartiality play into this dynamic? Understanding impartiality as a component of legitimacy for now, perhaps the unique feature of institutions or rules that are considered legitimate is their ability to encourage voluntary compliance—to command a higher degree of support or acquiescence than might otherwise exist in the absence of coercion or self-interest.[5] A procedure perceived to be more legitimate and impartial could thus encourage a greater willingness on the part of domestic groups to engage in consensual restructuring processes and then implement the resulting agreements with relative equanimity, thereby minimizing the second-order disruptions that can accompany a restructuring. Of course, this is hardly to deny that the anger arising out of debt restructuring is frequently justified, and that it can direct attention to important power imbalances both domestically and internationally. But if a consensual debt workout frequently *is* the right choice, then we should strive to identify mechanisms that restructure debt in a smooth, efficient, and minimally disruptive manner. And, of course, this instrumental value of legitimacy only supports the inherent value—recognized by many—of institutions that enable individuals and groups to comply with agreements as a result of considered choice rather than perceived duress or coercion.

All that said, a number of tensions and difficulties immediately emerge with an explicit focus on legitimacy and impartiality, particularly given that the concepts can mean different things to different people. Claiming legitimacy or impartiality on behalf of a particular institution, mechanism, rule, or process is a fraught exercise, as the content of these terms can be difficult to pin down. Indeed, "legitimacy speak" has been soundly criticized by important international legal scholars for its indeterminacy and lack of substance.[6] Applying such conceptually slippery terms to the complex world of sovereign debt is no easy task.

The goal of the remainder of this contribution, then, is relatively circumscribed. It does not aim to formulate comprehensive or universal typologies of legitimacy and impartiality applicable across all arenas.[7] Rather,

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4. For an overview of possible distributional ramifications resulting from a decision to restructure (or the decision to delay restructuring), see Odette Lienau, *The Longer-Term Consequences of Sovereign Debt Restructuring*, *in* SOVEREIGN DEBT MANAGEMENT 85, 89–90 (Lee Buchheit & Rosa Lastra eds., 2014). For a discussion of both the practical problems with austerity measures and their intellectual history, see MARK BLYTH, AUSTERITY: THE HISTORY OF A DANGEROUS IDEA (2013).

5. *See* discussion *infra*, Part I.A.

6. James Crawford, *The Problems of Legitimacy-Speak*, 98 ASIL PROC. 271, 271 (2004) (noting the "fuzziness and indeterminacy" of the term); *see also* Martti Koskenniemi, *Miserable Comforters: International Relations as New Natural Law*, 15 EUR. J. INT'L REL. 395, 409 (2009) (suggesting that "[l]egitimacy is not about normative substance . . . . Its point is to *avoid* such substance but nonetheless to uphold a *semblance* of substance"). .

7. Indeed, understandings of legitimacy are necessarily variable and historically grounded. For a study of how shifts in conceptions of legitimacy ground systemic change in international society, see IAN CLARK, LEGITIMACY IN INTERNATIONAL SOCIETY (2005). Joseph Weiler suggests that forms of international lawmaking, including the legitimacy arguments with which they are associated, are best

it presents a preliminary working understanding of institutional features that might enhance the perception that debt restructuring practices are more (or less) legitimate and impartial in the current, complex global context. The final elements ultimately incorporated into future debt restructurings are of course matters to be negotiated among key global stakeholders, involving decision-making that necessarily attends to the broader goals of pragmatic feasibility, timeliness, and cost effectiveness.

II. BASICS AND THE BROAD AUDIENCE FOR LEGITIMACY

As hinted at above, at the most general level, *a rule, mechanism, norm, or institution can be understood as legitimate if it is considered worthy of voluntary compliance and/or support*. If a rule or mechanism is perceived as legitimate, then approval and compliance result at least in part from that assessment, rather than from coercion, habit, self-interest, or other possible reasons for action.[8] Part of the special virtue or power of a legitimate rule thus lies in its capacity to coordinate preferences and decisions effectively even in the absence of other bases for action. This quality becomes especially important in the international arena—including for a globally supported debt workout—where no supranational authority with broadly accepted powers of coercion exists. As discussed more fully below, legitimacy may derive from the initial *source* of, ongoing *process* of, or ultimate substantive *outcome* resulting from a rule, mechanism, or institution, or from some combination of these three basic components.

A. The Broad Audience for Assessing Legitimacy

The importance of legitimacy as a basis for action has long been recognized in the social sciences and in legal studies. For example, Max Weber formulated a definition relevant for sociological theory to the effect that "a norm or institutional arrangement is legitimate if, as a matter of fact, it finds the approval of those who are supposed to live in this group."[9] Thomas Franck proposed a definition of legitimacy intended for international law and international relations, initially formulated to apply among states, as "a property of a rule or rule-making institution which itself exerts a pull toward compliance on those addressed normatively because those addressed believe that the rule or institution has come into being and operates in accordance with generally accepted principles of right process."[10] In the last several decades, questions of the legitimacy of global governance have become even more central in both academic and policy writing, and scholars and activists have

understood not as periodization but rather, drawing from geology, as stratification, in which sediments of past practices continue into the present. Joseph H. H.Weiler, *The Geology of International Law—Governance, Democracy and Legitimacy*, 64 ZAÖRV 547 (2004).

8. *See, e.g.*, Christopher A. Thomas, *The Uses and Abuses of Legitimacy in International Law*, 34 OXFORD J. LEGAL STUD. 729 (2014).

9. MAX WEBER, ECONOMY AND SOCIETY: AN OUTLINE OF INTERPRETIVE SOCIOLOGY, as quoted (and translated) in Lukas H. Meyer & Pranay Sanklecha, *Introduction* to Lukas H. Meyer, Legitimacy, Justice, and Public International Law (Cambridge University Press, 2009), 2.

10. THOMAS FRANCK, THE POWER OF LEGITIMACY AMONG NATIONS 24 (1990),.

built upon and extended these themes.[11] In one recent influential article, Allen Buchanan and Robert Keohane emphasize that the concept of legitimacy appeals to a "common capacity to be moved by what might be called *normative reasons*," and a "complex belief" that institutions may deserve support even if they fail to maximize self-interest and also fall short of (inevitably divergent) understandings of perfect justice.[12]

Central to these formulations is the idea that conforming action is motivated by the legitimacy of the mechanism itself *through the belief or normative approval of the relevant audience*. This interactive element leads to several preliminary implications. First, the relevant audience for legitimacy purposes in any sovereign debt restructuring should ideally include all those actually affected by the restructuring—that is, all those who live in the group to which the applicable processes, mechanisms, or decisions apply. This audience encompasses those without the position or power to enact or enforce rules, including citizens of countries undergoing a debt workout and small creditors who may have had minimal voice in the restructuring process. This definition of the relevant audience accords with one of the general goals of establishing a legitimate order, which is to encourage voluntary adherence by all relevant actors to the extent possible. This includes those individuals who may not have participated in either institutional design or particular restructuring processes, but who are nonetheless affected by their outcomes and who may therefore object to or impede implementation once decisions are made. The contention that a broad audience is relevant for assessing legitimacy does not mean that universal acceptance or adherence is required. For example, it is possible that certain actors will remain intransigent even in the face of a rule, institution, or outcome generally determined to be legitimate, in which case *opposition* might well be considered illegitimate. However, care should be taken when drawing these lines, particularly given the political import and distributional impact of claims about legitimacy or illegitimacy.

B. Components of Legitimacy: Source, Process, and Outcome

The preceding discussion should make clear that determining one limited set of indicators for legitimacy would be overly simplistic, given the breadth and multiplicity of its audience. Indeed, for any context and historical moment, legitimacy can be understood as "a composite of, and an accommodation between, a number of other norms, both procedural and substantive."[13] This section thus lays out key features that frequently play a part in claims about legitimacy. Drawing from multiple schools of thought, there are three main approaches to legitimation.[14] These, in turn, correspond to three questions

11. See, among others, JUTTA BRUNNÉE &STEPHEN TOOPE, LEGITIMACY AND LEGALITY IN INTERNATIONAL LAW (2010); MEYER, *supra* note 12; and RÜDIGER WOLFRUM & VOLKER RÖBEN, LEGITIMACY IN INTERNATIONAL LAW (2008)

12. Allen Buchanan & Robert Keohane, *The Legitimacy of Global Governance Institutions*, *in* Rüdiger Wolfrum &Volker Röben, *supra* note 12, at 30, 31-32.

13. Clark, *supra* note 8, at 207.

14. This organizational framework and language is selected to be relatively simple, colloquial, and appropriate for the issue area. For related typologies applied in different applications, see Vivien A. Schmidt, *Democracy and Legitimacy in the European Union Revisited: Input, Output and 'Throughput'*,

relevant for thinking through legitimacy in sovereign debt restructuring:

Source Legitimacy: First, how are debt restructuring processes, or particular rules associated with these processes, to be formulated—and by whom? A rule, mechanism, or institution may be considered more legitimate if its source and initial establishment satisfy the key values of the legitimating group.

Process Legitimacy: Second, are the processes by which a sovereign debt restructuring unfolds in line with broadly accepted procedural standards? The ongoing processes or procedures through which an institution works or a rule is implemented, as distinct from either the initial development of the rule or its results, may confer an additional and separate layer of legitimacy.

Outcome or Substantive Legitimacy: Finally, is a sovereign debt restructuring able to generate successful outcomes, understood in terms of substantive goals? Aside from considerations on the source or process front, an institution or rule may be considered legitimate if it generates desired outcomes. Key follow-up questions here include how to define and determine positive substantive outcomes, and also who should make this assessment.

Again, given the large and diverse audience for legitimacy, different groups will likely put more or less weight on particular levels or understandings of the concept. Although this oversimplifies somewhat, a debt-restructuring regime that aims to incorporate key features drawn from each level may have the best chance of being considered more legitimate by a broader audience. Of course, there can be tensions between particular legitimizing characteristics—for example, maximum efficiency and broad participation—which would have to be balanced at both a general institutional level and within any particular debt workout situation. To begin with, however, this section offers an overview of which elements actually merit consideration by sovereign debt negotiators attentive to legitimacy issues.

1. Source (or Establishment) Legitimacy

One central understanding of legitimacy involves a focus on how a practice, rule, mechanism, or rule-giving institution is originally established. To the extent that this initial establishment falls in line with core values of the applicable audience or community, the norm or regime may be considered more legitimate. There are several possible ways to think through the legitimacy of debt restructuring practices at the source level.

The classic legitimating mode in international law and global relations is *state consent*. In this traditional view, states are considered the key creators of international law as well as their primary (and perhaps only) subjects. Explicit state consent, for example in a treaty is necessary and in some cases sufficient for source legitimacy under this view. Although this approach has been soundly criticized, in particular for failing to consider the legitimacy or illegitimacy of states themselves, it remains a widely acknowledged standard for source legitimacy in international law and global affairs.[15]

61 POL. STUD. 2 (2013); and Thomas, *supra* note 9.

15. For criticisms of the state consent model, see Buchanan & Keohane, *supra* note 12, at 35-

Democratic legitimation is a central legitimating framework in many nations, and is increasingly discussed at the global level as well. Here, the legitimacy of a rule, mechanism, or governance body is only achieved if it is grounded in the support and input (either directly or through representatives) of the underlying people. Such support, perhaps offered through majoritarian electoral institutions or other mechanisms, can legitimately bind even those not in favor of a particular rule. One vision of global democracy might characterize all inhabitants of the globe as citizens, and attempt to aggregate their voices directly through a mechanism that bypasses states and other intermediaries. However, this latter approach is far from workable at this point, even were it normatively desirable. A general attentiveness to the voices of individuals (rather than only to states or other group entities), however, may offer some element of democratic legitimacy to sovereign debt restructurings.

Participatory legitimation would aim for the participation of important (and potentially divergent) groups in sovereign debt restructurings. Less demanding than strict democratic legitimation, this approach does not narrowly specify the identity of the stakeholders or the mechanism of participation and control. However, it does mandate that a good faith effort be made to identify and involve an appropriately broad, or at least broadly representative, array of stakeholders through meaningful participatory mechanisms.[16] Central to this legitimating element is the principle that participatory mechanisms should be *impartial*, not favoring or biased toward one particular group.

Expertise or authority represents a final form of source legitimacy. If accepted authority figures play central roles in developing rules or institutions, then the rules may be considered more legitimate. Classic forms of authority-based source legitimacy involve religious or moral codes; scientific, technical, or academic expertise; and traditional government.

2. Process (or Implementation) Legitimacy

A second level of legitimacy, which may complement other types, can be understood as process legitimacy. Once a restructuring mechanism is actually established, the nature of its implementation and ongoing functioning may also affect perceptions of legitimacy. In particular, processes that adhere to certain procedural standards, including those that guard impartiality (discussed as a

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36; Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of International Public Authority*, *in* CARLOS ESPOSITO, YUEFEN LI & JUAN PABLO BOHOSLAVSKY, SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 48 (eds., 2014). However, Benedict Kingsbury highlights the distributional ramifications of a commitment to sovereign state equality and state consent, noting that "a decline in the traditional sovereign system weakens the relationship of mutual containment between sovereignty and inequality." Benedict Kingsbury, *Sovereignty and Inequality*, *in* INEQUALITY, GLOBALIZATION, AND WORLD POLITICS, 92 (Andrew Hurrell & Ngaire Woods, eds., 1999). And as Joseph Weiler points out, even those norms grounded in earlier ideological periods may still have some resonance today. Weiler, *supra* note 7.

16. Along these lines, Terence Halliday highlights the potential importance of what he calls a representative basis for the legitimacy of international organizations, which involves "persuading prospective audiences that future products of an organization have been formulated by actors that share their interests or attributes." Terence C. Halliday, *Legitimacy, Technology, and Leverage: The Building Blocks of Insolvency Architecture in the Decade Past and the Decade Ahead*, 32 BROOKLYN J. OF INT'L L. 1084 (2006-2007).

separate principle below), may grant them greater legitimacy in the eyes of key constituents. One caveat to keep in mind in terms of process, however, is that certain generally desirable elements—for example, broad participation and transparency—may be less feasible in specific emergency or crisis management situations. As such, future discussions on sovereign debt restructuring might include a consideration of whether modified procedures are appropriate for such situations, and a mechanism for delineating when the application of a modified process would be warranted.

In line with ideas of procedural fairness, the *ongoing participation* and input of affected individuals and groups, particularly before key decisions are made, could enhance the perceived legitimacy of sovereign debt restructurings. Such participation might work through either direct access or representative structures. In order to ensure the presence of a broad array of voices, participatory processes can allow for input from third parties (such as NGOs) acting as amici curiae. More specifically, this could involve the opportunity to be heard or provide comments on possible restructuring plans, the allowance of debt claims, and other issues. The notice and comment procedures present in American administrative law, along with the claim allowance procedure in some domestic insolvency proceedings, could provide guidance on this front. And the mechanisms for ongoing participation would ideally strive to be impartial, not inappropriately privileging one or another viewpoint.

One exception to this general preference for impartial procedures involves the idea of *country ownership*, which would allow a special attentiveness to the concerns of the sovereign debtor undergoing a restructuring. "Ownership" of adjustment programs, particularly those mandated by International Financial Institutions (IFIs), has been considered an important element of process legitimacy in current sovereign debt restructuring practice and would be relevant going forward. This comports with ongoing commitments to self-determination and sovereign control, which remain overarching principles in international law. Like process legitimacy itself, country ownership also can have instrumental value. As pointed out in a study of the challenges in reconciling country ownership with conditionality, "program ownership, by reflecting a firm commitment from the government, implies that the difficult policy measures . . . are more likely to be implemented."[17]

Comprehensiveness and full involvement present a particular challenge for any governance system, especially at the global level, where disparate parties often fail to take collective action. This certainly is the case in sovereign debt issues, and scholars and policymakers have identified lack of creditor cooperation and forum fragmentation as central problems.[18] The

17. Mohsin S. Khan & Sunil Sharma, *Reconciling Conditionality and Country Ownership*, 39 FIN. & DEV. no. 2 (June 2002); *see also* J.H. Johnson, *Borrower Ownership of Adjustment Programs and the Political Economy of Reform*, World Bank Discussion Paper No. 199 (1992).

18. See, for example, UNCTAD, Debt Workout Mechanism Framing Paper, 2 September 2013, at 3. Available at: http://www.unctad.info/upload/Framing%20Paper%2027%20August_finalwithlogo.pdf. Framing Document. See also UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (2015) *at* http://www.unctad.info/en/Debt-Portal.

formulation and successful implementation of procedures that address these problems would thus be especially relevant to perceptions of process legitimacy in future sovereign debt restructurings. The goal here is to ensure not just the opportunity to participate, but also to ensure that all relevant parties in fact *do* participate to the extent possible. This element of comprehensiveness is likely to have an impact on outcome legitimacy as well, as full involvement by relevant parties is more likely to result in a final resolution of debt claims, a return to economic growth, and an enhanced capacity to access capital markets at better rates.

Transparency has value in and of itself and also supports many other elements associated with process legitimacy.[19] To begin with, it is a precondition for ongoing participation and honest communication, as it allows for the dissemination of information and restructuring proposals about which parties may have views. Furthermore, it allows stakeholders to determine whether an institution or mechanism functions in line with its goals and is likely to result in positive outcomes. It is thus unsurprising that agencies involved in global governance, including the IMF and the World Bank, have tried to become more transparent, albeit sometimes in response to significant external pressure.

Reason-giving, that is, clarifying the reasons for particular decisions, includes providing the analytical and informational or evidentiary foundations underpinning final outcomes.[20] Closely related to transparency, reason-giving helps to ensure that the views of various stakeholders have in fact been taken into account, and that improper bases for decision-making have not impacted the outcome.

Efficiency of procedures also constitutes one element of process or implementation legitimacy. Parties will be more likely to accept an institution, rule, or mechanism if the procedures with which it is associated do not divert undue resources, time, and attention away from the pursuit of other important goals. This element also implicates outcome legitimacy, as even generally positive results, such as a return to debt sustainability or the achievement of satisfactory levels of socio-economic rights, will be undermined if they are not achieved in a reasonably timely fashion.[21]

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19. Matthias Goldmann, "Good Faith and Transparency in Sovereign Debt Workouts," Paper Prepared for the Second Session of the UNCTAD Working Group on a Debt Workout Mechanism, 23 January 2014. See especially 17-23. In addition, it has been highlighted as a general principle of Global Administrative Law and an important emerging feature of international law and global governance. See Benedict Kingsbury, Nico Krisch, & Richard B. Stewart, "The Emergence of Global Administrative Law," *Law & Contemporary Problems*, vol. 68, 15-61 (2005), 37-39; Andrea Bianchi and Anne Peters, *Transparency in International Law* (Cambridge University Press, 2013); Alexandru Grigorescu, "Transparency of Intergovernmental Organizations," *International Studies Quarterly*, vol. 51 (2007).

20. The importance of reason-giving in an international adjudicatory setting is accepted in, for example, the statute of the International Court of Justice, which states in article 56(1) that "[t]he judgment shall state the reasons on which it is based." Statute of the I.C.J., art. 56(1). Armin von Bogdandy and Ingo Venzke note that reason-giving permits "decisions to be discursively embedded and to be critiqued before the court of public opinion." Armin von Bogdandy & Ingo Venzke, *On the Democratic Legitimation of International Lawmaking*, 12 GERMAN L. J. 1341, 1343 (2011).

21. The phrasing of Principle 15 of the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing, which requires that any restructuring "should be undertaken promptly, efficiently, and fairly," very explicitly incorporates this element. UNCTAD, Principles on Promoting Responsible Sovereign Lending and Borrowing, 10 January 2012. Available at:

Finally, the possibility of *review* by an external entity of the procedures and decisions implicated in a debt restructuring may help to support fair and impartial processes as well as outcome legitimacy. Improper biases or procedural irregularities could be corrected or compensated for, responding to those dissatisfied by particular outcomes or at least ensuring that their specific concerns have been heard. Perhaps more important, the possibility of review can heighten internal monitoring, encouraging parties and decision makers to more closely scrutinize their own actions, and thus magnifying the impact of all of the other elements associated with process legitimacy just discussed. In addition, external review may help to ensure that restructuring outcomes comply with central principles and objectives.

3. Outcome or Substantive Legitimacy

A final set of standards relevant to the perceived legitimacy of a restructuring would involve its ability to generate successful outcomes, understood in terms of substantive goals. The capacity of a rule, institution, or mechanism to produce results that satisfy the needs or desires of constituents will almost always confer an important degree of legitimacy.[22] While it is unlikely that any institution or rule could produce absolutely optimal outcomes, however defined, the restructuring in question would still need to meet a minimum threshold of success to be acceptable.[23] The type of outcome that characterizes 'success' necessarily varies across issue area, but several possibilities are especially relevant for a sovereign debt restructuring.

Positive *economic and financial results* will feature importantly in the perceived outcome legitimacy of any debt workout. From the sovereign debtor perspective, a successful restructuring outcome would involve a return to debt sustainability and economic growth,[24] and perhaps also an eventual improvement in creditworthiness and a return to capital market access. From a creditor perspective, it would involve reasonable recovery on an investment. Outcome considerations calibrated according to more specific standards—for instance, approaches associated with "global justice" advocated by certain groups—may consider other economic results to be desirable, such as global redistribution of wealth. Asset recovery may also feature as a desirable financial outcome and could partially relieve the need for creditor losses or harsh austerity measures.

Basic *human impact* in the debtor country would also serve as a basis for evaluating any restructuring. Under this broad rubric, alternative approaches might focus on a simple concern for basic well-being or on the active improvement of outcomes for individuals in terms of a more expansive

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http://www.unctad.info/upload/Debt%20Portal/Principles%20drafts/SLB_Principles_English_Doha_22-04-2012.pdf.

22. In the EU context, this is called "output legitimacy" by Fritz Scharpf, Vivien Schmidt, and others. Fritz Scharpf, *Governing in Europe* (Oxford University Press, 1999); Vivien Schmidt, n. 14.

23. Buchanan and Keohane refer to this more instrumental perspective as a concern with "comparative benefit" as compared to other possible institutions (or presumably as compared to the absence of an institution, if that is the alternative). Buchanan and Keohane, n. 12, 46-47.

24. On the concept of debt sustainability, see Bohoslavsky and Goldmann, note 1.

conception of human rights. In addition, there may be questions as to which standards are sufficiently established and internationally appropriate to ground outcome judgments.[25] Adherence to *other substantive principles* or doctrines may also be relevant to judging outcomes. These might include unclean hands, unconscionability, fraudulent transfer, and concerns about governmental responsiveness to and responsibility for underlying populations.

Consistency across cases provides one final feature that could be associated with perceptions of outcome legitimacy. Such consistency would enhance the predictability and stability of markets, a benefit for both sovereign borrowers and investors alike. Forum fragmentation and variations in (and possibly inconsistent interpretations of) the laws, principles, and procedures that apply to debt restructurings currently undermine this consistency. That said, as a cautionary note, it is important to keep in mind that the consistent application of a problematic practice—perhaps leading to uniformly substandard results—is not necessarily favorable in and of itself. As such, consistency perhaps should be understood as a subsidiary element. In addition, given the political, social, and economic variability that can exist among sovereign debt situations, any restructuring should likely not focus on consistency at the expense of attentiveness to the situation at hand.

III. THE IMPORTANCE OF IMPARTIALITY

A central companion to and support for legitimacy in the international arena is the ideal of impartiality. Indeed, I consider impartiality to be a core factor underpinning the more comprehensive category of legitimacy, as well as a valuable principle in its own right. Particularly in the context of decision-making bodies such as tribunals, impartiality and independence have been called "the most important determinant of political legitimacy at the international level," with legitimacy requiring that such bodies "be sufficiently independent of the powerful actors that dominate the political sphere to take less powerful and minority interests into consideration."[26] Thus, although impartiality has already been implicated in several of the legitimating features mentioned above, it deserves further explication. I organize the bulk of this brief discussion into a consideration of *institutional* impartiality, *actor* impartiality, and what I call *informational* impartiality.

A. Basic Definition

Generally speaking, impartiality can be understood as *a way of thinking, decision-making or acting that is free of bias or preference and that is grounded in independence and objectivity*.[27] It is an essential component of

25. Along these lines, Buchanan and Keohane refer to "minimal moral acceptability" and a "non-violation of human rights." Buchanan and Keohane, n. 12, 46.

26. Eyal Benvenisti & George W. Downs, "Prospects for the Increased Independence of International Tribunals," *German Law Journal*, vol. 12, no. 5, 1057-1082 (2011), 1058.

27. Steven Ratner, for example, describes impartiality as "a way that individuals and institutions decide and act, one based on disinterestedness, consistency, and fairness and not merely personal motives." Steven R. Ratner, "Do international organizations play favorites? An impartialist account," in Meyer, ed., n. 11, 128.

colloquial understandings of justice and fairness. Impartiality may be compromised by biases or preferences grounded in national, regional, political, ideological, or personal affiliation. Although these biases are perhaps most easily cognizable in how individuals think and act, they can also impact how institutions or institutionalized practices are established and can therefore affect their goals and operating processes.

As a central underpinning of legitimacy, impartiality plays a role not only through actual objectivity and independence, but also through perceptions and acknowledgment of objectivity and independence by relevant constituencies. In other words, the interactive element of legitimacy contemplated above translates to impartiality as well.[28] Although complete impartiality (like universal legitimacy) is perhaps impossible to achieve, impartiality remains an important factor to consider in any sovereign debt workout.

B. Elements of Impartiality

To maximize *institutional impartiality*, any sovereign debt restructuring should be organized to avoid systematic bias in favor of one or another interested group. One key sub-feature that could support this larger goal is institutional independence: the organizations and mechanisms involved in a workout ideally would minimize their affiliation with groups or actors that might be affected by the restructuring processes. This separation might include attentiveness to *financial* independence, *personnel* independence, and perhaps *physical* independence (such as through geographic location in a neutral setting). This would be especially important to the extent that any restructuring regime eventually involves a more permanent organization. Transparency-enhancing and review procedures, discussed above, could enhance this type of impartiality by making an institution's inner workings more visible to interested parties, and by serving as a check on those procedures.

To the extent that any debt restructuring involves a central role for third party decision-makers, whether serving as mediators, facilitators, or adjudicators, it would be important to ensure *actor impartiality* as well. Perhaps the central feature of actor impartiality involves independence, or ensuring that decision makers and mediators remain independent of the negotiating parties, both individually and as a group (in multi-party decision-making situations).[29] As part of actor impartiality, decision maker disclosure requirements may be appropriate. Furthermore, requiring decision makers to specify the rationale for any conclusion through processes of reasoned judgment can help to support actor impartiality. This practice ensures that decision makers clarify for themselves that the underlying analysis is impartial, and also allows other actors to provide a check on any bias that may exist. Finally, the use of multi-person decision-making may help to mitigate actor

28. The desirability of drawing from a plurality of traditions and standards, discussed in the context of legitimacy above, is applicable to the principle of impartiality as well, given that it will be judged by the same multiple audiences.

29. This gives rise to the expectation or requirement, in many domestic and international judicial settings, of judicial decision-makers recusing themselves from cases in which they may be biased or be perceived to be biased.

bias, as decisions will have to be discussed and justified. This depends, of course, on a balanced initial selection of individuals, as well as on a commitment on the part of these individuals to think and act as impartially as possible.

A third dimension of impartiality includes what I call *informational impartiality*, or the impartiality of informational inputs. Although information may be presented as objective, such inputs can embed biases or preferences in subtle ways. This can affect both a restructuring outcome and also the final opinion or assessment of its success. Indicators constitute one central informational input into any sovereign debt restructuring, and recent work has highlighted the economic and legal aspects of the use of indicators in a potential debt workout mechanism.[30] In addition, social science models, which predict the likely outcomes of restructurings and related domestic measures (in terms of GDP growth, social costs, and other metrics), can feature importantly in any sovereign debt decision. They may be used by debtors, creditors, and other decision makers to determine the *ex ante* feasibility of a particular restructuring plan, and in particular to determine the extent of relief necessary to return a debtor to sustainability. Although such models are no doubt presented in good faith, they can fail to characterize the situation fully and may thus favor one or another group in a debt crisis, even when relevant actors and institutions aim for independence and objectivity in their assessments.[31] The question of which models and methodologies are appropriate, and of who should make this selection, can thus be quite controversial. As such, care should be taken to ensure that the selection and use of social science models reflects an understanding of their political character and distributional ramifications.[32]

IV. FOUNDATIONS IN DOMESTIC INSOLVENCY PRINCIPLES

To what degree are elements of legitimacy and impartiality already incorporated into areas related to sovereign debt restructuring? In this and the following Sections, I look at two regimes with important parallels to sovereign debt in order to imagine how future workouts might incorporate features associated with these principles. In this section, I focus on domestic insolvency and debt restructuring institutions, primarily as interpreted through the United Nations Commission on International Trade Law ("UNCITRAL") Legislative

30. Michael Riegner, "Legal frameworks and general principles for indicators in sovereign debt restructuring," in this issue; Jasper Lukkezen and Hugo Romagossa, "Early warning indicators in a debt restructuring mechanism," UNCTAD Working Group Paper (2014).

31. In the first days of 2013, IMF chief economist Olivier Blanchard co-published a working paper (interpreted as a *mea culpa*) suggesting the organization had misjudged and underestimated the negative effect of austerity measures on growth in European countries during the crisis. See Olivier Blanchard and Daniel Leigh, "Growth Forecast Errors and Fiscal Multipliers," IMF Working Paper No. 13/1, 3 January 2013; Howard Schneider, "An Amazing *Mea Culpa* from the IMF's Chief Economist on Austerity," *Washington Post online*, 3 January 2013.

32. This insight is central to the discipline of international political economy. For volumes emphasizing the contingent and politically conditioned nature of economic models, see Jonathan Kirshner, ed., *Monetary Orders: Ambiguous Economics, Ubiquitous Politics* (Cornell University Press, 2003); Rawi Abdelal, Mark Blyth, and Craig Parsons, eds., *Constructing the International Economy* (Cornell University Press, 2010).

Guide on Insolvency. I then consider rules covering two adjudicative bodies involved with investor-state arbitration.

While the development and study of comparative insolvency law as a standalone field is relatively recent,[33] the last decades have seen an explosion of interest in promoting and harmonizing the rules and mechanisms governing insolvency. Perhaps the most comprehensive and successful effort to formulate both shared principles for insolvency and possible models for their implementation culminated in the UNCITRAL Legislative Guide on Insolvency, initially published in 2005.[34] Given significant similarities with the sovereign debt situation, it is notable that features designed to promote legitimacy and impartiality play a central role in both UNCITRAL's collective effort to identify best practices as well as in domestic insolvency proceedings themselves.

A. Legitimacy Concerns

To begin with, the UNCITRAL guide itself was developed on the basis of representation and through the auspices of a working group attuned to source legitimacy concerns.[35] This representation involved official and observer state delegations, international financial institutions, international governance organizations, and professional associations. Expert-based source legitimacy also derived from the involvement of these professional associations, along with the use of experts from practice, academia, policy, and other arenas in more ad hoc drafting sessions. General state consent to the process and to the product was offered through General Assembly Resolution 59/40,[36] though of course the actual enactment and implementation of insolvency laws work through the national level.

Domestic insolvency proceedings tend to place considerable emphasis on process legitimacy and procedural fairness, including impartiality, which may be understood as a norm applicable to insolvency more generally and thus translatable to the global level as well. One of the key objectives of insolvency procedures, as laid out in the UNCITRAL Guide, is to provide for a "timely,

33. Particularly since the 1970s, there has been serious attention paid to this field at the national level, with authoritative study groups and committees formulating principles and recommendations for modernizing bankruptcy/insolvency policy and legislation. See, for example, the Commission on the Bankruptcy Laws of the United States (1970, partially leading to the major 1978 reforms of federal bankruptcy legislation); Report of the Review Committee on Insolvency ('Cork Report,' 1982); Report of the Canadian Advisory Committee on Bankruptcy and Insolvency ('Colter Report', 1986); Australian Law Reform Commission's Report No. 45: General Insolvency Inquiry ('Harmer Report,' 1988).

34. The foundational text of the UNCITRAL Legislative Guide is available at http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf. For a fascinating overview of its developments, as well as the ways that global-local tensions can result in implementation gaps, see Terence C. Halliday and Bruce G. Carruthers, *Bankrupt: Global Lawmaking and Systemic Financial Crisis* (Stanford, 2009).

35. This attentiveness to legitimacy was deepened because of UNCITRAL's recognition that it had been brought into the process in part due to the legitimacy problems of other institutions, in particular the IMF and the World Bank (due to suspicion of their activities among some developing countries and their association with Washington, D.C.), INSOL and the IBA (primarily insolvency and legal practitioners, respectively, with professional biases and associated pecuniary interests); and the regional development banks. Halliday & Carruthers, id., 128-129.

36. United Nations General Assembly, A/Res/59/40 (2 December 2004).

efficient and impartial resolution of insolvency."[37] The Guide further emphasizes the centrality of transparency, noting that enacted laws should "[e]nsure a transparent and predictable insolvency law that contains incentives for gathering and dispensing information."[38] In every jurisdiction, debtors can voluntarily commence insolvency proceedings, which presumably helps to encourage ownership of the process. To balance this debtor control, some jurisdictions require an eligibility determination before the insolvency mechanism is technically triggered and applicable standstill provisions, or stays on collection and litigation, are put in place.[39] Broadening the range of participation, domestic insolvency proceedings ideally seek to provide fair process and a right to be heard for creditors whose claims will be determined and possibly curtailed. Given the large number of creditors involved in some insolvency proceedings, many national jurisdictions contemplate the use of committees as a mode of participation. However, the Guide notes that steps should be taken to ensure that such committees are truly representative and impartial as to the interests of its members, for example by disallowing the appointment of unduly partial creditors to a committee.[40]

In addition, comprehensiveness is central to perceptions of legitimacy in domestic insolvency systems. A distinctive feature of insolvency law is its recognition of a debtor's inability to pay creditors as a group, as opposed to just one particular creditor. Insolvency legislation thus deals with unsustainable debt on a collective basis.[41] This collective element means that to an important degree creditors may be in tension with one another rather than only with the debtor. But creditors as a whole should gain from cooperation, as compared to a situation in which each seeks payment for itself but risks the prospect of complete nonpayment in the event of coming late to the game. As such, to the extent that creditors intend to make any claim on the debtor's assets, their participation in the process is required. This fact ensures a high degree of involvement, and is accompanied by procedures that allow for the full participation of interested creditors or creditor groups, at least through representation. In the words of Rosalind Mason, "insolvency law features the notion of collective impartiality . . . [because] there is a moratorium on creditor action and proceedings and a consolidation of the conduct of litigation. Individual claims are addressed through the collective administration, which balances the disparate interests of the various parties."[42]

In terms of outcome, the UNCITRAL Guide, as well as most national insolvency procedures, sets a baseline of acceptable creditor recovery. The

37. Recommendation 1(e), at 14.

38. Recommendation 1(g), at 14.

39. There is also variation in the availability and strength of involuntary proceedings. In any case, given the special sovereignty and autonomy concerns at the sovereign debt level, these would not be relevant.

40. See, for example, UNCITRAL Guide Recommendation 131, at 204.

41. Thus creditors may conflict with one another, as well as the debtor. For one early overview, see Elizabeth Warren, "Bankruptcy Policy," *University of Chicago Law Review*, vol. 54, 775 (1987), esp. 780-789.

42. Rosalind Mason, Cross-Border Insolvency Law: Where Private International Law and Insolvency Law Meet," in Paul Omar, ed., *International Insolvency Law: Themes and Perspectives* (Ashgate, 2008), 32.

first key objective of the Guide, namely achieving a balance between liquidation and reorganization, includes the provision that in any restructuring "creditors would not involuntarily receive less than in liquidation."[43] Given the non-applicability of financially liquidating a sovereign state, this is difficult to translate. However, it relates to the general requirement that creditors be treated in good faith, and that they not be required to accept a lower payout than is necessary for the debtor's recovery. On the debtor side, as a general matter, restructuring plans in insolvency proceedings should not be agreed to or confirmed (to the extent that court confirmation is required) unless they are likely to actually rehabilitate the debtor in question.[44] Thus a restructuring plan considered to be "too little" for the debtor problems at issue would not be considered outcome-legitimate, and therefore likely should not be confirmed or agreed to under general insolvency principles.

Many states have ratified the major human rights conventions, which could be considered an element of outcome legitimacy (as well as binding international law). Indeed, the UNCITRAL Guide notes that, in determining whether a natural person debtor's assets should be excluded from creditor recovery, "consideration might need to be given to applicable human rights obligations" in order to "allow for the minimum necessary to preserve the personal rights of the debtor [and relevant family members] and allow the debtor to lead a productive life."[45] The more general implication could be that human rights should be protected regardless of how natural persons are situated in an insolvency—that is, regardless of whether individuals are situated as debtors themselves or are simply among those impacted by a sovereign state debtor's restructuring.[46]

B. Impartiality in Insolvency

While process legitimacy, with its implication of impartiality, is a core element of domestic insolvency proceedings, impartiality also features as a central and independent principle of insolvency in its own right. In terms of institutional impartiality, there is considerable variation among states in the organizational settings for insolvency proceedings. Civil law countries like France, for example, mandate significant court involvement for any major decision. At the other end of the spectrum, Australia advocates that debtors dealing with insolvency avoid court oversight to the extent possible. While the UNCITRAL Guide remains neutral, it does specify that "competent and

43. UNCITRAL Guide (2004), 14-15. Quoted in Halliday & Carruthers, n. 34, 141.

44. In the U.S. Chapter 11 context, for example, a court may not confirm a reorganization plan unless it meets the requirement of feasibility, in that it is not likely to result in an eventual liquidation. See 11. U.S. §1129.

45. UNCITRAL Guide, Part II, A, para. 19, at 80. Additional references to human rights along these lines may be found in Part III, A., paras. 19 & 29. Para. 19 notes that the rights of "a natural person debtor in insolvency proceedings may be affected by obligations under international and regional treaties such as the International Covenant on Civil and Political Rights and the European Convention on Human Rights."

46. Human impact more generally can be considered relevant in insolvency proceedings. For example, the U.S. Bankruptcy Code provides exceptions to the general rule that unsecured debts will be discharged in liquidation. However, even these exceptions may be excused if continued debt payment would constitute "undue hardship" for the debtor. See 11 U.S. Code §523(a)(8).

independent" courts should be available as a neutral background institution.

Even greater focus is placed on actor impartiality, particularly given that the Guide contemplates (but does not mandate) the appointment of an "insolvency representative" such as a trustee, administrator, or judicial manager to oversee the proceedings. Any such individual must not only be knowledgeable but also have the attributes of "integrity, impartiality, and independence."[47] The Guide recommends that any insolvency law "require the disclosure of a conflict of interest, a lack of independence or circumstances that may lead to a conflict of interest or lack of independence" and also that this obligation "continue throughout the insolvency proceedings."[48]

In short, domestic insolvency law, and particularly UNCITRAL's clarification of globally applicable and accepted insolvency law principles, emphasizes features associated with claims about legitimacy and impartiality. In so doing, these sources demonstrate a number of practices that might enhance the perceived legitimacy and impartiality of future debt restructurings at the sovereign level.

V. EFFORTS TOWARD IMPARTIALITY AND LEGITIMACY IN INVESTOR TREATY ARBITRATION

Investor treaty arbitration lends additional support for attending to characteristics associated with legitimacy and impartiality. Such arbitration, which may be incorporated into hard law instruments such as bilateral investment treaties or concession contracts, directly involves sovereign states and investors. By its nature such arbitration is ad hoc and not built upon systems of precedent, and some observers raise serious concerns about inconsistency, bias, and other problems. Even more troubling charges have been made that such arbitration may be systematically biased in favor of investor claimants.[49] Nonetheless, certain procedural rules in these arbitrations

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47. UNCITRAL Guide, Recommendation 115, at 188.

48. UNCITRAL Guide, Recommendations 116 & 117, at 188. Less explicit attention is paid to informational impartiality in domestic insolvency proceedings. However, as part of general process requirements, parties to insolvency proceedings are often allowed to offer expert opinions and testimony to support their projections of the likelihood of success (or of the value of particular assets, etc.) and also challenge the claims made by opposing stakeholders (for example, of the likely effect of a plan or plan provisions).

49. Gus Van Harten, for example, suggests that "the system is flawed, above all because it submits the sovereign authority and budgets of states to formal control by adjudicators who may be suspected—because they are untenured and because only one class of parties can bring claims—of interpreting investment treaties broadly in order to expand the system's appeal to potential claimants and, in turn, their own prospects for future appointment." Van Harten acknowledges that certain arbitrators may develop reputations for fairness and balance, but suggests that there is nonetheless "an unreliable bias." Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007), vii. See also Pia Eberhardt & Cecilia Olivet, "Profiting from Injustice: How Law Firms, Arbitrators, and Financiers are Fuelling an Investment Arbitration Boom," (Corporate Europe Observatory and the Transnational Institute, Nov. 2012). UNCTAD has also highlighted concerns with the current investor-state dispute settlement regime and laid out advantages and disadvantages to five potential paths to reform. See UNCTAD, "Reform of Investor-State Dispute Settlement: In Search of a Roadmap," IIA Issues Note, June 2013; available at: http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf. For a response to critics and a defense of the basic contours of the current system, see Charles N. Brower & Sadie Blanchard, "From 'Dealing in Virtue' to 'Profiting from Injustice': The Case Against 'Re-Stratification' of Investment Dispute Resolution," *Harvard International Law Journal Online*, vol. 55 (January 2014).

offer insight into how characteristics designed to enhance legitimacy are broadly incorporated and acknowledged to be desirable, even in this controversial arena and even when not fully successful. Two sets of rules commonly used, and thus referred to in this section, are the International Centre for Settlement of Investment Disputes (ICSID) Rules and the UNCITRAL Rules.

A. Impartiality

To begin with, it is important to highlight that one of the central purported benefits of arbitration is that parties enjoy a greater degree of control over the proceedings than in a conventional judicial dispute resolution setting. As such, by design, there is a lower degree of institutional independence in both the ICSID and UNCITRAL Rules than in standard domestic court settings. For example, the parties pay the arbitrators directly and have significant control over the arbitral location.[50]

Still, some attention is paid to supporting process legitimacy through a degree of attentiveness to actor impartiality, particularly in the selection of arbitrators. ICSID rule 6(2) requires that all arbitrators sign a declaration of independence in advance of the first session that lists any factors that might compromise their impartiality.[51] In addition, article 39 of the ICSID Convention specifies that the majority of arbitrators be citizens of states other than the claimant-investor's home state and the respondent state. Similarly, in the event that the parties are unable to arrange a panel independently, arbitrators appointed by the Chairman of ICSID's Administrative Council must not be nationals of either the state party or the home state of the claimant-investor.[52] Finally, the default procedures for ICSID stipulate a three-person tribunal, with each party appointing one arbitrator and then agreeing on a third, who serves as the panel's president.[53]

The basic orientation is very similar under the UNCITRAL Rules. Both prospective and appointed arbitrators have an ongoing duty to disclose circumstances that may raise doubts as to their impartiality or independence.[54] Although the UNCITRAL Rules do not specify nationality requirements for arbitrators, they do mandate that the appointing authority consider "the advisability of appointing an arbitrator of a nationality other than the nationalities of the parties."[55] The UNCITRAL Rules also presume (but do not require) that three individuals will be appointed to the arbitration panel. Each

50. However, given the absence of a standing institution with full-time professional decision-makers, there is arguably less of a risk that a longstanding and deep-seated institutional bias would develop.

51. ICSID Rule 6(2). Note that ICSID maintains a pre-screened Panel of Arbitrators considered to have sufficient expertise and professionalism to be appropriate. However, parties may select arbitrators that are not on this list and so additional safeguards of impartiality have been put in place.

52. ICSID Convention Art. 38.

53. ICSID Convention Art. 37(2)(b); ICSID Rule 3.

54. UNCITRAL Rev. Art. 11. An annex to the UNCITRAL Rules even provides model "Statements of Independence" that can be used by arbitrators.

55. UNCITRAL Art. 6(4).

party appoints one arbitrator, and then the two initial appointees consult and jointly select a third.[56]

Commentators have charged that even these procedures fall short and that problems are more endemic.[57] Critics note that, in any case, the parties have not followed the processes sufficiently to rid investor state dispute settlement of bias or the perception of bias.[58] Nonetheless, these institutional features clearly are designed to promote the goal and general principle of impartiality. They therefore can provide a guideline—or perhaps a baseline—for thinking through elements that might support perceptions of impartiality in future sovereign debt restructurings.

B. Legitimacy

Although impartiality is in itself a core legitimating element in investor-state arbitration, other features mentioned in the conceptual discussion of legitimacy in Section 3 above are present as well. As just noted in the overview of impartiality and investor-state arbitration, party ownership and control—important elements in understandings of legitimacy—are especially central in investor-state arbitration. Given the limited number of parties generally involved, their equal participation is less of a problem than it might be in other settings. And, notably, a series of amendments to the ICSID Rules in 2006 aimed to improve the transparency and participatory element of proceedings even for non-parties. In particular, rule 37 makes possible submissions by "non-disputing parties" through amici curiae, rule 32 covers the possibility of making hearings open to the public, and rule 48 governs the publication of awards.[59]

In regard to efficiency, the ICSID Rules specify that a tribunal should be constituted "as soon as possible" and "with all possible dispatch" after an arbitration is requested, with a series of time frames for arbitrator appointments.[60] The UNCITRAL Rules similarly note a time window for constituting the tribunal and appointing arbitrators, specifying that the appointing authority is required to make the election "as promptly as possible."[61] However, under both processes there exists the possibility of manipulation and delay by the parties, particularly through the process of appointing (and objecting to) arbitrators. As such, the process ownership and

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56. Parties may also agree on a sole arbitrator, or on the appointing authority for a sole arbitrator, with the Secretary General of the Permanent Court of Arbitration serving as the default in the event that the parties fail to reach agreement. UNCITRAL Art. 6.

57. Van Harten, n. 49; Eberhardt & Olivet, n. 49.

58. One much remarked upon ICSID arbitration is that of Vivendi II, in which an ad hoc committee reviewing a tribunal's decision criticized one of the arbitrators for failing to disclose her board position at a bank holding shares in the claimant investor, but ultimately upheld the award. *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic* (ICSID Case No. ARB/97/3) (Annulment Proceeding) (10 August 2010). See especially para. 231-232.

59. Jason Yackee and Jarrod Wong review these amendments in detail, and generally consider them to be "modest, incremental, and conservative." Jason W. Yackee & Jarrod Wong, "The 2006 Procedural and Transparency-Related Amendments to the ICSID Arbitration Rules," in *Yearbook on International Investment Law & Policy*, Karl. P. Sauvant, ed., ch. 6 (Oxford University Press, 2010).

60. See ICSID Convention Article 37(1); ICSID Rule 1.

61. UNCITRAL Art. 6(3).

consent elements of investment treaty arbitration may undermine efficiency.[62]

As with domestic insolvency, the rules governing investor treaty arbitration do value several mechanisms associated with process legitimacy. Although this incorporation is neither complete nor entirely successful, it does indicate the degree to which these design elements are held in high regard and broadly utilized. It also offers more specific ideas for incorporating features associated with legitimacy claims into potential future sovereign debt restructurings.

CONCLUSION

This essay has suggested that attentiveness to the principles of legitimacy and impartiality may contribute to the instrumental success of any sovereign debt restructuring, and has highlighted institutional elements or practices often associated with these goals. An additional question can be raised as to whether these principles might have a further claim to special consideration, as part of emerging customary international law or general principles of law. Any determination along these lines is made difficult by the fact that legitimacy is a composite principle, constituted of multiple procedural and substantive norms, and perhaps lacks the necessary specificity to be a legal rule itself.[63] Impartiality also is a multi-faceted ideal, though it links so deeply to understandings of legal rule that it may well constitute a general principle of international law in certain adjudicative settings. Regardless, both legitimacy and impartiality can be understood as background guiding principles in international and domestic legal regimes alike. As such, they can help to orient the formulation of more specific rules and decision-making procedures in sovereign debt restructuring going forward.

Of course, neither principle can be achieved perfectly in any institutional setting, particularly given the need to balance goals of political feasibility, timeliness, and cost effectiveness. And, pragmatically speaking, neither works on a binary basis—few institutions or practices are either perfectly legitimate and impartial or entirely illegitimate and partial. Given that compliance with each is a matter of degree, one goal in thinking through incremental improvements in sovereign debt restructuring could be to eventually incorporate as many features associated with legitimacy and impartiality as possible. This objective might ground negotiations to establish more rational, coherent, and broadly supported sovereign debt practices for the future.

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62. For a brief description of delay tactics from a practitioner perspective, Stephen Jagusch & Jeffrey Sullivan, "A Comparison of ICSID and UNCITRAL Arbitration: Areas of Divergence and Concern," in Claire Balchin, Liz Kyo-Hwa Chung, Asha Kaushal & Michael Waibel, eds., *The Backlash against Investment Arbitration: Perceptions and Reality*, 79, 84-85 (Kluwer 2010). Note that this refers to a previous version of the UNCITRAL Rules, but the themes remain pertinent.

63. Customary international law, accepted in key international documents as one potential source of law (along with treaties and general legal principles), is identified through "evidence of a general practice accepted as law." The emergence of customary international law on a topic can be demonstrated by the existence of relevant state practice in conjunction with a sense of legal obligation (*opinio juris*) – the belief on the part of the acting state that the practice is required by law. ICJ Article 38(1).

Putting your Faith in Good Faith: A Principled Strategy for Smoother Sovereign Debt Workouts

Matthias Goldmann*

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I. GOOD FAITH AS PART OF AN INCREMENTAL APPROACH TO SOVEREIGN DEBT WORKOUTS

This Article considers the potential of good faith as a general principle of law for sovereign debt workouts. This endeavor takes inspiration from, and contributes to, an incremental approach to sovereign debt restructuring.[1] The incremental approach aims for a third way between statutory and contractual avenues for improving the legal framework governing sovereign debt workouts. There is a pressing need for such a third approach given the dysfunction of the current system: sovereign debt workouts often are too little in volume, and they frequently come too late, allowing the debt problem to worsen unnecessarily.[2] What is more, holdout creditors try to extract profits from the lack of a

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1. *Cf.* Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*, 41 YALE J. INT'L L. ONLINE, 475 (2016), in this issue.

2. UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (April 2015), *available at* http://www.unctad.info/en/Debt-Portal/; Lee C. Buchheit, et al., *Revisiting Sovereign Bankruptcy* (Brookings Committee on International Economic Policy and Reform, 2013), *available at* http://www.brookings.edu/~/media/research/files/reports/2013/10/sovereign-bankruptcy /ciepr_2013_revisitingsovereignbankruptcyreport.pdf.

compulsory sovereign debt restructuring mechanism by suing debtor states for the repayment of sovereign debt instruments at nominal value – which they may have purchased at a considerable discount.[3] Statutory solutions like a new international treaty might be the most effective means, and proposals for such mechanisms abound.[4] But the sovereignty costs of statutory solutions make important states and stakeholders inclined to promote innovative contractual solutions such as more robust collective action clauses.[5] While collective action clauses have some practical advantages, they also have their limitations. They take time to implement, and holdout creditors have shown that they can often acquire blocking minorities.[6] Most importantly, even the best collective action clauses would not help in the face of debtor-induced delays in sovereign debt workouts, exaggerated growth expectations, or problems concerning the fair distribution of the economic and financial burden of debt crises.[7]

In light of these challenges, this special issue explores a third, complementary strategy that seeks the incremental improvement of the current framework through legal principles.[8] Principles in international law, whether general principles of law or principles of international law,[9] have an important ordering function due to their general and abstract character.[10] On the one hand, they have a descriptive character, revealing the basic structures of the existing legal framework. On the other hand, their normative potential reaches beyond the *status quo*. It allows for a distinction between progressive and non-progressive practices within the present legal framework. In other words, it separates practices that are fully in line with principles from those that are not.[11] The idea behind the incremental approach is to deploy this potential for improving current debt workout practice.

This Article examines the potential of the good faith principle for the

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3. Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L. J. 1043 (2004); Bohoslavsky & Goldmann, *supra* note 1.

4. Overview: Kenneth Rogoff & Jeromin Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976–2001*, 49 IMF STAFF PAPERS 470 (2002).

5. E.g. International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF Policy Paper (April 26, 2013); International Monetary Fund, *Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring,* IMF Policy Paper (October 1, 2014); International Capital Markets Association, *Standard Aggregated Collective Action Clauses ("CACs") for the Terms and Conditions of Sovereign Notes* (Aug 2014), *available at* http://www.icmagroup.org/resources/Sovereign-Debt-Information.

6. International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF Policy Paper 28 (April 26, 2013).

7. UNCTAD, *supra* note 2.

8. For an earlier, tentative proposal in this direction see HOLGER SCHIER, TOWARDS A REORGANISATION SYSTEM FOR SOVEREIGN DEBT AN INTERNATIONAL LAW PERSPECTIVE 109 et seq. (2007).

9. On the different types of principles: Rüdiger Wolfrum, *General International Law (Principles, Rules, and Standards), in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW (Rüdiger Wolfrum ed., 2010).

10. On the function of principles in legal orders see RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 22 (1977); JÜRGEN HABERMAS, BETWEEN FACTS AND NORMS. CONTRIBUTIONS TO A DISCOURSE THEORY OF LAW AND DEMOCRACY ch. 5.1.3 and 5.2.1 (Repr. ed. 2008).

11. *Cf.* Armin von Bogdandy, *General Principles of International Public Authority: Sketching a Research Field*, 9 GERMAN LAW JOURNAL 1909 (2008); Markus Patberg, *Supranational constitutional politics and the method of rational reconstruction*, 40 PHILOSOPHY & SOCIAL CRITICISM 501 (2014).

incremental approach. It has both a methodological and a doctrinal objective. Methodologically, it shows how principles, especially general principles of law, may be used to advance a particular area of international law. Doctrinally, it argues that the good faith principle has the potential to smoothen debt workouts by establishing a duty to negotiate, to exercise voting rights in good faith, and to refrain from abusive holdout strategies. The Article begins with an inquiry into the nature and formation of general principles of law. Principles reveal basic structures of a legal order. They are not merely discovered, but rather constructed in a hermeneutic process which one might describe as "doctrinal constructivism."[12] The Article next aims to carve out the basic ideas characterizing the respective legal order. Good faith is an established general principle of law embodying the idea of fairness in legal relationships.[13] Because the good faith principle is rather general, this Article contextualizes it in order to concretize its meaning. To this end, the Article identifies the basic ideas underlying the current legal framework for sovereign debt workouts. The Article shows that, as a consequence of a paradigm shift over the last decades, sovereign debt workouts are now geared towards debt sustainability.[14] This idea should guide the application of the good faith principle to sovereign debt workouts. In doing so, the Article identifies four possible concretizations of the good faith principle in the context of debt restructurings: a duty to participate in debt workout negotiations, a duty to stipulate equitable restructuring terms, a duty not to jeopardize the result of good faith negotiations by a negative vote, and a standstill of holdout litigation seeking to extract a preferential treatment.[15] Since this concretization of the broad concept of good faith is fraught with some uncertainty, this Article argues that soft legal instruments and domestic legislation would increase the effectiveness of the incremental approach.[16]

II. GOOD FAITH AS A GENERAL PRINCIPLE OF LAW

A. The Nature and Formation of General Principles of Law

General principles of law are a proper source of international law.[17] They have been widely recognized since their incorporation in Article 38(3) of the Statute of the Permanent Court of International Justice in 1920, which became Article 38(1)(c) of the International Court of Justice (ICJ) Statute in 1945. Before 1920, the legal status of general principles was heavily disputed,[18]

12. *Infra,* part II.A.
13. *Infra*, part II.B.
14. *Infra*, part III.
15. *Infra*, part IV.
16. *Infra*, part V.
17. This is why Koskenniemi designates them as "normative" general principles, see Martti Koskenniemi, *General Principles: Reflexions on Constructivist Thinking in International Law*, *in* SOURCES OF INTERNATIONAL LAW 360-402, 364-5 (Martti Koskenniemi ed. 2000).
18. Alfred Verdross, *Les principes généraux de droit dans le système des sources du droit international public*, *in* RECUEIL D'ETUDES DE DROIT INTENRATIONAL EN HOMMAGE A PAUL GUGGENHEIM 521-30 (Faculté de droit Université de Genève ed. 1968).

although arbitral tribunals frequently referred to them.[19] Unlike *principles of international law*,[20] which are distilled from other international legal rules, *general principles of law* constitute extrapolations from domestic legal orders by means of analogical and comparative reasoning.[21] Based on a proposal by Alain Pellet,[22] one can define a general principle as:

an unwritten legal rule of wide-ranging character. Principles should be distinguished from moral rules. They are just another form of legal rules, although of a more abstract and general character.[23] They usually express the ratio of more specific rules and serve as guidelines for their interpretation and application.[24] But it is also possible to base an argument about the legality of a certain act on its conformity with a specific general principle;

recognized in the municipal laws of States. Most legal orders should be familiar with a principle considered to be a general principle, but not necessarily all;[25]

transferable to the international level. The principle needs to be meaningful on the international level. Principles that are contingent upon specific features of domestic legal orders may not be considered general principles.[26] By contrast, it is a clear sign of the transferability of a principle and hence of its existence if international legal practice already reflects that principle.

International courts use general principles of law to fill lacunae[27] and to avoid decisions that would contradict basic principles of justice if the existence of a customary rule cannot be proven.[28] General principles thus presuppose that international law is not just a chaotic array of rules, but represents a form of order that transcends the sum of its rules and comprises fundamental ideas of justice.[29] This idea of order is what Wolfgang Friedmann has described as the law of cooperation.[30] This idea of order is embedded in legal practice and

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19. Alain Pellet, *Article 38*, *in* THE STATUTE OF THE INTERNATIONAL COURT OF JUSTICE: A COMMENTARY marginal no. 247 (Andreas Zimmermann, et al. eds., 2006); Vladimir D. Degan, *General Principles of Law (A Source of General International Law)*, 3 FINNISH YEARBOOK OF INTERNATIONAL LAW 1, 22 et seq. (1992).

20. Cf. Bohoslavsky and Goldmann, *supra* note 1, part B.

21. HERSCH LAUTERPACHT, PRIVATE LAW SOURCES AND ANALOGIES OF INTERNATIONAL LAW 67 et seq. (Repr. ed. 1970) – From this type of general principle of law, one needs to distinguish general principles of international law, cf. Giorgio Gaja, *General Principles*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW marginal no. 17 et seq. (Rüdiger Wolfrum ed. 2007). The latter have no relevance for this study.

22. Pellet, *supra* note 19, marginal no. 249.

23. On the theoretical debate surrounding the distinction between rules and principles see Dworkin, *supra* note 10; Habermas, *supra* note 10.

24. Robert Kolb, *General Principles of Procedural Law*, *in* THE STATUTE OF THE INTERNATIONAL COURT OF JUSTICE marginal no. 2 (Andreas Zimmermann, et al. eds., 2006).

25. According to Gaja, *supra* note 21, marginal no. 16, the International Court of Justice is reluctant to recognize general principles when it would require controversial discussions of comparative law.

26. VLADIMIR DURO DEGAN, SOURCES OF INTERNATIONAL LAW 103 (1997).

27. Pellet, *supra* note 19, marginal no. 245.

28. Lauterpacht, *supra* note 21, 60-63.

29. ROBERT KOLB, LA BONNE FOI EN DROIT INTERNATIONAL PUBLIC. CONTRIBUTION A L'ETUDE DES PRINCIPES GENERAUX DE DROIT 24-5, 45 et seq. (2000); Degan, *supra* note 26, 58 et seq.

30. WOLFGANG G. FRIEDMANN, THE CHANGING STRUCTURE OF INTERNATIONAL LAW 60 et seq. (1964).

wholly conforms to basic tenets of legal positivism, rather than natural law.[31]

General principles of law are developed and specified through a process of conceptual reasoning which some have called "doctrinal constructivism."[32] Doctrinal constructivism proceeds in a dialectical fashion that departs, on the one hand, from current practice (in case of general principles, that would normally be domestic practice), and on the other hand, from the ideas characterizing the current international order. These ideas provide selection criteria for the identification and concretization of principles, informing the distinction between relevant and less relevant practices and possible interpretations.[33] They need to reflect the present state of international law. Examples comprise the ideas of sovereignty and cooperation,[34] and increasingly also the ideas of human rights, the rule of law, and legitimacy.[35] For more specific legal regimes, doctrinal constructivism requires a grasp of their underlying ideas.[36]

Doctrinal constructivism thus takes place through a dialogue between scholarship and practice, especially that of courts. To be sure, the ICJ Statute stipulates that scholarship and court decisions are merely subsidiary means for the recognition of the law.[37] But it would be a deception to assume that this process of "recognition" amounts to a purely deductive exercise. Rather, the evolution of our understanding of language brought about by what is commonly referred to as the "linguistic turn," has shattered the assumption of a strict separation between law-making and interpretation. Accordingly, the meaning of legal rules is not only indeterminate, but also context-sensitive to the extent that it only emerges in the practice of their interpretation and application. Each interpretation of the law is tantamount to its further development.[38] In other words, the practice of courts and legal scholarship always contributes to the further development of the law. This is especially acute in international law, a relatively young and developing field of law characterized by decentralized institutions, cases, and practices.[39] For example, the contemporary definition of international treaties emerged in legal

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31. For postmodern concepts of unity of the international legal order, see MARIO PROST, THE CONCEPT OF UNITY IN PUBLIC INTERNATIONAL LAW (2012).

32. Armin von Bogdandy, *The Past and Promise of Doctrinal Constructivism: A Strategy for Responding to the Challenges Facing Constitutional Scholarship in Europe*, 7 INT'L J. CONST. L. 364 (2009); with a view to international law: Anne Peters, *Realizing Utopia as a Scholarly Endeavour*, 24 EUR. J. INT'L L. 533, 545-6 (2013).

33. Matthias Goldmann, *Dogmatik als rationale Rekonstruktion: Versuch einer Metatheorie am Beispiel völkerrechtlicher Prinzipien*, 53 DER STAAT 373 (2014).

34. Cf. Friedmann, *supra* note 30.

35. Mattias Kumm et al., *How large is the world of global constitutionalism?*, 3 GLOBAL CONSTITUTIONALISM 1 (2014); Armin von Bogdandy, *Common principles for a plurality of orders: A study on public authority in the European legal area*, 12 INT'L J. CONST. L. 980 (2014).

36. *See infra* section III. in respect of sovereign debt workouts.

37. Art. 38(1)(d) ICJ Statute.

38. Seminal on the concept of language advocated by the linguistic turn: LUDWIG WITTGENSTEIN, PHILOSOPHISCHE UNTERSUCHUNGEN 262 (sec. 43) (16th ed. 2004). On the significance of the linguistic turn for international law, see JEAN D'ASPREMONT, FORMALISM AND THE SOURCES OF INTERNATIONAL LAW - A THEORY OF THE ASCERTAINMENT OF LEGAL RULES 196 et seq. (Oxford University Press. 2011).

39. Peters, *supra* note 32, 533, 537; Fernando Tesón, *International Law*, *in* THE ROLE OF ACADEMICS IN THE LEGAL SYSTEM 941 (Mark Tushnet, et al. eds., 2005).

scholarship during the period spanning from the end of the 19th century to the First World War.[40] However, this does not mean that "anything goes" and that doctrinal constructivism can skirt ordinary law-making procedures. Rather, the decisive difference between law-making and doctrinal constructivism lies in the way in which scholars, courts, and lawmakers argue, or rather, need to argue. Scholars need to *argue* that a certain rule exists or has this or that content. As soon as their *argument* is that a rule does not exist yet but that there are pertinent reasons why this rule should exist, they are making a political statement, not a doctrinal one.[41] The requirements of legal reasoning thus provide for argumentative constraints that discipline doctrinal constructivism. An example for these constraints is the odious debt doctrine, to which I will revert later.[42] Broadly speaking, it addresses the question whether sovereign debt that was not incurred in the public interest (e.g. in case of corruption) needs to be repaid. Many scholars argue that international law does not recognize this doctrine at present, as there is little practice supporting it, but that political or moral reasons militate for its adoption.[43]

B. Good Faith as a General Principle of Law

The concept of good faith seems to reflect almost universally shared ethical principles. Philosophical works have long recognized good faith as a principle closely related to notions of equity and justice.[44] Good faith appears as an indispensable requirement for social interactions,[45] which has guaranteed it a place in virtually any theory of international law since early modernity.[46] Natural law theories associate good faith with the idea of reason.[47] In Confucianist thought, the principle of "chengshi xinyong", which stands for trustworthiness and honesty, has an equivalent function.[48] Modern theories of justice like that of John Rawls are built around the idea of fairness, closely related to good faith.[49]

Given its widely shared ethical significance, it is not surprising that good faith is today widely accepted as a general principle of law. Most domestic legal orders recognize its coordinative function for private law relationships: It is particularly widespread in the civil law tradition. A famous manifestation of

40. MILOŠ VEC, RECHT UND NORMIERUNG IN DER INDUSTRIELLEN REVOLUTION 112 et seq. (2006).

41. Habermas, *supra* note 10, 146-7, 397.

42. *Infra* IV.B.

43. *Id*.

44. Cf. the Aristotelian concept of equity: SARAH BROADIE & CHRISTOPHER ROWE, ARISTOTLE: NICOMACHEAN ETHICS: TRANSLATION introduction, book 5, ch. 10 (2011).

45. HUGO GROTIUS, THE RIGHTS OF WAR AND PEACE, IN THREE BOOKS WHEREIN ARE EXPLAINED, THE LAW OF NATURE AND NATIONS, AND THE PRINCIPAL POINTS RELATING TO GOVERNMENT vol. 3, ch. 25 (Jean Barbeyrac transl. 2015 (1625)).

46. JOSEPH F. O'CONNOR, GOOD FAITH IN INTERNATIONAL LAW 45-79 (1991).

47. Kolb, *supra* note 29, 86-92.

48. Markus Kotzur, *Good faith (Bona fide)*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW marginal no. 6 (Rüdiger Wolfrum ed. 2009).

49. John Rawls, *Justice as fairness: political not metaphysical*, 14 PHILOSOPHY & PUBLIC AFFAIRS 223 (1985).

good faith is Article 1134 of the French Code Civil.[50] Other private law codifications contain comparable provisions.[51] By contrast, the concept of good faith entered into English law at a relatively late stage.[52] An exception from the 18th century is Lord Mansfield's famous claim that good faith constituted a "governing principle . . . applicable to all contracts and dealings."[53] Despite the hesitation in adopting the concept of good faith in the common law,[54] English law recognizes principles such as estoppel,[55] which constitutes a concrete manifestation of good faith in civil law jurisdictions.[56] In addition, one might consider equity as such as being built on an equivalent of the idea of good faith.[57] Be that as it may, the breakthrough for the concept of good faith in the common law came with the adoption of Section 1-304 of the Uniform Commercial Code, which recognizes good faith as a principle governing the performance and enforcement of contractual obligations.[58] Good faith has since found recognition as a principle underlying any contract under United States federal law,[59] as well as in international codifications of contract law, such as Article 7 of the United Nations Convention on the International Sale of Goods[60] and Art. 1.7 of the UNIDROIT Principles of International Commercial Contracts.[61] Good faith also plays a crucial role in international commercial arbitration.[62]

In international law, the principle of good faith manifests itself in almost every international legal regime.[63] Thus, the Friendly Relations Declaration attributes to good faith the status of an overarching principle for the conduct of

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50. CODE CIVIL [C. CIV.] art. 1134 (Fr.).

51. E.g., Sec. 242 German BGB, Art. 422 Brazilian Civil Code. Overview: Ole Lando, *Good Faith in the Legal Systems of the European Union and in the Principles of European Contract Law*, *in* AEQUITAS AND EQUITY. EQUITY IN CIVIL LAW AND MIXED JURISDICTIONS 332 (Alfredo Mordechai Rabello ed. 1997).

52. Bernardo M Cremades, *Good Faith in International Arbitration*, 27 AM. U. INT'L L. REV. 761, 774-5 (2011).

53. *Carter v Boehm* (1766) 97 ER 1162, 1164 (Lord Mansfield).

54. Cf. Michael G. Bridge, *Does Anglo-Canadian Law Need a Doctrine of Good Faith?,* 9 CANADIAN BUSINESS LAW JOURNAL 385-426 (1984); Gunther Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies*, 61 THE MODERN LAW REVIEW 11 (1998).

55. E.g. McIlkenny v Chief Constable of the West Midlands, [1980] 2 All ER 227 (Q.B.).

56. ANTOINE MARTIN, L'ESTOPPEL EN DROIT INTERNATIONAL PUBLIC: PRECEDE D'UN APERÇU DE LA THEORIE DE L'ESTOPPEL EN DROIT ANGLAIS 9-14 (1979).

57. Ralph A. Newman, *Renaissance of Good Faith in Contracting in Anglo-American Law*, 54 CORNELL L. REV. 553-565 (1968-1969).

58. E. Allan Farnsworth, *Duties of Good Faith and Fair Dealing Under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, 3 TUL. J. INT'L & COMP. L. 47, 51-54 (1995).

59. *K.M.C. Co. v. Irving Trust Co*., US Court of Appeals, 6th Circuit, 757 F.2d 752 (1985). On the gap between recognition and enforcement, see Paul MacMahon, *Good faith and fair dealing as an underenforced legal norm*, 99 MINNESOTA L. REV. 2007 (2015).

60. United Nations Convention on Contracts for the International Sale of Goods, April 11, 1980, 1489 U.N.T.S. 3.

61. International Institute for the Unification of Private Law (Unidroit), Principles of International Commercial Contracts, 34 I.L.M. 1067 (1995).

62. Cremades, *supra* note 52, 765.

63. Overview on the manifestations of good faith in international economic law in Andreas R. Ziegler & Jorun Baumgartner, *Good Faith as a General Principle of (International) Law*, *in* GOOD FAITH AND INTERNATIONAL ECONOMIC LAW 9 (Andrew D. Mitchell, et al. eds., 2015).

international affairs.[64] The Vienna Convention on the Law of Treaties (VCLT) notes in its preamble that "the principles of free consent and of good faith and the *pacta sunt servanda* rule are universally recognized."[65]

The content and meaning of good faith as a general principle of law is necessarily broad and defies any precise definition. This is a consequence of the principle's function: good faith plays an accessory,[66] supportive role in legal relationships that expose the parties to the influence and discretion of other parties. Hence, there is some uncertainty in these relationships about the exact scope of the rights and duties of either party. The good faith principle is meant to offset these risks by requiring mutual trust from the parties.[67] This role requires considerable vagueness from the good faith principle itself, as it needs to apply to a vastly array of divergent relationships and situations that are by definition unpredictable. The broad, general scope of good faith is thus simultaneously its virtue and its vice. For precisely this reason, courts are sometimes hesitant to apply it.[68]

The challenge for legal scholarship is therefore to narrow down the meaning of good faith through a typology that is simultaneously precise enough to facilitate the application of the principle in practice and general enough to allow for its further development establishment of sufficient mutual trust among the parties to a legal relationship even in unforeseen situations. This endeavor is complicated by the fact that good faith has a bearing both upon the substantive content of rights and duties, and on the procedures by which they are exercised.[69] Thus, Anthony D'Amato summarizes the content of good faith as requirements to treat the other party fairly, represent one's motives truthfully, and to refrain from taking unfair advantage of one's counterparty.[70] Similarly, Robert Kolb understands the significance of good faith as being threefold: to protect legitimate expectations, to prohibit the abuse of rights, and to prevent unjustified advantage from unlawful acts.[71] These descriptions are still rather categorical. A more granular typology might distinguish four stages in the life of a legal relationship: its creation, interpretation, the exercise and enforcement of the rights it creates, and the termination of those rights. Good faith has a particular bearing upon each of these stages:[72]

1. Good faith facilitates the creation of legal relationships. Acquiescence

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64. G.A. Res. 2625(XXV) (Oct 24, 1970).

65. Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331.

66. On the accessory character of good faith, with evidence from the case law of the International Court of Justice: Ziegler & Baumgartner, *supra* note 63, 14-5. Disagreeing: Kolb, *supra* note 29, 157-8.

67. Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401, 404 (1964).

68. Ziegler & Baumgartner, *supra* note 63, 9; in the context of U.S. law: MacMahon, *supra* note 59.

69. Abaclat et al. v. Argentine Republic, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, ¶ 647 et seq. (Aug 4, 2011); Kotzur, *supra* note 48, margin nos. 22-24.

70. Anthony D'Amato, *Good faith*, *in* ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW, vol. 2, 599 (Rudolf Bernhardt ed. 1995).

71. Robert Kolb, *Principles as sources of international law (with special reference to good faith)*, 53 NETHERLANDS INTERNATIONAL LAW REVIEW 1, 17-8 (2006).

72. The following draws on the typology provided by Ziegler & Baumgartner, *supra* note 63, 17 et seq.

as a corollary of good faith might lead to the formation of treaty obligations.[73]

2. Good faith is of paramount importance for the interpretation of treaties pursuant to VCLT Article 31(1),[74] and for the performance of treaty obligations by virtue of VCLT Article 26, which stipulates that "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith."[75] Several sub-categories can be distinguished:

First, good faith affords the protection of the parties' *legitimate expectations*. As the life of a treaty or similar legal relationship can extend over a considerable period of time, some circumstances might change. In an investment context, states might therefore deem it necessary to adjust their regulation in ways that affect the investor.[76] The good faith duty to protect investors' legitimate expectations defines the limits of possible regulatory changes.[77] While some tribunals have adopted a rather strict approach, barely allowing for regulatory changes, others have been more context-sensitive.[78] The WTO regime also protects states parties' legitimate expectations, but the Appellate Body is cautious to use this term to go beyond explicitly agreed upon rights and duties.[79]

In a similar way, the ICJ has used the good faith principle to contain the discretion of the United Nations with respect to decisions affecting the obligations of its current or future members.[80]

Further, good faith entails duties of information and disclosure of the parties to a legal relationship. The failure of a state to provide due notification to another state might give rise to damages.[81]

3. Good faith also governs the exercise and enforcement of a right under international law. At this stage, the good faith principle concerns the way in which disputes are approached and which claims the parties may raise. Concerning the former, the 1982 Manila Declaration on the Peaceful Settlement of International Disputes calls upon states to seek in good faith an early and equitable settlement of all disputes.[82] Concerning the latter, two concretizations of the good faith principle merit particular attention. One is the principle of *estoppel*, which bars a party to a dispute from contesting its own previous "clear and unequivocal representation."[83] The other one is the prohibition of the *abuse of rights*, a proposition that enjoys overwhelming

73. E.g. Norwegian Fisheries Case (U.K. v. Norway), 1951 I.C.J. 116, 136-7 (Dec 18).

74. *Supra* note 65.

75. *Supra* note 65.

76. Overview: UNCTAD, FAIR AND EQUITABLE TREATMENT. UNCTAD SERIES ON ISSUES IN INTERNATIONAL INVESTMENT AGREEMENTS 63 et seq. (2012).

77. *Id*.

78. *Id*.

79. Appellate Body Report, *EC – Asbestos*, ¶ 185-6, WT/DS135/AB/R (March 12, 2001), with reference to Art. XXIII:1(b) of the General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 U.N.T.S. 187 [hereinafter GATT 1994].

80. Conditions of Admission of a State to Membership in the United Nations, Advisory Opinion, 1948 I.C.J. 57 (May 28).

81. Kolb, *supra* note 71, 20.

82. G.A. Res. 37/10, ¶ 5 (Nov 15, 1982).

83. Temple of Preah Vihear (Cambodia v. Thailand), 1962 I.C.J. 6, 143-4 (dissenting opinion of Judge Spender (June 15 ,1962).

acceptance in international law.[84] One might distinguish three sub-categories of potential abuses of right.[85]

First, an abuse of right exists where a claim is being made and an alleged right is being enforced for the sole purpose of causing harm to another.[86]

A second category of abuse of right prohibits the misuse of procedural instruments in ways that run against their purpose (for example, illegitimate forum shopping).[87] While courts have rarely held that such a situation existed in a given case, they have recognized this sub-category in the abstract.[88]

Third, abuse of right also prohibits the abuse of a party's discretion. This exception relates both to the interpretation and the enforcement of international law. It has found support in the literature[89] and in case law.[90]

4. Finally, good faith governs the conditions for the termination of a legal relationship. Most significantly in this respect is the *clausula rebus sic stantibus*, which stipulates that a fundamental change of circumstances might lead to a suspension or termination of treaty obligations.[91]

On the whole, this overview of the meaning of good faith leads to two conclusions. First, good faith sometimes overlaps with other principles. For example, estoppel could be considered a general principle of law of its own, or a specific example of good faith. *Pacta sunt servanda* is sometimes qualified as a principle deriving from and comprised within the idea of good faith.[92] Good faith duties of information and consultation correspond to important elements of an (emerging) transparency principle.[93] Such overlaps flow from the necessary, inevitable normative openness of the good faith principle.

Second, while the aforementioned categories narrow the meaning of good faith to some extent, its full meaning cannot really be explored in the abstract. It is characteristic of the good faith principle that it is amenable to specific contexts and gains its full significance only in respect of a specific context, such as a specific international regime which the good faith principle is supposed to keep operative and bring in line with basic fairness requirements.[94]

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84. Ziegler & Baumgartner, *supra* note 63, 30 et seq.; Kolb, *supra* note 29, 463; Michael Byers, *Abuse of rights: an old principle, a new age*, 47 MCGILL L. J. 389 (2001).

85. Cf. Alexandre Kiss, *Abuse of Rights*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW marginal nos. 4-6 (Rüdiger Wolfrum ed. 2006).

86. A treaty law example of this sub-category which procedurally secures the protection of the states parties' legitimate expectations would be Art. 26.1 of the Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, 1869 U.N.T.S. 401.

87. E. De Brabandere, *'Good Faith', 'Abuse of Process' and the Initiation of Investment Treaty Claims*, 3 JOURNAL OF INTERNATIONAL DISPUTE SETTLEMENT 609, 619-20, 630 et seq. (2012); Kiss, *supra* note 85, marginal nos. 12-13.

88. *Id*.

89. Kolb, *supra* note 29, 464-5;

90. Appellate Body Report, *US – Shrimps*, ¶ 158-9, WT/DS58/AB/R (Oct 12, 1998): the abuse of rights doctrine bars states from overreaching in respect of measures for which they claim an exception under Art. XX GATT 1994 (*supra* note 79).

91. Art. 62, VCLT, *supra* note 65. For an early assessment see ERICH KAUFMANN, DAS WESEN DES VÖLKERRECHTS UND DIE CLAUSULA REBUS SIC STANTIBUS (1911).

92. O'Connor, *supra* note 46, 119; Ziegler & Baumgartner, *supra* note 63, 19.

93. Anne Peters, *Transparency as a Global Norm, in* TRANSPARENCY IN INTERNATIONAL LAW 534 (Anne Peters and Andrea Bianchi eds., 2013).

94. Kolb, *supra* note 71, 26-7; MARION PANIZZON, GOOD FAITH IN THE JURISPRUDENCE OF

This is why the subsequent part looks at sovereign debt workouts and what it means to keep this regime running.

III. CONTEXT: THE CURRENT LEGAL FRAMEWORK FOR SOVEREIGN DEBT WORKOUTS

In order to concretize the significance of good faith for sovereign debt workouts, an analysis of the ideas underlying the present framework for sovereign debt workouts seems apposite. Broadly speaking, the current legal framework for sovereign debt workouts reflects a recent paradigm change from a private law to a public law understanding of sovereign debt workouts.[95] For much of the history of the last two centuries, sovereign debt workouts were considered as a matter to be decided only between the debtor and its creditors.[96] Accordingly, creditors and their debtor state negotiated in a horizontally structured setting, pursuing only their own interests. The solution of debt crises did not appear to be a concern to the international community of states. After the end of the First World War, this paradigm began to shift towards a public law paradigm, which has become effective since about the 1990s.[97] The new paradigm is characterized by a common global interest in sovereign debt sustainability, which transcends the individual self-interests of creditors and their debtors.[98]

This trend began after the First World War with the efforts of the League of Nations to help countries regain market access.[99] After the Second World War, sovereign debt workouts began to be negotiated in an increasingly coordinated network of international fora including the International Monetary Fund (IMF), the Paris Club and the London Club, as well as other venues for private creditors.[100] In substance, the workouts facilitated by these institutions pursue a common global interest revolving around the notion of debt sustainability: the IMF defines debt sustainability as a situation where the

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THE WTO 23 (2006).

95. For the full story, see Bohoslavsky & Goldmann, *supra* note 1, Part C.

96. HORST FELDMANN, INTERNATIONALE UMSCHULDUNGEN IM 19. UND 20. JAHRHUNDERT. EINE ANALYSE IHRER URSACHEN, TECHNIKEN UND GRUNDPRINZIPIEN 20 et seq., 317 et seq. (1991).

97. On the public law paradigm in global governance, see generally Benedict Kingsbury, et al., *The Emergence of Global Administrative Law*, 68 LAW & CONTEMP. PROBS. 15 (2005); Benedict Kingsbury & Megan Donaldson, *From Bilateralism to Publicness in International Law*, *in* FROM BILATERLAISM TO COMMUNITY INTEREST 79 (Ulrich Fastenrath et al. eds., 2011); Armin von Bogdandy et al., *Developing the Publicness of Public International Law: Towards a Legal Framework for Global Governance Activities*, 9 GERMAN LAW JOURNAL 1375 (2008); JAN KLABBERS ET AL., THE CONSTITUTIONALIZATION OF INTERNATIONAL LAW (2009).

98. On the paradigm change in sovereign debt workouts, see Robert Howse, *Concluding Remarks in the Light of International Law*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 385-89 (Carlos Espósito et al. eds., 2013); ODETTE LIENAU, RETHINKING SOVEREIGN DEBT. POLITICS, REPUTATION, AND LEGITIMACY IN MODERN FINANCE (2014); Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of Public Authority: Towards a Decentralized Sovereign Insolvency Law*, *in* RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE SEARCH FOR COMMON PRINCIPLES 39-70 (Carlos Espósito et al. eds., 2012).

99. Juan H. Florez & Yann Decorzant, *Public borrowing in harsh times: The League of Nations Loans revisited*, (University of Geneva, Working Paper Series No. 12091, 2012).

100. For ample illustration, see International Monetary Fund, *Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Policy Framework*, IMF Policy Paper (April 26, 2013).

capacity of a state allows it with high probability to roll over or reduce its debt in the forseeable future without a major correction in the balance of income and expenditure.[101] This shift has been manifested in many important policy changes since the late 1980s. For example, the IMF initiated a policy of "lending into arrears," where it provides financial breathing space to states in default of their privately-held bonded debt while they organize a restructuring.[102] In order to promote economic development in debtor states, the Paris Club began granting debt relief with the introduction of its Toronto terms in 1988.[103] The Brady initiative exchanged nonperforming loans for performing bonds.[104] As such steps turned out to be insufficient, the IMF and the World Bank set up the Heavily Indebted Poor Countries Initiative (HIPC Initiative), which provides for nearly full relief of bilateral and private debt upon the fulfillment of certain conditions.[105] Important international declarations like the Monterrey Consensus epitomize the conviction that debt sustainability is a requirement for development.[106]

The global financial meltdown of 2008 and its aftermath have intensified the focus on debt sustainability. This is evident from the recalibration of the IMF's lending programs,[107] as well as new efforts geared towards the prevention of future debt crises such as the IMF's fiscal monitor or the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing (UNCTAD Principles).[108] Beyond the concern for economic development, increasing attention has been drawn to the human rights aspects debt workouts, especially to the effects of adjustment programs.[109] In 2012, the United Nations Human Rights Council adopted principles for bringing adjustment programs in conformity with human rights.[110]

Arguably, the Sovereign Debt Workout Principles proposed by UNCTAD[111] and the "Basic Principles on Sovereign Debt Restructuring

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101. International Monetary Fund, *Assessing Sustainability*, IMF Policy Paper 4 (May 28, 2002).

102. International Monetary Fund, *IMF Policy on Lending into Arrears to Private Creditors*, IMF Policy Paper (June 14, 1999); International Monetary Fund, *Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion*, IMF Policy Paper (July 30, 2002).

103. Paris Club, *Toronto Terms* (April 20, 2016, 10:40 AM), http://www.clubdeparis.org/en /communications/page/toronto-terms.

104. Manuel Monteagudo, *The Debt Problem: The Baker Plan and the Brady Initiative: A Latin American Perspective*, 28 THE INTERNATIONAL LAWYER 59 (1994).

105. LEONIE F. GUDER, THE ADMININSTRATION OF DEBT RELIEF BY THE INTERNATIONAL FINANCIAL INSTITUTIONS 30 et seq. (2009).

106. Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002, UN Doc. A/CONF.198/11.

107. International Monetary Fund, *To Help Countries Face Crisis, IMF Revamps Its Lending,* IMF SURVEY, March 24, 2009, *available at* http://www.imf.org/external/pubs/ft/survey/so/2009/NEW 032409A.htm.

108. UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing (Jan 10, 2012), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf.

109. Daniel D. Bradlow, *The World Bank, the IMF, and Human Rights*, 6 TRANSNATIONAL L. AND CONTEMP. PROBS. 47 (1996).

110. Human Rights Council, The effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, UN Doc. A/HRC/RES/20/10 (July 18, 2012).

111. UNCTAD, *supra* note 2.

Processes" adopted by the UN General Assembly in 2015[112] epitomize the new paradigm in respect of debt restructuring. The two sets of principles show a remarkable degree of overlap. Both of them consider as determinative the principles of sustainability, transparency, impartiality, legitimacy, and – good faith.[113] The General Assembly added the principles of sovereignty, immunity, equitable treatment, and majority restructuring.[114] While sovereignty and immunity are well-entrenched principles of international law, the latter two (equitable treatment and majority restructuring) follow from a combination of good faith and sustainability in the taxonomy proposed by the UNCTAD Sovereign Debt Workout Principles. Thus, the public law approach to sovereign debt workouts assigns a central role to the good faith principle, which one needs to understand in the context of debt sustainability as an objective. The following section spells out this reading.

IV. CONTENT: GOOD FAITH IN SOVEREIGN DEBT WORKOUTS

Good faith has a bearing upon contemporary sovereign debt workouts in at least four respects. This section examines them in chronological order, starting with the beginning of workout negotiations and concluding with holdout litigation. It does not consider whether good faith has any relevance for debtors or creditors when states incur debt.[115] The first respect in which good faith facilitates sustainable sovereign debt workouts is the duty to negotiate.[116] This is the most obvious candidate since the Basic Principles of the General Assembly mention it explicitly as an emanation of good faith.[117] Another respect is the need for the debtor to treat all creditors equitably. It resonates with the good faith duty to protect legitimate expectations.[118] The exercise of voting rights[119] and the imposition of a standstill on holdout litigation[120] are constrained by estoppel and, most importantly, the abuse of rights doctrine.[121]

In each of these respects, the application of good faith draws on the idea of debt sustainability and the general normative thrust of the public law approach. At the same time, doctrinal constructivism demands that each concretization of the good faith principle finds at least some degree of support in domestic or international practice. From a methodological viewpoint, the concretization of the good faith principle in the context of sovereign debt is therefore not much different from the establishment of a new principle.

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112. G.A. Res. 69/319 (Sept 10, 2015).

113. UNCTAD, *supra* note 2, 22-23; UNCTAD, *supra* note 108, principle no. 7.

114. *Supra* note 112.

115. In that respect, one might also speak of fiduciary relationships, see José R. Oyola & Marie Sudreau, *Fiduciary Relations: Legal Framework and Implications for Responsible Sovereign Debt Management*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 213 (Carlos Espósito, et al. eds., 2013).

116. *Infra,* IV.A.

117. *Supra* note 112.

118. *Infra* IV.B. On the duty to protect legitimate expectations, see *supra* notes 76 to 79 and accompanying text.

119. *Infra* IV.C.

120. *Infra* IV.D.

121. On estoppel and abuse of rights, see *supra* notes 83 to 90.

A. Duty to Negotiate

Good faith imposes a duty on sovereign debtors and their creditors to enter into negotiations once the debt of a state has become unsustainable. In this respect, the Basic Principles on Sovereign Debt Restructuring Processes stipulate that:

[g]ood faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations and other stages of the process with the aim of a prompt and durable re-establishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms.[122]

Similarly, Principle 7 of the UNCTAD Principles establishes the obligation of lenders to engage in good faith negotiations with borrowing states in case their debt becomes unsustainable.[123]

This concretization of the good faith principle finds confirmation in international and domestic practice. Most notably, since 1999, the IMF has made access to its "lending into arrears" policy conditional upon the debtor state's good faith efforts to reach a restructuring agreement with its private creditors.[124] The meaning of good faith in this context was spelled out in a policy paper of 2002.[125] Accordingly, debtor states need to seek an early dialogue with their private creditors, ideally before they default. They also need to share information on their financial situation and on the restructuring plan, especially on how it would re-establish medium-term debt sustainability, and on the treatment proposed for different kinds of debt. The modalities of such good faith efforts will depend on the complexity and urgency of the case, as well as on the behavior of creditors (in particular on the establishment of representative creditors' committees).[126] In 2015, this policy was extended to arrears with official creditors in light of the case of Ukraine.[127] It refers to the definition of good faith proposed in the 2002 policy paper. Debtors may approach their creditors unilaterally or through multilateral institutions like the Paris Club.[128] As a consequence, the IMF regime now obliges debtor states to good faith negotiations with any of their creditors.

A similar duty might arise for private creditors as a consequence of the spread of Collective Action Clauses (CACs) in the terms applicable to sovereign bonds. One could characterize the function of CACs as that of an ersatz debt restructuring mechanisms. At the time of their comprehensive introduction, CACs were considered as a less costly, easier to implement, but

122. *Supra* note 112, ¶ 2.

123. *Supra* note 108.

124. International Monetary Fund, *IMF Policy on Lending into Arrears to Private Creditors*, IMF Policy Paper 1 (June 14, 1999).

125. International Monetary Fund, *Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion*, IMF Policy Paper 9 et seq. (July 30, 2002).

126. *Id*.

127. International Monetary Fund, *Reforming the Fund's Policy on Non-toleration of Arrears to Official Creditors*, IMF Policy Paper, Annex I: Description of Proposed Policy (Oct 15, 2015).

128. *Id*.

functionally equivalent alternative to a treaty-based sovereign debt restructuring mechanism.[129] One might argue that it defeats the purpose of CACs to refuse to participate in debt workout negotiations which have the purpose of finding agreement on terms of treatment that a vote that find the support of the majority. In this respect, it is important to note that in international arbitration, the parties to a dispute have a duty to negotiate before they submit a case to a tribunal.[130] Similarly, trade law imposes a duty on states to negotiate before imposing unilateral trade restrictions.[131]

Several developments on the domestic level corroborate this conclusion. Domestic bankruptcy laws usually oblige the parties to participate in debt restructurings.[132] Parties need to respect the applicable law and the decisions of competent authorities, which may modify or cancel promissory or property rights.[133] Even though these duties are not explicitly considered as an aspect of good faith, they have an analogous function to good faith duties on the international level.[134] Conversely, the obligatory character of domestic debt restructuring mechanisms supports the view that creditors and debtors have at least a good faith duty to use available international mechanisms.[135]

Further, a duty to negotiate is an important step towards greater sovereign debt sustainability. Sovereign debt sustainability requires smooth workouts.[136] As there is currently no obligatory insolvency mechanism for states with the possibility of a cram-down on creditors' claims, the only way to achieve a workout is by negotiating a restructuring. Hence, one might conclude debt sustainability corroborates a good faith duty for both creditors and debtors to negotiate a restructuring when sustainability is at risk. Debtor states may not unilaterally repudiate their debt, while creditors need to ensure adequate representation.

A crucial question is whether the foregoing concretization of good faith is precise enough to smoothen debt workout practice.[137] The following issues seem to require further clarification, which might be achieved through the adoption of soft or hard legal rules:

1. Trigger: What are the triggering factors for the duty to negotiate?

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129. Randall Quarles, *Herding Cats: Collective-Action Clauses in Sovereign Debt - The Genesis of the Project to Change the Market Practice in 2001 through 2003*, 73 LAW & CONTEMP. PROBS. 29 (2010).

130. Michael Waibel, *The Diplomatic Channel*, *in* THE LAW OF INTERNATIONAL RESPONSIBILITY 1093 (James Crawford et al. eds., 2010).

131. Panizzon, *supra* note 94, 81-84.

132. Matthias Goldmann, *Responsible Sovereign Lending and Borrowing: The View from Domestic Jurisdictions*. *A Comparative Survey* (UNCTAD, Working Paper 39 et seq., Feb 2012), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2012misc3_en.pdf.

133. *Id*.

134. On analogous reasoning in the context of the establishment of general principles, see *supra* note 21.

135. von Bogdandy & Goldmann, *supra* note 98, 57.

136. UNCTAD, *supra* note 111, 24.

137. von Bogdandy & Goldmann, *supra* note 98, 57; for the opposite view: Christian Tietje & Matthias Lehmann, *Legal Opinion concerning several points of law relating to public and private international law in connection with enforcing von [sic] claims arising from Argentine sovereign bonds in Germany* 16 (manuscript, on file with the author, 2013).

Certainly, it is up to the debtor state to initiate negotiations.[138] But what are the requirements? One might consider an IMF Debt Sustainability Analysis sufficient or require an independent assessment.[139]

2. Forum: There are informal negotiating structures generated by practice, such as traditional creditors' committees, or inter-state fora like the Paris Club.[140] One might argue that there is a good faith duty to use them if possible.

3. Who is obliged to make a good faith effort to negotiate? Should this duty be incumbent upon every creditor individually? For practical reasons, retail investors might only be obliged to select representatives. What criteria should be applied for representation?[141] Should the debtor be obliged to negotiate with any creditor committee? It would be more in line with good faith to require committees to be representative.[142]

4. Under which conditions may one of them legitimately terminate ongoing negotiations? How much time, how many resources and efforts are creditors or debtors obliged to invest? One might argue that the timeframe should depend on the debtor state's liquidity needs, the dimension and complexity of the debt crisis.

B. Equitable Restructuring Terms

Good faith guarantees creditors' legitimate expectations. While it is in the nature of a sovereign debt workout that creditors will suffer an economic loss of the quantity necessary for reaching sustainable debt levels, creditors can legitimately expect not to be discriminated against in that process or suffer disproportionate losses.[143] Good faith therefore requires that the debtor treats all creditors equitably and that no group of creditors extracts excessive advantages to the detriment of other groups. Everything else would constitute a disincentive for creditors, making debt workouts more difficult and debt sustainability harder to regain. However, equitable treatment does not amount to identical treatment. There is a wide range of creditors and debt instruments with vastly different risk profiles.[144] It might thus be justified to treat certain creditors differently, like multinational institutions providing interim finance after a certain cut-off date. Short-term trade credits might also be exempted in order to ensure a continuous provision of essential services on the part of the debtor state.[145]

These considerations find support in current sovereign debt restructuring practice. A fundamental principle of the Paris Club is that it requires the debtor state to ensure the "comparability of treatment" of all groups of creditors in a

138. UNCTAD, *supra* note 111, 31.

139. On the problems related to indicators of sustainability, see Michael Riegner, *Legal frameworks and general principles for indicators in sovereign debt restructuring*, 41 YALE J. INT'L L. ONLINE, in this issue (2016).

140. Udaibir S. Das, et al. *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* (International Monetary Fund, Working Paper WP/12/203, 2012).

141. Cf. von Bogdandy & Goldmann, *supra* note 98, 59.

142. Cf. *infra* D.II.

143. On legitimate expectations, see *supra* notes 76 to 79 and accompanying text.

144. Anna Gelpern, *Sovereign Debt. Now What?*, in this issue, part II.

145. UNCTAD, *supra* note 111, 39.

restructuring.[146] As other creditor groups require the same, comparability of treatment becomes a mutual requirement.[147] However, "comparability of treatment" is an imprecise standard that is highly context-specific. The best way to ensure the comparability of treatment might be fair and inclusive negotiations.

Another potential good faith issue is whether and when debt incurred in bad faith should be repudiated. However, despite the remarkable theoretical support which the "odious debt" doctrine has received over time from various angles,[148] in practice it has yet to yield many tangible results.[149] Iraq's debt is a case in point. After the United States' 2003 invasion, Iraq received a generous debt restructuring.[150] But the United States and other participating states meticulously avoided recognizing the odious character of the debt concerned.[151] This shows that potentially odious debt is normally not excluded *a priori* from workout negotiations. Exceptions are instances of gross corruption or cronyism like the *Tinoco* case, where a British bank deliberately made payments due under a concession agreement to the Costa Rican ruler's and his brother's personal accounts, not to the state.[152] Other than that, one should handle the odious debt doctrine with care. Instead, questions related to the odious character of sovereign debt might have an indirect impact on the terms of the debt workout agreement.[153]

C. Exercise of Voting Rights

Good faith does not oblige creditors to cast their vote in favor of a negotiated draft workout or even to accept a majority decision as binding, whether or not the applicable bond includes a collective action clause.[154] Governments and courts have repeatedly emphasized the consensual nature of debt restructurings.[155] Absent this consensual nature, the stipulation of CACs

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146. Paris Club, *What Does Comparability of Treatment Mean?* (April 20, 2016, 10:41 AM), http://www.clubdeparis.org/en/communications/page/what-does-comparability-of-treatment-mean.

147. Gelpern, *supra* note 144, part I: "cross-conditionality".

148. Pathbreaking: ALEXANDER N. SACK, LES EFFETS DES TRANSFORMATIONS DES ETATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIERES 157 (Sirey. 1927); *see also* Anna Gelpern, *Odious, Not Debt*, 70 LAW & CONTEMP. PROBS. 101 (2007); Human Rights Council, Financial complicity: lending to States engaged in gross human rights violations, Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Juan Pablo Bohoslavsky, U.N. Doc. A/HRC/28/59 (Dec. 22, 2014).

149. Cf. Tai-Heng Cheng, *Renegotiating the odious debt doctrine*, 70 LAW & CONTEMP. PROBS 7, 14 et seq. (2007); SABINE MICHALOWSKI, UNCONSTITUTIONAL REGIMES AND THE VALIDITY OF SOVEREIGN DEBT 37 (2007).

150. Christoph G. Paulus, *Debts*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW marginal no. 28 (Rüdiger Wolfrum ed. 2013).

151. *Id*.

152. Aguilar-Amory and Royal Bank of Canada Claims, U.K. v. Costa Rica, 18 AM. J. INT'L L. 147 (1924).

153. Cf. Robert Howse, *The Concept of Odious Debt in Public International Law*, UNCTAD Discussion Paper 8-9 (2007), *available at* http://unctad.org/en/Docs/osgdp20074_en.pdf, who demonstrates that the concept of odiousness has played an important role in past negotiations.

154. In this sense, however, Tietje & Lehmann, *supra* note 137.

155. Cf. NML v. Republic of Argentina, Brief for the United States of America as Amicus Curiae in Support of Reversal, 6 et seq., case 12-105-cv(L) (2nd Cir.) (April 4, 2012).

comprising majority-voting clauses – which appear in many variations regarding the voting procedure, the majorities required, or the lists of "reserved matters" to which the majority voting requirements apply – would be pointless. Thus, there is no general duty to accept majority decisions unless provided for in applicable CACs. Good faith exceptions to the unfettered exercise of contractual voting rights must not lightly be presumed.

In this respect, debtors have been largely unsuccessful in invoking the *clausula rebus sic stantibus* in order to impose a restructuring agreement on creditors. This concretization of good faith implies that fundamental changes of the circumstances which the parties to a contract or a treaty assumed to prevail at the conclusion of the contract or treaty might give rise to a termination or adjustment of contractual duties.[156] However, in almost all major jurisdictions, the *clausula* does not apply to cases of economic necessity, no matter whether the debtor is a state or a private person.[157] Debt crises are not considered as unforeseen, but as the result of the behavior of one or both contracting parties for which they have to bear responsibility.[158] Only unexpected circumstances like war or natural disasters might give rise to a right to adjust the terms of a contract or treaty under the *clausula*.[159]

However, it has been argued that good faith does oblige creditors and debtors to contribute to an equitable debt workout and not to frustrate it without legitimate reason.[160] This has three repercussions for the exercise of voting rights. First, conflicts of interest might bar the exercise of voting rights as a matter of good faith. Such conflicts of interest might arise when states buy back some of their bonds either directly or through intermediaries under their control. In the corporate context, treasury stock (or treasury shares) is usually excluded from voting since it is only legally part of capital, not in an economic sense. The European Central Bank (ECB) might face a different conflict of interest when restructuring debt by Eurozone members, as this might be qualified as a circumvention of the prohibition of monetary financing.[161] However, one might also consider the participation of the ECB in sovereign debt restructurings as a necessary aspect of its monetary policy: lending money to commercial banks against collateral always involves the risk that the collateral might lose some of its value. Therefore, the ECB should not generally exclude to vote in favor of a sovereign debt restructuring of a Eurozone member.[162]

Second, creditors might be estopped from voting against a restructuring if they did not negotiate in good faith. For example, one might think of creditors

156. *Supra* note 91 and accompanying text.

157. Goldmann, *supra* note 132, 37-8 (based on a sample of 15 jurisdictions from all regions of the world).

158. August Reinisch, *Debt Restructuring and State Responsibility*, *in* LA DETTE EXTÉRIEURE 537, 570 (Dominique Carreau & Malcolm N. Shaw eds., 1995).

159. Goldmann, *supra* note 132, 37-8.

160. *Supra* D.II.

161. Consolidated Version of the Treaty on the Functioning of the European Union Art. 123, May 9, 2008, 2008 O.J. (C115) 47.

162. *But see* Case C-62/14, Gauweiler et al. v. Deutscher Bundestag, Opinion of Advocate General Cruz Villalón, ¶ 235, 2015 EUR-Lex 62014CJ0062 (Jan. 14, 2015).

making specific representations during the negotiations which tilt the draft workout agreement in a certain way. It seems fair to argue that they should be estopped from voting against the agreement for reasons that contradict their earlier representations, unless the rejection is due to a change in circumstances which it did not and could not foresee doing the negotiations. By contrast, it would be a legitimate reason for a bilateral creditor to reject a negotiated agreement if it cannot get the necessary consent of domestic institutions like the parliament and if it has been made clear during the negotiations that such consent is required.

Third, and most importantly, creditors may not abuse their voting rights in order to extract an advantage from the frustration of a workout. As stated in the implications to Principle 7 of the UNCTAD Principles, creditors who buy debt of troubled states for the purpose of extracting a preferential treatment act abusively. In the same vein, the *amicus curiae* brief submitted by the United States government in the recent *NML v. Argentina* case,[163] while formally insisting that debt workouts had to be voluntary, stressed that this should not allow individual creditors to thwart an entire workout.[164] The backlash against "vulture funds" shows that this conviction is widespread.[165] However, there is some uncertainty regarding the criteria that qualify the exercise of voting rights as abusive. The UNCTAD Principles refer to the "intent" of the buyer of such debt. This is a very subjective criterion that can hardly be proven unless it is corroborated by objective indiciae. In this respect, in order to establish that the acquisition of certain debt was abusive, one might take into account the following criteria proposed by UNCTAD,[166] some of which were included in the 2015 Belgian anti-vulture legislation:[167]

1. the difference between the nominal and market price at the time of the acquisition;

2. the time of the acquisition (e.g. whether a multilateral institution had established an unsustainable level of debt before the purchase);

3. the volume acquired, especially if it amounts to a blocking minority under the applicable collective action clause;

4. most importantly, whether the creditor made a good faith effort to reach a debt workout. This is not the case with creditors whose business model consists in buying distressed debt at discounts in order to litigate for full repayment.

In principle, an abusive exercise of voting rights might not only exist where debt instruments were *acquired* for the sole purpose of extracting a preferential treatment, but also where a creditor buys the debt originally in good faith. The ratio underlying this concretization of the abuse of rights doctrine is the idea that free-riding violates good faith, no matter whether the debt was acquired in good or in bad faith. Even creditors who purchased debt

163. NML Capital et al. v. Argentina, 699 F.3d 246, 263 (2d Cir. 2012).

164. Brief for the United States of America, *supra* note 155, 17.

165. Extensively: Bohoslavsky & Goldmann, *supra* note 1, part E.III.

166. UNCTAD, *supra* note 2, 59.

167. Projet de loi relative à la lutte contre les activités des fonds vautours art. 2, Chambre des representants de Belgique, Doc. 54 1057/005 (July 1, 2015).

instruments in good faith cannot expect sovereign debt to be a risk-free investment or to free-ride in case the risks inherent in these instruments materialize. But the acquisition of distressed debt is usually the best indication of bad faith. Legal certainty would benefit from further legislative clarification of the criteria for the identification of abusive creditor behavior, following the example of the Belgian anti-vulture legislation.

D. Standstill on Holdout Litigation

In line with the foregoing considerations, it can be argued that a general principle of law is emerging according to which the negotiation or implementation of a sovereign debt workout leads to a standstill on abusive holdout litigation.[168] One might consider such a standstill rule as a concretization of good faith, or as a general principle of law of its own.[169] The qualification depends on whether one places the emphasis on deductive or inductive aspects that speak in favor of such a rule. The difference has little practical significance.

Deductively, it seems rather straightforward that a standstill on holdout litigation protecting negotiated sovereign debt workouts would foster sovereign debt sustainability.[170] Inductively, the case for a standstill rule is getting stronger and stronger: in practically all domestic jurisdictions, bankruptcy filings of private entities trigger a stay on enforcement actions.[171] Although domestic law might vary in some details from one legal order to the other, in particular as some jurisdictions require prior court approvals, on an abstract level there is a high degree of convergence: authoritative, centralized insolvency proceedings bar individual enforcement against the creditor in default.[172] This rule originating in private sector insolvencies is increasingly applied to defaults of public entities at the sub-national level. Thus, under Chapter 9 of Title 11 of the U.S. Code, automatic stay is applicable in bankruptcy procedures against municipalities.[173] Other states that have enacted bankruptcy legislation for sub-national entities include Brazil, Bulgaria, Hungary, Romania, and South Africa.[174] It routinely includes some form of stay

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168. In this sense: Rudolf Dolzer, *Staatliche Zahlungsunfähigkeit: Zum Begriff und zu den Rechtsfolgen im Völkerrecht*, *in* DES MENSCHEN RECHT ZWISCHEN FREIHEIT UND VERANTWORTUNG (FESTSCHRIFT PARTSCH) 531, 546-7 (Jürgen Jekewitz et al. eds., 1989); recognizing standstill as a general principle of law *in statu nascendi:* Schier, *supra* note 8, 160, 163.

169. Cf. Matthias Goldmann, *Necessity and Feasibility of a Standstill Rule for Sovereign Debt Workouts*, UNCTAD Working Paper (Jan 23, 2014), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2014misc4_en.pdf.

170. *Id*.

171. International Law Association Sovereign Insolvency Study Group, *State Insolvency: Options for the Way Forward*, 23 (2010); Christopher G. Paulus, *A Statutory Procedure for Restructuring Debts of Sovereign States*, 49 RECHT DER INTERNATIONALEN WIRTSCHAFT 401, 404 (2003); Michael Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*, 101 AM. J. INT'L L. 711, 750 (2007).

172. Goldmann, *supra* note 132; this has been recognized by international tribunals, cf. Noble Ventures Inc. v. Romania, ICSID Case No. ARB/01/11, Award (Oct 12, 2005).

173. 11 U.S.C., §§ 901(a), 362.

174. Comprehensively: Lili Liu & Michael Waibel, *Subnational Insolvency: Cross-Country Experiences and Lessons* 26 (World Bank, Policy Research Working Paper No. 4496, 2008).

on enforcement.[175]

Concerning sovereign default, there are encouraging signs in state practice for the recognition of a standstill rule in order to protect the integrity of a sovereign debt workout and related negotiations. An early example is a 1962 judgment of the German Federal Constitutional Court concerning Germany's post-war default, in which it recognized that sovereign defaults justified highly intrusive measures including the legislative cancellation of debt without compensation.[176] The court cited the high significance of the state for politics and the economy in general and the ensuing impossibility to liquidate all of the state's assets.[177] In 1984, the United States federal Court of Appeals for the Second Circuit ruled in favour of Costa Rica against a holdout creditor.[178] The court held that Costa Rica seemed to be negotiating in good faith at the time. When the restructuring later amounted to a rather unilateral suspension of payments, the first ruling was reversed.[179] A year later, the New York state Supreme Court recognized the principle that proceedings should be stayed during a workout in a suit against Venezuela, basing it on the duty of the plaintiff to respect creditor solidarity.[180]

A more recent example for this line of reasoning is provided by the Second Circuit's 2005 summary order in *EM Ltd. v. Argentina* and *NML Capital v. Argentina*.[181] Although this order formally lacks precedential value,[182] it has been widely cited for the remarkable considerations of the court, which decided that "the District Court acted well within its authority to vacate the remedies in order to avoid a substantial risk to the successful conclusion of the debt restructuring. That restructuring is obviously of critical importance to the economic health of a nation."[183] At around the same time, the Italian Corte di Cassazione recognized that the need to safeguard essential public interests and human rights justified extending immunity over Argentina's emergency laws, even though it had waived its immunity for the bonds in dispute.[184] The underlying rationale is the same, even though the court presents it as a combination of arguments relating to necessity and immunity.[185]

The Second Circuit's 2011 decision *CVI v. Argentina* seems to endorse the court's earlier line of reasoning, although only indirectly.[186] In this case, the court upheld the attachments received by CVI on Argentina's reversionary

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175. *Id*.

176. Bundesverfassungsgericht [Federal Constitutional Court], Nov 14, 1962, 15 BVerfGE 126.

177. *Id*., at 140-144.

178. Allied Bank Int'l v. Banco Credito Agricola de Cartago, 733 F.2d 23 (2d Cir. 1984).

179. Allied Bank Int'l vs. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985); *see also* Rogoff & Zettelmeyer, *supra* note 4, 475.

180. Crédit français S.A. v. Sociedad financiera de Comercio, 490 N.Y.S.2d 670 (N.Y.S.C. 1985); Dolzer, *supra* note 168, 539.

181. EM Ltd. v. Argentina; NML Capital v. Argentina, 05-1525-cv et al., Summary Order (May 13, 2005), 2d Cir. R. 32.1.

182. *Id*.

183. *Id*.

184. Corte di Cassazione, Sezione Unite Civile, n. 11225 (May 27, 2005), 88 RIVISTA DI DIRITTO INTERNAZIONALE (2005) 856 (Ital.); *see also* Waibel, *supra* note 171, 757.

185. Corte di Cassazione, *supra* note 184.

186. Capital Ventures International v. Republic of Argentina, 652 F.3d 266 (2d Cir. 2011).

interest in collateral pledged for Brady bonds (i.e. when exchanging Brady bonds, Argentina would receive the pledged collateral, which CVI would then have "confiscated" pursuant to the attachment orders).[187] However, the court based its decision primarily on the argument that the attachments concerned only a relatively small sum (USD 100m), while the volumes of the planned restructuring and thus of the expected reversionary interest were much larger.[188] Therefore, the court concluded that the attachment would not obstruct Argentina's finances.[189] If one reverses this argument, attachments could principally be vacated in case they obstruct a sovereign debt workout.[190] In *NML v. Argentina*, the Second Circuit proved to be very creditor-friendly by upholding the District Court's injunction obliging banks acting for Argentina to make ratable payments.[191] But at the same time, it emphasized that this did not threaten the implementation of Argentina's restructuring plan and would not trigger a new financial and economic crisis. At least in theory, the court seemed concerned that its decisions might obstruct sovereign debt workouts, a view is shared by the United States government: In its amicus brief submitted in that case, while formally insisting on the voluntary character of sovereign debt workouts, the government stressed that this should not allow individual creditors to thwart an entire workout.[192] This represents a remarkable shift of opinion over the last years. In *Pravin Banker v. Banco Popular del Peru*, decided in 1997 while Peru was negotiating an exchange of defaulted sovereign debt into Brady bonds, the Second Circuit only declined to stay the case as a matter of comity because the United States government had considered participation in a Brady plan restructuring as a strictly voluntary matter.[193]

Further, legislation like the Belgian Anti-vulture Act[194] or the 2010 United Kingdom Debt Relief (Developing Countries) Act[195] prevent holdout strategies. The latter reduces claims of private creditors against countries participating in the HIPC proportionate to the relief granted to them under the initiative.[196] Although it does not impose standstill in a technical sense, it serves the purpose of ensuring the orderly resolution of debt crises through international negotiations while preserving the equality of creditors.

The trend towards secure negotiated settlements and prevent judicial interference does not stop at the international level. Some modern bilateral

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187. *Id*.

188. *Id*.

189. *Id*.

190. *See also* Capital Ventures International v. Argentina, 443 F.3d 214, 217 (2d Cir. 2006), regarding the risk that the order of attachment might create "confusion" among the creditors participating in the exchange offer (obiter dictum): "[W]e can conceive, perhaps, of a situation in which an order of attachment might be against the public interest for some reason not addressed in the CPLR (statute)."

191. NML Capital et al. v. Argentina, 699 F.3d 246, 263 (2d Cir. 2012).

192. *Supra* note 155.

193. Pravin Banker v. Banco Popular del Peru, 109 F.3d 850, 855 (2d Cir. 1997); *see also* Ugo Panizza, et al, *The Economics and Law of Sovereign Debt and Default*, 47 JOURNAL OF ECONOMIC LITERATURE 651, 659 (2009).

194. *Supra* note 167 and accompanying text.

195. United Kingdom Debt Relief (Developing Countries) Act, 2009-2010, H.C. Bill [22], *available at* http://www.legislation.gov.uk/ukpga/ 2010/22/contents.

196. *Id*., sec. 3.

investment treaties (BITs) bar access to investment arbitration if a negotiated workout has received the required majority.[197] Even in the absence of such a clause in the relevant BIT, the arbitral tribunal in *Poštová banka* concluded that sovereign debt did not fall under the definition of investment contained in that BIT because of the social and political significance of sovereign debt.[198]

Certainly, the mentioned developments represent only part of the picture. The trend is not uniform. Particularly infamous is the decision of a Belgian court in *Elliot Associates v. Peru*, the first decision recognizing a right of creditors to ratable payments.[199] U.S. judges have rendered dozens of judgments in favour of vulture funds attempting to reclaim the nominal amount of their debt against Argentina in which they did not recognize that Argentina had a legitimate interest to have the proceedings stayed until the conclusion of its restructuring.[200] However, the cases against Argentina in essence seemed to rotate about diverging views as to whether Argentina itself had acted in good faith – which a state invoking good faith indeed should do.[201] In a recent case before the German Federal Court of Justice (FCJ), a standstill rule based on good faith was explicitly rejected.[202] In its decision, the FCJ relied entirely on a 2007 judgment of the German Federal Constitutional Court (FCC).[203] The Court of Justice indeed claimed not to add anything to the latter judgment. Otherwise it would have had to submit the case to the FCC, the sole court competent for the ascertainment of general principles of law in Germany.[204] However, the 2007 judgment did not even mention standstill or good faith as general principles of law. It was exclusively concerned with ascertaining whether Argentina could invoke necessity as a defence originating in customary international law. The FCJ got around this by overstating and taking out of context one particular sentence of the FCC's 2007 judgment which reiterated the obvious, namely that there was no (statutory) international regime for sovereign debt restructuring. A suit has been filed with the FCC for reasons of the FCJ's failure to submit the case to the FCC, but the outcome is uncertain given Argentina's attempts to reach a settlement of its remaining old debt.

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197. E.g. Treaty Between the United States of America and the Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment, Annex G (Oct 25, 2004), 44 I.L.M. 268 (2005).

198. Poštová banka, a.s. and Istrokapital SE v. Hellenic Republic, ICSID Case No. ARB/13/8, Award, ¶ 324 et seq. (April 9, 2015).

199. Elliott Assocs., L.P., General Docket No. 2000/QR/92, Cour d'Appel [Court of Appeal] Bruxelles, 8éme ch., Sept. 26, 2000 (Belg.).

200. E.g. EM Ltd. v. Argentina, 720 F.Supp.2d 273 (S.D.N.Y. 2010); *see also* the list of judgments against Argentina, totalling more than $500m, in Aurelius Capital Partners et al. v. Argentina, 07-Civ-2715(TPG), Restraining Order (Jan. 15, 2010). *But see* in this as well as 11 other cases the order of the same court lifting an earlier restraining order concerning funds of the Argentinean central bank held at the Federal Reserve Bank of New York in order to enforce judgments of a total worth of over $2.2bn, see EM Ltd. v. Argentina, 865 F.Supp.2d 415 (S.D.N.Y. 2012).

201. On Argentina's efforts to find a negotiated settlement, see J. F. HORNBECK, CONG. RESEARCH SERV., R41029, Argentina's Defaulted Sovereign Debt: Dealing with the "Holdouts" (2010).

202. Bundesgerichtshof [Federal Court of Justice], Feb 2, 2015, Neue Juristische Wochenschrift 2328, 2015 (Ger.).

203. Bundesverfassungsgericht [Federal Constitutional Court], May 8, 2007, 118 BVerfGE 124 (Ger.).

204. Art. 100(2), Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [Basic Law], May 23, 1949, BGBl. I (Ger.).

For the above reasons, it seems possible to identify a – normatively well-founded – conviction across legal orders that sovereign debt workouts must not be jeopardized by holdout litigation. All requirements for the emergence of a general principle of law, whether as a concretization of good faith or a separate principle, seem to be met.[205]

V. SPECIFYING AND IMPLEMENTING GOOD FAITH THROUGH SOFT AND HARD LAW

This Article has revealed so far that good faith as a general principle of law has great potential for promoting sovereign debt sustainability and smoothening sovereign debt workouts. It therefore lends itself as another key principle of the incremental approach to sovereign debt restructuring, the subject of this special issue.

However, in order to make these principles operational, it might be advisable to set out some issues in further detail, possibly in the form of a soft law instrument. These issues include the conditions necessary for creditors and debtors to meet their good faith duty to negotiate, or the criteria which make holdout litigation an abuse of rights. In respect of the latter, the Belgian[206] and UK[207] legislation against holdout creditors provide highly relevant guidance that might inspire an international model law. The Basic Principles on Sovereign Debt Restructuring Processes adopted by the UN General Assembly[208] also constitute a great step in that they provide a principled recognition of the concretizations of good faith that are the subject of this paper. However, they might lack the granularity that is desirable to ensure legal certainty. A soft law instrument proposing some more detailed rules might serve as a blueprint for domestic legislation.

Such legislation is also desirable because general principles of law are, first of all, sources of international law. States need to comply with them as a matter of international law. Their applicability in domestic legal orders depends on the status of international law in the latter. Some constitutions incorporate general principles into the domestic legal order, either directly by cross-referencing,[209] or indirectly, e.g. as an aspect of comity.[210] Other countries need to enact appropriate legislation. The incremental approach is thus much more than a matter of general principles alone. It requires the combined efforts of various actors and diverse instruments on all levels of government.

205. According to the taxonomy proposed in Matthias Goldmann, *On the Comparative Foundations of Principles in International Law: The Move Towards Rules and Transparency in Fiscal Policy as Examples*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW 113 (Carlos Espósito, et al. eds., 2013), this principle would be characterized as a guiding principle about to mature to a general principle, if not as an existing general principle.

206. *Supra* note 167.

207. *Supra* note 195.

208. *Supra* note 112.

209. E.g. Art. 25, Basic Law, *supra* note 204.

210. Christopher C. Wheeler & Amir Attaran, *Declawing the Vulture Funds: Rehabilitation of a Comity Defense in Sovereign Debt Litigation*, 39 STAN. J. INT'L L. 253 (2003).

Legal Frameworks and General Principles for Indicators in Sovereign Debt Restructuring

Michael Riegner*

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I. INTRODUCTION: INDICATORS AND INTERNATIONAL LAW

Sovereign debt has traditionally been characterized by a relative dearth of international legal regulation. This also applied to sovereign debt restructurings, defined here as the bundle of measures associated with debt reduction, adjustment and conditional lending.[1] Earlier attempts at establishing a multilateral insolvency regime for sovereign states failed, and most influential creditor states favored market-based solutions relying on contractual collective action clauses, which allow a supermajority of debtors to agree on a binding restructuring. However, in the context of the most recent financial crisis new initiatives for an international legal regime governing sovereign debt workouts

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1. Bogdandy and Goldmann, *Sovereign Debt Restructurings as Exercises of International Public Authority* in ESPÓSITO, LI AND BOHOSLAVSKY (EDS.), SOVEREIGN FINANCING AND INTERNATIONAL LAW: THE UNCTAD PRINCIPLES ON RESPONSIBLE SOVEREIGN LENDING AND BORROWING 49 (2013). A narrower definition of restructuring is used in DAS, PAPAIOANNOU AND TREBESCH, SOVEREIGN DEBT RESTRUCTURINGS 1950–2010: LITERATURE SURVEY, DATA, AND STYLIZED FACTS 7 (2012).

have emerged. Amidst controversy between debtor and creditor states, the UN General Assembly called for 'the establishment of a multilateral legal framework for sovereign debt restructuring processes' in 2014.[2] In spring 2015, the UN Conference on Trade and Development (UNCTAD) published the 'UNCTAD Principles Guiding Sovereign Debt Workouts' ('UNCTAD Principles'), taken up in a later UN General Assembly Resolution.[3] These multilateral initiatives seek to address a series of problems with contemporary debt workouts: Procrastination and too-little-too-late solutions, creditor (un)coordination and holdout litigation, as well as forum fragmentation. Beyond these, restructurings may contribute to economic distress, social decline, poverty, and political instability.[4]

This articles addresses one key element of any contemporary restructuring exercise, which also represents a building block for the proposed international Debt Workout Mechanism (DWM): The criteria and indicators that guide the decision on whether, and how, to restructure sovereign debt. Debt thresholds, sustainability indicators and measures of over-borrowing are already used in existing legal frameworks for sovereign debt, and they also figure prominently in the UNCTAD Principles. They are intended to mitigate procrastination and coordination problems by signaling when sovereign debt becomes unsustainable and needs restructuring. Indicators thus promise to deliver objective measurements and to inform evidence-based decision making in the face of competing interests and political controversy. Their use in sovereign debt is part of a wider trend in which indicators have become a 'technology of global governance'.[5] Defined as quantitative measures of complex social and economic phenomena, indicators are widely used to measure performance, produce knowledge, and allocate resource in fields as diverse as development finance, human rights, education, and public management more generally.[6] They are not primarily legal concepts, and the

2. General Assembly resolution 68/304. UN Doc. A/RES/68/304 (2014) para. 31. *See also* General Assembly resolution 69/247, UN Doc. A/RES/69/247 (2015): Modalities for the implementation of resolution 68/304, UN Doc. A/C.2/69/L.59 (2014), para 1.

3. UNCTAD, Sovereign Debt Workouts: Going Forward, Roadmap and Guide (2015) available at http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf (last visited 6.4.2016); General Assembly resolution 69/319, UN Doc. A/RES/69/319 (2015): Basic Principles on Sovereign Debt Restructuring.

4. For an overview of the problems, see BROOKINGS, REVISITING SOVEREIGN BANKRUPTCY REPORT 5-15 (2013); Gelpern, *A Skeptic's Case for Sovereign Bankruptcy,* 50 HOUS. L. REV. 1095 (2013); KAISER, 'RESOLVING SOVEREIGN DEBT CRISES - TOWARDS A FAIR AND TRANSPARENT INTERNATIONAL INSOLVENCY FRAMEWORK' (2013); DAS, PAPAIOANNOU AND TREBESCH, *supra* note 1; IMF, 'SOVEREIGN DEBT RESTRUCTURINGS - RECENT DEVELOPMENTS AND IMPLICATIONS FOR THE FUND'S LEGAL AND POLICY FRAMEWORK' 15 et seq (2013); UNCTAD, 'DEBT WORKOUT MECHANISM FRAMING PAPER' 3 (2013); TREBESCH, 'DELAYS IN SOVEREIGN DEBT RESTRUCTURING' (2008); TIETJE, 'DIE ARGENTINIEN-KRISE AUS RECHTLICHER SICHT: STAATSANLEIHEN UND STAATENINSOLVENZ' (2005).

5. Davis, Kingsbury and Merry, *Indicators as a Technology of Global Governance,* 46 LAW AND SOC'Y REV 71, 73 (2012). *See also* DAVIS, KINGSBURY, MERRY AND FISHER (EDS.), GOVERNANCE BY INDICATORS (2012). The aggregated nature and the specific naming distinguish indicators from simple statistical data. Indicators can become benchmarks or thresholds when target values are defined.

6. Urueña, *'Indicators a political spaces'* (2015) 12 INTERNATIONAL ORGANIZATIONS LAW REVIEW 1, and the other contributions to the Special Forum on Indicators in that journal issue; MERRY, DAVIS AND KINGSBURY (EDS.), THE QUIET POWER OF INDICATORS (2015); Merry, '*Measuring the World: Indicators, Human Rights, and Global Governance*' (Suppl. 3) CURRENT ANTHROPOLOGY 83–95 (2011); Rittich, '*Governing by Measuring: The Millenium Development Goals in Global*

validity and reliability of measures such as the debt-to-GDP ratio is properly dealt with by economists and statisticians.[7] However, the strengths and pitfalls of indicators in sovereign debt depend not only on their technical quality, but also on institutional contexts, compliance with existing legal requirements, and political acceptance among borrowers, lenders, international institutions and affected citizens. These aspects raise genuinely legal questions.

This article thus analyzes legal questions raised by the use of indicators in a DWM and proposes some tentative answers. It discusses existing legal frameworks of indicators in sovereign debt, develops general principles guiding the use of such indicators in restructurings, and recommends concrete rules on how indicators should be used in a DWM. The ultimate goal of this article is thus pragmatic: To provide a practical input into ongoing political and legal debates on how to design a multilateral DWM. Its main finding is that indicators should be used as normative benchmarks among others, but subject to an appropriate legal and institutional framework that ensures their effectiveness and legitimacy. The major contribution of this paper to the existing literature is the development of four general principles that govern such a normative framework for indicators in a DWM. These principles guide the evaluation, interpretation and evolution of rules and provide standards for a principled and transparent discussion of design choices for a DWM. These general principles also structure the proper interplay of economic, political and legal factors in restructurings. International law thus goes beyond facilitating 'managerial' solutions based on technical fixes; it also provides general evaluative standards for assessing the legitimacy of institutional arrangements and provides a normative framework for a principled discussion of design proposals for a DWM.

At the same time, the need for the international legal framework developed here is rooted in three theoretical approaches to global governance. The first is the International Public Authority approach, which proposes to focus legal doctrine and public law requirements on exercises of "International Public Authority" (IPA), defined as any unilateral act, whether binding or not, which has the potential to condition legal subjects in their individual or collective autonomy, that is, build up sufficient pressure for that subject to follow the act's impetus.[8] In this view, sovereign debt restructurings represent an exercise of IPA to the extent that they impact the choice of sovereign states to restructure or that they impinge on individual rights, either of debtors or of citizens subjected to austerity measures.[9] Similar effects can result from

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Governance', in FABRI, WOLFRUM AND GOGOLIN (EDS.), SELECT PROCEEDINGS OF THE ESIL (2010), 463; Rosga and Satterthwaite, '*The Trust in Indicators: Measuring Human Rights'* 27 BERKELEY J. OF INT'L L. 253 (2008); Anders, '*The Normativity of Numbers: World Bank and IMF Conditionality'* 31 POLITICAL AND LEGAL ANTHROPOLOGY REVIEW 187 (2008); Salais, '*On the correct (and incorrect) use of indicators in public action'* 27 COMP. LAB. L. & POL'Y J. 237 (2006).

7. *See* the UNCTAD Working Group paper by Lukkezen and Rojas-Romagosa, *Early Warning Indicators in a Debt Restructuring Mechanism* (2014). Overview of debt indicators with IMF, DAS, PAPAIOANNOU AND TREBESCH, *supra* note 1 at 68-71.

8. Bogdandy, Dann and Goldmann, '*Developing the Publicness of Public International Law: Towards a Legal Framework for Global Governance Activities'* 9 GERMAN LAW JOURNAL 1376 (2008), namely at 1381.

9. Bogdandy and Goldmann, *supra* note 1.

indicators and national policy assessments by international institutions, such as debt sustainability assessments that condition borrowers' access to capital markets and thus require a legitimating public law framework.[10] Inspiration for the content of such a framework can be drawn from a second theoretical approach to global governance, that of Global Administrative Law and its general principles of participation, transparency, reason-giving and review.[11] The basis of these general principles in positive law remains shaky, but for the purposes of the present article, they can be used at least as analytical and heuristic categories that structure an inquiry into how far these requirements are grounded in the existing rules and principles of sovereign debt law. A third approach, informed by the two others, is based on the recognition that much of global governance and global administration consists of informational action, i.e. the production, exchange, use and dissemination of information. It thus proposes to reconstruct the existing legal rules and principles governing such informational action, including sovereign debt indicators, as an international institutional law of information.[12]

On this basis, the article proceeds in three steps: Section II takes stock of existing legal frameworks for indicators on the international, regional, national and private level. How are debt indicators used? What is their legal relevance? What lessons can we learn for a DWM? Section III reconstructs four general principles guiding indicator use from existing sources of international and domestic law: Sustainability, transparency, ownership, and human rights. These principles, and the lessons learned, form the basis for the recommendations in section IV. These recommendations contain proposals for the legal design of the required DWM indicator framework and recommends tentative solutions to three main questions: How should indicators be used in a DWM; namely, should they signal the need for a restructuring? What should be their sources and who should design them? And how should indicators be applied? The last section concludes with considerations on the limits of the approach chosen here and on further research.

II. LESSONS LEARNED FROM EXISTING LEGAL FRAMEWORKS OF INDICATORS IN SOVEREIGN DEBT

This section reviews existing institutional and legal frameworks for

10. *See generally* Bogdandy and Goldmann, *The Exercise of International Public Authority Through National Policy Assessment* 5 INT'L ORGANIZATIONS L. REV. 241 (2008); Cassese and Casini, *'Public Regulation of Global Indicators'*, in DAVIS, FISHER, KINGSBURY AND MERRY (EDS.) (n 5), 465. Specifically on capital market dependency, see Riegner, *Governance Indicators in the Law of Development Finance: A Legal Analysis of the World Bank's Country Policy and Institutional Assessment* 19 JOURNAL OF INT'L ECONOMIC LAW 1 (2016).

11. Kingsbury, Krisch and Stewart, *The Emergence of Global Administrative Law* 68 LAW & CONTEMP. PROBS 15 (2005). *See also* CASSESE (ED.), RESEARCH HANDBOOK ON GLOBAL ADMINISTRATIVE LAW (2016).

12. Riegner, '*Towards an international institutional law of information'* 12 INTERNATIONAL ORGANIZATIONS LAW REVIEW 50 (2015); Schmidt-Aßmann, *'Principles of an International Order of Information',* in ANTHONY (ED), VALUES IN GLOBAL ADMINISTRATIVE LAW (2011), 117. For an application to the new Sustainable Development Goals, see Riegner, 'Implementing the "Data Revolution" for the post-2015 Sustainable Development Goals - Towards a Global Administrative Law of Information', in BOISSON DE CHAZOURNES, CISSÉ ET AL. (EDS.), 7 WORLD BANK LEGAL REVIEW 17 (2016).

sovereign debt indicators. It primarily contrasts the International Monetary Fund's (IMF) approach with that of the European Union in subsections A and B. It then goes on to consider insights from domestic public law and from private actors and litigation in subsections C and D. It closes in section E with a summary of lessons learned and, on this basis, concludes that indicators should indeed be used in a DWM, subject to an adequate legal framework. The analysis in this Part sets out the *status quo* to which any reform must be compared, and it builds the foundation for the reconstruction of general principles in Part IV and for the concrete recommendations in Part V.[13]

A. International law: The IMF's debt sustainability framework

At the international level, a number of formal international organizations and informal institutions contribute to debt restructuring processes. The UN General Assembly and UNCTAD set soft standards, the World Bank is involved in lending, debt data and policy analysis, the Paris and London Clubs conduct restructuring negotiations, and the Organization for Economic Co-operation and Development (OECD) also provides debt statistics.[14] The present analysis focuses on the IMF, which is directly involved in restructurings and conducts influential indicator-based debt sustainability assessments. The Fund does not have an explicit legal mandate for debt restructurings and cannot legally compel a member to initiate a restructuring. However, its Articles of Agreement empower it to "oversee the international monetary system" and member state compliance (Art. IV Sec. 3). Based on this competence and on its lending functions, the Fund plays several important roles in restructuring processes such as analysis and policy advice to countries on debt sustainability. It provides lending to countries in debt distress under its Exceptional Access Policy and acts as analyst and advisor in restructuring negotiations and agreements, namely in the Paris Club. Furthermore, the Fund also acts as information provider for markets and the general public. [15] In exercising these roles, the Fund IMF relies on a formal "Debt Sustainability Framework" (DSF), last overhauled in 2013. The DSF is not explicitly regulated in the IMF Articles of Agreement or formal secondary or internal law enacted by the institution's organs, but is based on an internal 2013 Policy Paper and a 2013 Staff Guidance Note.[16] These are issued by Fund management based on its general competence to conduct the "ordinary business of the Fund."[17] They are not directly binding on member states, but must be observed internally by

13. For a brief comparative overview of *private* insolvency law, which are less relevant for the purposes of this paper, see GOLDMANN, 'RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE VIEW FROM DOMESTIC JURISDICTIONS' 38-9 (2012).

14. For an overview, see the contribution by Goldmann & Bohoslavsky in this issue; GOLDMANN, *id.*, at 30.

15. DAS, PAPAIOANNOU AND TREBESCH, *supra* note 2, at 15; ERCE, SOVEREIGN DEBT RESTRUCTURINGS AND THE IMF: IMPLICATIONS FOR FUTURE OFFICIAL INTERVENTIONS, AT 4, 13, 17 (2013).

16. IMF, 'STAFF GUIDANCE NOTE FOR PUBLIC DEBT SUSTAINABILITY ANALYSIS IN MARKET-ACCESS COUNTRIES' (2013); IMF, 'THE JOINT WORLD BANK–IMF DEBT SUSTAINABILITY FRAMEWORK FOR LOW-INCOME COUNTRIES FACTSHEET' (2013).

17. Art. 12 Sec. 4 b) IMF Articles of Agreement.

management staff. Neither the general rules of the DSF nor their application is subject to formalized participation rights by member states, civil society organizations (CSO), or the general public.

The DSF documents detail the process and criteria for "Debt Sustainability Assessments" (DSA). These DSAs employ indicators for three distinct but related purposes: surveillance, lending, and disbursement monitoring. First of all, IMF staff conduct periodic DSAs as part of the Fund's surveillance mandate and raise possible concerns about debt sustainability in Article IV consultations.[18] Indicators serve monitoring and policy advice functions. Their consequence is the publication of a more or less favorable assessment. A finding of irresponsible borrowing might also inform World Bank International Development Association (IDA) lending decisions. For IMF lending purposes, its staff conduct a DSA with a view to determining debt sustainability when a country applies for additional lending under the Exceptional Access Policy because it has lost market access. Exceptional lending is conditional upon the restoration of debt sustainability, which can require a restructuring and budgetary adjustment. The DSA feeds into restructuring advice and negotiations, namely within the Paris and London Clubs. The DSAs often play a role in determining the size of haircuts, but this role is not legally formalized, and losses are not apportioned according to a pre-determined formula.[19] With regard to the third purpose, disbursement monitoring, distinct performance indicators are included in lending agreements as legal triggers for disbursement, and they play a particular role in Heavily Indebted Poor Country (HIPC) debt relief.[20]

The content of the DSA indicators is analyzed in detail in the economic literature.[21] The key feature is a two-step analysis that calibrates the intensity of scrutiny and applicable indicators to the risk of a debt crisis in the respective country. For developed and emerging economies (so-called "market-access countries"), these steps are as follows: Firstly, countries are classified as high risk or low risk, mainly on the basis of quantitative indicators. Higher risk is present if aggregate public debt exceeds 50% of GDP in case of emerging markets and 60% of GDP in case of advanced economies; or alternatively, if public gross financing needs exceed 10% of GDP in case of emerging markets and 15% in case of advanced economies.[22] In the second step, a country receives additional scrutiny that can be higher or lower, depending on the initial classification. Higher scrutiny countries are subjected to additional vulnerability indicators and more elaborate baseline scenarios and stress tests.[23]

18. IMF (n 4), 15.

19. On the indicator-based performance-based distribution formula used in the allocation of concessional IDA funds, *see* Riegner *supra* note 10.

20. This function of indicators is related to the issue of lending conditionality, which is beyond the scope of this paper, for further reference see Bogdandy and Goldmann, *supra* note 2, at 50; Anders, *supra* note 6. On HIPC, see DAS, PAPAIOANNOU AND TREBESCH, *supra* note 2, at 29; GUDER, THE ADMINISTRATION OF DEBT RELIEF BY THE INTERNATIONAL FINANCIAL INSTITUTIONS (2009).

21. See with further references LUKKEZEN AND ROJAS-ROMAGOSA, *supra* note 7.

22. IMF, *supra* note 16 at 5-6. In addition, countries receive higher scrutiny if they currently have access to IMF funds under the Exceptional Access Policy.

23. *Id*. at 6 *et seq*. This involves a whole set of further indicators relating to economic context (e.g. coefficient of growth variation), debt profile (e.g. external financing needs), contingent liabilities

DSAs for developing countries without market access use a structurally similar assessment based on indicator thresholds.[24] The indicators and respective thresholds reflect evolving economic analysis and practical experience, e.g. on the inter-relationship of debt levels and growth. The framework leaves staff discretion in applying and weighing the indicators, and the final sustainability verdict is thus ultimately subject to expert judgment.[25]

An evaluation of the DSF indicates the following strengths and problems that hold lessons learned for a DWM: In practice, DSAs have indicated unsustainable debt in cases that did in fact lead to a later restructuring; in other cases, predictions were less accurate.[26] The Fund itself admits that its projections may at times have been "too sanguine"[27], and the critical literature points to instances where overoptimistic DSAs for restructurings led to undersized haircuts and thus failed to restore debt sustainability.[28] These difficulties partly lie in the nature of projections about the future, which are always subject to uncertainty; it remains to be seen how the new framework in place since 2013 will perform. Ultimately, indicators can ascertain vulnerability, but the triggering event for a crisis is often not foreseeable. Another problem is that states may lack the willingness, the incentives or the capacity to provide reliable data as needed to make accurate predictions. Another positive feature is that the DSF remains flexible due to its soft sources and relatively context-sensitive application. This enables the DSF to be adapted to evolving economic research and country experience. At the same time, the softness of the DSF is not backed by legal obligations or sanctions, and accurate predictions of debt crises were thus not always sufficient to convince states to restructure early enough. In addition, the flexibility gives rise to the criticism that the DSF is ultimately indeterminate and thus judgmental in nature and arbitrary in application.[29] Expert analysis by IMF staff is likely to be less self-interested than assessments by the debtor state or private lenders. However, the IMF itself conflates the role as a provider of analysis and advice, which requires objectivity and impartiality, with the role as a major lender, whose chief interest is to get repaid. Commentators criticize that this may create conflicts of interest and compromise the impartiality of analysis; some thus propose to entrust assessments to a non-lending UN agency.[30] While there is no

(e.g. risks in the banking sector) and other factors.

24. See IMF, *supra* note 16; LUKKEZEN AND ROJAS-ROMAGOSA, *supra* note 7. The initial classification for non-market access countries is based on the World Bank's Country Policy and Institutional Assessment, a governance index produced annually by Bank staff. *Cf.* Riegner, *supra* note 10.

25. IMF, *supra* note 16, 7-8; LUKKEZEN AND ROJAS-ROMAGOSA *supra* note 7, at 6-7.

26. On strengths and weaknesses of the DSF, see LUKKEZEN AND ROJAS-ROMAGOSA, *supra* note 7, at 7.

27. IMF, *supra* note 4 at 24.

28. Brookings, *supra* note 4 at 12; IMF, Country Report No. 13/156 Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement, June 2013.

29. ERCE, *supra* note 15 at 2-3; SCHADLER, UNSUSTAINABLE DEBT AND THE POLITICAL ECONOMY OF LENDING: CONSTRAINING THE IMF'S ROLE IN SOVEREIGN DEBT CRISES (2013); SIMPSON, THE ROLE OF THE IMF IN DEBT RESTRUCTURINGS: LENDING INTO ARREARS, MORAL HAZARD AND SUSTAINABILITY CONCERNS (2006).

30. ERCE *supra* note 15 at 2; Lienau, 'Extending the European Debt Discussion to Broader International Governance' *ASIL Proceedings* 141 (2011), at 142; EURODAD, A FAIR AND TRANSPARENT

empirical evidence that this problem has actually materialized, the mere appearance of conflicts of interest (as well as arbitrariness) can be a risk for the credibility of indicator-based assessments and thus compromise their acceptance. Finally, the Fund's approach to debt assessment is criticized for not sufficiently taking into account social standards and distributional consequences of restructurings and adjustments.[31] These critiques have at least two legal dimensions addressed further below: Do institutions involved in restructurings have the legal mandate, and if so, even a legal obligation, to consider non-financial factors? And to what extent must economic, social and cultural rights be factored into restructuring assessments and processes?

B. Regional arrangements: European Union fiscal governance

Regional organizations have also developed mechanisms for budgetary discipline in member states. These mechanisms often rely on formal debt and deficit thresholds, measured as percentage to GDP. For instance, the European Union established a binding ceiling of 3% of GDP for annual deficit and a threshold of 60% of GDP for aggregate debt in 1998. Mercosur agreed on numerical convergence targets of 3% of GDP for deficit and 40% of GDP for debt in 2000. The Andean Community followed in 2001 with targets of 3% and 50% respectively.[32]

Among these regional arrangements, the EU's common economic and monetary policy has evolved into the most integrated and legally formalized context for debt indicators. The EU does not have a comprehensive sovereign debt restructuring mechanism, but debt thresholds and indicators are used for three important purposes: Since 1998, EU law imposes legally binding ceilings on all member states for annual budget deficits (3% of GDP) and for aggregate debt (60% of GDP), unless exceptions apply. If surpassed, these benchmarks trigger an "Excessive Debt Procedure" conducted independently by the European Commission, which may ultimately impose financial sanctions on Eurozone members (Art. 121 and 126 TFEU[33]).[34] Since 2010, Eurozone members in debt distress can receive lending from a new treaty-based lending mechanism (now made permanent as the "European Stability Mechanism"). Such lending is conditional upon 1) compliance with the EU deficit and debt framework, and 2) debt sustainability, as determined by the European

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DEBT WORK-OUT PROCEDURE: 10 CORE CIVIL SOCIETY PRINCIPLES, at 4, 6 (2009).

31. *See, e.g.*, *Debt Relief as if Justice Mattered*, NEW ECONOMICS FOUNDATION (2008), http://b.3cdn.net/nefoundation/f7691d7567cca8ada5_5rm6bi5u6.pdf (last visited May 4, 2016).

32. Cf. GOLDMANN, *supra* note 13 at 26-27.

33. Treaty on the Functioning of the European Union, art. 126 [*hereinafter,* "TFEU"].

34. For a detailed analysis of this aspect and the following, see Antpöhler, *Emergenz der europäischen Wirtschaftsregierung: Das Six Pack als Zeichen supranationaler Leistungsfähigkeit*, 72 ZEITSCHRIFT FÜR AUSLÄNDISCHES ÖFFENTLICHES RECHT UND VÖLKERRECHT 353 (2012); Craig, *The Stability, Coordination and Governance Treaty: Principle, Politics and Pragmatism*, 37 EUR. L. REV. 231 (2012). Debt exceeding the 60% threshold must be reduced at a pre-determined average rate. If a Eurozone member fails to decrease deficit and debt as required, the Commission may, *inter alia*, fine the state 0.1-0.5% of its GDP. When deciding about sanctions, the Commission takes into account multiple factors and retains a measure of discretion. Initially, sanctions required political approval from the Council, but since 2012 a Commission decision can only be reversed by a negative, qualified majority of 2/3 in the Council.

Commission in cooperation with the IMF and based on an indicator-based assessment modelled upon the Fund's DSAs.[35] Since 2011, economic and fiscal policies in all but two EU member states are subject to enhanced surveillance by the European Commission, relying *inter alia* on budget monitoring against fiscal targets, medium-term budgetary objectives, a macroeconomic imbalances procedure and intensified coordination procedures.[36]

The EU's framework for indicators displays some similarity to the IMF: Like the IMF, the EU cannot legally force member states to default and to restructure, based on indicator triggers or otherwise. Similarly, decisions about lending to distressed countries rely on an indicator-based DSA. But there are also major differences: EU debt discipline relies on a single threshold of 60% of GDP, and not on a multiplicity of indicators. The debt-to-GDP ratio is specified as an indicator in primary treaty law (Art. 126 TFEU), and the 60% reference value is laid down in a separate treaty and secondary legislation enacted by EU lawmaking organs.[37] This threshold is directly binding on member states, and enforcement is delegated to the relatively independent Commission. The indicators were negotiated by governments, and respective treaties were ratified by national parliaments. The 2012 Fiscal Compact, a new treaty, also requires the debt and deficit thresholds to be enacted as domestic law, preferably on a constitutional level.

An evaluation of the EU debt framework raises three major issues regarding the effectiveness of the debt threshold, the enforceability and (in)flexibility of thresholds, and the effect of "gaming the indicators." The 60% of GDP ceiling has not been effective in preventing debt crises in Greece, Portugal, Ireland, and Cyprus.[38] Actual debt levels have exceeded the prescribed level in many member states. In 2012, debt to GDP stood at 81% in Germany, 86% in Spain and 127% in Italy.[39] However, some observers also point out that governments would likely have accumulated even higher debt in the absence of hard-and-fast European thresholds.[40] The European debt crisis also illustrates that gross debt levels to GDP are poor indicators of long term sustainability: Distress occurs at different levels and for reasons unrelated to debt levels, such as contingent liabilities in the banking sector. Single aggregate indicators thus carry the risk of detracting attention from other relevant, but more complex, statistical raw data and qualitative factors. The ineffectiveness is also related to problems with enforceability. In principle, enshrining thresholds in hard-to-amend treaty law enhances commitment, visibility and credibility. Still, the thresholds proved unenforceable against powerful

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35. *See* Article 13 of the ESM Treaty; ERCE, *supra* note 15 at 1, 17. Such DSAs are public. *See, eg.*, http://ec.europa.eu/economy_finance/publications/economic_paper/2012/pdf/ecp466_en.pdf .

36. EUROPEAN COMMISSION, http://ec.europa.eu/economy_finance/economic_governance/index_en.htm.

37. The 1998 Stability and Growth Pact, replaced in 2012 by the Treaty on Stability, Coordination and Governance (the "Fiscal Compact"). *See* Craig, *supra* note 34.

38. *See only* Brookings, *supra* note 4 at 27.

39. EUROSTAT, http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&plugin=1&language=en&pcode=teina225.

40. Manasse, *Deficit Limits and Fiscal Rules for Dummies,* 54 IMF STAFF PAPERS 455, 469 (2007).

members like Germany and France: When they were in recession in 2005, there was no political majority (then needed) to impose sanctions recommended by the Commission, and exception clauses and secondary legislation were used to water down the initial commitment. This damaged the normativity of the commitment and has only been remedied partly by increased delegation of authority to the Commission, which now imposes semi-automatic sanctions.[41] Yet these and further developments in the financial crisis also show that it is problematic to cast in stone a single, inflexible debt-to-GDP indicator, irrespective of country context and changing economic circumstances. A general problem with fixed quantitative indicators is that they remain vulnerable to strategic behavior. The more specific numbers matter, the more opportunity and incentive there is to "game indicators", either by merely superficial "mock compliance" or by outright statistical manipulation.[42] In the EU context, this took the form of "creative" accounting practices used by member states to fulfil Euro entry requirements.[43] This phenomenon is familiar from other contexts like development finance and from research on new public management techniques.[44]

C. National law

In democratic nation states, budget decisions are first and foremost the prerogative of democratically elected parliaments, which decide annually about expenditures and revenues, including debt. At the same time, many domestic legal orders regulate sovereign debt beyond the annual budget law, be it on a constitutional or legislative level. A (necessarily cursory and incomplete) review[45] of these rules reveals that procedures for public debt *restructurings* are legally regulated only for subnational governments in some jurisdictions. Domestic legal orders do not foresee formal insolvency procedures for central government debt, even though ad hoc legislation may accompany restructurings. Numerous states have rules for ex ante budget discipline and debt reduction.

A related but often overlooked domestic aspect that pre-determines the functioning of any indicator-based debt system is that any indicator depends on the accuracy of national fiscal and economic statistics. Domestic legislation generally requires that relevant financial and economic data is provided by nominally independent statistical offices and is made publicly available. In practice, however, data quality and transparency varies greatly from country to country. Statistical offices particularly but not exclusively in developing countries may lack the capacity or impartiality to provide adequate statistics. Large informal sectors may distort economic indicators, and some contingency

41. Antpöhler, *supra* note 34.

42. Hammergren, *Indices, Indicators and Statistics: A View from the Project Side as to Their Utility and Pitfalls,* HAGUE JOURNAL ON THE RULE OF LAW 3 (2011) 305; Salais (n 8). On superficial "mock compliance" with soft law, see GELPERN, HARD, SOFT, AND EMBEDDED: IMPLEMENTING PRINCIPLES ON PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING, 15 (2012).

43. Manasse, *supra* note 40 at 469.

44. See generally DAVIS, KINGSBURY, MERRY AND FISHER (n 5).

45. For a more comprehensive comparative overview, see GOLDMANN, *supra* note 13.

remains even when statistics are produced *lege artis*. For instance, when the statistical office of Ghana recently updated the base year for its GDP measurements according to international standards, the country's GDP is reported to have jumped up by roughly 60% from one year to the next.[46] This has to be borne in mind in the analysis of domestic debt indicators and an international DWM.

1. Subnational debt

Subnational insolvencies are of interest because they are sometimes proposed as a model for an international DWM.[47] Of the domestic legal orders reviewed here, only few allow sub-state entities to file for bankruptcy. Among them are the United States, Brazil, Bulgaria, Hungary, Romania, and South Africa. Most other states covered here do not have explicit legal provisions on insolvency of sub-state entities. In Germany, for instance, there seems to be a preference for ad hoc administrative arrangements, and local government is not subject to the federal insolvency act.[48]

Jurisdictions that do allow for sub-national insolvency provide for two kinds of mechanisms: Administrative procedure or court proceedings. The main difference is the degree of political influence and judicial independence. Both procedures foresee three core elements: the definition of an insolvency trigger for the procedure; fiscal adjustment for the debtor; and negotiations with creditors to restructure. The insolvency trigger consists of qualitative legal definitions. The United States and Hungary, for instance, define insolvency as inability to pay and undisputed debt. South Africa uses one set of triggers for serious financial problems and another set for persistent material breach of financial commitments.[49] U.S. law illustrates these elements: Chapter 9 of the U.S. Bankruptcy Code contains a federal debt restructuring mechanism for political subdivisions and agencies of US states. It allows municipalities to file for bankruptcy, but subjects them to more stringent requirements compared to regular insolvencies of private entities. For instance, to avoid strategic filings, municipalities must undertake pre-filing efforts to work out debt. In order to preserve state sovereignty and immunity, only debtors may file for Chapter 9, the filing is subject to state consent, and federal courts may not exercise jurisdiction over policy choices and budget priorities of the debtor. In contrast, in South Africa and Hungary, any creditor can trigger the insolvency procedure.[50] Chapter 9 has been successfully used, for example, to restructure debt in New York City, and it is currently applied to resolve the insolvency of the city of Detroit. It thus indicates that sovereign insolvency procedures are in principle feasible, even though generalizations for the international context

46. On the poorness of such statistics in general and the GDP example in particular, see notably JERVEN, POOR NUMBERS: HOW WE ARE MISLED BY AFRICAN DEVELOPMENT STATISTICS AND WHAT TO DO ABOUT IT (2013).

47. See Raffert, *Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face,* 18 WORLD DEVELOPMENT 301 (1990).

48. Liu and Waibel, *Subnational Borrowing, Insolvency, and Regulation*, in SHAH (ED.), MACRO FEDERALISM AND LOCAL FINANCE (2008); GOLDMANN, *supra* note 13 at 41.

49. For detail see Liu and Waibel, *supra* note 48 at 14.

50. *Id.* at 14.

must be mindful of differing political and legal contexts. Local defaults and restructurings are embedded in democratic political and judicial processes, and economic indicators do not play a major, legally formalized role. For the concrete question of how indicators should be used for international debt restructurings, Chapter 9 thus offers little guidance.

2. Central government debt

Domestic legal orders do not foresee formal insolvency procedures for central government debt, but ad hoc legislation may accompany restructurings. Such ex post legislation depends on the law under which government bonds are issued, and may find some outer limits in constitutional property rights. For example, Greek legislation retroactively inserted Collective Action Clauses (CAC) in Greek bonds, which allowed for a supermajority of creditors to accept a restructuring proposal and make it binding for all bondholders. Likewise, UK legislation reduces private claims against countries participating in the HIPC initiative in proportion to debt relief granted by public creditors.[51] More commonly, central government debt is subject to ex ante constraints that impose limits on budget deficits and aggregate debt. In the EU, for instance, eighteen domestic debt rules were in operation across member states in 2008, and more have been enacted since the 2012 Fiscal Pact requires member states to enshrine EU deficit and debt ceilings in domestic law. Other countries like the United States, Brazil, India and Tanzania have similarly enacted statutory debt limits. A comparative overview reveals at least three regulatory models: First, the model of constitutional deficit limits. Fiscal rules may constrain governments to incur new debt, e.g., by limiting budget deficits to the amount of public investment. A 2011 amendment to the German constitution, enforceable in the Constitutional Court, imposed a 'debt brake' that requires reducing the annual structural budget deficit to 0.35% of GDP. A similar statutory rule already in place in India did not, however, lead to significant reductions of aggregate debt.[52] The second model are ceilings for aggregate debt based on indicators. These are often expressed as percentage of GDP, as is the case in the EU, though other indicators exist. Developing countries with a large informal sector do not find GDP as a helpful reference point. For example, Tanzania operates a debt ceiling based on the ratio of the country's foreign exchange earnings and debt service cost. [53] Thirdly, there are absolute debt ceilings. The US Congress has enacted an aggregate debt ceiling expressed in absolute terms (US $16,699 billion as of May 2013). The aggregate number is arrived at in Congressional negotiations and not directly determined by economic indicators. This ceiling repeatedly brought the federal government at

51. Boudreau, *Restructuring Sovereign Debt Under Local Law: Are Retrofit Collective Action Clauses Expropriatory*? HARVARD BUS. L. REV. ONLINE (2012), http://www.hblr.org/2012/05/retrofit-collective-action-clauses/ (last visited 5.4.2016). Going even further, a 2011 Spanish Constitutional amendment gives debt service explicit preference over other government expenses and thus restrains domestic restructurings in a rather exceptional way, cf. ABAD AND GALANTE, 'SPANISH CONSTITUTIONAL REFORM - WHAT IS SEEN AND NOT SEEN' (2011). On the 2010 United Kingdom Debt Relief (Developing Countries) Act, see Bogdandy and Goldmann, *supra* note 1 at 57.

52. Articles 109 and 115 of the German Basic Law. Cf. GOLDMANN, *supra* note 13 at 26-28.

53. Ibid., 27-28.

the brink of default and forced it to limit its activities ("government shut down").[54]

Four key observations regarding political decisions, legal limits, effectiveness and data quality emerge from the comparative analysis: First, debt decisions in democratic nation states are primarily political decisions, subject to parliamentary budget prerogatives. Restructurings cannot be legally enforced against central governments, and in federal states, central government can generally not enforce sub-state insolvencies against the will of the respective state government. Second, in many jurisdictions, political discretion on incurring debt is limited by legal constraints. These are mostly statutory, but sometimes also enshrined in constitutions. In many cases these are based on economic indicators related to GDP, but non-GDP indicators and ceilings without indicators also exist. Third, subnational restructurings are often successful, while research on the overall effectiveness of central budget fiscal rules shows mixed results. Ceilings of all types have failed to prevent debt levels from rising in many states. Absolute ceilings negotiated in a purely political process have brought even the US at the brink of default and disrupted government activities. On the other hand, numerical fiscal rules do influence budgetary outcomes, depending on a number of design features, including the statutory basis of the rule, budgetary monitoring against the fiscal targets, and particularly the strength of corrective mechanisms and enforcement in case of non-compliance.[55] Fourth, data quality is a crucial and underestimated aspect of any numerical debt framework and can compromise in particular cross-country GDP-based indicators meant to apply globally. This problem deserves particular attention when indicators are made part of an international DWM.

D. Private actors and litigation

Private actors and market processes are also relevant for debt restructuring. In economics, prices are considered to contain information about market expectations, and interest rates and credit default swap prices are thus sometimes considered indicators of the likelihood of debtor default or used to determine the scope of debt relief. In addition, private credit rating agencies engage in debt sustainability assessments when they determine the creditworthiness of sovereign debtors.[56] While prices and ratings may indicate market expectations, they have however not proved reliable predictors of debt crises. Iceland is a case in point, in which contingent liabilities in the banking sector were not expressed in prices and ratings. Besides, impartial comparative data and indicators have attributes of a global public good that will remain

54. On the evolution and current situation, see AUSTIN AND LEVIT, THE DEBT LIMIT: HISTORY AND RECENT INCREASES (2013).

55. Manasse, *supra* note 40; Wagschal, '*Allheilmittel oder Budgetmimikry: Wie wirksam sind Verschuldungsgrenzen zur Haushaltskonsolidierung?'* 9 JOURNAL FOR COMPARATIVE GOVERNMENT AND EUROPEAN POLICY 352 (2011); European Commission, 'Analysis of National Fiscal Frameworks' (2010), http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/documents/analysis_national_fiscal_frameworks_pfr_2010.pdf (last visited May 4, 2016).

56. DAS, PAPAIOANNOU AND TREBESCH, *supra* note 1 at 39-40. On private initiatives and measurements see also GELPERN, *supra* note 42 at 29-35.

undersupplied in the market unless public institutions step in.[57] Courts and arbitral tribunals sometimes face the difficulty of distinguishing inability to pay from unwillingness to pay when they are called upon to determine whether a Collective Action Clause is triggered, or when a sovereign debtor claims the defense of economic necessity. Collective action clauses generally do not contain quantitative indicators or thresholds but are rather triggered by the declaration or actual occurrence of default. Judges and arbitrators tend to use a rather loosely qualitative notion of default and insolvency, even though they may at times refer to IMF assessments.[58]

Conversely, indicators issued by public institutions can impact on market prices and perceptions as well as on litigation. Such "governance by information"[59] with regard to private actors is relevant for a DWM in two ways. On the one hand, it facilitates ex post coordination. There is some evidence from the related field of development finance that commonly agreed indicators have the potential to coordinate the perceptions and actions of multiple public and private actors. For example, the Millennium Development Goals (MDG) have enabled improved donor coordination in many instances, because these gained wide acceptance owing to their basis in a consensual U.N. General Assembly Resolution.[60] Similarly, if the various creditors, institutions and fora involved in sovereign debt restructurings were to refer (possibly in bond terms and CACs) to one single set of indicators or one debt sustainability assessment, this might reduce disagreements and could help coordinate otherwise fragmented negotiation and litigation processes.

On the other hand, indicators also enable ex ante governance by information. They can influence market perceptions and, when they signal debt distress, contribute to trends in (dis)investment decisions. They may also affect the allocation of risks in contracts and their enforcement, as they may make risk levels transparent to drafters and judges. There is also empirical evidence that systematic governance by indicators can impact government policy. For instance, the World Bank International Finance Corporation's (IFC) *Doing Business Ranking* has incentivized business regulation reforms in dozens of countries intent on attracting foreign direct investment (FDI).[61] Unlike the MDGs however, the *Doing Business* Indicators have met with considerable resistance from states and CSOs, namely because the ranking criteria were accused of violating International Labour Organization (ILO) labor standards, but also because the indicators were simply decreed by World Bank

57. ERCE, *supra* note 15 at 17. Generally Stiglitz, '*Knowledge as a Global Public Good'*, in KAUL, GRUNBERG AND STERN (EDS.), GLOBAL PUBLIC GOODS (1999).

58. See generally DAS, PAPAIOANNOU AND TREBESCH *supra* note 1 at 43-45, 50 *et seq*.; Lienau, *supra* note 30 at 142. On necessity, see ILC 8th Report on State Responsibility, UN Cov A/CN.4/318/Add. 5.

59. On this model of governance by information, see Kingsbury, Davis and Merry, *supra* note 5.

60. Adam and Gunning, '*Redesigning the Aid Contract: Donor-Use of Performance Indicators in Uganda'* WORLD DEVELOPMENT 30 (2002) 2045; UNITED NATIONS, MDG GAP TASK FORCE REPORT (2010); Riegner, *supra* note 12. But see Wisor, '*After the MDGs: Citizen Deliberation and the Post-2015 Development Framework'* 26 ETHICS & INTERNATIONAL AFFAIRS 113 (2012) (criticizing the expert-led MDG *indicator* process).

61. WORLD BANK, DOING BUSINESS (2006).

management and not agreed upon by states or even CSOs.[62] This reinforces the view that legal compliance and legitimate sources for indicators matter for their success.[63]

Absent agreement on a DWM, indicators may be used to coordinate actors, induce state behavior and monitor compliance with benchmarks for responsible borrowing.[64] Such systematic "governance by information" can have functionally equivalent effects to legal regulation and entail the exercise of International Public Authority. Legal doctrine has developed criteria to determine when indicators exceed that threshold. Such indicators in particular require a public legal framework that ensures their sustained legitimacy and effectiveness.[65]

E. Summary and preliminary conclusions

From the comparison of existing legal contexts, the following key findings, lessons learned and basic conclusions emerge. Three initial findings concern the legal relevance of existing indicators: Firstly, the decision to restructure formally remains with the sovereign debtor. At present, there is no international or domestic mechanism that can legally enforce a restructuring against a national government's will, whether based on indicators or on other economic analysis. International organizations' competences are limited to surveillance and lending. Secondly, debt policy and restructurings are legally constrained by other, indicator-based mechanisms. International mechanisms exercise some leverage over national debt policy and restructurings. They use indicators to trigger sanctions to enforce budget discipline, to condition official lending, and to affect market behavior through governance by information. Thirdly, alternatives to indicators can take the form of qualitative expert assessments or politically negotiated absolute debt ceilings (as in the US). Often, indicators are combined with, or used as the basis for, expert judgment or political decisions, as in IMF DSAs and EU sanctions.

The lessons learned indicate the potential of indicators and certain determinants for their successful use, but also point to significant pitfalls and risks. These aspects are captured by the general principles developed in section III below and inform the recommendations in section IV. The potential of indicators is fourfold: First, they facilitate evidence-based policy. Indicators are an important element in rational, evidence-based policy making and complement more complex statistical raw data and qualitative considerations. They can provide objective grounds for decisions, de-politicize polarized debates and enable decision making under uncertainty. This is captured by the

62. Schueth, *'Assembling International Competitiveness: The Republic of Georgia, USAID, and the Doing Business Project'* 87 ECONOMIC GEOGRAPHY 51 (2011); BERG AND CAZES, 'THE DOING BUSINESS INDICATORS: MEASUREMENT ISSUES AND POLITICAL IMPLICATIONS' (2007).

63. Cf. Bogdandy and Goldmann, *supra* note 10.

64. GELPERN *supra* note 42 at 36, 38. Such a mechanism might raise the problem of "stigma" associated with the declaration of its debt as non-sustainable, cf. UNCTAD, 'BRAINSTORMING MEETING SUMMARY ON A DEBT WORKOUT MECHANISM' 2 (2013); this is however also a problem under the present system.

65. Bogdandy and Goldmann, *supra* note 10; Cassese and Casini *supra* note 10; Riegner, *supra* note 10.

principle of sustainability. Second, they support coordination processes between actors. Quantitative indicators provide a common language and enable communication across national borders, governance levels and institutions. Single aggregate numbers provide a focal point for multiple actors and can potentially serve as common reference point for the coordination of negotiation and dispute resolution. Third, indicators can strengthen transparency and acceptance. They reduce complexity and may be easier to comprehend than complex datasets. They can thus make fiscal policy more understandable and transparent for citizens. This may improve informed collective decision making and mobilize support for a particular debt policy. Fourth, they allow for commensurability of social concerns. As finance and debt are largely dominated by quantitative forms of knowledge and reasoning, indicators provide a vehicle for incorporating human and social considerations into restructurings. For instance, indicators for economic, social and cultural rights can make non-quantitative considerations commensurable with the logic and language of finance. This is captured by the principle of human rights and social protection.

Whether these potentials are realized, however, depends on a series of determinants and enabling conditions, namely the quality of indicators, independence and impartiality, acceptance and legitimacy, as well as enforceability and delegation. A primary determinant is how valid and reliable an indicator is in predicting debt crises ex ante. Good indicators require flexibility and context-sensitivity to account for unexpected events and for country context, and they depend on quality data. This is especially relevant with regard to developing countries where statistical capacity and economic structure pose particular measurement challenges. Hence, indicators need to remain open to correction and improvement as research and experience evolve. While national governments retain the prerogative to decide on a restructuring, self-interest and political economy can prevent them from providing and acting upon objective debt data in a timely manner. International organizations can be a source for independent advice and analysis, including indicators. Yet their own incentive structure must be aligned so as to guarantee true impartiality. In order avoid even the appearance of partiality or self-interest, this calls for the inter- or intra-organizational separation of analysis and lending functions as well as procedural safeguards and external review mechanisms. The effectiveness of indicators in resolving debt crises also depends on their acceptance by the actors involved, including creditors, debtors, international institutions, and affected citizens. Acceptance in turn hinges on transparent explanations of the indicators themselves to the public, on the legitimacy of the institution that authors the indicators, and on the process by which indicators are agreed upon and applied. It also depends on the serious inclusion of social concerns widely held to be important, without however reducing social rights to mere numbers. The success of numerical budget rules depends in large part on their enforceability, which would require a "hard" legal source. However, even treaty-based indicators in the EU have not guaranteed full compliance by powerful states. In the present international regime, the effect of indicators depends on the varying leverage of lending and of governance by information,

which in turn hinges on a country's dependency on external finance.

Indicators also have pitfalls and present risks that must be avoided if they are used in a DWM. First, they hold the risks for obscuring value choices and uncertainty. Quantification in general and indicators in particular are forms of knowledge that claim objectivity based on expertise. This may obscure value judgments built into indicators and assessment scenarios.[66] Indicators may also obscure uncertainty in predictions, even though the question of how to make decisions in the presence of uncertainty is a normative and political one. Highly aggregated indicators are particularly vulnerable to criticisms of de-politicization, technocracy and illegitimate "rule by experts".[67] Consequently, legal rules are needed to allocate/delegate such political discretion and to determine who is best suited and legitimate to make value choices and to be accountable for them. Second, indicators can deceptively simulate precision and obscure problems with data availability and quality. Estimates and margins of error in raw data disappear in aggregated indicators, which create the impression of precision and accuracy for the lay public and for decision makers not well versed in statistics. At worst, the indicators mask manipulation and conflicts of interest. Consequently, any indicator-based DWM must be accompanied by sound statistical governance, rules on quality assurance and impartiality safeguards. Third, indicators can misguide attention and incentives. Narrowly defined indicators may detract attention from other relevant factors and render them less visible. The more debt assessments are based on a single indicator, the more it creates incentives and opportunities for gaming this indicator and for purely superficial compliance. Some critics consider these deficits unavoidable and thus conclude that "[w]hen a measure becomes a target, it ceases to be a good measure."[68] In order to at least mitigate these risks and to incentivize genuine compliance with a DWM, indicators need to be correlated and cross-checked with other quantitative measures and be complemented by qualitative assessments, which must in turn be transparent and be based on public reason-giving, as elaborated below. Fourth, indicators can be a source of unchecked power. Exceptionally, they can become very powerful instruments of "governance by information" and lead to significant policy change and human impact, as is the case with the World Bank *Doing Business* ranking. If unregulated, such indicators risk exercising unchecked and depoliticized International Public Authority by themselves. They thus need to be re-integrated into a legitimating public law framework based on legal and political control, transparency, reason-giving, participation and review, as elaborated below.[69]

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66. On judgments hidden in IMF DSAs, see LUKKEZEN AND ROJAS-ROMAGOSA *supra* note 7 at 7.

67. Cf. Merry *supra* note 6; Salais *supra* note 6. *See generally* EASTERLY, THE TYRANNY OF EXPERTS (2013); Kennedy, '*Challenging expert rule: The politics of global governance*' SYDNEY L. REV. 27 (2005) 5; Howse, '*From Politics to Technocracy and Back Again: The Fate of the Multilateral Trading System*' 96 AM. J. INT'L L. 94 (2002).

68. Strathern, '*Improving Ratings: Audit in the British University System*' 5 EUROPEAN REVIEW 305, 308 (1997). On similar problems with human rights and humanitarian indicators, see Rosga and Satterthwaite *supra* note 6 at 285-87; Satterthwaite, *Indicators in Crisis: Rights-Based Humanitarian Indicators in Post-Earthquake* 43 N.Y.U. J. INT'L L. & POL. 865, 913 (2011).

69. Cassese and Casini *supra* note 10; Riegner *supra* note 10; Bogdandy and Goldmann, *supra*

The above findings and lessons learned lead to the following basic conclusion: Indicators should be used in a DWM, but only in an adequate legal framework and in conjunction with other factors. This is based on three main considerations: Firstly, indicators already enter restructuring decisions in a variety of ways, and even qualitative decisions and negotiations about restructurings are informed by, and rely on, statistics and indicators, at least in informal ways. Not using indicators at all would mean *going back* behind the status quo (and possibly require banning them actively), which is unlikely and undesirable. Secondly, alternative modes of decision making are not inherently superior. Purely political decision making processes or the informal use of statistics and raw data have not solved existing debt problems, and their effectiveness and legitimacy equally depend on adequate institutional and legal frameworks. Thirdly, if indicators are governed by an adequate legal framework, their potential outweighs their weaknesses. Such a framework must ensure that indicators are constructed in a manner that makes them effective and acceptable, that they are embedded in a legitimate process of decision making, and that their inherent risks are mitigated. This raises the question of how such a legal framework should look like. Before specific design questions are addressed, the following part develops general principles of such a framework that help make indicators effective, acceptable and legitimate from a legal point of view.

III. GENERAL PRINCIPLES OF AN INTERNATIONAL LEGAL FRAMEWORK FOR DWM INDICATORS

This section develops general principles governing an international legal framework for a DWM. Subsection A specifies the nature of the principles and the methodological approach. Subsections B through D lay out the four principles. These principles form a general evaluative framework that enables transparent discussions and value judgments on how indicators should be used in a DWM. They respond to problems experienced in existing debt indicators discussed in section II above and lay the normative foundation for concrete recommendations for indicator use in a DWM in section IV below.

A. Principles: Nature and methodology

The notion of "principle" employed here is based on a doctrinal reconstruction of applicable law. Such principles can be reconstructed in two methodological ways: Inductively from already existing rules that govern statistics and indicators in various jurisdictions, in as much as these rules converge; or deductively from other general principles as applicable to debt restructurings in general, and to indicators specifically.[70] Depending on their

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note 10.

70. This notion of principle is closely linked to the method of doctrinal constructivism. On this approach in general Bogdandy, '*General Principles of International Public Authority: Sketching a Research Field'* 9 GERMAN LAW JOURNAL 1909 (2008). On principles in international law generally see Koskenniemi, *'General Principles'*, in KOSKENNIEMI (ED.), SOURCES IN INTERNATIONAL LAW (2000). The principles used here operate in positive law and are thus different from, but may coincide with, principles of "Global Administrative Law" as proposed by Kingsbury, Krisch and Stewart, *supra* note

source, they may be binding legal principles, or structural principles that guide interpretation and development of rules *de lege ferenda*. Both types of principles provide a normative standard for assessing the legitimacy of a DWM and its indicators. More generally, they contour the normative foundations of an emerging global administrative law of knowledge and information.[71] The principles cut across levels of governance and draw from three types of sources as analyzed above in Section II.: International law, such as the IMF Articles of Agreement, the secondary and internal law of international institutions (referred to as "secondary law"), and principles like sovereign equality or good faith; domestic law in national constitutions and legislation (including, for the purposes of this paper, EU law), whose convergence can give rise to structural principles or a general principle of law under Art. 38 (1) (c) ICJ Statute; and non-binding "soft law", which often shapes actual behavior and may indicate emerging principles.[72] For the purposes of this paper, soft law includes internal administrative guidance and rule-based administrative practice of international institutions, as well as four important sets of principles:

The UNCTAD Principles on Responsible Sovereign Lending and Borrowing (henceforth "UNCTAD Principles"); the UN Principles for International Statistical Activities (applicable to international organizations) and the UN Principles for Official Statistics (applicable to national statistics)[73], as developed by the UN Statistical Commission and endorsed by the Economic and Social Council (ECOSOC) (henceforth collectively referred to as "UN Statistical Principles")[74], and stressing that "in order to be effective, the fundamental values and principles that govern statistical work have to be guaranteed by legal and institutional frameworks", the UN Guiding principles on foreign debt and human rights, developed under the auspices of the UN Independent Expert on the effects of foreign debt on human rights and endorsed by the UN Human Rights Council[75]; the Paris Declaration on Aid Effectiveness, agreed on by aid donors and recipients in 2005 ("Paris Declaration") and reaffirmed in 2008 by the *Accra Agenda for Action*. The Declaration stipulates explicit principles on the use of indicators in development finance, which are relevant in the debt context in as much as they

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71. Riegner, *supra* note 12.

72. On the sources in sovereign debt see GELPERN (n 42); Bohoslavsky, Li and Sudreau, *Emerging customary international law in sovereign debt governance?* 9 CAPITAL MARKETS L. J. 55 (2014).

73. Fundamental Principles of Official Statistics, *available at* http://unstats.un.org/unsd/dnss/gp/fundprinciples.aspx (last visited Apr 5, 2016).

74. Principles Governing International Statistical Activities (PISA) http://unstats.un.org/unsd/methods/statorg/Principles_stat_activities/principles_stat_activities.asp (last visited May 4, 2016).

75. UN, 'Guiding principles on foreign debt and human rights: Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephas Lumina' (2011), A/HRC/20/23, 10 April 2011, http://daccess-dds-ny.un.org/doc/UNDOC/GEN/G12/128/80/PDF/G1212880.pdf?OpenElement (last visited 5.4.2016); UH Human Rights Council, 'Resolution 20/10, A/HRC/RES/20/10' (2012), Resolution 20/10, A/HRC/RES/20/10, 18 July 2012, http://daccess-dds-ny.un.org/doc/RESOLUTION/GEN/G12/162/01/PDF/G1216201.pdf?OpenElement (last visited May 5, 2016).

perform a comparable function.

Depending on the degree of determinacy and convergence, principles sometimes require the adoption of a specific rule or interpretation in regard of an indicator. In other instances, principles do not lead to determinate substantive solutions and may conflict with each other. In these cases, they provide an argumentative framework that makes value choices transparent and enables a principled discussion about the relative merits and trade-offs of a proposed DWM rule or interpretation. The following subsections first state the general content of the respective principle(s), then expound their sources, and conclude on the consequences for indicators in a DWM.

B. Economy and sustainability

Sovereign debt restructurings are firstly governed by the principles of economy and of sustainability. In general, economy requires public finances to be managed in a way that is purposeful, results-oriented, and cost efficient. With regard to sovereign debt, economy finds expression in the principle of sustainability: Debt must be managed in a way that uses public resources in a manner that is efficient in the longer term and that prevents avoidable financial burdens. This entails a duty to restructure debt if a restructuring is evidently the only way to avoid excessive burdens on public finances. If a restructuring occurs, it must save public resources wherever possible and aim at restoring debt sustainability. This also means that actors must work towards an amount of debt relief tailored to restore debt sustainability.[76] At the present stage of legal development, the principles do not go so far as to legally define a precise point in time at which a restructuring must definitively take place. As no actor alone can bring about sustainable results, the principles do not impose obligations of result but rather obligations of means, which jointly bind creditors, debtors and the institutions involved. These obligations of means include a duty to take decisions and conduct negotiations on the basis of impartial and reliable evidence. To satisfy this duty, public actors must use all relevant and practically available evidence, whether qualitative or quantitative, whether simple statistics or aggregated indicators. It may require the production of such evidence where this is necessary for economy and sustainability and does not incur disproportionate cost. In many instances, international law and domestic legislation requires the production and use of specific financial data, statistics and indicators, e.g., the IMF Articles of Agreement (Art. VIII Sec. 5).

The principles of economy and sustainability are based on international and domestic sources and are primarily applicable to international institutions and debtor states, but indirectly extend to private actors, too. International organizations like the IMF and the World Bank are obligated by their Articles of Agreement and their secondary and internal law to spend their resources in an economically efficient and sustainable way and to contribute to debt sustainability in their members. In this, they are required to take into account economic analysis and data. National legal orders and European Union law impose fiscal obligations of economy and sustainability upon the respective

76. DAS, PAPAIOANNOU AND TREBESCH *supra* note 1 at 83.

public institutions. These legal orders tend to require impartial official statistics to be produced and used for these purposes. Soft law instruments restate and concretize the principles of economy and sustainability. The UNCTAD Principles specify that restructurings should be undertaken promptly, efficiently and fairly, and Principle 13 requires debt to be monitored and managed on the basis of impartially produced fiscal and economic data. In the related field of development finance, the Paris Declaration calls for lending to be organized in a results-oriented manner and to use "information to improve decision-making"; this explicitly includes a requirement to use "a manageable number of indicators".[77] The UN Statistical Principles recognize statistics as an "indispensable element" in public policy and require them to meet the test of practical utility for public purposes. This entails a requirement of impartiality and scientific quality for official statistics.[78]

Private lenders are subject to a standstill rule and to the good faith obligation to participate constructively in restructuring negotiations, which have already been established as part of general principles of a DWM.[79] This is partly codified in UNCTAD Principles 7 and 15, which require them to contribute to restructuring efforts and thus establish a responsibility for restoring debt sustainability on their part. These obligations arguably entail a good faith obligation to accept reliable statistical evidence as a basis for negotiations and dispute settlement.

The principles of economy and sustainability and their legal sources permit the following conclusions for DWM indicator framework design. Economy and sustainability are standards for the output legitimacy of a DWM and its indicators: The more debt assessments and indicators contribute to economic and sustainable restructurings, the more output legitimacy they acquire.[80] There is no hard legal principle that requires the use of specific indicators in a DWM. There is however a soft principle to use indicators for those forms of lending that qualify as official development assistance under the Paris Declaration. In order to achieve economy and sustainability, debt restructuring negotiations and decisions must be based on impartial and reliable statistical evidence. Specific indicators must be used where required by concrete rules, as elaborated in Subsection B. In order to ensure availability, impartiality and quality of statistics and indicators, the principles require institutional and organizational measures by states and international institutions. These measures include at a minimum: 1) maintaining sufficient statistical capacity, and where necessary, technical assistance to build that capacity; 2) rules and procedures ensuring state-of-the-art scientific methods; 3) organizational safeguards to ensure integrity; this requires independence of statistical functions and may call for the organizational separation from

77. Paris Declaration on Aid Effectiveness, paras. 43-4.

78. Fundamental Principles 1 and 2.

79. GOLDMANN, 'NECESSITY AND FEASIBILITY OF A STANDSTILL RULE FOR SOVEREIGN DEBT WORKOUTS', UNCTAD Paper (2014), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2014 misc4_en.pdf (last visited Apr. 10, 2016).

80. For an overview of output and other types of legitimacy, see only Schmidt, '*Democracy and Legitimacy in the European Union Revisited: Input, Output and 'Throughput'*' 61 POLITICAL STUDIES 2-22 (2013).

operational activities.

When indicators are used for decision making, this must be done in a way that acknowledges uncertainty and possible errors and that remains open to continuous improvement. This entails at a minimum: 1) communicative duties to make uncertainty visible and to flag margins of error; 2) periodic review of indicators by an independent body that has no stake in the existing system. For instance, World Bank indicators have repeatedly been scrutinized by its Independent Evaluation Group and external ad hoc expert panels. For validity and reliability aspects, evaluation is the functionally adequate review mechanism (rather than judicial review); 3) A formal opportunity to publicly contest individual assessments of debt sustainability in a particular state; 4) Given the present state of knowledge and risks of indicator gaming, there is a prudential requirement not to imbue a single set of untested indicators in isolation with too significant legal and economic consequences.

The existing legal and institutional context and practice of debt restructurings do not consistently satisfy these principled requirements. Late restructurings impose avoidable financial cost on public finances and do not always restore debt sustainability. Poor or sugarcoated fiscal and economic data masks the necessity for restructurings and jeopardizes a sound basis for restructuring negotiations and decisions. There still is an undersupply of good and widely accepted indicators to predict debt crises. The IMF's DSAs do acknowledge uncertainty to some extent, but the system is not subject to institutionalized periodic reviews and public contestation. A DWM should remedy these deficits in order to better realize the principles of economy and sustainability.

C. Transparency and reason-giving

Transparency and reason-giving are further principles governing debt restructurings that are relevant to indicators. Transparency has been codified as UNCTAD Principle 10 and has already been established as a general principle governing a DWM.[81] Moreover, transparency and reason-giving are currently debated as a general principle for a wide variety of global governance contexts.[82] They have instrumental value in improving the quality of information upon which market negotiations and restructuring decisions are based, and intrinsic value in improving the inclusiveness of deliberation and enabling informed autonomous decisions. They thus contribute to throughput and input legitimacy and acceptance of a DWM.[83]

The content of transparency and reason-giving takes two forms relevant for restructurings: *Process transparency,* which requires negotiations and procedures of decision making to be transparent; and *outcome transparency,*

81. GOLDMANN, GOOD FAITH AND TRANSPARENCY IN SOVEREIGN DEBT WORKOUTS, UNCTAD Paper (2014), available at http://unctad.org/en/PublicationsLibrary/gdsddf2014misc3_en.pdf (last visited Apr. 10, 2016).

82. BIANCHI AND PETERS, TRANSPARENCY IN INTERNATIONAL LAW (2013); Grigorescu, '*Transparency of Intergovernmental Organizations'* INT'L STUDIES QUARTERLY 51 (2007) 625; Kingsbury, Krisch and Stewart, *supra* note 11 at 37-39.

83. DAS, PAPAIOANNOU AND TREBESCH, *supra* note 1 at 29; GOLDMANN *supra* note 79 at 16.

which calls for publicity of decisions, for reason-giving and for disclosure of evidentiary bases for decisions. In both cases, transparency means publicity to, and access for, negotiating partners as well as the general public.

In restructurings, transparency can have two different objects: the restructuring itself and the indicator use. As regards the former, the process and the outcome of restructuring *decisions* and negotiations can be more or less transparent. Transparency and reason-giving requirements of this kind are already in place, as elaborated below. These requirements are fulfilled, *inter alia*, by the provision of statistics and indicators. For instance, the IMF's DSA themselves can be seen as ensuring transparency and reason-giving for the Fund's decisions on exceptional access lending. Similarly, the statistics and indicators used in restructuring can themselves be more or less transparent, both in terms of the process in which they are used and in terms of the way in which their outcome is presented and sources are disclosed. This also means indicators must be adequately named, lest misleading labels obscure what they actually measure. Existing rules already require this form of indicator transparency in some instances, and particularly influential indicators are subject further demands and arguably requirements for disclosure and reason giving.

The sources of transparency vary according to the actor and governance level. As for states, many domestic legal orders have specific legislation on budget transparency and general freedom of information acts. Internationally, transparency and information sharing are already required from defaulting states under existing IMF and Paris Club legal frameworks.[84] Besides, the principle of good faith obliges sovereign debtors to provide accurate macroeconomic data and debt information relevant for the workout.[85] This obligation is partly codified in UNCTAD Principle 15: "The sovereign borrower should provide the necessary information which would demonstrate that the sovereign is unable to normally service its debt." In addition, Principles 10, 11 and 13 establish transparency, disclosure and monitoring requirements for regular debt operations which apply *a fortiori* throughout debt restructuring negotiations.[86] International organizations involved in debt restructuring are also subject to transparency requirements. The IMF and the World Bank have embraced transparency in internally binding Access to Information and Transparency Policies.[87] These Policies stipulate concrete rules and exceptions, and the IMF's Policy calls transparency an "*overarching principle*".[88] This

84. IMF Articles of Agreement, Article IV; disclosure is also part of the Comparability of Treatment Clause, one of the Five Key Principles of the Paris Club, cf. http://www.clubdeparis.org/sections/composition/principes/cinq-grands-principes (last visited 5.4.2016). Cf. GOLDMANN *supra* note 79 at 21.

85. GOLDMANN *supra* note 79 at 20.

86. Id. at 20.

87. IMF, '2013 REVIEW OF THE FUND'S TRANSPARENCY POLICY -- SUPPLEMENTARY INFORMATION AND REVISED PROPOSED DECISIONS; June 17, 2013' (2013); World Bank, *Access to Information Policy* (2010). On these, see Hunter, '*International Law and Public Participation in Policy-Making at the International Financial Institutions'*, in BRADLOW AND HUNTER (EDS.), INTERNATIONAL FINANCIAL INSTITUTIONS AND INTERNATIONAL LAW (2010); DANN, THE LAW OF DEVELOPMENT COOPERATION 458 (2013).

88. *Id*. at 6.

means not only that the default rule is that documents and information are accessible, but also that exceptions should be narrowly interpreted.[89] The DSF Guidance Note already requires higher scrutiny cases to be accompanied by a write up giving reasons. More generally, the UN Statistical Principles make clear that official statistics must be accessible to all in order to "honour citizens' entitlement to public information".[90] Private lender*s* are *a priori* not directly subject to these public transparency requirements, but national law usually subjects them to disclosure rules that increase with the size and system-relevance of the actor. Besides, public transparency is a legitimate basis for making private investors acknowledge part of their responsibility in a default if they chose to extend credit notwithstanding insurmountable existing debts known to the public.[91]

These existing transparency rules are broadly applicable to public activities and do not, as a rule, exclude indicators from their application. More specifically, the UN Statistical Principles explicitly require mandates and rules under which statistical systems operate to be made public and stipulate that statistical standards, categories and classifications must be made transparent for all users.[92] The IMF's Transparency Policy subjects a wide range of documents containing statistical information to disclosure. This applies *a priori* not only to the DSA and indicators used in them, but also statistics and raw data on which they are based. The IMF Staff Guidance Note explicitly requires staff to be transparent and provide justification when they exercise discretion in the application of DSF indicators.[93] Transparency and reason-giving obligations generally increase with the intensity of governance by information exercised by a particular indicator or DSA.[94]

The principle of transparency and its respective legal sources thus lead to the following conclusions for DWM indicators: As a rule, public institutions must make all debt data and indicators in their possession available to the public, unless explicit exceptions apply. If public decisions are based on indicators, this basis must be disclosed. If one or a set of indicators is chosen for a DWM, this presupposes that relevant actors can be obliged to disclose the necessary data. In particular, such regulation must specify which financial information a creditor must disclose in order to enjoy the benefits of a restructuring. In this, transparency must be balanced with the need to conduct restructurings negotiations effectively with aim of restoring sustainability.[95] The process in which indicators are constructed and applied should be transparent. The mandate of the respective institution, the methods and process

89. Note however that Ibid., para. 76, allows for edits to market-sensitive information, including statements on liquidity and solvency. Another example for such an explicit exception is contained in the World Bank's Access to Information Policy which excepts write ups for the World Bank's Country Policy and Institutional Assessment Indicators from disclosure, see Riegner *supra* note 12.

90. Fundamental Principle 1; Principle of International Statistical Activities 1.

91. GELPERN, *supra* note 42; UNCTAD, *supra* note 64 at 2-3.

92. Fundamental Principle 7; International Statistics Principles 3 and 4.

93. IMF, *supra* note 16 at 8.

94. Cassese and Casini, *supra* note 10; Bogdandy and Goldmann, *supra* note 10.

95. GOLDMANN, *supra* note 81 at 21-22.

used, as well as the data sources that feed into indicators should be disclosed in advance. Indicators should be accurately named to designate what they actually measure. The outcome of indicators should be publicly available, along with raw data and other evidentiary bases. This applies in particular for indicators that have significant legal consequences or involve the exercise of International Public Authority.

The existing debt regimes do not yet ensure transparency at an optimal level. The bases upon which decisions are made, including economic data and indicators, often remain obscure despite detailed requirements to the contrary in UNCTAD principles 10, 11, 13, and 15. Lack of transparency on the part of sovereign debt administrators has caused price shocks when crucial information is eventually revealed, as has been the case when true extent of the Greek budget deficit became known in 2009. Sometimes creditors and debtors disagree on whether specific financial information must be disclosed in negotiations, e.g. currency reserves.[96] The process in which the IMF's DSF evolved and is applied is less than transparent and would benefit from extensive application of the disclosure rules. A DWM indicator framework should remedy this situation and better balance the principle of transparency with other requirements.

D. Ownership and collective autonomy

Ownership and collective autonomy are further principles that govern restructurings in general and the use of indicators in particular. They represent an area-specific reformulation of the principle of sovereignty, which is increasingly regarded not as a purpose unto itself but as a vehicle for collective self-determination and domestic democracy. Restructuring and adjustment processes can have significant impact on a state's ability to exercise meaningful financial and economic self-determination. Doctrinally, this has been expressed by qualifying restructurings as an exercise of International Public Authority by international institutions that determines and conditions collective autonomy.[97] Ownership over restructurings thus remains a major factor for the input legitimacy of a DWM, and it constitutes an effective response to concerns about technocracy and depoliticization, which can seriously compromise acceptance. It thus needs to be carefully balanced with competing principles.

The sources are found, firstly, in the principle of sovereignty as adapted to the debt restructuring context. Besides, ownership has been codified as a key principle of development finance in the Paris Declaration, reaffirmed in 2008 by the *Accra Agenda for Action*, and has become a guiding principle for the international financial institutions.[98] It is expressed and given effect in concrete procedural rules in IMF and World Bank Policies and Procedures.[99] In domestic law, constitutional principles of democracy generally require parliamentary approval of budgetary measures in order to guarantee collective

96. GOLDMANN, *supra* note 81 at 16; GELPERN, *supra* note 42.
97. Bogdandy and Goldmann, *supra* note 1.
98. Cf. Ibid., 58.
99. DANN, *supra* note 87 at 225.

autonomy. Some of these sources explicitly apply ownership to indicators: The Paris Declaration expressly requires donors to refrain "from requesting the introduction of performance indicators that are not consistent with partners' national development strategies" and to link funding "to a single framework of conditions and/or a manageable set of indicators derived from the national development strategy."[100] World Bank Policies and Staff Guidance Notes encourage country ownership of quantitative poverty assessments and indicators.[101] Ownership can also be exercised within international institutions by empowering their political organs that represent the member states: The OECD Programme for International Student Assessment (PISA) indicators, for instance, are based on an explicit mandate from the political organs that laid out the fundamental political orientation of the indicator system.[102] Likewise, in domestic law, otherwise independent statistical offices are subject to political direction when it comes to the purposes and political priorities of data collection.

In terms of content, sovereignty traditionally entails that the legitimate authorities of a state have independent control over the direction of the national economy and effective involvement in economic planning.[103] In the DWM context, this entails ownership by the state over the restructuring. This materializes on three levels: First, in autonomy in restructuring decision. States remain formally sovereign to decide whether to restructure. They cannot be legally forced to default without their consent. States can consent to a restructuring ad hoc on the occasion of an individual restructuring or express consent ex ante by means of a treaty or secondary legislation. Domestic law specifies how far democratic principles require the participation of parliament in such decisions. Second, it materializes in ownership over restructuring process. Once a state has declared its default and a restructuring is negotiated, ownership requires a measure of control by the state over the process. Besides, it plays a role for lending conditionalities (an issue beyond the scope of this study). The flipside of state ownership is a responsibility of the government to actively engage in negotiations and take the lead in making reasonable proposals. The ability to do so presupposes sufficiently reliable financial data. Third, it materializes in ownership over statistics and indicators. While sustainability and transparency may require less government control and less political influence over statistics and indicators in some respects, some non-technical aspects are subject to ownership requirements. Hence, even where an independent institution produces sustainability assessments and indicators, some form of functionally adequate political control needs to remain in order to ensure oversight and political legitimacy of value choices and uncertainty management.

This leads to the following conclusions on indicators in a DWM. No indicator can currently be imposed as a legally binding, automatic trigger

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100. Paris Declaration on Aid Effectiveness, paras. 45, 16.

101. World Bank Operational Policy 1.00; World Bank Guidance Note on Poverty Assessments, July 2004.

102. IMF, *supra* note 4 at 25-26.

103. DANN, *supra* note 87 at 239 et seq.

compelling governments to restructure without their consent. Changing this would require a formal treaty or an amendment to existing treaties transferring this competence to an international institution. Where indicators entail political value choices, normative decisions on how to deal with uncertainty and/or the exercise of International Public Authority, these choices should be made (or be explicitly delegated) by appropriately legitimated political organs. States can delegate such choices ex ante to political organs of international organizations in which affected member states are fairly represented. In any event, states should be given a formal opportunity to publicly comment on, and if need be, rebut independent debt sustainability assessments and indicators. This may involve a formal three-step procedure with a draft DSA, a public government response, and a final determination.[104]

However, there remain two open questions. The first concerns the scope of participation, *i.e.,* it is still subject to debate whether ownership legally requires participation of other actors, namely, private creditors, CSOs and the general public.[105] Literature and commentators have voiced doubts whether state consent alone is sufficient under all circumstances, and have called for more inclusive processes in assessing debt sustainability and in deciding on restructurings.[106] In this regard, national law generally requires parliamentary involvement but not necessarily public consultation or direct participation in budgeting. Internationally, participation has been cited a principle of an emerging Global Administrative Law, and the UN Statistical Principles call at least for "regular consultations with key users both inside and outside the relevant organization to ascertain that their needs are met".[107] The second pertains to equality. Sovereign equality requires international institutions to treat their members equally. Little thought has been given so far what this means for indicators: Does equal treatment require the application of the same indicators and consistent thresholds across countries? Or rather that unlike countries be treated differently? The UN Statistical Principles simply point out that the use of uniform international concepts and classifications promotes consistency.[108] Yet, practice is uneven, and the IMF for instance insists that the DSF should take into account country specific features.[109]

So far, ownership has been realized to varying degrees and in a variety of ways. In practice, it depends on the capacities of the defaulting state and its relative bargaining power. In the EU, indicators negotiated by member state governments and ratified by national parliaments display higher ownership than those developed and applied exclusively by international organization technical staff without any involvement of political bodies. The IMF DSF was considered mainly a technical affair and left to the international expert bureaucracy, with no formal endorsement or mandate for the indicators from

104. For such a proposal, see Brookings, *supra* note 4 at 33.

105. For active NGO contributions to the debt debate, see only KAISER, *supra* note 4; EURODAD, *supra* note 30.

106. Bogdandy and Goldmann, *supra* note 1 at 58. Cf. also IMF, *supra* note 4 at 40. On participation as a GAL principle, see Kingsbury, Krisch and Stewart, *supra* note 11.

107. Principle of International Statistical Activities Principle 1.

108. Fundamental Principle 9.

109. DAS, PAPAIOANNOU AND TREBESCH, *supra* note 1 at 83.

the political bodies of the Fund. Again, a new DWM requires careful balancing of ownership with other principles so as to give effect to collective autonomy, while avoiding dysfunctional or even paralyzed political decision-making processes.[110]

E. Human rights and social protection

The success of a restructuring is not only determined by the restoration of debt sustainability but also on the minimization of the social and human cost and suffering it entails. These concerns are captured by the principle of human rights and social protection. This principle requires states and international organizations to respect, protect and fulfill human rights when they engage in restructuring and adjustment measures and to limit negative impacts on rights whenever possible. As restructurings are exercises of International Public Authority that may curtail individual entitlements, they must comply with human rights obligations.[111] This view has recently been confirmed by case law within the EU and by independent UN experts. [112] Human rights entail an obligation to monitor rights fulfillment based on statistics and indicators and to take these into account in debt assessments and restructuring negotiations. Assessing and mitigating human and social impact contribute to both the throughput and output-legitimacy of a DWM.

The sources of the principle of human rights and social protection are found primarily in domestic constitutions and legislation as well as in regional and international human rights treaties.[113] A particularly relevant source is the International Covenant on Economic, Social and Cultural Rights (ICESCR/"the Covenant"), as the rights contained in this treaty are often primarily affected by debt service and adjustment measures. Further, the constituent treaties and the secondary law of IMF, World Bank, the ILO and the EU lay down social objectives with regard to poverty reduction, standards of living or employment.[114] Substantive human rights obligations, as well as associated monitoring duties, are likewise reinforced by other global political commitments to poverty reduction and social protection, such as the Millennium Development Goals and their successors, the Sustainable Development Goals.

110. Bogdandy and Goldmann, *supra* note 1.

111. Id. at 60 *et seq*. Another justification is based on the *erga omnes* effect of human rights obligations Pfeiffer, '*Zahlungskrisen ausländischer Staaten im deutschen und internationalen Rechtsverkehr'* 141 ZEITSCHRIFT FÜR VERGLEICHENDE RECHTSWISSENSCHAFT 102 (2003); Hoffmann and Krajewski, *'Staatsschuldenkrisen im Euro-Raum und die Austeritätsprogramme von IWF und EU'* 45 KRITISCHE JUSTIZ 2 (2012).

112. The European Committee of Social Rights held that labour market reforms implemented by Greece in the course of its debt crisis violated the European Social Charter, European Committee of Social Rights, Complaints No. 65/2011 and 66/2011, decisions on the merits of 23 May 2012. *See* further UN documents cited *supra* note 75.

113. From the vast literature, see most recently Krennerich, '*Social Security – Just as much a Human Right in Developing Countries and Emerging Markets'* 47 LAW AND POLITICS IN ASIA, AFRICA AND LATIN AMERICA 105 (2014), and the further contributions in that special issue; and BADERIN AND MCCORQUODALE (EDS.), ECONOMIC, SOCIAL AND CULTURAL RIGHTS IN ACTION (2007).

114. See namely IMF Art. I (ii); IBRD/IDA Articles I and OP 1.00 on poverty reduction; Art. 3 (3) of the Treaty on European Union.

The content of human rights obligations in restructurings has recently been restated in the *UN Guiding Principles on Foreign Debt and Human Rights*. These call upon states to "ensure that any and all of their activities concerning their lending and borrowing decisions, those of international or national public or private institutions to which they belong or in which they have an interest, the negotiation and implementation of loan agreements or other debt instruments, the utilization of loan funds, debt repayments, the renegotiation and restructuring of external debt, and the provision of debt relief when appropriate, do not derogate from [human rights] obligations".[115] Rights potentially curtailed during a restructuring include the rights to health, to food, to education, and to social security. These rights are subject to the principles of non-discrimination, progressive realization, non-retrogression and the guarantee of minimum core obligations, as has been elaborated by the General Comments of the Committee on Economic, Social and Cultural Rights and human rights doctrine. This means at the very least that cutting back on social spending must be non-discriminatory, be justified and must not go below the floor set by minimum core obligations.[116]

These rights and principles also entail a procedural duty to monitor the fulfillment of the rights. UN Treaty Bodies have interpreted this duty to require the collection and use of specific human rights statistics and indicators, enabling comparisons over time and disaggregated for vulnerable groups.[117] The UN Office of the High Commissioner for Human Rights (OHCHR) has developed a set of indicators to measure ESC rights for these purposes in a participatory procedure.[118] In addition, the UN Independent Expert on debt and human rights has a mandate for quantifying minimum standards to support the realization of the Millennium Development Goals.[119] Generally, social or human rights impact assessments are becoming an increasingly widespread tool in policy-making and are also used, for instance, in development finance and EU trade policy.[120]

Human rights obligations apply to a variety of actors and result in the

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115. UN documents cited *supra* note 75.

116. UN documents cited *supra* note 75; *Dowell-Jones, 'The Sovereign Bond Markets and Socio-Economic Rights: Understanding the Challenge of Austerity'*, in RIEDEL (ED.), ECONOMIC, SOCIAL AND CULTURAL RIGHTS (2014), 51. *See generally*, Committee on Economic, Social and Cultural Rights, General Comment No. 3: The Nature of States Parties' Obligations (Fifth session, 1993), U.N. doc E/1991/23.

117. Heymann, McNeill and Raub, *'Rights Monitoring and Assessment using Quantitative Indicators of Law and Policy: International Covenant on Economic, Social and Cultural Rights'* 37 HUM. RTS. Q. 1071 (2015); Kalantry, Getgen and Koh, *'Enhancing Enforcement of Economic, Social, and Cultural Rights Using Indicators*' 32 HUM. RTS. Q. 253 (2010); Rosga and Satterthwaite *supra* note 6; Welling, *'International Indicators and Economic, Social, and Cultural Rights'* 30 HUM. RTS. Q. 933 (2008).

118. OHCHR, 'HUMAN RIGHTS INDICATORS. A GUIDE TO MEASUREMENT AND IMPLEMENTATION' (2013). For other approaches, see, e.g., Fukuda-Parr, Lawson-Remer and Randolph, *An Index of Economic and Social Rights Fulfilment: Concept and Methodology*, 8 JOURNAL OF HUMAN RIGHTS 195 (2009).

119. *Cf.* http://www.ohchr.org/EN/Issues/Development/IEDebt/Pages/IEDebtIndex.aspx; *see also* http://www.imf.org/external/np/exr/facts/pdf/jdsf.pdf (last visited 5.4.2016)

120. *See generally* Walker, *'Human rights impact assessments: Emerging practice and challenges'*, in RIEDEL (ED.), ECONOMIC, SOCIAL AND CULTURAL RIGHTS 391 (2014); UNDP, 'HUMAN DEVELOPMENT IMPACT ASSESSMENT OF TRADE POLICY' (2012).

following conclusions for a DWM. Human rights impact assessments based on ESC rights indicators should be conducted for three distinct purposes in restructurings and adjustments: 1) For monitoring the evolution of rights enjoyment in order to detect and mitigate disproportionate and disparate human impact; 2) For distinguishing between inability and unwillingness to serve debt, as indicators help define a legally required floor of minimum social protection and spending; 3) For ascertaining the permissible volume and content of adjustment, and consequently the necessary size of restructuring and haircuts.

States are required to protect and monitor rights in their own territory when they restructure their debt and go through adjustment. These obligations also apply, in principle, to creditor states when they act within international institutions and/or with extraterritorial effect.[121] Both creditor and debtor states are under a duty to collect human rights statistics and indicators, as specified by UN Treaty Bodies and the OHCHR, and are required to take them into account in restructuring negotiations and decisions. International organizations are indirectly bound by human rights, by virtue of their status as special organizations of the UN or on other doctrinal grounds.[122] This also means that they must not aid or assist breaches of ESC rights by states through advice or finance.[123] At a minimum, this includes an obligation to take into account the human rights indicators introduced by states in restructuring and adjustment negotiations. The limited mandate of an international organization should not be interpreted as an obstacle to considering and measuring the impact of the organization's operations on human rights and human development.[124] Finally, if international aid is allocated to a restructuring state, an appropriate fraction of this assistance should be devoted, where necessary, to building statistical capacity for human rights and human development monitoring.

Private creditors must be legally regulated by states so as to prevent them from violating human rights of others, and they are under their own moral obligation to comply with fundamental human rights standards, as specified by the UN Guiding Principles on Business and Human Rights.[125] The Human Rights Council has explicitly affirmed that this includes private sovereign debt creditors.[126] Finally, all creditors, public and private, are bound by a good faith obligation not to request debt workouts and adjustment, which would prevent

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121. Carmona, *'The obligations of 'international assistance and cooperation' under the International Covenant on Economic, Social and Cultural Rights'* 13 THE INT'L J. HUM. RTS. 86 (2009); Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights, Reproduced in 34 HUM. RTS. Q. 1084 (2012).

122. DANN, *supra* note 87 at 263 et seq.; Bernstorff, '*Social Rights in the WTO'* 42 LAW AND POLITICS IN ASIA, AFRICA AND LATIN AMERICA 4 (2009); DARROW, BETWEEN LIGHT AND SHADOW: THE WORLD BANK, THE INTERNATIONAL MONETARY FUND AND INTERNATIONAL HUMAN RIGHTS LAW (2003); SKOGLY, HUMAN RIGHTS OBLIGATIONS OF THE WORLD BANK AND THE IMF (2001).

123. Art. 14 of the International Law Commissions' Draft Articles on the Responsibility of International Organizations, 2011, Yearbook of the International Law Commission, 2011, vol. II, Part Two.

124. Coomans, '*Application of the International Covenant on Economic, Social and Cultural Rights in the Framework of International Organisations'* 11 MAX PLANCK YEARBOOK OF UNITED NATIONS LAW 339 (2007).

125. UN, 'Guiding Principles on Business and Human Rights: A/HRC/17/31' (2011).

126. UN HR Council, Resolution 20/10, A/HRC/RES/20/10, 18 July 2012, paras. 12-13.

the debtor state from fulfilling its international human rights obligations.[127] This in turn entails an obligation to take into account human rights indicators introduced into negotiations and dispute settlement by the state, as assisted by international institutions.

These obligations can in some instances be legally enforced through e.g. the European Court of Human Rights, the European Social Charter Committee, or UN human right bodies and procedures.[128] But even independently of legal enforcement, they can have a discursive effect on public opinion and in political negotiations, parliamentary debates and economic bargaining. The more ESC rights claims are substantiated through statistical evidence, the more potential there is for their serious consideration in restructurings. Yet methodological and prudential caveats apply to the quantification of rights with particular force: Indicators must never reduce rights to mere numbers in cost-benefit calculations, and they can never replace judicial enforcement and political activism. Rights indicators will only contribute to the legitimacy of a DWM if they make human impact a genuine concern of all actors and make them take rights seriously.[129]

In the practice of contemporary restructurings, these obligations flowing from human rights law have not adequately been complied with, nor have human rights considerations been integrated in the procedures of major creditor institutions. The IMF DSF does not include a formalized human impact assessment. There is little evidence that human rights considerations played a role in debt restructuring negotiations during the Eurocrisis, and austerity measures imposed on Greece have led to considerable regression with respect to the realization of Economic, Social and Cultural rights.[130]

IV. Recommendations for the Use of Indicators in a DWM

This section makes concrete recommendations for the use of indicators in a DWM and proposals for the legal design of the required indicator framework. It first answers how indicators should be used and what functions they should perform in a DWM (A), then turns to what their sources should be and who should design them (B), and finally addresses how indicators should be applied (C).

The recommendations and proposals draw from the lessons learned discussed in Part B. and are based on the general principles developed in Section III. The lessons learned ground the recommendations in practical experience, and the principles provide a normative framework for assessing and discussing the effectiveness and legitimacy of DWM indicators. The proposed framework contributes to the solution of problems encountered in current debt

127. Goldmann *supra* note 81 at 14.

128. *See, e.g.,* European Committee of Social Rights, Complaints No. 65/2011 and 66/2011, decisions on the merits of 23 May 2012. *See also* UN documents cited *supra* note 75.

129. Cf. Dworkin, '*Rights as Trumps'*, in Waldron (ed.), Theories of Rights 153 (1984) (arguing that rights are trumps that escape cost-benefit-calculus). On the pitfalls of rights indicators, see Satterthwaite, *supra* note 68; Rosga and Satterthwaite, *supra* note 6.

130. See only Salomon, *Of Austerity, Human Rights and International Institutions* 21 European L. J. 521 (2015).

restructurings, such as procrastination and fragmentation, and to the acceptance of a DWM among relevant stakeholders. In this, international law makes an essential contribution to a DWM, while avoiding overregulation of matters better left to statistical and economic expertise.

A. How should indicators be used in a DWM

Recommendation 1 – Initiation of a restructuring: A restructuring under the DWM should require a formal request by the debtor state, and the substantive finding by a competent international institution that debt is unsustainable. Indicators should not be used as automatic triggers for a debt restructuring. Rather, a workout process should be initiated when the cumulative requirements of a formal government request and a substantive finding of debt unsustainability are met. In this case, a standstill of litigation and good faith obligations will be triggered. A finding that debt is unsustainable should create a presumption that a restructuring is needed and require a government unwilling to restructure to publicly respond to the finding and to rebut the presumption.[131]

Recommendation 2 – Debt sustainability assessment to signal need for restructuring: Debt sustainability should be assessed by a set of indicators in conjunction with a reasoned and transparent qualitative assessment. The need for a restructuring should be assessed and signaled by a debt sustainability assessment. This assessment should not be based on a single indicator but should instead use a set of several indicators, which should be cross-checked against one another. In addition, indicators should be combined with a qualitative expert assessment. This assessment should be reasoned and transparent in all cases, and not only when it departs from standard indicators classifications. It should be conducted periodically for all states and be complemented by extraordinary assessments when vulnerable countries are hit by shocks. Extraordinary assessments should lead to a rapid determination whether debt has become unsustainable. Periodic debt sustainability assessments should be used more systematically for early warning and to induce responsible borrowing. Relevant indicators should be named appropriately not to mislead about what they measure. States must disclose the relevant data necessary for all assessments and indicators.[132]

Recommendation 3 – Restructuring negotiations and disputes: Debt assessments and indicators should be used to render restructuring negotiations and dispute settlement more efficient, coordinated and transparent. Debt assessments and indicators should be used as formal bases for restructuring negotiations in order to reach their aim of restoring debt sustainability more efficiently. These bases should be publicly available. There should not be an indicator-based automatism for determining haircuts and allocating losses. The indicator-based sustainability assessment should be referred to more consistently in contract drafting and dispute settlement in order to achieve coordination and minimize the effects of forum fragmentation. The assessment

131. *See* Sections II.A, II.B, II.E, III.B, and III.D.
132. *See* Sections II.A-E, III.A-C.

and indicators should particularly affect the risk allocation in ex ante contract drafting and ex post litigation where the law allows judges such interpretive moves.[133]

Recommendation 4 – Human impact assessment: Human rights and social indicators should be used to monitor and mitigate the social and human impact of restructurings. A debt sustainability assessment should not be considered valid unless it also assesses available evidence and indicators on economic, social and cultural rights. These findings should help establish a minimum floor for social spending and should be taken into account when distinguishing unwillingness from inability to pay and when determining the size of permissible adjustment and of necessary haircut.[134]

B. What should be the sources of indicators and who should design them?

Recommendation 5 – General Assembly Resolution on general principles: A United Nations General Assembly resolution on a DWM should recognize general principles governing debt assessments and indicators. If the General Assembly passes a resolution on a DWM, this resolution should contain a clause that recognizes general principles for debt assessments and indicators. These general principles should be based on applicable law and should guide any further design and use of debt assessments and indicators in restructuring.[135]

Recommendation 6 – Sources and competences: A DWM can be realized in three scenarios: treaty-based DWM, DWM with enhanced role of existing institutions, and DWM without institutional change based on soft principles. If the DWM is based on a new treaty, that treaty should a) provide for a competence of the political organ to regulate basic features of debt sustainability assessments and indicators in secondary law by lawmaking organs; b) lay down general principles for debt assessments and indicators, including that their basic political orientation should be defined by secondary regulation; c) define competences and procedures for the implementation of these principles and for the application of the indicators by an expert organ. If the DWM is based on the enhanced role of existing institutions, those institutions should enact formal secondary legislation that a) lays down general principles for debt assessments and indicators; b) specifies the mandate for sustainability assessments and indicators and defines their basic political orientation; c) defines competences and procedures for the implementation of the mandate and for the application of the indicators by an expert organ. If the DWM is not accompanied by institutional change, a set of soft law principles should a) lay down general principles for sustainability assessments and indicators and specify rules for their design and application; b) encourage relevant actors to implement these rules and principles in their internal regulations and practice.

Indicators should neither be enshrined directly in treaty law nor left

133. *See* Sections II.A, II.D, II.E, and Sections III.B-D.
134. *See* Sections II.A, II.E, and III.E.
135. *See* Sections II.D, II.E, III.A, III.C, and III.D.

entirely to experts without normative guidance. Instead, debt sustainability assessments and indicators should be regulated in a cascade of legal sources and be designed in an interplay of political and expert organs. Depending on the ultimate institutional setup of the DWM, general principles and competences for debt assessments and indicators should be regulated in treaty or secondary law of the institutions. Assessment criteria and indicators they should be based on an explicit mandate from a political organ. This mandate should spell out the basic political orientation of the criteria and indicators, namely regarding value choices and treatment of uncertainty. The implementation of the mandate should be delegated to expert organs that act impartially and free from political influence. These expert organs should ultimately design and apply the concrete assessment criteria and indicators, subject to the general principles and legal mandate. If a DWM does not involve new legislation, soft law principles should be enacted and formulate the above principles and rules as guidance for existing arrangements and promote their implementation in law and practice of existing institutions.[136]

C. How should indicators be applied?

Recommendation 7 – Independent application of assessment criteria and indicators: Assessment criteria and indicators should be applied by independent expert organs of a competent international institution whose impartiality is guaranteed by organizational safeguards. A non-political organ of a competent international institution should apply the assessment criteria and indicators based on expert knowledge. This process should be insulated from political influence. The assessment should be organizationally separated and fire-walled from eventual lending operations that the same institution might perform.[137]

Recommendation 8 – Procedure for debt sustainability assessment: The procedure in which assessment criteria and indicators are applied should involve a mandatory government response, be transparent and subject to reason-giving, and provide an opportunity for public comment. The application procedure should proceed in three steps: The competent international institution first produces a reasoned draft DSA and transmits it to the government for a response. The government is required to respond and to disclose information and data necessary for the assessment. Draft DSA and response are then made public to give creditors, other international institutions, CSOs and the general public notice and opportunity for comment. After a reasonable time period, the international institution publishes a final DSA taking into account government response and public comment. The final DSA gives reasons that justify the determination made and indicates possible disagreement with the government. The use of indicators in the DSA should equally be justified in a generally understandable manner. Data sources and statistical methods should be disclosed and margins of error and possible uncertainties be flagged.[138]

136. *See* Sections II.A-E, and Sections III.B-D.
137. *See* Sections II.A, II.B, II.E and III.B.
138. *See* Sections II.D, II.E, and Sections III.B-E.

Recommendation 9 – Data quality and good statistical governance: Indicator use should be accompanied by measures ensuring data quality and good statistical governance. Any debt sustainability framework hinges on availability and reliability of financial, economic and social data. States are thus required to maintain sufficient statistical capacity and to ensure observance of state-of-the-art scientific methods. Where necessary and appropriate, technical assistance needs to build this capacity, in particular for monitoring economic, social and cultural rights.[139]

Recommendation 10 – External review and political re-evaluation: Sustainability assessments and indicators should be subject to periodic external expert review and to political re-evaluation in regular intervals. The assessment process, criteria and indicator should also be periodically reviewed by an independent external body. This should take the form of expert evaluation. The resulting evaluation reports should feed into a political process that reconsiders the adequacy of existing arrangements in regular intervals and initiates necessary reforms.[140]

CONCLUSION

The purpose of this paper was to evaluate the present state of international law with respect to indicators in sovereign debt restructurings and to make practical proposals for their use in a DWM based on general legal principles. At the same time, this analysis complements the literatures on International Public Authority and Global Administrative Law by a methodological focus on indicator-based informational action. Focusing on informational action enables a more finely-grained analysis based on a basic category of human cognition, knowledge and action – information –, and it allows reconstructing applicable legal rules and principles of an emerging international institutional law of information.[141] Given the purpose of the present paper, this reconstruction was based on a doctrinal method and was put to pragmatic ends to make concrete recommendations. This does not mean, however, that analysis of indicators and information law in sovereign debt, and in global governance more generally, should be limited in this way. Sovereign debt has its own political economy which shapes how information and knowledge about the world is produced and perceived, and global indicators and quantitative knowledge in themselves pose important questions of politics, morality and justice. Behind the law of indicators thus lurk much deeper questions than this article could address.[142]

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139. *See* Sections II.D, II.E, III.B, III.C and III.E.

140, *See* Sections II.B, II.E, and III.C.

141. See in detail Riegner, *supra* note 12.

142. On these questions, *see, e.g.*, Urueña, *supra* note 6; MATTEI AND HASKELL (EDS.), RESEARCH HANDBOOK ON POLITICAL ECONOMY AND LAW (2015), Part 2; BOAVENTURA DE SOUSA SANTOS, EPISTEMOLOGIES OF THE SOUTH: JUSTICE AGAINST EPISTEMICIDE (2014); Thomas Pogge, *Developing Morally Plausible Indices of Poverty and Gender Equity* 37 PHILOSOPHICAL TOPICS 199 (2009); PORTER, TRUST IN NUMBERS: THE PURSUIT OF OBJECTIVITY IN SCIENCE AND PUBLIC LIFE (1995).

Economic Inequality, Debt Crises and Human Rights

Juan Pablo Bohoslavsky*

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I. INTRODUCTION

Severe economic inequality frequently affects the effective enjoyment of particular human rights, both civil and political rights, as well as social, economic and cultural ones. It may also lead to forms of discrimination that are prohibited under international human rights law. Human rights law therefore imposes certain legal obligations on States to address economic inequalities affecting the enjoyment of human rights and bestows effectual guidance for reducing inequalities, including the prioritization of policy responses in this

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field. Recognizing these interdependencies, human rights protection mechanisms have recently increased their attention for economic inequality.[1]

This is also the result of a better understanding of the negative effects of increased economic inequality on social development that has emerged recently among scholars and civil society organizations. In a testament to this new sensitivity, a commitment to reduce inequality within and among countries is now enshrined in Goal 10 of the Sustainable Development Goals. Accordingly, the international community strives not only to promote the social, economic, and political inclusion of all, but also the adoption of fiscal, wage, and social policies to progressively achieve greater equality and better regulation of global financial markets and institutions.

Yet there is one particular facet of inequality that has been frequently neglected: the linkages among economic inequality, sovereign debt crises, and human rights. There is widespread acknowledgement that debt crises and adjustment programs adopted to respond to them not only impair a country's general economic performance, but also frequently increase inequality and have a negative impact on socioeconomic outcomes and particularly on vulnerable populations. However, inequality may also be an important contributing factor to the emergence of debt crises. This article offers reflections on both dimensions, exploring answers to the following questions: Does inequality matter from a human rights perspective? Does inequality impair debt sustainability? Does lower debt sustainability lead to higher levels of inequality? And, finally, what guidance does human rights law provide for addressing inequality?

In so doing, this Article will be exclusively devoted to the relationship between human rights and economic inequality, and specifically income and wealth inequality. Hence, the term "inequality" employed in this Article, unless otherwise qualified, should be understood as referring to these types of inequality.[2]

As explained by Bohoslavsky and Goldmann,[3] the incremental approach to sovereign debt restructuring, the focus of this special issue, requires legal principles, whether principles of public international law, general principles of law, or of another legal status, reflecting progressive trends in current debt restructuring practice. The contribution of this Article lies not so much in the establishment of new principles, as human rights and nondiscrimination are well entrenched in international law.[4] Rather, its contribution lies in an analysis

1. *See, e.g.,* Report of the Special Rapporteur on Extreme Poverty and Human rights, U.N. Doc. A/HRC/29/31 (2015).

2. Moreover, while both income and wealth inequality relate to economic disparities, there are important differences between the two aspects. Inequality in wealth appears to be more pronounced in many countries and in the world generally. Policy responses designed to address wealth inequality on the one hand and income inequality on the other hand may differ. Therefore, the article clearly distinguishes between those two forms of inequality where necessary. However, if such distinction is not expressly made, then the term "inequality" encompasses both forms of economic inequality.

3. Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*, in this issue.

4. On the question of whether human rights are customary rules or general principles, see Bruno Simma & Philip Alston, *The Sources of Human Rights Law: Custom, Jus Cogens, General*

of the potential of such established principles to further sustainable sovereign debt levels. The following considerations thus show how the debt restructuring principles turn attention to hitherto underdeveloped aspects of the meaning of certain human rights. This is particularly compelling because human rights have emerged as a constituent part of the principle of debt sustainability in the Basic Principles on Sovereign Debt Restructuring Processes adopted by the U.N. General Assembly.[5] Likewise, the Sustainable Development Goals establish a connection between sovereign debt sustainability and human development, which comprises the progressive realization of economic, social, and cultural rights.[6]

II. THE IMPORTANCE OF CONSIDERING ECONOMIC INEQUALITY FROM A HUMAN RIGHTS PERSPECTIVE

The financial crisis has brought the growth of income and wealth inequalities back onto the global agenda.

Global inequality currently stands at extremely high levels and is further increasing. The United Nations Development Program (UNDP) has reported that the richest eight per cent of the world's population earns half of the world's total income, leaving the other half for the remaining ninety-two per cent.[7] Over the past two decades, income inequality has increased by nine per cent in developed countries and eleven per cent in developing countries.[8] Top incomes dramatically increased from the 1980s, mostly in developed countries but also in emerging economies, such as India and China.[9] In addition to wealth transmitted through inheritance, top wages have increased dramatically, outpacing increases in average wages many times and resulting in an unprecedented accumulation of wealth by a small but powerful elite.[10] In 2015, the richest one per cent of people in the world owned more than fifty per cent of global wealth, up from forty-four per cent in 2010.[11] Furthermore, the eighty richest individuals currently own as much wealth as the bottom fifty per cent of the entire global population.[12]

International human rights law addresses inequality on many levels. First, the recognition of economic and social rights imposes upon States the duty to address and/or prevent inequality inasmuch as it constitutes a threat to human rights realization. These rights include fundamental workers' rights—in particular the right to form and join trade unions and the right to fair remuneration—and social rights—in particular the rights to education, health,

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Principles, 12 AUSTRALIAN YEARBOOK OF INTERNATIONAL LAW 82-108 (1989).

5. G.A. Res. 69/319, U.N. Doc. A/RES/69/319 (Sept. 29, 2015).

6. G.A. Res. 70/1, U.N. Doc. A/RES/70/1, ¶ 54 (Oct. 21, 2015).

7. *See* U.N. Development Program (UNDP), *Humanity Divided: Confronting Inequality in Developing Countries* (2013).

8. *Id*. at 7, using the Gini coefficient.

9. *See* Anothony B. Atkinson, Thomas Piketty & Emmanuel Saez, *Top Income in the Long Run of History*, 49 J. ECON. LIT. 3 (2011).

10. *See* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (2014).

11. *See Global Wealth Report*, CREDIT SUISSE RES. INST. 19, 21 (2015).

12. *See* WEALTH: HAVING IT ALL AND WANTING MORE, OXFAM INT'L 2, 3 (2015).

and social security.[13]

Moreover, guarantees of nondiscrimination and equality might be infringed by socioeconomic disadvantages. All international and regional human rights treaties include a broadly constructed principle of nondiscrimination[14] that covers formal discrimination on prohibited grounds in law or official policy documents as well as substantive discrimination, i.e. discrimination in practice and in outcomes. For example, States have certain obligations to ensure equal access to health services, adequate housing, and water and sanitation.[15] The prohibition of discrimination extends not only to the grounds explicitly enumerated in article 2(2) of the International Covenant on Economic, Social and Cultural Rights, such as race, color, sex, or religion, but also to grounds based exclusively on economic and social status.[16]

While human rights law does not necessarily imply a perfectly equal distribution of income and wealth, it does require conditions in which rights can be fully exercised. As a consequence, a certain level of distribution of resources is expected to guarantee individuals an equal enjoyment of the realization of their basic rights without resulting in discriminatory outcomes.[17] When income inequality creates discriminatory outcomes, it becomes a human rights issue. States can make an important contribution to overcoming discrimination by ensuring equal opportunity for all members of society. However, the notion of equal opportunity resembles a myth in many countries and situations, and many people in the world do not have reasonable means for overcoming socioeconomic handicaps.[18]

Inequality implies a violation of the rights enshrined in the Covenant when a significant number of individuals within a society cannot enjoy minimum essential levels of each of the rights enumerated in the Covenant, while other individuals within the society have more than sufficient resources available to guarantee a basic enjoyment of those rights. The violation in such cases appears to be twofold: States may fail to meet their minimum core obligations and to mobilize maximum available resources for the progressive realization of rights, as explained below.

According to the views of the Committee on Social, Economic and Cultural Rights, when a significant number of individuals living in a State party

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13. *See* U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 13, U.N. Doc. E/C.12/1999/10, at ¶ 6(b)(iii) (1999); U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 14, U.N. Doc. E/C.12/2000/4, at ¶ 19 (2000); U.N. Committee on Economic, Social and Cultural Rights, General Comment No. 19, U.N. Doc. E/C.12/GC/19, at ¶¶ 16, 25 (2008).

14. *See, e.g.*, article 2(1) of the International Covenant on Civil and Political Rights *or* article 2(2) of the International Covenant on Economic, Social and Cultural Rights; article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms; article 1(1) of the American Convention on Human Rights.

15. See Committee on Economic, Social and Cultural Rights, General Comment No. 20, U.N. Doc. E/C.12/GC/20 (2009) for commentary on nondiscrimination in economic, social, and cultural rights, among other general comments.

16. *Id.* at ¶ 35.

17. *See* Radhika Balakrishnan, James Heintz & Diane Elson, *What does inequality have to do with human rights?* POL. ECON. RES. INST., Working Paper Series No. 392, at 16 (2015).

18. JOSEPH E. STIGLITZ, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE 18 (2012).

are deprived of critical foodstuffs, essential primary health care, basic shelter and housing, or the most indispensable forms of education, there is a prima facie case of failure to discharge obligations under the Covenant.[19] It should be noted that the minimum income necessary for the enjoyment of such essential levels of economic, social, and cultural rights may differ from one individual to the other—an aged and sick person may potentially need more resources to enjoy effective access to adequate health care and medication than a healthy young person—and from one country to the other. In essence, international human rights norms require States to ensure that all persons residing in their territory live in conditions of dignity.

States are furthermore obliged to use maximum available resources for the progressive realization of economic, social, and cultural rights. Progressive realization implies that States have to ensure the enjoyment of minimum essential levels of rights on a non-discriminatory basis first and without retrogression. States may also fail to use their maximum available resources if they neglect to undertake reasonable efforts to ensure domestic revenue generation and redistribution to address income inequality that violates human rights—for example, if a State fails to address inequality through appropriate taxation or social policies.[20]

To reduce the concept of "maximum available resources" to only those resources on the balance sheet of the treasury would be contrary to the purpose of the Covenant and the Universal Declaration of Human Rights, which guarantees to every person a life with dignity and freedom from fear and want. The term "maximum available resources" also encompasses those resources that a State can reasonably generate through adequate, appropriate, and fair taxation of individuals and corporations or through the levying of tariffs.

In addition, it should be noted that article 2(1) of the Covenant explicitly refers to those resources that can be made available through international assistance and cooperation, in particular economic and technical assistance. It also extends to an obligation to create an international enabling environment conducive to the universal fulfillment of human rights. This international terrain includes bilateral and multilateral trade, investment, taxation, finance, environmental protection, and development cooperation. In other words, human rights law requires a certain degree of redistribution of resources and support based on available capacities within and among nations. This encompasses an organization of the local and global economies that prevents and eradicates extreme poverty.[21] Violations of this principle are pervasive: With 795 million people worldwide being undernourished, at least one out of nine persons on Earth is currently excluded from enjoying essential minimum levels of the right to food.[22] The United Nations Human Settlements Program has estimated that

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19. See Committee on Economic, Social and Cultural Rights, General Comment No. 3, U.N. Doc. E/1991/23, at ¶ 10 (1990), for an explanation of the nature of States parties' obligations.

20. See ASOCIACION CIVIL POR LA IGUALDAD Y LA JUSTICIA ET AL., POLÍTICA FISCAL Y DERECHOS HUMANOS EN LAS AMÉRICAS: MOVILIZAR LOS RECURSOS PARA GARANTIZAR LOS DERECHOS (2015), *available at* www.cesr.org/downloads/cidh_fiscalidad_ddhh_oct2015.pdf.

21. *See* ETO, *Maastricht Principles on Extraterritorial Obligations of States in the Area of Economic, Social and Cultural Rights*, principle 29 (2013).

22. *See* U.N. FOOD AND AGRICULTURE ORGANIZATION (FAO), THE STATE OF FOOD

close to one billion people currently do not have adequate housing but instead often live in informal settlements in developing countries.[23] Inequalities within and among nations are an important contributing factor to these unsettling outcomes. Inequality is both a cause and a symptom of massive violations of economic, social, and cultural rights.

Economic inequality also matters from a human rights perspective when it translates into other types of inequalities. The enjoyment of human rights does not depend only on access to goods and services reflecting the minimum needed for survival; an individual's access to resources relative to others is also of crucial importance. Data suggests that high levels of relative inequality may have substantial negative effects on the practice of human rights. It has been observed that low-income households in a very unequal society may do worse than households with the identical income in a more equal society.[24] This pattern is obvious in numerous areas, including legal representation, education, political influence, health, housing, and social discrimination that can escalate into conflict.

To illustrate, a poor domestic worker may not be able to sue his or her employer to challenge an unfair unilaterally imposed pay cut, both because labor rights may not be institutionalized in the State and because legal representation is not affordable. Continuing to work in unfair conditions or quitting the job may be the only viable options, which is a choice that can beget oppression, particularly when market conditions of high unemployment make replacing employees rather easy.

Likewise, people in poverty may not be able to afford higher education because of prohibitively high tuition fees, the need to work for immediate income, and the inability to move themselves out of unskilled positions. These circumstances can become a multigenerational trap, as generation after generation is not able to break this chain.[25]

It is also common for poorer segments of the population to be marginalized or even effectively excluded from the political process. As noted by the Special Rapporteur on extreme poverty and human rights, Philip Alston, economic and social inequalities often reinforce one another "when individuals with higher incomes or their family members have more political power or access to better education than those with lower incomes."[26] In failing to recognize the connection between social and economic inequalities, there is a risk of political capture of the political system by economic elites, effectively undermining the right to vote and the principle of democracy.

INSECURITY IN THE WORLD, MEETING THE 2015 INTERNATIONAL HUNGER TARGETS: TAKING STOCK OF UNEVEN PROGRESS 8 (2015). FAO employs a narrow definition of undernourishment, which has faced heavy criticism for masking the magnitude of the hunger problem, *see* Frances M. Lappé et al., *How We Count Hunger Matters*, 27 ETHICS & INT'L AFF. 251 (2013).

23. *See* U.N. Habitat, *UN-Habitat and POST-2015*, http://mirror.unhabitat.org/content.asp?cid=11848&catid=746&typeid=24&subMenuId=0.

24. *See* Balakrishnan, Heintz & Elson, *supra* note 17; *see also* RICHARD WILKINSON & KATE PICKETT, THE SPIRIT LEVEL: WHY MORE EQUAL SOCIETIES ALMOST ALWAYS DO BETTER (2009).

25. For more information on the negative effect of income inequality on the right to education, see the Report of the Special Rapporteur on Extreme Poverty and Human Rights, *supra* note 1, at ¶ 30.

26. *Id*. at ¶ 6.

Equally significant is that those on the high end of the income and wealth divide become less dependent on public goods and services because they have the means to purchase private alternatives. At the same time, the poor are getting more dependent on public services, as private alternatives become less affordable for them. As soon as the more affluent and powerful groups in society cease to depend on public goods and services, the State is less likely investing in public, collective goods, leading to a vicious circle of their degeneration.

Moreover, countries suffering from high levels of inequality have worse health outcomes compared to other countries with a similar gross domestic product (GDP).[27] For example, there is a strong positive correlation between rates of child mortality and inequality among countries at similar levels of development. Also, inequality may impair the availability of adequate housing for low-income households.[28]

Inequality often contributes to social exclusion and marginalization of certain groups and individuals. In addition, if inequality entrenches social cleavages along regional, religious, racial, or ethnic lines, social instability and violent internal conflict are more frequent.[29] It has recently been noted that "[w]hen the poor are from one race, ethnicity, religion or region and the rich are from another, a lethal, destabilizing dynamic often emerges."[30] Inequality not only increases the risk of economic and social rights violations, it also augments the likelihood of severe violations of civil and political rights.[31]

III. THE RELATIONSHIP BETWEEN INEQUALITY AND SOVEREIGN DEBT CRISES

A. Inequality as a Source of Sovereign Debt Increase and Crisis

Inequality may affect sovereign debt both directly and indirectly.[32] In short, the direct impact proceeds from the "corrosive" influence of inequality on the tax base, as well as from its enhancing effect on demand for redistribution through debt default. As for the indirect impact, it is mainly private debt that acts as an interface between inequality and sovereign debt. Increasing inequality may lead to private over-borrowing and over-lending. The resulting excessive private leverage can accumulate over many years, destabilize the financial system[33] and even become so volatile for the economy that the debt can trigger a banking crisis, leading to both output losses and

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27. See Wilkinson & Pickett, *supra* note 24.

28. See Janna L. Matlack & Jacob L. Vigdor, *Do Rising Tides Lift All Prices? Income Inequality and Housing Affordability*, 17 J. HOUSING ECON., 212 (2008).

29. *See* Lars-Erik Cederman et al., *Horizontal Inequalities and Ethnonationalist Civil War: a Global Comparison*, 105 AM. POL. SCI. REV. 478, 487-89 (2011).

30. *See* Michael W. Doyle & Joseph E. Stiglitz, *Eliminating Extreme Inequality: a Sustainable Development Goal, 2015-2030*, 28 ETHICS & INT'L AFF. (2014).

31. *See* Todd Landman & Marco Larizza, *Inequality and Human Rights: Who Controls What, When, and How*, 53 INT'L STUD. Q.,715 (2009).

32. For a detailed overview of the interrelationships between inequality and financial crises, see Rémi Bazillier & Jérôme Hericourt in *The Circulare Relationship Between Inequality, Leverage and Financial Crisis*, LABORATOIRE D'ÉCONOMIE D'ORLÉANS, (2015).

33. *See* Michael Kumhof, Roman Rancière & Pablo Winant, *Inequality, Leverage and Crises*, 105 AM. ECON. REV. 1217 (2015).

massive bailout costs for State governments. In addition, both the direct and the indirect channel may simultaneously prompt a currency crisis if external debt is involved.

1. Inequality as a Direct Cause of Sovereign Debt Increase and Crisis

Inequality may exert a considerable direct influence on the structure and the level of government revenues and spending. Increased levels of inequality also mean that the income tax base of the State concerned is rather small, at least if income taxation is not progressive. This diminishes sovereign revenues and consequently makes the State more dependent on borrowing. Thus inequality contributes in many cases to sovereign debt, which may eventually result in sovereign default and financial crises. There is a growing body of evidence for this mechanism.

Empirical studies point to a clear nexus between inequality, income tax base, and sovereign debt. One study, using data from fifty countries in 2007, 2009, and 2011, found a negative correlation between income inequality and the tax base and a positive correlation with sovereign debt.[34] An analysis of a panel of seventeen countries of the Organization for Economic Cooperation and Development (OECD) covering the period 1974-2005 found a positive correlation between the top one per cent income share, a widely used indicator of income inequality, and fiscal deficit.[35] The erosion of the income tax base following an increase in inequality is also likely to affect the structure of tax revenue. The alternative to experiencing a fiscal deficit would be to increase other types of taxes, such as import or export duties and indirect or corporate taxes. This would, however, lead to higher revenue volatility, consequently increasing the risk of sovereign debt crisis.

Increased inequality is also found to contribute to the degeneration of sovereign debt into sovereign debt crises. A number of studies show that high inequality increases the probability of default significantly.[36] In one research paper, it was emphasized that sudden, rapid rises in inequality, in particular, can considerably increase the sovereign default risk. The authors specify that such "inequality shocks" generate a far higher probability of default than collapses of domestic production of the same scale.[37] Several authors have also established that progressive income taxes, which decrease income inequality, can decrease the default risk.[38]

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34. *See* Joshua Aizenman & Yothin Jinjarak, *Income Inequality, Tax Base and Sovereign Spreads*, 68 FINANZARCHIV: PUBLIC FINANCE ANALYSIS 431 (2012).

35. *See* Santo Milasi, Top Income Shares and Budget Deficits, 10 CTR. ECON. & INT'L STUD. (2013).

36. *See* Andrew Berg & Jeffrey Sachs, *The Debt Crisis Structural Explanations of Country Performance*, 29 J. DEV. ECON. 271 (1988); Jeffrey Sachs, *The Debt Overhang of Developing Countries* in DEBT, STABILIZATION AND DEVELOPMENT: ESSAYS IN MEMORY OF CARLOS DIAZ ALEJANDRO (1989) and the papers referred to in footnotes 37-40.

37. *See* K. Jeon & Z. Kabukcuoglu, *Income Inequality and Sovereign Default*, working paper (University of Pittsburgh, 2015).

38. *Id.*; *see also* A. Ferriere, *Sovereign Default, Inequality and Progressive Taxation*, job market paper (New York University, 2014).

One explanation for these links focuses on the incentives of the government to reap the short-term gains of a default. By defaulting, the government may obtain new fiscal freedom—even if this freedom might be short-lived—permitting tax cuts or spending increases to the benefit of the poorer. These benefits are considered greater in more unequal societies with a larger number of low-income households.[39] At the same time, owing to the higher probability that a government in highly unequal States may decide to default, lenders may accept only lower levels of aggregate debt before they sharply raise interest rates or even refuse to issue further credit.[40]

Yet in the long run, default normally implies future costs owing to a (temporary) exclusion from financial markets. As the government cannot incur additional debt to smooth taxes, it is forced to adjust its tax revenues to any short-term fluctuation. The resulting volatile taxation harms poorer households in particular. The more numerous they are, the larger the future costs of default therefore become. However, the incentives to default tend to dominate the second long-term effects in very unequal societies; hence, economies with more progressive taxation have less incentive to default.[41]

2. *Inequality as an Indirect Cause of Sovereign Debt Increase and Crisis*

Inequality can also indirectly contribute to increased sovereign debt and consequently to sovereign debt crises. There are at least two avenues to such outcomes: (a) high levels of inequality contribute significantly to the generation and increase of private debt, with strong interrelationships between excessive private debt, sovereign debt, and financial crises; and (b) inequality adversely affects social and political stability, thereby hampering growth and eventually affecting both government revenue and spending.

39. *See id.*; *see also* Y.K. Kim, *Inequality and Sovereign Default Under Democracy*, 6 EUR. J. ECON. & POL. STUD. 5 (2013). It is important to note that a default does not imply per se negative consequences for the population. It is mainly the fiscal retrenchment following the default—because the government cannot anymore borrow on financial markets—which impacts negatively the people's human rights.

40. *See* Alessandro Dovis, Mikhail Golosov & Ali Shourideh, *Political Economy of Sovereign Debt: Cycles of Debt Crisis and Inequality Overhang*, Working Paper (2015), *available at* https://economics.sas.upenn.edu/sites/economics.sas.upenn.edu/files/u21/Dovis-et-al.pdf.

41. Ferriere, *supra* note 38.

a. Interrelationships between Private Debt, Sovereign Debt and Financial Crises

A boom in private debt is usually considered a more accurate predictor of financial instability than the level or development of sovereign debt.[42] However, sovereign debt may be, depending on the circumstances, a major factor for triggering or worsening financial crisis. For example, excessive sovereign debt in some countries has been a prominent contributor to the recent global financial crisis. Public and private debts are linked in many ways, often reinforcing the other's negative effects, which may be described as a diabolical loop between both.[43] Even when financial crises are not necessarily driven by public debt, such debt has an impact on the aftermath of crises, leading to more prolonged periods of economic depression.[44]

The consequences of a financial crisis on public finances are immense. Nationalization of private debts along with bailout and recapitalizing costs for the banking system has contributed to an explosion of sovereign debt. Further important factors to the aggregation of sovereign debt are decreases in production, consecutive contractions in the tax base, and countercyclical policies set to fight the downturn resulting in higher government spending. If the country instead uses consolidation policies to reduce its debt, this often turns out counterproductive because reduced government spending has a negative impact on economic growth and employment, as the International Monetary Fund (IMF) has recently acknowledged.[45]

There are several channels through which inequality affects private debt and financial crises. As a starting point, it is noteworthy that household debt and top income share—a standard indicator of inequality—are strongly correlated: in many countries, household debt and top income share have grown simultaneously and at a similar pace over many years.[46] Recent research has focused on credit demand and supply channels for explaining the nexus between private debt and inequality.

According to the credit-demand line of reasoning, private debt increases as households try to maintain certain absolute or relative levels of consumption, while facing growing inequality.[47] In other words, people borrow more extensively to maintain their absolute or relative standard of living. Data collected for the United States of America confirm this interpretation: a study

42. *See* Moritz Schularik & Alan M. Taylor, *Credit Booms Gone Bust: Monetary Policy, Leverage Cycles and Financial Crises, 1870-2008*, 102 AM. ECON. REV. 1029 (2012).

43. *See* Markus K. Brunnermeier et al., *European Safe Bonds* (Euro-nomics group 2011).

44. *See* Oscar Jordà, Moritz Schularick & Alan M. Taylor, *Sovereigns Versus Banks: Credit, Crises and Consequences*, (National Bureau of Economic Research, working paper No. 19506, 2013).

45. *See* IMF, *World Economic Outlook 2012: Coping with High Debt and Sluggish Growth*, (World Economic and Financial Surveys, 2012); N. Batini, L. Eyraud, L. Forni & A. Weber, *Fiscal Multipliers: Size, Determinants and Use in Macroeconomic Projections*, IMF technical notes and manuals No. 14 (2014).

46. *See* Bazillier & Hericourt, *supra* note 32.

47. *See* James K. Galbraith, INEQUALITY AND INSTABILITY. A STUDY OF THE WORLD ECONOMY JUST BEFORE THE GREAT CRISIS (2012).

from 2006 revealed that, over the previous twenty-five years, income inequalities in the United States had increased without being followed by an increase in consumption inequalities.[48] Some explain this as a result of a higher dispersion of transitory income, but it appears likely that massive permanent income shifts play a more prominent role here.[49] In particular, the observation that the debt-to-income ratio of the top five per cent and bottom ninety-five per cent households has undergone a dramatic reversion between 1983 and 2007 supports the latter view.[33] Also, a negative link between income inequality and social mobility was found by analyzing a sample of sixteen countries.[50] For numerous developing and developed countries, it has also been shown that the increase in inequality was mainly due to an increase in between-group inequality, reflecting permanent income shocks.[51] Explanations for persistent borrowing by low- and middle-income households despite growing income inequality can be found in several variants of the relative income hypothesis, according to which household consumption is a function of the household's position in the income distribution and its past levels of consumption.[52]

Another theory connects inequality, credit demand, and monetary policy. It holds that highly unequal income distribution leads to overreliance on investment and luxury consumption. This may not be sufficient for a sustainable level of economic output, prompting low interest rates that itself allows private debt to increase beyond sustainable levels.[53]

In turn, the rise in the incomes of the richest will also increase their savings, leading to a huge accumulation of private wealth. This rising supply of capital requires more investment opportunities and consequently boosts the credit supply, even for riskier borrowers.[54] Moreover, a possible consequence of this accumulation of private wealth is creditor-led lobbying to favor policies that may lead banks to issue risky loans and eventually to a massive distribution of subprime loans to low-income individuals. It has been argued that "growing income inequality in the United States . . . led to political pressure for more housing credit," which eventually "distorted lending in the

48. *See* Dirk Krueger & Fabrizio Peri, *Does Income Inequality Lead to Consumption Inequality? Evidence and Theory*, 73 REV. ECON. STUD. 163 (2006).

49. *See* Rorbert A. Moffitt & Peter Gottschalk, *Trends in the Transitory Variance of Male Earnings in the United States, 1970-2004*, (National Bureau of Economic Research, working paper No. 16833, 2011); Matteo Iacoviello, *Household Debt and Income Inequality, 1963-2003*, 40 J. MONEY, CREDIT AND BANKING, 929 (2008).

50. *See* D. Andrews & A. Leigh, *More Inequality, Less Social Mobility*, 16 APPLIED ECON. LETTERS 1489 (2009).

51. *Id*.; *see also* R. Kanbur, C. Rhee & J. Zhuang, *Rising Inequality in Asia and Policy Implications*(East Asian Bureau of Economic Research, macroeconomics working paper No. 23973, 2014).

52. *See* T. van Treeck, *Did Inequality Cause the United States Financial Crisis?*, 28 J. ECON. SURVEY 421 (2014); R.H. Frank, Adam S. Levine & Oege Dijk, *Expenditure Cascades*, 1 REV. BEHAVIORAL ECON. 55 (2014).

53. *See* J.-P. Fitousso & F. Saraceno, *How Deep is a Crisis? Policy Responses and Structural Factors Behind Diverging Performances*, (Observatoire français des conjonctures économiques, working document No. 2009-31, 2009); A.B. Atkinson & S. Morelli, *Economic Crises & Inequality*, (United Nations Development Program, Human Development Research Paper No. 2011/06, 2011).

54. *See* P. Lysandrou, Global Inequality, *Wealth Concentration and the Subprime Crisis: a Marxian Commodity Theory Analysis*, 42 DEVELOPMENT & CHANGE 183 (2011). *See also* M. Kumhof et al., *supra* note 33.

financial sector."[55]

It seems likely that the credit demand and credit supply channel are activated simultaneously. Other factors also play an important role.[56] A general shift towards a radical free-market stance,[57] the prevalent finance-led model of growth and the accompanying deregulation of the financial sector even seem to be main factors explaining the global financial and economic crises that began in 2007, which is often labelled the "Great Recession."[58] The decline of workers' bargaining power owing to labor market flexibility and wage moderation has possibly contributed to the demand side of the crisis described above. Financial liberalization and deregulation explain, besides the growing wealth at the top, increased credit supply.[59]

Based on the theoretical considerations above, it is not surprising that an examination of eighteen OECD countries over the period 1970-2007 revealed a positive link between income inequality and credit growth.[60] Moreover, over the period 1980-2010, a large majority of banking crises were preceded by persistently high levels of income inequality.[61] Concerning the United States specifically, one study that investigated the period 1980-2003 found a "strong positive effect of income inequality in household debt relative to disposable income as well as the components of the household debt (mortgage debt, revolving debt, e.g. credit cards, and non-revolving debts, e.g. car loans)".[62] Although these results seem to confirm the theoretical ideas above, it should be noted that more empirical research is needed.

b. Impact of Inequalities on Social and Political Stability and Growth

Inequality may also reduce social and political stability. This creates disincentives for investment, disruptions in business activity, disunity,[63] threats

55. *See* R.G. RAJAN, FAULT LINES: HOW HIDDEN FRACTURES STILL THREATEN THE WORLD ECONOMY (2010); *see also* Galbraith, *supra* note 47.

56. *See* Bazillier & Hericourt, *supra* note 32.

57. *See* P. Krugman, *Inequality and Crises*, NYTIMESBLOG (June 2010), http://krugman.blogs.nytimes.com/2010/06/28/inequality-and-crises.

58. *See* Galbraith, *supra* note 47. He also identifies mainly financial forces as the source of growing inequality.

59. *See* P. Tridico, *Financial Crisis and Global Imbalances: Its Labor Market Origins and the Aftermath*, 36 CAMBRIDGE J. ECON. 17 (2012).

60. *See* C. Perugini, J. Hölscher & S. Collie, *Inequality, credit and financial crises*, 40 CAMBRIDGE JOURNAL OF ECONOMICS 227 (2016).

61. *See* G. Bellettini & F. Delbono, *Persistence of high income inequality and banking crises: 1980-2010*, (University of Bologna, Department of Economics, working paper No. 885, 2013). By contrast, works by A.B. Atkinson and S. Morelli come to inconclusive results, both for increases and levels of inequalities; see id, *Income inequality and banking crisis: a first look, report prepared for the Global Labor Forum 2011* (International Labour Organization (ILO), Turin, 2010) and *Inequality and crises revisited* (Centre for Studies in Economics and Finance, University of Naples, working paper No. 387, 2015). They also provide for possible explanations for their outcomes, in particular the choice of inequality measures and contagion between national economies due to globalization.

62. *See* M. Christen & R. Morgan, *Keeping up with the Joneses: analyzing the effect of income inequality on consumer borrowing*, 3 QUANTITATIVE MARKETING AND ECONOMICS 145, at 148 (2005).

63. *See* K.H. Park, *Income inequality and economic progress: an empirical test of the institutionalist approach*, 55 AMERICAN JOURNAL OF ECONOMICS AND SOCIOLOGY 87 (1996).

to property, and policy uncertainty and may even raise the probability of coups and mass violence. The result is a lower level of growth, which consequently provokes higher levels of debt. The link between inequality, political instability, and investment has been confirmed by an empirical study made on seventy countries over the period 1960-1985.[64]

Recent cross-country evidence supports the notion that inequality reduces economic growth. Based on vast data for both OECD and emerging countries, an IMF study from 2014 provides a solid case that lower inequality is robustly correlated with faster and more durable growth.[65] A further IMF study supports these conclusions using a sample of 159 advanced, emerging, and developing economies. The authors conclude that the income distribution itself matters for growth. Specifically, if the income share of the top twenty per cent increases, then GDP growth actually declines over the medium term, suggesting that the benefits do not trickle down. In contrast, an increase in the income share of the bottom twenty per cent is associated with higher GDP growth.[66]

B. Impact of Sovereign Debt Crises on Inequality

Sovereign debt crises, like financial crises generally, have enormous distributional consequences, originating in several factors.

1. Decline in Economic Output

To start with, financial crises may massively hamper economic growth, principally because of decline in investment in production, as a result of credit contraction. Banking crises usually lead to a significant output drop. On average, the real per capita GDP drop amounts to over nine per cent, with a recovery time of two years.[67] An analysis of financial crises, taking into account both banking and currency crises, has revealed that the average output loss is twenty per cent of GDP, with a recovery time of three to four years.[68] However, isolated currency crises as such may have mixed effects: they usually increase the price of imported goods and may lead to a contraction of available credit, considerably encumbering growth. At the same time, currency crises may also benefit the exporting sector of a country.

The consequences of sovereign debt crisis on economic growth are difficult to isolate, as they are generally preceded by, or coincide with, banking crises. However, there is a strong negative correlation between extreme levels of sovereign debt or sovereign default on the one hand and growth on the other.

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64. *See* A. Alesina & R. Perotti, *Income distribution, political instability, and investment*, 40 EUROPEAN ECONOMIC REVIEW 1203 (1996).

65. *See* J. Ostry, J. Berg & C.G. Tsangarides, *Redistribution, inequality and growth*, (IMF staff discussion note No. 14/02, 2014).

66. *See* E. Dabla-Norris et al., *Causes and consequences of income inequality: a global perspective*, (IMF staff discussion note No. 15/13, 2015).

67. *See* C.M. Reinhart & K.S. Rogoff, *The aftermath of financial crises*, 99 AMERICAN ECONOMIC REVIEW 466 (2009).

68. *See* M.D. Bordo et al., *Is the crisis problem growing more severe?*, 16 ECONOMIC POLICY 51 (2001). The authors also demonstrate that banking and currency crises have become more frequent in the last quarter of the twentieth century.

One study, for example, has found that debt crises lead to significant and long-lasting output losses, reducing output by about ten per cent after eight years.[69]

2. *Inflation, Unemployment and Labour Share*

In addition to this slowdown in economic activity, there are several other channels through which financial crises affect income and wealth distribution. Currency crises exert their influence by leading to relative price changes, fiscal retrenchment, and changes in assets.[70] Devaluation leads to the aforementioned fall in earnings of those employed in the non-tradable sector, while it increases the demand for exports and therefore may benefit employment and earnings in this sector. The poor may also be affected by the price increase of imported goods, especially food prices. Fiscal retrenchment and public spending cuts may affect social assistance outlays, amplifying the consequences of the crisis on the poor. Lastly, changes in the value of assets have an impact on income distribution because variations in interest rates, assets, and real estate prices are more likely to affect the wealth of the better off.

In the aftermath of banking crises, the associated unemployment rate rises on average by about seven percentage points for a period of over four years.[71] Currency crises also affect the labor share of income.[72] The labor share is a key indicator for the distribution of income in a country: it shows how much of national income is distributed to labor and how much to capital. Currency crises are associated with a strong fall of the labor share, which is only partially compensated in the following years. Even the long-term trend of declining labor share that has been observed for decades may at least partly be explained by financial crises. This implies consistently growing income inequality, as a falling labor share means that an ever-larger share of the benefits of growth accrues to owners of capital. This development may be even more significant in developing countries, where a large share of the capital is held by foreigners.[73]

3. *Increase in Poverty*

Financial crises might have a magnifying impact on both the spread of poverty and inequality. For example, based on the Gini coefficient, one

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69. *See* D. Furceri & A. Zdzienicka, *How costly are debt crises?*, 31 JOURNAL OF INTERNATIONAL MONEY AND FINANCE 726 (2012); *see also* F. Sturzenegger, *Toolkit for the analysis of debt problems*, 1 JOURNAL OF RESTRUCTURING FINANCE 201 (2004); and B. De Paoli & G. Hoggarth, *Costs of sovereign default*, BANK OF ENGLAND QUARTERLY BULLETIN (Q3, 2006), finding negative correlations between sovereign default and growth. Although some researchers interpret sovereign default as the beginning of economic recovery, for example, E. Levy Yeyati & U. Panizza, *The elusive costs of sovereign defaults*, 94 JOURNAL OF DEVELOPMENT ECONOMICS 95 (2011), this does not contradict the finding that high increasing levels of sovereign debt may hamper economic growth, as "the anticipation of a default causes low growth", *ibid*.

70. *See* E. Baldacci, L. de Mello & G. Inchauste, *Financial crises, poverty and income distribution*, (IMF working paper No. 02/4, 2002).

71. *See* C.M. Reinhart & K.S. Rogoff, *supra* note 67.

72. See R. Bazillier & B. Najman, *Labour and Financial Crises: Is Labour Paying the Price of the Crisis?* (LEO Working Paper, 2012), *available at* http://remi.bazillier.free.fr/bazillier_najman_v2.pdf.

73. *See* I. Diwan, *Debt as Sweat: Labor, Financial Crises, and the Globalization of Capital* (World Bank Working Paper, Washington, D.C., 2001); and P. Maarek & E. Orgiazzi, *Currency crises and the labor share*, 80 ECONOMICA 566 (2013).

particular study found a significant increase in inequality during a currency crisis relative to the pre-crisis year. Moreover, the correlation between crises and income distribution was stronger when crises were followed by average income losses. This fall of income accounted for fifteen to thirty per cent of the variations in the poverty and inequality indicators. The study also found a more-than-proportional fall in the income share of the lowest income quintiles and an increase in the income share of the highest quintile.[74] Another study concluded that on the average inequality rises by 16.2 per cent in the two-year period immediately following a currency crisis as opposed to 3.2 per cent in years without crises.[75] The Great Recession, best described as a systemic banking crisis, which has been followed by a debt crisis, especially in the European Union, has led to massive inequality jumps. Using the ratio between the share of income available to ninety per cent of the population and the richest 10 per cent as a proxy of inequality, United States income inequalities have risen by 11 per cent between 2007 and 2011.[76]

When assessing the impact of financial crises on inequality, it is necessary to keep two aspects in mind that may lead to distortions of the outcomes. First, poverty rates may only be a limited indicator of the scope of the problem, as the number of people falling into poverty and escaping poverty over the same period may surge, increasing the depth of poverty, while the poverty rate remains stable. Second, top income earners may experience a decrease of their revenues in the short run owing to a crisis because of their higher dependence on capital income. This may explain why the distributional effect of crises is not always clear in the very short run.

4. *Structural Factors Mitigating Social Impacts, Labour Regulations and Safety Nets*

Some other factors have significant influence on the effects of financial crises on inequality. For example, it appears that crises exacerbate inequalities more in the most deregulated labor markets. Financial crises have had worse effects on Latin American workers than on Asians, and stronger adverse impacts on Asians than on the organized workers of Northern economies.[77] This finding suggests that there is a crucial interaction between labor market institutions and the specific effects of financial crises.

One should also note that the impact of crises on inequality depends on the existing social protection system in the country, as well as the level of public spending, which serves as an automatic stabilizer during a recession. Experiences in the OECD support this notion: during the period 2007-2009, in the OECD, the household sector in the aggregate appears to have been well

74. *See* Baldacci et al., *supra* note 70.

75. *See* J.K. Galbraith & L. Jiaqing, *Inequality and financial crises: some early findings* (University of Texas working paper No. 9, 1999), using the Theil Index, another inequality indicator.

76. *See* B.D. Meyer & J.X. Sullivan, *Consumption and income inequality and the great recession*, 103 AMERICAN ECONOMIC REVIEW 178 (2013).

77. "[…] it is the rich, advanced, and successful economies that have the bestpaid workers, the most stable wage structures, and the strongest forms of insulation from economic shocks, including financial shocks" Galbraith & Jiaqing, *supra* note 75, at 7.

protected from the impact of the downturn. This was possible because of government intervention through tax and benefit systems in most countries.[78] However, consolidation policies implemented after 2010 are likely to have a greater effect on income distribution.[79]

5. *Impacts of Government Responses to Crises:Fiscal Consolidation*

In most countries, financial crisis is followed by fiscal consolidation, which may also have a strong distributional impact. Several studies on OECD countries and other emerging and advanced economies have demonstrated that fiscal consolidation is usually associated with a rise of inequality, a fall of the labor share, and a rise of long-term unemployment.[80] One study came to the conclusion that fifteen to twenty per cent of the increase in inequality following a fiscal consolidation is explained by the rise of unemployment.[81] Social spending cuts are another substantial contributor to rising inequalities. A one per cent decrease in social spending is associated with a rise of 0.2-0.7 per cent in inequality measured by the Gini coefficient.[82] Crises usually have strong effects on social spending, with lowest income countries being more likely to cut social spending during crises.[83] The Great Recession, for example, has led to broad and deep cuts in social security spending.[84]

With sovereign debt crises, it is challenging to disentangle the specific effects of default from those of the stabilization policies, such as those that tend to follow IMF interventions in developing countries. What seems clear is that IMF programs are associated with a worsening of income distribution and a reduction in the incomes of the poorest citizens when external imbalances were high prior to the program. These programs may only decrease income inequality when external imbalances are less severe.[85]

The dynamics of inequality in Latin America in the 1980s offer good insights into the potential distributive impact of debt crises. A study on this region during that decade provided strong evidence confirming that income inequality "mirrors the economic cycle, rising during recessions."[86] The costs of the crises have not been borne equally[87] and most adjustment programs

78. *See* S.P. JENKINS ET AL., THE GREAT RECESSION AND THE DISTRIBUTION OF HOUSEHOLD INCOME (Oxford, Oxford University Press, 2013).

79. *Ibid.*

80. *See* L. Ball et al., *The distributional effects of fiscal consolidation*, (IMF working paper No. 13/151, 2013); J. Woo et al., *Distributional effects of fiscal consolidation and the role of fiscal policy: what do the data say?* (IMF working paper 13/195, 2013).

81. J. Woo et al., *supra* note 80.

82. *Ibid*.

83. *See* M. Lewis & M. Verhoeven , "*inancial crises and social spending: the impact of the 2008-2009 crisis*, (World Bank, Other Operational Studies No. 12965, 2010).

84. *See* F. Bonnet, E. Ehmke & K. Hagemejer, *Social security in times of crisis*, 63 INTERNATIONAL SOCIAL SECURITY REVIEW 47, 48 (2010).

85. *See* M. Pastor, *The effects of IMF programs in the third world: debate and evidence from Latin America*, 15 WORLD DEVELOPMENT 249 (1987); and G. Garuda, *The distributional effects of IMF programs: a cross-country analysis*, 28 WORLD DEVELOPMENT, 1031 (2000).

86. *See* G. Psacharopoulos et al., *Poverty and income inequality in Latin America during the 1980s*, 41 REVIEW OF INCOME AND WEALTH 245 (1995).

87. *See* N. Lustig, *The 1982 debt crisis, Chiapas, NAFTA, and Mexico's poor*, 38

resulted in "overkill" leading to increases in poverty and inequality beyond what was necessary (and legal).[88]

6. *Social Impact of Financial Crises*

Financial crises and the austerity measures adopted in response also have a robust negative social impact that, in turn, perpetuates or exacerbates inequality. The organization Caritas has summarized that the situation of many households in Europe "remains serious, as poverty and social exclusion are rising in most member States, affecting particularly the working age population and, consequently, children. Young people are seriously affected by labor market exclusion: nearly a quarter of economically active young people in the European Union are unemployed."[89] In one study, OECD notes that "the numbers living in households without any income from work have doubled in Greece, Ireland and Spain. Low-income groups have been hit hardest, as have young people and families with children."[90] The study also points out the adverse long-term impact of the Great Recession on families, fertility, and health. Drops in fertility rates have already been observed. Families have cut back on essential spending, compromising their current and future well-being. Furthermore, although it is too early to assess the overall impact on health, unemployment and connected economic difficulties are known to increase health problems, including mental illness. Cutbacks in social protection are also likely to increase health problems. As an illustration, Oxfam reports that twenty per cent of pharmacy clients in Lisbon did not complete their whole prescriptions owing to rising costs.[91] In a case study on Greece, Oxfam reports a strong impact of increased poverty and inequality on crime and suicide rates.[92] In Spain, meanwhile, a harsh set of austerity measures has driven a dramatic uptick in unmet health needs among the poor, wage precariousness, income inequality, and poverty, especially among children.[93]

Similarly, several United Nations bodies have identified the social impact of debt crises and related structural adjustment programs.[94] Studies by the United Nations Children's Fund (UNICEF) have demonstrated that debt-servicing obligations diverted cash from social welfare programs with adverse

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CHALLENGE, 45 (1995).

88. *See* L. Gasparini & A. L. Lustig, *The Rise and Fall of Income Inequality in Latin America* (Center for Distributive, Labor and Social Studies, Working Paper, 2011).

89. CARITAS CRISIS MONITORING REPORT, POVERTY AND INEQUALITY ON THE RISE 29 (2015).

90. *See* OECD, SOCIETY AT A GLANCE 2014: OECD SOCIAL INDICATORS (Paris, 2014), *available at* http://dx.doi.org/10.1787/soc_glance-2014-en.

91. *See* T. Cavero & K. Poinsasamy, *A Cautionary Tale: The True Cost of Austerity and Inequality in Europe*, (Oxfam, Briefing Paper 2013).

92. *See* G. Cavero, *The True Cost of Austerity and Inequality in Europe – Greek Case Study*, (Oxfam, Case Study 2013).

93. *See Visualizing Rights: A Snapshot of Relevant Statistics on Spain*, (Centre for Economic and Social Rights, Fact Sheet No. 14 2015).

94. *See* E/C.12/ESP/CO/5; E/C.12/GRC/CO/2; E/C.12/PRT/CO/4; A/HRC/25/Add.1; UNICEF, Austerity measures threaten children and poor households, working paper (September 2011); UNICEF, CHILDREN OF THE RECESSION: THE IMPACT OF THE ECONOMIC CRISIS ON CHILD WELL-BEING IN RICH COUNTRIES (New York, 2014); and ILO, WORLD SOCIAL PROTECTION REPORT 2014-15 (Geneva, 2014).

consequences on human development.[95] Austerity measures have exacerbated the negative social impact for disadvantaged groups such as women, children, person with disabilities, older persons, people with HIV/AIDS, indigenous peoples, ethnic minorities, migrants, refugees, and the unemployed, as documented in a report by the Office of the United Nations High Commissioner for Human Rights in 2013.[96] Overall, adjustment plans without substantial sovereign debt relief have proven to be detrimental to human development and human rights, at least in the short term. Alternatively, substantial sovereign debt relief has allowed targeted countries to scale up "poverty-reducing" expenditures.[97]

IV. CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions

This article has demonstrated that linkages between inequality, private and sovereign debt, and the occurrence of financial crises are manifold. Although economic research only recently has turned to this field and many aspects still need to be examined, a number of important outcomes appear to be established at this stage. First, there are strong indications that inequality may substantially contribute to and exacerbate the emergence and the course of financial crises, even if other factors, in particular financial deregulation, obviously also play a crucial role. Inequality erodes States' tax base, thereby depleting revenue. Inequality also appears to prompt increased levels of private credit, which in turn may adversely affect sovereign debt and the stability of financial markets. This phenomenon is mainly explained by rising credit demand and credit supply. Aggregate under-consumption in conjunction with corresponding low interest monetary policy may be a contributing factor to an increased credit supply.

Second, according to most studies, financial crises and the subsequent policy measures commonly implemented to alleviate their consequences—e.g., fiscal retrenchment and stabilization policies—enhance inequalities, with devastating social consequences. A debt crisis may have a massive depressive impact on output, which may in turn affect the level of inequality. Most studies also concur that financial crises result in an increase in income inequality. Fiscal consolidation following a sovereign debt overhang may also have strong distributional consequences, both directly and indirectly, for example, through the increase in the unemployment rate and social spending cuts. The social effects of crises are often catastrophic, particularly for the most vulnerable in society. Widespread poverty, the emergence of health issues, and rising unemployment are only a few common problems.

This Article has traced the numerous social and human rights dimensions of inequality and outlined corresponding human rights obligations of States.

95. *See* G.A. CORDIA, R. JOLLY & F. STEWART, ADJUSTMENT WITH A HUMAN FACE, VOL. II, (Clarendon Press, Oxford, 1988).

96. UN Doc. E/2013/82.

97. *See* UN Doc. A/HRC/23/37.

The finding that inequality may contribute to the occurrence of financial crises, which in turn exacerbate inequality and adversely affect human rights, has far reaching policy and legal implications. It underscores that human rights, social and economic aspects are inseparably intertwined, calling for a holistic approach to preventing and confronting financial crises. This Article suggests that financial crises may not be prevented without addressing the contributing human rights shortcomings, including those connected to inequality. The same is true for crisis-response measures: any reaction to a financial crisis that neglects the effects on human rights and inequality does not only run afoul of human rights duties and responsibilities but also risks creating the same problems again and again, preventing any economically sustainable future.[98] This lends additional urgency to the international community's commitment to reducing inequality reflected in Goal 10 of the Sustainable Development Goals.

Enhancing our knowledge and understanding of the interlinkages among inequality, debt crises, and human rights leads us to raise questions about the way we deal with sovereign debt restructurings. The incremental approach lends a normative framework to improve present practice. As shown in the following recommendations, debt restructuring practice reflects the way we understand how inequality affects debt sustainability and human rights. By improving our understanding of these interlinkages, it is possible to foster human rights through existing mechanisms, strategies, contracts, rules, and principles currently used to prevent and deal with debt crises. Human rights law has, then, a great transformative potential in modern financial markets.

B. *Recommendations*

Preventing and responding to financial crises and combating inequalities must thus go hand in hand. Hence, policymakers must ensure that they tackle dangerous destabilizing developments in the financial sphere while addressing inequality directly. While financial regulation, labor and education policies, access to justice, the financing of political parties, ensuring pluralism in the media, and consumer protection should be all on the agenda when discussing recommendations to tackle inequality and debt sustainability,[99] this article focuses on fiscal policies and crisis response as they are more directly related to debt restructurings.

1. *Fiscal Policies*

Tax justice is a legal issue,[100] and as such, it might suggest that inequalities be reduced through taxation and transfers, the latter including in cash and in kind.[101] In the field of taxation, there are numerous ways for

98. *See* Bohoslavsky & Goldmann, *supra* note 3.

99. See recommendations on these aspects in the report on illicit financial flows of the Independent Expert on Foreign Debt and Human Rights, UN Doc. A/HRC/28/5.9.

100. *See* THOMAS POGGE & KRISHEN MEHTA (EDS.), GLOBAL TAX FAIRNESS (2016), and Asociación Civil por la Igualdad y la Justicia et al., *supra* note 20.

101. On this topic, see the report of the Secretary-General on the role of the United Nations in promoting a new global human order and an assessment of the implications of inequality for development, UN Doc. A/67/394, para. 56, in which he exhorts that governments "may wish to consider

addressing inequalities.[20] To start with, it is crucial to rely more on direct than indirect taxes, as the latter tend to be regressive or proportional to incomes.[102] This is particularly true for excise duties and taxes.[103]

Income taxation needs to be aligned with a number of principles. First and foremost, tax progressivity is an important factor in fostering increased equality and should therefore be a prominent guiding principle of income taxation. Trends in the most recent decades of decreasing progressivity have massively contributed to the widening of the wealth and income gap. Moreover, tax progressivity decreases the probability of financial crises and default. The top marginal income tax rate should thus be considerably higher than what is currently common.[104] The minimum taxable income must always be above the poverty line.

In general, States should take care that capital income does not receive privileged treatment compared to income from labor, as is currently prevalent in many States. Obviously, this may call for amendments to applicable tax laws, but changes in other parts of the States' legal systems may also contribute to ending the special status of capital income, as described below.

Another important step towards increased equality should be to phase out certain tax deductions and excessive and unjustified tax privileges applicable to certain sources of income and sectors. Such privileges usually benefit the high earners disproportionally and thus foil progressive taxation.

Introducing a wealth tax is another measure States should consider. Against the backdrop of increasing inequality, wealth taxes have recently drawn new attention[105] and may provide another way for increasing tax revenues while also fostering equality. States should also reassess other forms of taxation of property, including the transfer of assets. Broadening the tax base this way, and by closing loopholes in the tax code, has the benefit of improving both efficiency and equity.[106]

Furthermore, States should put an emphasis on fighting tax evasion and avoidance.[107] Tax loopholes used by wealthy individuals and multinational companies must be closed. Corporate tax minimizing strategies need to be addressed urgently. For this to be sufficiently effective, and in order to avoid detrimental outcomes for States advancing with such efforts, the work in this

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a combination of progressive income taxes and highly redistributive transfers to decrease income inequality and its impact on social development."

102. See *Fiscal policy and income*, IMF policy paper 18 (January 2014); C. O'Donoaghue, M. Baldini, & D. Mantovani, *Modelling the redistributive impact of indirect taxes in Europe: an application of EUROMOD*, (Euromod working paper No. EM7/01, University of Essex, 2004); and S. CNOSSEN, THEORY AND PRACTICE OF EXCISE TAXATION: SMOKING, DRINKING, GAMBLING, POLLUTING, AND DRIVING (Oxford, Oxford University Press, 2005).

103. *See* IMF, *supra* note 102.

104. In JOSEPH STIGLITZ, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE 273 (2012), the author suggests that the top marginal tax rate should be well in excess of 50 percent and plausibly in excess of 70 percent; in A.B. ATKINSON, INEQUALITY: WHAT CAN BE DONE? 179 (2015), the author promotes a top marginal tax rate of 65 percent.

105. *See* PIKETTY, *supra* note 10.

106. *See* F. Cingano, *Trends in Income Inequality and its Impact on Economic Growth*, at para. 58 (OECD Social, Employment and Migration Working Papers No. 163 2014).

107. See the report of the Independent Expert on Foreign Debt and Human Rights, UN Doc. A/HRC/31/61.

field, as in others discussed before, needs to be international in its scope.

Simultaneously, the findings of this article call for consistent public spending policies that ensure full compliance with the human rights obligations of the States. Such policies must first and foremost ensure that the human rights of the poorest and most vulnerable be respected, protected, and fulfilled. They also must include decisive steps towards reversing the trend towards increasing inequality within and among States.

It is of utmost importance that States provide and progressively extend social protection floors, in accordance with the Social Protection Floor Initiative, the ILO Social Protection Floors Recommendation, 2012 (No. 202), and Goal 1.3 of the Sustainable Development Goals.[108] This entails at a minimum that "all in need have access to essential health care and to basic income security,"[109] in particular for socially disadvantaged groups. However, States are under the obligation to work progressively towards the full realization of economic, social, and cultural rights, using the maximum of the available resources. Consequently, States must continue further developing and extending their social systems, if resources permit. Cuts in social spending, and particularly social security and unemployment benefits, may only be made in cases of absolute necessity, after the most careful consideration of all alternatives, which may include tax reforms,[20] and only if they are duly justified by reference to the totality of the rights provided for in the Covenant in the context of the full use of the State party's maximum available resources (obligation to realize progressively economic, social, and cultural rights).[110]

Public spending must be structured in a way that it benefits mostly persons and groups in need. Despite great efforts of many States and the international community, redistributive policies all too often favor the haves rather than the have-nots, widening the income and wealth gap and making highly inefficient use of financial resources. For example, redistributions in the pension sector may increase inequality if they do not tackle the limited coverage of the system and/or benefit workers and pensioners with high income.[111]

2. *Crisis Response*

It cannot be stressed too often that any response to financial crises, in particular sovereign debt crises, must fully comply with human rights law. In her report, the former Independent Expert on human rights and extreme poverty, Magdalena Sepúlveda Carmona, has provided very detailed recommendations for such human rights compliant crises responses.[112] This

108. *See* the report of the Special Rapporteur on extreme poverty and human rights, Philip Alston, in which a thorough analysis of the linkages between social protection and human rights is provided, UN Doc. A/69/297); and Human Rights Council resolution 25/11.

109. Sec. 4, ILO Social Protection Floors Recommendation, 2012 (No. 202).

110. *See* Committee on Economic, Social and Cultural Rights, General Comment No. 3, 1990.

111. *See* A. NIETO RAMOS, EL EFECTO DE LAS PENSIONES SOBRE LA DESIGUADAD DE INGRESOS EN COLOMBIA (Bogotá, Universidad de los Andes, 2014). *See also* Asociación Civil por la Igualdad y la Justicia et al., *supra* note 20, at n. 16.

112. *See* UN Doc. A/HRC/17/34.

Article therefore focuses on highlighting only very few important aspects of relevance in the context of inequalities and financial crises.

Fiscal stability and GDP may not be the sole targets of adjustment, and adjustment may not overrule, suspend, or dilute existing human rights obligations and responsibilities. Preserving economic, social, and cultural rights—including the right to work and the rights to social security, health, housing, and education—must be a critical priority.[113] Socioeconomic inequalities must be fully taken into account when implementing crises response measures.

While certain spending cuts may be temporarily necessary, debtor and creditor (*"implementing"*) States must always provide evidence of the following:

(1) the existence of a compelling State interest; (2) the necessity, reasonableness, temporariness and proportionality of the austerity measures; (3) the exhaustion of alternative and less restrictive measures; (4) the non-discriminatory nature of the proposed measures; (5) protection of a minimum core content of the rights; and (6) genuine participation of affected groups and individuals in decision-making processes.[114]

In light of the evidence provided in this article, avoidance of exacerbating inequality should also be a limiting factor.

Austerity policies must ensure, to the extent possible, that social spending is the last and the least to be affected. To the extent possible, States should strongly focus on finding and creating progressive ways of increasing revenues. The protection of vulnerable groups must have the highest priority, which may call for exemptions from cuts or even the implementation of new social protection programs. The recent experiences of Iceland evidence that this approach is realistic and can yield fruitful results.

More specifically,[115] Iceland's adjustment program emphasized increasing revenue generation through taxation, while focusing to a lesser extent on public expenditure cuts. The reintroduction of a progressive income tax system helped to shelter the most vulnerable groups from the effects of the crisis. In addition, the flat tax on capital income was increased and a wealth tax was temporarily introduced to generate revenue. The only regressive tax measure was a one per cent increase in the value added tax from 24.5 to

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113. *See* the end-of-mission statement of the Independent Expert on Foreign Debt and Human Rights of his mission to Greece (December 8, 2015), *available at* www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=16852&LangID=E.

114. *See* the Report of the United Nations High Commissioner for Human Rights, UN Doc. E/2013/82 (May 7, 2013), para 15, laying out the criteria States should apply when considering the adoption of austerity measures, available at http://www.un.org/ga/search/view_doc.asp?symbol=E/2013/82; the Letter of the Chair of the Committee on Economic, Social and Cultural Rights addressed to States parties to the International Covenant on Economic, Social and Cultural Rights dated 16 May 2012; and a more comprehensive statement issued by the same Committee on Public debt, austerity measures and the International Covenant on Economic, Social and Cultural Rights, UN Doc. E/C.12/2016/1 (June 24, 2016), *available at* http://tbinternet.ohchr.org/_layouts/treatybodyexternal/Download.aspx?symbolno=E/C.12/2016/1&Lang=en, outlining obligations relating to borrowing and lending for States and international financial institutions and organizations.

115. See the report of the Independent Expert on Foreign Debt and Human Rights on his mission to Iceland, UN Doc. A/HRC/28/59/Add.1.

25.5per cent. On the whole, social benefits were directed to lower-income households, mainly by cutting maternal and parental leave entitlements. Disposable income fell across the entire society. The poorest 20 per cent of the population in Iceland lost around 9 per cent of their disposable income between 2008 and 2010. In contrast, 10 per cent of the wealthiest households that had accumulated assets during the boom years of the bubble economy lost 38 per cent of their income. Social transfers and taxation policies reduced inequality in Iceland significantly. They also helped to stabilize internal demand, as the citizens with lower incomes spent a much higher percentage of their funds on goods and services.[116]

Crises responses, including any agreements between creditors and debtor States, should comply with the principles of transparency, accountability, and participation. Structural adjustment measures should be subjected to robust human rights impact assessments, both before the implementation and at regular intervals after. Both creditors and debtors must honor their human rights obligations and responsibilities in their response to debt crises. This may include agreeing on sufficient debt relief in order to avert human rights violations the growth of severe economic inequality. [117]

The principles referred to in the previous paragraph are considered to be building blocks of an emerging set of principles to frame debt restructurings,[118] and debt sustainability is intrinsically linked to minimum levels of equality. Therefore, inequality should be given the utmost consideration in debt workout negotiations and judicial decisions relating thereto, not only to prevent further human rights violations in the context of ongoing debt crises but also to avert their recurrence.

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116. *See* Stefán Ólafsson, *The Icelandic Way Out of the Crisis: Welfarism, Redistribution and Austerity* (Social Research Centre, University of Iceland, Working Paper No. 1, 2012); and Bruno Martorano, *Is it possible to adjust 'with a human face'? Differences in fiscal consolidation strategies between Hungary and Iceland* (UNICEF Office of Research Working Paper, WP-2014-No. 03, 2014).

117. See the report of the Independent Expert on Foreign Debt and Human Rights submitted to the General Assembly in 2015, UN Doc. A/70/275.

118. *See* The UN the Guiding Principles on Business and Human Rights (2011); UN Guiding Principles on Foreign Debt and Human Rights (2012); UNCTAD Principles on Responsible Sovereign Lending and Borrowing (2012); the UNCTAD Roadmap and Guide on Sovereign Debt Workouts (2015); and the UN Basic Principles on Sovereign Debt Restructuring Processes (2015).

Can Parallel Lines Ever Meet? The Strange Case of the International Standards on Sovereign Debt and Business and Human Rights

Daniel D. Bradlow*

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INTRODUCTION

Sovereigns have a long history of defaulting on their debts.[1] Despite the bitter lessons learned through this history, the international community has not yet developed an effective method for dealing with these events. There is not a single forum or mechanism that is mandated to help the debtor and all its creditors develop a comprehensive plan for resolving its debt crisis. Instead the debtor is usually required to negotiate in different forums with each of its different categories of creditors. There are no formal mechanisms of coordination between these different sets of negotiations even though their individual outcomes are affected by what happens in the other negotiations as each group of creditors seeks to ensure that it is not being treated unfairly by

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1. CARMEN M. REINHART AND KENNETH ROGOFF, THIS TIME IS DIFFERENT: EIGHT CENTURIES OF FINANCIAL FOLLY (2009).

the debtor. As a result, each sovereign's debt restructuring process is likely to be conflict ridden, inefficient and to have a high probability of resulting in a sub-optimal outcome. In fact, the risk of sub-optimal outcomes has increased as financial markets have become larger and more globalized so that sovereign debtors—at least those with access to financial markets – are able to borrow from a broader range of creditors.

One consequence is that sovereign debt restructurings (SODRs), as can be seen from the cases of Greece[2] and Argentina,[3] are difficult, often traumatic, experiences for the sovereign debtors and their populations and frustrating and potentially costly for their creditors. It is invariably the case that in a SODR, the sovereign, because it either has lost access to financing or can only obtain it on more expensive terms, will be forced to reduce its expenditures in order to try and meet its existing debt obligations. This means that it is entirely foreseeable that the sovereign's debt problems will have a range of adverse economic, social and political impacts[4] in the debtor country. It is also likely that the creditors will suffer financial losses due to the costs associated with the renegotiation of their credit transactions with a sovereign borrower in difficulty. There may also be losses associated with the delayed or reduced interest payments, and possibly reduced principle repayments that result from the SODR.

The SODR therefore carries a high risk of having adverse human rights impacts on at least some of the stakeholders in the SODR. These impacts can include less access to health services, education services and other social services as funding for these services are reduced; loss of access to justice as spending on police, courts and legal services are cut; and job losses.[5] On the creditor side, depending on the size of the loss and the identity of the ultimate holders of the debt, the SODR can result in job losses for the creditor's employees or the loss of savings and income for pensioners and other bondholders of modest means.[6] The net effect of these potential impacts is that

2. Truth Committee on Greek Public Debt: *Preliminary Report* (June 18, 2015), *available at* http://cadtm.org/Preliminary-Report-of-the-Truth; Margot E. Salomon & Olivier De Schutter, *Economic Policy Conditionality, Socio-Economic Rights and International Legal Responsibility: The Case of Greece 2010-2015* (Legal Brief prepared for the Special Committee of the Hellenic Parliament on the audit of the Greek Debt, 2015); U.N. Human Rights Council, Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights on his mission to Greece, A/HRC/31/60/Add.2 (Feb 29, 2016).

3. Brad Setser & Anna Gelpern, *Pathways Through Financial Crisis: Argentina*, 1 GLOBAL GOVERNANCE: A REVIEW OF MULTILATERALISM AND INTERNATIONAL ORGANIZATIONS 465 (2006).

4. Sovereign debt crises also can have substantial adverse environmental and social effects. However since the focus of this article is on the human rights impacts of these crises, the environmental consequences will not be discussed. It should be noted, however, that these environmental consequences can have human rights implications and to this extent fall within the ambit of this article.

5. Truth Committee on Greek Public Debt, *supra* note 2; The Inspection Panel Report on ARGENTINA–SEGBA V Power Distribution Project (Loan No. 2854 – AR), *available at* http://siteresources.worldbank.org/EXTINSPECTIONPANEL/Resources/ParaguayEligibilityReportwannexes.pdf; ECtHR: *Koufaki and Adedy v Greece*, Appl. Nos. 57665/12 57657/12, *available at* http://hudoc.echr.coe.int/app/conversion/pdf/?library=ECHR&id=002-7627&filename=002-7627.pdf; Abaclat et al. v. Argentine Republic, ICSID case number ARB/07/5, Decision on Jurisdiction and Admissibility (Aug 4, 2011), *available at* http://www.italaw.com/sites/default/files/case-documents/ita0236.pdf.

6. Jessica Beess und Chrostin, *Sovereign Debt Restructuring and Mass Claims Arbitration*

SODRs will involve a struggle between the debtor and its creditors and amongst the different stakeholders on both the creditor and debtor sides to avoid having to bear more than their fair (as they define it) share of the financial losses and to mitigate the economic, financial, social, human rights and political consequences of the SODR.

Given these high stakes, it is not surprising that efforts have been made over the past 70 years to improve the process. One recent manifestation of this effort has been the promulgation of a number of international norms and standards that either explicitly or implicitly are applicable to SODRs. These include norms and standards that are expressly designed to improve the efficiency of the sovereign debt negotiation and renegotiation processes such as the Institute for International Finance's (IIF),[7] "Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets", and the United Nations Conference on Trade and Development's (UNCTAD) "Principles on Responsible Sovereign Lending and Borrowing",[8] and "Sovereign Debt Workouts: Roadmap and Guide" (Roadmap)[9] and the UN's Guiding Principles on Foreign Debt and Human Rights.[10]

Interestingly, the documents dealing with the SODR process all recognize that SODRs have substantial social and political effects in addition to their financial and economic consequences. In fact, they all appear to accept that the parties to the SODR will need to take these impacts into account in arranging a sustainable SODR. However, they do not provide detailed guidance to the parties on how they should deal with these social and political impacts in negotiating and agreeing on a sustainable SODR. Except for the UN Guiding Principles on Foreign Debt and Human Rights and the UNCTAD Roadmap, which does so briefly, they do not discuss the human rights impacts of SODRs. This is surprising given the norms and standards that companies and states have developed for dealing with the social responsibilities, including in regard to human rights, of businesses. These norms and standards include the UN's Guiding Principles on Business and Human Rights (UNGPs),[11] the Global

before the ICSID: The Abaclat Case, 53 HARV. INT'L LJ 505 (2012); Stacie I. Strong, *Rogue Debtors and Unanticipated Risk*, 35 U. PA. J. INT'L L. 1139 (2013).

7. Institute of International Finance, *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets* (March 31, 2005), *available at* https://www.iif.com/topics/principles-stable-capital-flows-and-fair-debt-restructuring; Institute of International Finance, *PCG Report on Implementation of the Principles* (2015), *available at* https://www.iif.com/news/capital-markets-and-emerging-markets-policy/2013-pcg-report-implementation-principles. See *infra n*otes 34-38 and accompanying text for discussion of these Principles.

8. UNCTAD, Principles on Promoting Responsible Sovereign Lending and Borrowing, UNCTAD/GDS/DDF/2012/Misc.1 (Jan 10, 2012), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf. *See infra* notes 39-50 and accompanying text for discussion of these Principles.

9. UNCTAD, *Sovereign Debt Workouts: Going Forward. Roadmap and Guide* (2015), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf; see *infra* notes 51-56 and accompanying text for discussion of the Roadmap.

10. Annex to Resolution 20/10 of the U.N. Human Rights Council, The Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of All Human Rights, particularly Economic, Social and Cultural Rights, U.N. Doc. A/HRC/RES/20/10 (July 18, 2012).

11. UNITED NATIONS OFFICE OF THE HIGH COMMISSIONER FOR HUMAN RIGHTS, GUIDING PRINCIPLES ON BUSINESS AND HUMAN RIGHTS, U.N. DOC. HR/PUB/11/04, *available at* http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.

Compact,[12] the OECD Guidelines on Multinational Enterprises[13] and ISO 26000.[14]

The seeming disconnect between the developments related to the SODR process and to business and human rights is intriguing, particularly because many of the world's most significant financial institutions have publically available human rights policies that, at least *prima facie,* are applicable to all their business operations and relations.[15] Moreover, given the scope of their operations, they are likely to be creditors in at least some SODRs. In addition, the human rights implications of SODRs are sufficiently predictable, profound and adverse that one would expect that these institutions, if they take their own human rights policies seriously, would try and ensure that the SODRs in which they participate conform to their own human rights policies and to the international standards dealing with human rights and business, which are often referenced in those policies.

The disconnect between these two developments raises at least two questions. First, should the human rights and business standards be applied to the SODR process. Second, if they should be applied to the SODR process, how should they be applied?

The primary purpose of this article is to answer these two questions. This exercise serves three purposes. First, it will enable us to see if these human rights and business standards can add value to SODRs in the sense of reducing their human rights costs without unduly increasing their financial costs. Second it will provide some additional insight into how easily human rights law can be adapted to financial transactions specifically and to business more generally. Third, this exercise might help us better understand how to plug the gap in global economic governance that allows different actors in global governance to develop international standards on SODR and on business and human rights on parallel tracks that do not seem to communicate with each other.

The consideration of these issues leads to three conclusions. First, SODRs would benefit from the incorporation of business and human rights standards. These standards would help SODRs reach outcomes that produce fewer and/or less severe adverse human rights impacts. This, in turn, should improve the legitimacy of the SODR outcome, thereby facilitating its implementation and enhancing its sustainability to the benefit of all parties to the SODR. Second the application of the UNGPs to SODRs indicates that the subject of business and human rights poses a challenge for human rights law. The reason is that the way in which human rights issues arise in the business context is often different from the way in which they arise in the relationship between the state and its citizens. As a

12. U.N. Global Compact, *The Ten Principles of the Global Compact* (Jan 31, 1999), *available at* https://www.unglobalcompact.org/what-is-gc/mission/principles, see *infra* notes 83-88 and accompanying text for discussion of the Global Compact.

13. OECD, Guidelines for Multinational Enterprises (May 25, 2011), *available at* http://www.oecd.org/daf/inv/mne/48004323.pdf, see *infra* note 82 and accompanying text for discussion of these Guidelines.

14. ISO 26000 Guidance to Social Responsibility (Nov 1, 2010), *available at* https://www.iso.org/obp/ui/#iso:std:iso:26000:ed-1:v1:en, see *infra* note 89-91 and accompanying text for discussion of ISO 26000.

15. See, *infra*, notes 100-109 and accompanying text for discussion of the human rights policies of the major international banks.

result, the jurisprudence on the application of human rights principles in the latter context cannot simply be transposed without adjustments into the former context. However, we do not yet have the knowledge or experience to fully understand the nature and type of adjustments that are needed for this transposition to be effective. Third, the article will conclude that the lack of coordination between the international standards applicable to SODRs and those applicable to the human rights responsibilities of creditors is a symptom of a coordination problem in global economic governance. One consequence of which is an over-emphasis on financial and economic considerations in complex financial transactions like SODRs.

In order to make this case, this article is divided into five sections. The first section will provide a brief overview of the key characteristics of the SODR process that are relevant to understanding the human rights impacts of these transactions. The second section will describe the various international norms and standards applicable to SODRs. The third section will describe the primary international standards applicable to the issue of business and human rights. The fourth section will consider the applicability of the UNGPs to SODRs. The final section is the conclusion.

I. SOME RELEVANT CONSIDERATIONS REGARDING THE SODR PROCESS

The purpose of this paper is to focus on how sovereign debtors and financial institutions that extend credit to them currently deal with human rights issues in SODRs. It is not to give a comprehensive overview of SODRs.[16] In order to place the issue of SODR's human rights impacts in context, the focus of this section is on the planning and negotiating process in SODRs. It will not discuss in any detail the role that international financial institutions like the IMF or bilateral creditors play in the SODR process,[17] the many financial and economic factors that may influence the ultimate results of the SODR process or the many important contractual issues that can arise in SODRs.[18]

In order to place the points made below in context it is useful to give a brief overview of the current approach to the SODR process. The usual SODR involves a number of different debtor-creditor negotiations. The debtor will negotiate with its official bilateral creditors in the Paris Club, an informal forum, housed within the French Treasury.[19] It is possible that there may be

16. *See generally* SOVEREIGN DEBT MANAGEMENT (Rosa M. Lastra and Lee C. Buccheit eds., 2014) (providing an overview of the legal and other issues involved in SODRs).

17. It should be noted that the multilateral development banks and bilateral official creditors can be important actors in many SODRs, particularly in the case of low income countries.

18. Steven L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 CORNELL L. REV. 956 (2000); Matthias Goldmann, *Human Rights and Sovereign Debt Workouts, in* MAKING SOVEREIGN FINANCING AND HUMAN RIGHTS WORK 79 (Juan Pablo Bohoslavsky & J. Letnar Cernic eds., 2014); Steven L. Schwarcz, *Sovereign Debt Restructuring Options: An Analytical Comparison*, 2 HARV. BUSINESS L. REV. (2012); Francois Gianviti et al., *A European Mechanism for Sovereign Debt Crisis Resolution: A Proposal,* BRUEGEL BLUEPRINT SERIES (2010), *available at* http://bruegel.org/wp-content/uploads/imported/publications/101109_BP_as_jpf_jvh_A_European _mechanism_for_sovereign_debt_crisis_resolution_a_proposal.pdf.

19. The Paris Club, which is informal in the sense that it has no independent legal identity, is a grouping of official creditors who meet with sovereign debtors in difficulty to renegotiate their debts to

some official creditors who are not part of the Paris Club and with whom the debtor will need to negotiate separately.

The sovereign debtor will negotiate with its commercial creditors in one or more forums.[20] For example, it may negotiate with its bond holders in one forum, often informally referred to as "the London Club", its commercial bank creditors in a separate forum and with companies to whom it has outstanding debts on goods and services that it has purchased or to whom it owes payments for items such as royalties or dividends in another forum, in which the various companies either participate collectively or in sub-groups or it may negotiate with them individually. The creditors in these different forums are likely to seek to ensure, at least to the extent of their bargaining power, that the debtor treats them all more or less equivalently.[21] It is also possible that the agreements reached in some of these negotiating forums are not comprehensive in the sense that not all creditors eligible to participate in the particular forum sign the agreement reached in that forum. In this case, the debtor can be forced into a second set of negotiations, or, for example as happened in Argentina,[22] into litigation with these disgruntled creditors. In most circumstances the multilateral official creditors of the debtor, such as the multilateral development banks or the International Monetary Fund, do not participate as creditors in the SODR.[23] The reason for this is that by custom they have preferred creditor status and so their debts are not included in the SODR.[24] Their contribution to the SODR process typically is to provide financial and technical support to the sovereign debtor during the SODR.

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these official creditors. The creditors and the debtor agree, in an Agreed Minute, on the general terms on which all qualifying official debts shall be renegotiated. Each official creditor then concludes its own bilateral agreement with the sovereign debtor based on the terms in the Agreed Minute. There are currently 20 countries whose official financial agencies, such as their export credit agencies and their aid agencies, participate as permanent participants in the Paris Club. Other countries and their agencies can participate on an *ad hoc* basis in the negotiations for a particular debtor country. See generally http://www.clubdeparis.org; MARTIN A. WEISS, CONG. RESEARCH SERV., RS21482, THE PARIS CLUB AND INTERNATIONAL DEBT RELIEF (2004); THOMAS CALLAGHY, INNOVATION IN THE SOVEREIGN DEBT REGIME: FROM THE PARIS CLUB TO ENHANCED HIPC AND BEYOND (2004).

20. Raman Uppal & Cynthia Van Hulle, *Sovereign Debt and the London Club: A Precommitment Device for Limiting Punishment for Default*, 21 JOURNAL OF BANKING & FINANCE 741 (1997); Giovanni Vitale, *Multilateral Sovereign Debt Restructuring: the Paris Club and the London Club, in* CRISIS? WHAT CRISIS? ORDERLY WORKOUT FORS SOVEREIGN DEBTORS 122 (Barry Eichengreen & Richard Portes eds., 1995); Udaibir Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* (International Monetary Fund Working Paper WP/12/203, 2012).

21. SOVEREIGN DEBT MANAGEMENT, supra note 16; Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L. J. 1317 (2002); Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L. J. 869 (2004); Gregory Makoff & Robert Kahn, *Sovereign Bond Reform – Implementing the New ICMA Pari Passu and Collective Action Clause* (CIGI Papers, 2015), *available at* https://www.cigionline.org/sites/default/files/cigi_paper_no_56.pdf.

22. NML Capital, Ltd. v. Argentina, No. 08 Civ 6978 (TPG) (S.D.N.Y. Feb. 23, 2012) (granting preliminary injunction); NML Capital, Ltd. V. Argentina, 699 F.3d 246, 264 (2d Cir. 2012); NML Capital, Ltd. v. Argentina, No. 08 Civ 6978 (TPG), 2012 U.S. Dist. LEXIS 167272 (S.D.N.Y. Nov. 21, 2012); Elliott Associates, L.P. v. Republic of Peru 12 F. Supp. 2d 328 (S.D.N.Y. 1998).

23. Emine Boz, *Sovereign Default, Private Sector Creditors, and the IFIs*, 83 J. OF INT'L ECONOMICS 70 (2011). It should be noted that there have been occasions, for example during the HIPC initiative, in which these institutions did agree to participate as creditors and to reduce the debt owed to them by their sovereign borrowers.

24. William Wilson Bratton & G. Mitu Gulati, *Sovereign Debt Restructuring and the Best Interest of Creditors*, 57 VANDERBILT L. REV. 1 (2010).

There are a few points that need to be highlighted in order to understand the treatment of human rights issues in the SODR process:

First, the creditors maintain that the sovereign freely assumed its debt obligations and promised to meet all its promises in regard to repayment. The fact that it is no longer living up to its promises, particularly when it has financial resources available,[25] is a choice for which it and its citizens must accept the consequences. From the creditors' position, this is not unfair because the debtor broke its promise to repay and there is no reason why the creditor and its stakeholders should have to bear the cost of this breach of its obligations. On the other hand, the citizens of the debtor country may contend that they were not expressly consulted by their government about the debts and the risks associated with taking on those debts. Consequently, they may not understand why they, rather than the creditors who did assume the risks associated with making the loan, should be expected to make sacrifices in order to meet the demands of the creditors.

Second, as indicated above, there is no formal independent mechanism that sovereign borrowers and their financial institution creditors can utilize during a SODR. This means that there is no third party entity that can help the sovereign debtor and the creditors reach a mutually acceptable agreement and then monitor and enforce the SODR.[26] Instead, the parties have to form and manage their own negotiating forums. Thus, the overall outcome of the negotiations in each of these forums and of the overall SODR is likely to depend on the relative bargaining power of the parties and their need to reach an agreement without any offsetting third party to try and ensure some balance in the negotiations. The uncertainty resulting from the sovereign's inability to fully service its debts gives both parties an incentive to reach agreement as quickly as possible. However, normally the sovereign has a greater need to resolve its situation than its creditors. This reality tilts the balance of bargaining power, in most SODRs, in favor of the creditors.[27]

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25. In most cases the sovereign debtor will have some financial resources, although not enough to meet all its financial commitments. Consequently, the creditors will contend that the decision not to meet its debt obligation is a choice in the sense that it is deciding to allocate its funds for purposes other than debt servicing.

26. The international community has periodically attempted to establish such a third party mechanism. See generally, Martin Guzman, José A. Ocampo & Joseph E. Stiglitz, *Creating a Framework for Sovereign Debt Restructuring that Works, in* TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES (Martin Guzman et al. eds., 2016). There have been two such efforts this century. See Eric Helleiner, *The Mystery of the Missing Sovereign Debt Restructuring Mechanism*, 27 CONTRIBUTIONS TO POLITICAL ECONOMY 91-113 (2008). In the early 2000s, the International Monetary Fund (IMF) explored the feasibility of creating a sovereign debt restructuring mechanism and concluded that it was not possible. See Anne O. Kreuger, *A New Approach to Sovereign Debt Restructuring* (IMF, 2002), *avaiable at* http://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf. More recently, the United Nations General Assembly passed a resolution calling for the creation of such a mechanism. This effort has resulted in a set of U.N. principles to guide the structuring of such a mechanism and a working group to consider its creation but not in an actual agreement to establish such a mechanism. See G.A. Res. 69/319 (Sept. 29, 2015), *available at* http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/69/319.

27. The IMF has indicated that in some cases it will be willing to lend into arrears, which may restore some balance to the distribution of bargaining power. See generally, IMF, *Policy on Lending into Arrears to Private Creditors* (June 14, 1999), *available at* https://www.imf.org/external/pubs/ft/privcred/lending.pdf; IMF, *Fund Policy on Lending into Arrears to Private Creditors—Further Consideration of the Good Faith Criterion* (July 30, 2002), *available at*

In light of the failure to reach agreement on the establishment of a formal independent sovereign debt restructuring mechanism,[28] the international community has used two different approaches, which are not mutually exclusive, to try and improve the SODR process. One strategy has been to adjust the contractual arrangements between debtors and creditors so that they provide for more efficient SODRs. The primary fruits of these efforts are the incorporation of collective action clauses and revised *pari passu* clauses in sovereign debt financing agreements.[29] The collective action clauses make it harder for small groups of recalcitrant creditors to block SODR agreements between the debtors and creditors. The revised *pari passu* clauses are intended to reduce the chances for success of claims like those made by the hold out creditors in the Argentinian litigation.[30] The second approach has been to develop standards that are designed to establish more efficient ground rules for the negotiation and renegotiation of sovereign debt. This second approach is discussed in detail in the next section of this paper.

Third, the balance of bargaining power is also affected by the fact that both parties understand that the borrower's situation is likely to continue deteriorating until an agreement is reached. Consequently, delay in reaching an agreement may increase the potential costs of the SODR to both creditors and debtor. This places both parties under time pressure and it inevitably means that any requirement that the parties collect new data in order to gain new insights and a better understanding of the borrower's situation has a cost for all stakeholders in the SODR. It thus creates a disincentive for the parties to add new steps to the SODR process, even if they do result in a more informed SODR outcome.

Fourth, by definition, in a SODR, the sovereign debtor does not have enough financing to meet all its financial commitments.[31] This does not necessarily mean that the sovereign has no foreign exchange. In fact, in most cases the sovereign will have access to some financing but probably not enough to meet all its commitments to its citizens and its creditors. The result is that it

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https://www.imf.org/external/pubs/ft/privcred/073002.pdf; IMF, *Sovereign Debt Restructuring – recent developments and implications for the fund's legal and policy framework* (Apr 26, 2013), *available at* http://www.imf.org/external/np/pp/eng/2013/042613.pdf.

28. See *supra* note 26.

29. Lee C. Buchheit et al., *supra* note 21; Skylar Brooks & Domenico Lombardi, *Governing Sovereign Debt Restructuring Through Regulatory Standards*, 6 JOURNAL OF GLOBALIZATION AND DEVELOPMENT 287 (2016); Roberto Blanco, Simon Brennan & Ian W. Marsh, *An Empirical Analysis of the Dynamic Relation between Investment Grade Bonds and Credit Default Swaps*, 60 THE JOURNAL OF FINANCE 2255 (2005); Lee C. Buchheit & Jeremiah S. Pam, *supra* note 21.

30. *See supra* note 22.

31. The tight constraints within which the sovereign has to make these choices are loosened to the extent that it can obtain foreign exchange from international financial institutions such as the IMF and the MDBs. However, these resources come at a price. The price is paid partially in terms of the conditionalities that the IFIs attach to their funding, which, in turn, impact on the sovereign's choices in how to allocate its foreign exchange. Once again these choices have social and human rights impacts. The issue of the IFI's human rights responsibilities is outside the scope of this paper but see, e.g., Daniel D. Bradlow, *World Bank, the IMF, and Human Rights* 6 TRANSNATIONAL LAW AND CONTEMPORARY PROBLEMS 47 (1996); MAC DARROW, BETWEEN LIGHT AND SHADOW: THE WORLD BANK, THE INTERNATIONAL MONETARY FUND AND INTERNATIONAL HUMAN RIGHTS LAW (2003). See generally, INTERNATIONAL FINANCIAL INSTITUTIONS & INTERNATIONAL LAW (Daniel D. Bradlow & David B. Hunter eds., 2010).

must make choices about how to allocate its available funds. These choices inevitably have human rights impacts that raise challenges for the sovereign's own human rights obligations. To the extent that the choices are influenced by negotiations with the creditors, these choices will also have implications for the human rights responsibilities of the commercial creditors.

Historically, all the parties to the SODR process have maintained, at least in a formal sense, that the decision of how to allocate the sovereign's limited financial resources is the prerogative of the sovereign debtor. This decision is perceived to relate to its responsibilities as a sovereign and it is a decision for which it is accountable to its citizens. The commercial creditors should respect the decision regardless of whether they think it is a wise decision or is consistent with the human rights obligations of the borrower.[32] This follows from the creditors' obligation to obey all the applicable law in the debtor state and to respect its sovereignty. Within the constraints of these obligations, the creditors are free to negotiate any SODR with the borrower that they deem acceptable.

Given the realities of the balance of bargaining power between the parties in an SODR, it is not tenable to maintain that this decision is purely a sovereign prerogative. The outcome of the debt renegotiation is a mutually bargained and agreed arrangement, in which both parties, in fact, have little choice other than to reach some sort of agreement. Moreover since the choice of how the sovereign allocates its limited foreign exchange has implications for the success of the SODR, it is not credible to maintain that the creditors merely passively accept the decision of the debtor and try to negotiate for the best possible deal within the constraints of this sovereign decision. Their negotiating strategy inevitably and intentionally influences the sovereign's decision on how it allocates its limited foreign exchange. This suggests that the responsibilities for the human rights impacts of the agreement should be attributed to both parties. It is not reasonable for the financial institutions to place all the responsibility for the human rights impacts of the agreement on the borrower. This is particularly the case when the creditors are able to block the sovereign debtor's access to international financial markets until an agreement is reached.

Fifth, historically the commercial creditors have used their bargaining power to exclude certain concerns of the sovereign from the ambit of the negotiations. For example, the creditors might not accept as relevant to their SODR negotiations claims by the sovereign that its responsibilities to provide their citizens with adequate food and medicine imports should have a higher priority than payment of commercial creditors.[33] This view, as long as it can be enforced by the creditors through their bargaining power, can result in the creditors demanding and receiving a larger share of the available foreign exchange than would have been the case if these other issues had been treated

32. *See generally*, Daniel D. Bradlow, *Differing Conceptions of Development and the Content of International Development Law,* 21 SOUTH AFRICAN JOURNAL ON HUMAN RIGHTS 1 (2005); Robert McCorquodale & Penelope Simons, *Responsibility Beyond Borders: State Responsibility for Extraterritorial Violations by Corporations of International Human Rights Law*, 70 THE MODERN LAW REVIEW 598 (2007).

33. Julius Nyerere, "Should we really let our people starve so we can pay our debts?" THE GUARDIAN, Mar. 21, 1985.

as valid considerations within the context of the SODR negotiations. The result can be to exacerbate the adverse human rights impacts of the SODR agreement.

Sixth, the creditors often argue that, while they understand that the proposed SODR outcome will cause the sovereign and its citizens pain, the situation would be worse if the sovereign does not pay them what they are asking. The reason is that, in the absence of the proposed agreement, the sovereign risks being frozen out of international financial markets for an unduly long period of time. Ultimately, they contend, this will cause the pain of the SODR to last for a longer period and to affect more people, than would otherwise have been the case. In short, they argue, at least by implication, that although the deal they are offering is painful for the sovereign and its subjects it will cause fewer and smaller adverse human rights impacts over time than will the more generous deal the sovereign is demanding.

The validity of the creditors' argument depends on a range of assumptions about how financial markets and the other stakeholders in the SODR will react if the creditors' proposals are adopted. In principle it is possible for the parties to assess the potential consequences of the creditors' proposals and their impacts on the various stakeholders in the SODR. However, it is not easy to do so, particularly when the assessments must be done under time pressure. This means that any *ex ante* assessments are likely to be based on imperfect and incomplete information.

Seventh, the SODR will be complicated by the fact that there is a bargaining process that takes place among the different stakeholders on the debtor side. In this process, for example, the different stakeholders in the debtor society will bargain with each other and the state over how to allocate the costs of the SODR. The most likely outcome of this process is that the more powerful stakeholders in the debtor state will use their power and influence to minimize the adjustment burden that they have to bear and to shift the burden onto weaker, and usually poorer stakeholders. This increases the likelihood that the SODR will have substantial adverse human rights consequences.

Given the stakes in these internal negotiations, all the domestic stakeholders are likely to use whatever allies they have both within the debtor state and among other stakeholders in the SODR to improve their bargaining positions. The various groups of creditors risk being drawn into this domestic negotiation and, regardless of their responses, having an impact on the outcome of the domestic negotiations and thereby on the overall SODR outcome. This suggests that the historical view that the decision on how to allocate the pain of the SODR decision is purely the prerogative of the sovereign, at best, elevates form over substance. The creditors will inevitably exert influence over these decisions, regardless of how well they may camouflage this reality behind legal formalities.

This raises the question of what consequences should follow from the fact that they are implicated in the decision. Increasingly, the international community is indicating that it expects the commercial creditors to behave responsibly, including in human right terms, in their lending decisions. The international community has developed one set of standards for guiding financial institutions in regard to their conduct in the SODR process and

another set in regard to their responsibilities for the human rights impacts of their transactions. These two sets of standards are discussed in the next two sections of the paper.

II. International Norms and Standards Applicable to Sovereign Debt Workouts

The most significant international standard specifically dealing with SODRs, given that most of the major international banks are members of the IIF[34] and are creditors in sovereign debt transactions, is the IIF's Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets.[35] This document seeks to establish SODR processes that are based on ". . . shared information, are conducted in good faith, and seek to achieve a fair outcome for all parties".[36] It stipulates four principles that should guide the SODR—transparency and timely flow of information, close debtor-creditor dialogue and cooperation to avoid restructuring, good faith actions, and fair treatment.[37] The IIF's elaboration on these principles states that the debtor should implement policies that promote macro-economic stability, sustainable growth and market confidence, that the SODR is a voluntary process of good faith negotiations that should respect the sanctity of contract, and that the debtor should avoid discriminating among its creditors. The IIF contends that a process based on its principles maximizes the likelihood that the debtor will regain market access "as soon as possible under sustainable macroeconomic conditions".[38] It is important to note that the Principles include no reference to the responsibilities of the creditors to respect the human rights of the citizens of the debtor country. In fact, the Principles do not suggest that the creditors have any responsibility to take the likely impact of their actions on these citizens into account in their negotiating and decision making process.

Another applicable standard is UNCTAD's Principles on Responsible Borrowing and Lending. [39] These principles seek to offer guidance to both sovereign borrowers and their creditors on how they can behave responsibly in both planning and implementing their financial transactions. They make clear that the sovereign debtor and its creditors share responsibility for ensuring that the sovereign's debts are sustainable.[40] The UNCTAD Principles stipulate, inter alia, that the lender should recognize that the government officials involved in sovereign borrowing have a responsibility to protect the public interest;[41] that the lender should make a realistic assessment of the borrower's capacity to service the loan based on the best available information and due diligence;[42]

34. According to the IIF's website, "[t]he Institute of International Finance is the global association of the financial industry, with close to 500 members from 70 countries." Available at: https://www.iif.com/about (last visited April 14, 2016).

35. *Supra* note 7.

36. *Id*., Principle 11.

37. *Id*.,13-16.

38. *Id*., 11.

39. UNCTAD, *supra* note 8.

40. *Id*., see Preamble at 4.

41. *Id*., Lender Principle 1.

42. *Id*., Lender Principle 4.

and that any debt restructurings should be based on good faith and a cooperative spirit to reach a consensual arrangement as quickly as is feasible.[43] The lenders also have a responsibility, in the specific context of project financing to conduct adequate social and environmental impact assessments that are proportional to the technical expertise of the lender and the size of the debt.[44]

The UNCTAD Principles stipulate that sovereign borrowers have complimentary responsibilities. Thus, governments have a responsibility to protect the interests of their citizens in their financial transactions;[45] they should honor their financial obligations;[46] they should be transparent in their obligations, including to their own citizens;[47] they should avoid over-borrowing and should manage their debts responsibly[48] and debt restructurings should be undertaken promptly, efficiently and fairly.[49] In the specific case of project finance, sovereign borrowers also have an obligation to undertake *ex ante* social and environmental impact assessments and should make their results public.[50] It is interesting to note that these Principles do not explicitly make reference to either the human rights obligations of the sovereign borrower or to the human rights responsibilities of the lenders.

UNCTAD has also issued the Roadmap for sovereign debt workouts.[51] It provides an overview of the shortcomings with the current SODR arrangements, a set of principles to guide SODRs, and recommendations on how the SODR process can be reformed. In its discussion of the short-comings with the current process it highlights the fragmented and uncoordinated nature of the current process, the fact that the process cannot guarantee a fair outcome for either the debtor or its creditors and that the process is inefficient and may result in an outcome that is "too little too late". It suggests furthermore that the process could be improved if it was based on a common set of principles.[52] These would ensure that the process is legitimate, impartial, transparent, conducted in good faith, and aimed at producing a sustainable outcome.[53] Importantly a sustainable outcome is defined as one that is based on a SODR process that is efficient, produces a debt situation that does not "lead to violations of economic or social rights or prevent the attainment of internationally agreed development goals".[54] The Roadmap's concern with human rights is indicated in Section 4 of the document, which deals with restructuring terms and post-restructuring issues. In its discussion of its recommendations regarding sustainability, the Roadmap states that

43. *Id*., Lender Principle 7.
44. *Id*., Lender Principle 5.
45. *Id*., Borrower Principle 8.
46. *Id*., Borrower Principle 9.
47. *Id*., Borrower Principles 10 and 11.
48. *Id*., Borrower Principles 13 and 14.
49. *Id*., Borrower Principle 15.
50. *Id*., Borrower Principle 12.
51. UNCTAD, *supra* note 9.
52. *Id*., Section 3: The Sovereign Debt Workout Principles 19-24.
53. *Id*.
54. UNCTAD, *supra* note 9, Principle 5 at 24.

sustainability is a holistic concept and thus "requires going beyond merely economic considerations" and stipulates that "[r]espect for human rights, particularly socio-economic rights, and political risks need to be taken into account".[55] In addition, the Roadmap, in its recommendations for dealing with uncooperative creditors, suggests that the debtor should not agree to any terms that would violate the "economic and social rights of citizens in the debtor state".[56]

It is important to note that the Roadmap provides no guidance on how the parties should implement these recommendations on human rights. In addition, the Roadmap focuses on social and economic rights and does not specifically discuss civil, political and cultural rights. It also makes no specific reference to any international human rights treaties. This is noteworthy because the international instruments dealing with business and human rights make clear that the responsibilities of businesses extend to all human rights and are not limited to specific categories of rights. This observation is also applicable to SODRs which, like any business transaction, can implicate the full range of human rights. Finally, it should be noted that the Roadmap, even though it was issued in 2015, makes no reference to the UNGPs.

In 2011, the United Nations Human Rights Council endorsed the Guiding Principles on Foreign Debt and Human Rights (HRC Guiding Principles).[57] These principles are designed to balance the contractual obligations of debtors and creditors arising from their external debt arrangements and their obligations to respect human rights.[58] The HRC Guiding Principles establish foundational principles for dealing with foreign debt and human rights that include the following:[59]

- ensuring the primacy of human rights—all states have the obligation to respect, protect and fulfill the human rights of their populations and all private corporations have the responsibility to respect human rights;
- equality and non-discrimination—states have an obligation to design and implement policies and programs that promote a "more equitable and non-discriminatory distribution of benefits. . ."[60] and should conduct impact analyses to promote this principle, particularly in regard to vulnerable groups in society;[61]
- progressive realization of rights—states are obliged to ensure that their external debt arrangements "do not hinder the progressive realization" of human rights and non-state lenders must ensure

55. UNCTAD, *supra* note 9, at 54.

56. *Id*., at 59.

57. U.N. Human Rights Council: Guiding principles on foreign debt and human rights, annexed to the Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephas Lumina, U.N. Doc. A/HRC/20/23 (April 10, 2011).

58. *Id*., Section 1 paragraph 2.

59. *Id*., Section II.

60. *Id*., paragraph 12.

61. *Id*., paragraphs 11-14.

that their debt contracts with states respect human rights;[62]

- minimum core obligations—states must ensure that their external debt obligations do not derogate from their obligations to provide "minimum essential levels of economic social and cultural rights;[63]
- non-retrogression—states should ensure that their external debt repayment obligations do not lead to them adopting measures that impair advancements of economic social and cultural rights.[64]

The HRC Guiding Principles also include a set of operational principles, which require the state to conduct a participatory and transparent needs assessment before borrowing and suggest that the lenders should conduct due diligence to ensure that the loan to the state will be used for a public purpose and will not lead to unsustainable debt servicing obligations for the state.[65] The principles also specify that the key terms of loan agreements should be publicly disclosed by both the borrower and the lenders[66] and that the debtor state should ensure that its debt servicing obligations are not so burdensome that they cause the diversion of states resources away from the realization of human rights.[67] In regard to sovereign debtors in difficulty, the HRC Guiding Principles stipulate that, while the debtor state should honor its "legitimate" external debt obligations,[68] it should renegotiate these obligations with the aim of reaching an agreement that "enables the debtor state to service its external debt without compromising its capacity to fulfill its international human rights obligations [. . .]".[69]

Two points should be noted about the HRC Guiding Principles. First, the HRC Guiding Principles deal explicitly with the human rights impacts of SODRs, as well as all other aspects of the human rights implications of external debt. Nevertheless, the HRC Guiding Principles are not specifically referred to in any of the other norms and standards relevant to SODRs discussed above. As will be seen below, they are also not specifically referenced in any of the human rights policies of the leading financial institutions, although many of them do make specific references to other relevant norms and standards in their human rights policies.[70] Second, the HRC Guiding Principles, which were endorsed by the UN Human Rights Council less than a month after the endorsement of the UNGPs, are clearly influenced by them and their view of the responsibilities of corporations to respect human rights.[71]

Finally, the United Nations General Assembly (UNGA) has adopted

62. *Id.*, paragraphs 15-16.
63. *Id.*, paragraph 18.
64. *Id.*, paragraphs 19-20.
65. *Id.*, paragraphs 36-41.
66. *Id.*, paragraph 43.
67. *Id.*, paragraphs 48-51.
68. *Id.*, paragraph 52.
69. *Id.*, paragraph 53.
70. See *infra* notes 101-108 and accompanying text (discussion of human rights policies of banks).
71. U.N. Human Rights Council, *supra* note 57, paragraph 9 and accompanying footnote.

resolutions dealing with sovereign debt restructurings and the need for a more effective and balanced sovereign debt workout mechanism. In 2014, it adopted a resolution calling for the establishment of a multilateral legal framework for sovereign debt restructuring.[72] The Resolution does not make specific reference to human rights. On the other hand, it does refer to the UNCTAD Principles on Responsible Sovereign Lending and Borrowing and on the need for the restructuring process to contribute to the fulfillment of the sustainable development goals and the progressive development and codification of international law. In 2015, the UNGA passed another resolution that sets out the basic principles for sovereign debt restructuring processes.[73] The resolution includes recognition of the sovereign prerogative to make its own economic policies, and calls for the sovereign debt renegotiation process to be based on the principles of good faith, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, and sustainability. The resolution includes a definition of sustainability that states that the SODR outcome should preserve creditors' rights and promote "sustained and inclusive growth and sustainable development", minimize "economic and social costs", warrant the "stability of the international financial system" and respect "human rights".[74]

It should also be noted that the IMF has also issued many documents dealing with sovereign debt restructuring, including proposals for a sovereign debt restructuring mechanisms.[75] However, these documents do not mention human rights as a factor for creditors and debtors to consider in their restructuring negotiations.

The common feature of all these documents is that they seek to establish processes for financial transactions, including debt workouts, with sovereign debtors that are transparent, based on good faith by both parties and will result in sustainable outcomes. In addition, the 2015 UNGA resolution includes principles relating to respect for the sovereignty of the debtor state, equitable treatment by the debtor of all its creditors, and creditor decisions by majority voting. The resolution includes a definition of sustainability that stipulates that the SODR outcome should preserve creditors' rights and promote "sustained and inclusive growth and sustainable development", minimize "economic and social costs, warrant the "stability of the international financial system" and respect "human rights".[76] This definition of sustainability is similar to the one in the Roadmap, which states "Sustainability requires that sovereign debt workouts are completed in a timely and efficient manner and lead to a stable debt situation while minimizing costs for economic and social rights and development in the debtor state".

As indicated, only three of these documents mention human rights. They

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72. G.A. Res. 68/304 (Sept. 17, 2014).

73. G.A. Res. 69/319, *supra* note 26.

74. *Id.*, paragraph 8.

75. Krueger, *supra* note 26: International Monetary Fund, *A Survey of Experiences with Emerging Market Sovereign Debt Restructurings, IMFs Monetary and Capital Markets Department* (June 5, 2012), *available at* http://www.imf.org/external/np/pp/eng/2012/060512.pdf.

76. G.A. Res. 69/319, *supra* note 26, paragraph 8.

are the HRC Guiding Principles, the 2015 UNGA Resolution containing principles on the sovereign debt restructuring process and the UNCTAD Roadmap.[77] Although, the HRC Guidelines have been endorsed by the UN Human Right Council, it is not clear if they have had any impact on the creditors. As indicated they have not been referred to in any of the other norms and standards dealing with SODRs or in any of the human rights policies of the major international financial institutions. There also does not appear to be any evidence that they have been expressly used by sovereign debtors in SODRs. The UNGA merely mentions human rights in its definition of sustainability. The third document was prepared by a group of experts and has not been formally endorsed by states.[78] Moreover, the Roadmap, which only expressly mentions the need to respect social and economic rights, does not discuss human rights in any detail, and does not cross reference any human rights treaties or other human rights documents, such as the UNGPs.

III. INTERNATIONAL NORMS AND STANDARDS DEALING WITH BUSINESS AND HUMAN RIGHTS

The most detailed and authoritative international instrument dealing with business and human rights is the United Nations Guiding Principles on Business and Human Rights (UNGPs).[79] It was endorsed by consensus by the United Nations Human Rights Council in 2011. Its "protect, respect and remedy" framework has been incorporated into a number of other international instruments dealing with the human rights responsibilities of particular types of businesses, for example multinational companies, in the OECD Guidelines on Multinational Enterprises (Guidelines). It also been incorporated into some standards dealing with particular types of business activities, for example the Voluntary Principles on Security and Human Rights, developed by the extractive industries in the US and the UK and interested civil society organizations, and applicable to the security practices in the extractive industry. The applicability of the UNGPs to financial institutions has been acknowledged, as indicated above, by various individual financial institutions[80] as well as by groupings of financial institutions.[81] In addition, it is the

77. It should be noted that in January 2015, the current U.N. Independent Expert on foreign debt and other related international financial obligations proposed 6 human rights benchmarks that should be taken into account in developing a multilateral framework for debt restructurings that build on the UNGPs and the UNCTAD Principles. However, these benchmarks have not yet been incorporated into any set of norms and standards applicable to SODRs by the Human Rights Council. See, Juan Pablo Bohoslavsky, *Towards a Multilateral Legal Framework for Debt Restructuring: Six Human Rights Benchmarks States Should Consider* (Jan 26, 2015), *available at* http://www.ohchr.org/Documents/Issues/Development/IEDebt/DebtRestructuring.pdf.

78. It should be noted that the Principles on Responsible Sovereign Lending and Borrowing have been specifically endorsed by some countries, namely Argentina, Brazil, Cameroon, Gabon, Germany, Honduras, Italy, Morocco, Nepal, Norway, Mauritania and Paraguay. See UNCTAD, *Progress Report* (2013), *available at* http://unctad.org/en/PublicationsLibrary/gdsddf2013misc2_en.pdf.

79. UNITED NATIONS OFFICE OF THE HIGH COMMISSIONER FOR HUMAN RIGHTS, *supra* note 11.

80. See statements by individual banks cited above, *infra* notes 103-108 and accompanying text.

81. *See* Thun Group of Banks, *Discussion Paper for Banks on Implications of Principles 16–21* (October 2013), *available at* http://business-

international norm most relevant to the human rights impacts of SODRs because it deals with both the human rights obligations of the debtor state and the human rights responsibilities of the creditor financial institutions. It is discussed in more detail below.

The OECD Guidelines are the oldest general standard applicable to multinational enterprises (MNEs). It is important to note that they are intended to provide guidance from states to MNEs under their jurisdiction but are not binding on either the OECD member states or their MNEs. However, the states are expected to encourage the MNEs in their jurisdiction to comply with these Guidelines in their transnational operations. They are also expected to establish National Contact Points, to monitor the implementation of the Guidelines and to receive complaints about compliance with the Guidelines.

The Guidelines, which were originally developed in the 1970s, deal with all aspects of an enterprise's relations with its host governments. They are applicable to all MNEs[82] and so are applicable to all financial institutions that operated transnationally. They have been revised a number of times. The most recent revision was in 2011, when a new section was added specifically to deal with human rights. The new section is based on the UNGPs and it closely tracks those provisions of the UNGPs dealing with the responsibilities of companies. In order to assist financial institutions to meet their obligations under the Guidelines, the OECD, in 2014 prepared a guidance note for the financial sector on due diligence.[83] It is intended to help them determine their responsibilities for conducting due diligence in their operations and in their business relations so that they avoid causing, contributing to or being directly linked to adverse human rights impacts through these operations and relationships.

Another norm of general application to companies is the UN Global Compact.[84] The Compact requires signatory companies to pledge that they will comply with ten principles, the first two of which deal with human rights. These two principles require signatory companies to "support and respect the protection of internationally proclaimed human rights"[85] and to "make sure that they are not complicit in human rights abuses".[86] The four principles[87] dealing with labor issues are also relevant to the human rights responsibilities of signatory companies.[88] They require signatories to comply with international

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humanrights.org/sites/default/files/media/documents/thun-group-discussion-paper-final-2-oct-2013.pdf; Equator Principles (June 4, 2013), *available at* http://www.equator-principles.com/resources/equator_principles_iii.pdf; Global Alliance for Banking on Values, *Principles on Sustainable Banking* (2009), *available at* http://www.gabv.org/about-us/our-principles.

82. OECD Guidelines, *supra* note 13, Article I paragraph 4.

83. OECD GLOBAL FORUM ON RESPONSIBLE BUSINESS CONDUCT, DUE DILIGENCE IN THE FINANCIAL SECTOR - ADVERSE IMPACTS DIRECTLY LINKED TO FINANCIAL SECTOR OPERATIONS, PRODUCTS OR SERVICES BY A BUSINESS RELATIONSHIP (2014), *available at* https://mneguidelines.oecd.org/globalforumonresponsiblebusinessconduct/GFRBC-2014-financial-sector-document-1.pdf.

84. U.N. Global Compact, *supra* note 12.

85. *Id.*, Principle 1.

86. *Id.*, Principle 2.

87. *Id.*, Principles 3-6.

88. A total of 8610 companies have signed onto the Global Compact; this includes 171 banks and a total of 905 financial services companies. Information retrieved from

standards dealing with freedom of association and collective bargaining, forced labor, child labor and non-discrimination. It is important to note that the Compact is voluntary and signatories are only expected to submit information on how they are implementing the principles to the UN. There is no formal monitoring or evaluation of their compliance, although companies can be dropped from the list of signatory companies if they do not provide the requisite reports to the UN. In addition, the principles are not very detailed and so provide significant room for interpretation.

The third norm of general application, ISO 26000, is issued by the International Organization of Standards (ISO) and deals with social responsibility. This norm is also voluntary and can be used by all companies. According to the ISO, ISO 26000 "is intended to provide organizations with guidance concerning social responsibility".[89] The ISO does not certify that companies are in compliance with ISO 26000 and its website specifically states that the norm "is not intended to be interpreted as an "international standard", "guideline" or "recommendation" . . . Further, it is not intended to provide a basis for legal actions, complaints, defenses or other claims in any international, domestic or other proceeding".[90] Nevertheless it has a detailed section on human rights that, like the UNGPs, deals with issues like due diligence and grievance mechanisms to address the potential human rights impacts of the operations and relationships of companies adopting ISO 26000.[91]

In addition, to these norms and standards of general application there are some that are specifically applicable to the financial sector. The best known of these is the Equator Principles,[92] which is designed to guide the conduct of banks engaged in project financing. It has been adopted by 83 financial institutions in 36 countries,[93] all of which are expected to prepare annual reports on their implementation of the Equator Principles. The Principles are modeled on the IFC's Sustainability Framework, which provides guidance to the IFC and its clients on what the IFC expects in regard to assessing and monitoring the impact on sustainability of those projects that it funds. Both the IFC framework and the Equator Principles include provisions dealing with human rights, which, like the UNGPs, impose a responsibility on companies to assess the human rights impact of their activities. However, in both cases, this guidance is limited to the project financing context. Nevertheless, the Equator Principles can be seen as providing some sense of the standards of conduct expected from financial institutions when their operations have a significant impact on sustainability, including a significant human rights impact.

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https://www.unglobalcompact.org/ (April 14, 2016).

89. See http://www.iso.org/iso/catalogue_detail?csnumber=42546 (April 14, 2016).

90. *Id*.

91. See ISO, DISCOVERING ISO 26000 (2014), *available at* http://www.iso.org/iso/discovering_iso_26000.pdf. Interestingly for a document that is expected to promote social responsibility, the ISO sells ISO 26000 for a price of CHF 198, which effectively makes it unaffordable to many potential stakeholders that may have an interest in understanding how the companies that may adopt ISO 26000 understand and implement their social responsibility.

92. Equator Principles, *supra* note 81.

93. *Id*.

The one international standard that has been developed within the United Nations that is explicitly aimed at the financial sector is the United Nations Environmental Programme's Principles for Responsible Investment.[94] Its six principles are designed to encourage institutional investors and commit signatories to pay greater attention to environmental, social and governance issues in their operations and business relations. There is no explicit mention of human rights in these principles. To date approximately 1500 asset managers, investment managers and professional service partners have signed onto these principles.[95]

UNGPs

The UNGPs, which were endorsed by consensus by the state members of the UN Human Rights Council, are applicable to all businesses, including financial institutions, and to all states. This non-binding instrument is based on the following three propositions:[96]

> 1) Under existing human rights law, states have an obligation to respect, protect and fulfill the human rights of their citizens.
>
> 2) Business enterprises have a responsibility to comply with all applicable law and to respect the human rights of those individuals that are impacted by their operations.
>
> 3) There need to be appropriate remedies available to all who are harmed by the failure of states and companies to live up to their respective obligations and responsibilities.

Based on these propositions, the UNGPs consist of thirty-one principles divided into three pillars. The first pillar, which consists of ten principles, focuses on the state duty to protect human rights.[97] It stipulates that the state must protect against human rights being abused by third parties including business enterprises that are subject to its jurisdiction. In furtherance of this obligation, states must take steps to prevent human rights violations through their policies, legislation and regulations. They should also clearly set out their expectations of the business enterprises operating in their jurisdictions regarding human rights and, where appropriate, should encourage businesses to communicate how they address human rights impacts in their operations. They also have an obligation to promote respect for human rights by the business enterprises with which they conduct commercial transactions.

The second pillar, which consists of thirteen principles, deals with the responsibilities of business enterprises.[98] It states that business enterprises should respect human rights, which means that they should avoid infringing human rights and should address the adverse human rights impacts in which they are involved. It also clarifies that for these purposes, "human rights"

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94. United Nations Environmental Programme, *Principles for Responsible Investment* (2006), *available at* http://www.unpri.org/about-pri/the-six-principles/.

95. See http://www.unpri.org/signatories/signatories/ (April 14, 2016).

96. U.N. Global Compact, *supra* note 11.

97. *Id*.

98. *Id*.

means the rights expressed in the International Covenants on Civil and Political Rights and on Economic, Social and Cultural Rights and the principles set out in the ILO's Declaration on Fundamental Principles and Rights at Work. The principles also stipulate that businesses should have human rights policies that are approved at a high level in the company and are publicly available. The UNGPs also clearly state that the responsibility to respect human rights requires companies to avoid causing or contributing to adverse human rights impacts and to seek to mitigate or prevent adverse impacts that are directly linked to their operations. It further stipulates that companies should have in place due diligence procedures to identify, prevent, mitigate and account for the human rights impacts of their operations. This process should assess both actual and potential impacts that are caused by the company, to which the company contributes or which may be directly linked to its operations. The company should communicate how these impacts will be addressed and be monitored. It is important to note that these human rights impact studies differ from "standard" corporate due diligence procedures in that their focus is on the impact of the company's operations on its various stakeholders—workers, customers, communities—rather than on the potential risks to the company arising from the operations. Nevertheless, human rights impact assessments (HRIA) may be similar in methodology and may address some of the issues considered in a company's environmental, social and health impact assessments. In fact, in many cases, the company can consider incorporating the HRIA into its environmental and social impact assessment.[99]

The UNGPs make clear that the appropriate human rights due diligence process in any particular business situation will vary according to the size of the enterprise, the risk of severe human rights impacts and the nature and context of the operation. The nature of the enterprise's response to the identified adverse impacts will also vary according to the severity of the impact, the role that the enterprise plays in the adverse impact, and its leverage in addressing the adverse impact. The UNGPs also make clear that the responsibility of the company is ongoing and it is expected to continue monitoring the situation and to keep assessing the adverse impacts throughout the life of the transaction or operation. It is important to note that the fact that the due diligence is ongoing, indicates that the UNGPs contemplate that the human rights impacts of the project can vary over the life of the project or transaction and that the company should continue monitoring and dealing with the impacts as they evolve over the life of the project. Finally, the UNGPs acknowledge that the company may need to prioritize actions to address the actual and potential adverse human rights impacts of its operations and suggests that it should first seek to prevent and mitigate those impacts that are most severe or for which delayed responses may make them irremediable.

The third pillar deals with access to remedies.[100] It stipulates that states, as part of their duty to protect against human rights abuses must take steps to

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99. THE DANISH INSTITUTE FOR HUMAN RIGHTS, INTEGRATING HUMAN RIGHTS INTO ENVIRONMENTAL, SOCIAL AND HEALTH IMPACT ASSESSMENTS – A PRACTICAL GUIDE FOR THE OIL AND GAS INDUSTRY (2013); see also IPIECA, *available at* www.ipieca.org and www.humanrights.dk.

100. Equator Principles, *supra* note 81.

ensure that those who are adversely affected by a business' operations should have access to either judicial or non-judicial remedies. The UNGPS also state that businesses, in order to ensure that grievances relating to adverse human rights impacts, are addressed as early as possible and can be remediated as directly as possible, should provide effective operational level grievance mechanisms. Finally, the UNGPs require that in order for non-judicial grievance mechanisms, including operational level mechanisms, to be considered effective they must be legitimate, accessible, predictable, equitable, transparent, rights compatible, and a source of continuous learning by the company. The Principles also suggest that these mechanisms should be based on engagement and dialogue with stakeholder groups.

It is clear from this brief description of the UNGPs, that there is no specific type of business or financial transaction to which they are not, at least in principle, applicable. In fact, a number of financial institutions have begun to express support for this view in their human rights policies, which are publicly available documents and in their public reports.[101] For example, JP Morgan Chase & Co. states in its human rights policy that ". . .we acknowledge the Guiding Principles on Business and Human Rights as the recognized framework for corporations to respect human rights in their own operations and through their business relationships."[102] Barclays, in its human rights policy states that: "We aim to operate in accordance with the Universal Declaration of Human Rights as well as other international standards, including the Organisation for Economic Cooperation and Development's Guidelines for Multinational Enterprises and International Labour Organization Core Conventions."[103] Goldman Sachs, states in its policy that: "As a global financial institution, Goldman Sachs recognizes and takes seriously its responsibility to help protect, preserve and promote human rights around the world."[104] HSBC states in its human rights policy that: "HSBC is guided by the International Bill of Human Rights and supports the UN Declaration of Human Rights and the principles concerning fundamental rights set out in the International Labour Organisation's Declaration on Fundamental Principles and Rights at Work. . . . The UN Guiding Principles state that all private enterprises hold an equal responsibility to respect human rights. HSBC is committed to respecting human rights".[105] Deutsche Bank states in its Corporate Responsibility Report for 2014 at p34: "We are committed to respecting human rights, in accordance with our values and beliefs . . . and as a signatory to the

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101. It should be noted that not all banks have human rights policies or include human rights statements in their reports on sustainability and corporate social responsibility. For example leading Asian institutions such as Mizuho Bank Ltd., Mitsubishi UFJ Financial Group, and ICICI Bank Ltd do not have explicit human rights policies.

102. See https://www.jpmorganchase.com/corporate/About-JPMC/ab-human-rights.htm.

103. Barclays Group Statement on Human Rights 2015, *available at* https://www.home.barclays/content/dam/barclayspublic/docs/Citizenship/Policy-Positions/barclays-statement-human-rights.pdf.

104. See Goldman Sachs statement on Human Rights, *available at* http://www.goldmansachs.com/investor-relations/corporate-governance/corporate-governance-documents/human-rights-statement.pdf.

105. HSBC Statement on Human Rights 2015, *available at* http://www.hsbc.com/~/media/hsbc-com/citizenship/our-values/pdfs/150930-hsbc-statement-on-human-rights.

UN Global Compact. Our policies and guidelines reflect our commitment to the UN Guiding Principles on Business and Human Rights."[106]

Banks are not the only financial institutions to have stated that it is their policy to respect human rights in their operations. Insurance companies have made similar statements. For example, Allianz states in its 2014 Sustainability Report that:

> [R]especting human rights is not just an issue for states and governments today. Companies from all industries have an increasing responsibility to incorporate human rights issues into their business standards, wherever and however they operate. . . .Corporations are not only expected to take into consideration the human rights impacts directly caused by their own activities and operations, but also those linked to a business relationship with business partners. The latter makes the determination of the appropriate action more complex, as the link is only through the business relationship. Corporations must look at human rights not only from a business risk perspective, but also from the perspective of the people impacted, the "rights-holders.[107]

In fact, of the 38 financial institutions represented on the Board of Trustees of the IIF, 30 have human rights policies that include similar statements to the ones cited above.[108] All the institutions cited above except Barclays are represented on the IIF Board. Moreover, 21 of the 30 globally significant financial institutions (GSIFIs) have human rights policies that specifically refer to at least some of the applicable human rights norms and standards. In fact, eight GSIFIs specifically express support for the UNGPs in their human rights policies.[109] Another GSIFI has a public statement that indicates that it accepts that it has human rights responsibilities but it does not expressly refer to any of the applicable human rights norms and standards and two other GSIFIs do not have human rights policies but have signed the UN Global Compact.[110]

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106. *See* https://www.db.com/cr/en/positions/human_rights.htm.

107. *See* https://www.allianz.com/en/sustainability/sustainability_report_2014/special_topics /human_rights.html/.

108. The 30 financial institutions that have human rights policies are: HSBC, Credit Suisse AG, SEB, Akbank T.A.S, Swiss Re Ltd., Itaú Unibanco Holding S/A, Banco de Crédito del Perú, Erste Group Bank AG, Allianz SE, UBS AG, Commerzbank AG, Standard Chartered Bank, Grupo Santander, The Goldman Sachs Group, Inc., Citigroup, Deutsche Bank AG, Zurich Insurance Group, UniCredit Group, Aberdeen Asset Management, BBVA, Morgan Stanley, DBS Group Holdings and & DBS Bank Ltd, ING Group, BNY Mellon, MetLife, Inc., Standard Bank Group Ltd, BNP Paribas, Société Générale, JPMorgan Chase, Scotiabank; the 8 financial institutions that do not have human rights policies are: Gulf international Bank, Qatar National Bank, Mizuho Bank Ltd., Mitsubishi UFJ Financial Group, ICICI Bank Ltd, Industrial and Commercial Bank of China, Sumitomo Mitsui Financial Group, Bank of China.

109. The eight GSIFIs that express support for the UNGPs in their human rights policy are Citigroup, Deutsche Bank, UniCredit, Credit Suisse, Nordea, Royal Bank of Scotland, Santander, and UBS.

110. Information is based on a review of the policies available on the websites of the GSIFIs, as defined by the Financial Stability Board. *See* http://www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf for list of GSIFIs. The 21 GSIFIs that have human rights policy are: HSBC, JP Morgan Chase, Barclays, BNP Paribas, Citigroup, Deutsche Bank AG, Bank of America, Credit Suisse, Goldman Sachs Inc., Morgan Stanley, Unicredit, BNY Mellon, Groupe BPCE, Group Credit Agricole, ING Group, Nordea, Royal Bank of Scotland, Société Générale, Standard Chartered Bank, UBS, Grupo Santander. The GSIFI, which has a public statement that indicates that it accepts that it has human rights responsibilities but does not expressly refer to any of the applicable human rights norms, is Wells Fargo. The two GSIFIs that do not indicate expressly state that they accept human rights responsibility but have signed the U.N. Global Compact are State Street and

This suggests that, at least in theory, the UNGPs should be taken into account by the debtor state and its commercial creditors in a sovereign debt workout. The issue of what role, if any, the UNGPS should play in SODRs will be considered in the next section.

IV. THE ROLE OF THE UNGPS IN SODR[111]

The issue of the potential role of the UNGPs in SODRs can be divided into three sub-issues: First, should the UNGPs be part of the framework that helps guide SODRs? Second, can the UNGPs add value to SODRs? Third, what do the UNGPs suggest that the debtor and creditors should do in regard to assessing and preventing or mitigating adverse human rights impacts in SODRs? Each question will be discussed in turn, below.

A. The Role of the UNGPs in the SODR Framework

First, I will address the question of whether the UNGPs should be part of the framework that helps guide transactions in SODRs. As indicated above, the UNGPs are applicable to all businesses in all their operations and business relations. This suggests that the UNGPs, at least in theory, should be applicable to SODRs in the case of states that have commercial institutions as creditors.[112] This supposition is strengthened by the fact that the UNGPs do not include any language indicating that there are exceptions to their applicability to all businesses and their activities.

It is, of course, also true that the UNGPs are non-binding. This means that, in principle, both the sovereign debtor and its creditors are free to decide not to utilize the UNGPs in their SODRs. However, for both parties such a decision does not necessarily mean that they have no human rights responsibilities in conducting an SODR. The reason is that the sovereign debtor is bound, under international law, by the human rights treaties that it has signed and ratified and by customary international law.[113] This means, since all states have signed at least some treaties, and most states have signed the two core

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Industrial and Commercial Bank of China Limited. The six GSIFIs that do not have a human rights policy or any statement referring to any human rights norms and standards are: Mitsibushi UFG FG, Agricultural Bank of China, Bank of China, China Construction Bank, Mizuho FG, Sumitomo Mitsui FG.

111. It is important to note that the U.N. Principles on Foreign Debt and Human Rights are also applicable to SODRs. They are not directly discussed in this section for two reasons. First, as indicated above, they are based, in part, on the UNGPs. Thus, they impose similar responsibilities on both debtors and creditors as the UNGPs. Second, the Principles do not seem to have gained any influence with financial institutions. For example, they have not been referred to in any of the human rights policies of individual financial institutions reviewed for this paper.

112. The UNGPs apply to businesses. Consequently, they would only be applicable to commercial creditors of sovereign debtors. This means that the discussion in this section is unlikely to be relevant to low income sovereign debtors who only have official bilateral and multilateral institutions as creditors.

113. *See* John Humphrey, *The Universal Declaration of Human Rights: Its History, Impact and Judicial Character, in* HUMAN RIGHT: THIRTY YEARS AFTER THE UNIVERSAL DECLARATION (Bertrand G. Ramcharan ed., 1984); Final Act of the Conference on Security and Co-Operation in Europe, *The Helsinki Accord*, 14 ILM 293 (1975); Hurst Hannum, *The Status of the Universal Declaration of Human Rights in National and International Law*, 25 GA. J. INT'L & COMP. L. 287 (1995).

international human rights covenants[114]—the Covenants on Civil and Political Rights[115] and on Economic, Social and Cultural Rights[116]—that all sovereign debtor states have some binding human rights obligations. At a minimum, therefore, each debtor state,[117] in a SODR process, will be required to respect, protect and fulfill the rights enshrined in the human rights treaties it has signed or that are binding under customary international law, regardless of its views of the applicability of the UNGPs to the process. This means, *inter alia*, it has an obligation to protect the rights of its citizens from any adverse human rights impacts they may suffer that are caused by third parties, such as businesses operating in their territory or that are directly linked to these businesses or to which these businesses are contributing.

The situation of the creditors is more complicated. They are not signatories of any of the human rights treaties and, since they are not subjects of international law, are not directly bound by customary international law. Consequently, they do not have any explicit human rights obligations under international law. However, they are obliged to comply with the law in the states in which they operate. This suggests that, to the extent that these states have incorporated their international human rights treaties into domestic law, these companies will be required to respect the international human rights commitments of their home and host states. In addition, the companies may have assumed at least a moral commitment to respect human rights to the extent they have adopted their own individual human rights policies or have signed onto one or more of the applicable international standards dealing with human rights and businesses.[118] As indicated above, a number of leading financial institutions have adopted human rights policies in which they expressly acknowledge that they have human rights responsibilities, and that these responsibilities are based on core international human rights instruments.[119] Some of them have also expressed support for the non-binding international standards. These institutions have not indicated that their human rights policies are not applicable to any specific category of their activities.

114. There are 168 state parties to ICCPR as of 18 March 2016. Seven states have signed but not ratified treaty, 22 states neither signed nor ratified treaty. There are 164 state parties to ICESCR as of 18 March 2016, six states have signed but not ratified treaty, 25 states neither signed nor ratified treaty. Information retrieved from http://indicators.ohchr.org/.

115. International Covenant on Civil and Political Rights (1966) entered into force on 23 March 1976, G.A. Res. 21/2200A (XXI), available at http://www.ohchr.org/Documents/ProfessionalInterest /ccpr.pdf.

116. International Covenant on Economic, Social and Cultural Rights (1966), entered into force 3 January 1976, G.A. Res. 21/2200A (XXI), 993 UNTS 3, *available a*t http://www.ohchr.org/Documents/ProfessionalInterest/cescr.pdf.

117. It should be noted that the home state of the creditor institutions may also have some extra-territorial human rights obligations, including to ensure that their creditor institutions respect the human rights of the populations of the debtor state. *See* Maastricht Principles on Extra-Territorial Obligations of States in the Area of Economic Social and Cultural Rights (2013) *available at* http://www.etoconsortium.org/nc/en/mainnavigation/library/maastrichtprinciples/?tx_drblob_pi1%5BdownloadUid%5D=23 (last visited April 14, 2016).

118. In the case of the financial sector, the relevant international standards are the UNGPs, Global Compact, Equator Principles, UNEP Principles on Responsible Investing, Thun Group statement, OECD Guidelines.

119. *See* examples *supra* notes 101-110 (dealing with IIF members and GSIFIs that have human rights policies).

Consequently, there is no principled basis on which they can claim that either their own human rights policies or those international standards for which they have expressed support are not applicable to SODRs. The failure to apply them without an adequate explanation, therefore, should result at least in reputational costs to these financial institutions. It may also, at least at the margins, provide the debtor with some bargaining leverage in their negotiations with these financial institutions.

The conclusion to be drawn from the above is that the obligations and responsibilities set out in the UNGPs do apply to SODRs, at least in regard to the sovereign debtor and to those creditors that have voluntarily accepted the responsibilities of the UNGPs and have not expressly excluded SODRs from this responsibility.

B. The Value-Add of UNGPs

The second question that the parties must consider is whether the UNGPs can add value to their efforts to restructure the sovereign's debts. There are several reasons for thinking that the UNGPs can add value to these difficult negotiations.

First, as shown above, it is almost inevitable that SODRs will have adverse human rights impacts. This follows from the fact that the debtor does not have sufficient funds to meet all its obligations to both its creditors and its citizens. Consequently, it will have to deprive some of these stakeholders of resources—financing, goods and services—that they are expecting. These decisions of the debtor will have human rights consequences at least to the extent that they affect expenditures on such items as health, education, social services, the justice system, and unemployment compensation. There may also be human rights impacts if the debtor's policies generate significant public opposition. The UNGPs, by providing guidance to states on how they should account for the human rights impacts arising from their financial transactions, can assist the sovereign debtor in ensuring that it adequately accounts for the actual and potential adverse human rights impacts in the planning, negotiation and implementation of its SODR.

Second, as indicated above, many of the globally significant financial institutions, which are likely to be participants in many SODRs, have publicly acknowledged that they do have human rights responsibilities. Moreover, a number of the leading financial institutions have specifically expressed their support for the UNGPs in their human rights policies. It should be noted that these institutions have not explicitly stated whether or not their human rights policies apply to SODRs. In the absence of such a statement and given that their policies appear to be applicable to all the activities of the institutions, there does not seem any *a priori* reason to assume that their policies are not applicable to SODRs. The UNGPs, by providing guidance to financial institutions on how they should implement their responsibility to respect human rights can assist the creditors to understand how to structure SODR outcomes that avoid or mitigate the adverse human rights effects of their SODR proposals and of the eventual agreements that they reach with their sovereign debtors.

Third, the UNGPs, with their emphasis on due diligence and access to remedies, remind the debtor and its creditors that they will need to take all stakeholders who may suffer adverse impacts into account in their transaction. This is useful because, at least in principle, they will ensure that there are no interests on either the borrower or the lender side that are not taken into account in the planning and execution of the SODR. This means that the interests of those debtor country citizens who are adversely affected by the budgetary allocation decisions of the sovereign debtor should receive due consideration. In addition, it means that the interests of relevant creditor stakeholders, such as pensioners who are bondholders[120] who may be adversely by the SODR outcome, should be taken into account.

Fourth, history suggests that SODRs that do not pay adequate attention to the adverse human rights and other impacts of their outcomes may not be fully implemented and may need to be renegotiated. This can happen because, *inter alia*, the debtor is unable to implement the agreement as planned due to the opposition of domestic stakeholders or because the financial markets lack confidence in the viability of the outcome and so do not participate as anticipated in it. These developments may force the parties to renegotiate the restructuring, possibly under more difficult financial and more contentious negotiating conditions and at considerable expense to the parties. The net effect of these developments is likely to be that the adverse human rights impacts of the SODR outcome will also be exacerbated. The UNGPs can help the parties mitigate the risk of such a situation by making sure that they pay appropriate attention to human rights considerations in their first round of SODR negotiations.

It should be noted that incorporating the UNGPs into the SODR also has a cost. This follows from the fact that the UNGPs add a new requirement onto the SODR process. They require the parties to incorporate human rights considerations, as determined through a human rights impact assessment, into the SODR process. As will be discussed below, performing an adequate human rights impact assessment under the time pressures of a sovereign debt crisis and in the context in which the outcome of the SODR is hard to predict *ex ante* is challenging. Inevitably the assessment will be imperfect and is likely to expose the creditors to reputational risk. This follows from the probability that the SODR will result in substantial adverse impacts for at least some segments of the debtor country population and from the fact that the sovereign debtor has a strong incentive to blame the creditors for the adverse impacts of the SODR.

However, it is important to recognize that the creditors are likely to incur this cost regardless of whether it follows the UNGPs and conducts the requisite human rights impact assessment or not. The reason is that if, in fact, there are adverse impacts, the debtor and its adversely affected citizens will have a strong incentive to blame the creditors for them. Showing that they are complying with the UNGPs may help the creditors mitigate these risks. The reason is that they can show that they have taken human rights considerations

120. This was the case with some of Argentina's creditors and with the holders of Puerto Rican bonds.

into account and that they have done so in conformity with the best applicable international standard. In addition, their human rights impact assessments might help demonstrate that they have worked to reach the least costly and most feasible, in human rights terms, SODRs agreements.

The above suggests that on balance the benefits of incorporating the UNGPs into the SODR outweigh the costs. The reason is that the benefits flow directly from the UNGPs and cannot easily be earned from a substitute approach. The costs arise from the specific context of a sovereign debt crisis and, to that extent, are unavoidable. However, the UNGPs may help the parties mitigate the consequences of these costs.

C. Debtors, Creditors and Human Rights in SODRs

In order to answer the third question—what the UNGPs suggest that the debtor and creditors should do in regard to human rights in SODRs—each of the three pillars of the UNGPs will be discussed separately.

1. The First Pillar: Duties of the Sovereign Debtor

As indicated above, the state, under international human rights law has a duty to protect, respect and fulfill the human rights of its citizens. This duty includes the duty to protect its citizens against human rights violations by business enterprises.

This means that the state has a general duty to protect its citizens against adverse human rights impacts that are caused by financial institutions, to which financial institutions contribute or which are directly linked to financial institutions. This duty includes protecting its citizens against the adverse human rights impacts that flow from financial transactions between the state and financial institutions. In other words, the state, in the context of SODR has two duties. It must ensure that its own actions comply with its duty to protect, respect and fulfill the human rights of its citizens. In addition, it has a duty to protect its citizens against the adverse human rights impacts that may arise from or be connected to the conduct of its creditors in its financial transactions.

In regard to its own actions, in order to ensure that it is not failing to comply with its own human rights obligations, the state needs to determine the nature of the adverse impacts of its proposed course of action in the SODR. In particular, it needs to consider if these actions will merely result in slower realization of some or all of its subjects' rights than would otherwise have happened or if it will result in an actual deterioration in some or all of the human rights of its subjects over the same period. Armed with this knowledge the sovereign debtor will have to determine what it can do to prevent or mitigate the adverse impacts. To the extent this is not possible, at least over the relevant time period for the transaction, it will have to decide what it can do to compensate those adversely affected for their losses. It is important to note that this obligation, if fully complied with, requires the state to make an assessment of how the individual adverse impacts will evolve over the life of the SODR transaction and also how the various human rights impacts will interact with each other over the relevant time period. It will also have to consider whether

either these individual or cumulative impacts will continue beyond the term of the SODR. This assessment may also result in the state having to make some decisions on whether it is acceptable to impose the adverse impacts on the present generation of citizens with the expectation that doing so will generate benefits for future generations.

The state's obligation to protect its citizens against human rights violations by its creditor counterparts means that it should not agree to a transaction that causes avoidable adverse impacts on the human rights of its citizens. [121] This does not necessarily mean that the state cannot agree to any SODR that has adverse human rights consequences, particularly when the exigencies of the situation leading to the SODR are taken into account. However, it does mean that the state needs to understand the human rights impacts of the offers made to it by the creditors and to assess whether these impacts can be avoided or mitigated if the offer is accepted and implemented. In order to make a fully informed decision in this regard, the debtor should be aware of the human rights policies of the financial institutions with which it is doing business so that it can understand if their offers are consistent with these policies and, if not, why the financial institutions are deviating from their own policies. Finally, the debtor state needs to engage in discussions with the creditors about the most effective way to mitigate the adverse human rights impacts of their transaction within the context of the SODR. In this regard, the sovereign debtor needs to make sure that its creditors understand the debtor's human rights obligations and how it thinks they should apply in the context of the SODR.

Within the context of SODRs, the state's obligation to protect needs to include some plan for either restoring the *ex ante* human rights situation by the end of the SODR implementation period or for compensating those adversely affected for their losses. This requires the state to assess the evolution of both the impacts of the SODR transaction and the steps taken to mitigate the adverse impacts over time. It will also have to determine what to do in the event that its projections about the evolution of these impacts turns out to be inaccurate and the human rights situation turns out to be different from what it anticipated.

This brief description of the state's obligations suggests the most effective way to gain this insight, at least in theory, is for the state to do a careful human rights impact assessment of the likely human rights consequences of the SODR. As indicated in the UNGPs, although in the

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121. *See* Committee on Economic, Social and Cultural Rights, General Comment 3, The nature of States parties' obligations (Fifth session, 1990), U.N. Doc. E/1991/23, annex III at 86 (Dec 14, 1990), reprinted in Compilation of General Comments and General Recommendations Adopted by Human Rights Treaty Bodies, U.N. Doc. HRI/GEN/1/Rev.6 at 14 (May 27, 2003). Paragraph 10 of this Comment stipulates that states have "a minimum core obligation to ensure the satisfaction of, at the very least, minimum essential levels of each of the rights…it must be noted that any assessment as to whether a State has discharged its minimum core obligation must also take account of resource constraints applying within the country concerned. In order for a State party to be able to attribute its failure to meet at least its minimum core obligations to a lack of available resources it must demonstrate that every effort has been made to use all resources that are at its disposition in an effort to satisfy, as a matter of priority, those minimum obligations." Paragraph 11 of the Comment adds that "…even where the available resources are demonstrably inadequate, the obligation remains for a State party to strive to ensure the widest possible enjoyment of the relevant rights under the prevailing circumstances."

context of the responsibilities of business, such due diligence is not a one-off requirement. Instead the state should continue monitoring and assessing the situation on an ongoing basis throughout the life of the transaction. This suggests that the state has an obligation to perform the HRIA in advance of its decision to enter into the SODR and to continue updating it through the negotiations with its creditors and then throughout the implementation of the agreement reached in the SODR.[122]

There are two important considerations that the state will need to take into account in undertaking the HRIA. The first is that the advent of a debt crisis can happen quickly and can demand a prompt response. Thus, the HRIA must be done under considerable time pressure that is exacerbated by the fact that the process leading to the decision to enter into the SODR must be managed with discretion. If the news that the sovereign debtor is contemplating entering into a SODR leaks prematurely it can adversely affect the financial situation of the state, and thereby exacerbate the human rights consequences of the SODR.

This suggests that the HRIA in the case of SODR is unlikely to comply with best practice standards of transparency and participation and detailed analysis in regard to such impact studies.[123] This also means that there is a heightened risk of unexpected adverse human rights outcomes once the SODR is being implemented. This, in turn, underscores the importance of the debtor creating a grievance mechanism, a topic to which we will return when discussing the third pillar of the UNGPs.

The second issue, as discussed above, is that a SODR almost inevitably will require the state to make budget cuts.[124] The supposed justification for these cuts, which all SODR participants understand will cause pain and adverse human rights impacts, is that the society must accept some short term costs, in order to restore a sustainable macro-economic situation and to position itself on a sustainable growth path. This in turn is expected to generate future human rights gains. Assuming that this justification is correct, it amounts to concluding that it is acceptable to impose current human rights sacrifices in order to reap future human rights gains. It is unclear how human rights law should assess this inter-temporal human rights trade-off. Although, at a minimum it should comply with the requirements that retrogressive measures should be non-discriminatory, proportionate and should comply with the states minimum core obligations.[125]Evaluating this trade-off is further complicated by

122. In this regard it is interesting to note that the European Commission has done a social impact assessment of the stability support programme for Greece. See European Commission, *Assessment of the Social Impact of the new Stability Support Programme for Greece*, Commission Staff Working Document, SWD(2015) 162 final (Aug 19, 2015).

123. It is interesting to note that Iceland made an effort to understand the human rights impacts of its proposed SODR during its 2008 banking crisis. *See* Report of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights on his mission to Greece, U.N. Doc. A/HRC/31/60/Add.2 (Feb 29, 2016).

124. The extent of these cuts will be influenced by its ability to identify new sources of financial support. Many debtor states will obtain such support from the IMF and multilateral development banks.

125. *See* General Comment 3 of the Committee on Economic Social and Cultural Rights, *supra* note 118; Goldmann, *supra* note 18.

the fact that the current human rights costs can be assessed with reasonable certainty but the future human rights benefits are uncertain and their scope and scale depend on the assumptions made about the likely future trajectory of the SODR and its impacts. In addition, the identity of the current losers can be determined with a reasonable degree of confidence but the identity of the future winners is less easily established. Moreover, there is no necessary reason to assume that the future gainers will be the current losers. This is particularly relevant because in the context of SODRs, human rights impacts in fact are likely to be cumulative, that is, for example, current cuts in education spending can have adverse impacts on the future health of the adversely affected learners and can have negative impacts on their job prospects. There is no obvious reason to assume that these currently adversely affected learners will benefit from future increases in education spending.

2. The Second Pillar: The Responsibility of Financial Institutions

The UNGPs stipulate that business enterprises have a responsibility to respect the human rights of those actually or potentially affected by their operations or business relations. It clarifies that the core of this obligation is for the business enterprise to engage in sufficient due diligence to identify the human rights impacts of its planned operations and to take steps to prevent or mitigate the adverse impacts.

This standard suggests that the creditor financial institutions have a responsibility to undertake a HRIA before engaging with the sovereign debtor about the SODR. In addition, they should continue updating the HRIA during the SODR negotiations, and when it is concluded and is being implemented. As in the case of the sovereign debtor, the financial institutions are expected to undertake this HRIA under considerable time constraints and in conditions in which complying with high standards of detailed analysis, transparency and participation will be difficult if not impossible. Furthermore, as in the case of the sovereign, this situation places a premium on the need for providing those adversely affected by the SODR with access to remedies.

It is clear from the literature on HRIAs that they are still a relatively new form of impact assessment and that practitioners are still working out the best way to do such assessments.[126] Nevertheless, there are certain characteristics that should feature in any HRIA that complies with the UNGPs. Each of these is discussed below together with the issues they raise in the context of SODRs.

It is well understood that in all impact assessments it is necessary to have a sense of the human rights conditions that exist before the parties enter into their transaction or operation. In principle, this should not be a problem

126. ISO 26000 *supra* note 14; Danish Institute for Human Rights, *supra* note 99; Oxfam Technical Briefing, *A Oxfam Perspective on the UN Guiding Principles* (2013), *available at* https://www.oxfam.org/sites/www.oxfam.org/files/tb-business-human-rights-oxfam-perspective-un-guiding-principles-130613-en.pdf; Oxfam & FIDH, *Community-Based Human Rights Impact Assessment: The Getting it Right Tool* (2011), *available at* https://www.fidh.org/IMG/pdf/cobhra_training_manual.pdf; DANISH INSTITUTE FOR HUMAN RIGHTS, HUMAN RIGHTS IMPACT ASSESSMENT – GUIDANCE AND TOOLBOX (2016), *available at* http://www.humanrights.dk/sites/humanrights.dk/files/media/dokumenter/business/hria_toolbox/hria_guidance_and_toolbox_final_feb2016.pdf.

because, pursuant to the UNGPs, the financial institutions and the sovereign borrower should have done HRIAs before they entered into their original debt transactions and they should be monitoring the impacts over the life of the transaction. In this case, they would have a good sense of the existing human rights situation before commencing the SODR. However, in reality, at least while the HRIAs requirement is still relatively new, it is unlikely that the parties have done HRIAs for all their financial transactions.

Even if the creditors had done HRIAs of their individual transactions with the borrower, it is unlikely that they would have gathered information on the cumulative impacts of all the debtor's financial transactions. This is because they may not have been involved in all the transactions and so would not have done, *ab initio*, studies indicating how the impacts of the various transactions interact with each other, either to reduce or increase over time the adverse human rights impacts. Thus, they are unlikely to be in a position on their own to make a truly informed judgement about the likely human rights impacts of the SODR. If one looks at cases of recent SODRs, such as Greece,[127] it is clear that the cumulative impacts of these multiple agreements can be substantial. In addition, it is clear that understanding them is a pre-condition for assessing the likely impacts of an SODR. This suggests that there will be a need for the creditors and the debtor to cooperate in undertaking the SODR HRIA.

In the event that the parties do not have a good baseline study, they will be confronted with a complicated human rights challenge. Both parties will know that they are undertaking a transaction that is likely to adversely impact the human rights of at least some of the debtor's subjects but without a clear understanding of the scope and scale of the impacts or how they may interact with each other. They may also not have the information to determine which of the possible SODR outcomes would be the least harmful option for all the affected stakeholders. Moreover, they will lack the time to undertake the kinds of studies that might help them understand the impacts. The net effect is that they will enter into the SODR with imperfect knowledge about the human rights implications of their proposed actions and in conditions in which they cannot easily take the public into their confidences about the proposed transaction.

The conclusion to be drawn from this situation is not that it is too difficult to apply the UNGPs to SODR. Rather, it is that the UNGPs need to be applied pragmatically. The parties should do the best HRIA that is feasible under the circumstances, understanding that they are unlikely to meet HRIA best practice standards.

The situation is further complicated by the fact that the outcome of the SODR will be a negotiated solution that will depend to a large extent on the negotiating dynamics and the balance of bargaining power between the state and its creditors. This means that neither the state nor the creditors can fully assess the impacts of the SODR before an agreement is concluded. They will not be able to determine, with any degree of confidence the full range, scale or

127. Truth Committee on Greek Public Debt, *supra* note 2; Salomon & De Schutter, *supra* note 2.

scope of all the impacts until they have a clear understanding of how much the debtor will have to pay, over what period and subject to what conditions. Consequently, their initial *ex ante* assessments will be more in the nature of a list of likely human rights impacts, without detailed information on the scale of the impact. This assessment will need to be adjusted as their negotiations proceed toward the final deal. The factors that will influence their assessment of the human rights impact of the SODR outcome include the size of the budget cuts the debtor will have to make, over what period, what external support may be available to help deal with these cuts, how this may change over time, and what measures the adversely affected stakeholders can take to counter the effects of the cuts. This information will also allow them to more confidently assess the trajectory of the adverse human rights impacts over time.

It is important to note that the HRIA needs to evaluate the impact of any proposed SODR on all relevant stakeholders and to assess whether the overall impact of the transaction on all these stakeholders is the least harmful from a human rights perspective. This suggests that there will be some situations where the financial institutions are contemplating transactions that may have irreconcilable, in human rights terms, impacts. For example if they pay too much attention to those adversely affected in the debtor country and take too generous steps to prevent or mitigate their harm, they may end up unduly impacting the interests of some bondholders, such as pensioners that count on the interest they earn as holders of the debtor's bonds for their monthly income. This suggests that, at least in some cases, SODR is a zero-sum game and that in making their HRIA assessments, the financial institutions will need to assess how this game evolves over the life of the SODR.

Needless to say, the parties' assessment of these outcomes over this period will depend on the assumptions they make about the relative severity of the impacts on the different stakeholders, and the reactions of the affected persons. In addition, their estimate of the human rights impacts will be affected by their assumption about the time period over which the impacts will manifest themselves. If they assume too short a time horizon they may over-estimate certain adverse human rights impacts which manifest themselves immediately after the SODR is concluded and may under-estimate certain mitigating factors relating to these impacts that manifest themselves more slowly. Conversely they may under-estimate the actual adverse impacts if they do not allow sufficient time to assess how the adverse impacts interact with each other and to determine their cumulative impacts. This means that certain possible SODR outcomes could be seen as being more or less desirable depending on the time horizon used in the impact assessment.

These issues and the complexities of applying the first two pillars of the UNGPs in the context of SODR, underscores the importance of the third pillar for dealing with the grievances that are likely to arise in the context of the implementation of the SODR.

3. The Third Pillar: Access to Remedies

As indicated above, there are substantial constraints on the ability of both the state and the creditors to undertake effective due diligence in advance of

agreeing a SODR. Consequently, there is a strong likelihood that there will be stakeholders whose interests have not been adequately accounted for in the HRIA of the outcome of the SODR. According to the UNGPs they should be given access to either judicial or non-judicial forums in which they can seek a remedy for this situation.[128] Clearly in many cases, these stakeholders may, in principle, be able to bring their grievance to a judicial or administrative forum either in the debtor state or in one of the home states of the creditors. However, this can be expensive, time consuming and the result can be uncertain. Consequently, it is not clear if, in all cases, judicial forums will be able to offer adequate effective relief to all those stakeholders whose human rights have been adversely affected by the SODR.

This suggests that in many SODRs there will be a need for aggrieved parties to have access to some form of SODR-specific grievance mechanism. The UNGPs stipulates that these mechanisms should be legitimate, accessible, predictable, equitable, transparent, rights compatible, and a source of continuous learning by the company.[129] The UNGPs also suggest that in setting up the mechanism, the parties should consult affected stakeholders on its performance and design.[130] Subject to these criteria, the parties are free to design and operate a grievance mechanism that best suits their purposes.

A SODR-specific grievance mechanism offers the sovereign debtor and its creditors three benefits. First, it provides the parties with a relatively flexible, informal and independent third party dispute settlement forum. Thus, an aggrieved party, provided they meet its access requirements, can use the mechanism to have their claim for a remedy for the human rights harm caused by the SODR addressed by someone other than the debtor or the creditor. If the process is transparent and participatory, it should give claimants confidence that their claims have been fairly addressed and thus enable them to accept even an unfavorable outcome of the grievance mechanism procedure. This fact should also help boost public confidence in the responsiveness of the debtor and the creditors to the interests of all stakeholders in the SODR. This can help build support for the agreement amongst all stakeholders, thereby building confidence in the ability of the parties to implement the agreement.

Second, this is a mechanism for dealing with the unintended adverse human rights impacts of the SODR. Since these agreements will have been concluded under time pressure and in the context of a crisis, there is a probability that the parties to it will not take account of all relevant stakeholder interests. As a result, there is a reasonable chance that the agreement will have some unintended but adverse human rights impacts on some stakeholders. An operational level grievance mechanism offers these stakeholders a means for informing the debtor and creditor about these impacts before they become too severe. It also provides a way for the affected parties and the debtor and creditors to have a relatively independent third party deal with them on their merits. This can help reduce the risk that the unaddressed concern becomes

128. *Id*.
129. Principle 31, UNGPs, *supra* note 11.
130. *Id*.

politicized and a potential threat to the overall efficacy of the agreement.

Third, a grievance mechanism, as indicated in the UNGPs, can perform a useful lessons learned function. The reason is that the mechanism generates empirical data about the actual impacts of SODR agreements and about how they can most effectively be managed. This may be of greater benefit to the creditors, many of whom are likely to have to deal with SODRs in the future, than to the sovereign debtor—who no doubt hopes not to have to repeat the SODR experience.

The benefits of the grievance mechanism are offset by two costs. First, the mechanism costs money to establish and maintain. An additional possible cost can arise if the grievance mechanism can provide compensation to parties that have been particularly severely affected by the SODR.

The question is who should be responsible for providing these funds—the debtor or the creditor? The answer to this question can have human rights implications. For example, if the debtor has to contribute the funds, it will have to cut its budget somewhere else, which may lead to such adverse impacts as job losses, reduced access to health care, education or social security for some citizens or reduced access to the justice system. On the other hand, if the creditor provides the funds, it might provide less debt relief to the debtor, which could also result in adverse human rights impacts.

Given, as indicated above, that the mechanism provides benefits to both the debtor and the creditor, it seems reasonable to expect both parties to contribute to the cost of the grievance mechanism. This would also have the benefit of enhancing the impression that the mechanism is impartial and independent.

A second potential challenge is that the mechanism could be overwhelmed, if individuals are allowed to bring complaints to the mechanism. This concern can be addressed through the jurisdictional requirements for the mechanism. For example, it could require cases to be brought by groups of individuals or organizations representing groups of individuals who have all been adversely affected in the same way. Such a requirement would also help the mechanism identify the most substantial and urgent complaints, thereby assisting it in allocating its time and resources efficiently and in optimizing its positive human rights impact on the SODR transaction.

The above discussion suggests that, on balance, the grievance mechanism offers more advantages than disadvantages to the SODR. This impression follows from the fact that the downsides of the mechanism, while not insignificant, can be effectively managed by the debtor and the creditors. Moreover, as the discussion of Pillars 1 and 2 of the UNGPs shows, there is a substantial risk that neither the creditors nor the debtor will be able to fully meet their/its responsibilities or obligations under the relevant pillar of the UNGPs in the context of a sovereign debt crisis. Consequently, they will benefit from having an independent, channel through which qualifying grievances can be addressed efficiently and fairly.

VI. SODRS AND GLOBAL GOVERNANCE[131]

The above discussion suggests that there are gaps in global economic governance relating to SODRs. The problem is not just that there is not a third party mechanism for coordinating and enforcing sovereign debt workouts. It is also that different aspects of the sovereign debt issue are being dealt with in different parts of the institutional architecture of global economic governance and they are not communicating effectively with each other.

Thus, the procedural issues of SODR are being deal with on an *ad hoc* basis and in arrangements established by the parties. "Procedural" in this context refers to the arrangements for the negotiations between the debtor and creditors in an SODR. It includes such issues as the sharing of information and how the parties should conduct themselves in these negotiations. It does not include "substantive" issues such as the principles that should guide the parties in deciding how to share the costs and benefits of the SODR among all the stakeholders in the negotiation, and how to account to those stakeholders who are adversely affected by the SODR for how they have been affected by the SODR. As this article indicates, the IIF and UNCTAD have developed some standards that seek to establish some principles to guide the SODR process.[132] However, they focus on procedural concerns and do not deal in any detail with the substantive issues that are likely to arise in SODRs.

The substantive issues that can arise in SODRs can be divided into two categories. The first category consists of the economic and financial issues that need to be addressed in order to reach a sustainable outcome. These are usually dealt with by the parties through negotiation, although the IMF and possibly some of the multilateral development banks may play a role in facilitating agreement on these issues. At times, other international institutions may play a role. For example, the Bank for International Settlement has provided support in a number of SODRs,[133] and the European Commission and the European Central Bank have played a role in the SODRs of Greece, Portugal, Ireland and Spain.[134]

The second category consists of the social and political, including human rights, issues that arise in SODRs that will influence the sustainability of the SODR outcomes. Formally these issues are considered to be the prerogative of the sovereign debtor. This means that the sovereign is responsible for making the difficult choices about how to allocate, *inter alia*, the human rights costs of the SODR. However, as indicated above, *de facto*, it is untenable to maintain that the creditors and international financial institutions such as the IMF do not play a role in these allocative decisions. Moreover, in general terms, the

131. It is clear that this is a complex topic that cannot be discussed in any great detail in this paper. Consequently, this section will focus on how to promote a more integrated and holistic approach to the development of international standards applicable to the economic, financial, human rights, social and political aspects of SODRs and not on such global governance challenges as the creation of a sovereign debt restructuring mechanism.

132. *Supra* notes 7 and 8.

133. Ugo Panizza, Federico Sturzenegger & Jeromin Zettelmeyer, *The Economics and Law of Sovereign Debt and Default,* 47 JOURNAL OF ECONOMIC LITERATURE 651 (2009).

134. Philip R. Lane, *The European Sovereign Debt Crisis*, 26 THE JOURNAL OF ECONOMIC PERSPECTIVES 49 (2012); Gianviti et al., *supra* note 18.

international community through such instruments as the UNGPs, the Global Compact and the OECD Guidelines has made clear that it thinks that businesses, including financial institutions, have a responsibility to deal with the human rights impacts of their operations. Nevertheless, in no case, to date, has any sovereign debtor or its creditors expressly applied the international standards applicable to business and human rights to a SODR, despite the fact that some of the debtor states[135] have endorsed the UNGPs and some of their creditors have expressly acknowledged their human rights responsibilities.

The fact that these procedural and substantive standards appear to run in parallel and appear not to intersect is problematic.[136] At the level of the individual debtor state, sovereign debt crises are experienced holistically by the debtor country and its citizens. However, the fact that the international standards like the IIF Principles are taken into consideration by the creditors while international standards like the UNGPs are excluded from the SODR negotiations means that the human rights aspects of the crisis are unlikely to receive the same consideration as the economic and financial factors. The result is an over-emphasis on economic and financial considerations and an under-estimation of the human rights and other social impacts, to the detriment of the overall efficacy and sustainability of the SODR.[137]

This situation is a symptom of a coordination gap in global governance arrangements that allows these two strands of thinking about financial interactions to operate in parallel rather than in communication with each other. It is possible that this deficiency could be corrected if all states could agree on one entity to which to delegate the responsibility to coordinate the development of international standards dealing with economics and finance issues and social, human rights and cultural matters. Such coordination would ensure that all these factors are taken into account in processes, such as SODRs, that are ultimately holistic in nature and are experienced as such by their stakeholders. While this may result in a SODR process that is more complicated and in negotiations between the debtor and creditor that are more difficult, it should also ultimately result in outcomes that are more sustainable and seen as more legitimate by all stakeholders.

The existence of this gap is intriguing given that the international community recognized the need for coordination between economic and social, including human rights, issues when it established the United Nations. The Economic and Social Council (ECOSOC) was expected to play this coordinating role.[138] Unfortunately, time has demonstrated that the ECOSOC

135. The UNGPs were endorsed by consensus by all the member states of the U.N. Human Rights Council in 2011. For a list of the participating states, see http://www.ohchr.org/EN/HRBodies/HRC/Pages/Year20102011.aspx.

136. The one exception to this observation is the UNGA resolution on sovereign debt restructuring, see *supra* note 26. However, it is too early to know if this resolution will have any impact on SODRs. In addition, the principles are set out in very general terms which may make them difficult to apply in a uniform way in different SODRs. Furthermore, history suggests that neither debtors nor creditors look to the UNGA for guidance when engaged in SODRs.

137. Concern about the dangers of paying inadequate attention to the social and human rights implications of SODRs was raised in Greece. See Truth Committee on Greek Public Debt, *supra* note 5; ECtHR, *Koufaki and Adedy v. Greece*, *supra* note 5, para. 47.

138. U.N. Charter, Chapter X (Articles 61–72) (Oct 24, 1945), 59 Stat. 1031, T.S. 993,

has not been effective in playing this role.[139] In addition, in the SODR context, the participants in the coordinating mechanism cannot be limited, like the ECOSOC, to states. As this article has shown, non-state actors, such as financial institutions are necessary participants in SODRs and thus will need to have access to any coordinating mechanism, if it is to be effective. Consequently there is a need for a new coordinating mechanism that can assist all relevant stakeholders in SODRs in ensuring that all the applicable international standards are integrated into the SODR process. Given the general complexities of SODRs and the lack of agreement on the need for an independent third party mechanism capable of enforcing a SODR outcome, and the range of considerations that should be taken into account in an SODR, it is unlikely that agreement could be reached on establishing a coordinating mechanism that has anything more than advisory powers. Nevertheless such an advisory mechanism if it had sufficient expertise and credibility and a sufficiently high profile, could play a useful informational role and could shift the burden of justifying exclusion of either the procedural or the substantive standards from an SODR onto those parties that are resistant to including both sets of standards.

CONCLUSION

SODRs are complicated transactions. They involve multiple actors with conflicting interests and agendas, sophisticated contractual arrangements; multiple regulatory environments, complex economic, financial and political contexts, and they need to be negotiated under time pressure. They usually must be concluded in the glare of publicity even though there are limitations on how transparent they can actually be if they are to be concluded relatively promptly and effectively.

The sovereign debtor and its creditors, in addition to dealing with all these factors, need to respond to the demands of at least some of the stakeholders in the SODRs that their outcomes comply with the evolving international norms dealing with the human rights responsibilities of businesses and the international legal obligations of sovereign debtors in this regard. The UNGPs offer the parties to the SODR, at least in those cases in which commercial creditors are involved, a basis for showing that they are responding to these demands and the applicable norms and standards. In practice this requires the parties to undertake appropriate due diligence, usually in the form of *ex ante* human rights impact assessments. However, as indicated above, in the specific context of SODRs there is not sufficient time or possibly the resources to fully apply the UNGP requirements, particularly in regard to due diligence. This means that both parties will have to do as much due diligence as is feasible under the circumstances. As a result, they will have to base their decisions on partial knowledge both about current human rights conditions and

available at http://www.un.org/en/sections/un-charter/chapter-x/; Goldmann, *supra* note 18; Sabine Michalowski, *Sovereign Debt and Social Rights–Legal Reflections on a Difficult Relationship*, 8 HUM. RTS. L. REV. 35 (2008).

139. Arguably the U.N. General Assembly is attempting to play this coordinating role in its 2015 resolution on sovereign debt principles. See *supra* note 26.

the likely impact of the SODR on these conditions and the trajectory of these impacts over the life of the SODR. Applying the UNGPs, will help the parties deal with the risks arising from this situation by making sure that they are aware of the human rights impacts of their proposed transaction. In addition, their ability to manage these impacts will be enhanced if they implement the UNGPs requirement to establish an SODR-specific grievance mechanism. This mechanism can address complaints arising from the SODR that the parties may not have anticipated and that cannot adequately be dealt with in the applicable judicial and administrative forums.

There are three conclusions that follow from this complicated situation. First, the fact that the international standards dealing with business and human rights are not expressly taken into account in SODRs is problematic. It increases the risk of the debtor and creditors agreeing a SODR outcome that over-emphasizes economic and financial considerations and under-emphasizes the human rights and other impacts of the SODR. This in turn increases the risk that the SODR outcome will be sub-optimal and possibly distorted. This in turn risks undermining the legitimacy and sustainability of the SODR.

Second, the application of the UNGPs to the context of SODR highlights an important challenge for human rights laws. It shows that the way in which human right issues arise in the context of specific business transactions pose new conceptual challenges for human rights law. For example, it is not clear that human rights law can give the parties adequate guidance in working out if or under what conditions it is acceptable, from a human rights perspective, for them to accept short term adverse human rights consequences for inherently uncertain long term benefits. Human rights law may also not be able to assist them to determine how far they should stretch the lines of causation in assessing the cumulative impacts of the SODR. For example, if the SODR is shown to have an adverse effect on access to education, should the human rights impact assessment consider the likely consequences of the reduced access to education on the future employment, health, social welfare and other rights of the children who lose access to education and their families? Human rights law may also not be able to guide them in assessing how to balance the competing claims of different stakeholders in a SODR. For example, it may not be able to guide the creditors in deciding if they should attach greater priority to the adverse impacts on the people who lose their jobs in the debtor country because of the SODR, the people who lose access to health care because of cuts in the health budget in the debtor country or the individual bondholders in a second country who relied on the representations of the debtor country to purchase its debt and now could lose part of their life savings or have their monthly incomes cut if the debtor receives debt relief.

This conclusion makes clear that while the norms and standards in regard to business and human rights are well established in the sense that there is general consensus that businesses have human rights responsibilities, we are still only in the early stages of developing our knowledge about how human rights should be applied to businesses and how they should go about fulfilling their human rights responsibilities. We are also only beginning to learn how states should help businesses fulfill these responsibilities and how this will

affect the human rights obligations of states. These are all issues that are in need of further research.

The third conclusion relates to global economic governance. This article suggests that there is a cost to be paid for treating the various international standards applicable to the process of SODR in isolation from the standards applicable to the substantive issues that arise in SODR, such as human rights impacts. These different standards need to interact with each and their application in specific contexts need to be coordinated to ensure that they operate in a mutually supportive fashion. This suggests that there is a need for an independent coordinating mechanism that can promote more effective coordination between the actors developing these two parallel strands of international norms and standards. Determining the precise nature, powers and make up of this mechanism requires further research.

On Functions and Finance: Sovereign Debt Workouts and Equality in International Organizations Law

Jan Klabbers*

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INTRODUCTION

The innocent Martian landing on earth may be forgiven the somewhat bewildered look in her eyes when surveying the situation regarding regulation of international financial matters.[1] Contrary to what is the case with most recognized issue areas, international financial matters are not the province of a single, more or less universal international organization.[2] Where global health is served by the World Health Organization, and postal traffic is the province of the Universal Postal Union, there is no equivalent organization dealing with global finance.

Instead, there is a patchwork of entities, some formal, some less so,[3] addressing various aspects of financial matters. The field is fragmented to a high degree, with some entities assuming some responsibility for financial policy at large (the G20 in particular), and some engaged in financial regulation (the Basel Committee, part of the Bank for International Settlements – itself a curious entity –; the International Organization of Securities Commissions, the Financial Stability Board).[4] There are entities charged with oversight of

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1. I borrow the Martian from THOMAS M. FRANCK, THE POWER OF LEGITIMACY AMONG NATIONS (1990).

2. The only other major issue area to which this applies is the environment, which is likewise fragmented into a number of distinct regimes. One can only wonder whether it is a coincidence that both finance and the environment are regularly in crisis.

3. On the distinction, see Jan Klabbers, *Formal International Organizations*, *in* OXFORD HANDBOOK OF INTERNATIONAL ORGANIZATIONS (Jacob Katz Cogan et al., eds., forthcoming). *See also* Jan Klabbers, *Institutional Ambivalence by Design: Soft Organizations in International Law*, 70 NORDIC J. INT'L L. 403 (2001).

4. A useful overview of regulatory bodies and their work is HOWARD DAVIES & DAVID

financial dealings (such as the Financial Action Task Force.)[5] Some international organizations of broad membership and jurisdiction claim a stake in financial matters, with both the United Nations General Assembly and the United Nations Conference on Trade and Development (UNCTAD) aspiring to play a role, as does the Human Rights Council. Then there are a lot of entities, both universal and regional, providing loans and financial support for investment and development purposes, ranging from the World Bank and International Monetary Fund (IMF) to regional organizations such as the Nordic Investment Bank, the Council of Europe Development Bank, the Inter-American Development Bank or the African Development Bank, and ranging from established players (such as the World Bank) to ambitious newcomers, such as the China-inspired Asian Infrastructure Investment Bank (AIIB). And with no claims to exhaustiveness, there are several existing entities working on debt relief, including the aforementioned General Assembly, UNCTAD and IMF, and less well-known entities such as the informally named Paris Club (largely inter-state) and London Club (involving the private sector). If the fragmentation of general international law was considered troublesome a decade ago,[6] it pales in comparison with the fragmentation of international financial law, and if the latter has never seemed troublesome, it is most likely because the field has never been imagined as unitary, non-fragmented to begin with. If international trade law was 'invented' by the late John H. Jackson, as is sometimes suggested,[7] financial law has thus far lacked a similar unifying voice.[8]

The focus of this paper will rest on the tensions within the legal functionalism approach dominating international organizations law, brought to light by looking at the financial sector in general and debt relief in particular. Two of these tensions will be central to this paper: the role of sovereign equality in functionalist theory, and the nature of functionalism as it transpires from examining the financial sector. While this may seem to constitute an esoteric and impractical theoretical exercise, it should be remembered that international organizations (including financial institutions) benefit tremendously from functionalism, as it is functionalism that justifies the existence of large bureaucracies with broad competencies, taxation privileges, and a sheltered existence due to immunity from suit and the near-impossibility

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GREEN, GLOBAL FINANCIAL REGULATION: THE ESSENTIAL GUIDE (2008). On the more recently established Financial Stability Board, see Sara de Vido, *The Financial Stability Board and Other New Modes of Governance, in* THE LEGAL IMPLICATIONS OF GLOBAL FINANCIAL CRISES (Geneviève Bastid-Burdeau & Michael Waibel, eds., forthcoming).

5. Marie Wilke, *Emerging Informal Network Structures in Global Governance: Inside the Anti-Money Laundering Regime*, 77 NORDIC J. INT'L L. 509 (2008).

6. For a synthetic overview, effectively closing much of the debate, see MARTTI KOSKENNIEMI, FRAGMENTATION OF INTERNATIONAL LAW: DIFFICULTIES ARISING FROM THE DIVERSIFICATION AND EXPANSION OF INTERNATIONAL LAW. REPORT OF THE STUDY GROUP OF THE INTERNATIONAL LAW COMMISSION (Erik Castrén Institute, 2007).

7. *See* David Kennedy, *The International Style in Postwar Law and Policy: John Jackson and the Field of International Economic Law*, 10 AM. U. L. REV. 671 (1995).

8. A recent attempt, eventually too engaged with secondary policy questions to succeed fully, is Chris Brummer, *How International Financial Law Works (and How It Doesn't)*, 99 GEO. L. J. 257 (2011).

of being held to account by third parties.[9] Hence, this is not merely 'art for art's sake' – there actually is something at stake. A decline in the appeal and popularity of functionalism might entail that institutions lose their privileged status, hence it is of relevance to subject the workings of functionalism to closer scrutiny.

This paper is structured as follows. I will first sketch the patchwork of institutions addressing matters related to global finance and the resulting theoretical puzzles (I) and discuss some historical background relating to the emergence of international organizations (II). Subsequently, Section III will discuss some of the more prominent entities operating in debt relief, and will include a snapshot of the UNCTAD Roadmap and its follow-up. Section IV will discuss how the financial sector relates to functionalism, while Section V concludes.

One caveat is in order: I write this as an international lawyer with special interest in the law (and theory) of international organizations, rather than in financial law or sovereign debt relief. Consequently, this piece treats the international financial mechanisms and institutions as the empirical data that may or may not shine a light on the law of international organizations.

I. THE PATCHWORK

Even on closer scrutiny and from the perspective of the law of international organizations, the patchwork of formal and informal entities (Brummer speaks of a 'dizzying array')[10] engaged with different aspects of international financial law shows some remarkable characteristics. First, with the exception of the (many) organizations active in investment and development, most would be considered as highly informal. The G20, the Basel Committee, the Financial Stability Board, the Paris Club; none of them fits the textbook description of international organization.[11] If entities such as the World Health Organization (WHO) or Universal Postal Union (UPU) represent a Weberian ideal type, many of the financial entities depart considerably from the ideal.[12] In fact, not a single organization matches the ideal type; the best heuristic device is that of a continuum with the ideal type at its end. And even those among the financial entities that do come relatively close (the IMF, the investment and development institutions) nonetheless still depart significantly from the dominant model, in the ways their decision-making structures are set up, and often also in terms of their accountability. For instance, many of them explicitly rule out the possibility that member states can be held liable for the

9. For a general overview, see Jan Klabbers, *The EJIL Foreword: The Transformation of International Organizations Law*, 26 EUR. J. INT'L L. 9 (2015).

10. Brummer, *supra* note 8, at 259.

11. There actually is no single generally accepted textbook definition, but most authorities agree that international organizations typically (though not invariably) consist of states, are typically (though not invariably) based on a treaty, and typically have at least one organ, preferably one with a will distinct from the will of the member states. For one authoritative discussion, see HENRY G. SCHERMERS & NIELS M. BLOKKER, INTERNATIONAL INSTITUTIONAL LAW: UNITY WITHIN DIVERSITY 36-47 (2011).

12. On ideal types and their use in social theory, see MAX WEBER, ECONOMY AND SOCIETY, VOLUME I 20-22 (1978, Guenther Roth & Claus Wittich eds.).

organization's activities,[13] and many of them decide through what is referred to as weighted voting.

Second, many of the entities together providing global financial governance are special in the sense that they do not strive to be inclusive in terms of membership. The G20 is limited to, as the name suggests, 20 members; the Paris Club likewise counts twenty permanent creditor states; the Financial Stability Board, a creation of the G20, has 24 members,[14] and the Basel Committee does not have many more – 28, as of March 2016. Yet, it is abundantly clear that these entities of limited membership exercise authority over the world at large and, what is more, exercising such global authority is often precisely the ambition. In so doing, these entities depart fundamentally from the classic international ordering mechanism of 'sovereign equality', still honored as the normative cornerstone of the United Nations but often considered of symbolic value rather than an accurate representation of the global distribution of power.[15]

Thus put, global financial regulation presents the law of international organizations with some fundamental theoretical puzzles. The dominant theory is the theory of functionalism, and while it will be further set out below it is perhaps useful to spell out its main elements already here.[16] It is premised on the idea that states set up entities and give them a specific technical function (or small set of related of functions). The law is put in place to make sure that nothing impedes the performance of those functions, precisely because they are supposed to be technical, i.e. a-political, and thought to contribute to the greater good: one luminary could write, without irony, that organizations contribute to the 'salvation of mankind'.[17] International organizations law facilitates the working of international organizations by means of, for instance, allowing for broad conceptualizations of the implied powers doctrine, by granting privileges and immunities from jurisdiction, and by making it next to impossible for third parties (i.e. those other than member states) to control the activities of international organizations.[18]

In particular, the disorganization of global financial regulation raises two fundamental questions for functionalism. First, there is the position of non-member states to consider: it is clear that many non-members are affected, and that therewith ideas about sovereign equality become problematic. Surely, a country such as Malawi is not on a par with the US or China, neither in the organizations it is a member of (such as the World Bank) nor in the setting where its policies are affected by entities it is not a member of, such as the G20 or the Basel Committee. Even within an informal entity such as the Paris Club

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13. The point is highlighted in CHITTHARANJAN F. AMERASINGHE, PRINCIPLES OF THE INSTITUTIONAL LAW OF INTERNATIONAL ORGANIZATIONS 426-428 (2005).

14. The G20 members plus Brazil, China, India and Spain.

15. For in-depth discussion, see GERRY SIMPSON, GREAT POWERS AND OUTLAW STATES (2004).

16. Much of what follows is derived from Klabbers, *supra* note 9.

17. NAGENDRA SINGH, TERMINATION OF MEMBERSHIP OF INTERNATIONAL ORGANISATIONS vii (1958).

18. *See generally* JAN KLABBERS, AN INTRODUCTION TO INTERNATIONAL ORGANIZATIONS LAW (2015).

there seems to be a discrepancy between creditor states and debtor states, symbolized in the circumstance that the debtor never meets with all permanent members at once but only deals directly with the Chairperson, who exercises a power delegated to him by the permanent members.[19] And within the IMF the structural adjustment programs nominally insist on mutual consent, but somehow the borrowing state is hardly in a position not to. In short, to the extent that functionalism works on the presumption of the sovereign equality of states, the financial sector problematizes this fundamental notion.

Second, there is a challenge to the very heart of functionalism, and ironically it stems from the highly functional nature of the financial entities, whether formal or informal. While most organizations are either a mixture of managerialism and agora,[20] as it has been put, or are little else but 'debating clubs', uncharitably put,[21] the financial entities are extremely function-oriented. They do not debate on general matters of social justice; instead, they invest and develop, they regulate, they manage. There is broad agreement on the outlines of policy; this stems directly from the organization's function; and consequently, political debate (which inevitably takes place) tends to revolve around points of detail and individual loans, with only the occasional bigger issue flaring up precisely at the moment when the main function is questioned: think of the 'greening' or the 'human rights mainstreaming' of the financial institutions. Yet, ironically, instead of this resulting in financial entities being the poster children for functionalism, most observers suggest that these entities occupy a somewhat special place, at some removes from the ideal type.[22]

These two questions will be central to the current article. They are not the only questions worth asking in relation to the global financial order (such as it is). It would be extremely interesting to zoom in on synergies and competition between entities, as symbolized by the recent creation of the AIIB, but this is not the time or the place. Neither is this the time or the place to focus on the re-invention of entities that for a while were (or seemed to be) marginalized: UNCTAD's central role in financial matters these days departs from its constitutional mandate, but would constitute an intriguing example.[23] Finally, it would also be useful to pay closer attention to what it means for functionalism that some of the functions, as it turns out, are taken care of by entities that do not qualify as formal organizations. If formal organizations owe their existence to their capacity to perform specific functions, what happens if it is discovered

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19. As mentioned by Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of International Public Authority: Towards a Decentralized Sovereign Insolvency Law*, *in* SOVEREIGN FINANCING AND INTERNATIONAL LAW 39 (Carlos Esposito, Yuefen Li & Juan Pablo Bohoslavsky eds., 2013).

20. Jan Klabbers, *Two Concepts of International Organization*, 2 INT'L ORG. L. REV. 277 (2005).

21. Symbolized in clever *trouvailles* about their acronyms, where UNCTAD stands for Under No Circumstances Take Any Decision, GATT was the General Agreement to Talk and Talk, and the OECD is known as Office for Excellent Cocktail parties and Dinners.

22. This is rarely made explicit, but oozes from the textbooks, precisely because of the different voting procedures and the sheltered legal position of member states referred to above.

23. See also Jan Klabbers, *Marginalized International Organizations: Three Hypotheses Concerning the ILO*, *in* CHINA AND ILO FUNDAMENTAL PRINCIPLES AND RIGHTS AT WORK (Ulla Liukkunen & Yifeng Chen, eds., 2014).

that those same functions can also, and perhaps better (i.e. more efficiently or more effectively) be performed by others?[24]

II. THE BACKGROUND

When international organizations were first created and studied against a political background, they were generally heralded as marking an improvement in the lot of smaller and poorer states. These smaller powers used to be bossed around by the bigger powers, whether in the guise of a Concert, an Alliance (Holy or otherwise), or some kind of Balance of Powers, or under some form of colonial administration, even if only under the heading of a doctrine – such as the Monroe Doctrine. This changed, or so it seemed, with the emergence of international organizations: instead of being bullied by the bigger powers, now at least smaller and poorer states could act on the same footing with their bigger and more powerful neighbors. Typically, organizations worked on the principle of 'one state, one vote' in their plenary bodies, and while sometimes the use of majority voting meant that the individual smaller and poorer states could be outvoted, at least collectively they could take a stand.[25]

This rosy picture was not inaccurate, in that organizations often indeed typically work on the basis of sovereign equality and thus 'one state, one vote', marking something of an improvement. Nonetheless, it was always somewhat deceptive. For one thing, the smaller and poorer states engaged in 'lawfare' *avant la lettre* in order to try and change the international legal order and the implications of the foundational notion of sovereignty, if only by proposing new rules or opposing existing ones.[26] No lesser authority than Paul S. Reinsch, one of the founding fathers of the law of international organizations, pointed out that the distinction between colonial domination and domination through an international organization was a distinction of degree at best, not a distinction of kind.[27] And somehow, it usually transpired that while the poorer and smaller states might have equal voting rights in the plenary bodies of international organizations, these were rarely the politically relevant bodies: the real power would reside elsewhere, in bodies and organs of limited composition where voting would not be equal.

The most visible manifestations hereof these days are the UN Security Council with it five veto-wielding permanent members and the weighted voting prevalent in the financial institutions, but the pattern as such is well-nigh universal. In the International Maritime Organization (IMO), e.g., the relevant organ for much of the important work is the Council, a body of limited composition – the IMO's member states actively campaign for the right to sit

24. See also Jan Klabbers, *Contending Approaches to International Organizations: Between Functionalism and Constitutionalism*, *in* RESEARCH HANDBOOK ON THE LAW OF INTERNATIONAL ORGANIZATIONS (Jan Klabbers & Åsa Wallendahl, eds., 2011).

25. For an informed discussion in this vein, see BENGT BROMS, THE DOCTRINE OF EQUALITY OF STATES AS APPLIED IN INTERNATIONAL ORGANIZATIONS (1959).

26. See Arnulf Becker Lorca, *Sovereignty Beyond the West: The End of Classical International Law*, 13 JOURNAL OF THE HISTORY OF INTERNATIONAL LAW 7 (2011).

27. He did so for instance in his public speeches, trying to create enthusiasm for international organizations in his skeptical audiences. For further discussion, see Jan Klabbers, *The Emergence of Functionalism in International Institutional Law: Colonial Inspirations*, 25 EUR. J. INT'L L. 645 (2014).

on the Council for a limited period of time. Meanwhile in the World Trade Organization (WTO) decisions are either pre-cooked in informal meetings ('green room') or, when not pre-cooked, they are stalled indefinitely: witness the fate of the Doha Round.[28] Even within informal entities of large membership, the real action takes place 'en petit comité', as in the eighteen-member Technical Committee of the International Organization for Securities Commissions (IOSCO).[29] And many of the important topics have by now even been taken out of the reach of formal organizations and are decided upon in closed, self-appointed clubs such as the G20; in the Conferences or Meetings of the Parties set up under international environmental agreements, or in temporary and broad but ill-defined alliances such as the Contact Group on Piracy off the Somali Coast.

In short, the equality embedded in the formal decision-making processes of many international organizations has always been mostly of cosmetic or symbolic value. It suggests that all states are equal; that differences in political, military, economic or cultural power may matter in everyday life, but can be bracketed as the occasion arises. In so doing, the notion of sovereign equality is undergirded by a democratic theory of sorts. Arguably, it is a misguided, perhaps perverted, democracy theory that ignores whether the state concerned actually can be said to be representative of its citizens, but nonetheless, as noted, it was often considered a step forward in comparison to being bullied by the greater powers.

With this in mind, it should not come as a surprise that discussions about debt relief and sovereign default are usually taken in entities where, as a general rule, it remains unclear whether all members are equal, or whether some might be a bit more equal than others. Following the model of financial institutions generally, one would perhaps expect that mechanisms to facilitate debt relief too would work on the basis of financial clout, and indeed this seems by and large to be the case. Yet, things are not very open and transparent, and this may find its cause in the nature of the activity concerned, which remains something of a taboo from many directions.[30]

For one thing, if state A's debts are being mitigated or even swept away in a highly public fashion, then many other states will come and present similar demands: why, after all, give preferential status to A, but not to B and C? This pattern was clearly visible after much of Iraq's debt was relieved,[31] although there is less empirical support visible in other cases. Such distinctions breed discontent, and go against the general grain of international law. Even the granting of favorable treatment in trade relations has always been frowned

28. On patterns of inclusion and exclusion relating to the WTO and resulting from informal power exercises, see EXPERT KNOWLEDGE IN GLOBAL TRADE (Erin Hannah, et al., eds., 2016).

29. The point is made by Brummer, *supra* note 8, at 278. See on IOSCO generally also ANNE MARIE SLAUGHTER, A NEW WORLD ORDER (2004).

30. Note also that debt relief is, in current proportions, a fairly novel phenomenon. Indicative is that until the 1980s, studies on financial law would rarely devote attention to debt relief or debt workouts. See, e.g., FREDERICK A. MANN, THE LEGAL ASPECT OF MONEY (1982) (discussing such things as the currency of repayment, the calculation of interest, et cetera, but not paying much attention to relief or workouts).

31. See the discussion in YVONNE WONG, SOVEREIGN FINANCE AND THE POVERTY OF NATIONS: ODIOUS DEBT IN INTERNATIONAL LAW (2012).

upon: think of the ingenious phenomenon of the most-favored-nation principle, which has a history going back to the nineteenth century, i.e. long before the WTO or even its predecessor GATT was ever created. Hence, the states granting debt relief have something of an interest in trying to prevent things from becoming very public: providing relief is more suited for backroom negotiations than for the cameras of CNN and the publicity of twitter feeds, also with a view to keeping domestic audiences happy. And if this is the interest of the debt relievers, it is the interest of the debtor states as well: they must play along.

But there is a more interesting cultural phenomenon at work as well. Debt relief is often necessary not so much to service a particular loan, but rather to service the servicing of loans: over time, debts accumulate due to the imposition of interest. This entails that creditor states are, eventually, making money on other people's misery, and do so not just incidentally or for a particular project (this is what IMF and World Bank are for), but on a structural basis. This now sits uncomfortably with many ethical traditions, and may help explain why few are brazenly open about such issues.[32]

There are other ethical considerations militating against openness as well, none more so perhaps than the awkward circumstance that often, governments are loaned money which enable them to conduct wars and oppress their populations. There are no doubt circumstances where it can be argued that this is the right thing to do (think of World War II lend-lease, e.g.), but also circumstances where this is less felicitous: it is generally acknowledged that Saddam Hussein's Iraq borrowed huge sums of money first to engage in war with Iran, later also in order to invade Kuwait. The former was considered geopolitically justifiable (the Iranian revolution of the late 1970s was widely seen as threatening, so anyone wishing to stop Iran was welcome), but few would have approved of the latter, and indeed it led to the curious spectacle of the West having to spend lots of money to repel an invasion which itself had been sponsored by lots of western money.

III. THE ORGANIZATIONS

If debt relief is not a very transparent affair, often taking place far removed from the spotlights, one of the more active entities engaged in it is known as the Paris Club, with the designation itself already signifying an absence of formal structures. Despite not being very well-known to the general public and not occupying a prominent place in the general literature on international organizations or international economic law,[33] the Paris Club is not particularly shy.[34] It was set up in 1956 as an informal meeting of

32. This may be a residue form of debates surrounding the emergence of capitalism, which was not so much considered virtuous in its own right at the time, but rather as a useful antidote against greater evils. For a wonderful discussion, see ALBERT O. HIRSCHMANN, THE PASSIONS AND THE INTERESTS: POLITICAL ARGUMENTS FOR CAPITALISM BEFORE ITS TRIUMPH (2013 [1977]).

33. It is sometimes deemed worthy of a paragraph. See, e.g., BOB REINALDA, ROUTLEDGE HISTORY OF INTERNATIONAL ORGANIZATIONS: FROM 1815 TO THE PRESENT DAY 461 (2009); MATTHIAS HERDEGEN, PRINCIPLES OF INTERNATIONAL ECONOMIC LAW 465 (2013).

34. Much of the following was culled from its website: http://www.clubdeparis.org/en/.

Argentina's then creditor states, in Paris, in order to set up a deal. Since then, so its website proudly proclaims, the Paris Club has treated $ 583 billion in debts, through 433 agreements involving some 90 debtor countries. The Paris Club treats mainly bilateral debts; it serves as a forum for bringing the indebted state together with its creditors.[35]

The Paris Club counts 20 permanent members, all of them wealthy industrialized nations, and generally seen as Western (this includes Japan and Australia). Perhaps the most surprising member is Russia, which until not so long ago itself was often also listed as a debtor state. Russia actually joined in 1997 while also still a debtor state.

In addition, so called 'ad hoc participants' can participate in the work of the Paris Club. There are some 15 of those at present, including Brazil, Argentina and Turkey. Some nine international organizations (including IMF, World Bank, and OECD) are listed as observers, and non-member creditor countries too can participate in negotiations, providing the debtor state and permanent members agree. The Paris Club is served by a small secretariat, consisting of two handfuls of French Treasury officials, headed by a French official, and located within the French Treasury Department. Likewise, the chairman of the Paris Club is a senior French Treasury official.[36] This is, in a strong sense, a throwback to nineteenth century structures: the earlier international organizations tended to be located in the relevant ministry of the host state and staffed by employees of that host state's ministry.[37]

Decision-making in the Paris Club has two important characteristics. First, it takes place by consensus: under 'The Six Principles' at the heart of the Club's operational model, 'decisions cannot be taken without a consensus among the participating creditor countries'. Second, while 'formally' (if the word is appropriate in the context of the Paris Club) merely an observer, the IMF plays an important role: the Paris Club borrows (no pun intended) conditionality standards set by the IMF, and demands that the creditor country has a current IMF arrangement of one form or another. Put differently, even though the Paris Club focuses on bilateral debts, the creditor needs the backing of the IMF in order to stand a chance with the Paris Club – and this adds a multilateral element.

Perhaps noteworthy is that for a long time, the Paris Club, while happy to discuss and restructure debts, was not at all keen on providing debt relief. This only started to happen in the 1990s, after the club adopted its so-called Naples terms in 1994, followed in 2003 by more extensive Evian terms. As Bohoslavsky and Goldmann suggest, this marks the transition from a purely contractual perspective on debts to something of a more public concern.[38]

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35. For a useful, if somewhat outdated, discussion, see Alexis Riefel, *The Paris Club, 1978-1983*, 23 COLUM. J. TRANSNAT'L L. 83 (1984).

36. Sometimes these go on to bigger things still: Michel Camdessus chaired the Paris Club from 1978 until 1984, and three years later became managing director of the IMF. See ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 625 (2002).

37. EDOUARD DESCAMPS, LES OFFICES INTERNATIONAUX ET LEUR AVENIR (1894).

38. Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*, in this issue.

The Paris Club is, like so many international organizations, an organization departing from the standard blueprint model. It has no constitutional instrument to speak of; it is unclear who can join, and how they can join; and it has no organs other than a small and outsourced secretariat. Neither does it produce law, strictly speaking: once the Club and the debtor country reach an agreement this is given the ostensibly non-binding form of 'agreed minutes',[39] the contents of which will be worked out in bilateral agreements between the debtor state and its individual creditors. And yet, despite all this informality, it would seem that the Paris Club is an international organization, at least for heuristic purposes, and can be analyzed in those terms. It has been in existence for sixty years, and clearly seems to fill a need. Still, there is a sense that it has outlived its utility: Gelpern suggests that the Paris Club no longer meets today's needs, and its decline has become 'impossible to ignore'.[40]

If the Paris Club has largely operated in a self-imposed twilight zone, the IMF, by contrast, has been highly visible over the past seven decades. The IMF, as is well-known, was set up in 1944, together with the World Bank and the ill-fated International Trade Organization, in order to help structure the post-war economy.[41] It main brief was, and is, to deal with monetary imbalances. Equally well-known is that its decision-making structure does little to pay homage to the 'one state, one vote' idea: decision-making takes place by weighted voting,[42] and the weight of votes of each member state is dependent on the amounts of money it has invested in the IMF. In short: the more you put in, the more power you can exercise. As many have suspected, over the years the IMF has proved to be highly sensitive to instructions and demands coming its way from the United States Treasury department. In particular during the Clinton administration, 'it was often difficult . . . to tell where US policy ended and [IMF] management strategy began.'[43]

Of the Bretton Woods institutions, it is the IMF that is most often associated with debt relief. It launched the so-called Highly Indebted Poor Countries (HIPC) in 1996, and proposed the creation of a Sovereign Debt Restructuring Mechanism in 2003. The former is often considered successful, at least in terms of output; the latter, however, was never accepted by the relevant states. Instead, the richer nations continue to rely on market-based mechanisms,[44] such as the Collective Action Clauses often included in

39. Incidentally, this label itself is no airtight indication of legal status. Other 'agreed minutes' clearly having legal force included the boundary treaty between Iraq and Kuwait, so flagrantly violated by Saddam Hussein in 1990. For further reflection, see JAN KLABBERS, THE CONCEPT OF TREATY IN INTERNATIONAL LAW (1996).

40. *See* Anna Gelpern, *Sovereign Debt. Now What?*, in this issue.

41. RICHARD N. GARDNER, STERLING-DOLLAR DIPLOMACY IN CURRENT PERSPECTIVE: THE ORIGINS AND THE PROSPECTS OF OUR INTERNATIONAL ECONOMIC ORDER (1980).

42. Tarullo speaks, less innocuously, of 'the radically asymmetrical allocation of voting power' with the IMF. See Daniel K. Tarullo, *The Role of the IMF in Sovereign Debt Restructuring*, 6 CHI. J. INT'L L. 287, 292 (2005).

43. RANDALL W. STONE, CONTROLLING INSTITUTIONS: INTERNATIONAL ORGANIZATIONS AND THE GLOBAL ECONOMY 212 (2011).

44. Relying on investment arbitration is likely to be fraught with problems: see Michael Waibel, *Opening Pandora's Box: Sovereign Bonds in International Arbitration*, 101 AM. J. INT'L L. 711 (2007).

sovereign bonds. These allow a supermajority among creditors to bind a dissenting minority, and therewith are thought to facilitate debt relief workouts, as the minority cannot hold the majority captive.

Perhaps the main political imperatives regarding debt relief tend to come from the economic superpowers meeting once a year under the innocuous headings of first G7, then with Russia joining known as G8, and nowadays G20 (the latter also including some of the larger developing economies). During the 1980s and early 1990s, the (then) G7 did little to stimulate debt relief: the major economic powers were of the opinion that at best, debts should be restructured, but that once incurred, debts should be fully repaid.[45] That said, a first change came about in 1987, when the G7 agreed, in Venice, to let poor African states defer their payments, provided they accepted structural adjustment directives from the IMF.[46]

As far as institutionalized manifestations of global governance go, the G7/G8/G20 (apologies for awkward labeling, in itself indicative of elusive institutionalization) must rank amongst the more opaque examples. It may be relatively clear who are members at present, but is unclear on what criteria members are selected, by whom they are selected, and how members can join or leave.[47] Decision-making, likewise, is lacking in transparency, and the legal status of their communiqués is less than certain. What is clear though is that the G7/G8/G20 plays an important role in global governance, exercising power both directly and indirectly, through the influence its members have on decision-making in IMF and World Bank.[48] This also extends to issues of debt relief, even in the absence of any formal safeguards.[49] It was, e.g., the G7 that spurred the creation of the Financial Stability Board, and the G7/G8/G20 was instrumental in providing the OECD with the impetus to start working on a global taxation regime in the form of the BEPS project.[50] While many proclaim the relevance of the Rule of Law, the economic superpowers tend to be keen on circumventing such philosophies in their own dealings, preferring the flexibility offered by the absence of formal procedure to the legitimacy associated with proper legal procedure.[51]

Perhaps the most prominent recent attempt to create something of a global debt relief mechanism has been located, not entirely according to

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45. NGAIRE WOODS, THE GLOBALIZERS: THE IMF, THE WORLD BANK, AND THEIR BORROWERS 163 (2006).

46. Wong, *supra* note 31, at 51.

47. For an analysis in legal-institutional terms, see Peter Holcomb Henley & Niels Blokker, *The Group of 20: A Short Legal Anatomy from the Perspective of International Institutional Law*, 14 MEL. J. INT'L L. 550 (2013).

48. Christian Walter, *Debt Crisis*, *in* MAX PLANCK ENCYCLOPEDIA OF INTERNATIONAL LAW, VOL. II 1074 (Rüdiger Wolfrum ed., 2012).

49. Important enough to warrant the inclusion of a recent communiqué in a collection of international legal instruments. See INTERNATIONAL LAW DOCUMENTS (Jan Klabbers, ed., forthcoming) (contains the text of the 2013 Brisbane G20 Communiqué).

50. BEPS stands for Base Erosion and Profit Shifting; the project aims to close some of the taxation loopholes that global companies make such gregariously use of. On tax law and international law generally, see REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME (2007).

51. One example among many is LON L. FULLER, THE MORALITY OF LAW (1969).

expectation[52], within UNCTAD. UNCTAD was set up in 1964 as an organ of the UN General Assembly. Influenced by the dependency economics of Raul Prebisch, André Gunder Frank and others, the global south envisaged UNCTAD to become a counterweight against western-dominated organizations such as the IMF and, at the time, GATT. UNCTAD was highly active for a while, developing amongst others a number of commodity agreements and a global instrument (albeit non-binding) to regulate the behavior of multinational companies[53], but threatened to slip into marginalization.

In recent years, however, UNCTAD seems to have re-invented itself as a venue for discussion and information-gathering concerning investment and, in the wake thereof, debt relief. The most prominent output thereof to date is the so-called Roadmap on sovereign debt workouts, published in April 2015.[54]

Meanwhile, in December 2014, the UN General Assembly established an ad hoc committee on Sovereign Debt Restructuring Processes.[55] The ad hoc committee adopted a set of principles, partly overlapping with UNCTAD's roadmap on 24 July 2015, which came to be laid down in General Assembly Resolution 69/319. The principles taken together stand for what has been called an 'incremental approach', looking for the middle ground between market-based and statutory approaches.[56]

Indeed, more generally, the principles look for the middle ground, aiming to find a balance between the position of creditors and debtors. Debtors have a right to restructure their sovereign debt, so principle 1 suggests, but only as a last resort, and only by preserving creditors' rights. Creditors should refrain from exercising undue influence, while debtors continue to enjoy immunity from both jurisdiction and execution. And even within groups of creditors, some balance is sought: majority restructuring must be respected by outvoted creditors, while at the same time states must be encouraged to insert collective actions in the bonds and other instruments they issue. In short, the Principles aim to find a middle ground between all actors and on well-nigh all relevant topics, oozing the spirit of compromise.

One of the more noteworthy elements of the Roadmap is that it also suggests, in very careful, guarded terms, the creation of a Debt Workout Institution. This would be expected to provide technical support to the debtor (but without becoming its advocate), facilitate talks and provide expertise, assist in establishment and implementation of debt workouts, mediate, and maintain a list of abusive creditors. In the long run, it is even envisaged to host a sovereign debt restructuring tribunal. The Debt Workout Institution could be

52. It may have been expected, as Paulus suggests, that someone would start working on responsible debt, taking also the creditors' responsibility into account. See Christoph G. Paulus, *Debts*, *in* MAX PLANCK ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW, *supra* note 48, at 1089. What was unexpected, however, is that this would take place within UNCTAD.

53. This was the Restrictive Business Practices Code. For discussions, see Stuart Benson, *The UN Code on Restrictive Business Practices: An International Antitrust Code is Born*, 30 AM. U. L. REV. 1031 (1981).

54. UNCTAD, Sovereign Debt Workouts: Going Forward. Roadmap and Guide (UNCTAD, 2015).

55. G. A. Res. 69/247 (Dec. 29, 2014).

56. G. A. Res. 69/319 (Sept. 29, 2015). See also Bohoslavsky & Goldmann, *supra* note 38.

established either as a full-fledged international organization, as an independent non-profit entity, or perhaps as a subsidiary body of the UN General Assembly.[57]

IV. THE FUNCTIONALISTS

Ever since its inception a little over a century ago, the theory of functionalism as it relates to the law of international organizations[58] has dominated the way international organizations have been structured and perceived. In a nutshell, functionalism in international institutional law boils down to this. It is essentially a species of principal-agent theory, where the member states provide the organization with a specific function or set of related functions. Though structured as principal-agent theory, it comes with at least two twists. First, the principal is by definition a collective principal: it takes at least two states to create an international organization. Second, and more interestingly perhaps, the principal is represented within the agent and, at least nominally, remains in constant control. All organizations have a plenary organ composed of all member states which, in the final analysis, can tell the organization what to do and what not to do. While it is generally acknowledged that organizations can lead a life of their own (this is cast in legal terms as 'legal personality'), nonetheless they are also thought to remain under control of their member states.[59]

The very point of functionalism was to distill the work, structure and legal environment of any particular organization into simple terms, revolving around their assigned tasks. Thus, the function of the Universal Postal Union is to regulate postal relations, and the WHO somehow must regulate global public health. Conceptualized this way, those functions were considered to be merely 'technical' and a-political. The only political element involved was that functionalism promised that world peace and the 'salvation of mankind' would follow on the re-imagining of the world away from sovereignty and along lines of functional differentiation.[60] After all, the UPU would have no reason to go to war against the WHO, since both would be engaged in purely functional tasks. Organizations, in contrast to sovereign states with their petty jealousies, would stick to their tasks, and heaven would descend on earth.[61]

This was probably never very plausible to begin with, and it soon

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57. UNCTAD, *supra* note 54, at 62-63.

58. It must be distinguished from its political science cousin, espoused by the likes of Mitrany and (as neo-functionalism) Haas, which instead of asking how organizations are structured, was always more interested in how cooperation begets further cooperation. David Mitrany, *The Prospect of Integration: Federal or Functional?,* 4 J. COMMON MARK. STUD 119 (1965); ERNST B. HAAS, BEYOND THE NATION-STATE (1964).

59. On the conceptually complicated relationship between organizations and their member states, see CATHERINE M. BRÖLMANN, THE INSTITUTIONAL VEIL IN PUBLIC INTERNATIONAL LAW: INTERNATIONAL ORGANISATIONS AND THE LAW OF TREATIES (2007).

60. *See also* David Kennedy, *The Move to Institutions*, 8 CARDOZO L. REV. 841 (1987) (describing how peace and institutionalization were thought to go hand in hand).

61. This spirit is highly visible, without the quasi-religious hyperbole, in the work of the main founding father, Wisconsin law and political scientists Paul Reinsch. See, e.g., PAUL S. REINISCH, PUBLIC INTERNATIONAL UNIONS, THEIR WORK AND ORGANIZATION: A STUDY IN INTERNATIONAL ADMINISTRATIVE LAW (1911). Also Klabbers, *supra* note 27.

transpired that there were two major issues. The first of these, largely unrealized at the time, was the very concept of international organization: did this encompass only those entities that could meaningfully be said to work for the global good, or would it cover pretty much every form of institutionalized cooperation between states? The literature, spearheaded by the classic study by Frank Sayre and possibly blinded by the light of its promise, quickly tended to the latter.[62] The result hereof was however, that functionalism came to encompass not just institutions for the provision of public health or regulation of channels of communication, but also entities that were barely distinguishable from colonial enterprises, such as the river commissions of early twentieth century China, or international police forces protecting the interests of largely Western traders and investors in faraway places. In short, the link between organizations and the global public good (however elusive) was severed, and replaced by a link between organizations and someone's particular project, even if the latter often dressed up in universalist garb.

The second issue related to the putative a-political nature of international organizations. It soon turned out that even within international organizations, politics and the rivalries between states could not easily be dismissed. France made quite a *spiel* of enlisting the Permanent Court of International Justice in tightening the reins on the International Labor Organization (ILO) during the early 1920s,[63] and Great Britain did its best to expel Liberia from the League of Nations over concerns about Liberia's human rights record.[64] This may or may not have been ethically inspired (though one wonders about the hubris of the world's major colonial power berating others over their human rights record), but was difficult to reconcile with any functionalist consideration. If the League was created predominantly to achieve collective security, then surely how Liberia treated its citizens had little bearing on its potential contribution to the functioning of the League.

As a result, 'pure' functionalism probably never existed in real life, and would be most unlikely to arise at any rate, if only because what counts as 'functional' is bound by time and place and highly dependent on how issues are framed. Functions come and go; what once was 'functional' may no longer be quite as 'functional'. This forces organizations to adapt themselves and forces member states to redirect their creatures. Telling is the name change of the ITU: originally established as the International Telegraphic Union, it lost some of its appeal when the telegraph became obsolete, and was re-invented as International Telecommunications Union.[65]

Moreover, there is a level of analysis problem involved in functionalism,

62. FRANCIS B. SAYRE, EXPERIMENTS IN INTERNATIONAL ADMINISTRATION (1919).

63. PCIJ, Competence of the ILO to Examine Proposals for the Organisation and Development of Methods of Agricultural Production; and PCIJ, Competence of the ILO to Regulate the Conditions of Labour of Persons Employed in Agriculture, advisory opinions nos. 2 and 3 (1923).

64. ALISON DUXBURY, THE PARTICIPATION OF STATES IN INTERNATIONAL ORGANISATIONS: THE ROLE OF HUMAN RIGHTS AND DEMOCRACY 107 (2011).

65. Another well-known example is how the Organization for European Economic Cooperation, set up to channel Marshall Aid, was transformed into the Organization for Economic Cooperation and Development. On the process, see Hugo J. Hahn, *Continuity in the Law of International Organization*, 13 ÖSTERREICHISCHE ZEITSCHRIFT FÜR ÖFFENTLICHES RECHT 167 (1964). On some level much the same applies to the moves from GATT to WTO, and from EEC via EC to EU.

rendering any identification of the precise function of any given organization highly unstable. The ILO is a prime example: its constitution suggests that its function was (and is) the provision of social justice insofar as it relates to labor. From a different perspective, however, its function was to prevent Western labor movements from succumbing to the charms of communism – it is no coincidence that it was set up shortly after the Russian revolution.[66] Both interpretations of the ILO's function are accurate enough, but the downside is that argument can tap into either interpretation, constantly opting for the one most conducive to the point under discussion. While this may have its advantages when it comes to papering over political disagreement, as an element of theory such instability lacks analytical rigor. In order for functionalism to be acceptable as theory, at least it should allow observers to identify the functions of any given organization with some cogency.

Given the fluidity of the idea of function, it is no surprise that generally, functionalism struggles with its scope of application. The functionalist ideal type is so much an ideal type, that it may legitimately be wondered whether any entity even comes close, and if that is the case, it raises serious questions about the capacity of the theory to explain things: if the theory has no matching entities in any empirically responsible manner, then what good is the theory? On such a note, it rapidly becomes ideology, and this may indeed apply to functionalism in the law of international organizations. After all, many organizations can only with difficulty be said to be 'functional', and this includes some of the more prominent ones. The EU is a case in point: it leads such a separate existence from its member states that it can hardly be considered merely to exercise a delegated function, as functionalism would entail.[67] The UN is less independent from its member states, but has so many functions that it is difficult to say which function it exercises: collective security? Global welfare mechanism? Other organizations, ranging from OPEC to the OIC and, in fact, all regional organizations, are interest clubs and upscale lobbyists, having long ago lost the connection to the public good that early functionalists deemed vital. And the WTO is, in effect, an organization without powers – a dispute settlement mechanism with a dysfunctional decision-making process attached.[68]

If the scope of functionalism has come under fire, so too has its explanatory potential. It was long thought (without anyone bothering to spell it out)[69] that functional theory could comprehensively explain all facets of the law of international organizations, but this is no longer generally accepted. For one thing, and from a broad perspective, being a theory about the relations between

66. Indeed, Cox can plausibly suggest that the ILO's well-known tripartite structure (with national delegations consisting of representatives from government, labour, and the business community) illustrates corporatism writ large. See ROBERT W. COX, PRODUCTION, POWER, AND WORLD ORDER: SOCIAL FORCES IN THE MAKING OF HISTORY 101 (1987).

67. So already Eric Stein, *Lawyers, Judges, and the Making of a Transnational Constitution*, 75 AM. J. INT'L L. 1 (1981).

68. Jan Klabbers, *Unity, Diversity, Accountability: The Ambivalent Concept of International Organization*, 14 MELB. J. INT'L L. 149 (2013).

69. Sometimes a 'tacit dimension' prevails, involving 'propositions and opinions shared by a group and so obvious to it that they are never fully or systematically articulated': see Hirschman, *supra* note 32, at 69.

the organization and its member states it has little to say about relations within the organization (for instance, between organs *inter se*), and equally little about relations between the organization and third parties.[70]

But even on the relationship between the organization and its member states, functionalism cannot explain all, although it should be acknowledged that on some topics, reference to the functions of the organizations is heuristically valuable. Thus, the doctrine of implied powers, in its more expansive guises, is linked to the functioning of the organization.[71] Likewise, functionalism helps explain why it is that organizations can enjoy privileges and immunities[72], and helps explain the existence of rules on membership, both on admission and on suspension or even expulsion of members. But one thing issue it has always found problematic relates to decision-making.

The problem is this. If it is indeed the case that organizations are set up to perform certain functions, functions moreover which are generally considered a-political, then there is little functional reason to insist on stringent 'quasi-democratic' decision-making procedures, where each member state has a vote, and the consent of all is needed in order to adopt any proposal. In other words, functionalism goes hand in hand with what I have termed elsewhere a 'managerial attitude', a 'just do it' mentality. If it is indeed the case that postal regulation is a technical function that can only be exercised for the greater good of humanity, then why not leave it to the experts? If it is indeed the case that the provision of public health is a technical exercise, then surely there is no need for interference by sovereign states? In fact, such interference is, eventually, dysfunctional: democratic interventions can only jeopardize the smooth functioning of postal regulation (to stick to the example). Obviously, this presupposes that indeed postal regulation is something that can be left to the experts: it is premised on the thought that there is only one way to do things properly, and it is this way that the experts can agree on. In such a setting, no democratic decision-making is needed; it can only obfuscate things.[73]

Put differently, there is an inherent tension in functionalism when it comes to decision-making. On the one hand, with organizations being agents of their collective principals, all principals want to retain their own share of control over the organization: this naturally results in a 'one state, one vote' model, and it is no coincidence that it is this model that has informed so many international organizations.

On the other hand, the functional nature of the tasks of the organization suggests that organizations are better off with decision-making procedures tailored to the task at hand. Whatever the merits of 'one state, one vote', it is not conducive to taking quick and nimble decisive action. Hence, as noted, quite a few organizations exist where the power to administer or to respond

70. Jan Klabbers, *Theorising International Organisations*, *in* OXFORD HANDBOOK OF THE THEORY OF INTERNATIONAL LAW (Anne Orford & Florian Hoffmann, eds., 2016).

71. ICJ, *Reparation for Injuries Suffered in the Service of the United Nations*, ICJ Reports 174 (1949); see also Klabbers, *supra* note 18, at 56 et seq.

72. PETER H. F. BEKKER, THE LEGAL POSITION OF INTERGOVERNMENTAL ORGANIZATIONS: A FUNCTIONAL NECESSITY ANALYSIS OF THEIR LEGAL STATUS AND IMMUNITIES (1994).

73. On the role of expert knowledge in general, see DAVID KENNEDY, A WORLD OF STRUGGLE: HOW POWER, LAW, AND EXPERTISE SHAPE GLOBAL POLITICAL ECONOMY (2016).

quickly to current events is granted to an executive organ of (relatively) small composition or even to a secretariat, often accompanied by a plenary with a 'one state, one vote' approach. Surprisingly perhaps, neat procedures for arranging the relations between plenary and executive are by and large missing.[74]

If this is the general pattern among international organizations, the financial institutions form the one major exception, where both in plenary and executive the voting is weighted. In the IMF, the plenary is the Board of Governors, where voting takes place in accordance with financial input. On this basis, in 2016 the US holds 16.8 percent of the votes. To put this in perspective, Uganda holds 0.1 percent, and a fairly wealthy Western state such as Finland still only 0.52 percent.[75] The Executive Board consists of 24 persons, most of them representing groups of states, and the managing director: the same voting percentages are carried over to the Executive Board, so at no point is the 'one state, one vote' idea given any credence. Much the same structure applies to the World Bank. With both financial institutions then, the orientation can be seen as highly functional. The point is to perform the task(s) assigned by the members in the constituent document, without getting derailed by political discussion or slow decision-making.

The same 'just do it' attitude is expressly reflected in the mandate of the World Bank, famously providing that decisions should be taken solely on the basis of economic considerations and the Bank shall not interfere in the political affair of any member states.[76] The message is clear: the Bank should stick to its main task, without being derailed or sidetracked by non-functional concerns. In this sense, it is difficult to think of an organization more closely aligned to functionalist theory than the World Bank: both its decision-making procedure and its explicit mandate tend to isolate the Bank from non-functional concerns.[77]

Similar provisions, if sometimes less strongly formulated, can be found in the constituent documents of some of the smaller, regional financial institutions. The newly created Asian Infrastructure Investment Bank, e.g., repeats almost verbatim the formula of article 4(10) of the International Bank for Reconstruction and Development's constituent document, and does so in article 31(2) of its Articles of Agreement.[78] The Nordic Investment Bank, by contrast, suggests much the same in fewer words when it is instructed to take its lending decisions 'in accordance with sound banking principles and taking into account socio-economic considerations'.[79]

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74. Jan Klabbers, *Checks and Balances in the Law of International Organizations*, *in* AUTONOMY IN THE LAW (Mortimer Sellers, ed., 2007).

75. *See* http://www.imf.org/external/np/sec/memdir/members.aspx.

76. Article 4(10), Articles of Agreement IBRD. For a fine analysis, see Ronald Janse, *(Why) Was the World Bank Supposed to Be a Nonpolitical Organization? An Interpretation of the Original Meaning and Rationale of Article 4(10) of the Articles of Agreement of the International Bank for Reconstruction and Development, 1941-1948*, 16 J. HIST. INT'L L. 113 (2014).

77. It has, accordingly, proven very difficult to insert other than purely functional concerns, as the entire discussion on the Bank and human rights suggests. For excellent discussion, see GALIT A. SARFATY, VALUES IN TRANSLATION: HUMAN RIGHTS AND THE CULTURE OF THE WORLD BANK (2012).

78. Articles of Agreement AIIB, article 31(2)

79. Agreement on the Nordic Investment Bank, article 1.

There are also exceptions though. Both the Council of Europe Development Bank and the European Bank for Reconstruction and Development (EBRD) have explicitly political mandates. The former was created with a view to help solve problems caused by large influxes of migrants and refugees.[80] The latter was set up to help eastern European economies transition and adopt the economic ways of the west. In the words of article 1 of the Agreement establishing the EBRD, the Bank shall in principle only sponsor projects in countries 'committed to and applying the principles of multiparty democracy, pluralism and market economics'.

This suggests another element of wobbliness at the heart of functionalism. In general, it seems, all multilateral investment banks and development banks share, roughly, the same purpose: to make money available for projects in states that need such financial support. Yet, as the founding fathers of the Council of Europe Development Bank and the EBRD acutely realized, such a function says little about what the organization is actually expected to do. Again then, the identification of function, as mentioned above, is dependent on the level of analysis. On a high level of abstraction, all financial institutions have the function of sponsoring projects; on a different level, they may have the function of sponsoring some projects over others. This renders functionalism inherently unstable, as any 'functionalist' argument will first have to reveal which 'function' it relies on.[81]

Related to this is the realization that no project is politically innocent, and more importantly, 'sound banking principles' and the like are not politically innocent either. The very existence of conditionality suggests that the financial institutions have specific opinions on how best to structure the economy, and the very debate on conditionality suggests that not everyone agrees. The very creation of the AIIB, moreover, is generally seen as a bid for world power by China: it is thought of as a counterpart to the US dominated Bretton Woods institutions, at least by the US itself,[82] therewith once again suggesting that the a-political nature so beloved by classical international institutional legal functionalism was never too plausible to begin with.[83]

From a broader perspective, it would seem that global financial regulation (*vel non*) precisely manages to escape the strictures of functionalism, while

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80. *See* Article 1 of its Articles of Agreement. Contrary to what one might expect, the Council of Europe Development Bank is not a recent creation, but was established in 1956, originally as the Council of Europe Social Development Fund.

81. It is possibly no coincidence that some have seen fit to include human rights in their discussions of the functions of otherwise fairly technical organizations. On these lines, the function of WIPO would be 'to regulate intellectual property while taking human rights seriously', rather than merely 'to regulate intellectual property'. A brief example is Edward Kwakwa, *An International Organisation's Point of View*, *in* ACCOUNTABILITY FOR HUMAN RIGHTS VIOLATIONS BY INTERNATIONAL ORGANISATIONS (Jan Wouters, et al., eds., 2010). The same thought prevails in the most recent report of the UN Special rapporteur on extreme poverty and human rights, Philip Alston, on the World Bank and human rights, UN Doc. A/70/274.

82. *See, e.g.*, Joseph Stiglitz, 'In Defence of the Asian Infrastructure Investment Bank', available at http://www.theguardian.com/business/2015/apr/14/in-defence-of-the-asian-infrastructure-investment-bank.

83. Outside the ambit of law, some have presented radically different theories concerning the growth of international institutions. See, e.g., CRAIG N. MURPHY, INTERNATIONAL ORGANIZATION AND INDUSTRIAL CHANGE: GLOBAL GOVERNANCE SINCE 1850 (1994).

remaining faithful to the spirit of functionalism, or, more accurately, remaining faithful to functionalism in spirit. Financial institutions, formal and informal alike, are highly function-oriented, far more so than most others. In this sense, they keep the spirit of functionalism alive. Yet, simultaneously, they undermine what many thought was among the main hallmarks of functionalist theory: the idea of sovereign equality. Or, perhaps more accurately, they do not so much undermine as re-configure the idea of sovereign equality. If traditionally, in the famous words of Vattel, a 'dwarf is as much a man as a giant', and therefore 'a small republic is no less a sovereign state than the most powerful kingdom',[84] this concept of sovereign equality no longer applies in the law on debt relief. As noted earlier, much relevant decision-making takes place in entities of limited composition but unlimited reach, and where the organizations themselves boast broad membership, voting is inevitably tilted in the direction of the powerful. Practice, in other words, makes two moves. First, in formal organizations, it limits the accessibility of decision-making processes to the rich and powerful; second, outside formal settings, it steers relevant decision-making to fora of limited composition and uncertain legal status, but backed by enormous economic clout.

As far as functionalism goes, this cannot but draw attention to the need to re-visit some of its classic tenets, most prominently the idea of representation of the collective principal by means of the organization's plenary organ. It is this element that provides international organizations with a gloss of input legitimacy. If Fritz Scharpf is correct in suggesting that organizations mostly depend on their output for their legitimacy (and that is *prima facie* a highly plausible thesis),[85] then such little input legitimacy as they can boast will stem from the inclusiveness of their decision-making procedures. Indeed, the very same point is reflected in the Basic Principles on Sovereign Debt Restructuring Processes adopted by the UN General Assembly in 2015: Principle 7 suggests, in so many words, that legitimacy demands that 'institutions and operations' respect 'requirements of inclusiveness and the rule of law'.[86] Small wonder then that functionalism has always straddled two concepts of international organization: it needs some quasi-democratic pedigree, and simultaneously is in need of some practical effectiveness.

This helps explain, no doubt, why all attempts to institutionalize debt relief through some kind of international mechanism have thus far failed. The IMF's proposal to create a Sovereign Debt Restructuring Mechanism never got very far, and it is noticeable (if not often noted) that one the elements of the UNCTAD Roadmap, the creation of a Debt Workout Institution,[87] has been overshadowed by the attention for substantive principles. This is not merely because of fears of expanding international bureaucracies, and not merely because, as has been suggested, the creation of a permanent institution would give the impression that debt relief is a normal, everyday occurrence, but also, and perhaps first and foremost, because (strange as it may sound), for any

84. EMER DE VATTEL, THE LAW OF NATIONS 75 (2008 [1758]).
85. FRITZ SCHARPF, GOVERNING IN EUROPE: EFFECTIVE AND DEMOCRATIC? (1999).
86. GA Res. 69/319, *supra* note 56, Principle 7.
87. UNCTAD, *supra* note 54, at 62-63.

institutional arrangement to be deemed acceptable it must cater both to democratic legitimation and to effectiveness. This is what the theory of functionalism suggests, however unwittingly perhaps, as anything else is domination.

The circumstance that in formal financial institutions weighted voting takes place and the adage of 'one state, one vote' has been all but lost finds, in turn, its justification in the practical concern that those who need to borrow have little to ask – 'beggars can't be choosers', in colloquial terms. Hence, this departure from functionalist theory could be pushed through, although it is fair to suggest that the financial institutions are paying the price on a daily basis: no other organizations are so often the subject of calls for institutional reform.[88]

The power distribution concerning debt relief, however, is different. Here there are no 'beggars', as the power of the indebted state can be considerable: a refusal to pay one's debts can shake the entire financial system. Indeed, it is surely no coincidence that sovereign debt relief was rarely considered a political issue during the 1970s, when states were largely indebted to private banks. A refusal to pay would have risked the stability of the Western banking system. This was considered highly undesirable (and politically difficult, in that re-election in the midst of such a crisis would be next to impossible), the result being that lending became increasingly multilateralized and the work of governments, however reluctantly perhaps.[89] This, however, also implied that there was less of an incentive to tackle debts early on, and debts could thus be piling on.[90] Either way, the point to note is that being indebted also creates, curiously enough, something of a power base, if only because domestic parties need to be brought on board: as a result, the indebted can insist on formal equality, but their victory is Pyrrhic, and the indebted need to maintain a fine balance, as the 2015 Greek referendum seems to illustrate.

CONCLUSION

This paper has suggested that there are tensions inherent in the dominant functionalist theory of international institutional law, and those tensions have a bearing on the possible creation of international institutions or mechanisms mandated to address debt relief or debt workouts. Entities established or proposed to deal with debt relief tend to wish to evade the strictures of formal international organizations law, either by being set up as informal entities or by utilizing different decision-making rules, departing from the basic notion of sovereign equality. Yet, this basic notion of sovereign equality remains fundamental to international organizations: it is, in part, what their legitimacy depends on.[91] The only way out, it seems, might be to depart from functionalism altogether, but if so, the financial institutions as currently

88. With the exception, no doubt, of the UN Security Council, for much the same reason.

89. Lee C. Buchheit, *The Role of the Official Sector in Sovereign Debt Workouts*, 6 CHI. J. INT'L L. 333 (2005).

90. See Wong, *supra* note 31, at 50-51.

91. The best analysis of legitimacy in the international realm remains Martti Koskenniemi, *Legitimacy, Rights and Ideology. Notes towards a Critique of the New Moral Internationalism*, 7 ASSOCIATIONS 349 (2003).

organized (including those devoted to debt relief) will have a hard time justifying their existence. In a putative constitutional global order – an alternative universe, to be sure[92] – the weighted voting of the IMF or the exclusive nature of the G20 or the Paris Club, are difficult to envisage, let alone to justify, no matter how effective their work may be. Considerations of effectiveness should always be accompanied by the question 'effective for whom?', and if so, it will often transpire that effectiveness alone, while not irrelevant, cannot always help to justify an institution, mechanism or procedure. Something else is required: it is no coincidence that the *auctor intellectualis* of functionalism, Paul Reinsch, limited his analysis – somewhat unwittingly perhaps – to institutions serving the global public good.[93] While this notion, too, is obviously susceptible to manipulation and can be framed in different ways, at least reference to the public good makes clear that effectiveness alone will rarely be sufficient. Reinsch was wrong to insist that international organizations are a-political creatures; but he was right in suggesting that some kind of reference to the public good is required. It is this consideration which informs his functionalist legacy but has largely been overshadowed by the broadening of the scope of the concept of international organization occasioned by Sayre's work.[94]

This places the financial sector before something of a dilemma: under a constitutional theory, it cannot get away with purely market-based solutions. Hence, it benefits from functionalism, but can only do so meaningfully as long as it accepts some of the basic tenets thereof, including inclusiveness. Obviously, one might respond that theories are irrelevant for practical purposes, but this would be to miss the point that functionalist theory has been facilitating the operation of international institutions to a considerable extent, as it undergirds many of the legal rules and institutions that have created to the benefit of international organizations. Tilting functionalism towards managerialism then, a distinctively visible trend in the global financial sector, threatens to throw out the baby with the bathwater, and this, most would agree, is not a good idea.

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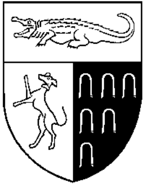
92. JAN KLABBERS, ANNE PETERS & GEIR ULFSTEIN, THE CONSTITUTIONALIZATION OF INTERNATIONAL LAW (2009) (sketching what a constitutional global order could possibly look like).

93. Reinsch, *supra* note 61. See also Klabbers, *supra* note 68.

94. Sayre, *supra* note 62. I sketch this process of overshadowing extensively in Klabbers, *supra* note 9.



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