TO: New Rules for Global Finance

Re: Sovereign Debt Restructuring – Draft Feedback

Please see feedback to your draft paper overleaf. BANGO is a national network of NGOs and the Focal Point for civil society affairs as recognized by the Government of Barbados. This paper was circulated among NGOs and comments were solicited.

In summary, it is our opinion that the IMF should guarantee debt at the point of default, in order to prevent the kind of mess Argentina endured. This could become a racket at the expense of taxpayers and economies, even to the point where governments could become complicit.

As an international fund, the IMF should be poised to protect the financial interests of its member governments. Governments should not be allowed to become subject to laws outside its jurisdiction except international law. Rules should be equally binding on countries and international finance should not be subject to local laws.

BANGO therefore submits the following in response to your draft paper.

Roosevelt O. King
Secretary General
Comments on Proposals for Sovereign Debt Restructuring

Introduction
Debt restructuring is sought, and hopefully granted, when a country’s debt is deemed to be unsustainable – that is, when there is a high probability of default. The goal of restructuring is to return the country to a path of growth and debt sustainability.

There are aspects of the paper from the Centre for International Governance Innovation (CIGI) that have only marginal relevance to the Barbados Debt situation. We can, for example, ignore Paris Club and London club restructurings. It is nevertheless a paper from which we can learn a great deal. Barbados is after all a country with what is, by international standards, a high Debt/GDP ratio (100%) and that borrows 100% of the money needed to pay interest on its debt. The need for debt restructuring is therefore not beyond the realm of probability.

Yet, as the paper is at pains to point out, “sovereign defaults and debt restructurings are often messy and painful.” In addition, the outcome of debt restructuring negotiations is often unpredictable. The paper surveys the merits and demerits of current proposals to make restructuring less messy, less painful and more predictable.

Can we reform the architecture to ensure that, when they do occur, sovereign debt restructurings are handled in a more timely, orderly, and fair manner?
Successful debt restructuring is in the interest of the international financial community as a whole since it reduces the disruptive effects of defaults and contributes to global financial stability. It follows that proposals for reform of the debt restructuring architecture will go nowhere if they do not balance creditor and debtor interests. A mutual recognition of interests is a precondition for the ingredients of successful reform measures.

Creditors wish to protect as far as possible the value of their asset (debt) and to minimize the amount of debt relief/forgiveness that they agree to as a condition for restructuring. Debtors seek to: maximize debt relief and external support; reduce the need for adjustment (austerity); and return to growth (through access to complementary investor resources and access to capital markets).

Given the complexity of the competing interests that must be reconciled if a restructuring is to succeed, there is no single solution that will do the trick – although the IMF Debt Reprofiling comes closest. Our support therefore is for a combination of contractual and statutory reforms, supported by enhanced IMF mediation and participation as follows:

- **Collective action clauses (CACs).** Writing the terms of a restructuring into the bond contract can help mitigate the collective action problems by binding creditors to a common and well-specified restructuring
procedure. As the recent Greece and Argentina cases demonstrate, CAC clauses are no guarantee that individual bondholders will not seek to recover their investment in full through the courts. As the paper notes, the experience with these cases reinforces the need to improve the way sovereign debt restructuring is governed beyond the contractual approach of CACs.

- **Creation of a more formal, statutory mechanism or framework for restructuring sovereign debt – something akin to an international bankruptcy procedure for sovereigns.** What is relevant here, and what the paper does not say is that the failure of the CACs in the case of Greece and Argentina is in part due to unanticipated behavior on the part of these countries that CACs are not equipped to handle: default on the part of Greece in spite of their restructuring, and refusal by Argentina to negotiate a settlement with holdouts until they were taken to court. In general, however, it is in the interest of debtors to reduce the feasibility of the holdout problem (the temptation on the part of a minority of creditors to break with the group and seek in court what they could not achieve in negotiations). As the paper notes, “Depending on the design of the mechanism, restraints on litigation could be subject to approval by a supermajority of creditors. Second, there would be a procedure for assigning creditor seniority and ensuring that new private lending is protected from restructuring. Third, a statutory mechanism would allow a supermajority of creditors to vote to accept the terms of a restructuring arrangement, and ensure that minority creditors were bound by this decision. Finally, the mechanism would include a venue and process for fact-checking information, resolving disputes, and overseeing the bondholder voting process.”

- **A Sovereign Debt Tribunal and Arbitration Process.** From a debtor point of view this is perhaps the most desirable of the proposed solutions. The decision to subject restructuring disputes to an arbitration panel would be based on a contractual agreement between the sovereign debtor and its creditors and specified in the bond contract or debt instrument at the time of issuance – i.e., prior to any debt servicing difficulties. Second, an
arbitration panel would serve as a neutral forum to resolve disputes between and among creditors and debtors. To ensure such neutrality, it would be important to establish the SDT under the auspices of a multilateral institution that is not itself a creditor. It should not be adopted in exclusion to CACs and Statutory Mechanisms, but as a fallback solution in case all else failed. It should also appease those who are reluctant to have the IMF play the role of creditor as well as Arbitrator In Chief.

- **The IMF and Debt Reprofiling.** There would seem to be considerable merit to having this modality added to the tool kit of the IMF. In cases of uncertainty, where neither the sustainability nor the unsustainability of a member’s debt can be established with “high probability,” Fund staff advocate an approach that relies on reprofiling debt rather than restructuring it. Under a reprofiling, there would be an extension of maturities on existing sovereign debt, but no change to the interest or principal. Reprofiling would be conditional upon a member country already having lost market access; that way, reprofiling would not trigger a loss of market confidence.

**Conclusion**

However messy or however painful, debt restructurings are sometimes necessary and on occasion desirable. The test of when the debt service of a sovereign is unsustainable is not always easy to determine with certainty. As a practical matter creditors look to the IMF to determine whether a country’s debt as negotiated is sustainable and therefore in need of restructuring. This test also determines whether a debtor qualifies for IMF assistance as part of a restructuring package.

While restructurings can and have been negotiated without IMF participation, there is a reason why this happens only rarely: the IMF has the expertise and resources to act as lender of last resort on terms and conditions that would attract complementary support from private and official sources. To the extent that this support is forthcoming it lessens the need for austerity on the part of the debtor.

The choice outlined in the Conclusion to the paper between increasing the fire power of the IMF and other similar institutions, on the one hand, and reforming the mechanisms and institutional arrangements that govern sovereign debt so as to provide a greater role for private creditors to be bailed-in to debt crises, on the other hand, is therefore a false one.