UN Workshop
Financing for Development
Monterrey Consensus
Debt

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Panel Comments
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- I am grateful to Benu Schneider and the other organizers of this workshop for putting together such an impressive and diverse set of perspectives, and for inviting me to contribute a few thoughts.
- Congratulations to Benu, Steve Kargman and Christoph Paulus on producing fascinating and important papers that help advance the policy conversation on debt restructuring.
- Benu asked me to pull together some themes from yesterday and today as they relate to reforming the debt **restructuring regime** – thus my focus will be more on *ex-post* procedures, rather than *ex-ante* incentives. (This is appropriate as lawyers get a warmer welcome *ex-post*.)
- I will start with a recent debt restructuring story, talk about the papers, and how they might feed into the broader reform agenda.

I. Backdoor Bankruptcy?

- On May 22, the UN Security Council passed Resolution 1483, establishing the framework for the occupation and reconstruction of Iraq. The operative language reads as follows:

> *Noting* the relevance of the establishment of an internationally recognized, representative government of Iraq and the desirability of prompt completion of the restructuring of Iraq's debt as referred to in paragraph 15 above, further [the Security Council] *decides* that, until December 31, 2007, unless the Council decides otherwise, petroleum, petroleum products, and natural gas originating in Iraq shall be immune, until title passes to the initial purchaser from legal proceedings against them and not be subject to any form of attachment, garnishment, or execution, and that all States shall take any steps that may be necessary under their respective domestic legal systems to assure this protection, and that proceeds and obligations arising from sales thereof, as well as the Development Fund for Iraq, shall enjoy privileges and immunities equivalent to those enjoyed by the United Nations except that the above-mentioned privileges and immunities will not apply with respect to any legal proceeding in which recourse to such proceeds or obligations is necessary to satisfy liability for damages assessed in connection with an ecological accident, including an oil spill, that occurs after the date of adoption of this resolution.

- Ironically, this resolution came a little over a month after the death of the IMF's sovereign debt restructuring mechanism at the Spring Meetings in Washington.

- By the time it was shelved, the IMF's proposal was a modest one. Its goal was to resolve expected coordination problems among foreign bondholders of middle-income countries.
- It would have been a standing mechanism, but one that barely encroached on the existing ad-hoc system of debt rescheduling, including:
    - The "paradoxical non-institution" (Mr Trichet's words) of Paris Club, for restructuring official bilateral credits, AND
    - For middle-income countries, the case-by-case bond restructuring pattern that was emerging with Ecuador, Pakistan, and Ukraine
    - For low-income countries whose debt was overwhelmingly official, HIPC then MDRI
    - All of these were linked, with the IMF as the hub – as Benu's paper shows – in a predictable, but neither formal nor obligatory fashion
- SDRM would have added a modest standing creditor coordination mechanism and a dispute resolution forum limited for the most part to restructuring procedures.
    - It would not block legal proceedings against debtor countries (although it might permit recovery of litigation proceeds).
- Even this modest proposal was ultimately judged too intrusive by market participants, the United States, some of the other G-7 and, importantly, by representatives of large emerging market issuers.

- The passage of Resolution 1483 implemented one of the most controversial aspects of the IMF's initial design, yet it was barely noticed in the broader sovereign debt circles. The resolution was exceptional and political – premised on "threat to international peace and security"; the implementing Executive Order in the US cited an "unusual and extraordinary threat to the national security and foreign policy of the United States."[1]

- But in its exceptionalism, the resolution reflects the essence of the current sovereign debt restructuring regime – it is **piecemeal, ad-hoc, and informal.** It is also at least as political as it is technical, and for low-income countries, substantially controlled by the creditors.

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[1] The relevant language is as follows: "*Determining* that the situation in Iraq, although improved, continues to constitute a threat to international peace and security . . ." Security Council Res No 1483, UN Doc S/RES/1483, preamble (May 22, 2003). "[T]o address the unusual and extraordinary threat to the national security and foreign policy of the United States posed by obstacles to the orderly reconstruction of Iraq . . . I find that the threat of attachment or other judicial process against the Central Bank of Iraq constitutes one of these obstacles." The President, Exec Order 13364—Modifying the Protection Granted to the Development Fund for Iraq and Certain Property in Which Iraq Has an Interest and Protecting the Central Bank of Iraq, 69 Fed Reg 70177, preamble (Nov 29, 2004).

II. The Challenge

- The papers for this session address this fragmentation and informality.
    - Benu's focus is on fairness, legitimacy, and transparency in the Paris Club process and the IMF as its implicit (and flawed) center. She advocates among other things
        - Formally and transparently linking dispersed debt negotiations
        - Confronting and debating the fact that debt relief has become a mode of development finance.
            - Notable symptom – layering of conditionality
        - Getting impartial judgments about appropriate debt levels in view of countries' development needs.
            - Her critique of sustainability methodology reflects a broader concern with legitimacy and perceptions of legitimacy, questions such as who sets the debt relief agenda and to what end.
            - She concludes that sustainability decisions must be made outside the IMF, if only to avoid appearance of conflict.
    - Steve's and Christoph's contribution is a standing dispute resolution mechanism, which – if you read between the lines of their "pragmatic and modest approach" – could serve as a kernel for a more comprehensive insolvency regime for sovereigns.
        - If you make an arbitration mechanism **credible**, it will be widely accepted because it will fill a hole that states and private creditors acknowledge – lack of predictability in sovereign distress.
        - Institution will grow norms, and a bankruptcy regime will develop organically.
            - (The premise evokes a perennial challenge in law – can norms grow out of process?)
- The essential policy recommendations in both papers are hard to argue with.
- But in view of what we heard yesterday afternoon about the changes in sovereign debt composition, I wonder about the basic approach of growing a debt restructuring regime on the basis of an institution like the Paris Club (whose clientele, like the IMF's, is shrinking rapidly) and private bond contracts (where arbitration provisions would reside).
- The right approach depends entirely on your diagnosis of the problem with debt restructuring. Different proponents give very different reasons for advocating sovereign bankruptcy.

- If problem is that some countries end up in permanent receivership, lose policy autonomy and capacity as a result of repeated restructuring and layering conditionality, the solution may be different than if you think that
- Problem is collective action among bondholders [Note large U.S. corporate statistics – reorganizations take years]… or
- Illegitimate – odious – debt … **and still different than if you think that**
- The challenge is the sheer diversity of stakeholders in debt distress – including domestic institutions and individuals, BOTH as debt holders AND as recipients of government services – with no agreed way of allocating losses among them.

- I worry that legal and institutional reform for restructuring any subset of debt – official, bonded, external, domestic – is doomed to fight the last war, and not worth the scarce political capital – it might even do harm by preempting a more open discussion of systemic solutions.
  - To an outsider like me, the singling out of external debt in the Monterrey Consensus looks almost quaint today
  - International community sank almost a decade into collective action clauses in external bonds, but no one so much as asked about what domestic debt contracts look like.
  - Legal form and status of loans from new creditors are not well known in most policy circles.

- Domestic bankruptcy is a comprehensive, collective and compulsory process – that is its biggest value.

- On this analogy, advancing Monterrey Consensus in the debt area may be best served by a more holistic approach that identifies stakeholders and their claims, and advances a legitimate process and forum where these claims can be discussed and perhaps ultimately resolved.
  - This would not be a simple bilateral transaction with poor states demanding more concessions from the wealthy; it may erode the position of international institutions and threaten the authority of states over domestic creditors and domestic law debt.

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- Resolution 1483 showed that where there is a will, the technical way is easy. In contrast, no amount of technical finesse could overcome opposition to SDRM.
- So far, the will has been directed at fortifying the ad-hoc-ery, which has preempted more systematic approaches. A great value added of this workshop is its comprehensive outlook.
- It would be interesting and productive to maintain this perspective as it feeds into the Monterrey process.