Closing the Gap for Fairness and Prosperity: Annamaria Viterbo's Sovereign Debt Restructuring: The Role and Limits of Public international Law

By:

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The most glaring gap in global economic governance is the lack of an orderly and fair sovereign debt restructuring arrangement. Annamaria Viterbo's new volume, *Sovereign Debt Restructuring: the Role and Limits of Public International Law*, helps us understand why this is so and how we might move forward. Fortunately for all of us, this books hits right as the world economy faces another global debt crisis. Viterbo's book should be essential reading for anyone trying to make the COVID-19 induced global financial crisis the last one that results in lost decades of prosperity.

Debt is an important component of economic growth and development. However, credit is inherently unstable and procyclical—tending to surge in good times and retreat in bad. Such surges and sudden stops are particularly worrisome for countries that do not issue key currencies—such emerging market and developing countries in Africa and beyond. Surges push up exchange rates an encourage more borrowing (given that the strong domestic exchange rate is seen as collateral) but sudden stops drastically reduce the value of a domestic exchange rate and thus often balloon the value of foreign exchange denominated debt. Surges and sudden stops are largely a function of monetary policies in developed countries, and accentuated by other types of external shocks such as climate-change related hurricanes, and by macroeconomic policy and conditions in borrowing states.

After struggling to cope at home, many countries then resort to the International Monetary Fund (IMF) to help pay their external creditors. When such episodes are mild, IMF programs can help get the debtor country on track, though the academic evidence shows at a significant price. While IMF programs in such setting allow external creditors and exporters to receive their financing back, such programs also tend to condition procyclical policy and are associated with increasing poverty and inequality. proposed a global mechanism for working out debt problems, but it was rejected by the US government and the global business community. In its place are collective action clauses that have not become widespread and face a number of obstacles to becoming adequate.

For many countries however, IMF programs are short term relief at best and restructuring eventually becomes a new resort. When a sovereign government is no longer willing or able to pay its debts, sovereign restructurings occur during what amounts to a formal change to debt contracts negotiated between creditors and debtors. Restructurings (or “workouts”) often take the form of reducing the face value of the debt, “swaps” where new bonds with lower interest rates and longer maturities are exchanged for the defaulted bonds, and so forth. Such workouts are usually highly discounted and result in a loss for bondholders. Losses or discounts are commonly referred to as “haircuts”.

As Viterbo outlines in the short history in the beginning of the book, this system

has long been plagued by collective action problems. On the creditor side it is increasingly hard to assemble all of a countries' bondholders and creditors and each actor may not be able to decipher that they might all be better off with a restructuring when the counter-factual is a complete default. Debtors also face collective action problems as they are reluctant to step forward to call for orderly mechanisms as they may be seen as vulnerable and on the verge of default.

Viterbo goes deep into history to show how different versions of this have been at issue through times of bonds, syndicated loans, and back to bonds. Indeed, she marks Adam Smith as the father of thinking about creating a regime for sovereign debt restructuring. In his Inquiry into theNature and Causes of the Wealth of Nations, Viterbo quotes Smith as saying "When it becomes necessary for a State to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor and least hurtful to the creditor"While steeped in history, she often draws on the more recent cases in Greece and Argentina to help readers understand how these issues are playing out.

Drawing on the Argentina crisis, in the early 2000s the IMF proposed a "Sovereign Debt Restructuring Mechanism" (SDRM). The SDRM sought to provide a fair forum for negotiation between bondholders and governments; a standstill clause whereby bondholders can't yank their money out of a debtor nation in a herd; a facility to provide short-term financing and to prioritise a debtor nations' debt schedule; and clauses that limit the ability of disgruntled minority bondholders to file lawsuits against debtor nations. Viterbo refers to this as the public international law approach, which however was was swiftly rejected by the US government and the business community.

Instead, the US proposed normalizing what Viterbo refers to across the book as the 'contractual approach', the use of collective action clauses (CACs). CACs have the following features: a *collective representation* component where a bondholders' meeting can take place where they exchange views and discuss the default/restructuring; a *majority restructuring* component that enables a 75% "supermajority" of bondholders to bind all holders within the same bond

issue to the terms of restructuring; and a *minimum enforcement* component whereby a minimum of 25% of the bondholders must agree that litigation can be taken.

This first five chapters of the book provide that legal history and then performs an analysis of the relative merits of the public international law and contractural approaches from both creditor and debtor views, and outlines the role and legal context of international institutions. Perhaps the most innovative chapter is Chapter 5, where Viterbo brings the reader to the present to understand the role of private actors in a globalized, financialized world. Many readers may not be aware of the fact that the Institute of International Finance, The International Capital Market Association (ICMA), and especially The International Swaps and Derivatives Association (ISDA) all in many ways 'regulate' sovereign debt markets without any hand from sovereign governments or international institutions. Indeed, it is the ISDA that can rule out a CAC and pay out insurance to bondholders instead.

Viterbo concludes with the hard truth. Public international law is shrinking with respect to its weight in solving sovereign debt problems. That said, the contractual approach has dominated and must be credited for making significant improvements. The questions that looms is whether the contractural approach truly allows for fair and orderly workouts. Unfortunately the contractural regime will be put to the test in the wake of the COVID-19 crisis. This scholar will guess that the regime is not yet equipped to deal with massive debt workouts in a fair and orderly way. Viterbo's book gives us the ingredients to make informed decisions regarding how to make another step forward.

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