Commentary

Benu Schneider, "Sovereign Debt Restructuring: the Road Ahead"

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This chapter by Benu Schneider provides an excellent and elaborated discussion of the recent history and future prospects of sovereign debt restructuring mechanisms. It starts summarizing the evolution of institutions and instruments to restructure sovereign debt and the changing role and views of the IMF. And from this, she provides a broad and balanced view of the challenges and policy options in a sufficiently wide agenda-menu. Having read before some of the reports on expert group meetings on the subject (e.g. United Nations, 2012) I find this paper much more fair in terms of the directions of reform which I would prefer: those that require an architecture with much more statutory elements than the decentralized market-driven approach that has been favored until recently and after the demise of the SDRM proposed by the IMF at the beginning of the past decade. Still, the conclusions of the paper are halfway from accepting a strong move into this direction, when it is said that there are many steps and dimensions of improved mechanisms that can be undertaken so as to make voluntary arrangements workable and effective. I understand the balanced position taken in the paper but tend to disagree with such a view, although I must say that my reading is pretty much influenced by the case of Argentina and the recent developments in the US courts that I see as a demonstration of the limits to the non-statutory way. This is irrespective of the criticism that Argentina deserves for not learning enough from its own default in 2001, or from being regarded as a compulsive defaulter by some academic economists (see Reinhart, 2008; Porzecanski, 2012).

Sovereign debt restructurings are one part of a larger disruption that belongs to the realm of the macroeconomics of broken promises (Heymann, 2008); they are not just a disruption of contracts between a borrower and creditors. Two ingredients are noticeable. First, it is an event that leads to economy-wide contractual disruptions due to aggregate inconsistencies that are difficult to judge or predict in advance. Second, debtors are governments in democracies that are subjected to severe coordination problems that do not guarantee that the costs of adjustment will be minimized; rather the opposite seems true in many cases. Both facts tend to blur the ex-ante, ex-post dichotomy both in terms of evaluations of debt sustainability (see Wyplosz, 2011) and of incentives and welfare impacts. Faced with an environment where fundamentals and expectations are difficult to grasp, economic agents will turn to behavioral modes of coping with observed phenomena. This not only applies to domestic or foreign agents; it also necessarily applies to governments, politicians and to international financial institutions. So, economic policy becomes pretty much behavioral in these instances because agents and politicians are confronting catastrophic states of nature (see Noll, 1996).

The welfare analytics of such a scenario are difficult to deal with, but at least one can say two things. First, Pareto inferior equilibria a-la-Stiglitz will be much more likely than in many other instances. Second, we will need global institutions to

coordinate such environments, even more when externalities and global public goods problems are so included. Therefore, and despite positive advances, the market-based approach does not look promising (ex-post, and even less ex-ante) to lead the way out of the debt crises. The evidence shows that creditors cannot commit themselves to severe incentive problems involved in the working of financial markets, where gambling for debt default ex-ante and hold outs ex-post are clear examples. Full reliance to third party arbitration in courts as required by voluntary or market driven restructuring is not the solution and instead may become part of the problem, as the recent developments in the Argentine case show. Courts who are supposed to complete otherwise incomplete contracts reject that role and instead follow legal-ethics in favor of individual investors rights. Benu Schneider points at the need to develop a model language for key contractual clauses, such as the pari passu clauses. Indeed, treated by Jorge Luis Borges years ago, the issue of the borders of language and meaning has never been more important and problematic for Argentina.

Much of the lack of progress in solving missing institutional arrangements as those related to sovereign debt restructuring comes from the unwillingness of stakeholders representing creditors, and their ability to set or block the agenda for institutional reform. The paper, as it adopts a balanced position, pays attention to many issues and instrumental arrangements that belong to the agenda that creditors have been forcing in roundtables. Thus there are excessive, from my perspective, attention to issues such as the asymmetries between official and private creditors. I do not reject its relevance, as shown by the recent European experience and the need for a balance in the IMF role as arbiter and lender. However, this is unavoidable given what the official sector is expected and supposed to do. The criticisms sound like complaining about the fire brigade preferential treatment in traffic jams. Other mechanisms such as standstill clauses are incomplete or insufficient instruments for debt resolution if not accompanied by a broader platform. When presented as part of the menu of improvements in the voluntary restructuring agenda they raise doubts on implementation and interpretation of conditions that again depend on courts. Rather, they may make more sense as part of a statutory approach.

To sum up, the statutory approach to such a complex thing as a sovereign debt restructuring needs more hands-on elaboration towards implementation. An international debt restructuring court seems a way forward, but mixed alternatives as those illustrated in the paper deserves attention too. On the other hand, instrumental proposals part of the voluntary restructuring approach such as creditor coordination, CACs, aggregation clauses, standstill clauses and consultative mechanisms are worth considering only as a perfection of the contractual technology of sovereign debt. They should not be seen as a convenient substitute of a much needed institutional reform.

References

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