Expert dialogue

For a sustainable solution to the global debt crisis and a rules-based debt resolution architecture:

How to fulfil the German coalition treaty agreement on debt relief?

Summary report

On 24 November, around 100 sovereign debt experts from academia, think tanks, international financial institutions, ministries, parliament from Germany and other countries and civil society gathered in Berlin to discuss a sustainable solution to the global debt crisis and reforms towards a fair and effective debt resolution architecture. This report aims to summarize key discussion points and results. The discussion was divided into three panels: Looking back into lessons from history, looking forward on future steps to take based on those lessons and opportunities for reform. The discussion took place under Chatham House Rules.

The following summary of discussion points must not be considered as common agreement or endorsement by the conference, but as different views and expertise that were shared among the participants.

Summary of the discussions

Panel 1
Stocktaking and lessons learned from past and current debt relief initiatives 1980 to 2022

Lead questions for the panel:
From *Brady Bonds* to the *HIPC Initiative* to contractual approaches and the *G20 Common Framework*: When do debt restructurings happen, how long do they take and how fast do debtor countries re-access capital markets? To what extent have debt relief initiatives been fair and effective? What can be learned from previous initiatives for future crisis management? What has triggered major changes in the past? What can these teach us for today's initiatives? Are instruments in the current architecture enough and the discussion on an international insolvency framework misplaced?

Panel 2
Steps towards fair and efficient debt relief and improved rules-of-law-based mechanisms

Lead questions for the panel:
What were key characteristics for the success or failure of past reform attempts for a sovereign insolvency framework? What are possibilities and limitations of imposing public decisions on private claims? What elements of current crisis cases can inspire future reforms? What potential do current reform proposals by debtor states or precedents for extraordinary debt relief have? What are key steps for a reform agenda?

Debt restructurings have become quicker in general, but the problem remains that debt relief granted is too low so that serial restructurings are often necessary. There was a move from a problem of length in the process to a “too little too late” problem. Historically, the IMF has contributed significantly to the too little too late problem with its analyses and lending. However, the IMF can also play a positive role such as with realistic debt sustainability analyses that can help country officials to counter and overcome domestic and international vested interests in debt restructuring discussions. There is however the question what happens if creditors do not accept the debt sustainability analysis (DSA) – this can delay an orderly process and why some see an international insolvency framework as necessary. In some contexts, when a country falls into arrears, if the penalty interest rate is high, this is an incentive for creditors to delay a deal. DSA should be at the centre of the public debate, to develop a global common sense when it comes to debt restructurings.

There was the point that the DSA in a debt restructuring should be a public document to allow public scrutiny. There was the suggestion by several participants, besides transparency, to have other institutions more aligned with debtor countries to also produce DSA. This was contrasted by some that the DSA cannot be taken away from the IMF as long as the DSA is part of the lending framework of the Fund and as long as the Fund is a lender of last resort. However, there is no legal authority of the IMF over DSA in general, only when a country wants to borrow from the Fund. There was discussion that there is also pressure within the

IMF to make optimistic assumptions to avoid restructuring. The question came up what DSA should actually look like, especially whether an IMF DSA, that mainly looks at repayability of the particular IMF program in a shorter term instead of considering a long-term horizon on debt sustainability (including issues such as climate change) is really fit for purpose. Some see it to have a bias towards fiscal adjustment to service debt and that it is a problem that the IMF as an self-interested party in the process. There was disagreement on the question whether the (IMF) DSA is more of a political or rather a technical (apolitical) assessment. There was also the suggestion that World Bank and IMF need to work together more and better.

After a debt restructuring, countries usually re-enter capital markets quickly. On average, it pays off for creditors to enter this market, despite of debt restructurings and "haircuts" – real return is high.

Major evolvements in the debt architecture were usually triggered by unresolved debt crises either in individual cases or in country groups, from Mexico's default in 1982, when the IMF assumed a central role in dealing with the debt default, a role, which remained for the last 40 years, to the Brady Plan 1989, through which it was acknowledged that debt deferrals do not resolve, but rather intensify solvency crises and that for investments to resurge, deep debt relief is the way to go to Argentina's debt default in 2001, which triggered the development of Collective Action Clauses to allow a super majority of creditors to bind a minority. The Brady initiative was successful not only because of the way bank loans were exchanged, but mainly because of the carrots and sticks-approach by the official sector to the commercial banks, among others by threatening with financial regulation. While in 1989, the official sector could set the incentives for commercial bank creditors, the question arouse, what incentives can be set today to bring the different set-up of creditors to the table. There was also the point that it is not only (individual) crises, but also geopolitical shifts that trigger change. As Germany has important geopolitical influence, some saw for Germany an important role to play.

Uruguay's debt restructuring 2003 was seen as a successful example of an individual restructuring due to a very professional handling of debt renegotiations by the former government of Uruguay and due to "getting the debt relief right". Some discussants questioned whether the restructuring – from an ex-post-analysis – would really have been that successful without the successive commodity boom of the early 2000s that helped in debt sustainability.

Many examples of unsuccessful debt restructurings exist, mainly characterized by serial renegotiations without a final exit from the crisis or countries that need to restructure repeatedly. The latter is not always due to fiscal mismanagement, but also due to external events, such as extreme climate events. There was disagreement on the question, whether the official institutions such as the IMF are able (or should have more power) to enforce fiscal rectitude on member countries, before those request a program with the IMF.

While collective action clauses, which are part of the current market-based approach in the global debt restructuring regime, are helpful to deal with some intercreditor problems, they are not enough to address the "too little too late" problem. In general, there are significant

asymmetries between debtors and their creditors in terms of power and access to information, which complicate debt restructurings. Calls on transparency are usually focused on the debtor, but some think that creditors know more about debtors than vice versa, which has not been tackled yet.

In 2014/2015, the UN General Assembly started a process on a multilateral legal framework for debt restructurings, which however failed due resistance by some. The process was triggered due to the dissatisfaction with unfair outcomes from debt restructuring processes before. Different stakeholders, including IMF and World Bank, did not want to participate in the discussions. In the second half of the decade, without such a framework, debt problems deteriorated. Some think that, if debt restructuring processes would follow the UN basic principles on sovereign debt restructurings, that were adopted in 2015, the debt restructuring processes would be much more effective, than what the current regime offers.

In the current debt restructuring regime, particularly the G20 Common Framework, there are several caveats: a lack of debt transparency, outdated debt sustainability analyses and long, light and lopsided debt restructurings (long negotiations, light restructurings (with the incentive to not provide enough relief) and lopsided settlements). There was an agreement by some that the debt restructuring regime is not ready for the crisis to come. Some see the Common Framework to be far from what is being aspired as an "international insolvency framework", including the lack of comprehensiveness, the reliance on moral persuasion instead of clear incentives especially for the private sector to participate in restructurings, the lack of stock treatments, etc. Under the shadow of bankruptcy law in other contexts, creditors behave mature with a recognition that there is a risk in lending. But sovereign debtors are not protected by a bankruptcy code, so every creditor have a contract enforced in a model law. The obligation to find a collective solution that benefits everyone is moral, not legal. If ignoring the moral impetus, creditors are free to pursue their legal remedies – which some find repugnant. The point was raised several times that the country not only owes to its international creditors, but also has social/constitutional obligations such as to public pensionaries and other stakeholders. There was disappointment voiced by several participants that so little new ideas come to the table, while many agree that the Common Framework does not deliver, as well as that offered solutions do not match the scale of the interrelated crises. Some argued that the Common Framework is still too much a process of traditional Paris Club members and that there should be a framework more aligned to newer creditors.

The effectiveness of "Comparability of treatment" is a central principle to guarantee comprehensive creditor participation not only in the G20 Common Framework. It has also been a principle in Paris Club restructurings for a long time: there is historical evidence that the principle has often not worked to ensure comprehensive and comparable creditor participation in debt restructurings, at the same time comparability of treatment has never been enforced. This is also true in recent times, in which different groups of creditors try to outperform each other. The free-riding problem is urgent as ever. Some see a need to agree on a formula on how to actually measure comparability, some are skeptical, that it is ever possible to get the "right" formula to distribute burdens. Some proposed to take insights from

insolvency law to get the principle of comparability of treatment right as well as from the idea of proportionality that is common in constitutional law.

There was a suggestion for more punitive measures to be applied in the Common Framework, as especially private creditors constitute a bigger part of the current debt owned by developing countries and that the German government could play a role in pushing for those measures. There were remarks on the lack of involvement of UNCTAD as an observer in the Common Framework, different from Paris Club treatments – which was seen as a concrete point to take action on. There was also the suggestion to establish some kind of secretariat to help with the debt restructuring process to speed up the process.

There is a need of a global common sense on debt restructurings. UNCTAD played this role frequently in giving a common orientation to the discussion, including a set of clear and shared principles. UNCTAD can play the role to elaborate a model of a debt workout process that some think is missing from the narrative around debt restructuring.

There was a discussion on the tendency to think about the consequences that countries face going into default, while in reality, countries under distress face an incredibly intense pressure to design policies to stimulate growth.

There is a strong role for domestic law in introducing new legislation (especially in court jurisdiction) that governs foreign debt, especially to overcome difficulties in private creditors' participation and ensuring sufficient debt relief and effective restructuring. The view was articulated that voluntary arrangements usually do not work. There was a proposal in 2020 in the UK by lawyers to give the G20 DSSI a legislative effect in terms of debt service on sovereign bonds under English law, which could be reconsidered. There was a strong vote for the need of a debt standstill during debt restructuring negotiations, which, under English law, could be made reality by extending existing legislation in some areas. There was the view that insolvency law can serve as central inspiration in terms of principles.

The role of the IMF's lending policy in debt restructuring processes was extensively discussed, including to set incentives for an early restructuring and to set the debt relief envelope that is needed to be borne by creditors. With its lending into arrears policy (LiA), the IMF can ignore the disagreement of creditors with a restructuring process and provide financing even if a country goes into arrears to dissenting creditors. This policy could be used more proactively, also when it comes to official bilateral creditors. It was discussed that the assumption that creditors do only have limited leverage to get full recovery, is not true, at least in the case of some bigger creditors, such as China, where LiA could play a role.

For any reform, there was the argument that there is the need of different champions, including G7 members. The UN Tax convention that was advanced by the group of African countries and adopted by consensus can be an inspiration of how countries in the Global South took initiative and had success in achieving what they aimed at.

Panel 3
Outlook: Opportunities for reform and the role of different actors

Lead questions for the panel:
What are potential reform proposals for a political reform agenda in the next two to three years? What are political opportunities to bring an ambitious reform agenda forward? Who are relevant actors and allies? And what role can different actors play?

There was the call towards the German finance ministry, which is in the lead on international debt policy in the current government coalition, to put clear actions on the table to achieve the commitment in the coalition treaty. Some think that while so much emphasis is on China, Germany should not lie back, as Germany is seen as having legitimacy to move forward new proposals. Some urged, that we shouldn't think that if China agrees, the Common Framework would work efficiently, and that there is no time to wait for the current architecture to prove itself, but that there is a need to go for changes now. Some see that Germany should move towards a codified international insolvency framework – as is spelled out in the coalition agreement between the parties of the government coalition – while at the same time working at improvements in the Common Framework, such as on a standstill during negotiations. In general, participants expressed high expectations in relation to the agreement of the German government in its coalition treaty. Some see that Germany should take more leadership. It was mentioned that this could be in the area of capacity building of critically indebted governments as well as in terms of what options exist to improve private sector involvement. Germany could also play a role in pushing for DSA to include climate risks better as well as to reform its debt swap facility.

Participants remembered that in the past, that the parliamentary will to deal with debt issues was absent, which is different in this legislative period, where all coalition parties agreed on debt architecture goals. However, there was also the question on how to move from parliamentary consensus to government consensus. One suggestion related to having the German chancellery appoint a kind of "coordinator" that supports movement towards the coalition treaty agreement.

Some see it difficult to reach an international consensus on a new debt architecture. While international improvements require agreements at the G7/G20/UN level, Germany could also send a strong signal that Germany does its part on debt relief, by taking national measures: National legislation is seen by many as a way to improve private sector participation and a chance for statutory reform that could move relatively fast, also in Germany. Some pointed out, that Germany should make sure that a potential law is not adopted for symbolic reasons only and that it should go beyond vulture funds.

There was a discussion on how the IMF fails in setting decision parameters for governments right, by being hesitant to recommend debt relief as a growth-promoting, preemptive option more proactively, that will be key – not an impediment – to restore market access, and that there is a need for capacity building and awareness rising that debt restructurings are nothing to fear but a good way out.

Potential allies could come from Latin America as the region goes through a political turn with more progressive governments, with different angles and experiences on the issue, such as Colombia, Honduras, Argentina, Chile and Brazil. Also, in other debtor countries such as in Pakistan, the current crisis is shaking the status quo. In this puzzle of finding a champion, some see it important that Germany becomes such a champion in the Global North. Norway can be seen as an ally in improving the Common Framework, including on the idea of carrots and sticks to bring the private sector to the table.

There were suggestions about connecting debt issues with other conflicts with a similar political impasse to move on debt-related reforms, as well as suggestions to think about debt reforms in the context of loss and damage compensation. On eliminating asymmetries, there was the suggestion to offer capacity building for debt renegotiations, as countries often lack capacity and resources to being on par with creditors' lawyers.

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