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Taking Stock of Proposals for more Ordered Workouts
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Task Force on Debt Restructuring and Sovereign Bankruptcy

TAKING STOCK OF PROPOSALS
FOR MORE ORDERED WORKOUTS

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This chapter intends to give an overview of proposals, which have been presented for more orderly sovereign debt workouts. It presents a set of criteria on which to judge the individual proposals' strengths and weaknesses. Finally it takes stock of the international debt management reform process and suggests some practical steps in order to move it forward.

Which kind of problems to solve?

The history of personal and company debt management shows that reform never occurs unless existing procedures are found wanting by some of the relevant players. The same is true for sovereign debt management. Over the past twenty years changes in the traditional creditor-dominated negotiation forums like the Paris Club, the London Club or the International Financial Institutions (IFIs) as hosts of the Heavily Indebted Poor Countries (HIPC) Initiative would never have been brought about if creditors found that the existing schemes served the purposes they were set up for. Alternatively in a few instances heavyweight debtors exerted enough pressure to receive a treatment that was more favorable than existing frameworks would have allowed. Those treatments then occasionally were translated into new frameworks for a given set of debtor countries. When presenting the more recent proposals for a comprehensive new approach, I therefore shall first outline the deficits in existing schemes that they have been intended to overcome. It will become fairly clear that different proposals have been designed with different objectives. However, it not only makes sense to measure each one by its own yardstick, but to also apply all criteria to all the approaches.

The majority of the proposals discussed below were introduced in the last five years. International sovereign debt management in this period has been characterized by:

- The assumption that the poorest and most severely indebted countries would actually be cared for via the HIPC-Initiative, in its reformed version (“HIPC-II” or “Cologne Debt Initiative” of 1999), at least once it has been amended by the Multilateral Debt Relief Initiative MDRI at the summit of the Group of 8 (G8) in Gleneagles 2005.

- The looming, or already virulent, Argentine crisis, for which — due to private bondholders not having been a major creditor group during the last major debt crisis in the 1980s — no meaningful negotiation forum existed.

- The uneasiness of major creditor governments with the approach of large-scale official financing organized by the International Monetary Fund (IMF) (plus debt renegotiation in extreme cases); i.e. the common practice of the IFIs in the 1990s was to bail out private creditors via huge financing packages for crisis countries.

Ever since, the last two points have remained key elements of the debate around the future of the IFIs and international debt management in general. The vision of a “fourth world” being sustainably relieved from its crushing debt burden through HIPC has in the meantime given way to the general acknowledgement that — if any at all — only a small number of countries out of the group of 42 HIPC-eligible countries will not have to come back to creditors for more relief in the immediate future. {1} Apart from adding MDRI to HIPC relief, the International Financial Institutions reacted to this challenge by establishing the “Debt Sustainability Framework” (DSF) — a complicated framework through which the World Bank and the IMF define at what point debt becomes excessive, raising the question of how they intend to punish debtor countries that take out loans beyond thresholds established by the institutions as “sustainable”. Whether deterrence against inappropriate new borrowing can indeed serve to prevent new unsustainable debt build-up remains to be seen. However, as an instrument that exclusively lays the burden and adjustment efforts again exclusively at the doorstep of the debtor, {2} the DSF certainly does not qualify as an instrument for comprehensive debt workout and is therefore not considered any further in this text.

These deficiencies give some strength to the call for a broader debt relief framework, instead of the closed country lists that define which country will have access to what kind of procedure. The authors of some of the proposals discussed below may not have foreseen this development.

Proposals for new debt workout mechanisms have been selected on the basis of two criteria that the author thinks are essential for any meaningful reform:

– The proposal should provide a comprehensive solution in the sense that not only portions of a country's foreign debt are being negotiated under the proposed scheme, but that a solution is sought with regard to a sovereign's debt problem as a whole. The introduction of HIPC in 1996 has already been an acknowledgement of the limitation of the traditional piecemeal negotiations in distinct forums. Additionally, the Pakistan and Ecuador arrangements of 2001 brought a new asset class – sovereign bonds – into the world of debt restructuring, adding impetus to the necessity of comprehensive solutions.

– The proposal should introduce an element of neutrality into the process, normally via the introduction of an independent third party, which more or less will drive the negotiation process. There needs to be more than direct independent negotiations, which parties are, of course, always free to undertake.

The result is a continuum of proposals from the voluntary inclusion of third party advice to debtors and creditors (who remain in the driver's seat) to strictly coercive procedures under the binding force of international law.

Approaches

The following matrix will briefly present the various approaches according to three sets of characteristics:

First, the basic principles, the institutional framework, and the legal status of the reformed negotiation process will be described.

Second, the range of issues regarding individual countries' debt problems will be outlined with respect to three criteria, namely, the set of eligible countries, the eligible debt to be negotiated, and the criteria applied in determining the relief or repayment of the debt. This latter point also raises the question of whether sustainability is the sole criterion for debt relief versus questioning the legitimacy of a creditor's specific claims.

Third, procedural matters will be described, namely the negotiation process as such, the opportunity for stakeholders to intervene into the process, and the related question of transparency.

Under these criteria we shall look at the following proposals:

Two proposals coming from the financial community:

– Proposal for a sovereign debt forum by Richard Gitlin (Gitlin & Partners)

– The IMF's proposal for a Sovereign Debt Restructuring Mechanisms (SDRM) in its last version. (IMF 2002)

Two (sets of) proposals building on concepts of international law and commonly agreed international negotiation techniques outside the sovereign debt sphere:

- Proposal by Prof. Christoph Paulus' (Humboldt University, Berlin) for an insolvency model law along the lines of those suggested by the United Nations Commission on International Trade Law (UNCITRAL) for non-sovereign debt. (Paulus 2002)
- Mediation, as an example of a broader set of alternative dispute resolution techniques (ADRs) {3}

Finally two variants of the proposal for an International Insolvency Framework, coming out of the work of international debt campaigns, are discussed:

- The Fair and Transparent (and ad-hoc) Arbitration Process (FTAP), as proposed by Prof. Kunibert Raffer (University of Vienna) {4} and erlassjahr.de (Jubilee Germany) {5}
- The proposal for an international insolvency court within or without the UN system, notably the Tribunal on Sovereign Debt (TIADS) by Latin American economists Alberto Acosta & Oscar Ugarteche and the Proposal for an International Insolvency Court by AFRODAD (Harare).

Comparative evaluation

With the exception of a few cases of mediation, none of these mechanisms has been applied in the sphere of sovereign debt as of yet. So, their implications, merits, and drawbacks can only be evaluated from a theoretical point of view.

In this section the various approaches are examined regarding targets that have been formulated in the context of the overall debt management reform debate. Due to limitation of space this part will be restricted to the most important aims of a restructuring process, while minor or somewhat more technical aspects, such as whether or not to implement an automatic stay of payments, will only be referred to in the footnotes.

Target: Restore debt sustainability

Reducing the debtor country's exposure to a level that can be considered as "sustainable" is common ground to all the approaches. Even those proposals by non-governmental organizations (NGOs), which put more emphasis on accounting for the questionable legitimacy of individual claims, do consider restoring the debt sustainability of the sovereign as a major aim of the process. However, substantial differences exist regarding the definition of debt sustainability: Will it be established as a global threshold or will it be designed individually for each debtor country? Who is actually going to make the assessment? Notably, will that be part of the established new impartial institution, or will that remain a privilege of the IFIs, which many creditors consider to be the most suitable institutions?

Particularly the "who will do it?" distinguishes those proposals from the creditor side from those designed from a debtors' or civil society perspective. While the former either do not see a problem in the double role of the IFIs as creditors and experts, {6} or consider this as a minor and acceptable disadvantage given these institutions' technical capacities and data access, the latter will insist on expertise from an impartial side which does not pursue any interests of its own in the debtor country or with its creditors.

Target: Provide security to new investors

Debt workouts normally function on the basis of a cut-off-date separating loans that are to be restructured from those that are exempt. This cut-off-date can be set at the beginning of the current process, thus including any claims on the debtor country as it goes into the restructuring process. Or it can be established sometime in the past, for instance following the Paris Club practice of using the first ever negotiations of the country in question in the Club as a cut-off-date.

All proposals implicitly or explicitly state that the most justice that can be done to future lenders and investors will be through establishing clear rules for any future crisis.

Regarding future investment, the SDRM and the Gitlin proposal are explicitly designed as one-off operations, which presume that no future investment will be affected. However, should another debt crisis emerge, the suggested instruments would again be available for a renewed restructuring of the debt. FTAP, TIADS and AFRODAD rather presume that debt crises will surge in the future and are explicitly designed in order to establish the framework for future negotiations.

Target: Guarantee fair burden sharing

Burden Sharing between debtor and creditors

The first dimension for evaluating burden sharing in a debt negotiation process is that between the debtor and its creditors. It is generally assumed that this will be guaranteed via the establishment of an adequate sustainability threshold — wherever this might be located by the various approaches. {7} NGO proposals moreover include the legitimacy criterion as an essential element of fairness in the process. This not only refers to debtor-creditor burden sharing, i.e. relieving the debtor of a claim that it rightfully should not honor because it was granted under improper circumstances, but it has an inter-creditor dimension as well (see below). Normally this term (or rather its negation, "illegitimacy") refers to the criteria for “odious debt” as established by the Russian scholar Alexander Nahum Sack in 1927. According to this doctrine, which has been further elaborated over the years, a loan is “odious” and therefore should be deemed uncollectible if it:

– Has not been contracted by a competent institution or person on behalf of the debtor, paying due regard to constitutional procedures (“absence of consent”);

- Has not benefited the population of the debtor country by any measure (“absence of benefit”), and
- The creditor has been aware of the two above-mentioned facts; i.e. he has undertaken the appropriate measures to collect all relevant information (“creditor awareness”) and he has not been deceived.

Burden sharing between creditors

The second aspect of burden sharing refers to the distribution of unavoidable losses between creditors or classes of creditors. The Argentine crisis in particular has given rise to a lively debate on burden sharing between various creditors, as it has always been the view of the official sector that private bondholders would suffer nearly the complete write-off of claims necessary to restore debt sustainability. The officials’ own Paris Club might be prepared to concede some rescheduling, possibly at more favorable interest rates, whereas the IMF along with all other multilateral creditors would be exempt from taking any losses at all.

There has been no agreement between the various proposals and their proponents regarding the justification for the IFIs' claim to have a “preferred” – in fact rather an “exempt” – creditor status. Nonetheless there is a broad range of suggestions regarding equity between the other creditor groups.

The IMF in its SDRM proposal extends the current practice by claiming to be exempt itself, and leaving it to the Paris Club to decide whether it would be prepared to become part of the SDRM process as a separate asset class. Until the end of the SDRM debate at the WB/IMF spring meetings of 2003 the Paris Club had not taken any decision regarding its participation or non-participation. However, private investors had strongly opposed the SDRM, among other reasons for considering the privileged treatment of official claims to be unfair to them.

At the other end of the spectrum, NGO proposals insist that there can be no exempt creditor status whatsoever. Any claim on the debtor needs to be part of the negotiation process. Whether this necessarily leads to equal treatment, however, is still debated among proponents of both ad- hoc as well as institutionalized impartial tribunals. In fact, among the proponents of the various versions of the proposal there are supporters of a strictly equal treatment {8} as well as those who would want to give the panel the opportunity to treat various classes of creditors differently, if the hearings give reason for such differentiation. The “equal treaters” fear that without such a strict rule the IFIs, which are likely to be important financiers in a post-agreement era, will exert strong pressure on the decision makers and thus maintain their preferred status implicitly. On the other hand, it is suggested that for the debtor country it might indeed be advantageous if, for instance, smaller multilateral creditors that handle regional central bank reserves could receive a somewhat more favorable treatment. This position, however, will have to accommodate concerns regarding an eventual moral hazard, resulting from a persisting exemption of some lending institutions from suffering the consequences of past bad lending or bad advice given to debtor countries.

The relevance of internal debt has only recently been more vocally voiced. {9} For a long time, internal debt has not been considered as essential for restructuring as external debt, mainly because it normally has been issued in local currency and under local jurisdiction. It had to be noticed that emerging market, as well as low-income, countries have resorted more and more to refinancing external debt service through the issuance of internal debt. As far as the proposals discussed in this chapter have considered the problem, there is a trend towards including internal debt into an overall restructuring approach. However, the implications of this inclusion have not yet been extensively discussed.

Finally, it should be mentioned that the legitimacy issue discussed in the previous section also has an inter-creditor dimension. In the context of debt relief for the post-Saddam Iraq it has occasionally been mentioned that honest creditors, which have financed sound projects with little or no embezzlement and good prospects for return, should not be subjected to the same kind of write-off that is (rightfully) claimed from those who have financed the dictator's war and repression machinery. However, up to now, fear of setting precedents with incalculable consequences has superseded this perspective among those creditors of Iraq who claim to have "clean sheets".

The SDRM has been the only proposal that has explicitly ruled that option out; while others either tacitly permit consideration of debt legitimacy or explicitly call for it.

Target: Minimize unavoidable losses to creditors and investors

IMF staff have invested considerable efforts during the SDRM debate to convince creditors of the overall merits of orderly debt workouts as opposed to unilateral standstills. Indeed, it looks logical that a disorderly and unilateral cessation of payments is the most costly form of a debt crisis for the creditors. {10} This is particularly so, as it tends to come with some selectivity in debtors paying some creditors, while leaving others completely unattended. The IMF and the Gitlin proposals are very much in one line regarding that aspect, featuring a mixture of coercion and incentive for individual creditors to become part of an orderly process.

NGO insolvency frameworks are accommodating this concern to a lesser extent. From their development-oriented perspective, minimizing losses to creditors is much less of a concern. In the normally broad grey zone where debt indicators are unclear on whether the debt of a country already is truly sustainable level, NGO proposals regularly tend to demand solutions at the lower end of the indicators' range. The logic behind this is that the first and foremost aim of a debt workout needs to be the reestablishment of the debtor's solvency. In order to guarantee this, an impartial panel should in principle define the relief rather too generously than too narrowly. The debtor coming back to its creditors for a rescheduling within a short timeframe would be far more of a failure to the panel than creditors forgoing a bit more of their claims than might ultimately have been unavoidable. Debt campaigns tend to cite the case of the German debt relief via the London Agreement of 1953, which in hindsight was clearly more generous than would actually have been necessary in order to restore West Germany’s creditworthiness and economic viability. However, the agreement was doubtlessly successful in disarming the kind of crisis that 25 years earlier had given rise to tremendous economic problems in the debtor country, and thus contributed to paving the way for the fascist regime and the subsequent world war. From their individual perspectives, however, it would take creditors a high degree of political and economic insight to agree to this principle. It is a classic "collective action" problem that requires intervention by a public authority that can bring the creditors beyond seeking to protect their individual interests. No agreement between NGOs and (private) creditors’ views are therefore likely to emerge here.

Proponents of an ad-hoc mediation process, however, emphasize that it has been used and did work in a case where interests of the major powers to restore political and social stability in an over-indebted state led to a pro-active engagement of some official creditors towards a substantial write-off. The mediation process as such was catalytic in allowing an acceptable burden sharing between proponents and opponents of a far-reaching write-off in the Paris Club’s arrangement with Indonesia in 1970, which was brought about with the help of a mediator. As in the German case, here again creditors (who happened to be exclusively governments) can claim to have suffered more losses than were actually unavoidable. However, following the arrangement, Indonesia entered a stage of exceptional economic growth and, overall, investors were more than compensated for the losses suffered through the Paris Club arrangement over nearly three decades of highly profitable investments in that country. {11}

Target: Establish a reliable ex-ante framework for confronting future crisis situations

All proposals claim to accomplish an important stabilizing effect for the international financial system by establishing clear rules for debt workouts, should they become necessary for whatever reason. The important difference between creditors' and civil society proposals can again be found in the examination of the legitimacy of claims by the latter. The IMF and the Gitlin proposals remain in line with current debt management practice by considering any claim valid that comes with an apparently authorized signature on the dotted line. Therefore their proposals remain indifferent towards the quality of future lending. While an SDRM might serve to caution (private) creditors against lending to an already over-exposed debtor, it would not contribute to deterring creditors from extending loans either for unviable projects at unsustainable conditions or through questionable procedures, for example, avoiding constitutionally mandated consultation with parliament. {12}

In contrast, civil society proposals emphasize the legitimacy of claims as a key criterion within debt management, insisting, moreover on a huge element of transparency and stakeholder involvement. It is assumed that only a credible threat that in any future debt crisis questions will be asked of creditors can provide lenders with enough of an incentive to forgo an apparently profitable if "odious" deal. Such a deal should come with the risk of a major loss of principal if a claim would be audited and declared void by an independent arbitration panel. Up to now, the few instances, where parliaments became involved with the payment of a disputed foreign debt have been ex-post efforts: In Argentina, the *Ley Cerrojo* of 2004 served to prevent the government from improving the offer made to external bondholders, while in Nigeria during the negotiations in 2005, the parliament conditioned the payment of the country's Paris Club debt on concessions by creditors. Certainly, neither parliamentary vote was produced against the will of the respective administration. Although parliamentary review can be considered as having an ex-ante potential regarding curtailing inappropriate future borrowing, this is extremely limited in practice and not yet near a serious framework for enforcing the consideration that only legitimate loans be undertaken.

Implications for Reform

As a matter of conclusion, the question to ask is where are we in the process of debt management reform? It is now years after the “death” of the IMF’s SDRM proposal, after the abandoning of the HIPC debt-sustainability concept as a logic for actual debt relief, and after some years during which many countries have been exceptionally successful in their export markets, thus substantially reducing the imminent need for debt work out mechanisms.

Where does the reform process stand?

The UNCTAD Secretariat has advocated a fundamental reform in international debt crisis management, giving due regard to development finance as well as ethical considerations, ever since the publication of its 1986 *Trade and Development Report*.

NGOs have also been lobbying for an international insolvency framework since the late eighties. Based on the proposal for the internationalization of chapter 9 of the US Insolvency Code, {13} the demand for a systematic reform beyond mere demands for debt relief has more or less prominently been part of NGOs’ and churches’ agenda as they have taken up the debt issue.

Governments, the private sector and international financial institutions have for a long time rejected any such proposal as either undesirable or impractical. The SDRM, as proposed in late 2001 by Anne Krueger, at the time the First Deputy Managing Director of the IMF, not only responded to the various crises which were threatening the financial system at the beginning of the 21st century; it was also a belated reaction to an ever-growing reform debate that had long since reached parliamentary and occasionally ministerial floors. {14}

It is to the IMF's great merit that it catalyzed this debate by making even the most unwilling IMF members consider it through the presentation of the SDRM proposal. Fund staff, led by the First Deputy Managing Director, certainly seized an opportune moment, when an encouraging note from then US Treasury Secretary Paul O'Neill towards then Managing Director Horst Koehler was immediately used to take the ready-made proposal out of the drawer. O'Neill stayed supportive of the SDRM proposal until he lost his job in early 2003. {15} Consequently, the SDRM was doomed, when the far more critical Under-Secretary for International Relations, John Taylor, won the upper hand.

Like most voices from the NGO scene, this author does not believe that any real international agreement ever had a chance to come about via the debate within the Fund. The major reason for this was the IMF, the institution which brought it forward, was playing too many contradictory roles in that process:

- a creditor defending the integrity of its own claims against competing creditors' interests;
- a recognized international expert institution having to defend its key role in debt management and the macroeconomic steering of member countries in general;
- the proponent of a concept which needed to be academically sound and defendable in order to stand against many other proposals, reflecting competing interests;

and, last but not least,

- the stronghold of some ideological perceptions which were not necessarily always reconcilable with the idea of an intergovernmental institution interfering with private actors' businesses.

The contradiction between the Fund's interest to stay firmly in control of debt management on the one hand and the process to reform the framework on the other, turned out to be the major strategic stumbling block. It prevented the institution from building alliances with at least partially like-minded institutions. Instead Fund staff kept refining the concept more and more, building ever more clauses and exceptions into it in order to accommodate concerns that had been voiced on the way between November 2001 and April 2003. The result was a complicated proposal, which lacked much of the straightforwardness that Ms. Krueger had shown in November 2001.

Ever since April 2003 IMF staff have kept telling the world that the SDRM was "not dead", that some underground life was persisting in some remote drawers around 19th Street and that, given the right moment in the context of the next big crisis, the world would see a resurrection. It might have a different name and perhaps some changes in conception and wording, but basically it would be the same concept.

And indeed, there is some evidence to this underground life. In 2004, after the demise of the original proposal, then German Finance Minister Hans Eichel emphasized this same point during his speech before the International Monetary and Financial Committee at the IMF Annual Meetings by explicitly stating, "The Fund should continue its conceptual work on issues raised in the discussion on Sovereign Debt Restructuring Mechanisms." Thus, he paid tribute to the fact that the German government indeed had a clear political commitment pointing towards establishing an international insolvency framework. Upon request from parliament during the previous legislative period, the governing coalition had included this as a major reform project in the context of the international financial architecture as well as global north-south relationships into its coalition agreement. The new government, taking over in 2005, has largely been silent on the issue.

Second, the minister's remark aimed at opposing the US, which since April 2003 had expressed opposition to such reform in general and the SDRM proposal in particular. Moreover, the recent process that led to setting up the Multilateral Debt Relief Initiative (MDRI) as a post-HIPC framework for the poorest countries has demonstrated how views differed as well between continental Europe and the US on other debt-relief matters, with the former insisting on sustainability-based debt relief procedures, while the Bush administration envisaged eliminating the poorest countries from international borrowing altogether and providing them with grants instead. Meanwhile non-HIPCs should be expected to not be in need of more relief in future than reschedulings of repayment obligations. Thus, among the "issues to be raised" on Eichel's list, a new framework for defining sustainability, with new actors possibly entering the stage, would certainly have a prominent role.

That debate marked an important change in the overall consideration of reform. After November 2001, the discussion was over the "introduction" of a new framework, something like a "big bang" to be ignited by an international agreement within the IMF. Instead, incremental changes were made to existing procedures. These changes, however, have a potential to be different from the merely technical improvements from Toronto Terms to Cologne Terms or from HIPC-I to HIPC-II. They touch upon the character of debtor-creditor relationships, even if occasionally disguised by technical-looking decisions. The definition of debt sustainability is the salient issue at stake at the moment.

The background for the re-consideration of low-income country debt workouts, as well as those of middle-income developing countries, is set by a series of unresolved cases of over-indebtedness. The one key country, which strongly catalyzed the SDRM process, Argentina, shows impressive growth, although some debt indicators remain alarmingly high. Creditor coherence is far from resolved there. As of November 2007, the Paris Club in particular is still facing challenges from Argentina's private creditors for a "reverse comparability" of treatment, which the Club has so far never been prepared to apply. {16} No viable proposals for solving the coherence problems can be seen.

Similarly, while Iraq has received a phased 80%-reduction from the Club, it has not paid due regard to the substantial reparations claims that the country will be facing through the next decade. The agreement has been a successful maneuver to buy time in the face of internal turmoil and fundamental contradictions between creditor demands. {17} Most important, however, may be a third case, namely, the severe threat to the Paris Club creditors' debt relief logic, which finds expression in the "Free Rider" problem, i.e. the threat to post-MDRI HIPCs' debt sustainability through excessive borrowing on non-concessional terms from private and official lenders. The result of such over-borrowing can be a renewed insolvency problem, possibly triggering the same cycle of private bail-out through public crisis lending and subsequent public debt relief efforts. {18} The HIPC Initiative's failure to deliver the alleged robust exit from debt rescheduling has been largely due to an inadequate understanding of debt sustainability and a flawed application of even existing concepts by the IFIs which have rather been pursuing their own institutional interests than assuring that the initiative could become successful. {19} There is hardly any way to express more discontent with a debt management framework than suggesting that its key element be completely eliminated.

With these individual country cases in view, an improved procedure for defining and applying an improved understanding of debt sustainability – with all the consequences this has regarding debt renegotiation and partial cancellation – may well become the entry point for introducing key elements of a sovereign insolvency framework.

Conclusion

This brings us to the final question: What are the key elements of a meaningful reform process for sovereign debt management, which may be considered independently from the manner in which it will be implemented?

First: Impartiality counts

The cornerstone of a reformed framework is impartiality as a principle. Unless it is being practiced in decision-making as well as the analysis of the debtor’s economic situation, and hence its need for relief, the system will rather provide more of the same in a disguised form than the new quality in lending, borrowing and negotiation, demanded by governments in the north and the south.

The proposals for ad-hoc mediation, FTAP or an international debt court would provide this key element in distinct forms. The IMF’s SDRM on the other hand brings in a new player through the SDDRF (see table). However, being established under the aegis of the IMF’s administration and consisting of members from a pre-defined pool established by the IMF Managing Director, it would constitute only a very limited form of impartiality. Its credibility among the parties would be consequently quite low. {20}

Impartiality is not simply translatable into the existence of a third party who is neither debtor nor creditor. A lot depends on the way this third party has been selected and its ability to operate independently from the other parties. Mediators and independent arbitration panels and courts certainly do formally go further than an SDDRF. However, neither of them is a panacea against undue influence from either side.

Second: Reform cannot come from just anywhere

The strength of the SDRM debate – namely that it came from the IMF – also constituted its greatest weakness. The IMF not only was judge and party in the existing debt management system, it also monopolized where overcoming, or at least improving, the system would be discussed. There was simply too much of conflicting interests in this institution, which in itself already has to reconcile diverging interests.

So, where could a renewed reform initiative come from? There seem to be basically two options, which may be pursued in parallel:

– New forms and forums can be established by a small set of actors, who pursue common interests from different angles. The US government demonstrated little restriction by existing rules and regulations in pursuing generous debt relief for Iraq. When the Group of Eight (G8) approved their "Evian Approach" in 2003, this was certainly a response to the fact that the Paris Club's existing frameworks, which would formally have excluded Iraq from any substantial relief, needed to become more flexible. Certainly, this was a questionable reform approach, but one that already has had repercussions on debt management in general.

  A different constellation than the G8 might emerge, if some like-minded creditors join forces with selected debtor governments, before post-completion point HIPCs are forced to enter their next round of negotiations. Such a coalition might demand that the biased debt sustainability analyses by the World Bank and IMF be replaced by some independent expertise. The HIPC Finance Ministers statement at the World Bank/IMF Annual Meetings in October 2004 laid some foundations for this kind of co-operation. {21} In any case will such an initiative not lead to an overall reform debate, but rather to some incremental changes to existing mechanisms, which then in turn will provide a challenge to those mechanisms as a whole?

– In the context of the Financing for Development Process, the UN has taken debt management reform on board as one topic among many for political debate. However, there was no consensus among governments to push the issue to its full potential. The UN system hosts a broad range of institutions which are working on issues of debt crisis resolution. It embodies considerable expertise and legitimacy in matters of international economic law, including work in fields of impartial dispute resolution; therefore it has a potential for a much stronger role. First of all, as an institution it is neither lender nor debtor of any sovereign. Thus, as a forum for not only discussing but also actually elaborating applicable alternatives, it could play a much more unbiased role than the IMF.

Third: Debtor governments are key

The SDRM was not only stalled by the US government, but also by the neglect or even outright opposition of major emerging market countries. Independently of whether one thinks in terms of incremental reform in individual country cases or in terms of a renewed global debate, here is a presupposition for a strong and pro-active role of indebted countries' governments. International institutions, NGOs and even like-minded creditors will depend on the governments of those countries, which are actually suffering from over-indebtedness, to actively support new mechanisms, even at the costs of short-term political conflicts. All international institutions, social movements and supportive creditors can do is set the stage.

Endnotes

1. The strongest expression of this has been the Multilateral Debt Relief Initiative (MDRI) at the summit of the Group of 8 in 2005 in Gleneagles. While HIPC had been based on a concept of debt sustainability (and the subsequent cancellation of any debt that exceeded the uniform HIPC thresholds), the MDRI marked the return to the Pre-HIPC relief quota system. Under MDRI a selection of important multilateral creditors to many HIPCs, granted "100%" cancellation of their respective claims on those countries. Depending on the creditor profile of each debtor country, debt relief savings could be as far reaching as 80% (they never reached 100% anywhere, due to important caveats in the fine print) or as little as 20%. A haphazard, while certainly welcome, benefit to some countries was accomplished at the price of abandoning the link between debt sustainability and debt relief.

2. The DSF looks to "improved coordination" on the part of the creditors, but threatens them with no sanctions, such as a credible threat of losing a claim in case of lending that causes threshold violations. See International Development Association and IMF, "Review of Low-Income Country Debt Sustainability Framework and Implications of the MDRI", March 24, 2005.

3. For a broader overview of the various ADR techniques, for which mediation is discussed as a *pars pro toto,* see F. Orego Vicuña, "Arbitration in a New International Alternative Dispute Resolution System," ICSID News 18, 2; fall 2001.

4. See the latest in an extensive set of papers: K. Raffer, "FTAP – An Efficient and Just Way to Deal with the Sovereign Debt Problem," paper presented at the AFRODAD Workshop, Lusaka, September 2004.

5. Current information on civil society proposals may be found at: http://www.erlassjahr.de/content/ftap/index.php. From a Catholic perspective and with a strong foundation in Catholic social teaching, see "Sustainability and Justice: A Comprehensive Debt Workout for Poor Countries with An International Fair and Transparent Arbitration Process (FTAP)", CIDSE-Caritas Internationalis Position Paper (September 2004).

6. During the SDRM debate, IMF staff occasionally tried to deny the double role at all, claiming that the preferred creditor status will in fact immunize the IFIs from any conflict of interest. Indeed the preferred, or rather exempt, creditor status formally protects these institutions from suffering the economic consequences of their own poor expertise on a country's debt sustainability. Regardless whether one considers this constellation as desirable or not, the argument is not convincing here, because under HIPC despite their formally exempt creditor status, the IFIs could not help but be part of the overall relief. Their track record in assessing the debt problem and defining the need for relief has been generally poor.

7. The definition of debt sustainability is much more than a technical question. After working with debt sustainability as a concept under both HIPC Initiatives creditors have recently acknowledged that a more thorough analysis of debt sustainability needs to be applied. See: International Development Association and IMF, "Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework and Policy Implications," September 10, 2004; from a critical NGO perspective, see J. Kaiser, "Heads in the Sand—the IMF Discusses Debt Sustainability" (http://www.erlassjahr.de/content/languages/englisch/20040421_sustainability.php).

8. Raffer strongly advocates for equal treatment, pointing to the otherwise fatal incentive for the IFIs, who would remain immunized from suffering the economic consequences of either bad lending or bad advice. See: Raffer op.cit. On the other hand, Kaiser argues for leaving the parties with more flexibility when it comes to, for instance, rewarding a more constructive engagement of some creditors in the process, including the IMF's traditional crisis lending. See J. Kaiser, "Little Common Ground Left: the SDRM Draft Proposal from an FTAP Perspective" (www.erlassjahr.de).

9. Martin and UNCTAD have most clearly shed light on this problem which for some time has been absent from the international debt debate; see M. Martin, "Has Debt Relief Made Low-Income Countries' Debt Sustainable?" Paper presented to the Conference on Debt Relief and Global Governance, Rotterdam, June 17-18, 2004 and UNCTAD, *Debt Sustainability: Oasis or Mirage?* Geneva, 2004. For an updated discussion on the domestic debt problem, see International Development Association and IMF, "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief," November 6, 2006.

10. This has been discussed by the Congressional Research Service (CRS) of the US Congress on the Argentine cases; see "Argentine's Sovereign Debt Restructuring," CRS Report to Congress, October 9, 2004.

11. An evaluation of the mediation process for Indonesia is to be found in A. Hoffert, "Vermittlung bei Schuldenverhandlungen zwischen Entwicklungsländern, Banken, Staaten und dem IWF," Diss. Bochum, 2004.

12. This argument has among others been made in the court case filed in 1982 by the late Argentine journalist Alejandro Olmos against those responsible for the debt build-up under the Argentine de-facto governments; in 2000 the Argentine Criminal Court ruled in favor of Olmos (see Case No. 14.467, heard at the Buenos Aires Federal Economic Criminal Court No. 2 “Olmos, Alejandro versus Various Former Government Officers”).

13. The ground-breaking paper here being K. Raffer, “What’s Good for the United States Must Be Good for the World: Advocating an International Chapter 9 Insolvency,” in *From Cancún to Vienna: International Development in a New World*, Bruno Kreisky Forum for International Dialogue, Vienna, 1993, pp. 64-74.

14. In the case of Germany, parliament twice mandated the federal government to work towards an international insolvency framework in 2002. After its re-election in that same year, the Schroeder administration therefore declared this to be one of their aims during the legislative period 2002-2006 in its coalition agreement.

15. According to *World Bank News*, September 17, 2002: "Today, with no clear process for sovereign-debt restructuring in place, when a nation is on the brink of financial collapse we have two stark and uninviting options — unwarranted lending or sending the troubled nation off a cliff into a catastrophic default," US Treasury Secretary Paul O'Neill said in a recent speech. At a recent private lunch, says the story, O'Neill asked IMF Managing Director Horst Köhler directly to draw up language — by the IMF's spring meetings in April — to amend the articles of agreement to permit the plan to go into effect. Although the US Treasury didn't commit to supporting such an amendment, Fund officials came away from lunch convinced that the US was warming to the idea (see Setser in this volume).

16. That is, the Paris Club has long demanded each debtor country whose debt it treated seek "comparable treatment" from non-member creditors, including private lenders. When private creditors settle first, they may seek — but have never gotten — the Paris Club to base its decision on relief accorded in the private creditor agreement (for more details, see Cosío-Pascal, this volume).

17. This not only refers to the well-known differences between US and Continental European positions. The reluctance of Arab and Eastern European creditors to join the agreement's debt relief, about which they were not even consulted, may turn out to be far more detrimental for the debtor.

18. The IFIs have tried to find rather technical solutions to this structural coherence problem. See International Development Association, "IDA Countries and Non-concessional Debt: Dealing with the "Free-Rider" Problem in IDA 14 Grant-recipient and Post-MDRI Countries," Paper for Board Meeting, July 6, 2006.

19. For an extensive analysis of HIPC's shortcomings and their structural implications, see UNCTAD and Martin, op. cit., as well as "Cologne Five Years On" (http://www.erlassjahr.de).

20. The SDDRF would also have a very limited function, as it would neither mediate nor arbitrate, but help resolve disputes on individual loans (verify obligations) and organize creditors to vote on a restructuring proposal.

21. A pilot project for an independent debt sustainability analysis was under way in Bolivia, financed by the German Ministry of Economic Cooperation. Results were expected by mid-2007.

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Table 1

	Basic Principles	Institutional Framework & Process	Legal Status of the Process and its outcome	Eligible Countries	Eligible Debt	Criteria Applied regarding relief or repayment	Public Participation and transparency
Paulus	Development of a model insolvency law by UNCITRAL or another suitable UN institution, which would harmonize insolvency procedures into a worldwide set of principles for the negotiation of sovereign debt.	Establishment of a neutral party in the form of a pool of neutral "arbiters" from which individual panel members will be selected for resolving individual cases. Debtor works out a plan, which upon verification by the third party, then needs to be accepted by a supermajority of creditors.	"Arbiters" have no decision making power, but rather facilitate the process. Legal enforcement secured via universal adoption of the model law.	Any sovereign who wishes to trigger the process with a view to an eventual insolvency; eligibility needs to be verified by the third party.	Any debt of the sovereign, internal or external, needs to be part of the process.	No general criteria applied, but individual ad-hoc agreements between the parties.	Not foreseen.

	Basic Principles	Institutional Framework & Process	Legal Status of the Process and its outcome	Eligible Countries	Eligible Debt	Criteria Applied regarding relief or repayment	Public Participation and transparency
Gitlin	Develop best practices for sovereign debt negotiation and apply them through a Sovereign Debt Forum (SDF), with particular emphasis on sovereign bonds.	Establish a Sovereign Debt Forum (SDF) as a standing forum to negotiate sovereign debt problems; the SDF then works through a mediation panel.	Voluntary forum of market participants and other stakeholders with no coercive powers. Informal adjudication function foreseen, if necessary.	Any country that issues bonds, provided bonds do constitute a major portion of the foreign debt.	Unless otherwise agreed all debt owed to private and Paris Club creditors.	Based on debt sustainability analysis of the IMF.	Closed and confidential negotiation within the SDF; participants which are not party to the process may be included.
Mediation	Voluntary agreement by the parties towards involving a neutral mediator with no decision making power.	Mediator's shuttle diplomacy towards elaborating a proposal to the parties.	In most procedural setups, no legal status beyond voluntary acceptance by the parties.	Any sovereign can take recourse to mediation as it considers the technique adequate.	Any debt owed to any creditor who wishes or can be convinced to participate.	Any criterion which is being brought up by either of the parties can be considered.	Strict confidentiality as a rule.
SDRM	Classes of creditors would be aggregated to lay the basis for super-majority decisions while negotiating with the debtor; decision making by the parties, with facilitation by a Sovereign Debt Dispute Resolution Forum (SDDRF) established by the IMF at "arms-length" from its regular staff.	Process triggered by the Sovereign; SDDRF established as a panel for individual cases, has no decision making power, but serves as a facilitator. Debtor works out a plan, which upon verification by the SDDRF needs to be accepted by a supermajority of creditors, organized in asset classes.	Amendment of IMF's Articles of Agreement provides legal basis for negotiations before and decision making by the parties with the help and endorsement of the SDDRF.	Countries in need for debt relief outside the HIPC Initiative.	Debt owed to bondholders; debt owed to private banks and to official bilateral creditors may be included into the process as separate classes of creditors.	Debt sustainability assessment guided by the IMF.	Process is strictly confined to the parties involved; no public participation whatsoever.

	Basic Principles	Institutional Framework & Process	Legal Status of the Process and its outcome	Eligible Countries	Eligible Debt	Criteria Applied regarding relief or repayment	Public Participation and transparency
FTAP	Independent decision making and assessment of the debtor's situation as well as all other relevant aspects by a neutral arbitration panel, set up in equal numbers by the parties with an additional person nominated by the arbiters.	Process driven by an independent ad-hoc panel, established by the parties with the help of a technical secretariat.	Legal quality based on the ex-ante submission of the parties to the arbitration panel's decision; implementation via the New York Convention on the Recognition of Foreign Arbitral Awards of 1958. Alternatively rewards could be based on domestic law of a few debt-issuing key jurisdictions (Raffer) or on an amendment of the IMF's Articles of Agreement (other authors).	Any sovereign in need for debt relief.	All external debt of a sovereign; internal debt as well as non-sovereign external debt may be submitted to equal treatment arrangements. Internal debt needs to be subject to the FTAP – as long as it has not been dealt with under internal juridical procedures.	Any relevant aspect brought forward by the parties, notably sustainability, but also legitimacy of claims may be questioned by either of the parties or any stakeholder while exercising its right to be heard. The debtor's "sovereign sphere" is particularly protected in line with Chapter 9 of the US Insolvency Code.	Any stakeholder has the right to be heard via social organizations before the panel's final judgment is made.
TIADS/ Debt Arbitration Court	Independent decision making and assessment of the debtor's situation as well as all other relevant aspects by an Arbitration Court established according to international law.	Establishment of an international debt court with binding decision making power on any issue of international capital flows, either at the International Court of Justice (AFRODAD) or at UNCTAD (TIADS)[1]	Court's decision making based on international law, comparable to International Human Rights Agreements.	Any sovereign in need for debt relief.	All external debt of a sovereign.	Any relevant aspect brought forward by the parties, notably sustainability, but the legitimacy of claims may also be questioned by either of the parties or any stakeholder while exercising its right to be heard.	International court complying with relevant international standards for transparency and stakeholder participation.

[1] In earlier versions of their proposal, Acosta and Ugarteche had suggested the establishment of the tribunal at the International Chamber of Commerce.