ECOSOC special meeting on
"External debt sustainability and development: Lessons learned from debt crises and ongoing work on sovereign debt restructuring and debt resolution mechanisms"
(New York, 23 April 2013)

Executive summary

Pursuant to General Assembly resolution 67/198, the Economic and Social Council held, on 23 April 2013, a special one-day meeting on "External debt sustainability and development: Lessons learned from debt crises and ongoing work on sovereign debt restructuring and debt resolution mechanisms." The main substantive points of the meeting are summarized below.

Opening of the meeting

President of the ECOSOC, H.E. Mr. Nestor Osorio (Colombia)

The meeting was opened by the President of EC problems need to be monitored to prevent them from growing into major financial crises with the potential to halt a country's development agenda or even erode gains already made.

Mr. Panitchpakdi further commented on the global and systemic nature of today's sovereign debt crises with the cross-holding of sovereign debt instruments in a globalized economy. He pointed out that the uncertainty surrounding the debt restructuring process had caused unnecessary delays and high costs. He invited the international community to work towards a more predictable mechanism that would facilitate more orderly sovereign debt restructurings and allow space for collaborative and constructive dialogue between the debtor and all creditors.

In addition, he emphasized the importance of finding ways to minimize negative externalities arising from crises. He reported on progress made by his own institution, UNCTAD, in crisis prevention with the establishment of international norms and principles for responsible borrowing and lending. These principles cover all types of sovereign debt contracts, as a first step towards preventing crises generated by irresponsible, imprudent or opportunist behaviour by debtors and creditors. According to him, these "soft law" guidelines have gained support from a range of countries, and their growing acceptance can make a contribution to debt sustainability and global financial stability.

Ms. Shamshad Akhtar, Assistant Secretary General for Economic Development, UN-DESA

Ms. Akhtar emphasized the need for a structured framework to deal with sovereign debt. The recent global financial crisis has shown the limitation of the international financial architecture in solving debt crises. She pointed out that because defaults were costly in political terms and carried the risk of domestic banking system collapse, politicians and policymakers almost always postponed calling default, which made the ultimate cost higher. At the same time, she said that market-based, or voluntary, solutions did not generally provide enough debt relief for the debtor, often leaving the debtor country financially vulnerable to yet another debt crisis in the near future. She argued that improvements to the market-based approach, such as through collective action clauses (CACs), were not sufficient for several reasons. In particular, CACs leave open questions on how to aggregate votes across bond issues, as well as across different types of debt. The voluntary code of conduct and the principles of stable private capital flows and fair debt restructuring have not resulted

Lessons learned from the history of debt crisis

Mr. Jeffrey Lewis, Director of the Economic Policy, Debt and Trade Department, Poverty Reduction and Economic Management Network (PREM), World Bank.

Mr. Lewis focused on the debt relief provided under the Highly Indebted Poor Country (HIPC) Initiative and assessed it as a successful effort to recognize and partially solve a systemic debt crisis in low-income countries. According to Mr. Lewis, the reduction in the debt stock has opened the space for contracting new debt, including non-concessional debt. The increase in debt relief has been accompanied by rising expenditure on poverty reduction, though the causality between debt relief and the increase in expenditures has been harder to demonstrate. He noted that the HIPC Initiative responded flexibly to challenges but noted that another World Bank program (in the form of a trust fund hosted by the World Bank) aiming to reduce sovereign commercial debt has found it much harder to find consensus among private lenders to reduce debt. He noted that challenges remain in that there are countries that have been unable to avail themselves of HIPC debt relief.

Mr. Lewis highlighted the debt problems of small states in the Caribbean, ECCU and Latin America, which had high public debt levels and slow growth. These countries are highly vulnerable to external shocks and fiscal deficits and have limited fiscal space for counter-cyclical spending and financial capacity to cope with disasters. He emphasized that the face of global finance is changing and that there is the need to reduce the chances of debt crisis spreading to other sectors, such as the banking sector, which tends to hold sovereign debt on its balance sheet. Moreover, the focus of debt management strategies should be on risk management and on addressing underlying links between fiscal policy, debt sustainability and growth.

Mr. Christoph Paulus, Professor, Humboldt University, Berlin, Germany

Mr. Paulus noted that there was a broad consensus on the need to establish a legal framework for debt restructuring, but that, despite the ongoing sovereign debt crisis in the Euro zone, no

next step should be to discuss the “incentive and disincentive structure” so that responsible borrowing and lending could take place, and that high debt burdens did not deter growth.

Consensus had been reached on the fact there was a problem, there were gaps in the architecture for debt restructuring, and that there is a need to work towards improving the architecture for debt restructuring.

Keynote Address by Professor Joseph Stiglitz of Columbia University:
“Gaps in legal and institutional structures for debt restructuring”

Mr. Stiglitz argued that the goal of a bankruptcy regime is to provide for a fair and efficient restructuring that provides a sufficient write-down in debt to allow countries to resume growth. Both the objectives of efficiency and equity dictate that a fresh start for sovereign debtors is needed. The ultimate objective should be to promote economic growth and to protect the economic interests of citizens, who are made to bear the costs of the banking sector and politician’s mistakes.

According to Mr. Stiglitz, the current system does not meet any of these goals: restructurings have not treated all parties fairly, delays and prolonged negotiations have led to the destruction of assets during the restructuring process, and countries generally have not received sufficient write-downs. He argued that existing market-based mechanisms, such as collective action clauses, do not address the full spectrum of gaps and perverse incentives in the system. For example, he suggested that the lack of a fair bankruptcy regime has created incentives that have contributed to excessive lending, poor credit screening, and debt

which has turned into financial sector crises. The resulting burden of adjustment on the debtor is thus much larger and over a shorter period of time. The IMF is not designed to deal with such crisis and in the absence of a rules-based system, it has no other option but to come in with bail in financing and adjustments over short periods. Mr. Haley's proposal was to firstly endow the IMF or another international organization with powers to become a de factor international central bank. Another option was to design a SDRM to promote timely and orderly debt restructuring, which takes into account broader societal claims.

Even though voluntary approaches have been developed within the last decade, they have drawbacks, especially with the respect to the issue of aggregation in collective action clauses. Some of the problems in the voluntary approach were attempted to be resolved with the design of exit consents which created a credible threat of coercion to bring about a debt restructuring. The reasons why it is sensible to explore a more formal approach is that in its absence there are deadweight losses for debtors, creditors and international financial stability. A legal framework of how to deal with SDR would reduce uncertainty at the domestic level.