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MULTI-STAKEHOLDER CONSULTATION ON "SOVEREIGN DEBT FOR SUSTAINED DEVELOPMENT: ISSUES FOR COUNTRIES THAT ACCESS FINANCIAL MARKETS"

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Secretariat Report of the Consulta

while greater political will may be needed by debtor governments to avoid approaching the precipice, they are forced to operate in a volatile world and often with seriously limited administrative capacity.

On some issues, an apparent consensus on the surface hid differences just below it. In particular, while greater transparency was lauded as a general principle, there was much information that governments, international institutions and private investors did not wish to share. Indeed, the policy of the International Monetary Fund (IMF) on transparency consists of different publication regimes ("voluntary", "presumed", etc), which reflect the difficulty in finding a compromise that suitably addresses the diverse concerns of member governments, and that the Articles of Agreement limit the Fund's ability to publish a document related to a member country without the member's explicit consent. One reason for their reticence, as voiced by one speaker, appears to be the fear that release of information when confidence is declining would accelerate the decline. Similarly, IMF's Contingent Credit Line was never used out of concern that signing up for it would be taken as a signal of pending distress, even though the credit line was intended for countries with strong macroeconomic policies. It was argued, in contrast, that if investors had more information, they would be more confident. Not knowing, they assume the worst. But investors, on their side, could also bet on a crisis occurring and profit when it happens, which is not information they would readily share with a debtor government (although large speculative positions usually leave a trail in the market). Thus, the proper content of transparency (with its implications for accountability) remained a topic for discussion.

In addition, a number of proposals were brought to the table on how to operationalize debt "sustainability," how to improve information sharing and communication, and how to resolve debt crises. There was interest in some quarters in further considering a number of these ideas, and proposals were made to this effect. In sum, the consultation appears to have achieved its main purpose of helping to air a number of considerations on sovereign debt that are of importance to countries that seek to access international financial markets. It is hoped that the discussion clarified views and helped participants find some common ground.

Panel presentations in the Economic and Financial (Second) Committee of the General Assembly

Marco Balarezo, Chair of the Second Committee and Deputy Permanent Representative of Peru to the United Nations, welcomed participants in the consultation to the United Nations and explained the exploratory type of discussion the General Assembly was seeking to foster when it mandated the multi-stakeholder dialogues. He also drew attention to what the Member States of the United Nations had said in the Monterrey Consensus concerning sovereign debt problems (see statement).

trust between official and private sectors, which remain ill informed about each other. From his perspective, the multilateral institutions and borrowing governments still keep too many secrets. This reflected the political risk governments perceive from greater transparency about policy and outcomes for which they would be held accountable. Nevertheless, he believed that commitment to communicate in good times and bad is the best remedy.

Oscar Ugarteche, who is a professor at the Pontifical Catholic University of Peru and collaborates on the debt campaign of Estrategia Andina-CentroAmericana-Amazónica, followed up on the preceding statement by remarking nothing is impossible politically. Indeed, he called for major international reform. He criticized workouts from debt crises as inadequate and also unbalanced as private creditors have to carry most of the burden of debt restructuring owing to the preferred status of multilateral creditors. To remedy that, he advocated creation of a UN-based International Board of Arbitration for sovereign debt defaults. All creditors would have the same status and follow common rules of the game. More information would have to be provided by creditors and the government to the public as well as each other (civil society had as little information as the private creditors, he said). Social expenditure and investment should be protected. He did not fear that introduction of an arbitration process might raise the cost of international sovereign borrowing. In his view, it has been inappropriately cheap. Governments should rely more on their own tax revenues in his view.

Panel 2: "Debt sustainability: what it implies for policy makers, private sector and civil society"

Vikram Nehru, Director, Economic Policy and Debt Department, World Bank, moderated this panel. He moved directly to the presentations, taking the opportunity between presentations to offer comments, as on the need to focus on the overall debt of a sovereign and not just external debt. Indeed, there has been a substitution of domestic for foreign debt in a number of countries, which is not necessarily less risky, as domestic debt is usually costlier and carries greater risk of interest rate increases.

Beethoven Herrera, Economic Adviser to the Latin American regional workers' organization of the International Confederation of Free Trade Unions, noted that debt in Latin America increased 30 times compared to its levels in the 1970s. Given this fact and the poor state of development in the region, he asked how the borrowed funds had been spent and considered the possibility that much of this money had been appropriated by illegitimate political regimes. He saw the need to distinguish between loans made to legitimate and illegitimate regimes (according to him the concept of "odious" debt did not do the job). It was also necessary to distinguish between loans that were properly invested and those that were not. He suggested linking the flow of debt-servicing payments to exports and he supported the idea of creating an international independent arbitration body, which among various questions could address that of loan legitimacy (see statement).

Thomas Engle, Deputy Director, Office of Monetary Affairs, US Department of State, outlined US policy toward external debt of developing countries. Focusing first on crisis prevention and while acknowledging that "one size does not fit all" in policy design, he advocated: broadening the tax base and improving revenue collection; restraining fiscal expenditure, especially during boom times; building credibility of fiscal policy and transparency; being open to international trade and investment, in particular to speed adjustment and generation of additional tax revenue following currency devaluation; and addressing property rights, state enterprise reform and contingent liabilities. He applauded the spread of collective action clauses in bond contracts, the work in progress on a code of conduct for debtors and creditors, and efforts to develop policy-monitoring programmes at IMF as a market-signalling device for countries that do not need to borrow from IMF. On resolution of debt crises, he underlined the need to balance the interests of debtor and creditor, and to maximize the chances to return to sustainability and financial market access. He saw the Evian Approach in the Paris Club as an important initiative for ending the ineffective practice of serial rescheduling of the debt of insolvent countries (see statement).

Emmanuel Moulin, Secretary-General of the Paris Club and Chief, International Debt Office, Ministry of Finance of France, briefed the audience on the Evian Approach, which was adopted by the Club in 2003 for countries not participating in the initiative for heavily indebted poor countries (HIPCs). The key innovation is that Club members explicitly consider whether a country's debt situation is "unsustainable," drawing on a debt sustainability analysis (DSA) prepared by IMF. The Club thus seeks to distinguish insolvency from illiquidity, which requires different treatment. Debt treatments would be tailored to the situation in the country and delivered in stages. Also, more coordination with private creditors is intended in order to facilitate the debtor receiving comparable treatment from them. Mr. Moulin illustrated the Approach for the case of Iraq, where Paris Club creditors have held 32 per cent of its external debt of $114 billion. The DSA clearly demonstrated that Iraq's debt was unsustainable, and following assessments of various possible scenarios, the Club agreed to cut its claims in steps, summing to an 80 per cent cut by 200s8D -0.0352 5j 6 0 TD -0.035dTD -7ca -

debt servicing was absorbing a large share of government expenditures. Another alarming issue is that domestic banks hold much of this debt. It provides them with relatively risk-

The vital importance of government transparency was widely recognized, not only in the relations between debtor countries and their creditors, but also between the government and its people, whose right (and obligation) is to monitor how money from debt and taxes is spent. It was stressed that a debtor government in a workout from crisis could increase its present and future credibility by providing reliable information on how debt relief is used to promote debt sustainability and social goals. However, concern was voiced over how much transparency was optimal, as disclosure of sensitive information might by itself induce creditors to "test" the country's sustainability by a speculative attack, bringing about a crisis that might not have occurred on the basis of economic fundamentals.

Different participants pointed out the increasing role of domestic debt and the importance of deepening domestic financial markets in order to reduce financial sector vulnerabilities. Private sector participants stressed the positive role that domestic branches of foreign banks could play in domestic financial market development.

There seemed a general agreement on the difficulty in designing an unambiguous analytical concept or measure of debt sustainability applicable to all countries. It was indispensable to differentiate between countries and regions in the discussion of the appropriate management of external debt (Africa, Latin America, and Asia are in very different situations). In addition to difficulties in quantifying reliable indicators, some commonly used indicators can also be misleading. Examples given included the debt service ratio, which only measures actual debt service payments, but ignores arrears. Also, it was agreed that qualitative judgments of specific country conditions were always necessary. Citing the recent experience in assessing debt sustainability in Argentina both before and after the recent default, it was proposed that consideration be given to measuring the ability to sustain debt relative to the potential growth rate of the economy. For debt restructurings in general, this suggests a need for flexibility within a system of norms.

A recurring theme in the discussion was how to handle debt crises. Several participants argued that an arbitration framework would provide a superior way to work out from unsustainable debt. While there were doubts about the political viability and legal standing of such a mechanism, voiced mainly by private sector participants, many of the discussants favoured the idea of exploring some sort of an international agreement on arbitration. There were, however, differing views about practical implementation. Most participants argued that IMF would not be credible as a neutral arbitrator, given its conflicting interest as a preferred creditor. At the same time, participants from the private sector were not sure that the UN would be the appropriate forum to develop such a framework since the private sector is not represented there.

It was recognized that different stakeholders have fundamentally different objectives in debt negotiations. Private enterprise, including financial institutions, requires profits for continued operation. Private creditors are rewarded for taking risks by the possibility to make profits, but risk also means there will be losses from time to time. Governments operate under different principles: they are responsible for ensuring their

citizens' welfare and economic development, while international financial institutions have a mandate to promote stability and development. Although there were calls for "comparable" treatment of private and official loans in a debt workout, it was widely accepted that "comparable" would not be the same as equal, given their different roles.

Private sector participants pointed out that, in any debt restructuring, consideration should be given to future financial inflows. While this required sufficient debt relief to allow for future sustainability, without which a country would not have access to the international capital market, it also meant relief could be excessive if it deterred private creditors from future lending.

It was stressed that lending to sovereigns was a political process, and thus debt renegotiations per se were also political processes. In this context, there was a need to recall the importance that the Monterrey Consensus gave to developing countries' responsibility for and ownership of their own development. It was argued this implied giving them greater influence over the outcome their debt renegotiations, as well as commensurate responsibility in determining the policies of the multilateral financial institutions that oversee the international strategy for debt workouts.

Roundtable 2

Participants in the roundtable rapidly fell into an animated discussion covering a wide range of issues, reflecting the complexity of some of them and the diversity of perspectives and interests of the stakeholders. The main themes discussed were debt sustainability, debtor/creditor relations and debt workoutsr 0 art

banks that dominated international lending in the 1970s and 1980s has changed how the market makes its assessment. However, an additional consideration was raised concerning small versus large investors. Financial intermediaries retailed Argentine bonds mainly to inexperienced European households when professional investors judged them as too risky and were trying to sell them. One private sector view was that this practice should be prevented.

Dealing with exogenous shocks like natural disasters, especially in small island developing states, was extremely difficult for a government attempting to manage debt in

How the Bretton Woods institutions monitor debt-workout negotiations between a sovereign debtor and its private and public creditors and their prospective impact on the debtor country's adjustment programme was discussed with the example of Argentina in mind. Discussions followed on the cost of paying back debt versus defaulting. Some participants pointed out the difference in post-default opportunities between small countries (not likely to be able to work out a successful debt restructuring on their own) versus countries with large economies and huge debt burdens (more likely).

The issue of debt resolution through collective action clauses (CACs) was also raised here. Presently there is a growing trend to include CACs in new bond issues, but the full benefit in debt restructuring can only be achieved when they are included in the entire stock of securities. This will take perhaps ten to fifteen years. What, it was asked, are the mechanisms in place for debt restructuring in the transition period?

Looking toward potential agreed international reform, some government and civil society participants called for a clear set of rules for workouts from sovereign default. Some participants said that current debtor/creditor relations excessively favour creditors. Besides answering complaints about government secrecy, new rules could address concerns expressed about lack of creditor transparency, as on their willingness to take losses and forgive debt. New rules could also address the concerns of some participants about inadequate involvement of civil society during debt rescheduling (and also when contracting debt). Under such rules, it was argued that the voices of both creditors and debtors should be considered. One proposed mechanism was an independent, fair and transparent arbitration process, which would preferably be organized under the auspices of the UN.

A significant part of the roundtable discussion focused on the issue of "odious debt," although participants did not reach a consensus on how to address this issue. Some believed a workable definition was possible, while others argued the notion was too sensitive to be clearly defined. In this regard, one participant suggested the creation of a working group that would attempt to come up with a clear definition of the term, with a view to arriving at internationally agreed norms to apply to new borrowing so that creditors lending in such circumstances would understand from the start that the status of their loans was internationally compromised.

Concluding discussion: focus on the future

The consultation reconvened the morning following the two roundtables to consider the degree to which the discussion seemed to be leading towards interesting conclusions and proposals. Each of the following points received a measure of consideration and thus warranted being reported here.

future owing to the Paris Club rescheduling of debt-servicing instead of a write down of the debt. Another criticism was levied at the IMF. It was said that the IMF's role as an independent advisor and mediator was compromised by its role as a creditor, which could lead to a conflict of interest. Also, the IMF Executive Board, which is dominated by developed countries, was said not to reflect developing country interests.

It was also stressed that in debt negotiations small developing countries were often at a disadvantage compared to bigger developing countries, such as Argentina. Not only did large countries put more investor claims at risk during a debt renegotiation, but they also had better ability to absorb the cost of advisors for more sophisticated negotiating strategies. In small countries, one civil servant might have responsibility for what would be done by a staff unit in a large country. Also, some participants raised the issue of differential treatment and questioned why the Paris Club applied comprehensive treatment to the external debt to certain countries such as Iraq and not to other equally, or even more, pressing cases like Nigeria. Moreover, it was argued that the creditors' *quid pro quo* for relief for weakened or less independent governments has gone so far as to include effective handover of economic sovereignty; i.e., debtor government policy changes had to be accepted that national policy makers had earlier rejected. Indeed, it was asked why countries that had already reformed their macroeconomic policies but were still in need of a debt restructuring should be required to accept the conditionality embodied in a new IMF programme in order to complete their debt relief negotiation?

Although it was not on the agenda, one part of the discussion focused on the Highly Indebted Poor Countries (HIPC) Initiative. There was little controversy that the Initiative had brought benefits to HIPCs. However, a number of participants emphasized that the Initiative did not relieve fiscal pressure on governments, as HIPCs were expected to increase social and human development expenditures in exchange for debt relief. The result was a "debt swap" rather than debt relief. While the Bretton Woods institutions actually did not impose a strict dollar-for-dollar requirement in this regard, they did encourage such a redirection of spending. The key point, which c5 egohe In Tc0358 uidego Tc -13.5 TD -

debt obligation, usually one incurred by a previous regime. A participant proposed creation of a working group under the auspices of the United Nations to develop a legal framework that would facilitate applying the concept of odious debt in a forward-looking manner.

It was taken to be the consensus view that all nations need an effective domestic bankruptcy law and that the cost of having no bankruptcy law would be very high. On this basis, several participants from academia and civil society organizations suggested a mechanism to improve debt workouts at the international level modelled after Chapter 9 in the US Bankruptcy Code, which is for municipalities and other non-sovereign domestic entities. In this view, internationalising Chapter 9 procedures would safeguard the debtor's sovereignty, give the population a voice and ensure a fair and transparent process. On a similar note, some participants supported the proposal for a “fair and transparent arbitration process” (FTAusa4045 p -13soaj 0 -114 Tc 0.2564n oaho48gn FTAuo1I9ms3y(-)ilar not

Annex. **Biographical sketches of speakers on the panels**

Panel #1: Debtor/creditor relations

Moderator

AXEL BERTUCH-SAMUELS is Deputy Director of the Capital Markets Department of the International Monetary Fund. He has been at IMF in various capacities during his career, including as an Alternate Executive Director for his country, Germany, and special advisor to the Managing Director. He has held senior positions at the European Bank for Reconstruction and Development, the Ministry of Finance of Germany, and at the German Savings Banks Association. He has also worked in the 1970s for the United Farm Workers of America as an exchange volunteer.

Panelists

PEDRO FACHADA obtained an M.S. in Economics at the Pontifícia Universidade Católica do Rio de Janeiro in 1989. He worked in the private sector until 1997. He joined the Research

sub-national development, fiscal analysis, HIPC implementation, low income country debt sustainability, and middle income country debt dynamics. Prior to that he was the Manager of the Heavily Indebted Poor Countries (HIPC) Unit, which is responsible for implementing the HIPC Initiative. An Indian national, Mr. Nehru completed his graduate and postgraduate degrees at Oxford University before working with the Government of India for four years. He began his career with the World Bank in 1981.

Panelists

IWAN AZIS is a professor at the University of Indonesia and Cornell University, where he is currently teaching microeconomics and financial economics at the Johnson Graduate School of Management. He has published on topics of macroeconomic and financial modelling and macro-micro linkages. His recent publications cover topics such as policy analysis in a financial crisis situation; the dynamics of debt management; modelling the impact of asymmetric information on monetary policy; and the role of international financial institutions. Prof. Azis has conducted research and consulting work for various international organizations, and is currently helping the Indonesian Central Bank (*Bank Indonesia*) with its policy research.

THOMAS ENGLE is Deputy Director for Monetary Affairs at the United States Department of State. He is a career member of the U.S. Foreign Service, having joined in 1986. Besides Washington assignments in the State Department's International Finance and Development deputate, he has served at U.S. embassies abroad in China, Japan, Pakistan and Germany, and on secondment as a programme director at the APEC Secretariat in Singapore. His most recent overseas assignment was as Economic Counsellor at the U.S. Embassy in Berlin. Mr. Engle holds a masters degree in international relations from the Johns Hopkins University School of Advanced International Studies.

BEETHOVEN HERRERA is Emeritus Professor at the Universidad Nacional de Colombia, at the Universidad Externado de Colombia, visiting Professor at the United Nations Staff College in Turin (Italy) and a member of the Colombian Academy of Economics. Mr. Herrera is also an external consultant to the United Nations and external advisor to the Latin American Workers Organization and to the Latin American Episcopal Council (CELAM). He is a regular collaborator of the economics newspaper *Portafolio.*

EMMANUEL MOULIN joined the French Treasury in 1996, after graduating from the French National School of Administration (ENA). He held positions as deputy head of division in several services until 2000, when he became alternate Executive Director for France at the World Bank in Washington D.C. He's been head of the International Debt Division at the French Treasury and Secretary-General of the Paris Club since September 2003.

KHALID SHEIKH joined ABN AMRO in September 1987, after having worked as an economics and policy advisor at the Dutch Ministry of Foreign Affairs, and undertaken a Doctorandus at Erasmus University, Rotterdam. Mr. Sheikh also holds a master Degree in Development Economics from Erasmus University in Rotterdam and a post-doctorate Master in Financial Economics Degree from the Tilburg Institute of Academic Studies. Currently, Mr. Sheikh is working at Group Risk Management. Also, he has been an active member of an international working group on Collective Action Clauses and Codes of Conduct. He was also heavily involved in determining a private-sector alternative to the IMF's SDRM-proposal.