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Edited by Juan Pablo Bohoslavsky , Kunibert Raffer
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Introduction

We Need to Learn from Experience

JUAN PABLO BOHOSLAVSKY AND KUNIBERT RAFFER*

This book tries to find out what could be learned from debt crises that have occurred regularly since the early 1980s. This whole period can be seen as an age of sovereign debt crises, occasionally interrupted by a few years in which neither a crisis occurred nor countries had to suffer from the orthodox recipe against debt crises, i.e. harsh and undue austerity measures and 'structural reform' programmes. The number and recurrence of crises and their disastrous social and economic consequences distinctly reveal the inadequate response of states and the international community to this global challenge.

One reason for this inadequacy is fierce political resistance by stakeholders that actually benefit from this *status quo*; fear of trying alternative responses seems to be another. Unfortunately both were strong enough to block change for the better. This is nowadays crystal clear in the case of Greece, which experienced huge pressure from lenders (especially when decisions whether to accept or refuse bailouts and 'adjustment programmes' were to be taken by referenda or by democratically elected parliaments), combined with a government that does not dare reject the implementation of further austerity, which the electorate explicitly opposes, against its own promise.[1]

Under the current system, debt has become a form of political government through a relation of subjection,[2] a tool to bypass democratic institutions and

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[1] See on this Juan Pablo Bohoslavsky, report to the UN Human Rights Council on his visit to institutions of the EU, discussing the response of the EU institutions to the sovereign debt crisis from a human rights perspective, 14 December 2016 (A/HRC/34/57/Add.1).

[2] *See* on this Matthias Goldmann and Silvia Steininger, 'A Discourse Theoretical Approach to Sovereign Debt Restructuring: Towards a Democratic Financial Order', *German Law Journal*, 2016, Vol. 17, No. 5, pp. 709–46.

to govern debtor countries by creditors' whim – the replacement of democratic citizenship by market citizenship. This is why, in our view, the need to improve the way debt crises are tackled is not only about designing and implementing efficient economic policies and realizing economic and social rights but also about enhancing democratic governance.[3]

There is another important reason for why debt crises are not adequately prevented or tackled. Poor systematization of experiences with and reasons for debt crises certainly help to explain why crucial lessons have not been learned (Machiavelli *dixit*) and corresponding policy options and their consequences have not been fully explored. Valuable knowledge is not readily available and, hence, not used when confronting another crisis. Actually, there is no global data registry for debt restructurings.[4]

Lenders getting multibillion-dollar profits or political benefits under the current state of affairs are hardly keen on searching for more efficient and human rights–oriented options. This situation helps to understand why most creditors do not engage in any policy or institutional initiative that goes beyond Collective Action Clauses: it is not about preventing crises, nor about ensuring human rights, but only about minimizing losses and dealing with inter-creditor equity.

On the other hand, there is a certain unwillingness to learn on the part of politicians and decision-makers, as they appear to fear that new options may force them to acknowledge the seriousness of the situation (a news that nobody likes giving) and offer less room for manoeuvre in their negotiation with creditors, making this process even tougher and less popular in the eyes of the creditors. In addition, once politicians consider a crisis to be over, i.e. once they have absorbed the shock and defused the most threatening problems to creditors, they lose interest in designing, building consensus and implementing alternative responses. Yet, governments may perceive an incentive to learn and make an effort to implement alternative proposals: by giving priority to their population's rights, they would become politically stronger in domestic politics. We saw this happen in Argentina while the state was pushing for a meaningful haircut to its creditors. However, on the one hand – and this is obvious – creditors' pressure does not make this option easy at all. On the

3 *See* on this Goldmann and Steininger, 'A Discourse Theoretical Approach to Sovereign Debt Restructuring'.

4 There are in economic literature only a few academic attempts to systematize data on debt restructurings, such as Tamon Asonuma, 'Serial Sovereign Defaults and Debt Restructurings', IMF Working Paper Research Department, March 2016; Christoph Trebesch and Juan J. Cruces, 'Sovereign Defaults: The Price of Haircuts', *American Economic Journal: Macroeconomics*, 2013, Vol. 5, No. 3, pp. 85–117.

other hand, we need to keep in mind that crises and austerity do not hit all people in debtor countries the same way. A number of powerful domestic stakeholders stand ready to support austerity programmes instead of progressive tax reforms to overcome the crisis.

The first shock wave after Mexico's 1994–95 crash triggered a call by the Organisation for Economic Co-Operation and Development (OECD) for a larger 'officially provided safety net' for speculators, but also a short-lived revival of the idea of sovereign insolvency. Then Chairman of the US Federal Reserve System Alan Greenspan suggested thinking about international insolvency procedures as an appropriate mechanism to settle debt problems. The *Financial Times* reported that Treasury Secretary Robert Rubin said he carefully avoided the term 'international bankruptcy court', but that some procedures to work out the debt obligations of debtors were needed. In the *Wall Street Journal* (10 April 1995), Representative Jim Leach, Chairman of the House Banking and Financial Services Committee, recommended international insolvency proceedings: 'What is needed today is a Chapter 11 process for the global financial system, a technique to keep nation-states and their people from the impoverishing implications of insolvency.' Mentioning the little-known Chapter 9 proceedings briefly, he specifically pointed out its implicit understanding that local government must continue to function. It was even considered informally to bring the issue to the table of the Halifax G7 summit, but this was not done. New euphoria on capital flows to East Asia soon eclipsed the Mexican shock. The problem faded away from public interest again.[5] While the Highly Indebted Poor Countries (HIPC) Initiative, the increasing use of Collective Action Clauses and the promotion of code of conducts elaborated by private lenders[6] might tackle some of the collective action problems that every debt crisis entails, they do not seem to provide a robust legal or institutional framework to deal with the problems at stake.

And this even applies to rather global initiatives such as those promoted in the United Nations. In September 2015, the UN General Assembly approved a

[5] *Cf.* Kunibert Raffer, *Debt Management for Development – Protection of the Poor and the Millennium Development Goals*, Cheltenham and Northampton: Edward Elgar, 2010, p. 79; on internationalizing Chapter 9, Title 11 US Code v. Kunibert Raffer, 'Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face', *World Development*, 1990, Vol. 18, No. 2, pp. 301ff; or Kunibert Raffer 'Debts, Human Rights, and the Rule of Law: Advocating a Fair and Efficient Sovereign Insolvency Model', in: Martin Guzman, José Antonio Ocampo, Joseph E. Stiglitz (eds) *Too Little, Too Late, the Quest to Resolve Sovereign Debt Crises*, New York: Columbia University Press, 2016, pp. 253ff.

[6] Such as the *Principles* for Stable Capital Flows and Fair Debt *Restructuring* of the Institute of International Finance.

resolution on 'Basic Principles for Sovereign Debt Restructuring'.[7] These principles adopted an incremental approach, offering a progressive guide so that debt-restructuring practices become gradually in line with a set of well-rooted international legal principles such as sovereign debt sustainability, good faith, legitimacy, impartiality and human rights. In light of the lessons drawn from the country cases described in this volume, these UN principles have learned a great deal from past experience and understood some of the fundamental problems underlying debt crises while crystallizing an effective guidance to prevent and/or minimize them in a sustainable and human rights–sensitive way.

However, there is a huge gap between theory and practice. One the one hand, most developed countries voted against or abstained from this resolution. On the other, Argentina was the main sponsor and promoter of this UN resolution. Actually, after this resolution was passed by the General Assembly, the national Argentine Congress explicitly incorporated it into the country's domestic law. Yet, after resisting for a decade the judicial battering of vulture funds, Argentina capitulated in 2016 and decided to reimburse the full amount defaulted in 2001, plus (in some cases exorbitant) interest and other costs, thereby violating the very essence of the principles.

We obviously need to learn more about why some countries succeed and others fail when dealing with debt crises. Why do a few sovereign debtors overcome economic problems very quickly and at minor human rights costs to their people (like Iceland), while others remain trapped by debts for years (Greece, for instance), struggling with overwhelming debt burdens and exacerbating economic problems and human suffering? What happens to the countries that try something different, and to those that follow options that have repeatedly failed? To what extent do debtors and creditors consider the real implications of each option to tackle debt crises before making a decision?

To explore these and other questions, our book seeks to highlight fundamental lessons that should be drawn from the past. A more informed decision-making process about available options to deal with debt and financial crises could help lenders, but more importantly governments, to perform more sophisticated cost-benefit analyses in order to decide strategies. It would also help *bona fide* creditors, by far the largest group of creditors.

7 Which were built on the 'UNCTAD Principles on Responsible Sovereign Lending and Borrowing'; *see* Juan Pablo Bohoslavsky and Matthias Goldmann, 'An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law', *Yale Journal of International Law*, 2016, Vol. 41, pp. 13ff.

This challenge concerns most countries, even though some of them seem to ignore it. One the one hand, the continuously rising burden of sovereign and private debt in both developing and developed countries tells us that debt problems (and the political, social and economic problems they bring about) will be among us for the foreseeable future. On the other hand, as the April 2016 G20 Ministerial Meeting demonstrated, debt restructuring is not yet considered a policy option, remaining an elephant in the room that needs to be addressed. It would be of advantage to discuss this problem before another shock wave produced by the next debt crisis hits.

Drawing useful conclusions is all the more necessary, as UNCTAD has just warned of 'a new round of debt crises'[8] in developing countries that would send shockwaves through the global financial system, with disastrous human rights consequences.[9] UNCTAD's Report stressed the vulnerability of poor states to falling commodity prices and higher interest rates, the same scenario as during the pre-1982 years. Now that the Fed has stopped its policy of 'free' money, the danger of debt crises also looms over many OECD countries, especially euro-member countries. Their huge debt burdens are presently sustainable due to low interest rates or even negative interest rates for borrowing by countries like Germany. A change to normal interest rate levels – understandably not presently on the agenda of the European Central Bank (ECB) – let alone a period of high interest rates as in the early 1980s, would definitely raise gravest problems for quite a few countries worldwide. UNCTAD concludes:

> While the current situation seems less ominous than in 2008, it is proving more difficult to manage. With the financial system on a firmer footing, politicians and policymakers have recovered their sense of impotence in the face of supposedly insurmountable global forces, and have made 'business as usual' their default policy option. Financial markets are chastened but unreformed, debt levels are higher than ever and inequality continues to rise. Most of the upside gains have resulted from asset price rises and increased corporate profits. Meanwhile, most of the downside adjustment has fallen on debtor countries and working families, with wages, employment and welfare provision under constant pressure from a return to austerity measures.[10]

UNCTAD warns that Southern external debt stocks more than tripled between 2000 and 2015. In the North, Italy is already in an emergency situation now, at presently prevailing low interest rates and while the ECB is unreasonably

8 UNCTAD, 2016, *Trade and Development Report 2016*, p. I.
9 See Juan Pablo Bohoslavsky, report to the UN General Assembly on integrating human rights into debt policies to counter new debt vulnerabilities, 5 August 2016 (A/71/305).
10 UNCTAD, cit., II.

flooding markets with money. Greece is still stumbling under its debt burden, and so-called successes such as Spain, Portugal or Ireland are not really doing well either if one cares to lift the newspeak-veil that unaccountable and irresponsible eurocrats have pulled over these crises.

To make a long story short, drawing lessons from the past is probably more necessary right now than it has ever been.

The countries analysed in this book were chosen by the criterion of being different from the average or representative debtor country in distress. All have singularities that should help us to understand debt problems and ways to overcome them in ways that are economically indicated, consistent with the rule of law, and that take the human rights of debtors' population properly into account.

By analysing fourteen unique or singular country cases of sovereign debt problems that have not yet received enough or proper attention – some regarded as successful, some as unsuccessful, in dealing with debt or financial crises – this book aims at contributing to a better understanding of the policy and legal options available to countries struggling with debt problems. It tries to work out common trends and challenges and to find insights that could be useful to other cases.

Argentina is a fairly obvious choice for a number of reasons. Its history as a debtor, various unsuccessful attempts to overcome the debt crisis, its default only three months after the final futile IMF attempt to rescue Argentina in September 2001, among other interesting developments, predestine it as one case to be analysed in this book. It should be recalled that one reason for the scale of the crisis was the peso-dollar parity, introduced by Argentina in line with the IMF's fad at that time, namely currency boards and fixed pegs. The Ministry of Finance's attempts to put together a programme covering financial needs for 2001–02 while country spreads were about to reach 1,000 basis points was supported by nearly $20 billion of multilateral credits, $13.7 billion from the IMF alone. But as the unavoidable cannot be avoided, Argentina took the audacious step of unilaterally offering its creditors a cut of 75 per cent of nominal values, a proposal somewhat modified in 2004. In its desperate situation Argentina had no other choice but to get relief. As no formal framework existed, it chose this conflict-ridden strategy. It must be noted that Argentina openly opposed the IMF, even threatening not to pay the Fund as due (but later paying off what was owed to it). On several occasions Argentina prevailed against the IMF. Eventually, more than 90 per cent of creditors agreed to the reduction of Argentina's debts; only a small group of holdouts refused to do so.

Argentina's holding out against the holdouts was remarkable. So was the seismic decision by the New York judge Griesa to take consenting creditors as hostages, de facto expropriating them, which changed the rules in financial markets, and the final settlement with them by the new Argentine government, which in 2015 decided to pay them 100 per cent.

Brazil is an important debtor country, having a long history of currency or balance-of-payment financial crises, playing a major role both in the Latin American crisis of the 1980s and in the 'second-generation' crisis of the 1990s. But Brazil already faced debt problems much earlier: after negotiations in 1943, Brazil's debts were reduced by more than 75 per cent. Brazil and Argentina also spearheaded the new drive by Southern debtors to repay the IMF early, which created notable financial problems with the Fund. The IMF was on the brink of bankruptcy because of early repayments and a consequent shrinking of its outstanding claims from SDR 70 billion (2002) to some SDR 15.5 billion (end 2006), as well as income shortfalls that had been projected to surpass 40 per cent during 2008–10.[11] Another big international debt crisis once again saved the Fund. As in the early 1980s, it was an international debt crisis the IMF had helped to come about by propagating neoliberal agenda.

The interesting conclusion the chapter´s authors draw from Brazil's experience is at odds with prevailing, orthodox theory. Developing countries should not get indebted in foreign money – in money that they can neither issue nor depreciate. In other words, they should not try to grow with 'foreign savings' (current account deficits). Growth should not be externally financed. In the last 70 years the highest growth period (1947–72) of the Brazilian economy occurred with low levels of current account deficits.

Ecuador was chosen because it was the first 'Brady country' that officially defaulted, putting an end to the illusion that the Brady Initiative – a scheme first proposed by the then – Brazilian Minister of Finance, Luiz Carlos Bresser Perreira, and called Debt and Debt Service Reduction schemes after Brady's term at the US Treasury – had helped to overcome the debt crisis of the 1980s. Later on, in 2007, Ecuador established a Public Debt Audit Commission to evaluate the country's debt incurred over the previous three decades. Without going into the merits of this Commission's findings, one has to say that it proved a successful instrument in convincing (or simply scaring) more than 90 per cent of creditors to eventually accept selling their bonds at a 65 per cent discount to Ecuador after the country had defaulted on two of its bond issues in 2008. After a number of years without access to capital markets, Ecuador

11 Hector R. Torres, 'Reforming the International Monetary Fund – Why Its Legitimacy Is at Stake', *The Journal of International Economic Law*, 2007, Vol. 10, No. 3, pp. 1ff, available at www.networkideas.org/featart/aug2007/fa10_Hector_Torres.htm, p. 9.

agreed to repurchase most of its remaining defaulted debt and could issue bonds again in 2014. This sovereign restructuring of external debt is a rare case. Relief was obtained in the absence of acute financial stress. Furthermore, the sovereign obtained debt relief, at least in part, on the express assertion of illegitimacy of financial obligations.

Greece is the prime example of how incompetent and biased unelected bureaucrats that seem to have a different agenda than solving this crisis can easily turn a small problem into an outright catastrophe, snatching defeat from the jaws of victory. Any team of independent economists could have solved Greece's problem quickly and easily by obeying Art. 125 of the Maastricht Treaty. It shows how politicians can mess up a simple and easy-to-solve problem while purporting to 'rescue' a country. Greece's debt burden has increased substantially since 'rescue' efforts had started, its GDP has shrunk sizeably and avoidable (and sometimes irremediable) damages have been inflicted on Greece's people and economy, taxpayers in other euro-member states and the private sector. Future capital market access for euro countries may have been damaged. It is impossible to imagine how more damage could have been inflicted.

Greece is also an outlier in the EU-caused crisis. Whereas all other euro-countries are examples of what is called the second generation of debt crises (i.e. due to undue liberalization, a runaway private sector is allowed to destroy a sound economy and governments, whose fiscal indicators are wonderful), Greece recalls the Latin debt crisis of the 1980s (not Chile's, though). The government itself and the EU were the cause of problems, strongly aided and abetted by wrong regulatory decisions. Regulatory measures anointing euro-members with risklessness induced banks to hold too high amounts of euro-member-country debts that later turned out to have been very risky. As the euro-member could amass too high debts, these regulatory failures at least exacerbated the crisis if they did not create it. It is *the* showcase of incompetence of irresponsible functionaries.

Grenada might seem less obvious than the cases of Argentina and South Africa. It was chosen as an example representative of small island states. The small size of the island's economy and its limited diversification are customary features of such countries. A very special feature was the broad and forceful participation of civil society in the process of debt negotiations. Interventions of the influential Conference of Churches in Grenada resulted in a far more balanced economic reform programme than usual in highly indebted countries under pressure from the IMF and other creditors. Based on Grenada's example, the author of this chapter proposes a Heavily Indebted Small Island Developing States (HISIDS) initiative for all small island countries, which should build on the strengths of the HIPC Initiative while avoiding its weaknesses.

Iceland stands out as one of the few cases (arguably the only case) where the debt crisis did not result in abject poverty and austerity ruining the economy for years to come. Even with room for improvement, one may see Iceland as *the* blueprint for how to manage debt crises. Most significant, Iceland refused to bail out foreign investors (many of them speculators). Nevertheless, overcoming the crisis was not painless, but it was much less painful than in virtually all other debtor countries. International organizations and other countries can and should learn from the particular path chosen in Iceland, which included protecting its core social welfare system, progressive tax reforms, efforts to ensure citizens' participation in the decision-making process and endeavours to establish political, administrative and judicial accountability.

Indonesia was the country worst hit during the Asian Crisis in 1997–98. It was also the country that followed IMF instructions most obediently and faithfully. Once presented as a miracle by the Bretton Woods Institutions (BWIs) eagerly taking credit for another success due to their advice, Indonesia became a Severely Indebted Low Income Country (SILIC) as a result of BWI advice that produced the Asian crisis. From the paradise of an emerging – or newly industrializing – economy it fell into the category of the poorest countries. Indonesia was denied HIPC status, although simple divisions of total debts in present value terms and debt service by export revenues showed a debt/exports ratio of 252 per cent and a debt service/export ratio of 33 per cent in 1998. Economically and judged by HIPC-relevant debt indicators, it was a HIPC. As in Nigeria's case, the amount of debt was substantial ($150.8 billion). Seeing HIPC reductions as too costly, creditors denied HIPC treatment on economically unconvincing, bureaucratic grounds.[12] To put things into a nutshell: thanks to BWI advice and quick liberalization, Indonesia is another and a prime example of how a country can fall down the ladder from virtually developed to poorest. We need to pay attention to how all this happened.

Ireland, another recent case in euroland and a country also having better Maastricht criteria than Germany in jerry-built euroland before the country was forced to bail out foreign speculators, was chosen because it was abused by the EU to claim that its policies of bailing out speculators and foreign banks (often, though not always, necessarily identical actors) were successful. It also shows that the difference with Iceland is more than just one letter in spelling.

[12] Cf. Kunibert Raffer & H.W. Singer *The Economic North-South Divide: Six Decades of Unequal Development*, Cheltenham (UK)/Northampton (US): Elgar 2001 [paperback eds: 2002; 2004], pp. 191ff.

Malaysia's prudent and well-considered reaction to the Asian Crisis of 1997–98 makes it an obvious candidate for our list. Courageously defying IMF pressure, Malaysia followed its own policy strategy and imposed capital controls on short-term outflows. It opted for monetary policy autonomy and stable exchange rates, which are considered 'unorthodox' policies. This helped contain increases in non-performing loans. Legally, Malaysia simply used its membership right: any IMF member may exercise capital controls in a manner which will not restrict payments for current transactions, defined as 'not for the purpose of transferring capital' by the Fund's Articles of Agreement, right at the time when the IMF tried to change its statutes to anoint its illegal policy of forcing member states to liberalize capital accounts with legality. All countries had not only the right to control capital outflows – as the IMF had to admit when Malaysia exercised it; by forcing members to finance large and sustained outflows by speculators the IMF openly violated its own constitution, protecting speculators from those countries that control the Fund by their votes. Initially heavily criticized by the IMF and neoliberal economists, Malaysia's policies are meanwhile considered successful in shielding the country from the worst effects of this crisis, as especially the comparison with its neighbour Indonesia proves.

Mexico was again chosen for very obvious reasons. The historic fact apart that the Great Latin crisis 'officially' started in August 1982 when Jesús Silva Herzog, the then–minister of finance, informed creditors that Mexico would no longer be able to service its debt, Mexico shows a lot of peculiarities. Yet, officially dating Mexico as the start of the debt crisis of the 1980s is – like many official statements – at odds with the truth. Following BWI (especially IMF) advice, Chile suffered an enormous debt crisis in 1982, before Mexico. This was conveniently veiled by anointing Mexico as the first case. Poland also defaulted before Mexico. Progress overcoming yearly (and, for banks, highly profitable) rescheduling, so-called MYRAs (Multi-Year Rescheduling Arrangement) were first concluded with Mexico, even before the 'Brady Plan', a similar but limited debt exchange programme, was put into effect there under Baker, who officially demanded repayment of every cent. In a way, Mexico may be seen as some kind of test laboratory for sovereign debt management. Thus, the question of what can be learned from its experience is doubtlessly important.

Portugal, yet another euro-country cited as proof that the crisis could be overcome thanks to EU authorities, is equally worth a closer look. In May 2014, three years after the crisis broke, Portuguese authorities performed what was called a clean exit from the 'adjustment programme'. Analysing this case more closely and neutrally shows a very different picture. After the 'clean exit'