TOWARDS A LEGAL FRAMEWORK ON SOVEREIGN DEBT RESTRUCTURING: A DEVELOPING COUNTRIES' PERSPECTIVE

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DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the University of Nairobi.

……………………………….……….
MURIUKI MURIUNGI
(Candidate)

This dissertation has been submitted for examination with my approval as the student supervisor

……………………………….……….
MUTHOMI THIANKOLU
(Supervisor & Lecturer, Department of Public Law)

DEDICATION

For my nieces:

Stephanie and Daniela,

The newborns in my family,

For reminding me of innocence as a virtue,

You hold so much promise.

(Soon, I will have to buy you ‘A Stephanie-Daniela Mouse Story’ Book).

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I am eternally and stubbornly grateful to God for life and opportunity; for grace and providence.

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I lack words to fully express my appreciation to my long-suffering buddy, Alvin Kosgei, for all his grace. I would be remiss if I failed to express my most profound gratitude to my parents and lovely siblings for support. To the princess amongst women, Janette Mukiri: thou overwhelm me with thy kindness.

In the end, seeing that this debt of gratitude may become unsustainable; I am afraid that we will have to restructure it. Hopefully, those not mentioned here for want of space and time, will not hold out in the restructuring. You are all greatly valued.

Finally, the usual disclaimer applies!

LIST OF CASES

Federated Strategic Income Fund v *Mechala Group Jamaica Limited* [1999] WL 993648 (S.D.N.Y.).

Assénagon Asset Management S.A. v *Irish Bank Resolution Corporation* [2012] EWHC (Ch) 2090 (Eng.).

ACRONYMS AND ABBREVIATIONS

IMF- International Monetary Fund

MDRI- Multilateral Debt Relief Initiative

HIPC- Heavily Indebted Poor Countries

MEFMI- Macroeconomic and Financial Management Institute of Eastern and Southern Africa

UN- United Nations

UNGA- United Nations General Assembly

UNCTAD- United Nations Conference on Trade and Development

GDP- Gross Domestic Product

CACs- Collective Action Clauses

LIST OF STATUTES

The Civil Procedure Act, Cap 21 Laws of Kenya, Government Printer.

The Insolvency Act No. 18 of 2015, Government Printer.

Chapter 1: Introduction

1.1 Background

'Sovereign debt restructuring' refers to the making of voluntary changes to the terms of a loan extended to a sovereign debtor by a creditor so as to enable the debtor discharge its financial obligations.[1] It may be in the form of a composition or extension.[2] A sovereign debt crisis, on the other hand, refers to a situation of financial problems whereby a sovereign debtor is unable to meet its debt obligations as and when they fall due.[3]

The recent debt restructuring of Greece; the 2001 default by Argentina; and the continued uptake of sovereign debt by most African countries, including Kenya, point to the need for a global legal framework on debt rescheduling.[4] The absence of a global legal framework on sovereign debt restructuring affords an opportunity for minority creditors to hold out as against the majority creditors.[5] This complicates the process of economic recovery for the respective countries in

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[1] US Das; MG Papaioannou & C Trebesch, 'Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts' (2012) IMF Working Paper WP/12/203, 7.

[2] A composition is an agreement among creditors that they will agree to a partial payment of the total debts owed from a debtor and share such payments among them in a pro rata fashion. See <http://legal-dictionary.thefreedictionary.com/Composition+with+Creditors > accessed 9 March 2016.

[3] A Perscatori & NR Amadour, 'Debt Crises and the Development of International Capital Markets' (2004) IMF Working Paper WP/04/44, 6.

[4] See generally, P Adams, *Africa Debt Rising*, a publication by Africa Research Institute <http://www.africaresearchinstitute.org/publications/africa-debt-rising-2/> accessed 24 February 2016. Also see, J Zettelmeyer; C Trebesh & M Gulati, 'The Greek Debt Restructuring: An Autopsy' (2013) Economic Policy <https://economicpolicy.oxfordjournals.org/content/economicpolicy/28/75/513.full.pdf> accessed 24 February 2016. In particular, Kenya has tapped into the sovereign bond market to raise funds for infrastructural development and offsetting of a government loan. The prospectus for the infrastructural bond that was floated in the Irish Stock Exchange is available online at:

<https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&uact=8&ved=0ahUKEwjwnqbkyaHKAhUHOBQKHdsYA0AQFggjMAE&url=https%3A%2F%2Fwww.nse.co.ke%2Flisted-companies%2Fcompany-announcements.html%3Fdownload%3D7962%253Ainfrastructure-bond-offer-octoberprospectus2014&usg=AFQjCNFKiJR_VNbPwDsgt1mMusBksU4Zsw&sig2=r4LKXJNucekztq_a6Q-lxw> accessed 17 December 2015.

[5] By "hold out" in this context we mean, refusal by a creditor to accept the offer given by the debtor so as to enable the restructuring of a debt, and in turn demanding full payment of the extended loan. For an explanation of the

financial difficulties, thus compounding the economic problems faced by such countries.[6] Further, the absence of a legal framework is likely to lead to increased costs of bail outs.[7] This study examines the need for a global legal framework on sovereign debt restructuring from a developing nation's perspective to aid in resolution of sovereign debt crises even as debt consumption increases.

1.2 Problem Statement

The absence of a global legal framework on sovereign debt restructuring affords an opportunity for minority creditors to hold out as against the majority creditors.[8] The effect of this is to complicate the process of economic recovery for the respective countries in financial difficulties, thus compounding the economic problems faced by such countries.[9] Further, the absence of a legal framework is likely to lead to increased costs of bail outs by other countries as evidenced in the case of Greece and the European Union.[10] Moreover, the absence of a restructuring

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concept, see JF Hornbeck, 'Argentina's Defaulted Sovereign Debt: Dealing with the "Holdouts"'(2013) Congressional Research Service <*https://www.fas.org/sgp/crs/row/R41029.pdf*> accessed 24 February 2016.

[6] US Das *et al* n (1). For a comprehensive account of the various debt defaults by countries, see generally, C Reinhart & K Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton University Press, Princeton 2009).

[7] SF Taylor, 'Financial Crisis in the European Union: The Cases of Greece and Ireland' (Master of Arts in Political Science Thesis, Virginia Polytechnic Institute and State University 2011) <*https://theses.lib.vt.edu/theses/available/etd-09202011-160932/unrestricted/Taylor_SF_T_2011.pdf*> accessed 23 February 2016.

[8] DC Smith & P Stromberg, 'Maximizing the value of distressed assets: Bankruptcy law and the efficient reorganization of firms' Paper prepared for the World Bank project on Systemic Financial Distress, 11 <*http://www1.worldbank.org/finance/assets/images/Smith-Stromberg_Maximizing.pdf*> accessed 24 February 2016.

[9] For a comprehensive account of the various debt defaults by countries, see generally C Reinhart & K Rogoff, n (6).

[10] S Ardagna & F Caselli, 'The Political Economy of the Greek Debt Crisis: A Tale of Two Bailouts' (2012) CEP Special Paper No. 25, London School of Economics and Political Science <*http://cep.lse.ac.uk/pubs/download/special/cepsp25.pdf* > accessed 23 February 2016.

mechanism increases the likelihood of default by financially troubled nations, thus leading either to a further economic downturn, or the fostering of a moral hazard.[11]

1.3 Objectives

This study seeks, *inter alia*: to provide a critical academic review of the effects of the absence of a global legal framework to govern sovereign debt restructuring in the face of increasing public debt; to examine and demonstrate the need for the theoretical justification and rationale for debt restructuring or offering of debt relief to sovereign states whenever they are unable to pay; to demonstrate the manner, level, and extent to which the resolution of sovereign debt crises is impeded by the absence of a global restructuring mechanism; to illustrate the inadequacy of the subsisting specific debt restructuring mechanisms including the Collective Action Clauses, in the resolution of sovereign debt crises; to make a case for a global legal framework for sovereign debt restructuring especially from a Kenyan perspective, and offer an informed prognosis on the future trends in sovereign debt restructuring processes.

1.4 Research Questions

a) What is the rationale for offering debt relief or allowing debt restructuring for sovereign countries/debtors? b) To what extent does the absence of a global legal framework to govern sovereign debt restructuring hamper the resolution of debt crises? c) Do the Collective Action Clauses usually incorporated into debt contracts between states and creditors, compensate for the lack of a global debt restructuring mechanism? d) Is there need for a global legal framework to guide sovereign debt restructuring?

[11] Moral hazard refers to the tendency by debtors to engage in reckless borrowing and creditors to engage in reckless lending, in the knowledge that they will be assisted out of the financial difficulties. For an excellent overview of the concept of moral hazard within the context of IMF lending, see R Vaubel, 'The Moral Hazard of IMF Lending' (1983) 6 World Economy 291. See also Hornbeck (n 5).

1.5 Hypothesis

There is an ineffective and inadequate legal regime governing sovereign debt restructuring at the global level. The absence of an effective legal regime to guide sovereign debt restructuring inhibits such process thus contributing to persistent debt crises that are bad for the global economy. The current mechanisms of sovereign debt restructuring such as Collective Action Clauses contained in individual clauses are ineffective and/or inadequate. A global legal regime on sovereign debt restructuring is essential to overcoming debt crises especially for developing countries.

1.6 Theoretical Framework

This paper is premised on three main theories: the virtue ethics theory, the creditor's bargain theory, and the neo-liberal institutionalist theory.

Virtue ethics as a school in moral philosophy postulates that human beings should lead flourishing lives (*eudamonia*).[12] The theory holds that it is the function of the law to ensure that citizens lead flourishing lives.[13] Given that insolvency law and virtue jurisprudence[14] are both anchored on similar values of equity, fairness and morality, virtue ethics offers an appropriate normative account for debt restructuring or debt relief.[15] Unsustainable debts lead to debt crises, for individuals, corporations, and sovereign debtors. A country saddled with debts, and which expends most of its revenue towards the paying off of its debts rather than development,

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[12] P Koller, 'Law, Morality, and Virtue' in Rebecca L Walker and Philip J Ivanhoe (eds.), *Working Virtue: Virtue Ethics and Contemporary Moral Problems* (New York: Oxford University Press 2007) 191, 192.

[13] CF Cimino, 'Virtue and Contract Law' (2009) 88 Or. L. Rev. 703, 715. Cimino notes that Aristotle, the originator of virtue ethics, considered the achievement of human flourishing as the function of law and government.

[14] ibid 707, Cimino explains that the legal fraternity has used the phrase 'virtue jurisprudence' to refer to the theory of virtue ethics in bankruptcy law.

[15] M Nozemack, 'Note, Making Sense Out of Bankruptcy Courts' Recharacterization of Claims: Why Not Use § 510(c) Equitable Subordination?'(1999) 56 Washington & Lee Law Rev. 689. Nozemack argues that bankruptcy courts are courts of equity and fairness.

overburdens its taxpayers contributing to increased poverty. This in turn inhibits citizens of such a sovereign from leading flourishing lives, which is the main thesis of virtue ethics theory. To this extent virtue ethics offers a theoretical underpinning for debt relief or debt restructuring for sovereign debtors that are unable to meet their debt burden, thus enabling them to overcome their debt crisis.[16]

The Creditor's Bargain Theory holds that bankruptcy ought to reflect the conjectural settlement that creditors would reach among themselves in the event they had an opportunity to negotiate before a bankruptcy petition.[17] The theory holds as one of its aims, the maximization of the value of the debtor's assets, so as to effectively confront the 'common-pool problem'.[18] In as far as the theory explains how to avoid the 'common pool problem' in case of the insolvency of a debtor, the theory becomes relevant in explaining the need for the adoption of a debt restructuring mechanism by creditors so as to confront the same problem.[19] Creditors of a sovereign debtor need to agree on a 'bargain' as proposed by the Creditor's Bargain Theory, a situation that can only be made possible through the adoption of a binding sovereign debt restructuring regime that prevents hold-outs.

The Neo-liberal Institutionalism Theory holds that international institutions are formed by states, which are the main actors in the international system, as a consequence of increasing

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[16] For this perspective albeit within the context of corporate restructuring, see M Bruckner, 'The Virtue in Bankruptcy' (2013) 45 Loyola University Chicago Law Journal 233, 255-265.

[17] TH Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale Law Journal 857, 860.

[18] TH Jackson, *The Logic and Limits of Bankruptcy Law,* Vol 17 (Harvard University Press, Cambridge 1986) 24. The 'common pool problem' refers to the rush to court by creditors to collect a piece of the debtor's assets, upon bankruptcy of the debtor.

[19] We neither express any comment on the criticisms levelled against the Creditor's Bargain Theory nor do we focus on the flaws and aims of the theory that are not useful for our purposes, since they are beyond the scope of this paper.

interdependence.[20] It also holds that since states are guided by the pursuit of economic gain, they form international institutions in a bid to eschew market failures and eliminate mistrust.[21] Neo-liberalism assumes that regimes result from states that act as "political entrepreneurs who see potential profit in organizing collaboration".[22] These benefits accrue from increased transparency and collective monitoring caused by the coordinated action of states that are brought together by mutual interests.[23] In the context of sovereign debt and credit, various actors including states and creditors have a common interest of resolving their contractual bargains. The neo-liberalism theory thus offers a solid theoretical justification for the establishment of a sovereign debt restructuring regime by individual member states (sovereigns) who represent debtors at all times, and creditors in a great deal of time. It further explains the reasoning behind the claim made in the substantive part of this paper, that the global legal regime to be established must not be under the umbrella of any particular body that could be biased towards either debtors or creditors and should have provisions that enable it to be invoked by the respective member states.

1.7 Literature Review

1.7.1 The Absence of an Effective Global Legal Framework

Das *et al* argue that the international community has depended on informal and transitory mechanisms in debt readjustments that have been in the form of rescheduling the payment date,

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[20] R Keohane & L Martin, 'The Promise of the Institutionalist Theory' (1995) 20 (1) International Security 47<*http://www.jstor.org/stable/2539214?origin=crossref*>accessed 23 February 2016.

[21] The phrase 'neo-liberal institutionalism" may well be termed a bastard phrase owing to the inconsistency in its use in various contexts as argued here by AA Stein, 'Neoliberal Institutionalism' in Christian Reus-Smit and Duncan Snidal (eds), *The Oxford Handbook on International Relations* (New York: Oxford University Press 2008) 202. <*http://www.grandstrategy.net/Articles-pdf/11-Smit-Snidal-c11.pdf*> accessed 23 February2016. In view of this, we adopt the definition given above by Keohane for the purposes of this paper.

[22] RO Keohane, 'The Analysis of International Regimes: Toward a European-American Research Program. Regime Theory and International Relations' in V Rittenberger (ed) *Regime Theory* and *International Relations* (Oxford, Oxford University Press 1993) 34.

[23] RO Keohane, 'The Demand for International Regimes. International Regimes' in SD Krasner (ed) *International Regimes* (Ithaca, Cornell University Press 1983) 141-171.

lowering the interest rates accruing on the principal loan amount, or reducing the amount of debt owed.[24] This situation has obtained due to the absence of an effective legal framework to govern sovereign debt rescheduling at the global level. However, these mechanisms have not been satisfactory in so far as enabling debtor countries overcome their indebtedness and attain economic recovery and stability, is concerned.[25] While the authors present the challenge faced by sovereign debtors even as they endeavor to restructure, they do not proffer solutions to fill this vacuum.

Rogoff and Zettelmeyer have explained the rationale of initiating bankruptcy proceedings for debtors, as being the less hurtful to creditors and the less embarrassing to debtors.[26] Despite the significance of debt restructuring to both debtors, creditors and the wider economies, there is no structured mechanism at the global level to guide debt restructuring in case of sovereign states. This gap is adequately captured by Herman and Spiegel who characterize the absence of a sovereign debt restructuring mechanism as a 'missing link in the international financial architecture'.[27] A number of scholars such as Raffer[28] and Paulus[29] have proffered various mechanisms of filling the legal vacuum including the adoption of Chapter 9 of the United States insolvency regime to cases of sovereign debts and the formation of a standing arbitral tribunal to fill the void respectively. While the solutions advanced by the authors have their own merits,

[24] US Das *et al* (n 1) 7.
[25] C Daseking & R Powell, 'From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries' (1999) IMF Working Paper WP/99/142.
[26] K Rogoff & J Zettelmeyer,'Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001' (2002) 49 (3) IMF Staff Papers, 471 quoting Adam Smith in the Wealth of Nations.
[27] B Herman; S Spiegel, 'Sovereign Bankruptcy: A Piece of the International Financial Architecture Is Still Missing' (2007) (Paper for UN/Commonwealth Workshop on Debt, Finance and Emerging Issues in Financial Integration) <http://www.un.org/esa/ffd/events/2007debtworkshop/herman%20and%20spiegel.pdf> accessed 25 November 2015.
[28] R Kunibert, 'Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face' (1990) 18 World Development 301, 310.
[29] For further insights on this, see CG Paulus, 'A Standing Arbitral Tribunal as a Procedural Solution for Sovereign Debt Restructurings' in Carlos A Primo Barga & Gallina A Vincelette (eds), *Sovereign Debt and the Financial Crisis: Will This Time Be Different?* (Washington DC: World Bank 2010) 317.

they are neither adequate nor effective especially for developing countries, when one considers that the law of a developed country is to be imported into the international legal framework. In addition, a standing arbitral tribunal as this is likely to encourage a complicated and protracted process of dispute resolution.

1.7.2 Sovereign Debt Distinguished from Individual and Corporate Debt

Unlike corporate or individual debtors, there are problems of enforcement associated with sovereign debtors.[30] A creditor who is owed by a sovereign debtor has less avenues and means of enforcing his claim due to sovereign immunity enjoyed by states and the absence of assets to attach in debt enforcement.[31] Sovereign immunity derives from the principle of equality of all sovereign nations under international law. According to Ian Brownlie, due to the principle of equality of States, matters of one state cannot be properly adjudicated in the courts of another.[32] This notwithstanding, it is possible for a sovereign state to waive its immunity so that it is amenable to the judicial process. However, Brownlie notes that after the Second World War and as states began taking part in commercial activities, the initial absolute sovereign immunity transformed into restrictive sovereign immunity.[33] This is to say that sovereign states may now be sued in domestic courts of other states where they have defaulted in their contractual obligations that are of a commercial nature.[34] Other limitations on enforcement by creditors as

[30] See generally Lee C Buchheit & G Mitu Gulati, "Responsible Sovereign Lending and Borrowing' (2010) UNCTAD/OSG/DP/2010/2 <*http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2941&context=faculty_scholarship*> accessed 10 April 2016.
[31] ibid 2.
[32] I Brownlie, *Principles of Public International Law*, Sixth edition (New York: Oxford University Press 2003).
[33] ibid 325.
[34] The United States passed the Foreign Sovereign Immunities Act (FSIA) of 1976 as did the United Kingdom of a similar legislation in 1978, both of which embodied the concept of restrictive sovereign immunity with regard to commercial activities.

against sovereign debtors include the doctrine of act of state and that of international comity,[35] which, however, appear to be of decreasing relevance.

Further, unlike corporate debtors that may be liquidated whenever they become insolvent and their rescue appears uneconomical, a sovereign debtor cannot be liquidated since the same is a political question. Eichengreen and Portes argue that there is a public interest in ensuring the continued existence of a state as a going concern.[36] This view is shared by Macmillan who avers that discussions over whether there can be cases of economically efficient modes of liquidation of sovereign debtors and distribution of government's assets cannot arise.[37] The authors correctly identify the uniqueness of sovereign debt as contradistinguished with corporate and individual debt. They, however, fail to propose measures to confront this unique problem. They similarly do not address the changing nature of lenders and mode of debt especially with respect to developing countries which this study attempts to explore.

1.7.3 Problems Associated with the Subsisting Regime

The absence of a global legal framework on sovereign debt restructuring presents various difficulties as evidenced over the years. One of the main difficulties is the inability of the various classes of creditors to coordinate or agree to a restructuring. Joseph Stiglitz has argued that the lack of a sovereign debt rescheduling mechanism compounds the process of restructuring and increases its costs.[38] The absence of a binding legal framework gives an incentive to some minority creditors to refuse to the restructuring process and hold out for higher payments from the debtor.

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[35] For a detailed exposition of the doctrine of international comity, see Brownlie (n 32) 28.
[36] B Eichengreen & R Portes, *Crisis? What Crisis? Orderly Workouts For Sovereign Debtors* (London: CEPR 1995).
[37] R Macmillan, 'Towards a Sovereign Debt Work-Out System' (1995) 16 Nw. J. Int'lL. & Bus. 57, 75.
[38] JE Stiglitz, 'Sovereign Debt: Notes on Theoretical Frameworks and Policy Analyses' in Barry Herman, *et al*., (eds) *Overcoming Developing Country Debt Crises* (New York, University of Oxford Press 2010) 35.

Nouriel Roubini explains this situation thus:

> If a holdout creditor can choose not to accept the offer and then, through later litigation, receive the full amount of its claim while those who accepted the offer receive less, a strong incentive arises for creditors to hold out. If this creditor coordination problem cannot be solved, a disorderly workout will result, even if a cooperative solution would be in the interest of all creditors.[39]

A failure to restructure debts tends to prolong debt crises thus posing a threat to the international financial system, besides increasing poverty in most developing nations. Boorman argues that the poor in poor countries, which are usually the main sovereign debtors, suffer the most during a sovereign debt crisis.[40]

Linked to the problem of the lack of a global legal mechanism to bind creditors to sovereign debt restructuring is the likelihood of contributing to a moral hazard on the part of creditors.[41] When sovereigns are unable to repay their debts and in the absence of a restructuring, they are frequently bailed out by the International Monetary Fund (IMF). This tends to encourage recklessness among lenders in terms of extending credit and upon sovereign debtors who take up credit in the knowledge that they will be bailed out.[42] While it is the case that the IMF has enabled various sovereign debt restructurings over the years, it lacks any systematic instrument of conducting such a process thus leading to inconsistencies.[43] In particular, a restructuring done under the auspices of the IMF that mainly constitutes creditors is not likely to be in the interest of

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[39] N Roubini, 'Do We Need a New Bankruptcy Regime' (2002) Brookings Papers on Economic Activity, No.1, 321-33.

[40] J Boorman, 'Alternative Approaches to Sovereign Debt Restructuring' (2003) 23(1) Cato Journal 59.

[41] For an in-depth discussion on the concept of a 'moral hazard' and its applicability in the insolvency regime arena, see CG Hallinan, 'The 'Fresh Start' Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory' (1986) 21 U. RicH. L. Rev. 49, 84.

[42] ibid. In particular, Hallinan argues that the protection of debtors and creditors from the consequences of default tends to encourage excessive borrowing and lending, leading to bankruptcies.

[43] For an excellent account of this, see Diaz-Cassou *et al.*, 'The Role of the IMF in Recent Sovereign Debt Restructurings: Implications for the Policy of Lending into Arrears' Occasional Paper Series Bank of Spain, 9. <http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/PublicacionesSeriadas/DocumentosOcasionales/08/Fic/do0805e.pdf> accessed 24 February 2016.

debtors, more so developing countries. Whereas the reviewed literature is mostly focused on Europe and North America which mainly comprises developed nations, it does not examine the issue from a developing nation's perspective, a feat which this study attempts.

Goldman explores the issue of sovereign debt crises and argues that they impede the enjoyment of socio-economic rights by citizens especially in poor developing countries.[44] The adoption of a supranational legal framework by all States to govern sovereign debt restructuring is the surest way of alleviating debt crises. Moreover, Guzman and Stiglitz contend that collective action clauses (CACs) as currently the norm in a majority of sovereign bond contracts fail to offer a comprehensive, equitable and adequate solution to sovereign debt crises.[45] This view is shared by Scott who argues that collective action clauses are futile in facilitating debt restructurings in case of sovereign bonds due to the conflicting interests of creditors.[46] Choi *et al* make the argument that rarely do sovereign bond agreements contain these collective action clauses anyway thus making such clauses of limited utility.[47] To illustrate, they highlight the case of the Greece debt crisis whereby only the bonds issued under English law had collective action clauses provisions.[48] While the learned authors fault the utility of the subsisting legal regime governing sovereign debt restructuring, they do not offer a practical solution especially for developing countries that frequently tend to be debtors.

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[44] M Goldmann, 'Sovereign Debt Crises as Threats to the Peace: Restructuring under Chapter VII of the UN Charter?'(2012) 4 (1) Goettingen Journal of International Law 153.

[45] M Guzman & JE Stiglitz, 'Fixing Sovereign Debt Restructuring' (July 2015) <https://www0.gsb.columbia.edu/faculty/jstiglitz/download/papers/2015%20Fixing%20Sovereign%20Debt%20Restructuring.pdf> accessed 26 November 2015.

[46] HS Scott, 'A Bankruptcy Procedure for Sovereign Debtors?' (2003) 37 Int'l L. 103, 129.

[47] SJ Choi *et al*., 'Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution Mechanism' (2011) 2, 14 John M. Olin Law & Econ. Working Paper No. 541<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1713914>accessed 27 November 2015.

[48] ibid 14.

1.7.4 New Developments in Lending and Borrowing for Developing Countries

Besides, as noted by Giavinti *et al*., many sovereign debtors are turning to the bond market in search of funds in contrast to the traditional mode of direct loans from banks and international financial institutions.[49] For instance, Kenya, Senegal, Zambia, Ivory Coast (among other developing nations) have recently tapped into the sovereign bond market to plug their domestic budget deficits and fund infrastructural projects.[50] Similarly, there has been a shift in borrowing by African countries from the traditional lenders in the West to new lenders in China and other emerging markets. These developments in terms of the mode of finance and lenders, coupled with the increasing consumption of public debt by African countries necessitate the development of a global debt restructuring mechanism.[51] Such a framework will facilitate the rescheduling of debts for these African countries as and when they are unable to service their debts and enable them overcome debt crises, thus protecting their most vulnerable citizens. This shift in terms of lenders necessitates a mechanism for debt restructuring given that the prevailing individual restructuring arrangements will not be applicable to the new lenders. This change of affairs evincing higher likelihood of the need for sovereign debt restructuring is not well met in the literature, a gap that this study seeks to address.

[49] F Gianvitie *et al*., 'A European Mechanism For Sovereign Debt Restructuring Crisis Resolution: A Proposal' (2010) Bruegel 7 <http://www.bruegel.org/publications/publication-detail/publication/446-a-european-mechanism-for-sovereign-debt-crisis-resolution-a-proposal/>accessed 26 November 2015.

[50] Since 2006 when South Africa issued the first sovereign bond in Africa, a dozen African countries have tapped into the sovereign bond market. They include: Ghana, Gabon, Seychelles, Tanzania, Rwanda, Namibia, and Angola.

[51] For instance, a third of countries in Africa have a debt to GDP ratio that exceeds 40 percent. For a comprehensive account of these statistics, see African Economic Outlook (2015). Statistical Annex <http://www.africaneconomicoutlook.org/en/statistics>accessed 26 November 2015.

1.8 Research Methodology

The study makes use of desk-based research in examining the various literature published in the area, the various proposals put forward with regard to sovereign debt restructuring, case law especially in the United States and Argentina, and the various provisions of bond contracts

1.9 Chapter Breakdown

Chapter 1 is the introduction and the research proposal.

Chapter 2 examines the theoretical underpinnings and foundation for debt restructuring generally and avails the rationale for extending debt reliefs to debtors in insolvency law.

Chapter 3 investigates the extent to which the absence of a global legal framework on sovereign debt restructuring complicates the resolution of sovereign debt crises especially in developing countries, and the effects thereof.

Chapter 4 examines the various ways and proposals that have been advanced to circumvent the problem occasioned by the absence of a global sovereign debt rescheduling mechanism including Collective Action Clauses contained in contracts, and attempts to show the inadequacies of such proposals.

Chapter 5 concludes that there is need for a global sovereign debt restructuring framework and makes recommendations that are particularly relevant and useful from a developing nations' perspective.

CHAPTER 2: THEORETICAL JUSTIFICATION FOR SOVEREIGN DEBT RESTRUCTURING

2.1 Introduction

This Chapter examines the crucial subject of why debtors and creditors are allowed to restructure their debts whenever a debtor defaults on its obligations under insolvency law. It delves into the theoretical foundations and justification for such debt relief, with a special focus on sovereign debt restructurings. The next section of this chapter conducts an historical overview of sovereign debt defaults and restructurings particularly with respect to African countries, with a view to demonstrating the inevitableness of debt restructurings.

Sovereign debt restructuring refers to the exchange of outstanding debt obligations owed by a country either in the form of bonds or loans, for new debt instruments or money through a legal process.[52] Debt restructurings have persisted for as long as there have been debt defaults.[53] Sovereigns, just like corporates or individuals, have demands that frequently outweigh their available resources at any particular time. This, as a matter of fact, impels such sovereigns to source for alternative sources of financing from creditors through the issuing of debt. The need for more resources has been particularly apt for African countries in recent years, even as these countries seek to finance their huge developmental needs. As shall be demonstrated later in this paper, African countries have engaged in aggressive heavy borrowing from external sources in recent years, including tapping into the international capital markets, in a bid to fund various infrastructural projects in their countries. Not infrequently, domestic sources are barely able to

[52] US Das; MG Papaioannou; C Trebesch, 'Sovereign Debt Restructurings 1950–2010: Concepts, Literature Survey, and Stylized Facts' (2012) IMF Working Paper, 7.
[53] Debt default, in this context, refers to failure by a sovereign to repay the principal amount or the interest thereon within the due time or within the grace period. ibid 8.

meet the financing that a country may require, thus forcing sovereigns to look externally to fill this budgetary deficit.[54]

Debt restructuring generally, is a form of debt relief and is provided for in the bankruptcy and insolvency laws of various jurisdictions. Insolvency law, besides being an economic legislation meant to ensure efficacy of business, is also a social legislation that aims at meeting particular social goals.[55] As a consequence, therefore, insolvency law even within the domestic context enjoins creditors to agree to a restructuring where an individual or a corporate debtor has been unable to service the debts owing.[56] Sovereign debt restructuring, therefore, as a form of debt relief, may be justified for a variety of reasons.

2.2 Justification for Sovereign Debt Restructuring

One of the most popular justifications for sovereign debt restructurings or debt relief is efficiency. This reason is predicated both on moral suasions and economic efficiency grounds. To begin, a country that is highly indebted and is unable to service such debts can hardly progress economically since all its revenues from taxes are normally channeled towards the repayment of debts. This is particularly so in most developing countries especially in Africa. Usually, high debts owing on the part of a sovereign constitute a tax on various developmental efforts and investment since most of the gains accruing from the country are used to repay creditors.[57] One the one hand, this rationale is hinged on moral suasions in as far as it seeks to

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[54] For instance, Kenya floated a $2 billion sovereign bond in the European capital market in order to repay an outstanding loan and fund other infrastructural projects. Such a huge amount of money could hardly be afforded or extended by a domestic financier be it a bank, individual, or any other financial institution.

[55] See generally, TJ Zywicki, 'Bankruptcy Law as Social Legislation' George Mason Law & Economics Research Paper No. 01-18 <*http://www.law.gmu.edu/assets/files/publications/working_papers/01-18.pdf* > accessed 25 March 2016.

[56] For instance, see sections 275-288 of the Insolvency Act 2015 (Kenya).

[57] A Freytag and G Pehnelt, 'Debt Relief and Changing Governance Structures in Developing Countries' (2005) ECIPE Working Paper No. 02/2006 , 4 <*http://www.ecipe.org/app/uploads/2014/12/debt-relief-and-changing-governance-structures-in-developing-countries.pdf*> accessed 25 March 2016.

alleviate the burden of a sovereign debtor, enabling it to recover out of a debt crisis and thereby uplift the living standards of its people. On the other hand, it is based on economic efficiency in that whenever a sovereign debtor is relieved from some of its debt obligations through debt restructuring; it is able to regain its economic strength thus increasing the likelihood of offsetting its debt obligations going into the future.[58] Closely related is the argument that high indebtedness is likely to contribute to decreased growth due to low private investment caused by uncertainty among private investors regarding the actions that might be taken by the sovereign amidst the debt crisis.[59] For instance, the sovereign might opt to distort future taxation policies, or engineer inflation so as to increase money in the economy.[60]

The other rationale for extending debt relief to sovereigns in form of sovereign debt restructurings is premised on moral and global justice arguments.[61] It has been argued that it is immoral and unethical for impoverished developing nations to expend most of its vital resources that it would otherwise employ in availing vital services for its citizens, in repaying creditors who are mostly developed countries.[62] This argument makes greater appeal when it is considered that some of the debts incurred by developing nations are odious debts.[63]There are arguably cogent arguments that most of the debts contracted by developing nations may be odious debts under international law, of which the respective taxpayers of such nations have no moral

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[58] For a complex economic analysis of the benefits wrought through economic adjustments occasioned by debt relief see, S Tengstam, 'Debt relief and adjustment effort in a multi-period model' (2006) 91 Economic Letters 127. <http://www.gu.se/digitalAssets/1367/1367373_1-econlet.pdf> accessed 25 March 2016.
[59] B Clements; R Bhattacharya & TQ Nguyen 'Can debt relief boost growth in poor countries?' (2005) Washington, DC: International Monetary Fund (IMF Economic Issues No 34).
[60] ibid.
[61] For insights into the global justice arguments, see J Rawls, *The Law of Peoples with the Idea of Public Reason Revisited* (London, Harvard University Press 1999) 106.
[62] C Barry, 'Ethical Issues Relevant to Debt' (2006) International Affairs Working Paper 2006-05, 1.
[63] Odious debts are debts contracted by a state and used against the interests of such state, without the consent of the governed and in the full knowledge of the creditor. For an excellent discussion of this concept, see, CM Gentile, 'The Market for Odious Debts' (2010) 73 Law and Contemporary Problems 151. <http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1591&context=lcp> accessed 25 March 2016.

obligation to repay.[64] This is especially so considering the case that more often than not, sovereign debts incurred by such nations are either wasted through pilferage and corruption, or misapplied in unwise investments by the governing regime.[65] In a book assessing some of the reasons for underdevelopment in the African continent, Boyce and Ndikumana illustrate that most of the foreign loans taken up by Africa nations constitute odious debts, which they argue ought to be repudiated by these sovereigns.[66]

This is to say that the money given in form of loans is misapplied by leaders of the respective countries in projects that do not benefit citizens or merely squandered through corruption. In such an instance, it would arguably be moral to offer a debt relief to such a sovereign debtor so as to prevent a further strain on the taxpayers of such a country. The effect of heavy debt on the peoples of a nation is to militate against their enjoyment of fundamental human rights and freedoms.[67] In another sense, debt burden violates any meaningful development.[68] Huge debts constitute a form of slavery for a state and its people by limiting their sovereignty and freedom and acting as a tool for domination and exploitation.[69]

Sovereign debt restructuring is also justified on the grounds that it enables effective public debt management thus averting total losses for creditors in the event of a default. During a

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[64] For a similar argument, see James K Boyce & Leonce Ndikumana, 'Debt Audits and the Repudiation of Odious Debts' (2012) Association of Concerned Africa Scholars, Bulletin 36.

[65] Instances of alleged pilferage of public funds including sovereign debts abound. For instance, see the allegations of lost funds in the Kenyan 'Eurobond' (sovereign bond) whose expenditure has not been sufficiently accounted for. See, P Wafula, 'Audit: Sh 215b Eurobond cash unaccounted for' (2016) (The Standard, 8th September 2016). <http://www.standardmedia.co.ke/article/2000215138/audit-sh215b-eurobond-cash-unaccounted-for> accessed 11 November 2016.

[66] See generally, James K Boyce & Leonce Ndikumana, *Africa's Odious Debts: How Foreign Loans and Capital Flight Bled A Continent* (London: Zed Books, 2011).

[67] EH Guisse, 'Third World Debt a Continuing Legacy of Colonialism' (2004) A Working Paper for the UN Sub Committee on Human Rights (E/CN.4/Sub.2/2004/27) < http://southcentre.org/info/southbulletin85/bulletin85.htm.> accessed 26 March 2016.

[68] For a characterization of development as constituting the expansion of fundamental freedoms and capabilities, see generally, A Sen, *Development as Freedom* (New York: Oxford University Press 1999).

[69] A Hubers, 'The 'odious debt' principle morally justified (2004) <http://www.odiuosdebts/index.cfm?DSP=content&ContentID=10372 > accessed 26 March 2016.

restructuring, a sovereign debtor facing challenges in meeting its debt obligations enters into an arrangement with its creditors with a view to rescheduling or relieving some of its debts.[70] Given the unique enforcement problems associated with sovereign debt, a nation may opt to repudiate debts or default due to the absence of an option to restructure.[71] In such an event, the creditor will hardly have many remedies as against such debtor. The upshot of such an eventuality would be total losses falling on the creditor. If that were to be allowed or encouraged through an absence of sovereign debt restructuring, there would be a risk of the drying up of the credit market thus making credit inaccessible to countries that most need it.[72] Such a move would not only be inimical to international trade but also limit development the world over. Essentially, sovereign debt restructuring may be couched as a necessary evil on the international plane, which ought to be conducted in an orderly, efficient and predictable fashion.

2.3 An Overview of Sovereign Debt Defaults and their Treatment

Sovereign debt defaults have persisted for as long as sovereign borrowing has been alive.[73] The first ever recorded sovereign debt default was in the fourth century B.C when ten Greek municipalities defaulted on their obligations owing to the Delos Temple.[74] However, debt defaults as we understand them in modern day, began around two thousand years from then at

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[70] SU Das *et al* (n 1) 8.

[71] JE Fisch & CM Gentile, 'Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring' (2004). Faculty Scholarship Paper 1048, 1052.
< *http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2046&context=faculty_scholarship* > accessed 26 March 2016.

[72] N Roubini; B Setser, *Bailouts or Bail-ins? Responding to Financial Crises in Emerging Economies* (New York, Peterson Institute 2004). In chapter 3 of the book, the authors demonstrate the correlation between opportunistic defaults by sovereigns and the unavailability of credit for lending.

[73] Reinhart and Rogoff indicate that there have been around 250 sovereign debt defaults over 200 years between 1800 to early 2000s, see CM Reinhart; KS Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton, New Jersey, Princeton University Press 2009).

[74] M Winkler, *Foreign Bonds. An Autopsy: A Study of Defaults and Repudiations of Government Obligations* (Philadelphia, Roland Swain 1933).

around 12th Century A.D.[75] This occurred after wealthy families and bankers extended credit to governments and municipalities of Italy, South Germany and Spain and they defaulted on their repayments.[76] The mid-16th centuries witnessed debt defaults by Spain, Portugal and France. The seventeenth century experienced even more defaults with France, Spain, and Prussia being the leading defaulters, a phenomenon that increased exponentially in the subsequent century.[77] Part of the reason for the increased debt defaults both in terms of numbers and geographical areas in the 19th century, was the increased cross-border debts, new financial markets, and new independent governance systems in the respective countries.[78] The issue of sovereign debt defaults was not limited to the particular epochal period but proceeded into the 20th century. Owing to various factors such as revolutions, wars, and civil conflicts, many sovereigns found themselves either unable or unwilling to make repayments on their debts. For instance, at the beginning of the First World War, Bulgaria, Turkey, and the then Austria-Hungary suspended the payment of their debts to enemy creditors.[79] The same cue was borrowed by Japan, Italy and Turkey at the onset of the Second World War.[80] Cuba, China, Russia and Mexico also repudiated their debts either upon communist conquest in their countries or owing to revolutions.[81]

More recently, Argentina defaulted on its $82 billion debt in the year 2001, Ecuador defaulted on a $3.2 billion debt in 2008, Jamaica defaulted on a debt of $7.9 billion in February 2010 while

[75] A Kotze, Debt, 'Defaults and Crises: A Historical Perspective' (2015) 6 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2587342 > accessed 26 March 2016.
[76] ibid.
[77] CM Reinhart; KS Rogoff; MA Savastano, 'Debt Intolerance' (2003) Brookings Papers on Economic Activity 34.
[78] F Sturzenegger & J Zettelmeyer, *Debt defaults and lessons from a decade of crises* (Cambridge, MIT Press 2007) 4.
[79] ibid.
[80] ibid.
[81] ibid.

Greece recorded the largest sovereign debt default in history of up to $138 billion in March 2012.[82]

Perhaps, a useful point needs to be made at this stage. Within the context of sovereign debt particularly for developing countries, we note that sovereign debt default is not necessarily bad for a nation. Indeed, it may be beneficial for a nation particularly where it has been overburdened by debt due to careless lending since it lifts the burden of her poor people. Two theories have been propounded as to why sovereigns repay their debts yet there are no effective enforcement mechanisms as discussed elsewhere in this paper.[83] One of the theories is the reputational theory which is to the effect that sovereigns repay for fear of losing credit worthiness (reputation) which would limit its access to the international debt market when need arises.[84] This theory simply suggests that legal mechanisms for enforcement of sovereign debt are superfluous since sovereigns will repay anyway. However, this theory loses much rigour when examined in light of a recent empirical study in the case of Argentina after a New York court ruled in favour of creditors,[85] which found that it heightened expectations on the part of creditors that Argentina would default on her external debt after the ruling.[86] If at all Argentina would be concerned about her reputation in the international credit market or in a reputational theory model where legal rulings would otherwise be irrelevant, such fears would not have arisen among creditors. This is however, not to say that the theory is not without merit. The other theory propounded by Bulow and Rogoff is the punishment theory which is to the effect that creditors can seek to

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[82] IMF, 'Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework' (2014) 6 < *https://www.imf.org/external/np/pp/eng/2013/042613.pdf* > accessed 28 March 2016.
[83] See Chapter 2 of this paper.
[84] J Eaton & M Gersovitz, 'Debt with Potential Repudiation: Theoretical and Empirical Analysis' (1981) 48 (2) Review of Economic Studies 289.
[85] B Hebert & J Schreger, 'The Costs of Sovereign Default: Evidence from Argentina' (2015) mimeo, Harvard University.
[86] ibid.

punish a defaulting sovereign debtor through making use of the available legal and possible extra-legal mechanisms so as to interfere with a country's gains in international trade.[87]

At this juncture, it is prudent to examine how sovereign debt defaults were treated in history. Sovereign debt restructuring, which is a form of debt relief, did not exist in the earlier times. In cases of individual bankruptcies in olden times, individual debtors could be committed into jail when they defaulted on their debt obligations.[88] The harsh penalties levied on individual debtors that failed to honour their debt obligations were predicated on the notion that there is both a moral and legal imperative to repay debts.[89] It was considered morally and legally indefensible to default on one's debts and such a debtor was considered a thief.[90] Akin to the forceful enforcement of individual debt defaults, creditors to sovereign debtors employed military force to demand payment on the loans extended.[91] This military force included but was not limited to: blockadings, invasions and cannonading of defaulting nations.[92] In particular, in 1902, a number of European states employed naval blockades and gunboats in a bid to force Venezuela to meet its debt obligations.[93] The debt burden in Venezuela was a consequence of the 1898 revolution that had lasted for two years thus leading to a destruction of considerable property belonging to

[87] See J Bulow & K Rogoff, 'Multilateral Negotiations for Rescheduling Developing Country Debt: A Bargaining-Theoretic Framework' (1989b) 35 International Monetary Fund Staff Papers 644–657, December. Bulow and Rogoff built on the work by D Cohen & J Sachs, 'Growth and External Debt under Risk of Debt Repudiation' (1986) 30 European Economic Review 529.
[88] For a comprehensive account of this, see JM Czarnetzky, 'The Individual and Failure: A Theory of the Bankruptcy Discharge' (2000) 32 Arizona State Law Journal 393, 423-25. The author discusses the various harsh remedies available to creditors in the 14th Century England as against debtors, whenever they defaulted.
[89] LH White 'Bankruptcy as an Economic Intervention' (1977) 1 Journal of Libertarian Studies 281, 282. White notes that this practice of casting debtors into prison for debt defaults continued from the 14th Century to the 19th Century in England. Indeed, committal to civil jail as a creditor remedy remains in our statute books to date. See section 40 of the Civil Procedure Act, Cap 21 Laws of Kenya.
[90] ibid 282.
[91] AS Hershey, 'The Calvo and Drago Doctrines' (1907) 1 The American Journal of International Law 40 < *http://www.jstor.org/stable/pdf/2186283.pdf?_=1459135969251* > accessed 27 March 2016.
[92] LM Drago, 'State Loans in Their Relation to International Policy' (1907) 1(3) The American Journal of International Law 710 +< *http://www.jstor.org/stable/pdf/2186825.pdf* > accessed 27 March 2016.
[93] DG Munro, *Intervention and Dollar Diplomacy in the Caribbean, 1900-1921* (Princeton, Princeton University Press) 67.

foreigners.[94] Following the refusal by the Venezuelan president to repay the claims of the foreigners, Italy, Britain and Germany blockaded its ports forcing the President to acquiesce to the liquidation of the debts.[95]

The other instance that was marked by military force was in what has been referred to as the Roosevelt Corollary to the Monroe Doctrine.[96] This was in reference to the United States' President Theodore Roosevelt's interventionist policy that aimed at policing other states so as to protect European investors.[97] It did this by leveraging on its regional power so as to ensure that sovereign debts owed to European investors by countries in Central America and the Caribbean were honoured.[98] However, the use of military force to enforce sovereign debts gradually wore off after Latin American states began claiming sovereignty and equality of states in international law, a principle that demanded non-intervention.[99] This protest led to the signing of the Hague Peace Conference Treaty of 1907 by creditor states, which signaled the end of use of gunboat diplomacy and other military measures in debt enforcement.[100]

Following the move away from the use of military force, there had to develop other ways of debt enforcement.[101] Sometimes, the International Monetary Fund has tended to bail out states that have been unable to discharge their obligations, if only to overcome their debt crisis.[102]

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[94] ibid 68-69.
[95] AM Low, 'Venezuela and the Powers' (1903) American Monthly Review of Reviews 27, 39-43.
[96] KJ Mitchener & M Weidenmier, 'Empire, Public Goods, and the Roosevelt Corollary' (2005) 65 (3) The Journal of Economic History 658 < *http://www.jstor.org/stable/pdf/3875013.pdf?_=1459138417999* > accessed 27 March 2016.

[97] ibid 663.
[98] ibid.
[99] Hershey (n 83) 42.
[100] See generally, FC Hicks, 'The Equality of States and the Hague Conferences' (1908) 2 (3) The American Journal of International Law 530 < *http://www.jstor.org/stable/pdf/2186330.pdf* > accessed 28 March 2016.

[101] Roubini & Setser (n 69) 297.
[102] IMF, 'FactSheet IMF Lending' (2016) < *http://www.imf.org/external/np/exr/facts/howlend.htm* > accessed 28 March 2016.

However, one of the other modes of debt reliefs has been debt restructuring as has been witnessed in recent years.[103] We now turn to conduct a short synopsis of sovereign debt restructurings in Africa with a view to highlighting the experiences of developing countries.

2.4 A History of Sovereign Debt Restructurings in Africa

African countries have over the years consumed high and unsustainable levels of public debt owing to a variety of reasons. Firstly, the huge developmental needs to build up infrastructure have forced states to look for external sources of borrowing. Secondly, a number of politico-economic factors have led to increased lending to African countries especially from the West and China in recent years.[104] Thirdly, mismanagement of borrowed monies owing to weak legal and institutional frameworks coupled with corruption impedes repayment abilities of African countries, thus making such debts unsustainable.[105] These factors contrived to build up a huge debt liability on the part of African countries, a fact that necessitated some form of debt relief.[106]The debt relief, to a large extent, came by way of a sovereign debt restructuring under the auspices of the particular lenders. Most of the debt by African countries was owed to multilateral institutions such as the African Development Bank, the World Bank and the IMF, and particular bilateral lenders. Axiomatically, the debt restructurings that took place occurred

[103] Greece conducted the largest sovereign debt restructuring in history in the year 2012 for debts amounting to $ 138 billion.

[104] Some of these factors include the huge promise of African economies and strategic interests of the various countries.

[105] L Bategeka; L Kiiza & E Suruma, 'African Perspectives on Sovereign Debt Restructuring: The Ugandan Experience' (2014) 7, Paper commissioned for African Perspectives on Sovereign Debt Restructuring conference, Kampala, Uganda. The authors note that the weak legal framework between 1986 and 2006 in Uganda gave authority to any department or ministry to borrow externally, thus compounding efforts of proper sovereign debt management.

[106] See, I Elbadawi; B Ndulu & B Ndung'u, 'Debt Overhang and Economic Growth in Sub-Saharan Africa' in Z Igbal & R Kanbur (eds), *External Finance for Low-Income Countries* (Washington DC, IMF 1997). It should be noted that African countries continue to take up more debt to this day, see P Adams, 'Africa Debt Rising' (2015) Africa Research Institute <http://www.africaresearchinstitute.org/publications/africa-debt-rising-2/> accessed 27 March 2016.

through the respective channels of the lenders. The lesser amount of debt owing to private creditors was also restructured through a group of private commercial banks.

Despite the various debt restructurings of the 1970s and the 1980s, the debt crisis of the African countries was not helped. This forced the IMF and the World Bank to launch the Heavily Indebted Poor Countries (HIPC) Initiative in 1996 and the further Multilateral Debt Relief Initiative (MDRI) in 2006 in a bid to reduce the debt burden of these countries.[107] This was a result of the recognition that these low income countries could not afford to service the huge debts and still provide any useful development for its people. However, before a country could be eligible for debt relief under the HIPC Initiative, it was required to undertake particular structural and economic reforms, besides availing a poverty reduction programme that would be financed by the money that would otherwise have been employed in servicing the forgiven debt. Whereas the HIPC initiative helped the African countries to an extent in alleviating the debt burden, it was still too little as to cause a difference for the low income countries. As a consequence, the Group of 8[108] proposed the launch of the MDRI whereby the multilateral institutions would offer a 100 percent cancellation on debt owed by countries that were able to undergo the HIPC initiative successfully.[109] In particular, this programme was meant to help the respective countries achieve the Millennium Development Goals, to wit, reducing poverty by half by the year 2015.[110] To underscore the importance of these debt relief initiatives, a study conducted over the effectiveness of the programs indicates that the benefits accruing from the

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[107] IMF, 2013a. 'Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) — Statistical Update' (2013). The aim of the HIPC initiative was to ensure that no poor country incurred a debt burden that it could not manage.

[108] The Group of 8 was a government political forum that consisted of the 8 leading industrial nations in the world. Following the suspension of Russia from the forum, the club is now known as the Group of Seven (7).

[109] IMF, 'Factsheet: The Multilateral Debt Relief Initiative'(2015) <https://www.imf.org/external/np/exr/facts/mdri.htm > accessed 28 March 2016.

[110] ibid.

same far surpassed the costs of such debt relief.[111] Among these benefits include: improved standards of living, a stable macro-economic environment, improved investment climate, reduced debt repayments, and increased expenditure towards social amenities in the respective countries.[112] The utility of debt relief is further borne out empirically by the impressive economic growth in the period following the HIPC initiatives, and the higher levels of investment.[113]

2.5 Concluding Remarks

Noting that debt reliefs are frequently necessary especially when a country is overburdened, it then becomes necessary to examine sovereign debt restructuring as a form of debt relief. To be sure, debt relief in the form of total debt forgiveness or cancellation as happened with the HIPC and MDRI initiatives cannot always be guaranteed. So are the bailouts from the IMF to help debtor countries discharge their debt obligations. In fact, both of these measures have the added disincentive of contributing to a moral hazard that further hampers public debt management.[114] Nonetheless, African countries continue to increase their debt uptake to fund a number of projects.[115] This rapid rise in debt fueled by aggressive borrowing raises questions as to sustainability of the same, thereby presenting real risks of debt crises and debt defaults. It may well be the case that these African countries will require some form of debt relief going into the future, in the way of debt restructurings. Consequently, an effective legal framework to facilitate

[111] MEFMI, 'A Study on the Cost and Benefits of Debt Relief in the MEFMI Region' (2010) 52.
[112] ibid.
[113] N Bayraktar & H Fofack, 'Post-HIPC Growth Dynamics in Sub-Saharan Africa' (2011) The World Bank Policy Research Working Paper 5924 < *http://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-5924* > accessed 28 March 2016. Post-HIPC countries recorded economic growth of up to 5 percent for over a decade according to an assessment done in 2011.
[114] Moral hazard refers to the tendency by a debtor to engage in reckless behavior of borrowing, or the tendency by a lender to engage in reckless lending, in the hope that they will not suffer the consequences of their behavior.
[115] Net debt inflows to Africa in the year 2014 rose by 48 percent to average $ 47 billion according to *International Debt Statistics* (Washington, DC, World Bank 2016) 13.
< *http://data.worldbank.org/sites/default/files/ids-2016-book.pdf* > accessed 28 March 2016. In particular, Kenya's external debt stock in the year 2014 stood at $16.1 billion.

orderly and predictable sovereign debt restructurings is essential, if only to help African countries that are the most vulnerable.

Chapter 3: The Absence of a Sovereign Debt Restructuring Framework and Sovereign Debt Crises in Developing Countries

3.1 Introduction

This Chapter examines the extent to which the absence of a global legal framework on sovereign debt restructuring complicates the resolution of sovereign debt crises, particularly in developing nations, and the effect thereof. Towards this end, this chapter begins with an introduction on the subject of the absence of a sovereign debt restructuring framework generally. The second section conducts an assessment of the impact of the absence of a sovereign debt restructuring framework on debt crises. The third section reviews some empirical case studies in two countries, a developed and a developing nation, with a view to illustrating the difficulties faced by countries in debt crises. The fourth section makes concluding remarks.

Sovereign debt crisis usually occurs whenever a sovereign is unable or unwilling to repay the debts it has incurred, as and when they fall due. Whenever a difficulty in repaying debts materializes, a nation may either choose to default on the debt or agree with its creditors to a restructuring. The latter option is preferred to defaulting on the debt owing to the less severe consequences,[116] the need to maintain a good reputation in the international capital markets; and as a moral principle that debtors should honour their bargains. However, as argued in the preceding chapter, while a sovereign may choose to restructure its debts, it frequently may be

[116] Consequences of default include high cost of future loans due to higher interest rates and possible loss of access to the credit markets. See generally, Mark Wright & Mike Tomz, 'Sovereign Theft: Theory and Evidence about Sovereign Default and Expropriation' in William Hogan & Federico Sturzenegger (eds) *The Natural Resources Trap: Private Investment without Public Commitment* (Cambridge, MA, USA: MIT Press) 69–110.

unable to do so due to the collective action problem.[117] This is where its variant classes of creditors refuse to agree to an arrangement to take a 'haircut' on the principal amount owed.[118]

Importantly, cases of creditors, usually hedge funds, who buy credit owed by countries in the secondary market and then sue for the full amount in the courts, popularly known as 'vulture funds' owing to their predatory behaviour, abound.[119] A vulture fund simply buys debt at a discount in the secondary market and then sues for full recovery of the debt from the sovereign.[120] While legally justified and based on the concept of debt swap, actions by such vulture funds are morally reprehensible given that they invariably hold out thus preventing a restructuring thus causing a debt crisis in a developing nation to foment. An illustration of this is in order. A hedge fund or vulture fund known as Donegal bought a debt owing to Zambia with a value of $ 30 million from the secondary market for a figure of less than $ 4 million, and then sued Zambia for $ 55 million over the same debt in a British court.[121] Donegal won its claim against Zambia and the British court gave the vulture fund authority to enforce its claim against Zambia.[122] Vulture funds have recovered between 3 to 20 times the value of the price they have bought their debt in the secondary market, through litigation.[123] Eliott Associates LP, a vulture fund, bought a debt valued at $ 11.7 million defaulted by Peru with a face value of $ 20.7 million

[117] A collective action problem results when creditors refuse to agree to a coordinated manner in which restructuring can take place. For more insights on the coordination problem, see R Pitchford & M Wright, 'Holdouts in sovereign debt restructuring: A Theory of Negotiation in a Weak Contractual Environment' (2012) 79 Review of Economic Studies 812.

[118] A 'haircut' refers to the reduction in amount of the principal loan that a creditor is forced to do with, upon a restructuring arrangement.

[119] For a critical analysis of the damage caused by vulture funds, see Olufunmilayo B Arewa, 'Vultures, Hyenas and African Debt: Private Equity and Zambia' (2009) 29 Nw. J. Int'l L. & Bus. 643.

[120] D Pesendorfer, 'Good-Bye Neoliberalism? Contested Policy Responses to Uncertain Consequences of the 2007-2009 Financial Crisis' in Alexander Kern & Dhumale Rahul eds., *Research Handbook on International Financial Regulation* (Cheltenham: Edward Elgar, 2012) 426.

[121] Kanaga Raja, 'States asked to effectively control vulture fund activities' (2015) 598/599 Third World Economics 1, 19-22. <http://www.twn.my/title2/twe/2015/598-599/8.htm >accessed 11 November 2016.

[122] ibid.

[123] ibid.

and sued successfully for $ 58 million.[124] In November 2012, a New York court ordered that Argentina pays a vulture fund named NML Capital and other holdouts; a total of $ 1.33 billion-an amount equivalent to 1,600% profit on the part of the hedge funds-before paying any creditor.[125]

At the municipal level, private companies rely on domestic insolvency laws to enable a restructuring whereby a supermajority of creditors normally binds the minority. As such, the problem is normally less acute at the national level with respect to private debtors. The difficulties experienced by sovereigns, the uniqueness of the sovereign debtor notwithstanding, are normally due to the absence of a legal framework to guide restructuring arrangements. Sovereigns are usually unwilling to subject themselves to the municipal jurisdiction of another nation due to their exercise of sovereignty. There are also enforcement problems associated with sovereign debt.[126] The effect of a lack of restructuring is a default, which invariably leads to a debt crisis. A country that is mired in a sovereign debt crisis can barely access funds either from other creditors or from the capital markets, and may only rely on bailouts from the IMF or other multilateral institutions.

A State that is in a poor financial position and also denied the chance to raise any finances in the external markets is normally unable to discharge its central functions, including availing essential services for its people. This situation can be particularly acute in the case of low-income countries.

[124] ibid.
[125] ibid.
[126] The unique enforcement problems are discussed in Chapter 2 of this paper and include: restricted state immunity, absence of assets to attach and the impossibility of liquidating a nation as one would, a company.

3.2 Sovereign Debt Crises, their Causes and Impact on Developing Nations

It is not uncommon for countries, both developed[127] and developing, to suffer sovereign debt crises as a result of imprudent sovereign debt management, or due to unfortunate economic events.[128] There is nothing inherently wrong with generous borrowing, either internally or externally, so long as the borrowed funds are invested wisely. Indeed, the United States, which is the largest economy in the world, has always been in debt from earlier times till now.[129] However, as noted by Reinhart and Rogoff, advanced economies are better able to manage sovereign debt crises than developing nations.[130] Additionally, developing and transition economies have less cushions to protect their most vulnerable citizens, owing to the largely absent welfare system.[131] This is not to downplay the low economic status of citizens of developing nations who are largely unemployed and with little or no economic opportunities. It might well be said that developing nations have limited resources, poor debt management, corruption and economic mismanagement,[132] factors which contrive to obtain a situation marked

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[127] Greece and Spain, for instance, have been forced to take severe austerity measures due to the persistent debt crisis in the recent past resulting to riots and unemployment, while Ireland and Portugal were locked out of the sovereign bond market in 2010 and 2011.

[128] For instance, the 2007-2008 global financial crisis, though caused by the greed of market players in the United States, had a depressing effect on the economies of developing nations around the world. As such, while the event may have been a function of imprudence, at least in the United States, it was simply an unfortunate economic event for the vast majority of developing nations.

[129] See Matt Phillips, 'The Long Story of U.S Debt from 1790 to 2011 in 1 Little Chart'. *The Atlantic* (Massachusetts, 13 November 2012) 2, 8. <*http://www.theatlantic.com/business/archive/2012/11/the-long-story-of-us-debt-from-1790-to-2011-in-1-little-chart/265185/*> accessed 19 June 2016. Phillips notes that the United States was born in debt and the debt levels of the United States in the year 2011 stood at 100 percent of its Gross Domestic Product (GDP). Of course, the sustainability of this debt flows from proper investment of the debt capital which generates higher returns than the cost of initial capital financed through debt.

[130] See CM Reinhart & KS Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton, New Jersey, Princeton University Press 2009) 3. The authors note that until the 2007 global financial crisis, the presumption was that advanced economies were not nearly as vulnerable to financial crises as developing economies and that even if they were, they were better able to manage such crises due to their ability to make use of countercyclical policies.

[131] A Norton, Tim Conway & Mick Foster, 'Social Protection Concepts and Approaches: Implications for Policy and Practice in International Development' (2001) Centre for Aid and Public Expenditure Working Paper 143, 7. <*https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/2999.pdf*> accessed 19 June 2016.

[132] This is not to imply that corruption and economic mismanagement is unique to developing nations, only that the effects are more pronounced in such jurisdictions.

by huge unsustainable debts that such countries find difficult or virtually impossible to service or repay.[133] Countries borrow debt from both internal and external sources due to various circumstances and developments,[134] not least of which include business cycle fluctuations and even war financing.[135] The amount of sovereign debt among developing nations has been on the increase due to an exponential growth in governmental functions and the increasing demands of their citizens. Few countries have managed to maintain balanced budgets and thus refrain from incurring large amounts of sovereign debt.[136] The more a nation consumes debt, the more the chances that the cost of future loans will increase and the more taxes it may have to raise, so as to pay up for the increased debt costs. An increase in taxes upon an already overburdened citizenry can only lead to increased poverty. While international organizations such as the IMF and the World Bank may provide assistance in the form of aid to such a nation to overcome debt crises, it is not infrequent that such aid comes with conditionalities.[137] These conditionalities may present other unintended consequences that may not bode well for the country in resolving the debt crisis. From another perspective however, a nation faced with debt crisis may benefit as the crisis may force such a country to implement the needed economic reforms geared towards improving its financial position.[138]

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[133] For an assessment of the huge debt uptake by developing nations, particularly Kenya, see Chapter 2 of this paper.

[134] Some of these developments and circumstances entail special infrastructural projects that are a national priority, an unexpected disaster or emergency, unanticipated economic shocks caused by external factors such as fluctuating oil prices, budgetary deficits caused by corruption and other leakages, or simply to meet revenue shortfalls caused by failure to collect the targeted revenues by way of taxation.

[135] M Azzimonti, E Francisco & V Quadrini, 'Financial Globalization, Inequality, and the Raising of Public Debt' (2012) Federal Reserve Bank of Philadelphia, Philadelphia, Working Paper No. 12-6, 1.

[136] A balanced budget is one where the government spends its income and no more. Essentially, in a balanced budget there is neither a surplus nor a deficit in that the government neither leaves over excess money without spending nor does it borrow to spend. The wisdom of a balanced budget is unclear.

[137] The IMF regards the conditionalities that come with aid assistance as essential to helping countries address their underlying problems thereby enabling them to achieve external viability and restore the confidence of investors. See International Monetary Fund (IMF), 'The Joint World Bank- IMF Debt Sustainability Framework for Low Income Countries' (2014) 9.

[138] PR Lane, 'The European Sovereign Debt Crisis' (2012) 26 (3) Journal of Economic Perspectives 49, 65.

Concerns about the precarious position that a number of developing nations occupy with regard to high and unsustainable debt are not overblown. According to a study conducted by the IMF in 2013 relating to the sustainability of sovereign debt in 76 low-income countries, around 17 countries were in debt distress or facing high risks of default.[139] The high amount of debt uptake by developing nations, in this case Africa, is a result of readily available credit in the form of the American dollar following the 2008 global financial crisis. While credit by most countries was taken up when the dollar was weak, the strengthening of the dollar against the local currencies coupled with low prices of commodities have served to raise the cost of debt, thus making it more difficult for these countries to repay.[140] By way of illustration, a number of countries such as Ghana, Mozambique and Kenya have already entered into arrangements with the International Monetary Fund for loan facilities so as to offset their debt liabilities.[141] External debts, which form a substantial part of Africa's debt liability, are riskier than internal debts as they are normally susceptible to changes in the exchange rates since they are typically denominated in foreign currency.[142] It should be stated that while a high external debt relative to the Gross Domestic Product (GDP) may not be construed as indicating a debt crisis particularly where a government is conscious of the inherent risks and works towards reducing the debt deficits, it presents a huge risk nonetheless. Perhaps, a better way to construe a debt crisis for our purposes

[139] Jurgen Kaiser, 'Resolving Sovereign Debt Crises: Towards a Fair and Transparent International Insolvency Framework' Friedrich Ebert Stiftung 6. <*http://library.fes.de/pdf-files/iez/07497.pdf*> accessed 19 June 2016.

[140] African countries continue to heavily depend on their commodities to raise money through exports. The prices of these commodities have been negatively affected in the international market. For instance, Nigeria sold oil at nearly $ 110 a barrel in mid-2014, a figure that has decreased to around $ 30 a barrel in 2016.

[141] According to an IMF's Regional Economic Outlook: Sub-Saharan Africa report, Ghana spent up to 43 percent of its GDP in meeting its debt obligations; Kenya had an external debt of up to 48 percent of its GDP while Mozambique had debts of up to 50 percent of its GDP in the year 2015. <*https://www.imf.org/external/pubs/ft/reo/2016/afr/eng/pdf/sreo0416.pdf*> accessed 19 June 2016.

[142] V Arora & M Cerisola, 'How Does U.S. Monetary Policy Influence Sovereign Spreads in Emerging Markets?' (2001) 48 (3) IMF Staff Papers 474. This study shows that the interest rates in the United States affect debt costs.

would be in a stricter sense, to denote the moment a nation's debt obligations impede the achievement of such nation's sustainable development goals.[143]

A persistent and pervading sovereign debt crisis can have severe damaging consequences to any nation, no less a developing economy. For instance, increasing debt obligations that have to be met using the little financing of a country through taxation in foreign currency constrain the capacity of such country to make imports. This is because imports are usually paid using foreign currency, which during a time of a debt crisis, is normally in short supply. In addition, depressed export earnings resulting from reduced commodity prices due to a strengthening of the foreign currency reduce the foreign currency available for making imports. Once a nation is unable to make proper and adequate imports, its ability to undertake development projects is severely handicapped.[144] In this context, we examine developing nations that source most of their materials, machines and chemicals required for developmental projects from foreign countries through importation.

A second but more obvious consequence of a debt crisis is the reduced budget caused by the need to offset debt obligations, which eats into the ability of a nation in providing essential services to its people. The government of such a nation may be forced to take austerity measures in order to live within its reduced budget; a fact that can further depress the economy by increasing unemployment due to reduced spending.[145] Further, were such a nation to succeed in

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[143] This appears to be the position adopted by Jubilee Debt Campaign, a lobby group that campaigns for cancellation of debts against heavily indebted and low income countries around the world.
[144] This is because most of developmental projects make use of imports such as machinery and other equipment.
[145] See JM Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan 1936) 126 where Keynes argued on the potential of increased public spending, in reducing unemployment. At chapter 10 he stated thus: "If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coalmines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well-tried principles of *laissez-faire* to dig the notes up again (the right to do so being obtained, of course, by tendering for leases of the note-bearing territory), there need be no more unemployment and, with the help of the repercussions, the real income of the community, and its capital wealth also, would probably become a good deal greater than it actually is.

obtaining a loan facility from the IMF, the condition of such grant would be to adopt particular economic policies including austerity measures, factors which may not necessarily be prudent for an ailing economy.[146] As a consequence, the most obvious result of a sovereign debt crisis on a nation is to lead to a decline in the living standards of her people.

Another impact of a sovereign debt crisis is the constraint it places on the economic policies adopted by a nation. A debt crisis invariably sparks a crisis management situation, thereby reducing what would otherwise be a properly thought out economic policymaking to a mere exercise in crisis management. For instance, the government may have to stop implementing essential long term projects in education and health and do away with other programmes that rely on imports, in a bid to cut on expenditure. Most of the inadequate resources such as money and time are normally applied in formulating means of rescheduling debts and other related adjustment programmes so as to minimize the consequences of the debt crisis. Put differently, a debt crisis has the effect of compromising the making of macroeconomic policies in a nation, which are the fulcrum upon which structural reforms in a country are founded.[147]

Another effect of sovereign debt crisis is the reputational cost on the part of a country, which discourages investors from ploughing capital into such country and into its firms. The resulting

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It would, indeed, be more sensible to build houses and the like; but if there are political and practical difficulties in the way of this, the above would be better than nothing."
<http://cas.umkc.edu/economics/people/facultypages/kregel/courses/econ645/winter2011/generaltheory.pdf> accessed 19 June 2016.

[146] See Jesse Griffiths & Konstantinos Todoulos, 'Conditionality yours: An analysis of the policy conditions attached to IMF loans' (Eurodad 2014) 14 <http://www.eurodad.org/files/pdf/53466a66139aa.pdf> accessed 19 June 2016. The study notes that some of the conditionality attached to IMF loans include increasing regressive taxes such as consumer or Value Added Taxes, taxes that further impair the already weakened purchasing power of the poor.

[147] Macro-economic policies are concerned with the overall economy and are comprised of three instruments namely: monetary policy, fiscal policy and exchange rate policy. A tinkering with any of the macro-economic indicators has an effect on virtually every individual in a nation. To illustrate, inflation, which is a matter of monetary policy can be tinkered with by the financial regulator of a nation either to increase it or decrease it. High inflation has the effect of increasing money supply and thereby increasing the prices of goods thus making them unaffordable while attempts to lower the rate of inflation tends to decrease economic growth and accelerate unemployment, both situations that harm the poor.

capital flight from such nation caused by the uncreditworthiness of the particular country leads to a reduction in employment opportunities, and considerably decreases the chances of economic recovery. To be sure, we do not suggest for a moment that a sovereign debt restructuring framework would forestall a debt crisis in the first place. This is because a debt crisis is merely a function of either imprudent borrowing and excessive lending or unfortunate economic circumstances. Rather, a restructuring framework would help alleviate the harsh effects of a prolonged debt crisis on a developing nation's vulnerable citizens by mitigating and shortening the period over which such a crisis persists.

In the main, the impact of sovereign debt crisis on developing nations is socio-economic and political in character, to the extent that it may cause humanitarian crises, further economic recession and even ramp up civil unrest and insurrections. To be sure, the reduction in spending either resulting from forced austerity measures by the IMF or due to the absence of funds that have been applied in offsetting debt, inevitably leads to a cut in provision of social services. Other conditions of the IMF bailouts may include the need to privatize particular national institutions so as to improve their competitiveness and productivity. While such a move may indeed lead to improved economic efficiency if the conditions are right, privatization of national utilities which provide water, health, education, and electricity have the effect of taking them out of the reach of the poor.[148] This is because upon privatization, the public utilities are taken up by private actors in the market whose main concern is making profit.[149] Therefore, the ability of a

[148] See Ademola Ariyo & Afeikhena Jerome, 'Utility Privatization and the Poor: Nigeria in Focus' (2004) Global Issue Papers, Heinrich Boll Foundation 6. The authors examine the various ways in which privatization of utilities affect the poor and consider the microeconomic linkages which directly affect the poor. The argue that privatization of utilities aggravates the problem of accessibility of utility services by the poor since private providers tend to focus on high income areas so as to maximize profits on their investment. <*https://www.boell.de/sites/default/files/assets/boell.de/images/download_de/internationalepolitik/GIP12.pdf*> accessed 25 July 2016.

[149] ibid 6.

nation to employ its public utilities as an instrument of furthering particular social-political goals such as redressing inequalities and reducing poverty is severely limited.[150] In the developing countries' context, the government is frequently the largest purchaser in the market. This has at least two apparent implications. One, due to its reduced purchasing power, there is less economic activity, a fact that leads to reduced productivity conducing to economic depression. Second, the government finds itself unable to provide the essential services it normally would, since it is not in a position to acquire the particular services. In most developing nations, the government provides a host of essential social services such as health, education, and food, among others that mostly relate to the poor either through full or partial subsidies. In the absence of a global debt restructuring framework and an unwillingness of creditors to restructure, a government is only left with three options. These options include: defaulting on the debt and attracting some consequences, adopting austerity measures of reduced spending which harm the poor so as to continue repaying the debt, or the no less pernicious means of increasing taxes to generate more revenue to pay the debt. None of these options is attractive to a nation's people.

3.3 Case Studies

In order to illustrate the ubiquity and perniciousness of the debt problem in a number of countries, we assess some case studies with respect to two countries, Pakistan and Greece.

3.3.1 Pakistan

Pakistan is a country in Asia with a population of around 188 million people, with a majority of people living on less than 2 dollars a day.[151] With a vast population in the African continent

[150] Even within the context of public procurement, it is not uncommon for governments to employ procurement regulation as a tool of achieving social policies. See Sue Arrowsmith, 'Public Procurement as an Instrument of Policy and the Impact of Market Liberalization' (1995) 111 Law Quarterly Review 235.
[151] This is according to data by the World Bank <*http://data.worldbank.org/country/pakistan* > accessed 19 June 2016.

living on less than a dollar a day, Pakistan may be described as a developing or emergent market economy.[152] While the country has not been facing a debt crisis in the strict sense, it has been facing difficulties in its finances resulting into a large part of its budget being applied to debt repayment. The impact of its debt problem has been a reduction in public services, freezes on payments, adoption of regressive taxes, privatization of public utilities and increased unemployment.[153] In particular, in the year 2008-2010, the IMF attached conditions to its bail-out package titled 'Stand-By Arrangement', conditions that required the removal of energy subsidies, tax reforms and reduction in public expenditure.[154] This led to a deterioration of the Pakistan economy with the country forced to commit over half of its budgetary allocation to health and education to servicing its debt.[155] The upshot of this has been a breakdown in the public health system thereby affording only the well-off that can afford the private health systems, with the right to proper medication. In addition, by the year 2013, half of Pakistan citizens had problems accessing food.[156]

3.3.2 Greece

Greece, though a developed nation in Europe, has also faced a debt crisis only resolved through what has been the largest sovereign debt restructuring in history. We examine Greece as a case study to demonstrate that the problem of debt crisis is not unique to developing countries alone. The Greece experience further lends credence to the argument made in this study, of the need for a sovereign debt restructuring framework to help developing nations restructure debt whenever

[152] ibid. The World Bank characterizes Pakistan as a low middle income country.
[153] Jubilee Debt Campaign: Life and Debt: Global studies of debt and resistance (2013) <*http://jubileedebt.org.uk/wp-content/uploads/2013/10/Lifeand-debt_Final-version_10.13.pdf*> accessed 19 June 2016.

[154] Jubilee Debt Campaign: Life and Debt: Global studies of debt and resistance (2013) <*http://jubileedebt.org.uk/wp-content/uploads/2013/10/Lifeand-debt_Final-version_10.13.pdf*> accessed 19 June 2016.
[155] ibid.
[156] ibid.

they become onerous. The debt problem in Greece can be traced to its absorption into Europe, which was accompanied by its credit-driven growth in the early years of the second millennium.[157] The government had to seek financing through external debt in those years to meet its defence budget and also fund the Olympic Games that the country hosted in 2004.[158] After the 2008 global financial crisis, as with other countries around the world, Greece took advantage of the lending boom from other European countries with a view to plugging its lower tax revenues. Due to the high debt intake by Greece, creditors began to have concerns over the ability of the country to service its debt in 2010. This caused a soaring of the interest rates on the loan and Greece was bailed out by the European Union, the IMF and the European Central Bank. While the bailouts had the short-term benefit of enabling Greece to repay the outstanding debt to the European banks, it further increased its debt burden. The austerity measures that came with the bailout caused further economic recession and higher unemployment. Between 2008 and 2014, Greece had lost up to 29 percent of its GDP with the rate of unemployment more than doubling from around 10 percent to 25.7 percent within the same period.[159] Greece citizens have also suffered the loss of homes, a reduction in employment benefits, depression and even suicides.[160] In particular, the health system has experienced hard knocks from the economic situation exacerbated by the debt crisis.[161] Citizens have been forced to pay entrance fees in public health facilities.[162] In addition, several of these public hospitals are short on staff,

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[157] ibid.

[158] ibid.

[159] Indeed, by the year 2014, half of persons below the age of 25 were unemployed.

[160] G Rachiotis, D Stuckler, M McKee & C Hadjichristodoulou, 'What has happened to suicides during the Greek economic crisis? Findings from an ecological study of suicides and their determinants (2003–2012)' (2015) 5 (3) British Medical Journal Open <*http://bmjopen.bmj.com/content/5/3/e007295.full#aff-1* > accessed 19 June 2016.

[161] Médecins du Monde, 'Access to Healthcare in Europe in Times of Crisis and Rising Xenophobia' (2013) <*https://www.medicosdelmundo.org/index.php/mod.documentos/mem.descargar/fichero.documentos_MdM_Report_access_healthcare_times_crisis_and_rising_xenophobia_edcfd8a3%232E%23pdf* > accessed 19 June 2016.

[162] ibid.

equipment and medicine as are pharmacies.[163] Children have been at a risk as they have lost access to immunizations while other vulnerable groups such as drug users and migrants have borne the brunt of the austerity measures.[164]

A distinct but nonetheless important point with respect to dealing with the Greece debt crisis is the fact, as highlighted herein, that Greece's absorption into Europe enabled it to accrue a huge amount of debt.[165] As part of the regional bloc, namely the European Union, Greece was able to negotiate and attract loans at more favourable rates than it would have were it outside the European Union bloc.[166] The net effect of this was that it enjoyed favourable rates owing to the impressive credit ratings of other stronger European economies.[167] This concern is not idle as it becomes difficult not to take into account these regional integration imperatives when it is considered that nations around the world are increasingly integrating through regional blocs in the spirit of neo-liberal institutionalism.[168] Countries, including in the developing world and in East Africa, continue to move towards regional and global integration through trade blocs, with talks of political federation being floated.[169] The relevant issue in this context, thus, is whether the particular regional bloc ought to be involved in the negotiations towards a debt workout or restructuring, since it may happen to have been a crucial player in the contracting of the particular debts. Put differently, since regional integration influenced the taking up of debt, there

[163] See A Kentikelenis, M Karanikolos, A Reeves, M Mckee & D Stuckler, 'Greece's health crisis: from austerity to denialism' (2014) 383 Lancet Journal 748.
[164] ibid.
[165] Greece joined Europe in 1981 and adopted the Euro currency in 2001. The lower interest rates by virtue of being able to borrow in euros enabled it to take up more debt.
[166] H Wallop, 'Greece: Why did its economy fall so hard?' (The Telegraph, 28th April 2010) <http://www.telegraph.co.uk/news/worldnews/europe/greece/7646320/Greece-why-did-its-economy-fall-so-hard.html > accessed 11 November 2016.
[167] ibid.
[168] Regional blocs particularly to facilitate international trade abound. Examples include ECOWAS, COMESA, EAC, European Union, among others.
[169] For instance, see the East Africa Community established under the East Africa Community Treaty and rhe various institutions formed thereunder such the East Africa Legislative Assembly, Council of Ministers and the East Africa Court of Justice.

is a case for integration to similarly influence debt workouts. The regional integration imperatives and difficulties that the same presents, offer an interesting area of further research that this study identifies.[170]

Suffice to say that were there a proper debt restructuring framework in place; Greece would have made use of it and avoided seeking bailouts from the banks, thereby reducing its overall debt burden and enabling its economic recovery. It would have obviated the need for stringent austerity measures in a bid to raise more money to pay the debts, thus producing less pernicious effects on its citizenry.

3.4 Concluding Remarks

This chapter has assessed the effect of the absence of a global sovereign debt restructuring framework on developing nations. It has argued that the absence of a restructuring framework has led to persistent debt crises not only in developed nations but also in developing countries. A restructuring framework, though without potential to prevent the fomenting of a debt crisis in the first place,[171] would serve to mitigate or reduce the period over which sovereign debt crises persist, thus avoiding pernicious effects on a nation's people. The chapter has also assessed the various causes of sovereign debt crises in various countries, key of which include the increasing needs of citizens and the desire to fund more programs, factors that have fuelled more debt uptake. It has made the case that debt crises force governments to expend most of their revenue

[170] An analysis of the implications of the regional integration imperatives on the subject of sovereign debt is beyond the scope of this study and is suggested as an area of further research. I am grateful to my defence panel member, Mr. Tirimba Machogu, for calling my attention to this point.

[171] Debt crises are mainly a result of many factors practices such as over borrowing, inappropriate fiscal policies, international trade imbalances, reckless lending, misuse of funds and leakages or simply unfortunate economic events in a nation, among other practices. See generally, Ana-Maria Minescu, 'Debt Crisis- Causes and Implications' (2011) Petroleum-Gas University of Ploiesti BULLETIN Economic Sciences Series <*http://www.upg-bulletin-se.ro/archive/2011-2/9.%20Minescu.pdf* > accessed 25 July 2016. Also see, GM Wali Ullah & Samiul P Ahmed, 'A Review of European Sovereign Debt Crisis: Causes and Consequences' (2014) 3 (2) International Journal of Business and Economics Research 66.

towards debt servicing, or to increase taxes or adopt austerity measures, all of which have a negative effect on the citizenry in terms of reducing service delivery. The situation is even more acute within the context of developing nations whereby the government is normally the biggest purchaser and is concerned with other social-political goals. The bailouts provided by the IMF for most developing nations to enable them overcome debt crises have conditionalities attached, which include particular economic policies such as austerity measures and increase of regressive taxes and in other cases, privatization of public utilities. These economic adjustment programmes have the effect of undermining service delivery to the poor in developing countries, since essential services are normally taken away from government to the private sector which is little concerned with equity issues. The chapter has demonstrated the obtaining situation in a moment of debt crisis or even simply during a period of debt overhang, through an assessment of two case studies in Greece and Pakistan which represent developed and developing economies respectively. It has made the argument that even a simple debt overhang or difficulties in debt repayment not reaching the level of a debt crisis require a form of debt restructuring, if such debtor countries are to effectively avail essential social services to its people. Using global justice arguments, the chapter has made the case that those huge payments to creditors to satisfy debts, even when the situation has not reached a moment of debt crisis, serve to inhibit and compound the efforts of such nations in meeting their sustainable development goals. In the circumstances, there is need to ensure that debt burdened sovereigns are able to restructure their debts, so as to enable them discharge their critical function to their citizens-namely that of service delivery.

Chapter 4: Analysis of The Current Mechanisms and Proposals for Enabling Sovereign Debt Restructuring

4.1 Introduction

This Chapter explores the various prevailing mechanisms and proposals put forward for enabling and facilitating sovereign debt restructuring during debt crises. The first section is a general introduction on the subject generally and mentions the various mechanisms and proposals that dominate discussions around sovereign debt restructuring. The second section examines the extant mechanisms that seek to provide for sovereign debt restructuring, namely, Collective Action Clauses and Exit Consents that are normally incorporated into debt instruments. The third section examines the various proposals put forward to enable sovereign debt restructuring and explores their merits and demerits. The fourth section makes concluding remarks.

In the absence of a global sovereign debt restructuring framework, parties engaged in sovereign debt arrangements have devised *ad hoc* and informal means and ways of providing for restructuring when debt payments become onerous.[172] The provision for restructuring is normally embodied in the particular debt instrument as part of the contractual clauses.[173] Whenever a debtor under a loan arrangement is unable to discharge their obligation for whatever reason; such debtor may invoke the contractual clause that avails a mechanism for debt restructuring.[174] In doing this, the parties to the loan agreement seek to import the restructuring schemes normally embedded in municipal insolvency laws. The contractual clauses that provide for debt restructuring arrangement in individual contracts are known as Collective Action Clauses (CACs).[175] Owing to the inadequacies of the Collective Action Clauses over the years, various other mechanisms have been proposed by academics, practitioners and commentators,[176] which form the subject of discussion of this chapter.

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[172] US Das, MG Papaioannou & C Trebesch, 'Sovereign Debt Restructurings 1950-2010: Literature Survey, Data and Stylized Facts (2012) IMF Working Paper WP/12/203, 7.
[173] ibid.
[174] ibid.
[175] ibid 8.
[176] Stephen Choi & Mitu Gulati, 'Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds' (2007) University of California Berkeley, Working Paper No. 40 <*http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2068&context=faculty_scholarship*> accessed 13 July 2016; Lee C Buchheit, 'Choice of Law Clauses and Regulatory Statutes' (1996) 15 Int'l Fin. L. Rev. 3, 11-14;

4.2 Mechanisms of Sovereign Debt Restructurings

4.2.1 Collective Action Clauses

Collective Action Clauses (CACs)[177] are clauses incorporated into debt contracts or instruments and which have the effect of enabling a supermajority of creditors of the contracting parties in a loan arrangement to amend the terms of the agreement.[178] The supermajority in this context may be three-quarters or two-thirds of the contracting parties, while the terms to be amended may include the maturity date, the principal amount payable, the interest rates payable on the principal amount, or any other critical term of the loan.[179] Given that the clauses are normally incorporated into contracts, the CACs are considered a contractual approach to sovereign debt restructuring. They are usually meant to circumvent the holdout problem or the collective action problem whereby creditors refuse to agree to a plan to restructure debts in a manner that changes the critical terms of the initial debt contract. This rent-seeking behaviour is what constitutes the collective action problem,[180] from where the name Collective Action Clause, derives.[181] CACs may be included in a contract either at the time of the execution of such agreement or at a later time, by engaging in exchange offers with exit consents.[182] CACs are usually viewed as having the potential to reduce the need for bailouts, of facilitating investor bail-ins going forward,[183] and facilitating the orderly and quick restructuring of sovereign debt.[184] This has benefits to both

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Anna Gelpern & Mitu Gulati, 'Public Symbol in Private Contract: A Case Study' (2007) 84 Wash. U. L. Rev. 1627, 1633.

[177] Francis Palmer was arguably the first scholar to call for majority action clauses in trust deeds and debenture documents that bind other minority creditors in what he referred to as 'power of majorities'. See Francis B. Palmer, *Company Precedents* 397, 12th ed. (London Stevens 1922) 150-160.

[178] Steven L Schwarcz, 'Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach' (2000) 85 Cornell Law Review 956, 960 <*http://scholarship.law.duke.edu/faculty_scholarship/508/*> accessed 13 July 2016.

[179] ibid.

[180] By rent-seeking behavior, we mean the tendency by minority creditors to holdout from agreeing to a plan to take a cut on their principal loan amounts and instead litigating for full payments at the expense of the majority creditors. This self-serving behaviour is akin to extracting rents from a particular system, as explained in the rent-seeking theory. For further insights on the concept of rent-seeking, see Anne O Krueger, 'The Political Economy of the Rent-Seeking Society' (1974) 64 (3) American Economic Review 291.

[181] Kenneth M Kletzer, 'Sovereign Bond Restructuring: Collective Action Clauses and Official Crisis Intervention' (2003) IMF Working Paper, 4. <*https://www.imf.org/external/pubs/ft/wp/2003/wp03134.pdf*> accessed 13 July 2016. Kletzer, an economist, regards the collective action problem as a form of rent-seeking.

[182] Exchange offers with exit consents are discussed in the subsequent section in this Chapter.

[183] By bailing-in, we mean, roping in the private sector so as to share the burden faced by a country with huge debt obligations.

[184] Joy Dey, 'Collective Action Clauses: Sovereign Bondholders Cornered' (2009) 15 Law & Bus. Rev. Am. 485, 498.

creditors and debtors as the former are able to at least receive a fraction of their amount owing, while the latter are able to pull through their debt crises.

Very few sovereign debt restructurings have been governed by CACs to this day.[185] This is possibly because CACs are fraught with limitations that impede on their functionality as far as facilitating debt restructuring is concerned. First, it is not always that CACs are included in financing agreements involving a state debtor and a creditor.[186] This is evident in the case of Greece where only 10 percent of the debt that Greece borrowed was governed by the CACs.[187] Greece has since been mired in a debt crisis. Secondly, CACs suffer from a weakness stemming from their very contractual nature in that, they largely only work on an agreement to agreement basis.[188] This is of course assuming that we have overcome the first limitation by having all debt instruments incorporating CACs-quite an overly optimistic endeavour. What we mean by this second limitation is that if a particular group of creditors are unable to achieve the supermajority needed in the contract to bind all creditors; such group would by itself contribute to a holdout problem. While CACs may have their intended effect in a case where a sovereign has few creditors of bond issuances, they are of diminished utility if there are multiple bond issuances or creditors. Yet, this is increasingly becoming the case particularly in developing countries where there are multiple and varied bondholders and creditors. Bond issuances, particularly in the international capital markets, are usually fraught with multiple creditors in multiple jurisdictions and governed by multiple legal regimes.[189] In addition, these debt arrangements usually have differing maturity dates and repayment terms.[190] Thirdly and more importantly, CACs neither

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[185] Anna Gelpern & Mitu Gulati, 'Foreword: Of Lawyers, Leaders, and Returning Riddles in Sovereign Debt' (2010) 73 Law & Contemp. Probs., at i, viii, ix. <*http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1581&context=lcp*> accessed 13 July 2016. The authors state that only the New York law bonds issued in Belize made use of CACs during debt restructuring. They argue that most of the debt restructurings have happened outside the CACs.

[186] Stephen J Choi, Eric Posner & Mitu Gulati, 'Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution Mechanism' (2010) University of Chicago, John M. Olin Law & Economics Working Paper No. 541, 2.

[187] ibid 12. The authors note that up to 90 percent of the Greek debt was issued under Greek law, with only 10 percent of the debt being issued under foreign law which provided for CACs. <*http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1376&context=law_and_economics*> accessed 13 July 2016.

[188] Steven L Schwarcz, '"Idiot's Guide" to Sovereign Debt Restructuring' (2004) 53 Emory Law Journal 1189, 1205.

[189] Molly Ryan, 'Sovereign Bankruptcy: Why Now and Why Not in the IMF' (2014) 82 Fordham L. Rev. 2473, 2502 <*http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4990&context=flr*> accessed 13 July 2016.

[190] ibid.

mitigate the proclivity by sovereigns to over borrow nor reduce the time taken for restructuring to take place.

Given the limitations that accompany CACs, it would not be unsafe to state that reliance on CACs to resolve the collective action problem in sovereign debt restructuring is an 'exercise in futility'.[191] Indeed, an empirical study conducted among market participants and policy makers in sovereign debt market concludes that the market attaches little value to CACs.[192]

4.2.2 Exit Consents

Exit consents are the allowance of a majority class of creditors to use the amendment clauses in a debt instrument to change particular non-payment terms[193] in the contract, so as to encourage creditors keen on holding out into participating in a bond exchange.[194] The effect of an exit consent is that a holdout creditor retains the original debt with the original debt repayment terms, but since the contract would have been amended as to alter or remove say, protective financial covenants, the value of the debt significantly reduces.[195] Similarly, the enforcement of such debt would be significantly circumscribed.[196] Exit consents borrow their name from the fact that they involve a sovereign debtor seeking the consent of its creditors so as to amend the old contracts (to exit), while the creditors exchange their debts for new debt instruments issued by the debtor.[197] The efficacy of exit consents lies in the ability of such amendments to significantly reduce the value of the debt in the old debt instrument, minimize the chances of eventual debt repayment, and increase the difficulties of a holdout creditor in litigating against the sovereign debtor.[198] Essentially, since the debt instrument proscribes any one of the parties from interfering with the payment terms of the contract such as the date and amount of payment, exit consents rely on amending the other non-payment terms. By seeking permission from the majority of

[191] Hal S Scott, 'A Bankruptcy Procedure for Sovereign Debtors?' (2003) 37 Int'l L. 103, 129.
[192] Michael Bradley, James D Cox & Mitu Gulati, 'The Market Reaction to Legal Shocks and Their Antidotes: Lessons from the Sovereign Debt Market' (2010) 39 Journal of Legal Studies 289, 321 <*http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5500&context=faculty_scholarship*> accessed 13 July 2016.
[193] Some of these non-payment terms may include a waiver on state immunity or a change of financial covenants.
[194] For a more detailed exposition of exit consents, see Lee C Buchheit & Mitu Gulati, 'Exit Consents in Sovereign Bond Exchanges' (2000) 48 UCLA L. Rev. 59, 65–68. <*http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2081&context=faculty_scholarship*> accessed 14 July 2016.
[195] ibid.
[196] ibid.
[197] ibid 65-66.
[198] ibid 69.

creditors, the sovereign debtor amends the contract in a manner that makes the old initial debt less attractive, thus forcing creditors who had rather hold out into agreeing onto the new amended debt arrangement. The reason why majority creditors agree to such an amendment is that the minority holdout creditors usually present a threat to them no less than they do to the sovereign debtor. Over the years, exit consents have been employed by sovereign debtors with huge success, particularly by Ecuador in 2000.[199] Pakistan, Uruguay, Argentina, the Dominica Republic and Belize have also vested themselves of exit consents to successfully restructure their debts.[200]

Despite the apparent attractiveness and success of exit consent as a legal innovation in dealing with the holdout problem, it is not appropriate in all circumstances.[201] For instance, the size of the changes to be made to the principal amount of debt payable as to enable a sovereign debtor overcome a debt crisis may be so great, as to make exit consents inappropriate.[202] Secondly, the effect of the exit consents may be rendered superfluous in the event of a 'buoying up effect' of the restructuring, to an extent that it overcomes the negative results wrought by exit consents.[203] In other words, upon an exit consent, the value of the old debt is usually decreased thus facilitating restructuring.[204] Upon a restructuring, the debt burden on the sovereign debtor significantly reduces thus increasing the value of the debt due to the increased ability of repayment resulting from the reduced debt burden.[205] It is this increase in value of the debt that is referred to as the 'buoying up effect'.[206] In the event that this increase in value of the debt is greater than the reduction in value caused by the exit amendments, then the exit consents will have served no purpose. Thirdly, as demonstrated by the American case of *Federated Strategic Income Fund* v *Mechala Group Jamaica Limited*[207] and the British case of *Assénagon Asset*

[199] Federico Sturzenegger & Jeromin Zettelmeyer, *Debt Defaults and Lessons From A Decade Of Crises* (Cambridge, MIT Press 2007)) 157-160.
[200] ibid 141-143, 218. Also see Udaibir S Das, Michael G Papaioannou & Christoph Trebesch, 'Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts' (2012) 30 International Monetary Fund, Working Paper No. WP/12/203, 47. <https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf> accessed 14 July 2016.
[201] Jill E Fisch & Caroline M Gentile, 'Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring' (2004) 53 Emory Law Journal 1043, 1052.
[202] ibid.
[203] ibid.
[204] ibid.
[205] ibid.
[206] ibid.
[207] [1999] WL 993648 (S.D.N.Y.) 7.

Management S.A. v *Irish Bank Resolution Corporation,*[208] a court may consider the exit amendments as improper by finding that they are too substantial or oppressive to minority holdout creditors. To this extent, the continued existence and efficacy of the remedy of exit consents would be dependent on what the courts will say, if and when the matter ends up in court.[209] In addition, both the CACs and exit consents, which are essentially free market or contractual devices, suffer from the deficiency that outstanding debt instruments cannot be amended as to contain these contractual devices if they did not have them initially. This means that they can only be employed in yet to be executed financing agreements.

4.3 Proposals for Sovereign Debt Restructuring Frameworks

As a result of the inadequacies of the subsisting mechanisms of enabling sovereign debt restructuring, as the foregoing analysis has shown, various proposals have been put forward to overcome the difficulties that we have met. These proposals form the subject of the next section.

4.3.1 A Sovereign Debt Restructuring Mechanism[210]

One of the proposals put forward is that by former IMF Chief Anne Krueger of a Sovereign Debt Restructuring Mechanism (SDRM) to avail a formal insolvency framework for sovereign debtors at the international level.[211] The SDRM as proposed was meant to be invoked by the sovereign debtor whenever it ran into financial distress and was unable to satisfy its debts as they came due. Given its attractive features on both the debtors and the creditors alike, it was hoped that it would serve to eliminate the coordination problem and enable a quick and collaborative restructuring arrangement.[212] However, the SDRM as proposed by the IMF had one glaring omission that would without doubt diminish its efficacy. It neither provided for an automatic stay on litigation by unsatisfied creditors nor did it avail for an automatic moratorium on payments,

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[208] [2012] EWHC (Ch) 2090 (Eng.) 6.

[209] A similar argument is advanced here: Lee C Buchheit & G Mitu Gulati, 'Sovereign Bonds and the Collective Will' (2002) 51 Emory Law Journal 1317, 1346.

[210] This is a form of a statutory approach as it involves the adoption of a convention or a treaty as opposed to being a contractual clause. The idea of a statutory approach to sovereign debt restructuring was first mooted in 1933 in a Pan American Conference in Montevideo, see Eric Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism' (2008) 27 Contributions to Political Economy 91, 92.

[211] Anne Krueger, 'A New Approach to Sovereign Debt Restructuring' (November 26, 2001). <https://www.imf.org/external/np/speeches/2001/112601.htm> accessed 14 July 2016. Anne Krueger was the then First Deputy Managing Director of the International Monetary Fund when she gave the address.

[212] ibid.

which are common features in insolvency laws.[213] This appears to have emanated from the view by the IMF that a stay on litigation and payments would have provided an incentive for creditors to disengage from the restructuring arrangement when it became imminent that the SDRM would be invoked.[214] Instead, the SDRM proposal by the IMF provided that such stay on payments would only be allowed if three-quarters of the creditors sanctioned the same.[215] In addition, the IMF Executive Board reserved the power to determine the debt sustainability of a sovereign debtor, though disputes would be resolved by a Dispute Resolution Forum set up under the proposal.[216]Curiously, the proposal provided that official private debt and bilateral debt would be negotiated outside the SDRM mechanism or as a separate creditor class.[217] Given that most of the developing countries are consumers of this kind of debt, it would then appear that they would not benefit from the mechanism. Even more importantly, in order for the SDRM as proposed to take effect, there had to be an amendment to the IMF's Articles of Agreement that require an approval of 60 percent of member countries with 85 percent of the votes.[218] The United States, with 16.59 percent of the votes, can actually veto any resolution or scuttle any such amendment.[219] And so did it do in this instant case. As a result, the SDRM never came to fruition. In particular, the United States was concerned that the SDRM proposal would interfere with the contractual claims of its investors and that further; the dispute resolution body to be formed under the SDRM would supersede its domestic courts in restructuring processes.[220]

Another drawback with the IMF's SDRM proposal particularly with respect to developing countries is the huge role that was to be played by the IMF itself.[221] As stated above, the IMF would still retain the powers to determine the debt sustainability of a country and this would

[213] International Monetary Fund (IMF), 'Proposed Features Of A Sovereign Debt Restructuring Mechanism' (2003), 5. <himf.org/external/np/pdr/sdrm/2003/021203.pdf > accessed 14 July 2016.
[214] ibid.
[215] ibid 25.
[216] ibid 28.
[217] ibid 4.
[218] ibid 17. Also see, IMF, 'Articles of Agreement of the International Monetary Fund' (April 2016), Article XXVIII on amendments. <https://www.imf.org/external/pubs/ft/aa/> accessed 14 July 2016.
[219] See IMF, 'IMF Members' Quotas and Voting Power, and IMF Board of Governors' (2016) <https://www.imf.org/external/np/sec/memdir/members.aspx> accessed 14 July 2016.
[220] Sean Hagan, 'Designing a Legal Framework To Restructure Sovereign Debt' (2005) 36 Geo. J. Int'l L. 299, 391.
[221] Ugo Panizza, 'Do We Need a Mechanism for Solving Sovereign Debt Crises? A Rule-Based Discussion' (2013) 3 Graduate Inst. of Int'l Dev. Studies, Working Paper No. 03/2013, 16-17. <http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIDWP03-2013.pdf> accessed 14 July 2016. The author notes: 'Being a creditor itself, the Fund is unlikely to be perceived as an impartial arbiter in a debt restructuring exercise.'

have a bearing on the approval or disapproval of the debt restructuring plan.[222] Further, the IMF would continue availing funds in form of bailouts or loans to countries afflicted by a debt crisis.[223] In addition, the IMF would still house the dispute resolution body to be formed under the SDRM mechanism.[224] The huge role played by the IMF in this whole proposal would be unsettling and inappropriate for developing countries. This is because the IMF decision making organs and voting power is skewed in favour of creditor countries.[225] The possibilities of fairness in such a mechanism would be remote particularly for developing nations which constitute the majority debtors, especially with the exclusion of official bilateral lending from the SDRM mechanism.[226]Moreover, given that the IMF is also a large lender to most developing nations; it is not far-fetched to argue that it would be self-interested in having its loans repaid, to the detriment of debtor countries.[227] Indeed, this study makes the recommendation that an appropriate sovereign debt restructuring framework must not be under the auspices of the IMF or any other affiliated organization.[228]

4.3.2 A Statutory Model Law

A more recent proposal that has been floated, also a statutory approach, is that of a statutory framework, albeit in the form of a model law, as opposed to a convention.[229] Its proponents argue that such a model law would not require general acceptance by members to enable its implementation.[230] Given this advantage, its proponents charge that it is more politically feasible and is likely to garner support among nations compared to a statutory framework in form of a

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[222] This is particularly problematic since whatever is unsustainable debt particularly for developing countries may be different from what the IMF would consider it to be (See Chapter 3 of this paper). This is particularly important when one considers the assymetrical voting power of the IMF which is tilted in favour of developed nations who are usually (or their citizens), the dominant creditors.
[223] International Monetary Fund (IMF), 'Proposed Features Of A Sovereign Debt Restructuring Mechanism' (2003), 26. <*himf.org/external/np/pdr/sdrm/2003/021203.pdf* > accessed 14 July 2016. The problems associated with IMF bailouts particularly within the context of developing countries, were discussed at length in Chapter 3 of this paper.

[224] ibid 28.
[225] See this point elaborately discussed in Nouriel Roubini & Brad Setser, *Bailouts Or Bail-Ins? Responding To Financial Crises In Emerging Markets* (Washington, DC: Institute for International Economics 2004) 375.
[226] Hal S Scott, 'A Bankruptcy Procedure for Sovereign Debtors?' (2003) 37 Int'l Law 103, 126.
[227] ibid.
[228] This particular recommendation is discussed substantively and justified in the final chapter of this paper.
[229] Steven L Schwarcz, 'Sovereign Debt Restructuring: A Model-Law Approach' (2016) Journal of Globalization & Development 1. <*http://scholarship.law.duke.edu/faculty_scholarship/3492*> accessed 14 July 2016.
[230] ibid 11.

treaty or a convention.[231] A model law is simply a suggested legislation that municipal governments may consider while enacting their national legislations.[232] They may either choose to adopt it in *toto* or be guided by it while legislating. It normally acts more as a non-binding recommendation. Though it is non-binding, nations may feel compelled to conform or at least to align their national legislation with the model law, if only to be accepted by the international community if that is the prevailing norm. Model laws are frequently also termed as uniform laws for the very reason that they seek to achieve cross-jurisdictional legal uniformity.[233] This is achieved by countries enacting legislative texts that are similar to the text of the model law. Model laws may operate in an international context, such as the United Nations Commission on International Trade Law (UNICTRAL) Model Law on International Commercial Arbitration, or in a regional or sub-national context like the Uniform Commercial Code in the United States.

According to the Model Law as proposed by Schwarcz, there would be a supervisory authority but which would only be limited to ministerial actions.[234] This would obviate the need for a formal supervisory authority since disputes would be resolved through binding arbitration.[235] This would help deal with the problem of institutional bias that would otherwise ensue, were a dispute resolution body to be set up under the auspices of any of the international organizations. Indeed, Schwarcz cites this as an important advantage of the model law over a convention, which normally requires a formal supervisory body.[236]

Schwarcz predicates the feasibility of his model law on the fact that most sovereign bond contracts at present are governed by either New York law or English law save to the extent where such contracts are governed by the law of the sovereign debtor.[237] As such, so his argument goes, if a nation such as the United States or the United Kingdom or a state such as the New York state were to enact a law based on the model law; that alone would suffice.[238] This is

[231] ibid 7.
[232] ibid 6.
[233] ibid.
[234] ibid 15.
[235] ibid.
[236] ibid.
[237] Schwarcz bases his proposal on the arguments by Setser that most of the sovereign bond contracts are governed by either English law or New York law, and to a limited extent, by Japanese law. See Brad Setser, IPD Task Force on Sovereign Debt brief, 'The Political Economy of the SDRM' (2008), 1-2 <http://www.cfr.org/content/publications/attachments/Setser_IPD_ Debt_SDRM.pdf> accessed 14 July 2016.
[238] Steven L Schwarcz, 'Sovereign Debt Restructuring: A Model-Law Approach' (2016) Journal of Globalization & Development 1, 11. <http://scholarship.law.duke.edu/faculty_scholarship/3492> accessed 14 July 2016.

because either of the national jurisdictions is likely to refrain from preempting such a law since the same would force a sovereign debtor to issue its debts governed by the other nation's law.[239] This would significantly reduce the preemptive nation's law in the world of international finance.[240] At once, one sees the difficulties with this model as proposed by Schwarz. It cannot be assumed that only two nations' laws will continue to dominate the majority of sovereign debt contracts. Some sovereign debtors may choose to issue bonds in their own local laws, especially so as to guard against foreign currency fluctuations, or even as a matter of principle or pride. It further cannot be assumed that any of the nations whose law dominates sovereign bond contracts, will always be bothered about a relegation of its law in the world of international finance, as to prevent it from preempting such a model law.

Another important feature of Schwarcz's proposed model law is the concept of retroactivity, whereby he proposes that the model law would operate backwards as to cover existing debt contracts.[241] He argues for the retroactivity of the model law making the case that it is not proscribed under international law as long as it is not arbitrary or discriminatory in nature.[242] He also takes comfort in the fact that nothing in the English law appears to prohibit the retroactivity of laws, though he notes the difficulty in the United States.[243] Such a retroactive application of the model law as to cover extant debts is sure to face legal challenge in the courts.

In the main, however, the greatest weakness with the Model Law lies in its non-binding nature. Of course, Schwarz anticipates this and in its stead, proffers the argument that a non-binding instrument like a Model Law may be more appealing to nations especially during its experimentation stages, owing to its relaxed nature.[244] He argues that the less formalistic nature of enacting a Model Law as contrasted to a treaty, helps foster open communication and may

[239] ibid 12.
[240] ibid.
[241] ibid. Schwarz latches onto a similar argument by James S Rogers, 'The Impairment of Secured Creditors' Rights in Reorganization: A Study on the Relationship between the Fifth Amendment and The Bankruptcy Clause' (1983) 96 Harv. L. Rev. 973, 1016 who makes the claim that legislatures would want insolvency laws to operate retrospectively, so as to apply to all debts in order to eliminate financial crises.
[242] Steven L Schwarcz, 'Sovereign Debt Restructuring: A Model-Law Approach' (2016) Journal of Globalization & Development 1, 12. <*http://scholarship.law.duke.edu/faculty_scholarship/3492*> accessed 14 July 2016.

[243] ibid 13.
[244] ibid 7.

thus lead to increased success of such a law.[245] However, as noted by Schwarz, model laws may be denounced or amended unilaterally by a nation without causing an infraction of international law.[246] This means that even if a model law were to be developed, a nation may choose to refuse to follow through on its commitments, especially given the international politics that dominate the world of finance. The reduced certainty, (as contrasted with a convention or a treaty), significantly militate on the effectiveness of a model law.

4.3.3 Other Proposals

Other proposals[247] that have been floated have been modifications of the approaches already discussed, and face unique or similar problems and drawbacks,[248] particularly when viewed from a developing nation's perspective. This may be because academics and organizations that have formulated these proposals are westernized and mainly constitute developed nations, who are frequently the creditors. The proposal that comes closest to matching what we consider an appropriate sovereign debt restructuring framework,[249] is the one considered by the United Nations General Assembly in 2014, as a multilateral legal framework.[250] Notably, this proposal was first introduced by Bolivia on behalf of the 77 developing nations, and China.[251] It was, however, prompted and supported by a resolution by Argentina, a middle-income nation that has

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[245] ibid. To shore up this argument, he quotes Westbrook who argues that the UNCITRAL Model Law on International Commercial Arbitration (which has registered considerable success), was structured as a model law rather than as a treaty, due to the prevailing view that the latter would have been much more difficult to achieve. See Jay L Westbrook, 'Creating International Insolvency Law' (1996) 70 Am. Bankr. L.J. 563, 570–571.

[246] ibid 6.

[247] For instance, see R Kunibert, 'Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face' (1990) 18 World Development 301, 310; Christoph G Paulus, 'A Standing Tribunal as a Procedural Solution for Sovereign Debt Restructurings' in Carlos A Primo Barga & Gallina A Vincelette (eds), *Sovereign Debt and the Financial Crisis: Will this Time be Different* (Washington DC: World Bank 2010) 317.

[248] See also, Christoph G Paulus and Ignacio Tirado, 'Sweet and Lowdown: A 'Resolvency' Process and the Eurozone's Crisis Management Framework' (2013) Law and Economics Yearly Review II.2:504–559, 8, 22, 27, 28. The authors propose for a mechanism with resolvency courts that would function as sovereign debt tribunals to facilitate negotiations between debtors and creditors. Sovereign debtors would submit their restructuring plans for consideration and approval to a supermajority of creditors while allowing for financing of the debtor during the restructuring process.

[249] An appropriate framework, as we see it, forms the subject of the last chapter as part of the recommendations.

[250] See, United Nations General Assembly, 'Proposal for Sovereign Debt Restructuring Framework among 6 Draft Texts Approved by Second Committee' (5 December 2014). <http://www.un.org/press/en/2014/gaef3417.doc.htm> accessed 14 July 2016. According to the press release, the General Assembly voted to form an *ad hoc* committee to elaborate on the multilateral legal framework. The Second Committee (Economic and Financial) approved the draft of the text, but with the United States, Japan, Canada and Israel notably voting against it. The European Union, represented by an Italian delegate, insisted that the draft was almost similar to the one they had rejected earlier and would thus not support it. The European Union further added that the proper forum for a discussion on sovereign debt restructuring was the IMF.

[251] ibid. Indeed, not a single developed nation voted for the draft resolution with a majority abstaining from the vote.

borne the brunt of the collective action problem by hedge funds litigating in the United States.[252] The United Nations Conference on Trade and Development (UNCTAD) has since been mandated to propel the task forward.

4.4 Concluding Remarks

This Chapter has examined the various subsisting mechanisms that inform sovereign debt restructurings such as Collective Action Clauses and Exit Consents. It has demonstrated that they are both hardly effective in overcoming the collective action problem and inappropriate for developing countries. The Chapter has also assessed the current *ad hoc* regimes through which restructurings occur and illustrated the difficulties that attend such regimes and the need for an alternative framework. It has further considered the various proposals put forward by practitioners, academics and international organizations on an appropriate restructuring framework, and argued that they are ill-equipped to deal with the unique cases of developing countries. The Chapter has made the finding that the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the IMF and other variant frameworks by scholars such as a Model Law, though merited in particular circumstances, barely take into account the interests of developing countries who constitute the vast proportion of debtors. It has consequently made a case for the development and adoption of a sovereign debt restructuring framework that takes a statutory approach, to help deal with the problem of sovereign debt crises in developing economies.

[252] See generally, Rodrigo Olivares-Caminal, 'Sovereign Bonds: a Critical Analysis of Argentina's Debt Exchange Offer' (2008) J. Banking Regulation 1028. Also see Ugo Panizza, F Sturzenegger & J Zettelmeyer, 'The Economics and Law of Sovereign Debt and Default' (2009) 47 (3) Journal of Economic Literature, 651-698. <*http://people.ucsc.edu/~hutch/Econ241a/Articles/Panizza_Econ%26Law_SoverignDebt_JEL2009.pdf*> accessed 15 July 2016. The authors recount the attempts made by Argentinian creditors to recover their claims including seeking to attach the representation office of the province of Buenos Aires in New York, U.S accounts of a postal service, diplomatic premises, and Central Bank of Argentina reserves held in New York, among other measures.

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This study has made a case for the adoption of an appropriate global sovereign debt restructuring framework that takes into account the interests of developing countries. It has revealed that absent such a framework, debt crises are bound to persist thereby harming the most vulnerable in developing countries. It has also argued that a continued debt crisis absent a restructuring harms not only the debtor country but also creditors; as the former are usually unable to overcome a crisis while the latter do not get the monies lent. The study has further argued that concerns about unsustainability of debts giving rise to the need for restructuring are grounded on various theories, both moralistic and economic, not least of which include the virtue ethics theory, the creditor's bargain theory and the global justice theory. In chapter 3, the paper demonstrated the difficulties that citizens of developing countries in debt crises, have to surmount. The paper also assessed the extant informal and *ad hoc* regimes governing debt restructuring and demonstrated their inadequacies particularly from the perspective of developing countries. It illustrated the various efforts taken and the various options explored in a bid to have a restructuring framework in place. The paper also made the claim that the urgency of such a framework is even more pressing, when one considers the increasing uptake of debt of varied nature by developing nations. In light of the foregoing, this paper proposes a global sovereign debt restructuring legal framework that we consider appropriate, from a developing countries' perspective.

5.2 Proposed Sovereign Debt Restructuring Framework

We propose a statutory sovereign debt restructuring framework in the form of a convention or a treaty that should be under the auspices of the United Nations. The reason for housing the convention under the United Nations is because the body is composed of virtually all countries

of the world in addition to having more neutrality than other bodies such as the IMF. More importantly, members at the UN have a single vote; their economic or military superiority notwithstanding. This will give all countries, debtors and creditors, an equal power thus giving effect to the legal fiction of equality of States and serving to ensure that the interests of developing countries are taken care of. On the other hand, we prefer a convention or a treaty as opposed to a model law due to its binding nature. While there are still problems with enforcement of international obligations emanating from an international treaty, being a common difficulty in international law, a country may comply for fear of being isolated in the international arena or merely for purposes of comity.

The convention should provide that all forms of external debt extended to sovereigns shall be covered by the convention. The convention ought to have a clause that provides for the invocation of the treaty either by a creditor or a debtor, whenever debts become unsustainable. However, in order to avoid an abuse of this clause by opportunistic sovereign debtors, the convention should further provide that the triggering of the invocation clause will be subject to the approval by more than half of the members of the United Nations General Assembly (UNGA). We do not propose any court or tribunal to hear disputes arising therefrom, as this may present complexities in terms of the constitution of such tribunal and present an opportunity for abuse. The UN General Assembly (UNGA) will mainly be limited to ministerial functions. Further, given the difficulties faced by developing countries, the convention ought to provide that whatever may be defined as ‘unsustainable debt’ will be a question of fact in each case, to be determined through a vote by members upon an invocation of the convention. This is due to the difficulties of delineating whatever constitutes unsustainable debt for each country. It is however, proposed that the convention clarifies that unsustainable debt is not necessarily akin to a country

going bust, but it should mean when a country is unable to provide essential services due to debt servicing.

Moreover, it is proposed that the convention operates largely in similar ways to domestic insolvency legal frameworks. By this we mean that, following the successful invocation of the convention, there ought to be a moratorium on all payments to all creditors. Similarly, it must provide that the successful invocation of the convention puts an automatic stay on litigation by any creditors in any jurisdiction to enable the restructuring. Further, in light of the fact that a country undergoing a restructuring due to debt distress is normally in financial difficulties, the convention ought to provide for funding to such a debtor. It should be expressly provided that the IMF will continue to grant funds necessary to enable a debtor to restructure its debts. The IMF should be given a priority repayment claim in the convention, so as to facilitate its granting of interim funds during the restructuring process. However, the limits as to the amounts to be granted should be the preserve of a vote at the United Nations General Assembly to avoid over lending which would exacerbate the debt problem of such sovereign debtor.

5.3 The Political Economy of the Proposed Framework

5.3.1 Political Viability

Achieving the proposed statutory framework will not be without challenges. As evidenced during the discussions on the adoption of a Resolution on principles to govern sovereign debt restructuring, powerful developed countries are always reluctant of any change of *status quo*. The adoption of the convention as proposed will require international consensus building around the issue, which can be quite difficult.[253] At the moment, the international financial system is

[253253] Brad Setser, 'The Political Economy of the SDRM1-2' (3 Jan 2008) IPD Taskforce on Sovereign Debt Brief, 3.

creditor-driven, meaning that developed countries who are mainly creditors determine the rules. By doing this, they encourage creditor countries and other private creditors to overburden poor developing countries with unsustainable debts. Developing and Least Developed Countries (LDCs) cannot achieve their sustainable development goals or make any meaningful economic development if the financial system remains as it is. A fairer international financial system informed by a sovereign debt restructuring framework as herein proposed, is not only sure to reduce moral hazard on the part of creditors which leads to reckless lending, but will also ensure that debtors only take up sustainable debt. Again, it is an expression of sovereignty when a country is able to determine its macroeconomic policies including restructuring its debts.

In light of the radical changes that the framework proposes to cause, we have no illusions that the process is likely to be arduous. Discussions must begin from the premise that debt sustainability of all countries is central to their continued socio-economic development. Where countries are forced to service debt to an extent of being unable to provide essential services to its people, there cannot be said to be any socio-economic development. In order to achieve the post-2015 development agenda; debt sustainability must be properly considered. Developing countries constitute the larger number of members of the UN thus presenting an opportunity for voting in of such a convention, since each member has a single vote. This will however, only be feasible if developing countries act tactfully to bring such a draft convention for debate and consequent adoption. It would also help if they took it in their stead to reach out to some developed countries with a view to garnering their support.

There is also a likelihood that the proposed framework may be politically feasible given that it will remove the burden of bailing out financially distressed states from the IMF, which employs

monies contributed by countries (particularly developed countries) in such exercises.[254] Interconnected to this, the reduction in IMF bailouts is likely to get political support as it enhances sovereignty of nations by helping them avoid the conditionality that comes with IMF grants that influence these countries' economic policies.[255]

5.3.2 Economic Viability

The economic viability of the proposed restructuring framework invariably falls on the attendant costs and benefits of its adoption. Of course, a sovereign that is able to restructure its debts is normally able to borrow in the market at more attractive terms, for the simple reason that creditors are more assured of repayment.[256] The same situation obtains for restructured corporates that are able to borrow at more attractive rates.[257] Indeed, economists have argued that the absence of a restructuring framework actually increases borrowing costs.[258] Further, when viewed in a broader context, even if we were to assume that indeed restructuring raises the borrowing costs, the costs in saving that emanate from such a process internalize any such increases in borrowing costs.

On the other hand, viewed from the perspective of creditors, the reduced uncertainty as to payments that subsists in the absence of a restructuring framework would be an incentive for the adoption of the framework.[259]

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[254] ibid.
[255] See this point comprehensively discussed in Chapter 3 of this paper. Also see generally, A Jayadev & M Konczal, 'The Boom Not The Slump: The Right Time For Austerity' (2010) Economics Faculty Publication Series Paper 26.
[256] This is due to the reduced debt-equity ratio as a result of the restructuring.
[257] Steven L Schwarcz, 'Sovereign Debt Restructuring Options: An Analytical Comparison' (2012) 2 Harvard Business Law Review 95, 110-111.
[258] J Stiglitz, M Guzman, D Lombardi, JA Ocampo & J Svejnar, 'Frameworks for Sovereign Debt Restructuring' (Nov 2014) IPD-CIGI-CGEG Policy Brief - Policy Brief, Columbia University, 1. <https://www.cigionline.org/sites/default/files/sovereign_debt_restructuring.pdf > accessed 02 August 2016.
[259] ibid.

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