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Why a United Nations sovereign debt restructuring framework is key to implementing the post-2015 sustainable development agenda

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Executive summary

In September, the United Nations will agree on the sustainable development goals (SDGs), a new set of targets that will shape the international development agenda for the next 15 years. The restructuring of sovereign debt has been identified by the United Nations Open Working Group (OWG) as something the world must get right if it is to successfully implement these goals. Yet crippling national debt crises persist, and no system exists to restructure these debts in a speedy and effective manner.

A new opportunity to tackle this situation emerged in September last year, when the UN General Assembly voted in favour of a new debt restructuring mechanism. An ad hoc committee was set up and began meeting in February 2015.

Success now depends on the constructive engagement of all nations and the subsequent implementation of a new way to restructure debt that takes development needs into account. Yet several powerful nations are so far refusing to take part in this crucial process.

This briefing looks at how vulnerable many developed and developing countries remain to debt crises. It explores the impact of these crises and of long-term unsustainable debt; and it examines the deficiencies of existing mechanisms to deal with debt, while recommending a way forward.

This briefing finds that:

- **Developed and developing countries are facing an increasing risk of sovereign debt crises.** Public debt levels in several developed countries are historically high and austerity policies have not improved the situation. Meanwhile, developing countries are borrowing from increasingly risky and more expensive sources.

- **Acute debt crises and the economic recessions they have caused have devastating effects on the implementation of development goals**, and can even undo past progress.

- **There are currently no institutions to manage debt crises effectively.** Existing forums are fragmented, which makes negotiations difficult. Many, such as the International Monetary Fund (IMF), are dominated by creditors so cannot make impartial decisions and lack legitimacy.

- **Current UN-led negotiations about a multilateral framework to restructure these debts offer a unique opportunity.** It would be inclusive and could mitigate the negative social and economic consequences of debt crises.

Eurodad recommends that the international community seizes the opportunity created by the current negotiations at the UN to develop an international debt restructuring mechanism along criteria presented in this briefing. The UN General Assembly should adopt those criteria and organise negotiations at the UN to set up the multilateral mechanism.

Introduction

In the development community, 2015 is and will be dominated by three major processes. First, the third International Conference on Financing for Development (FfD), which will be held in Addis Ababa, Ethiopia, in July. Its outcome should support and contribute to the implementation of the Sustainable Development Goals (SDGs), and to a more effective and democratic international financial architecture. Second, the United Nations General Assembly (UNGA)will adopt the new SDGs, which will succeed the current Millennium Development Goals (MDGs), in September. Third, the United Nations Climate Change Conference (COP21) will take place in Paris in December. The aim of the conference is to adopt a legally binding and universal agreement on climate.

At the first FfD Conference, in Monterrey in 2002, developed and developing countries made a series of agreements. The Monterrey Consensus[1] called for the creation of an "international debt workout mechanism [...] that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner".

Due to the fact that this agreed action was not implemented, however, the question remains open in the international development agenda. The Open Working Group on Sustainable Development Goals (OWG) has, during a session discussing the implementation means of the SDGs, stated that "developed and developing countries alike would benefit from a permanent and effective sovereign debt workout mechanism to resolve their debt problems".[2] This implies that the implementation of the agreement made in Monterrey regarding the sovereign debt workout mechanism is clearly part of the discussion around the post-2015 agenda and its means of implementation.

In September 2014, the United Nations (UN) adopted a resolution that aimed to establish a "multilateral legal framework for sovereign debt restructuring processes".[3] In this resolution, the UNGA notes two different problems. First, debt crises are recurring and have significant political, economic and social consequences, provoking frequent restructuring processes. Second, there are a number of low- and middle-income countries that suffer from the burden of their external debts, which in turn impacts on their capacity to develop in a sustainable way. In consequence, and through this resolution, the UNGA decided to establish a multilateral framework for sovereign debt restructuring processes.

This resolution means that the UNGA has a mandate to develop and eventually adopt a proposal that would implement the international commitment made at the Monterrey Consensus. This is a unique opportunity that should be recognised by the international community.

This Eurodad briefing presents the main reasons why we need to fill the 'gaping hole' in the international financial architecture through a multilateral framework for sovereign debt restructuring – a framework that is fair, effective, and finds sustainable solutions to debt crises.

The first chapter describes how debt vulnerabilities around the world are increasing, and a new wave of debt crises is imminent – a wave for which the international community is currently not well prepared. The second chapter points out the harmful impact of debt crises, their negative development impact, the economic disruption they cause, and also the humanitarian crises that affect the poorest and most vulnerable people most. Debt crises could be avoided, or at least mitigated, if better institutions were in place. The third chapter analyses the shortcomings of the current non-regime that should be addressed by the UN's regime-building process. The fourth chapter outlines the key features that a new development-friendly debt workout mechanism should have through a series of recommendations.

The UNGA process is a key opportunity for the international community to implement the necessary reforms. Its successful conclusion, which also depends on the constructive participation of all UN Member States, is fundamental for the successful implementation of the whole post-2015 development agenda.

1 Debt vulnerabilities[4]

In recent years, the focus on sovereign debt vulnerabilities has shifted from developing to advanced economies where, according to the IMF World Economic Outlook Database, the ratio of public debt to Gross Domestic Product (GDP) averaged 105% in 2013. Although the financial crisis of 2007 has not led to major debt defaults and restructurings, with the exception of Greece and a number of mostly small island states, sovereign debt levels in many developed and developing countries should be considered as unsustainable. A rise in interest rates may provoke a new cycle of defaults and restructurings.

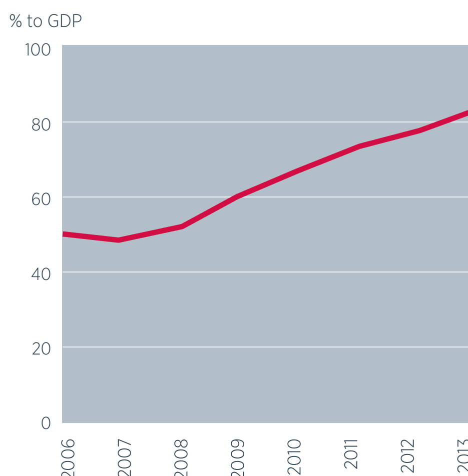
Debt vulnerabilities in some developed countries

This is particularly the case in high-income countries where the combination of several factors makes their debt sustainability questionable. Public debt levels have surged dramatically. In particular, the bailout of private banks in advanced economies has been extremely costly for the public purse, leading to the massive socialisation of private debts and surging sovereign debt levels. The European Commission reports that between 1 October 2008 and 1 October 2011, it approved state aid from EU Member States for a total amount of €4.5 trillion (36.7% of EU GDP).[5]

European countries have decided to adopt austerity policies to reduce their public debts. However, this strategy has been ineffective. By weakening economic growth, austerity policies have not improved the debt ratio of European countries (see Figure 1). The consequences of these policies on the economic output in Europe has actually had negative results for their debt sustainability. Greece illustrates this failure very well. Since 2010 and the beginning of a drastic austerity policy, GDP continued to considerably decrease and the public debt to GDP ratio to increase (from 130% in 2009 to 175% in 2013, despite the 2012 restructuring).[6] Economic recessions and low inflation rates have also perpetuated the high ratios of debt in the private sector, which have become a main constraining factor for financing new investments that could trigger an economic recovery.[7]

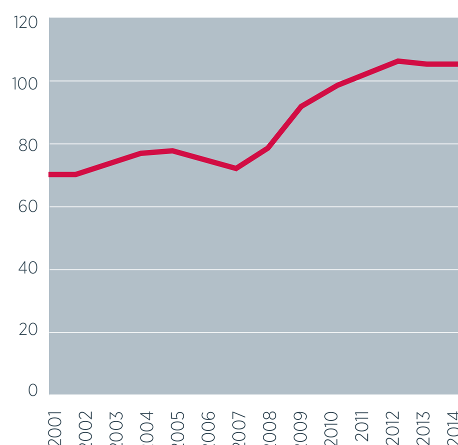
The combination of private sector bailouts and austerity policies has brought the public debt of some advanced economies to levels rarely seen in recent history (Figure 2). These levels could rise even further in the near future. Contingent liabilities, particularly from the financial sector, could further affect public debt levels. Contingent liabilities are private debts that affect public finances through explicit or implicit public guarantees, as in the recent example of bank bailouts. In this context, European countries have offered guarantees to failed banks that may be used in the future as the European financial sector has still not fully recovered from the crisis.

Figure 1: Eurozone average public debt (% to GDP, 2006-2013)



Source: IMF, World Economic Outlook Database

Figure 2: Advanced economies' average public debt (% to GDP, 2001-2014)



Source: IMF, World Economic Outlook Database

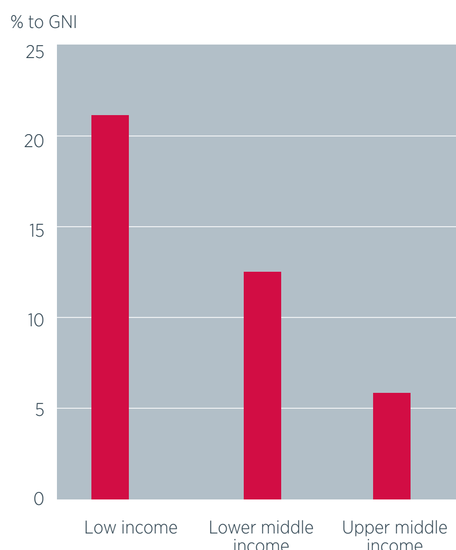
When some members of the Eurozone started to suffer from distress on debt markets, their creditors were bailout. However, bailouts in Cyprus, Greece, Ireland and Portugal cannot be reproduced in larger economies, as existing EU and IMF bailout instruments do not have the capacity to cope with a debt crisis in a major European economy. Considering this, if debt becomes considered as unsustainable, policy-makers will have few options but debt restructurings with private sector involvement. This would be a significant development since restructuring debt has so far been the exception in the Eurozone, debt-refinancing through bailouts being privileged over debt-solving through restructuring.

Debt in developing countries

Debt sustainability

Compared to advanced economies, the level of sovereign debt to Gross National Income (GNI) in middle- and low-income countries appear low. The World Bank database *International Debt Statistics* reveals that debt to GNI ratio in developing countries averaged 22% in 2012. However, the situation differs among countries, notably regarding external debt. Low-income countries are far more dependent on external debts than middle-income countries (Figure 3).

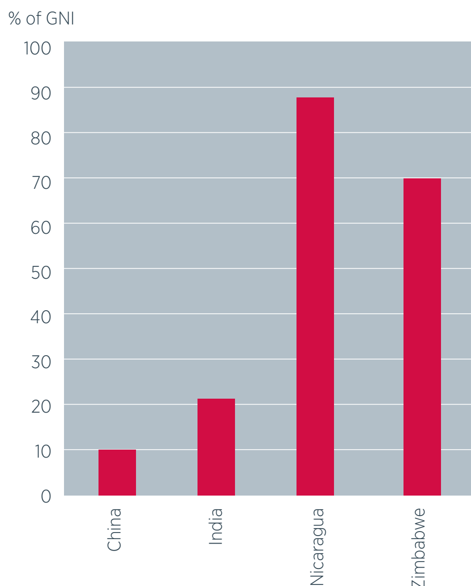
Figure 3: External public debt stock (% to GNI, 2012)



Source: World Bank International Debt Statistics

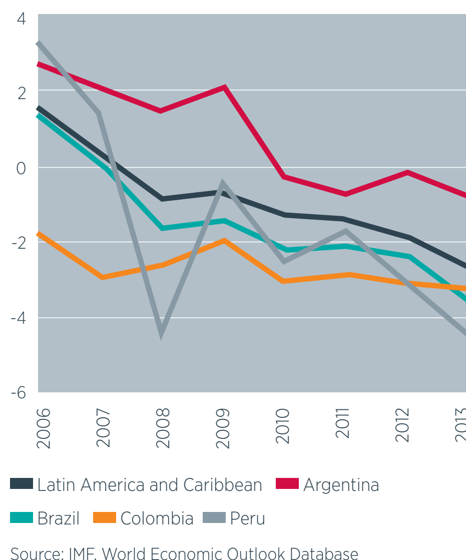
These aggregates do not reflect important differences between individual countries. Figure 4 (overleaf) illustrates this. Two of the biggest emerging countries (India and China) have very low external debt stocks (compared with GNI) driving down the aggregate level of middle income countries. At the same time, smaller countries (high and middle income) like Zimbabwe and Nicaragua continue to suffer from high debt burdens. Nicaragua and Zimbabwe are just two examples of developing countries that far exceed the levels seen as sustainable by the IMF and World Bank's Debt Sustainability Framework.

Figure 4: Selected countries' total external debt stocks (in % of GNI, 2013)



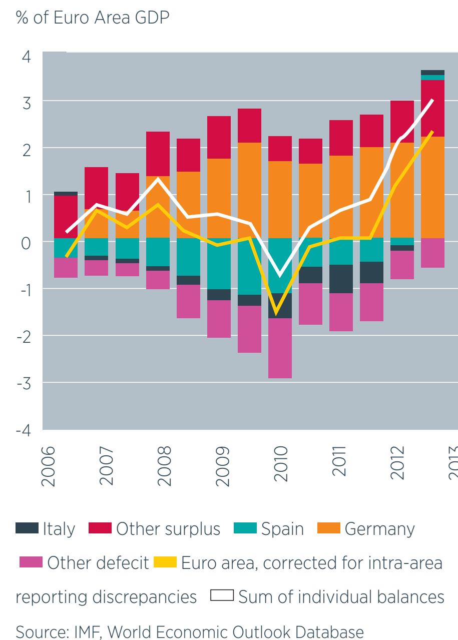
Source: World Bank International Debt Statistics

Figure 5: Current account balance – Latin America selected countries (2006-2013)



Source: IMF, World Economic Outlook Database

Figure 6: Current account imbalances – Euro Area (2001-2013)



Source: IMF, World Economic Outlook Database

Debt cost in low-income countries

Developing countries often have higher borrowing costs, and need to mobilise foreign currency to pay off external debt, which is why the costs of debt servicing are crucial to analysing their debt sustainability. Some countries are already dedicating a very large share of government revenues towards debt servicing (Jamaica: 28.2%; Panama: 17.7%; Tunisia: 15%; Ivory Coast: 18%; Sri Lanka: 21.9%).[8]

Debt servicing costs are expected to rise further. Jubilee UK has recently produced research analysing 43 developing countries.[9] This research shows that the proportion of government revenues dedicated to debt repayments will grow in the coming years. The study shows that 11 to 29 countries, according to the economic growth scenario, will face significant increases in debt payments. The average debt payment as a percentage of government revenues in the 43 countries will increase between 85% and 250%, depending on economic growth and frequency and extent of economic shock.

Following these trends, debt service will absorb more and more public resources in developing countries, reducing the funds available for the new SDGs. This is why debt restructuring is part of the discussion of the SDGs' means of implementation.

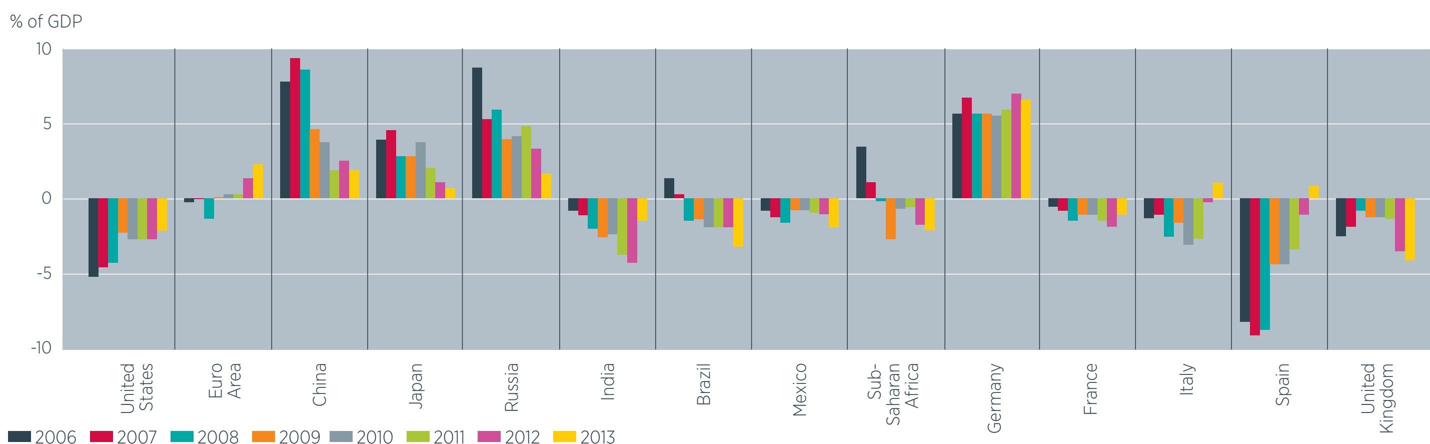
Current account balance: persistent imbalance

As well as the increasing risk of sovereign debt crises, there are also risks for balance of payment crises that arise from persistent trade imbalances, meaning that deficit countries need to attract foreign capital through investments or external borrowing, increasing their external debt. Recently, the US, India and Euro-area deficit countries have narrowed down their trade deficits (Spain and Italy are now running a trade surplus), while China and Japan have reduced their surplus. On the other hand, some other countries have widened their surplus (Germany, the Netherlands and Korea) or their deficits (Brazil, Mexico and UK).

Some developing countries are suffering from the effects of falling commodity prices. This is particularly the case in Latin America, where the drop of commodity prices[10] created trade gaps in important commodity exporters like Colombia, Peru, Argentina and Brazil.

In the absence of an efficient mechanism to correct trade imbalances, surplus countries have little incentive to adjust by increasing their imports. This is particularly notable in the context of the Eurozone. Demand compression and price adjustments in the zone's periphery reduced their deficits while countries like Germany and the Netherlands have continued to increase their surpluses.

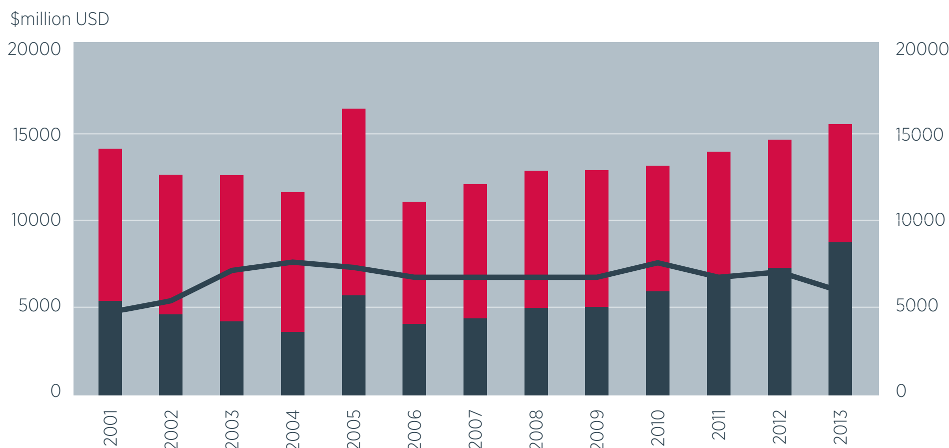
Figure 7: Current account balance (2006-2013)



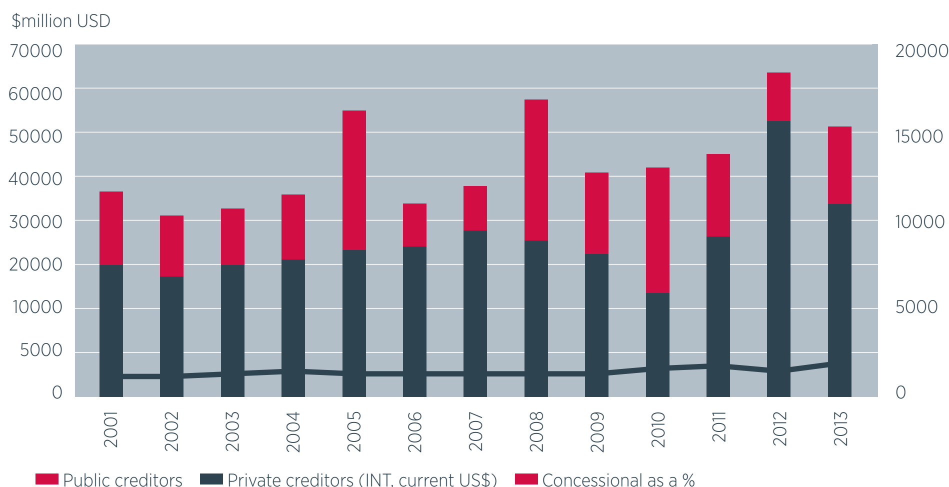
Source: IMF

Figure 8: Interest payments by lower and upper middle-income countries (In million USD, 2006-2013)

Lower-middle income countries



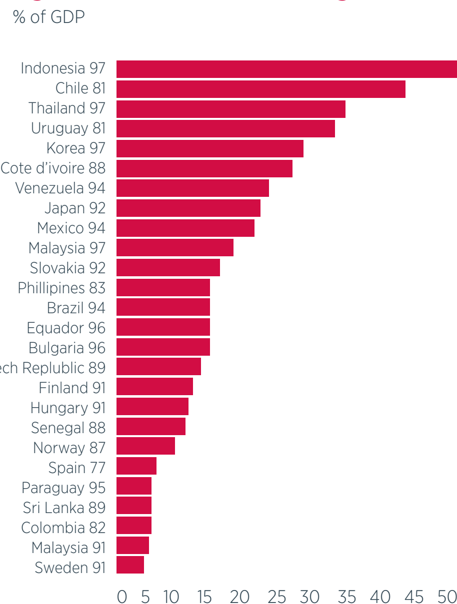
Upper-middle income countries



Source: World Bank International Debt Statistics

Figure 9: Fiscal costs of banking crises

% of GDP



Source: World Bank[11]

Consequently, the Eurozone now collectively runs a trade surplus that is negatively affecting the EU's trade partners.

Composition of sovereign debt: increasing share of private sector

Another trend that affects the debt sustainability of developing countries is the composition of sovereign debt, particularly in middle-income countries. From this perspective, it is noticeable that, in parallel to the decreasing rate of concessional loans, lower middle-income countries are contracting an increasing share of their debt from private creditors. In upper middle-income countries, the share of private sector credit already makes up by far the majority of public debt.

The increasing share of borrowing from private sources in lower-middle income countries has financial implications. Table 1 shows that the cost of private borrowing increases as the average loan's interest becomes higher. The average maturity of private loans is smaller, which is riskier for

Table 1: Average terms of new commitments of lower-middle income countries (2010-2013), World Bank

	2010	2011	2012	2013
Interest (%)				
Official creditors	1.9	1.6	1.7	1.4
Private creditors	4.6	4.6	4.6	2.9
Maturity (years)				
Official creditors	45.0	25.5	20.5	22.8
Private creditors	11.5	11.3	12.4	8.6

countries that will need to refinance their debt.

Given the exceptionally low levels of interest rates in recent times, the consequences of increased borrowing from the private sector have not been properly taken into account. On the contrary, middle-income countries have used this particular context to increase their borrowing. However, interest rates will not stay that low forever. Their eventual increase will have dramatic costs for many countries. Concretely, middle-income countries will need to generate and use more income to pay off similar large nominal debts. Their debt sustainability will therefore be affected as they turn to private sources of lending.

Contingent liabilities

Finally, sovereign debt sustainability could be eroded through contingent liabilities (see definition above). Recently, many European countries have been affected by contingent liabilities when bailing out private banks (see above). However, this is also the case in developing countries, which have been deeply affected in the past by contingent liabilities arising from banking crises. Figure 9 shows that, overall, governments spend a significant share of GDP on cleaning up financial systems when facing a banking crisis. On average, the countries in Figure 9 have spent 12.8% of GDP to avoid the collapse of their banking systems. Costs of bank bailouts can reach up to 50% of GDP.

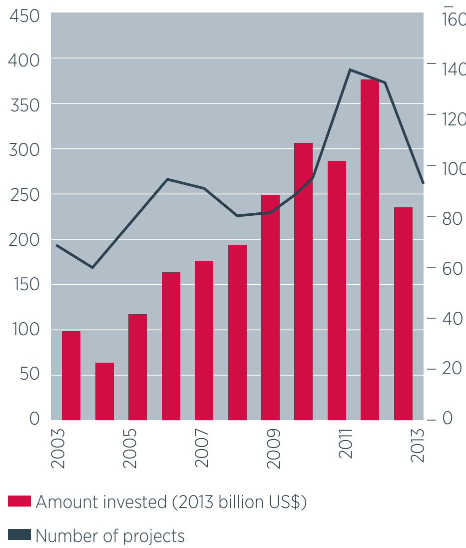
Although developing countries may also be affected by contingent liabilities from the banking sector, an additional concern currently comes from public-private partnerships (PPPs). PPPs are increasingly used across all regions of the world and most notably in middle-income countries. PPPs may play an even bigger role in the future as their promotion plays a key role in ongoing discussions on Financing for Development.[12] Pushed mainly by developed

countries,[13] PPPs are also playing an increasing role in the development agenda. They are viewed as a key feature of SDG implementation. This is particularly the case for infrastructure where many countries see PPPs as the best way to finance the huge needs faced by the developing world.

Although increasing globally, investments through PPPs are unevenly distributed. Latin America and South Asia are the regions where most PPPs are taking place. However, considering the increasing focus on the private sector's role in development finance and in particular PPPs, other regions may well follow this trend over the coming years.

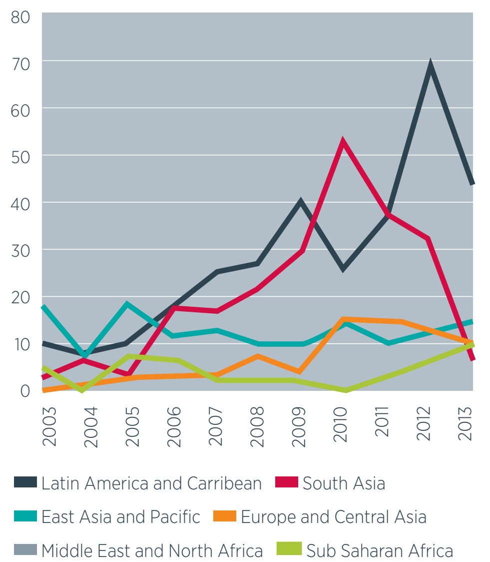
PPPs are a source of concern for debt sustainability because of typical unbalanced risks sharing that often includes revenue guarantees for the private investors, guaranteed by the public partner, with potentially high costs for the public purse over long periods of time.[15]

Figure 10: Investment commitments through PPPs and number of projects in the developing world (2003-2013)[14]



Source: Private participation in Infrastructure Projects Database (* Adjusted by US CPI)

Figure 11: Investment commitments through PPPs by region, $billion USD (2003-2013)

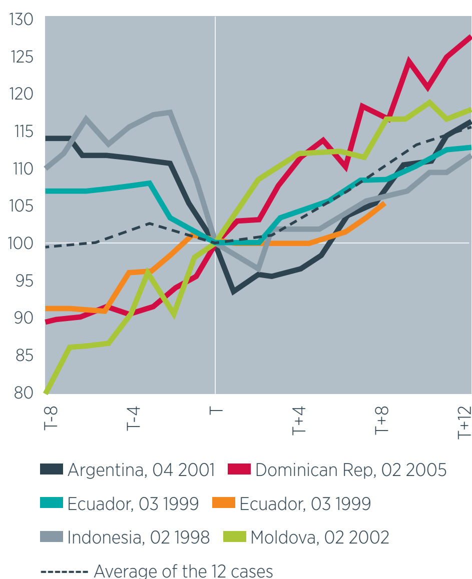


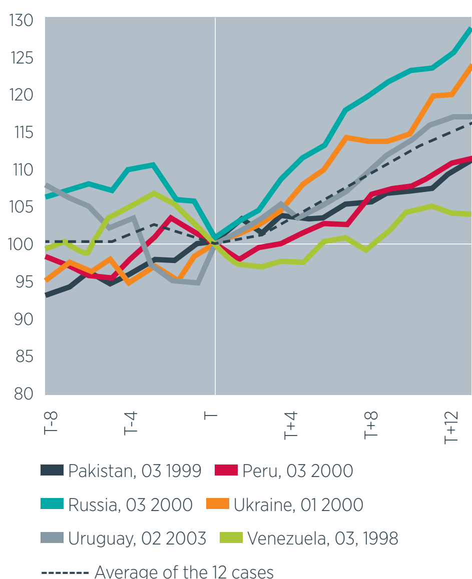
Source: Private participation in Infrastructure Projects Database (*adjusted by US CPI)

2 The impact of debt crises and unsustainable debt on social and economic development

Sovereign debt can undermine the sustainable development of a country in two different ways. First, debt crises can provoke economic recessions and humanitarian crises. Second, debt overhang – when the debt stock of a country exceeds its future capacity to repay it, making its debt unsustainable – can force goverments to dedicate a very large share of their revenues to debt services at the expense of public investments in favour of development.

Figure 12: Quarterly GDP developments before and after twelve public debt defaults or restructurings during the past 15 years (quarter of restructuring = 100, at constant prices)





Source: These figures are reproductions from Zsolt Darvas (Bruegel) (2011) Debt Restructuring in the euro area: A necessary but manageable evil?

Figure 12 shows 12 countries that restructured their debt and managed to overcome economic slowdown and return to high growth rates. This figure, produced by Bruegel,[16] shows that GDP was on average 17% higher three years after the default and restructuring. According to Bruegel, several factors explain these positive results and in particular the return of domestic confidence.

Due to the absence of an efficient, fair and transparent debt workout mechanism, countries tend to restructure their unsustainable debts too late, which implies they undergo several years of recession before the unavoidable debt restructuring process is conducted. A better mechanism that allows for timely and speedy debt restructurings would prevent the social and economic disasters created by both debt crises and unsustainable debt.

Debt crises, bailouts and austerity policies

A sovereign debt crisis occurs when a country faces significant difficulties in repaying its debts as a result of difficult access to capital markets. Unable to pay back its creditors, the government must choose between the default of its debt, its restructuring or receiving a mostly IMF-funded bailout and the austerity conditionalities that the IMF attaches to bailout loans in order to free up public resources or debt repayments in borrower countries.[17]

In the absence of efficient debt restructuring mechanisms, and given the reluctance of governments to default on their debt, the latter option is the most commonly used. However, in this situation, debt crises last longer, are economically more disruptive, and are more costly for all parties involved. Moreover, countries that have been bailed out are forced to adopt austerity measures and economic reforms through conditionalities. Their objective is to reduce their public debt by cutting their public expenses and raising their taxes. Austerity policies have been a feature of International Financial Institutions' (IFIs) lending programmes for a long time in developing countries. Since 2010, however, developed countries have also been affected by these policies.

Austerity policies have a negative impact on economic recovery, as the reduction of public expenses and tax increases reduce the economic output and therefore lower tax revenues and increase spending on benefits. The result is slower economic

Box 1: Greece[20]

The adoption of the Euro led to credit-driven growth in Greece in the early 2000s, thanks to massive lending by European banks. The government borrowed heavily to finance its defence budget and the organisation of the Olympic Games in 2004. Lending increased after 2008, with European governments lending massively to the government seeking to cope with lower tax revenues. Creditors began to lose confidence in Greece's ability to pay back those loans in 2010. Interest rates then started to increase and Greece was eventually bailed out in 2010 by the Troika of the EU, the European Central Bank (ECB) and the IMF. This bailout served to pay back the banks and increased the country's public debt. In addition, severe austerity measures were imposed in exchange for the €110 billion bailout. Economic recession and employment increased to levels that creditors did not predict. Greece has lost around 29% of its GDP between 2008 and 2014. Unemployment rose from 10% in 2009 to 25.7% in 2014 and has almost reached 50% for people under the age of 25.[21] Unemployment benefit allowances have been reduced by 22% and benefits are payable for one year only, after which recipients also lose access to free health care.

The situation in Greece has led to an increase in the number of homeless people, depression and suicides. Many people have lost access to health services. A report prepared by *Médecins du Monde* explains that, since October 2010, public hospitals have been imposing entrance fees and further examinations also need to be paid for. This excludes many people, despite the theoretical universal nature of the Greek public healthcare system. In addition, many hospitals lack staff, basic equipment and supplies. Pharmacies also lack supplies and require their patients to pay upfront. Children are losing access to vaccinations. The situation is worse for vulnerable groups such as asylum seekers, undocumented migrants, drug users, sex workers and homeless people. The report states that austerity policies seem likely to "exacerbate the general collapse of the health system".[22]

growth (or recession) and higher public deficit. Economic recession affects the level of employment, which in turn creates new conditions of poverty. Greece is a good example of this scenario, as its economy lost around 29% of its GDP since the beginning of the debt crisis. 25% of its population is unemployed (see Box 1).

Reduction of public expenses usually forces countries to undertake cuts in social services, affecting the poor who rely on free or subsidised social services more than others. In the absence of debt restructuring mechanisms, debt distressed countries are usually forced to make such cuts to avoid default.

In addition to the decrease in public expenditure, bailout loans often come with the conditionality of undertaking tax reforms. Eurodad found that the IMF often pushes countries to introduce or increase regressive taxes such as consumer taxes, and most notably their VAT[18]. As a flat tax, this puts relatively more burden on the poor, aggravating their situation even further.[19]

Finally, the conditions attached to bailout programmes often include privatisation programmes. Typically, the ownership or management of public utilities or services in sectors such as water, electricity, health care and education are privatised as a result of bailout programmes. This turns formerly public services such as health or education into user-fee-financed private services, often with the end result of excluding poor people from access.

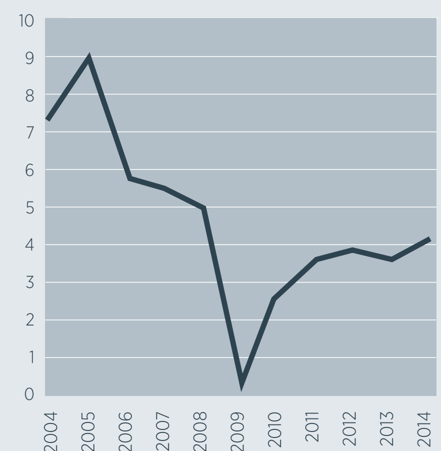
Debt overhang

Debt overhang describes a situation in which a country has not lost access to capital markets and is still able to face its obligations. However, to do so requires resources so vast that its capacity to invest in its development is dramatically reduced. This is why we speak of unsustainable debt. The UN Independent Expert on the effect of foreign debt on human rights reports, for example, that in 2005 Lebanon spent 52% of its budget on debt service and only 23.1% on health and education.[23] Because of their very negative impacts on the ability to finance sustainable development, debt overhangs are a problem that also need to be addressed by new debt restructuring mechanisms, despite the absence of any immediate risk of default. The financing needs of the sustainable development agenda need to be taken into account in the definition of debt sustainability, and in the design of debt restructuring mechanisms.

Box 2: Pakistan[24]

With 180 million inhabitants – 57% of whom live on less than $2 a day[25] – Pakistan is facing a severe debt overhang. This situation has led to the adoption of regressive tax reform, privatisation, unemployment, pay freezes, as well as cuts and disinvestment from public services. In 2008-2010, the IMF imposed a series of conditions attached to its loans (Stand-By Arrangement), which included cuts in public spending, tax reform and phasing out of energy subsidies. Pakistan's economic performance continued to deteriorate. Pakistan now pays out more than half of what it spends on health and education combined on debt service. As a result, the public health system has deteriorated, leaving few options to those who cannot afford private health care. According to the study, around half the population now do not have access to sufficient food.

Figure 13: GDP growth in Pakistan (2004-2014, constant prices, %)



Source: IMF, World Economic Outlook Database

3 Problems with current mechanisms to deal with sovereign debt crises and unsustainable debt

Debt crises and debt overhang are frequent and have disastrous social, political and economic impacts. However, there is no international mechanism that is able to solve those situations efficiently. The development of a mechanism allowing timely, efficient and comprehensive treatment of sovereign debt restructurings is crucial to prevent future crises and their disastrous social and economic impacts.

Debt crisis

The global financial crisis and the resulting debt crises in developed countries, as well as the recent legal disputes between Argentina and hedge funds, have highlighted the gaps in international architecture to deal with these issues. In particular, we have seen how the current architecture is fragmented, lacks legitimacy and is ineffective. The situation in Argentina (see Box 3) is far from unique, however. There are dozens of lawsuits intended by vulture funds against sovereign states. Some of those cases are still pending but many have reached a conclusion, often at the expense of the sovereign state. The Republic of Congo, Nicaragua, Peru and Zambia are some examples of poor countries that have fallen victim to the absence of an international framework to deal with debt restructuring.[26]

Fragmentation

Institutions like the Paris Club - an informal group of officials from creditor countries whose role is to find solutions to the payment difficulties experienced by debtor countries - only address specific shares of loans and are therefore unable to proceed to comprehensive debt restructurings. The fragmentation of fora that organise debt restructurings hinders fair and coherent debt workouts. In particular, it is more difficult to establish comparable treatment of creditors if the debtors have to negotiate with them separately. This facilitates the behaviour of holdouts (see Box 3 on vulture funds). Consequently, debtors have more difficulty in convincing their creditors to agree on a debt restructuring.

Table 2 illustrates the fragmentation of fora that are currently charged with negotiating sovereign debt. It also shows that for several debt instruments, forums are nonexistent or creditor-driven.

This situation is advantageous to some creditors. There is currently no impartial institution that would be in a position to force creditors to accept a debt restructuring. In those conditions, creditors maintain a strong position reinforced by IMF bailouts that limit risks of default. This brings us to the question of legitimacy.

Legitimacy

Creditor institutions, and in particular the IMF, have a crucial role to play when dealing with debt crises. They are, however, not impartial in their decisions, since they are judges and creditors at the same time, looking to get reimbursements from debtor states. That is why the IMF is not in a good position to deal fairly with debt workouts. The Paris Club is another example of a mechanism that lacks

Table 2: Fragmentation of fora organising debt restructurings

Creditor	Private		Public				
Instrument	Credits	Bonds	Bilateral ODA , Member of Club	Bilateral ODA, not Member of Club	Bilateral Commercial, Member of Club	Bilateral Commercial, not Member of Club	Multilateral
Forum of negotiation	London Club	Exchange Offer	Paris Club	No forum	Paris Club	No forum	No forum

Box 3: Vulture funds

The shortcomings of the current international architecture to deal with debt crises was recently highlighted by a decision of a US-based judge that may jeopardise the recent restructuring of Argentina's debt. In 2012, Judge Griesa from the New York Second Circuit Court decided to freeze funds transferred from Argentina to its creditors unless creditors who refused the debt restructuring – known as holdouts – were paid as well. This decision may jeopardise the restructuring of Argentina's public debt, started in 2005 after its 2001 default.[27]

This is the latest decision with international implications with regards to the strategy of so-called 'vulture funds'. Vulture funds are speculative investment funds. They are called 'vultures' because of their practice of buying the debt of distressed countries that are in default – or likely to default soon – at a very low price and then forcing the countries, through lawsuits, to repay the original debt with interest, penalties and legal fees. When the courts rule in their favour, vulture funds use measures to recover the debt, such as political pressure and the seizure of overseas assets. Vulture funds usually wait for a process of debt restructuring before starting their actions, taking advantage of the improving financial state of a country or company following the restructure to claim the full value of their bond in addition to interests and possibly delay penalties.

This strategy tends to pay dividends. From Peru, which had to pay US$58 million on a US$11 million debt to the Republic of Congo, which had to pay US$118 million on a US$31 million debt, many countries lost millions of dollars against vulture funds.[28]

The fact that vulture funds seem to win their cases against sovereign debtors will incentivise creditors to refuse to take part in debt restructuring initiatives in future, as holdouts usually make more profits than the creditors that accept a financial haircut. In the absence of a comprehensive framework for debt restructuring negotiations that would bind all creditors, each one of them has an incentive to refuse to participate, hoping to receive a higher pay-out. This problem has recently also been highlighted by the IMF.[29] With the incentive for creditors to holdout, debt restructuring will be more complex and take more time, provoking longer debt crises, leading to more economic hardship and long-term harm.

legitimacy. It represents creditor countries organising debt restructurings under their conditions.

Inefficiency

There are several factors that make current mechanisms ineffective. Their fragmentation creates some unpredictability in the outcome of the process. Their illegitimacy makes them politically difficult to justify. This is particularly the case when it comes to the IMF, which has a negative reputation in many countries where it has engaged during a debt crisis.

In September 2014 the UNGA decided to create a multilateral framework for sovereign debt restructurings (see Box 5). This situation discourages policy-makers from undertaking debt restructuring processes, which often delays urgently needed debt workouts. Delaying a debt workout during a debt crisis makes the workout more painful and in the meantime the crisis usually intensifies and more money is lost. In addition, the lack of effectiveness of debt restructurings is characterised by insufficient changes towards achieving debt sustainability. Given the unbalanced situation of debtors and creditors during a restructuring, creditors are usually in a position to make their interests prevail. This leads them to force through insufficient restructuring, although this may have negative implications in the long term. When a restructuring is insufficient to bring back debt sustainability, the debtor often has to operate repetitive restructurings.

The delayed restructurings and their insufficient scale is often described as 'too little, too late'. The restructuring of Greek debt in 2012 is a good example of this, as the IMF outlined it. In a report published in 2013, the IMF explains that Greece's access to official financing and the authorities' willingness to adopt a programme of fiscal adjustment delayed the restructuring. When it finally took place, the restructuring was not deep enough to bring back debt sustainability to Greece.[30]

Unsustainable debt

The current international architecture, with the IMF in the centre, consequently does not have any instrument to organise debt restructuring in the context of a debt overhang that undermines the achievement of SDGs. This is the result of the absence of consideration of the development impact of debt. The IMF Debt Sustainability Analysis (DSA) is a good example of an international instrument that lacks consideration for development and poverty indicators.

The achievement of SDGs, however, will require that the debt burden faced by sovereign states does not stop them from investing in their development. This is why the future multilateral framework on debt restructurings should consider a debt unsustainable when it undermines a country's development.

Benefits of a UN process towards a new sovereign debt restructuring framework

Negotiations on sovereign debt restructuring proposals have usually taken place at the IMF, most prominently in 2002 when IMF management proposed the inclusion of a Sovereign Debt Restructuring Mechanism (SDRM). In the absence of efficient and fair mechanisms to organise debt restructurings, in September 2014 the UNGA decided to create a multilateral framework for sovereign debt restructurings (see Box 5). The new UNGA process is the first time that the General Assembly has discussed this important pillar of the international financial architecture. The shift to the UN makes a lot of sense. The UNGA is the world's most inclusive regime-building body. All 193 UN Member States and other relevant stakeholders – which range from civil society organisations (CSOs) to the IMF – can participate in negotiations taking place at the UNGA. Moreover, UNGA negotiations are transparent, to the extent that sessions are even broadcast live online via the Internet. Only such an inclusive and transparent process can ensure that the new debt restructuring framework reflects common sense, is legitimate and universally applicable, and is broadly accepted.

Given its development and human rights promotion mandate, the UN is also the right place to embed the new sovereign debt restructuring framework as part of the sustainable development agenda.

Box 4: The IMF proposition to deal with debt crises

The IMF has recently developed some initiatives to create mechanisms for dealing with debt crises. In June 2014, the IMF released a proposal[31] to update the exceptional access framework allowing large-scale financing when debt is considered sustainable but requiring a debt restructuring when it is not.

This proposal suggests extending the maturities of governments' bonds in countries facing temporary liquidity problems but whose debt is considered sustainable. The extension of maturities – so-called 're-profiling' – would reduce the fiscal burden for distressed countries and allow them to manage temporary liquidity problems. In that sense, it would reduce the cost of debt crises.

However, a number of shortcomings in this proposal suggest that it might not be the appropriate answer to debt crises. First, the proposition is based on a voluntary approach. Concretely, creditors would have to volunteer to extend the maturities of the debtors, and their participation would be difficult to ensure. This means that the instrument would also lack comprehensiveness. Second, the decision to activate the re-profiling would depend on the IMF Board, which makes decisions on the basis of political considerations. Third, if it turns out that the debt re-profiling was insufficient, there would still be the need to restructure the debts, for which no effective framework exists.

When it comes to problems with debt restructurings as such, recent IMF proposals[32] address only one of the many problems – those related to collective action problems and vulture funds lawsuits. The IMF suggests that debtor countries should add improved collective action clauses (CACs) to their future bond issues, in order to make sure that a predatory minority of bondholders – the vulture funds – cannot undermine a debt restructuring process. This new action could indeed help to make the way vulture funds operate more difficult in future. However, even if all countries start to introduce these new clauses now, it will take many decades until all outstanding bonds are updated and safeguarded. Moreover, these CACs would only solve holdout problems for part of the debt that is bonds. It cannot avoid a holdout by bilateral Paris Club creditors, for example, or by the IMF itself. Only the introduction of a multilateral legal framework for sovereign debt restructurings is immediately effective, and can ensure the comprehensive treatment a country's total outstanding debt in one single and comprehensive process.

Another gap is that the financing needs for sustainable development play no role in the IMF's debt restructuring framework. A debt restructuring is triggered by the loss of market access, and the aim is simply to restore market access. Development or human rights criteria play no role.

Box 5: UN process key milestones

- In 2002, at the first International Conference on Financing for Development, the international community agreed, in what is now called the Monterrey Consensus, to create a debt workout mechanism to deal with unsustainable debts.[33]

- Following the Monterrey Consensus, the IMF organised a conference in 2003 to discuss its proposal[34] to create a Sovereign Debt Restructuring Mechanism. The process did not achieve any tangible results as the result of strong opposition from the US.[35]

- In April 2013, the IMF published a paper[36] setting the tone for a more fundamental overhaul of sovereign debt restructuring mechanisms. However, Board and governors instructed the staff to focus more on technical improvements within existing policies.

- UNGA's landmark Resolution 68/304,[37] adopted in September 2014, recognised "the sovereign right of any State to restructure its sovereign debt, which should not be frustrated or impeded by any measure emanating from another State", and noted "with concern that the international financial system does not have a sound legal framework for the orderly and predictable restructuring of sovereign debt". This resolution launched a process to adopt "a multilateral legal framework for sovereign debt restructuring processes".

- The first meeting of the new UNGA Committee for the creation of a new sovereign debt restructuring framework[38] took place in New York from 2 to 5 February 2015. During this meeting, it was clear that UN Member States were divided on this issue. Although the process received support from emerging economies, as well as civil society groups, rich nations holding strong positions at the IMF stayed away from the negotiations. This meeting will be followed by at least two other sessions to negotiate the framework.

- During this meeting, the G77 made a joint statement emphasising that "the lack of a structured mechanism is a major failure of the current international architecture, which leads, among other issues, to long delays in debt restructuring, unfair outcomes and loss of value for both debtors and creditors". Facing opposition from some countries to engage in this UN-led process instead of the IMF, Brazil emphasised that the UN is a forum with the most legitimacy to set the rules of a future debt restructuring framework, reminding observers that this mechanism is part of the 'means of implementation' for the post-2015 development agenda. During the session, Argentina presented a proposal[39] outlining how the future multilateral framework should be designed and should work.

- The second meeting took place in New York from from 20-30 April. Rich nations continued to be absent from the discussions while developing countries made new statements in favour of the UN framework.[40]

Conclusion and recommendations

Borrowing and lending are supposed to improve the allocation of resources and thus contribute to development. In practice, however, we see that debt often hinders rather than helps development. The successful implementation of the new sustainable development agenda requires a reform in borrowing and lending relations so that these become an enabler rather than a constraining factor in terms of development.

Resolving current problems with sovereign debt requires adherence to a set of principles for each step of a sovereign debt workout. Such principles include impartiality, legitimacy, transparency, good faith and sustainability.

A fair and development-friendly solution to sovereign debt problems requires an international debt restructuring mechanism that:

- Prevents debt crises by promoting compliance with responsible lending and borrowing principles, and is mandated to monitor such compliance and sanction non-compliance.
- Deals with the whole sovereign debt stock of a country in one single and comprehensive process, and ensures fair burden sharing among different creditor categories.
- Can invoke an automatic standstill on debt payments in times of crises or overhangs, and ensure that sufficient legal protection from vulture funds litigation is in place.
- Assesses sovereign debt sustainability from the perspective of SDG financing needs, and ensures that SDG-based debt sustainability analyses guide decision-making throughout the whole debt restructuring process.
- Acts in a transparent and accountable manner, makes all relevant information public, and gives all relevant stakeholders the right to be heard.
- The UN Committee should also set up a standing Debt Workout Institution, independent of creditors and debtors, to facilitate the debt restructuring processes.
- We hope that the international community will seize the opportunity created by the current negotiations at the UN to develop an international debt restructuring mechanism along the above-mentioned criteria. The UN General Assembly should adopt those criteria and organise negotiations at the UN to set up the multilateral mechanism.

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- research complex development finance policy issues
- synthesise and exchange NGO and official information and intelligence
- facilitate meetings and processes which improve concerted advocacy action by NGOs across Europe and in the South.

Eurodad pushes for policies that support pro-poor and democratically-defined sustainable development strategies. We support the empowerment of Southern people to chart their own path towards development and ending poverty. We seek appropriate development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development.

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