Background paper on:

SOFT LAW AND SOVEREIGN DEBT

By: Rosa M. Lastra and Marco Bodellini[1]

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

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Introduction

This paper discusses the role that soft law can play in (1) understanding debt management in the context of debt sustainability assessments; (2) enabling least developed countries to deal with debt vulnerabilities, (3) creating greater predictability in the context of debt restructuring and, generally (4) facilitating compliance and observance of international standards that do not create legal obligations.

It argues that UNCTAD can play a central role in the adoption and implementation of soft law principles to promote responsible sovereign lending and borrowing, working together with other international organisations, such as the IMF and the World Bank, as well as regional development banks, national Debt Management Offices and central banks. One can envisage a level of convergence in the area of sovereign debt similar to the convergence achieved by central banks in the area of capital regulation through the adoption of the soft law standards issued by the Basel Committee on Banking Supervision.

Debt sustainability is one of the main priorities of the Intergovernmental Group of Experts on Financing for Development. Its focus, as pointed out in the Addis Ababa Action Agenda (AAAA), is to assist developing countries in attaining long-term debt sustainability "through coordinated policies aimed at fostering debt financing, debt relief, debt restructuring and sound debt management, as appropriate" (paragraph 94).

While better data availability, quality of data and debt transparency are certainly needed, this paper contends that we should promote the role of soft law as an 'equalizer' in the negotiations between creditors and debtors, enabling and enhancing the legal capacity of emerging economices. . In the absence of an international convention that deals with sovereign debt matters, soft law fills the vacuum. In particular, the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing[2] can play a significant function with regard to the objective of debt sustainability and the effectiveness of sovereign debt restructurings.

The UNCTAD principles should be complemented and further implemented by specific technical legal standards (a 'manual') on how to negotiate sovereign debt instruments

[2] UNCTAD, 'Principles on Promoting Responsible Sovereign Lending and Borrowing', 10 January 2012, available at https://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf.

and how to carry out debt restructuring. A deep level of specificity could make less relevant the disparity of skills, resources and technical knowledge between creditors and debtors and their legal advisers.

The paper is divided into eight sections, following this introduction. Section 1 reviews the nature of soft law and the institutions that create financial soft law. Section 2 considers the taxonomy of soft law and the pros and cons of relying upon soft law. Section 3 surveys the implementation and transformation of soft law into hard law and the incentives to promote observance of soft law. Section 4 deals with the resolution of sovereign debt problems. Section 5 examines the role of the UNCTAD principles. Section 6 looks at the role of Debt Management Offices (DMOs). Section 7 analyses debt sustainability assessments (DSAs) from the perspective of predictability and uniformity in treatment. Section 8 concludes.

1. Nature of soft law and sources of international financial soft law

Soft law has been defined as rules that are not legally binding but which in practice are adhered to by those to whom they are addressed, or by those who subscribe to them for a variety of reasons, such as moral suasion, fear of adverse action, and other incentives.[3] It thus comprises 'a variety of non-legally binding instruments used in contemporary international relations'.[4]

A key feature of soft law is its informality. Informality distinguishes soft law from hard law.[5] As regards the origins of soft law some argue that its ancestors can be found in the medieval *lex mercatoria*, *i.e.* the mercantile codes and customs which reflected the usages of trade, the maritime and commercial practice at the time, whilst others think that they stem from 'the early 20th century theories of social law and legal pluralism'.[6]

Soft law should be regarded as law and, in the area of international financial law, it has become the most frequently adopted form of law.[7] This is because of the inherent difficulties involved in treaty (hard law) making in the field of finance. Accordingly, soft law has played a very significant function in filling this vacuum[8] and in coordinating the

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[3] Roy Goode, '*Commercial Law*', 2nd edn (London: Penguin Books, 1995) 20-1.
[4] Alan Boyle, 'Soft law in international law-making', in Malcom D. Evans (ed.), *International law*, 2nd edn (Oxford, OUP, 2006) 142. See also Christine Chinkin, *The Making of International Law*, (Oxford: OUP, 2007) 212.
[5] Rosa M. Lastra, '*International financial and monetary law*', 2nd edn (Oxford: OUP, 2015) 502.
[6] Anna Di Robilant, 'Genealogies of soft law', (2006) 54 The American Journal of Comparative Law, 499.
[7] Chris Brummer, '*Soft law and the global financial system*', 2nd edn (Cambridge: CUP, 2015) 120.
[8] Rosa M. Lastra, *supra*, 503.

regulatory process.[9] Though soft law rules do not create legal obligations, nonetheless they have legal effects.

With regard to the institutions that create international financial soft law, there are many entities, bodies and groupings involved in the process including the International Monetary Fund (IMF), development banks such as the International Bank for Reconstruction and Development (IBRD) and the European Bank for Reconstruction and Development (EBRD), the G7, G10 and G20, the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commission (IOSCO), the Financial Stability Board (FSB), and others.

Amongst the standard setters, there are intergovernmental entities whose rules have a 'top-down' nature,[10] and there are professional associations or market entities whose rules have a 'bottom-up' character such as ISDA (International Swaps and Derivatives Association) and other forms of self-regulation.[11]

The presence of a significant number of standard-setters involved in various ways in the adoption of general principles, guidelines and best practices poses a problem of coordination and risks inconsistency amongst the various rules and 'rulers'. To tackle these issues, the G20 leaders at the London Summit in 2009 committed themselves 'to establish much greater consistency and systematic cooperation between countries, and the framework of internationally agreed high standards, that a global financial system requires'[12] and the Financial Stability Board has a key role in this regard (including the publication of the Compendium of Standards).

2. The taxonomy of soft law and the pros and cons of soft law

There are different types of soft law rules according to: 1) their effect, 2) their scope, 3) their degree of specificity, 4) their source and nature, 5) their contents.

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[9] Chris Brummer, *supra*, 5.

[10] Particularly relevant in the field of sovereign debt are: UNCTAD, 'Principles on Promoting Responsible Sovereign Lending and Borrowing', 10 January 2012, available at https://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf; G20, 'Operational Guidelines for Sustainable Financing', March 2017; United Nations General Assembly, 'Resolution 69/319' on 10 September 2015, available at https://digitallibrary.un.org/record/804641/files/A_RES_69_319-EN.pdf.

[11] Rosa M. Lastra, *supra*, 504.

[12] G20, 'London Summit-Leaders' Statement' (2 April 2009).

In terms of their effect, soft law rules can vary from simple professional practices (such as best practices or gentlemen agreements) to uniform rules, codes and guidelines.[13] There is a hierarchy in soft law akin to the hierarchy in hard law, ranging from constitutional principles (primary law) to specific technical rules (secondary law).

With regard to their scope, it is possible to distinguish between sectoral standards (for instance, banking, securities and insurance standards) and functional standards (for instance, disclosure, governance, accounting standards, etc).

In relation to their degree of specificity, an interesting example is the distinction drawn by the Financial Stability Board (FSB)[14] among principles, practices and methodologies/guidelines, where the first ones give flexibility in the implementation, the second ones are more detailed and therefore offer less flexibility and the third ones provide either specific guidance or precise requirements thereby offering very little flexibility. From a practical perspective, their different level of specificity determines that national authorities will have more or less discretion in implementing them in their domestic jurisdictions.

Concerning their source, as mentioned above, there are 'top-down' rules adopted by official entities and 'bottom-up' rules usually emanated by market associations in the form of self-regulation.

From the point of view of their contents, there are substantive rules and rules that allocate regulatory jurisdiction.[15]

According to Brummer, soft law instruments can be grouped into three categories: 1) best practices, 2) regulatory reports and observations, and 3) information sharing and enforcement cooperation agreements.[16] Best practices aim at promoting 'sound regulatory supervision'.[17] They concern areas, such as 'capital adequacy, optimal disclosure rules, or due diligence techniques for preventing money laundering and terrorist financing. These practices may be promulgated by coalitions of wealthy regional bodies or even by organizations of private actors blessed by national authorities'.[18] Differently, 'reports create an official record of fact drawn on by financial

[13] Rosa M. Lastra, *supra*, 511.
[14] *Id.*
[15] *Id*. 511-512.
[16] Chris Brummer, *supra*, 121.
[17] *Id*., 121.
[18] *Id*., 121.

authorities to regulate and supervise markets'.[19] Sometimes, such records only collect data; other times, 'they record official opinions and institutional perspectives' concerning both financial data and their implications for the global economy.[20] Information-sharing agreements are international agreements that 'spell out the procedural means by which greater information sharing and enforcement cooperation can be achieved'.[21] Usually they are promulgated through memoranda of understanding. 'National regulators of the banking and securities industries routinely enter into these agreements whereby the regulators commit to better coordination with one another in order to enhance their prudential oversight and monitoring at home'.[22]

Brummer notes that 'while the legal effect of these different soft law instruments is not necessarily the same, it is characteristic of all of them that they are carefully negotiated, and often carefully drafted statements, which are in some cases intended to have some normative significance despite their non-binding, non-treaty form. There is at least an element of good faith commitment, and in many cases, a desire to influence state practice and an element of law-making intention and progressive development. In this sense non-binding soft law instruments are not fundamentally different from those multilateral treaties which serve much the same law-making purposes. In this respect they may be both an alternative to and a part of the process of multilateral treaty-making'.[23]

The main **advantages** of soft law are its flexibility, dynamism, informality and pragmatism.[24] Soft law rules are also characterised by a high level of sophistication and technical detail. The *modus operandi* of many 'international standard-setters' (the technical expertise of those involved, the commonality of knowledge and interests, and the relatively small size of the working groups) fosters pragmatism and mutual trust. In contrast, international treaty making (hard law) is a lengthy, slow, rigid and, at times politically motivated process. While this formality provides legitimacy and accountability (important considerations in a democratic system), it also leads to a rather 'static output' since once a treaty is agreed and adopted, it is complicated to amend since it requires - by unanimity or qualified majority - the consensus of the signatory States.

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[19] *Id*., 122.
[20] *Id*., 122.
[21] *Id*., 123.
[22] *Id*., 123.
[23] Alan Boyle, 'Some reflections on the relationship of treaties and soft law', (1999) 48, International and Comparative Law Quarterly, 902.
[24] Mario Giovanoli, 'A new architecture for the global financial markets: legal aspects of international financial standard setting', in Mario Giovanoli (ed), *International Monetary Law. Issues for the New Millenium*, (Oxford, OUP, 2000), 39.

The main **drawbacks** of soft law relate to its non-binding character and concerns about legitimacy and accountability. As regards the latter, of particular relevance is the country 'ownership' problem given the under-representation of developing countries within the international standard-setting bodies. This under-inclusiveness together with the level of sophistication of some standards may provide a challenge in the pursuit of regulatory convergence. [25] The proliferation of standards may also lead to complexity, inconsistency, overlaps or gaps. Over time the number of entities and bodies adopting soft law rules has significantly increased.[26]

In the area of financial law, one of the most relevant standard-setters is the Basel Committee on Banking Supervision (BCBS). Despite the lack of direct legal binding force of the BCBS standards, it has become a *de facto* international regulatory body.[27] Many argue that the informality and independence of the Committee have served well in the design of international banking rules, as it has acted with a fair degree of depoliticization and a considerable amount of technical expertise and competence in banking and monetary affairs.[28]

3. The implementation of soft law and its transformation into hard law

The evolution of law provides evidence of the formalization of rules over time. Many legal rules that are today binding were at some point customs, usages, or practices. Since financial law and, in particular, international financial law is a rather novel field of law, its dynamic and evolving character is unsurprising.

Formal law has often been born out of the development of informal law. This is not a new phenomenon; it is a recurrent feature in the history of law. The relation between soft law and legally binding rules often appears to be an evolutionary process. The evolution of international law and of commercial law, to cite two relevant examples, provides clear evidence in this regard.[29]

We referred above to the *lex mercatoria*, when talking about the origins of soft law. Many of the uncodified usages of trade, the maritime and commercial practice eventually became formal law. The primary sources of international law are conventional law

[25] Rosa M. Lastra, *supra*, 513-514.
[26] *Id*., 513.
[27] Since January 2013 it has its own 'charter' available at http://www.bis.org/bcbs/charter.htm. As stated in the Charter, the internal organisational structure of the BCBS comprises: (a) The Committee; (b) Groups, working groups and task forces; (c) the Chairman; (d) The Secretariat. The Committee's Secretariat is provided by the Bank for International Settlements (BIS) in Basel.
[28] Rosa M. Lastra, *supra*, 506.
[29] *Id*., 521.

(treaty law), customary law and the general principles of the law, as recognised by Article 38 of the Statute of the International Court of Justice. Customary international law, however, can evolve into conventional law. Indeed, important principles of customary international law have became codified in the Vienna Convention of the Law of the Treaties, thus acquiring the characteristic of 'conventional law'.

After the adoption of soft law rules, their implementation is typically done at national level with the domestic legislature passing a law or the regulator issuing specific regulation. It is due to such a formal legislative or regulatory act that the soft law rules become hard law rules thereby binding and enforceable at national level.

The hard law rules capability of being binding and enforceable is what mainly distinguishes them from soft law rules, that are not coercive, being mainly an 'expression of cooperation'.[30] The strength of the latter, indeed, only derives from the willingness of the involved parties to comply with them. Such a willingness sometimes can be stimulated by regulatory competition, in the sense that national jurisdictions might want to have in place the latest internationally adopted soft-law rules to make themselves a safe legal environment in which global financial players are comfortable to do business.

Concerning the relationship between soft law and hard law, it is worth noting that sometimes the former complements or supplements the latter. For instance, in the context of the law of the IMF, a number of international guidelines, recommendations, codes of conduct, standards, and policies have been developed to interpret, supplement, or implement the Articles of Agreement.[31]
It has been argued that while lawyers express a preference for hard law (legally binding, legitimate, and enforceable treaties), economists acknowledge the advantages of soft law rules (speed, flexibility, and pragmatism).[32]

There are incentives to promote observance of soft law rules. Indeed, in the absence of formal enforcement mechanisms, **'incentives'** compel those to whom they are

[30] Chris Brummer, *supra*, 132.
[31] See Joseph Gold, '*Interpretation: The IMF and International Law*' (London, the Hague, Boston: Kluwer Law International, 1996), 299–401. See also Joseph Gold, Strengthening the Soft International Law of Exchange Arrangements, (1983) 77, American Journal of International Law, 443.
[32] See Tommaso Padoa-Schioppa and Fabrizio Saccomanni, 'Managing a Market-Led Global Financial System' in Petter K Kenen (ed), *Managing the World Economy Fifty Years After Bretton Woods* (Washington DC: Institute of International Economics, 1994) 266.

addressed to observe the rules.[33] These incentives function as a substitute for formal enforcement mechanisms.[34]

The official sector has developed a number of policies and measures to promote observance of soft law rules. For example, the 'name and shame' practice associated with the list prepared by the Financial Action Task Force on Money Laundering (FATF) regarding non-cooperating jurisdictions[35] or the OECD list of offshore financial centres responsible for harmful tax competition[36] act as deterrents against 'non observance'. Institutionalized peer review is another official incentive to promote observance, often as a complement to financial sector surveillance. In 2010, the FSB launched a regular programme of peer reviews comprising: thematic reviews and country reviews. These reviews are focused on the implementation and effectiveness of international financial standards developed by standard-setting bodies (SSBs) and of policies agreed within the FSB. The FSB's Standing Committee on Standards Implementation (SCSI) oversees the functioning of the peer review programme that is mandatory for its members (Article 6.1 of the FSB Charter).[37]

The **use of IMF conditionality** acts as a very powerful official incentive as well, when the country's adherence to a particular set of standards is made a 'condition' for the disbursement of IMF funds under a standby or extended arrangement.[38]

The G-20 supports and encourages the 'official incentives' and at the G20 Pittsburgh Summit in 2009, the Leaders confirmed their commitment to take action with a consistent implementation of the global standards both nationally and internationally.[39] In addition to official incentives, there are various instruments of market discipline, such as credit risk weightings, private ratings, borrowing spreads, differentiated interest

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[33] Though the word 'compliance' is a term typically used in the case of hard law and 'observance' (or adherence to) in the case of soft law, sometimes the word compliance is also used in references to soft law.
[34] Rosa M. Lastra, *supra*, 516.
[35] See Financial Action Task Force on Money Laundering, 'Non-Cooperative Countries and Territories' (Paris: OECD Financial Action Task Force, 2004), at <http://www1.oecd.org/fatf/NCCT_en.htm#List>.
[36] See Organisation for Economic Cooperation and Development, 'List of Uncooperative Tax Havens' at <http://www.oecd.org/document/57/0,2340,en_2649_33745_30578809_1_1_1_37427,00.html>.
[37] The objectives and guidelines for the conduct of FSB peer reviews are included in the 'Handbook for FSB Peer Reviews', available at <http://www.financialstabilityboard.org/publications/r_140106.pdf> and for more information see, <http://www.financialstabilityboard.org/activities/peer_reviews.htm>.
[38] Rosa M. Lastra, *supra*, 517.
[39] G20 Leaders' Statement, Pittsburgh Summit, September 2009, available at <http://www.g20.org/documents/final-communique.pdf>.

rates, inter-bank exposure, and others that act as incentives to adhere to soft law rules.[40] These forms of market discipline are typically voluntary and require a developed framework of transparency or disclosure.

International investors often require that developing countries adopt the best available standards of best practice. This adoption enhances their credit standing and improves the attractiveness and reputation of their financial systems in the international marketplace.

The success of standardized clauses and model rules in private contracts developed by trade and financial industry associations (such as ISDA)[41] has demonstrated that markets are capable of spreading existing standards across jurisdictions and developing common rules (self-regulation).

An indirect incentive for countries to comply with soft law rules is the monitoring process carried out mostly by the main standard-setters themselves. The IMF and the World Bank have developed a framework for assessing member countries' observance of standards and codes (the 'Standards and Codes Initiative'), working in cooperation with national authorities, standard-setting agencies, and other international bodies.[42] The standards relate to data and policy transparency, financial sector regulation and supervision, and market integrity.[43] Assessments of the degree of implementation of these standards by countries result in the Reports on the Observance of Standards and Codes (ROSCs), which are discussed below.

The Basel Committee is also committed to monitor its members' compliance with the globally agreed minimum standards. Hence, a regulatory consistency assessment programme (RCAP) was launched in April 2012 with the aim to promote full and consistent implementation of Basel III. The assessment programme is conducted on

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[40] See Giovanoli, *supra*, 48.

[41] See generally <http://www.isda.org>.

[42] See generally International Monetary Fund, 'Standards and Codes: The Role of the IMF - Factsheet', (Washington DC: IMF, 2014), at <http://www.imf.org/external/np/exr/facts/sc.htm>. The standards and codes initiative was launched in 1999 as a prominent component of efforts to strengthen the international financial architecture. The initiative was designed to promote greater financial stability through the development, dissemination, adoption, and implementation of international standards and codes. The initiative covers 12 standards which the Bank and Fund Boards recognized as relevant for their work with regard to policy transparency, financial sector regulation and supervision, and market integrity. Assessments of the degree of implementation of these standards by countries result in the Reports on the Observance of Standards and Codes (ROSCs).

[43] See International Monetary Fund, 'IMF Executive Board Concludes Review of Standards and Codes Initiative', Public Information Notice (PIN) No. 11/38, March 22, 2011, available at <http://www.imf.org/external/np/sec/pn/2011/pn1138.htm>.

three levels: level 1, ensuring the timely adoption of Basel III; level 2, ensuring regulatory consistency with Basel III and level 3, ensuring consistency of outcomes.[44]

The Financial Sector Assessment Programme (FSAP) provides in-depth examinations of countries' financial sectors and constitutes a powerful official incentive to promote the observance of soft law rules. FSAPs are done jointly by World Bank and IMF staff in developing and emerging market countries (IBRD countries) and by the IMF alone in advanced economies. FSAPs have two main components: the financial stability assessment and—in developing and emerging market countries—the financial development assessment. These components may be assessed at the same time during a joint IMF-World Bank mission or at different times in separate stability and development "modules" conducted by the Fund and the Bank, respectively.[45]

The FSAP helps identify financial system vulnerabilities and develop appropriate policy responses and provides countries with an opportunity to measure their compliance with financial sector standards and codes and, therefore, to benchmark their regulatory and supervisory systems against internationally-accepted practices.[46]

The **Reports on Observance of Standards and Codes (ROSCs),** which are a key component of the FSAP, summarize the extent to which countries observe relevant internationally recognized standards and codes and are prepared and published at the request of the member country.[47] Participation by countries in standard assessment and

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[44] See, Basel Committee, 'Basel III Regulatory Consistency Assessment Programme' (April 2012), at <http://www.bis.org/publ/bcbs216.htm>.

[45] See International Monetary Fund, 'Financial Sector Assessment Program: Frequently Asked Questions', available at <http://www.imf.org/external/np/fsap/faq/index.htmMarch 2013> and 'Financial Sector Assessment Program (FSAP) - Factsheet' available at <http://www.imf.org/external/np/fsap/fsap.asp>.

[46] See The World Bank, 'Financial Sector Assessment Program (FSAP)' available at <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTFINANCIALSECTOR/0,,contentMDK:22142161~menuPK:6459396~pagePK:210058~piPK:210062~theSitePK:282885,00.html>. An FSAP report is prepared at the request of a member country by the staff of the Bank and the Fund. An FSAP report consists of three volumes. The first volume (Main Report) is an overall assessment of the member's financial sector. It is confidential and made available only to the country's competent authorities. The second volume (Selected Financial Sector Issues) is a detailed technical analysis, which is also confidential. These first two volumes are not published by the member, the Fund, or the Bank. The third volume of the FSAP report (Assessment of Observance of International Standards and Codes) contains a detailed assessment of the observance of selected financial sector standards, codes, and good practices. The authorities may publish these detailed assessments but only with the consent of the Bank and the Fund. See François Gianviti, 'Legal Aspects of the Financial Sector Assessment Program', paper presented at the IMF Seminar on Current Developments in Monetary and Financial Law in May 2002, available at <http://www.imf.org/external/np/leg/sem/2002cdmfl/eng/gianv2.pdf>.

[47] <http://www.imf.org/external/np/rosc/rosc.asp>.

ROSC publication are voluntary. The IMF has recognized twelve areas and associated standards as useful for the operational work of the Fund and the World Bank. These comprise accounting; auditing; anti-money laundering and countering the financing of terrorism (AML/CFT); banking supervision; corporate governance; data dissemination; fiscal transparency; insolvency and creditor rights; insurance supervision; monetary and financial policy transparency; payments systems; and securities regulation. They are used to help sharpen the institutions' policy discussions with national authorities, and in the private sector for risk assessment (by rating agencies and others). One could add the UNCTAD principles to the is set of standards assessed under the ROSCs. The 'good practices' identified through ROSCs can, in turn, generate more standards and codes

4. The resolution of sovereign debt problems

Over the last years the relationship between soft law and sovereign finance has become increasingly debated at the international level.[48] Reliance on soft law is one of several policy options that have been proposed to deal with the absence of a transnational sovereign bankruptcy regime or code concerning sovereign debt problems/crises, one that could permit sovereign borrowers to obtain debt relief when their financial obligations outstrip their ability to pay without worrying about hostile creditor action.

In this paper we argue that UNCTAD should have a central role in achieving normative convergence in the field of sovereign finance. But before discussing the role of the UNCTAD principles (soft law) we should review alternative and complementary proposals or policy options to deal with the ad hoc and fragmented nature of the resolution of sovereign debt problems.[49] These policy options range from statutory solutions to voluntary contractual solutions.

[48] Debt relief was advocated by Benjamin Friedman in a talk given in front of a number of Central Bankers in Lucerna – Switzerland; see Gillian Tett, 'A debt to history?', FT.COM/MAGAZINE, January 17/18 2018, stating that Friedman explicitly 'pointed out that one of the great beneficiaries of debt forgiveness throughout the last century was Germany: on multiple occasions (1924, 1929, 1932 and 1953), the western allies had restructured German debt. So why couldn't Germany do the same for others? **There is ample precedent within Europe for both debt relief and debt restructuring…** There is no economic ground for Germany to be the only European country in modern times to be granted official debt relief on a massive scale and certainly no moral ground either'.

[49] See generally Rosa Lastra and Lee Buchheit, '*Sovereign Debt Management*' (Oxford, Oxford University Press, 2014), which extensively deals with all these issues. See also the Report presented by the Sovereign Insolvency Study Group – chaired by Philip Wood – to the ILA Hague Conference (August, 2010) on 'State Insolvency: options for the way forward' (co-rapportuers: Michael Waibel and Brian Hunt).

The '<u>statutory solution</u>' to the problem of orderly resolution of sovereign debt crises refers to the possible adoption of what has been referred to as the Sovereign Debt Restructuring Mechanism or SDRM, with the IMF playing a central role. The adoption of the SDRM would in principle imply an amendment to the IMF Articles of Agreement. The creation at an international level of a bankruptcy procedure for countries, akin to Chapter 11 of the US bankruptcy code, and of an independent dispute resolution forum to verify claims, has been hailed in some official and academic circles as an improvement over the current piecemeal approach to the resolution of international debt crises, which involves a variety of actors, including international organizations (notably the IMF), informal clubs (the Paris Club for official debt, the London Club for commercial bank debt), national authorities, and private financial institutions.[50]

Advocates of the SDRM have claimed that it would fill a gap in the international financial system by providing a framework to help resolve the problems of collective action and creditor coordination and to encourage a country with unsustainable debt and its creditors to restructure before it gets to the point where default is the only option. The IMF started considering the SDRM in 2001,[51] though Jeffrey Sachs[52] anticipated the concept in 1995 and the idea of an international bankruptcy procedure was also discussed in the 1980s.[53] The SDRM was first proposed by Anne Krueger (under the

[50] See Anne Krueger, 'International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring', (November 26, 2001), at http://www.imf.org/external/np/speeches/2001/112601.htm; see generally, Sean Hagan, 'Designing a Legal Framework to Restructure Sovereign Debt', (2005) 36, Georgetown J. Int'l Law, 299. See Enrique Cosìo-Pascal, 'Paris Club', in Barry Herman, Josè Antonio Ocampo and Shari Spiegel (eds), *Overcoming Developing Country Debt Crises* (Oxford University Press 2010) 231, where it is underlined that debtor countries express genuine concern about the effectiveness and lack of impartiality of the 'Paris Club', the heavy cost in terms of the time consumed in individual negotiations with many creditors, and the fact that creditors can also apply pressure in bilateral rescheduling. Others have suggested the resort to arbitration or to a dispute resolution mechanism akin to the WTO dispute settlement system.

[51] See Anne Krueger, *supra*. See IMF fact-sheet, 'Proposals for a Sovereign Debt Restructuring Mechanism', January 2003 at <http://www.imf.org/external/np/exr/facts/sdrm.htm>.

[52] See Jeffrey Sachs, 'Do We Need an International Lender of Last Resort?', Frank D Graham Lecture, Princeton University, 1995, at <http://www.earthinstitute.columbia.edu/about/director/pubs/intllr.pdf>. Sachs argues that international bankruptcy procedures modelled upon Chapter 9 and Chapter 11 of the US Bankruptcy Code would be the best response to cope with crises of the Mexican type. Sachs's proposals included the reorganization of the IMF to act as a kind of international bankruptcy court rather than as a lender of last resort to member governments. Sachs emphasized the need to prevent a 'grab race' by creditors and the need to prevent a small number of dissident creditors from blocking an agreement acceptable to the vast majority of creditors. See also Barry Eichengreen and Richard Portes, 'Crisis? What Crisis? Orderly Workout for Sovereign Debtors' (London: Centre for Economic Policy Research, 1995), and Peter Kenen (ed), 'From Halifax to Lyons: What has been done about crises management?' Essays in International Finance No 200, Princeton University, October 1996.

[53] See eg Benjamin Cohen, 'A Global Chapter 11', (1989) 75, Foreign Policy, 109.

auspices of the IMF) and went through several modifications.[54] However, enthusiasm for the SDRM waned for over a decade after 2003 and reliance on market solutions (contractual mechanisms) became the preferred approach.

Political opposition in the US and resistance on the side of many market participants contributed to the loss of momentum. Enthusiasm for some form of SDRM (possibly one at the European level) has been reignited in the light of the Argentine litigation and the eurozone woes.[55]

An alternative and much more modest proposal could be a creative interpretation of Article VIII, section 2(a), of the IMF Articles of Agreement, which has been proposed for example by Lee Buchheit and Jeremy Pam. Article VIII section 2(a) reads as follows: 'Subject to [conditions not relevant here], no member shall, without the approval of the Fund, impose restrictions on the payment of payments and transfers for current international transactions'. It could be amended to either affect creditor rights (rendering unenforceable in the territories of any IMF member country a debt instrument that was invited to participate in a Sovereign Debt Adjustment program but declined to do so) or creditor remedies (immunizing in all IMF member countries the assets and revenue streams of the debtor country against which attachment by the holder of a debt instrument that was invited to participate in a Fund approved Sovereign Debt Adjustment Programme but declined to do so).[56]

The contractual (voluntary) solution, namely the reliance on contractual techniques, is the approach that has been favoured in recent years to confront the problems of sovereign debt workouts and in particular the hold-out problem. In 1996, a G10 Working Group issued a report (known as the Rey Report, after its Chairman, Jean-Jacques Rey of Belgium) recommending *inter alia* the inclusion of Collective Action Clauses in sovereign

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[54] Anne Krueger, 'New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking', Conference on 'Sovereign Debt Workouts: Hopes and Hazards', Institute for International Economics, Washington DC, 1 April 2002, at <http://www.imf.org/external/np/ speeches/2002/040102.htm>. On 24 March 2003, the Executive Board of the International Monetary Fund (IMF) continued its discussions on the possible features of a new Sovereign Debt Restructuring Mechanism (SDRM) based on the staff paper 'Proposed Features of a Sovereign Debt Restructuring Mechanism'. See PIN No 03/45, 3 April 2003, 'IMF Board discusses possible features of a Sovereign Debt Restructuring Mechanism' at <http://www.imf.org/external/np/sec/pn/2003/ pn0345.htm>.

[55] See Rodrigo Olivares-Caminal, 'Statutory Sovereign Debt Resolution Mechanisms' in Rosa M Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014), 333-358.

[56] Article VIII Section 2(b) of the IMF Articles of Agreement declares 'unenforceable in the territories of any member' certain types of contracts that are inconsistent with Fund-approved exchange control regulations. See a*Lee* C *Buchheit* and *Jeremiah S Pam*, 'The *Pari Passu Clause* in. *Sovereign Debt Instruments*' (*2004*) *53 Emory L.J. 869*, 871.

bonds and greater reliance on market discipline, following the Mexican 'bailout'.[57] The US Government, the G7, the International Monetary and Financial Committee of the IMF, and others supported this solution, which also enjoyed considerable academic support.

Collective Action Clauses (CACs) are provisions contained in bonds that allow the holders of a specified majority (seventy-five per cent) to amend the terms (payment and non-payment terms) of the bonds and make them binding on the minority.[58] CACs thus allow the debtor to restructure its debt by a resolution of a binding majority of bondholders. CACs thus permit a form of contractual 'cram-down' of changes to payment terms on dissenting minorities. This practice has become the norm worldwide and in the Euroarea it is now mandated by the ESM Treaty (Article 12, paragraph 3) for new issuances of bonds on or after January 1st, 2013.

Some advocate the use of State-contingent debt instruments to deal with sovereign debt problems. These financial instruments link the 'payoffs to a State variable (such as GDP, inflation or commodity prices) or to a trigger event (such as a natural disaster or a health epidemic)'. It is argued that they can 'reduce the likelihood of costly debt restructurings by providing an automatic mechanism of adjustment. Despite these potential benefits, adoption so far has been limited to few instances involving catastrophe bonds and climate change bonds'. [59]

What is interesting about CACs and other contractual techniques used in sovereign bond documentation is that they are increasingly becoming 'standard', a kind of new *lex mercatoria* in this field (creation of law *ex novo*). Indeed the way forward in terms of solft law and sovereign fiannce relies upon a combination of these 'bottom up' standardised contractual clauses with 'top-down' rules issued by intergovernmental entities such as the UNCTAD principles.

5. The role of the UNCTAD principles on responsible sovereign lending and borrowing

[57] See <http://www.bis.org/publ/gten03.htm>. There was another G10 Report on CACs published in September 2002.

[58] See Anna Gelpern and Mitu Gulati, 'The wonder-clause' (2013) 41 Journal of Comparative Economics 2, 367; Stephen J. Choi, Mitu Gulati and Eric A. Posner, 'The Evolution of Contractual Terms in Sovereign Bonds' (2012) 4 Journal of Legal Analysis 1, 141-42; Philip R Wood, 'Sovereign state restructuring and credit default swaps' (2011) 26 Journal of International Banking and Financial Law 11, 661.

[59] UNCTAD, 'Financing for development: debt and debt sustainability and interrelated systemic issues', Note by the UNCTAD Secretariat, 5 October 2018, 12.

The UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing[60] together with the G20 Operational Guidelines for Sustainable Financing,[61] and the United Nations General Assembly Resolution 69/319, on 10 September 2015[62] constitute an important step in the pursuit of debt sustainability and interrelated systemic issues via soft-law making.

These soft law rules seek to develop a set of behavioural standards that both lenders and borrowers should comply with in order to reduce the likelihood of a sovereign debt crisis. A broad consensus on these principles might help create a regulatory convergence at the national level and international level, that in turn could eventually end up favouring the adoption of hard law rules.[63]

The effectiveness of the UNCTAD principles could be enhanced through a variety of mechanisms and incentives, ranging from the ones mentioned above with regard to the IMF functions of conditional financial assistance and surveillance (in general and with regard to the FSAP/ROSCs), as well as peer reviews and consistency assessment programmes, coordinated efforts for dissemination and training of staff working in national Debt Management Offices and central banks, and increasing observance by courts of justice and arbitral tribumals, that can refer to the principles in their decisions, framing the discourse of soft law (as advocated by Matthias Goldman in the first expert meeting in November 2017)

Indeed, as the technical note distributed by UNCTAD ahead of the second expert meeting clearly states: 'There are different, but in principle complementary, methods to enhance the effective implementation of normative frameworks and best practice guides. These could be incorporated in advance into contract choice of law clauses for sovereign debt bonds; coordinated efforts could be stepped up to facilitate their dissemination and the build-up of national institutional and regulatory mechanisms for systematic implementation; and adjudicative bodies – domestic courts or arbitral tribunals – could take such guidelines into consideration in their own actions and decision-making'.[64]

[60] UNCTAD, 'Principles on Promoting Responsible Sovereign Lending and Borrowing', 10 January 2012, available at https://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf.
[61] G20, 'Operational Guidelines for Sustainable Financing', March 2017.
[62] United Nations General Assembly, 'Resolution 69/319', 10 September 2015, available at https://digitallibrary.un.org/record/804641/files/A_RES_69_319-EN.pdf.
[63] UNCTAD, 'Financing for development: debt and debt sustainability and interrelated systemic issues', *supra*, 11.
[64] *Id.*, 11.

It is worth recalling the 'constitutional' nature of the UNCTAD principles, which 'aim to promote more responsible behaviour and provide economic benefit to both sovereign borrowers and their lenders. They are also conceptualized in a holistic way and are thus meant to be applied to sovereign borrowers, developed or developing countries alike, as well as their lenders'.[65] Because of this 'constitutional' or rather generic nature, we advocate that the principles be implemented and complemented by a set of specific rules (a 'manual') on debt documentation, debt management and debt restructuring.

The UNCTAD principles try to establish a balance between to the responsibilities of lenders (agency, informed decisions, due authorisation, responsible credit decisions, project financing, international cooperation, debt restructurings) and the responsibilities of sovereign borrowers (agency, binding agreements, transparency, disclosure and publication, project financing, adequate management and monitoring, avoiding incidences of over-borrowing, restructuring). Irresponsible lending is as bad as irresponsible borrowing in the pursuit of debt sustainability and interrelated systemic issues. Acting responsibly is what should characterise the relationships between the sovereigns-debtors and their lenders-creditors.[66]

In the the area of debt restructuring, principle 7 concerning the lenders, and principle 15 concerning the sovereign borrowers are of particular relevance in the understanding of what it means to act responsibly. According to Principle 7: 'In circumstances where a sovereign is manifestly unable to service its debts, all lenders have a duty to behave in good faith and with cooperative spirit to reach a consensual rearrangement of those obligations. Creditors should seek a speedy and orderly resolution to the problem'.[67] Its rationale is based on the grounds that currently an internationally binding sovereign debt restructuring is missing. Therefore, a sovereign in distress is left only with the possibility to approach its creditors trying to find a workable solution to restructure its debt. In such a situation, by definition, the position of the sovereign debtor is weak. This is why the principle recalls the lenders' duty to act in good faith, by making efforts to find a mutually-satisfactory solution.

Principle 15 states that 'if a restructuring of sovereign debt obligations becomes unavoidable, it should be undertaken promptly, efficiently and fairly'.[68] It mainly

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[65] UNCTAD, 'Principles on Promoting Responsible Sovereign Lending and Borrowing', 10 January 2012, 4, available at https://unctad.org/en/PublicationsLibrary/gdsddf2012misc1_en.pdf.
[66] See Bodo Ellmers, 'The evolving nature of developing country debt and solutions for change', European Network on Debt and Development, July 2016, 22.
[67] UNCTAD, 'Principles on Promoting Responsible Sovereign Lending and Borrowing', *supra*, Principle 7.
[68] *Id.*, Principle 15.

requires the sovereign that finds itself in financial troubles to immediately inform its creditors and to quickly start working out a restructuring arrangement. A prompt resolution to the problem is in the interests of all stakeholders.

Following the decision adopted in July 2016 in Kenya to set up an 'Intergovernmental Group of Experts on Financing for Development', Member States agreed terms of reference for this Group of Experts in April 2017, and in November 2017 its first session took place in Geneva. The wider purpose of this Intergovernmental Group of Experts on Financing for Development (IGEFfD) is to provide an expert forum for discussion and deliberations on the issues, concerns and challenges raised in the Addis Ababa Action Agenda (AAAA).

The IGE FfD brings together experts in development finance from UNCTAD member States, as well as officials and invited experts from other organisations, academia and civil society. The main objective of the IGE FfD is to produce agreed policy recommendations on chosen topics, based on expert discussions and contributions. These recommendations are presented to UNCTAD's governing body, the Trade and Development Report, for consideration and endorsement. Pursuant to Resolution A/RES/72/204 of the UN General Assembly and in accordance with the Agreed Policy Recommendation of its first session, UNCTAD is requested to present the outcome of the work of the IGE FfD as a regular input to the UN ECOSOC Forum on Financing for Development Follow-up and Review in New York.

In a similar vein, the G20 Operational Guidelines for Sustainable Financing aim at enhancing the 'access to sound financing for development while ensuring that sovereign debt remains on a sustainable path by fostering information-sharing and cooperation among borrowers, creditors and international financial institutions, as well as learning through capacity building'.[69]

Such guidelines are divided in five categories, such as: 1) adequate financing for sustainable development, 2) information-sharing and transparency, 3) consistency of financial support, 4) coordination of stakeholders and 5) promotion of contractual and new financial instruments and minimising litigation issues to strengthen resilience.

All these principles play an important role in the prevention and effective resolution of sovereign debt problems. Debt sustainability is a fundamental long term policy

[69] G20, 'Operational Guidelines for Sustainable Financing', March 2017.

objective, one that should prevail above opportunistic behaviour for short term gains.[70]

With specific focus **on sovereign debt restructuring,** the United Nations General Assembly adopted its resolution 69/319 on 10 September 2015.[71] Such resolution contains nine basic principles to be observed in a sovereign debt restructuring procedure, namely, the right to sovereign debt restructuring, good faith, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, sustainability and principle of majority restructuring.[72]

In particular, the UN resolution clearly stresses that the sovereign country's right to design its macroeconomic policy, including restructuring its sovereign debt, should not be frustrated or impeded by any abusive measures. But still, restructuring has to be seen as the last resort and, at the same time, outset creditors' rights have to be preserved.[73] The use of good faith by both the sovereign debtor and all its creditors is specifically recalled and, from a practical perspective, this should entail the engagement of all the parties involved in constructive restructuring workout negotiations. The parties should pursue the aim of a prompt and durable re-establishment of debt sustainability and debt servicing.[74]

Obviously, the restructuring process has to be done in a transparent way allowing to enhance the accountability of the actors concerned.[75] The process should be characterised by impartiality. To be impartial, the process needs that all institutions and actors involved act independently and 'refrain from exercising any undue influence over other stakeholders or engaging in actions that would give rise to conflicts of interest or corruption or both'.[76]

Sovereigns have 'the duty to refrain from arbitrarily discriminating among creditors, unless a different treatment is justified under the law, is reasonable, and is correlated to the characteristics of the credit, guaranteeing inter-creditor equality, discussed among

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[70] In a similar vein, Bodo Ellmers, *supra*, 24, argues that 'an effective ex-post snactioning mechanism is therefore necessary to ensure that debt found non-compliant with responsible lending and borrowing principles is not being repaid. In other words, illegitimate debt must be repudiated by the debtor, and eventually cancelled'.
[71] United Nations General Assembly, 'Resolution 69/319', 10 September 2015, available at https://digitallibrary.un.org/record/804641/files/A_RES_69_319-EN.pdf.
[72] **It is worth noting that the United Nations General Assembly Resolution 69/319 has been adopted with 136 votes in favour, 6 votes against and 41 abstentions.**
[73] United Nations General Assembly, 'Resolution 69/319', 10 September 2015, Principle 1, available at https://digitallibrary.un.org/record/804641/files/A_RES_69_319-EN.pdf.
[74] *Id*. Principle 2.
[75] *Id*. Principle 3.
[76] *Id*. Principle 4.

all creditors. Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded *ex ante* from the sovereign debt restructuring process'.[77] (However, the IMF should maintain its preferred creditor status, as no other institutions has the lender of last resort role for countries that the IMF performs.)

'Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted'.[78]

'Legitimacy entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement'.[79]

The debt restructuring should be completed in a timely and efficient manner and lead to a stable debt situation, 'preserving the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights'.[80]

'States should be encouraged to include collective action clauses in their sovereign debt to be issued'. This is because 'majority restructuring implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors are not to be affected, jeopardized or otherwise impeded by a non-representative minority of creditors'.[81]

Such a resolution provides a complete set of principles that can help make the negotiations between sovereigns and borrowers both fair and effective. Its background is represented by the guidance developed by UNCTAD in its 'Sovereign Debt Workouts: Going Forward – Road Map and Guide' published back in 2015.[82] This work, in turn, 'appeals to five general legal principles – legitimacy, impartiality, transparency, good faith and sustainability – that provide an interpretative legal framework for a step-by-

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[77] *Id*. Principle 5.
[78] *Id*. Principle 6.
[79] *Id*. Principle 7.
[80] *Id*. Principle 8.
[81] *Id*. Principle 9.
[82] UNCTAD, Financing for development: debt and debt sustainability and interrelated systemic issues, *supra*, 14.

step guide to a fairer and more efficient sovereign debt workout procedure, covering all stages from the decision to restructure to preparing negotiations, the negotiations themselves and post-restructuring issues'.[83]

In line with soft-law making some have proposed a model-law approach to sovereign debt restructuring.[84] It is argued that it would be sufficient if either the UK or New York (or both) adopted a sovereign debt restructuring legal framework as their domestic law.[85] This is based on the consideration that the vast majority of sovereign bonds are regulated under either New York law or English law. Therefore, the enactment by one of these two jurisdictions of a bunch of rules allowing the efficient and effective restructuring of defaulting sovereign debt would be enough to reach the goal of having in place an efficient procedure without the need of adopting an international treaty.[86] The success of this proposal depends on the willingness of the UK and New York to pass a domestic law providing specific rules on how to restructure defaulting sovereign bonds.

6. Soft law rules and the role of debt management offices

Public debt management, according to the IMF, 'is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk'.[87]

Typically, governments set up debt management offices. Their primary function is to regularly deal with the main debt stakeholders and produce investor-friendly reports with debt statistics and other relevant information. The importance of these aspects is clearly underlined even by the UNCTAD, that has argued that 'close attention should be paid to capacity-building and investment in the area of debt data quality and transparency'.[88] And the main reason for this rests on the assumption that 'improved debt data availability and quality is indispensable to the design of appropriate debt sustainability policies, whether at the national or international levels, particularly given the growing complexity of debt instruments and the need to strengthen operational risk

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[83] *Id.*, 14.
[84] Steven L. Schwarcz, 'A model-law approach to restructuring unsustainable sovereign debt', CIGI Policy Brief, No. 64, August 2015, updated as of June 2017, 1.
[85] *Id.*, 2.
[86] *Id.*, 3.
[87] IMF, 'Revised Guidelines for Public Debt Management', Policy Paper, 1 April 2014, http://www.imf.org/external/pp/ppindex.aspx.
[88] UNCTAD, 'Financing for development: debt and debt sustainability and interrelated systemic issues', *supra*, 12.

management capacities'.[89]

In such context, the IMF has pointed out that 'the allocation of responsibilities among the ministry of finance, the central bank, or a separate debt management agency, for debt management policy advice and for undertaking primary debt issues, secondary market arrangements, depository facilities, and clearing and settlement arrangements for trade in government securities should be publicly disclosed'.[90]

One of the main practical obstacles to putting in place effective sovereign debt restructuring practices is the fact that developing countries often lack sophisticated and skilled debt management offices able to workout an efficient solution. They are meant to negotiate a workable solution with their creditors, who are mostly global financial institutions, such as international banks and investment funds, that in turn can rely on an 'army' of lawyers and financial advisors generously paid to take care of their own interests. The disparity in terms of resources between the counterparties is clear, as recognised by the G20 Operational Guidelines for Sustainable Financing, and is also very difficult to be eliminated. Indeed, for a country that has to restructure its own debt is never easy to make up a team of knowledgeable advisors willing to work to safeguard its interests in the restructuring procedure with its international creditors. This is why the G20 Operational Guidelines for Sustainable Financing stress the relevance of the 'Provision of the necessary technical assistance to debtor countries, directly or through the international institutions in order to enhance their debt management capacities, while ensuring recipient countries take ownership over building their debt management capacities'.[91]

We endorse in this paper the issuance under the auspices of UNCTAD of a set of specific and technical standards on how to negotiate sovereign bonds and how to carry out a debt restructuring process. A deep level of specificity could indeed make less relevant the disparity of skills and technical knowledge between the counterparties on the grounds that the procedure is somehow guided by these standards and therefore very little room is left to the discretion of the parties.

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[89] *Id.*, 12.

[90] IMF, 'Revised Guidelines for Public Debt Management', *supra*.

[91] G20, 'Operational Guidelines for Sustainable Financing', March 2017, also stating that 'This specifically covers the ability to staff and train debt management offices, and to ensure their familiarity with the different forms of sovereign borrowing, as well as the costs and opportunities attached to them. G20 countries support the Debt Management Facility (DMF) of the IMF and the World Bank and the Debt Management and Financial Analysis System (DMFAS) program of the United Nations Conference on Trade and Development (UNCTAD), and the ongoing work aimed at strengthening the Debt Sustainability Framework (DSF) of the IMF and the World Bank as a shared reference by all potential lenders in their dealings with a borrower'.

As usual when it comes to soft law principles, the success would rest on the willingness of the parties involved to make themselves voluntarily subject to such rules. Nevertheless, the support of international institutions, such as the IMF, the World Bank and the United Nations as well as the involvement of regional players can help in this effort of capacity building via the adoption of a set of specific and technical standards on the way to perform such restructuring procedure.

7. Debt Sustainability Assessments (DSAs)

A different way to make sovereign debt restructuring effective and, at the same time, sensitive to the public interests at stake is the so-called 'incremental approach' advocated by Matthias Goldmann and Juan Pablo Bohoslavsky.[92] Such approach should complement the way in which, currently, sovereign debt restructuring is performed, through the application of a number of general principles, the most significant of which is the principle of sovereign debt sustainability. In so doing, such principles should be able to remedy the shortcomings affecting sovereign debt restructuring procedures.[93]
This approach is based on the assumption that debt sustainability is now regarded as a principle of international public law that, in turn, embeds two important underlying public interests, such as economic development and growth, on one side, and protection of human rights, on the other side.[94]

With the Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative, in particular, debt sustainability has been recognized in the context of multilateral debt, thereby leading to a significant policy change.[95] In the same vein, the Paris Club[96] has further extended the possibility of debt relief, mainly through the

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[92] Juan Pablo Bohoslavsky and Matthias Goldmann, 'An incremental approach to sovereign debt restructuring: sovereign debt sustainability as a principle of public international law', (2016) 41, The Yale Journal of International Law Online, 13.
[93] *Id*., 15.
[94] *Id*., 21.
[95] See https://www.imf.org/external/np/exr/facts/hipc.htm and http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20634753~menuPK:4876270~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html.
[96] See www.clubdeparis.org, where the Club is defined as 'an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. As debtor countries undertake reforms to stabilize and restore their macroeconomic and financial situation, Paris Club creditors provide an appropriate debt treatment. Paris Club creditors provide debt treatments to debtor countries in the form of rescheduling, which is debt relief by postponement or, in the case of concessional rescheduling, reduction in debt service obligations during a defined period (flow treatment) or as of a set date (stock treatment). The origin of the Paris Club dates back to 1956 when Argentina agreed to meet its public creditors in Paris. Since

introduction of the Evian terms in 2003.[97] These measures lie on the grounds that debt sustainability is a precondition for economic development and growth.[98] Such a change of perspective has finally led to reconsidering debt sustainability as a global public matter in international law.[99]

The international recognition of debt sustainability as a primary goal to achieve in the context of debt restructuring has also found the support of both the IMF[100] and the World Bank.[101] In particular, the IMF has developed a formal framework for conducting public and external debt sustainability analyses (DSAs)[102] as a tool to better detect, prevent, and resolve potential crises. This framework became operational in 2002.[103]

'The objective of the framework is threefold, namely: 1) to assess the current debt situation, its maturity structure, whether it has fixed or floating rates, whether it is indexed, and by whom it is held; 2) to identify vulnerabilities in the debt structure or the policy framework far enough in advance so that policy corrections can be introduced

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then, the Paris Club has reached 433 agreements with 90 different debtor countries. Since 1956, the debt treated in the framework of Paris Club agreements amounts to $ 583 billion.'

[97] Martin Weiss, Cong. Research Serv, RS21482, 'The Paris Club and international debt relief' (2013), available at https://www.fas.org/sgp/crs/misc/RS21482.pdf.
[98] Barry Herman, José Antonio Ocampo & Shari Spiegel, 'Introduction: The Case for a New International Reform Effort', in *Overcoming Developing Country Debt Crises* 18 (Barry Herman, José Antonio Ocampo & Shari Spiegel eds., 2010)
[99] Juan Pablo Bohoslavsky and Matthias Goldmann, *supra*, 23.
[100] International Monetary Fund, 'Assessing Sustainability', IMF Policy Paper 4 (May 28, 2002) where debt sustainability is defined as 'a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure'.
[101] International Monetary Fund & International Development Association, 'Debt Sustainability in Low-Income Countries—Proposal for an Operational Framework and Policy Implications', (Staff Paper, 2004), 7, where debt sustainability is defined as 'the condition that this debt can be serviced without resort to exceptional financing or a major future correction in the balance of income and expenditure'.
[102] In a DSA a judgment is made about a member's debt-to-GDP ratio. It is deemed unsustainable if such ratio is likely to continue to rise in the medium term, no matter what adjustment measures are introduced and no matter how much financing is provided by the Fund. The Fund's approach to debt sustainability analysis differentiate between market-access countries, that typically have significant access to international capital markets, and low-income countries, which meet their external financings needs mostly through concessional resources. The assessments of public and external debt sustainability are conducted in the context of both IMF program design and reviews, and Article IV surveillance. The framework for public debt sustainability analysis was reformed in 2011 and guidance to staff on the implementation of the new framework was introduced in May 2013. See, International Monetary Fund, 'Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries', at http://www.imf.org/external/np/pp/eng/2013/050913.pdf, May 2013. The paper underlined the need for further improvements of the Fund's DSA Framework in order to make sharper judgments with respect to debt sustainability and ensure that debt restructuring is timely and sufficient in those cases where it is clearly warranted.
[103] IMF, 'Debt sustainability analysis', 28 July 2017, available at https://www.imf.org/external/pubs/ft/dsa.

before payment difficulties arise; 3) in cases where such difficulties have emerged, or are about to emerge, to examine the impact of alternative debt-stabilizing policy paths'.[104] 'The framework consists of two complementary components: the analysis of the sustainability of total public debt and that of total external debt. Each component includes a baseline scenario, based on a set of macroeconomic projections that articulate the government's intended policies, with the main assumptions and parameters clearly laid out; and a series of sensitivity tests applied to the baseline scenario, providing a probabilistic upper bound for the debt dynamics under various assumptions regarding policy variables, macroeconomic developments, and financing costs'.[105]

DSAs results 'must be assessed against relevant country-specific circumstances, including the particular features of a given country's debt as well as its policy track record and its policy space'.[106] 'Thus, two types of frameworks have been designed: those for market-access countries and those tailored for low-income countries. In both cases, the frameworks have been regularly refined with a view to—among other elements—bringing a greater discipline to the analysis and responding to the changing economic and financial environment'.[107]

In other words, the DSA is meant to ascertain whether a country has the capacity to grow out of its debt.[108]

From a general viewpoint, the United Nations General Assembly in its Resolution 69/319 has argued that 'Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.'[109] Particularly significant is the focus that the United Nations General Assembly has placed on the respect of human rights.

Sovereign debt sustainability is today widely recognized in international legal practice, on the grounds that it guides the policies of all major multilateral institutions dealing

[104] *Id.*
[105] *Id.*
[106] *Id.*
[107] *Id.*
[108] Sean Hagan, 'Debt Restructuring and Economic Recovery' in Rosa M Lastra and Lee Buchheit (eds), *Sovereign Debt Management* (Oxford: Oxford University Press, 2014), 359-385.
[109] United Nations General Assembly, 'Resolution 69/319', 10 September 2015, available at https://digitallibrary.un.org/record/804641/files/A_RES_69_319-EN.pdf.

with sovereign debt.[110] Nevertheless, this does not necessarily mean 'that private interests of creditors can no longer play a role in debt restructurings'.[111] Rather, they have 'to be balanced against the public interests reflected in sovereign debt sustainability'.[112]

The real challenge, however, is that courts around the world faced with holdout litigation have given relatively 'little consideration to defences raised by debtor states that invoked sovereign debt sustainability as a goal'.[113] Holdout creditors have kept on pursuing their own interests despite the multilateral efforts to relieve heavily indebted poor countries of their external debt burden.[114] From a practical perspective, it is claimed the lawsuits brought by holdout creditors have 'significantly eroded the (limited) fiscal space created by debt relief initiatives for resources to alleviate poverty and foster economic development in these countries'.[115]

In some jurisdictions, law courts have recognised the interests 'reflected in the principle of debt sustainability, by granting immunity to debt repudiation aimed at safeguarding the basic human rights of citizens in the debtor states'.[116]

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[110] Juan Pablo Bohoslavsky and Matthias Goldmann, *supra*, 26.
[111] *Id*., 26.
[112] *Id*., 27.
[113] *Id*., 28, who underline that 'Courts in the United States have persistently ruled that, in the absence of contractual clauses providing for majority vote, the sanctity of contracts prevails so that unanimity of creditors is needed to make a restructuring agreement binding for every creditor'. The authors quote a number of cases, such as Allied Bank International v. Banco Credito Agricola de Cartago, 757 F.2d 516 (2d Cir. 1985); Pravin Banker Associates v. Banco Popular del Peru, 109 F. 3d 850, 854 (2d Cir. 1997); Elliot Associates v. Banco de la Nacion and the Republic of Peru, 12 F. Supp. 2d 328 (S.D.N.Y. 1998). They also argue that 'invoking sovereign immunity has mostly been unsuccessful since the deliberate turn to sovereign debt litigation and the regular inclusion of waivers of immunities in the terms of debt instruments since the 1990s'. See also as regards the Argentine litigation: NML Capital et al. v. Argentina, 699 F.3d 246, 263 (2d Cir. 2012).
[114] Human Rights Council, 'Promotion and Protection of All Human Rights, Civil, Political, Economic, Social and Cultural Rights, Including the Right to Development', Report of the independent expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights, Cephas Lumina, A/HRC/14/21 (April 29, 2010).
[115] Juan Pablo Bohoslavsky and Matthias Goldmann, *supra*, 31-32, underlining that there have been some rare cases where courts have recognized sustainability concerns. Indeed, due to the potential global effects of the restructurings ongoing, US courts have sometime acknowledged a legitimate interest in order to safeguard financial stability. The authors mention the cases of Crédit francais, S.A. v. Sociedad financier de comercio, C.A., 128 Misc.2d 564 (S.C.N.Y. 1985); EM Ltd. v. Argentina, No. 05-1525-cv, Summary Order (May 13, 2005), 2d Cir. R. 32.1. (obiter dictum lacking precedential value).
[116] *Id*., 33, quoting some cases, such as the case about judicial immunity of Argentina in Italy: Corte di Cassazione, Sezione Unite Civile, n. 11225 (May 27, 2005), 88 Rivista di Diritto Internazionale (2005) 856 (Ital.); or the holdout litigation cases before Argentinean courts: Juzgado Nacional en lo Contencioso Administrativo Federal N° 1 [Lower National Court for Administrative Matter No. 1], 12/10/ 2006, La Ley [L.L.], Suplemento Derecho Constitucional L.L., Feb. 27, 2007.

Notwithstanding this recognition, in general the adequate protection of the broader policy considerations of sovereign debtors in debt restructurings is hampered by the fact that both parties (creditors and debtors) still rely on national courts of justice applying national law for the resolution of sovereign debt problems. The existential dilemma in sovereign debt restructuring is, indeed, the one between the sanctity of contract and broader policy considerations (*e.g.* poverty alleviation, sustainability, human rights).

In the words of Lee Buchheit:

> *To say that sovereigns should be accountable in municipal courts for their debt contracts, however, is not to say that municipal courts are an appropriate forum for administering a sovereign debt crisis. Judges, powerful as they may be within the four walls of their own courtrooms, are ill-equipped and ill-positioned to decide how the discomfort of a financial crisis should be apportioned among the citizens of the debtor country and the various classes of its creditors. Judges can only hand down judgments saying that, as a matter of law, the sovereign is bound to pay. They cannot prescribe the nature or the degree of the sacrifices that the sovereign would need to impose on its other stakeholders in order to make those payments or satisfy those judgments.(…) [W]e have thus established a framework that makes sovereigns accountable to the judiciary for the performance of their sovereign debt contracts even though everyone recognizes that the judiciary is wholly irrelevant in the face of a large sovereign debt problem (…).*[117]

Since unconditional respect for the sanctity of contract contributes to the success of the US and the UK as attractive business jurisdiction, they might not be willing to adopt a perspective that favours 'distributive justice' over 'procedural justice'. National courts and national law are not designed to deal with broader policy distributive issues.

Policy considerations fall into the legal category of public interests that, over time, defaulting sovereigns have often invoked in the lawsuits against their creditors. 'Public interest defences had considerably high success rates in the 1980s and even more so in the 1990s. However, these rates have significantly decreased since the 2000s'.[118] The current retreat from internationalism is a challenge to advance in the direction of giving

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[117] Lee Buchheit, 'Sovereign debt in the light of eternity' in Lastra and Buchheit*, Sovereign Debt Management supra (*OUP 2015), page 466. Hayk Kupelyants in his excellent book on '*Sovereign Defaults before domestic courts'* (OUP 2018), talks about distributive fairness and procedural fairness.
[118] Matthias Goldmann and Grygoriy Pustovit, 'Public interests in sovereign debt litigation: an empirical analysis', Goethe University Frankfurt, Research Center SAFE, February 2018, 2.

due consideration to the broader policy impact and human rights implications of sovereign debt workouts.[119]

A legislative solution (hard law) can of course give momentum to soft law initiatives. The United Kingdom and Belgium have adopted 'anti-vulture' legislation.[120] Such a legislation is mainly aimed at preventing 'claims against heavily indebted poor countries that exceed the amount that a holdout creditor would have received had he accepted the restructuring'.[121]

Sovereign debt sustainability is not just a private matter between the sovereign and its creditors, but rather a global public interest concerning the international community as a whole and, as such, it should be increasingly considered by the Courts of Justice adjudicating on these issues, even within the contractual dimension of the creditor-debtor relationship.

Though soft law rules are not binding and enforceable, they could acquire more legal strength if States chose to unilaterally adhere to them. Besides that, law courts could decide to implement such principles in interpreting contractual provisions anyway. In civil law jurisdictions, for example, general clauses, such as good faith, might lead to the application of principles to substantiate their meaning. In the same vein, in common law jurisdictions, comity or equity might provide similar outcomes.

To make such an approach even more effective, we would need a debt workout institution aimed at facilitating the application of such principles via specific recommendations and technical assistance. Such an institution would not necessarily need a treaty legal basis to be set up.[122] Indeed, UNCTAD could play a role in this regard.

8. Conclusion

The UNCTAD Principles on Sovereign Lending and Borrowing and other soft law standards aimed at debt sustainability can play an important role in filling the legal vacuum that exists in the absence of an international convention on matters of sovereign debt.

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[119] *Id.*, 2, pointing out that, by contrast, in the 1990s the US courts were 'much more receptive to public interest defences, in line with the political views of both the US Government and the international institutions at that time'.
[120] United Kingdom Debt Relief (Developing Countries) Act, 2009-2010, H.C. Bill [22], available at http://www.legislation.gov.uk/ukpga/ 2010/22/contents.
[121] Juan Pablo Bohoslavsky and Matthias Goldmann, *supra*, 33.
[122] *Id.*, 33-41.

The top-down soft principles agreed by UNCTAD together a set of specific technical rules (a 'manual') can complement the existing contractual regime (standardised clauses such as CACs, an example of bottom-up soft law) to create greater predictability in the context of debt restructuring and debt sustainability. UNCTAD could also monitor how member countries observe the provisions of such soft law rules.

Soft law can act as an 'equalizer' in the negotiations between debtors and creditors. UNCTAD can play a central role in a concerted effort by international organisations, such as the IMF, World Bank and regional development banks, working together with national Debt Management Offices and central banks, in the adoption and implementation of soft law principles to promote responsible sovereign lending and borrowing. Courts of Justice can also promote the observance of these soft law principles.

One can envisage a level of convergence in the area of sovereign debt similar to the convergence achieved by central banks in the area of capital regulation through the adoption of the soft law standards issued by the Basel Committee on Banking Supervision. What started as soft law is now hard law.