

The creation of a sovereign debt restructuring mechanism. A broken promise?

Leading questions

- (1). Why has the UN failed to implement its commitment to a multilateral debt workout mechanism?
- (2). How are the nine principles supposed to help countries at a high risk of debt default?

- In today's remarks, I would like to describe, **first**, the obstacles that the United Nations has encountered in moving forward with the establishment of a multilateral mechanism for debt restructuring. My presentation will focus on the political as opposed to the technical obstacles. **Second**, I would like to illustrate how a mechanism based on the 2015 UN Principles would help countries navigate through their unsustainable debt burdens.
- Within the United Nations framework, developing countries have put forth many initiatives to create a multilateral mechanism for restructuring sovereign debt, but to no avail. The UN's latest commitment on the matter was reflected in Resolution 69/247 –adopted by the General Assembly in 2014 and backed by 120 countries– which established an *ad hoc* committee to elaborate a multilateral legal framework for sovereign debt restructuring processes. However, as to this date, no substantive advances have been made.
- Two reasons can help explain why the UN has failed to implement its commitment to a debt restructuring mechanism.
 - The **first reason** that explains this failure is that proposals for reforming the international financial architecture have been systematically opposed by most financial centers. This opposition can partly be explained by coordination problems or budgetary concerns. In addition, developed countries' position is also influenced by the opposition of powerful private creditors. Indeed, creditors can and have successfully used their financial resources and market expertise to influence regulatory and policy outcomes through lobbying. Moreover, financially advanced countries have tried to protect creditor's contribution to the economy, and have thus been inclined to avoid taking any action that could destabilize financial markets. Both private creditors and developed countries generally fear that a more institutionalized debt restructuring mechanism might encourage more applications for debt relief and, more importantly, shift the terms of bargaining in favor of debtor countries. Against this backdrop, developing countries argue that the issue of debt is the exclusive preserve of the IMF and the World Bank, two institutions on which the United States and EU Member States traditionally wield considerable influence, rather than in the UN.
 - **Second**, debtor states may also have incentives to abstain from supporting any reform proposal if they fear that said endorsement might affect their credit ratings or otherwise undermine their creditworthiness in the eyes of creditors. Historically, in this debate over debt restructuring mechanisms, most developing countries have had to choose between defending their interest as individual borrowers and their collective interest in facilitating more efficient and equitable outcomes in the event of sovereign default. The need to avert credit downgrades creates strong economic incentives to 'short termism'

that remains a serious obstacle to any UN initiative on the matter. Even though advancing the implementation of a multilateral restructuring solution might benefit States in the event of a crisis, many still refuse to support initiatives that they fear could raise their international borrowing costs during normal times.

- If established, however, a framework based on UN Principles would contribute to resolve most of the deficiencies observed in recent restructuring processes. Among the nine UN Principles¹, I shall briefly focus on how a multilateral framework would boost sovereignty, impartiality and legitimacy in sovereign debt restructurings.
 - As for **sovereignty**, proposals to create a multilateral soft law forum to renegotiate debt would preserve State's sovereignty in two manners. First, since such a mechanism would *not* be a judicial or treaty-based institution that would require States to waive their sovereign immunity. Second, because it would minimize the possibility of litigation in foreign jurisdictions –such as London or New York courts– which may severely hamper the debtor's sovereignty.
 - Finally, regarding **impartiality and legitimacy**, a debt restructuring mechanism housed in the United Nations would help achieve institutional impartiality in debt workouts: the United Nations may be considered an impartial international institution to the extent that it is not itself implicated in sovereign lending -as opposed to the IMF or the World Bank. For instance, a UN-based mechanism could produce transparent assessments of debt sustainability – which are sometimes an issue during current debt restructurings. In effect, when States have to renegotiate before both private and bilateral or multilateral official creditors, private bondholders may question Debt Sustainability Assessments (DSAs) produced by the IMF or the World Bank, as they may rationally fear the possibility of bias or conflict of interest.
- Thank you very much

¹ Namely, sovereignty, good faith, transparency, impartiality, equitable treatment of creditors, sovereign immunity, legitimacy, sustainability, and majority restructuring.

