TOWARD JUSTICE CENTRED DEBT SOLUTIONS

Lessons from Argentina

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The report was commissioned by Debt & Development Coalition Ireland (DDCI), who fully endorse its findings, as part of our ongoing work to educate and advocate for just solutions to the global debt crisis. DDCI is a membership organisation based in Ireland working for global financial justice.

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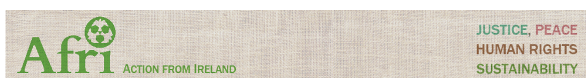

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executive summary

Argentina's experience with debt, default and restructuring has been—and continues to be—the focus of much international attention. There are good reasons for this. As countries in the European periphery struggle with unsustainable debt loads and austerity policies that privilege creditors while punishing working people and the poor, many are wondering, based on Argentina's experience, whether default wouldn't be a better option.

The story of Argentina's 2001 debt crisis and default starts twenty five years earlier, with the bloodiest military coup in the country's history and the implementation of neoliberal economic reforms. Since then, Argentina has had two major cycles of unsustainable debt accumulation and default. The first cycle took place during the dictatorship itself: between 1976 and 1983, Argentina's public debt quintupled, increasing from $9 billion to $45 billion. The second cycle occurred between 1991 and 2001 when Argentina's public debt increased from $60 billion to $144 billion leading to Argentina's spectacular December 2001 default.

Did default result in the catastrophe predicted by pundits for the European periphery countries should they try to follow Argentina's example? Quite the contrary, after default Argentina began a remarkable recovery. Default reduced external payment obligations and eliminated Argentina's dependence on foreign capital markets. More importantly, Argentina no longer had to submit to IMF tutelage, since it was no longer requesting IMF loans.

Argentina restructured its defaulted debt in 2005 and 2010. The restructuring was considered successful, with 92.4% of defaulted debtors accepting the government's offer that included a substantial capital reduction, longer maturities and lower interest rates. A small sub-group of the 7.6% of creditors that did not accept the government's restructuring offer are speculative investment funds—commonly referred to as vulture funds—who sued the Argentine government in New York courts for full payment. The US courts ruled in favour of the vulture funds, putting the entire Argentine debt restructuring at risk of collapse and leaving the country on the verge of yet another default.

As a result of the ruling, Argentina was forced into an impossible situation. If it chose to abide by the ruling, it would have exposed itself to similar lawsuits by the remainder of the 7.6% of holdout creditors, totalling an estimated $15 billion. Additionally, the creditors that had accepted the restructuring offers could have claimed that Argentina was making a better offer to holdouts and claim the same, improved, offer resulting in an unserviceable debt load and a new default.

If Argentina chose to ignore the court's ruling, it would have also faced severe problems as a substantial portion of restructured bonds are paid through the Bank of New York Mellon, a bank under the legal jurisdiction of the Second District Court. The court forbade the bank from paying restructured bonds unless it also paid the vulture funds at the same time. Therefore, if Argentina is not to be forced into default by the judge, it needs to find alternate routes for making payments.

The New York courts' ruling in favour of the vulture funds not only complicates Argentina's future, it also poses potentially insurmountable problems for any future sovereign debt restructuring. Argentina's experience highlights the imperative need for some form of generally agreed-to process to solve sovereign debt crises and defaults.

Proposals for sovereign debt resolution can be broadly grouped into two categories. On one side is a "market solution," promoted by the U.S. Treasury department, the International Capital Markets Association and the IMF. This approach promotes the inclusion of collective action clauses (CACs) in bond contracts hoping to prevent holdouts (and especially vulture funds) from derailing a restructuring process. Many market specialists and economists, including Nobel Prize winner Joseph Stiglitz, do not believe CACs will work as advertised.

On the other hand are those promoting a more formal, "statutory" solution. In its most reduced form this means legislation at the national level blocking vulture funds from using courts to sue periphery countries, such as that enacted in the UK and Belgium. More ambitiously, others call for some form of international legal framework to enable working out sovereign defaults. A resolution passed on September 9, 2014 by the United Nations General Assembly calling for the creation of a "multilateral legal framework for sovereign debt restructuring" gives new hope that an international statutory solution may be indeed possible. Despite multiple areas of uncertainty in the resolution, an ad-hoc committee began work in early 2015 on this framework.

key recommendations

It should be clear that, at least for the time being, no single proposal will provide a definitive solution in the transition to a more just and fair international order. Consequently, we suggest the following guidelines for action:

1. Promote multiple and concurrent measures rather than focusing exclusively on "market solutions": Tackling the problem of sovereign defaults and debt restructuring from different angles will make it less likely that vulture funds will be able to intervene.

2. Participate actively in multilateral framework negotiations: The multi-lateral approach has many areas in need of greater clarity: institutional framework, trigger mechanisms, scope of the process, and arbitration criteria, to name a few. Therefore, it is critical that a wide range of organizations participate in the process.

3. Participate based on non-negotiable working principles: Governments should use the following non-negotiable working principles:

- Given the IFIs are not neutral players, there should not be a decision-making role for the IMF and other international financial institutions in the multilateral framework.
- The resulting mechanism should be legitimate and impartial.
- Equality of all sovereign nations.
- Protection of the entire range of human rights.

4. Support sovereign nations' prerogative to default: The international financial architecture being what it currently is means that debt will continue to be an issue, especially for periphery countries, for quite some time. Until lasting solutions are found, solidarity with national government decisions to not pay illegitimate and unsustainable debts must deepen.

5. Work to bring about a more equitable and balanced international economic order: New debt resolution mechanisms may alleviate some suffering in times of debt crises, but will not ultimately change the international financial architecture nor solve its many profound problems. This is why much deeper changes are needed including:

- Putting an end to the macroeconomic policies of fiscal consolidation and austerity.
- Putting an end to fiscal benefits for economically powerful actors and the wealthy.
- Implementing more detailed controls on lending practices to regulate the intense level of debt flows in the global economy.

introduction

Argentina's experience with debt, default and restructuring has been—and continues to be—the focus of much international attention. There are good reasons for this. As countries in the European periphery[1] struggle with unsustainable debt loads and austerity policies that privilege creditors while punishing working people and the poor, many are wondering, based on Argentina's experience, whether default wouldn't be a better option. Indeed, much in Argentina's experience after default indicates that defaulting may well be the better option for countries struggling with debt and austerity while large segments of the population slide into poverty and destitution.

However, default, while potentially necessary, is only the first step in dealing with the profoundly destructive legacy of financialised[2] neoliberal globalisation. There are many other issues, such as how to conduct a debt audit to determine what portion, if any, of the debt is legitimate and, eventually, how much and under what conditions to restructure. In Argentina's case, successive governments since the December, 2001 default have chosen not to audit the debt considering all debt legitimate and, eventually, eligible for the debt restructuring process that Argentina undertook to leave the default behind.

The Argentine debt restructuring took place in 2005 and 2010 and was considered quite successful, with 92.4% (in value) of defaulted debtors accepting the government's offer—an offer that included a substantial capital reduction, substantially longer maturities and lower interest rates. A small sub-group of the 7.6% of creditors that did not accept the government's restructuring offer are speculative investment funds—commonly referred to as vulture funds—who sued the Argentine government in New York courts for full payment. The US legal system agreed with the vulture funds, putting the entire Argentine debt restructuring at risk of collapse and leaving the country on the verge of yet another default.

While the fallout of the court's ruling is still being played out at the time of this writing, there are many important lessons that emerge from the Argentine experience. The purpose of this report is to discuss these lessons in the hope that others may learn from them. We hope it will provide useful information and analysis for those working for more just and egalitarian economic and financial structures at the local, national and international levels. The report is structured as follows: In the first section we present an overview of Argentina's history with debt, the ensuing default, how Argentina fared after default and the issues surrounding the debt restructuring process and legal battles with the vulture funds. In section two, based on Argentina's experience, we discuss what alternatives are necessary or desirable to guarantee a fair and equitable solution to sovereign defaults. The report concludes with recommendations for multi-level citizen action.

1 In this paper, European periphery usually refers to Greece, Portugal, Ireland and Spain.

2 Since the mid 1970s, increasing financial deregulation nationally and internationally has led to a radical increase in power of financial actors and markets. Financialisation is the term used by progressive economists to describe this phenomenon.

#1 Argentina's default and its lessons

The story of Argentina's 2001 debt crisis and default starts twenty five years earlier, with the bloodiest military coup in the country's history. Not coincidentally, with the coup came the first wave of neoliberal economic reforms—primarily financial deregulation and opening up to foreign capital flows and speculation. Together with the neoliberal reforms came ruthless repression of organized labour and social movements. The dictatorship had systematically disappeared thousands of people by the time it left power in 1983.

Since its neoliberal turn in 1976, Argentina has had two major cycles of unsustainable debt accumulation, default and restructuring. The first cycle took place during the military dictatorship itself: between 1976 and 1983, Argentina's public debt quintupled, increasing from $9 billion to $45 billion. This debt, mostly with Northern banks, was subject of a court case that documented hundreds of irregularities. The trial provided solid evidence for considering this debt both illegitimate and odious,[3] but unfortunately Argentine governments to date have never exploited this opportunity.[4]

The second major cycle of debt accumulation occurred between 1991 and 2001 when Argentina's public debt increased from $60 billion to $144 billion. This period included the Brady bond restructuring in 1993, when debt to banks was transformed into bonds under US legislation. This had two significant results. First, Argentina relinquished sovereignty by accepting US legal jurisdiction for future disputes over Argentina's public debt. This was to have a substantial impact in later legal battles with the vultures. The second result was the change of creditors for Argentina's sovereign debt: no longer was money owed to banks, but to thousands, even millions, of bondholders world-wide. As we shall see below, this too was to have a direct connection to the vulture fund lawsuits.[5]

Debt service during the 1990s grew consistently, becoming unsustainable and leading to Argentina's December 2001 default, the largest sovereign default to date. What were the main causes for this spectacular debt accumulation and default? The main reason was the privatisation of social security in 1994, a policy strongly promoted by the International Monetary Fund (IMF) and the World Bank (WB). Data clearly shows that debt service and debt levels began to grow exponentially in 1994 following social security privatisation.[6]

Other factors contributing to debt build-up were foreign interest rate increases, which resulted in higher debt service payments. Additionally, when in 1998 it became clear that the Argentine debt service load and policy framework were becoming unsustainable and private sources of funding dried up, Argentina turned to the IMF for financial assistance. Just like in the European periphery today, the IMF lent, but with the usual austerity conditionality.[7] Not surprisingly, austerity policies had the same disastrous effects they are having in Europe today: the recession became a depression, macroeconomic imbalances worsened and the Argentine debt became unserviceable, making the December 2001 default inevitable.

Before looking at the impact of default on Argentina's economy, we should note that both debt cycles were the result of an intensely neoliberal economic policy framework, to which the IMF and WB contributed significantly. This points to a direct link between so-called "market friendly" policies, financial speculation and profiteering, debt accumulation and crisis. We should also note that none of this is socially neutral: unemployment, poverty, inequality and structural social exclusion have been long-lasting results of these cycles.

3 The documentation provided as evidence for the trial was the closest Argentina came to a debt audit, except that it was not an official initiative but that of private citizen and lawyer Alejandro Olmos.

4 Indeed, in late May 2014 the Argentine government reached an agreement with the Paris Club, establishing a payment schedule for debt in default since 2001. Approximately half of that debt was taken on by the dictatorship.

5 Briefly, if an inability to pay occurred in the case of commercial bank sovereign debt, what ensued was a negotiation between the banks. Litigation was rarely used since it would have interrupted the debt negotiation process. The opposite is true with bondholders, especially with vulture funds. Litigation is a common response to sovereign non-payment.

6 Privatisation in 1994 left a fiscal gap equivalent to 1% of GDP each year until the default occurred in 2001 (Baker and Weisbrot 2002). Given Argentina's currency board arrangement and inability to increase taxes, this fiscal gap was covered with new debt.

7 In the Argentine case, the IMF's diagnosis of the situation was mistaken, which led to mistaken policy prescriptions and disastrous results. For a more detailed description of the IMF's role see Cibils and Lo Vuolo (2007) and Cibils, Weisbrot and Kar (2002).

Default: End of the World or New Beginning?

By December 2001, after three full years of economic recession and unprecedented levels of unemployment, poverty and hunger, Argentina's debt burden was no longer sustainable leaving two options available. The first was to continue to borrow from the IMF to keep up debt service payments, deepening IMF-demanded fiscal austerity. This would have made the debt service load more unsustainable, and worsened the economic recession and social crisis, leading to a never-ending downward spiral of debt, depression and crisis.

The second option was to default, make corrections to the economic policy framework and attempt to start over. The political and economic crisis in Argentina in December of 2001 was such that the only real alternative was to default, which Argentina did.

Did default result in the catastrophe predicted by pundits for the European periphery countries should they try to follow Argentina's example? Quite the contrary! Not only did the catastrophe never materialise, but Argentina began a remarkable recovery. Default immediately reduced external payment obligations, freeing up much needed fiscal resources for more immediate needs. It also eliminated in one fell swoop Argentina's dependence on foreign capital markets: since the country was borrowing to service its debt, defaulting eliminated the need to borrow. More importantly, default meant that Argentina no longer had to submit to IMF tutelage, since it was no longer requesting IMF loans.[8]

Additionally, in February 2002 Argentina abandoned the fixed exchange rate (or convertibility) regime in existence since 1991. The convertibility regime pegged the peso to the dollar by law at a one-to-one exchange rate that resulted in a *de facto* voluntary renouncement of the ability to conduct independent monetary and exchange rate policies.[9] By eliminating the peg to the dollar Argentina recovered its monetary sovereignty and with it the ability to control its fiscal, monetary and exchange rate policies. Additionally, Argentine officials devalued the currency—which had become quite overvalued during the 1990s—improving the international competitiveness of domestically produced goods while making imported goods more expensive therefore providing incentives for domestic production.

Recovering monetary sovereignty and the ability to conduct independent macroeconomic policies enabled the country to shift priorities from pleasing financial markets to boosting demand, generating employment, and reducing poverty. Indeed, following default and devaluation, Argentina experienced seven years of unprecedented economic growth and recovery. One of the main factors explaining this remarkable performance is a fiscal subsidy to the unemployed (which peaked at more than two million beneficiaries), essentially kick-starting internal demand and economic activity. Additionally, the currency devaluation made Argentine exports more competitive internationally, boosting export production, while also making imports more expensive, providing incentives for some degree of import substitution. Finally, international commodity prices were very high, which resulted in large trade surpluses and foreign reserve accumulation.

Debt Restructuring: Swaps, Holdouts and Vultures

In early 2003, it became clear that Argentina was emerging from its political and economic crisis. As a result, the IMF and defaulted creditors increased pressure on Argentina for a solution to its default. After intense negotiations between Argentine government officials and creditors, a debt restructuring swap was opened in 2005 and 76.15% of defaulted debt was restructured. The new bonds were issued with a roughly 50% reduction in nominal value ("haircut"), substantially longer maturity dates, and lower interest rates. Additionally, more than half of the new debt was denominated in Argentine pesos, reducing pressure on the country's foreign reserves.

In 2010, Argentina issued another restructuring offer, with identical terms as the 2005 swap, to try to reduce the amount of outstanding debt in default. Between the 2005 and 2010 debt swaps, a total of 92.4% of defaulted debt had been restructured. By international sovereign default standards, this was considered a highly successful debt restructuring process. Furthermore, it was accomplished without any assistance from the international financial institutions.

However, the Argentine government's approach to debt restructuring has been criticised by progressive activists and politicians and some human rights organisations on several counts.

8 Argentina tried to renegotiate its debt with the IMF for a few years following default, but in order to do that the IMF required further austerity. Tired of these demands, in 2005 President Néstor Kirchner paid off the IMF in full, three years in advance of the loan due date.

9 The Argentine monetary regime under the convertibility law was not unlike the euro framework today, except in the Argentine case it was a unilateral, single-country decision.

How do vulture funds operate?

1. Vulture funds are highly speculative investment funds: they typically buy bonds of countries that are in distress (i.e. in crisis and about to default or even post-default) that typically sell on secondary markets at prices that are significantly below their nominal value. Vulture funds later sue the governments for full repayment. If they succeed, their profits will be huge.

2. Vulture funds are not bona fide creditors: these funds never purchase bonds when the country first issues them. In other words, they are not lending the country money in exchange for the bonds. Vulture funds purchase "off the bottom" of secondary markets, i.e. markets where bonds are traded after their initial issue.

3. Vulture funds have a long history: Argentina's legal battles with the vulture funds have been in the public eye on and off during the last decade. However, Argentina is certainly not the first country to have come under attack from the vultures, and will most likely not be the last if the current international financial order remains unchanged. Other countries that been attacked by vulture funds include Peru, Ecuador, Turkey, Ukraine, the Democratic Republic of Congo, Cameroon and Zambia, to name a few.

4. Vulture funds are very profitable: if the vulture funds get their way with Argentina, they will be obtaining a profit of 1600%! This is the kind of profit vulture funds expect from their dealings with sovereign bonds. Indeed, even their overall profit rate is substantially above average. NML Capital, the vulture fund that sued Argentina and brought the entire 2005-2010 debt restructuring to the brink of collapse has had an average yearly return of 14% since it started operating in 1977. Precisely these rates of profitability allow vulture funds to hire the most expensive lawyers. Additionally, they are in no hurry to cash in—they can wait, and usually do, until countries they sue have no alternative but to pay. That is their game.

5. Vulture funds are not regular (or even good) citizens: during a high-level Argentine congressional delegation to Washington to lobby the US Congress, a member of the US Congress told one of the Argentine representatives: what you call vultures, we call US citizens. Well, not quite. Most vulture funds are based in tax havens, like the Cayman Islands, which means they are trying to evade US taxes. Indeed, Kenneth Dart, owner of EM Ltd. (one of the vulture funds suing Argentina), renounced his US citizenship for that of the Cayman Islands to avoid paying US taxes.

6. Vulture funds serve no economically or socially useful function: vulture funds' main objective is to buy off "the bottom of market" and cash-in the full amount. In this sense, they are not like investors in financial markets that buy and sell based on portfolio objectives and, in so doing, serve to diversify risk and maturities of financial assets. Their only objective is to never lose and, so far, they rarely do.

1. Acceptance of all past debt as legitimate: Perhaps one of the most troubling aspects of the Argentine government's approach to debt restructuring is that it unquestioningly accepted all pre-default debt as valid.[10] This meant ignoring substantial irregularities committed by the military dictatorship (1976-1983) when contracting the debt.[11] Also taken as valid was debt resulting from the financial speculation cycles and restructuring scams of the 1990s, including the "socialisation" of private debt. Critics have rightfully argued that the government should have used the opportunity provided by the default to carry out a long overdue, in-depth audit of public debt.

2. Debt owed to the international financial institutions (IFIs) was serviced in full, without interruption or renegotiation: The official approach has been to fully honour the approximately $32 billion debt to the IFIs when the default took place. Official justification for this approach was that G7 support was needed for a successful debt restructuring and to challenge the validity of IFI debt could have threatened the success of the restructuring effort. As time has shown, this strategy failed, since the IMF and the G7 never did back the Argentine debt-restructuring process. As a result, the strategy on IFI debt implied a larger capital reduction on private creditors and preferential treatment to those who bear substantial responsibility for the Argentine catastrophe (the IMF and the World Bank).

3. All post-default bailouts unquestioned: Following default and devaluation, in order to avoid massive bankruptcies, the government converted all outstanding dollar denominated bank credit to pesos at the old exchange rate of one peso to one dollar, and issued bonds to the banks

10 However, in light of the problems resulting from the legal battles with the vulture funds, a law was passed on 12 September 2014 (law No. 26,984) to enable the government to seek alternative locations to New York to make scheduled debt payments. Article 12 of that law mandates the creation of a bi-cameral commission to investigate the "origin, evolution and current state" of Argentina's public debt. It is not clear whether this commission will ever be convened or whether an in-depth audit will be conducted. Still, article 12 could be used by activists and politicians to promote a debt audit.

11 These irregularities have been extensively documented by Argentine lawyer Alejandro Olmos and were the subject of a lawsuit aimed at forcing Argentina to repudiate that debt. Even though the legal system agreed with Olmos and remitted the findings to the Congress for action, the case has never been acted on by any of the governments since the ruling.

for the difference between the old and the then-current higher nominal exchange rates. In the process, the government bailed out countless large corporations, many of which produced mostly for export markets getting hard currency in exchange—corporations that were in no risk of bankruptcy due to the devaluation. This resulted in a de facto $35 billion increase of Argentine public debt. Critics have maintained that beneficiaries of this new debt should have been identified and a tax levied against those who benefited unduly. This was not done and, as a result, the Argentine workers and defaulted creditors are paying for this unnecessary corporate bailout.

Profits Above All: the Vultures Attack

The Argentine restructuring strategy since 2003, under the Kirchner administrations, can be characterised as prioritising normalisation of Argentina's relationship to the world in general, and financial markets in particular. Still, even this conciliatory approach has run into a major hurdle with a small portion of creditors that did not enter the 2005 or 2010 debt swaps—referred to as the "holdouts."[12] A relatively minor percentage of these holdouts are speculative investment funds, commonly referred to as vulture funds because of their predatory modus operandi. These funds have refused to accept the Argentine government's restructuring offers and sued the Argentine government for full payment of the defaulted bonds they hold, jeopardising the entire 2005-2010 debt restructuring effort and forcing the country towards yet another potential default.

The Vultures take on Argentina

Argentina's recent experience with the vultures dates back to the final months of 2001, when it became clear that the Argentine debt load was not realistically serviceable and that a default would occur sooner rather than later. During those months, funds like EM Ltd. (owned by Kenneth Dart), NML Capital (a subsidiary of Elliott, owned by Paul Singer), Aurelius, and Olifant Fund among many others started buying Argentine bonds on secondary markets at heavily discounted prices.[13]

While vulture fund legal actions against Argentina started as early as 2002, the first major appearance was during the Argentine debt restructuring process of 2004-2005, when some vulture funds attempted to block the process in U.S. courts in order to prevent defaulted creditors from accepting a capital reduction. Those attempts were unsuccessful, but they were a signal of what was to come.

Different vulture funds chose different strategies to cash in. Dart's EM Ltd. sued soon after Argentina's default, but did not get very far in the process.[14] NML Capital, the plaintiff in the lawsuit that has been making headlines for the last two years, initially chose a more spectacular strategy, attempting unsuccessfully to seize Argentine official assets abroad, including Argentine Central Bank reserves and other government assets.[15] Perhaps the most spectacular action was to seize an Argentine Navy training vessel, the *Fragata Libertad* (Liberty Frigate), when it docked in Ghana in October of 2012. The ship was eventually released, but the media impact of this action was substantial and the message was clear: vulture funds have global reach.

However, the most damaging vulture fund action came with what the *Financial Times* was to label the "trial of the century". The lawsuit filed by Paul Singer's NML Capital vulture fund against Argentina based its legal argument on a clause included in the defaulted bonds, known as the *pari passu* clause. This clause essentially states that all creditors should be treated equally, i.e., no creditor should be treated preferentially.[16] The vulture fund claimed that all of those creditors who accepted Argentina's restructuring offer were receiving preferential treatment, as they were being paid and the vulture funds (who rejected the offer) were not.[17]

In February 2012, Judge Thomas Griesa of the Southern District Court of New York sided with the vulture funds and ruled that Argentina could not continue to make payments on its 2005 and 2010 restructured bonds unless it also started to pay the NML Capital vulture fund. In other words, as the ruling stated, the vulture funds should be

12 Bondholders generally "hold out" because they hope to get a better offer down the road or because they hope that some other holdout (for example, vulture funds) will sue the defaulting government and then piggy-back on that lawsuit's outcome.

13 There is some debate about when Argentine bonds were purchased by vulture funds. In the case of NML Capital, some reports state they purchased bonds as late as 2008. While this is relevant information, it is not really central to the debate on the main issue of vulture fund predatory behaviour and the effect it has on debtor nations.

14 Interestingly, the same Judge—Thomas Griesa—who later ruled against Argentina, was not favourable to some of the earlier vulture fund demands.

15 The list of Argentine assets that vulture funds tried to seize is extensive, including the ambassador's residence in Washington, various buildings used by Argentine international delegations, and the official airplane used by the President to travel abroad. The list also spans several countries, including the U.S., Switzerland, France, and Belgium, among others (Burgueño 2014: 108-109).

16 This type of clause was a boilerplate clause in Federal Agency Agreement bonds and was standard in sovereign bonds issued prior to the Argentine 2001 crisis, but is rarely used these days. See Olivares-Caminal (2011) and Jarada (2012-2013).

17 In 1983, Elliott Associates, a vulture fund owned by Paul Singer and of which NML Capital is a subsidiary, successfully sued Perú in Belgian courts using the same type of pari passu clause (Bratton 2004).

Lessons from Argentina on solving sovereign debt crises

Argentina's experience with debt accumulation, crises, default and restructuring leaves important lessons for other indebted countries, bearing in mind that each country has specificities of its own and that no linear transposition can be made from one country to the next.

The first lesson is that a small, peripheral nation can make sovereign decisions about whether to continue to service its debt. If a country chooses to break the stranglehold of international financial markets and the IMF, it can do so unilaterally, as Argentina's experience shows.

Second, default is an option to be considered as it frees up fiscal resources and makes available policy space to change course. This was indeed the case for Argentina, as post-default economic performance indicates.

Third, recovering monetary sovereignty is key in order to be able to carry out independent, people-centred fiscal and monetary policies.

Fourth, a small peripheral nation like Argentina can indeed carry out a debt restructuring process involving a substantial capital reduction without the assistance of the IFIs. Clearly, it would be ideal to first carry out a comprehensive debt audit and to repudiate illegitimate and/or odious debt. Still, even when Argentina did not do that at the time of its 2005-2010 debt restructuring, it managed to successfully carry out the process with a high level of acceptance and a substantial capital reduction.

Fifth, vulture funds pose a real, clear and present danger to debt restructuring processes around the world. As Argentina's experience shows, even with a 92.4% acceptance of the debt restructuring offer, vulture funds have the potential ability to derail the entire process. This clearly points to substantial flaws in the international financial system and the urgent need for new arrangements, which is the subject of the next section.

Finally, New York financial markets should be avoided at all costs by periphery nations seeking to issue new debt. Judge Griesa's ruling, upheld by the appellate court and validated by the U.S. Supreme Court, sets jurisprudence applicable to future lawsuits like those of the vulture funds against Argentina. In other words, the New York financial markets have become a dangerous and hostile place for periphery countries and should be avoided when possible.

paid, and paid full value. Argentina appealed, but in October of the same year the appeals court upheld the lower court's order. Argentina appealed again, hoping that the US Supreme Court would overturn the ruling. However, in June of 2014, the Supreme Court decided not to take the case, thus confirming Griesa's original ruling.

Before turning to the real and potential effects of the ruling, we should highlight three substantial problems with the judge's ruling. The first is the judge's interpretation of the *pari passu* clause which surprised most legal experts. The plaintiffs (NML Capital) claimed that Argentina had violated the *pari passu* clause by paying restructured bondholders but not paying holdouts. Many predicted this strategy would fail. Indeed, one legal expert argued that "it's an arcane legal argument, and most legal scholars and those in the market sided with Argentina, stating that this was how debt restructuring had worked for decades."[18]

Argentina's lawyers argued that the *pari passu* clause was a boilerplate provision that guarantees to bondholders that their claims will not be subordinated to other claims, as the clause had been interpreted for more than 50 years.[19] Most analysts sided with Argentina, as reflected by the wide range of experts filing *amicus curiae* briefs on behalf of Argentina, including the International Monetary Fund (IMF), Anne Krueger (neoliberal economist, former Managing Director of the IMF for the United States), the US Justice Department, and the governments of the US, France, and Mexico, among many others.

Because there had been no consistent legal interpretation of the clause in the past, the court did not have any clear or obvious guidance in making its decision. Therefore, the judge adopted his own interpretation of the *pari passu* clause, stating that "securities will constitute... direct, unconditional, unsecured and unsubordinated obligations of the Republic and shall at all times rank *pari passu without* any preference among themselves. *The payment obligations of the Republic shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness.*"[20] In other words, contrary to what market analysts and experts expected, the court adopted an interpretation that was most favourable to the vulture funds.[21]

18 Davidoff Solomon (2012).

19 See Jarada (2012-2013: 227-229).

20 Quoted in Jarada (2012-2013:229), emphasis in original.

21 Indeed, Allen & Overy (2012) point out that the judge's interpretation of the pari passu clause is mistaken, as the clause stipulates equality of rank among debt instruments, but not equality of payment.

A second, dramatic problem stemming from the court's decision is that it blocks Argentina from making payments to bond-holders who accepted the restructuring offers, unless it pays the vulture funds at the same time. Indeed, this is what happened on June 30th, 2014, when Argentina deposited the funds in the Bank of New York Mellon to make a scheduled restructured debt payment. The judge blocked the funds, thus violating the rights of bond-holders to receive the payment that Argentina had transferred. In other words, by protecting the vulture funds, the judge has violated the rights of thousands of bond-holders.

Third, the court committed a substantial error, reflecting a lack of understanding of economics and what a *bond* actually is. In economics, a bond is not an unconditional contract of repayment, since it has a rate of return that includes a risk premium.[22] The higher the rate of return, the higher the risk that the bond issuer may default. This was indeed the case of Argentine bonds issued during the 1990s, especially those issued towards the end of that decade. The judge, conveniently for the vulture funds, stuck to the legal profession's mistaken understanding of what a bond actually is. Furthermore, in assessing late charges the judge used the same risk-adjusted rate of return—a very sweet deal for the vulture funds, but very poor economics.

So, what does the Second Circuit Court's decision mean for Argentina? If Argentina had chosen to abide by the ruling, it would have exposed itself to similar lawsuits by the remainder of the 7.6% of creditors that held out from the restructuring offers, totalling an estimated $15 billion. Additionally, the 92.4% of creditors that accepted the restructuring offers could have claimed that Argentina was making a better offer to holdouts than what they got when they accepted the 2005-2010 debt restructuring terms. All Argentina's restructured bonds have what is known as a RUFO (rights upon future offers) clause, that expires on 31st December, 2014, according to which bond holders are entitled to any improved future offer made by the Argentine government.[23] It makes sense that bond holders would have exercised this right if Argentina had paid the vultures with no capital reduction. Had this happened, Argentina's debt would become automatically unserviceable which would inevitably mean a new default.

If Argentina chooses to ignore the court's ruling, it also faces severe problems. First and foremost, a substantial portion of restructured bonds are paid through the Bank of New York Mellon, a bank under the legal jurisdiction of the Second District Court. The court forbade the bank from continuing to pay restructured bonds unless it also paid the vulture funds at the same time. In other words, Argentina will not be able to continue to pay through New York unless it also pays the vultures. Therefore, if Argentina is not to be forced into default by Judge Griesa, it needs to find alternate routes for making payments. A recently passed Argentine law attempts to do just that: it establishes a mechanism that will enable Argentina to continue to pay, bypassing the New York court's restrictions, using Argentine or French banks.[24]

While the actual mechanisms for an alternate payment route are still being worked out at the time of this writing, an additional problem has been Judge Griesa's 29 September, 2014 ruling declaring Argentina in contempt of court. This ruling has no immediate effects, however, the judge could eventually decide to assess a substantial daily fine, which could complicate Argentina's situation further.

Argentina's road ahead presents complications which could have a substantial impact on the country's economic situation. Whether the country chooses to abide by the court's ruling and eventually reach an agreement with the vulture funds, or whether it chooses to ignore the ruling and repudiate vulture fund claims, the country faces important hurdles that it must resolve. Civil society organizations (CSOs) that deal with debt justice issues have issued strong statements against vulture fund predatory behaviour. The Latin American Network on Debt and Development (Latindadd), Jubileo Sur Americas, and human rights organizations have all called for a strong stance against the vulture funds. Some organizations, like Diálogo 2000 (a member organization of Jubileo Sur Americas) have called for a suspension of all debt payments and a full debt audit, arguing that the problems with the vulture funds are but a manifestation of much deeper problems of periphery countries and their relationship with the Northern-dominated world capitalist system.

22 The legal profession has interpreted that bonds are contracts of repayment for decades. However, this is at odds with what this financial instrument actually is. Mario Blejer, an economist who worked for the IMF for 18 years, was president of the Argentine Central Bank and also directed the Centre for Central Banking Studies at the Bank of England, has made this point in numerous media interviews and reports. See, for example: http://www.cronista.com/economiapolitica/Blejer-y-Gonzalez-Fraga-en-el-Cronista-TV-Griesa-se-equivoco-pero-hay-que-seguir-negociando-20140804-0102.html.

23 At the time of publication of this report, the RUFO clause has expired, so this danger no longer exists. The Argentine govrenment, so far, has continued to insist that the vultures will not get a better offer than the 2005 and 2010 restructuring swaps.

24 Law No. 26,984 passed on September 11, 2014. The text of the law can be accessed (in Spanish) at: http://infoleg.mecon.gov.ar/infolegInternet/anexos/230000-234999/234982/norma.htm.

#2 Toward justice centred debt solutions

If the consequences of the New York courts' rulings in favour of the vulture funds complicate Argentina's future, they also pose potentially insurmountable problems for any future sovereign debt restructuring. Indeed, the court's ruling "will likely make restructuring more expensive, if parties attempt it at all."[25] The Argentine case has highlighted the urgent need for a profound debate on the framework of international lending and borrowing and the national and international economic systems based on these financial flows. Specifically, Argentina's experience highlights the imperative need for some form of generally agreed-to process to solve sovereign debt crises and defaults. It is therefore urgent that activists, academics and politicians work together to find solutions that are both fair and sustainable, guaranteeing a fair process of resolution of sovereign bankruptcies for all involved.

There are two key developments that facilitated the vulture funds' predatory lawsuits.[26] The first is related to the way the United States (and, eventually, most nations) came to understand the level of immunity of foreign governments from legal prosecution. Originally, absolute sovereign immunity was the norm. This meant that foreign states were immune from civil lawsuits or criminal prosecution in another nation's courts. Since the early 1950s, but especially since the passing of the Foreign Sovereign Immunity Act (FSIA)[27] in 1976, the United States adopted a far more limited interpretation of the immunity enjoyed by foreign governments. According to the FSIA, "states have no immunity from jurisdiction in commercial matters, which include the issuing of bonds."[28] In other words, foreign states can no longer claim immunity in US courts when faced with the inability to pay. This is the basis upon which vulture funds have been suing foreign governments in US and other developed nation courts.

The second development that facilitated vulture fund lawsuits was the transformation in the early 1990s of sovereign debt from commercial bank loans (the norm in the post World War II period) to bonds.[29] If an inability to pay occurred in the case of commercial bank sovereign debt, what ensued was a negotiation between the banks, the indebted country and often the IMF. Litigation was rarely used since it would have interrupted the debt negotiation process.[30] However, after the Latin American debt crises of the early 1980s, this changed. In the early 1990s, U.S. Secretary of the Treasury Nicholas Brady devised a strategy by which loans from private Northern banks to Southern governments were changed into bonds. Since bonds were issued under US legislation, creditors could now litigate in U.S. courts in the case of non-payment by the debtor state.[31]

These changes have made resolving debt crises and defaults more difficult for most periphery countries. The lack of established mechanisms and impartial institutions to deal with defaults is particularly problematic. Over the last decades, there have been multiple debates and proposals on what is the most fair and equitable way to resolve sovereign defaults. Proposals can be broadly grouped into two main categories. On one side, the initiative originally spearheaded by the U.S. Treasury department—and more recently supported by the International Capital Markets Association (ICMA)[32] and the IMF—is a "market solution." This approach promotes changes to bond contracts aimed at preventing holdouts (and especially vulture funds) from having the possibility of im-

25 Jarada (2012-2013:232).

26 See Mancuso and Verhoeven (2012) for a discussion of these developments.

27 The FSIA codified what had been standard US State Department practice since the "Tate Letter" of 1952, which adopted a restrictive interpretation of foreign state immunity before US legal courts. Restricted sovereign immunity was adopted in 1978 by the U.K. and has become the norm in most countries since (Mancuso and Verhoeven 2012).

28 Mancuso and Verhoeven (2012:114).

29 The mechanism for this change was that nations issued bonds, the proceeds of which were used to pay off the banks. As a result, Southern public debt was "socialised": creditors were no longer banks, but many thousands of individual and institutional bond-holders world-wide.

30 Mancuso and Verhoeven (2012:115)

31 To a lesser extent, bonds were also issued under Japanese, German, UK and French legislation.

32 The International Capital Markets Association (www.icmagroup.org) is a mostly European trade organization of firms participating in Capital Markets. Its stated objective is to develop and promote regulation and best practices in capital markets.

peding or derailing a restructuring process.[33] On the other hand are those promoting a more formal, "statutory" solution. In its most reduced form this means legislation at the national level blocking vulture funds from using courts to sue periphery countries. More ambitiously, others call for some form of international legal framework to enable working out sovereign defaults. In what follows we summarise some of the more representative proposals. The list is not comprehensive, but aimed at providing a general view and also useful information for discussion.

"Market-based" Solution: Collective Action Clauses

Collective action clauses (CACs) were first promoted by the U.S. Treasury as a non-statutory, market solution to the problems of sovereign default and restructuring and have become quite prevalent in sovereign bonds since the crises of the 1990s, especially since the Argentine crisis of 2001. Mexico was the first major sovereign issuer to include collective action clauses in its sovereign bonds in February 2003.[34] Since January 1, 2013 all eurozone government bonds with a maturity greater than one year are required to include a standardised collective action clause (CAC).

What are collective action clauses? CACs are a set of contractual provisions included in the terms of a sovereign bond. Two types are most commonly used. The first is a modification clause, that allows a specified majority of bondholders to agree to changes in the terms and conditions of the bond. In other words, in the case of a debt restructuring, if a specified majority of bondholders agrees, the original bond's conditions (maturity, rate of return, principal amount) can be changed. The second type of CAC is an acceleration clause which prevents individual bondholders from demanding full payment after a default, requiring a specified percentage of bondholders to agree on such a demand for it to be executed.[35]

CACs have been promoted by the US Treasury and more recently by the IMF and the International Capital Market Association.[36] These institutions have promoted financial market deregulation for decades, contributing significantly to the current state of affairs (cyclical financial crises, economic austerity, increases in job insecurity and poverty). It is therefore excellent news that they now publicly recognise the importance of placing limitations on vulture funds. Their favoured solution is a "market solution," which in their view is preferable to national or international regulation of financial capital.

However, there are well-founded doubts about the ability of CACs to deal with vulture fund holdouts in the future. As economics Nobel laureate Joseph Stiglitz remarks, "if it were so easy to resolve such issues by private contract, then bankruptcy laws and bankruptcy courts would not be such an integral part of the financial system in the United States—private contracting would exist in the corporate-debt context, making bankruptcy courts superfluous."[37] Stiglitz adds that, to his awareness, "no advanced country has been able to manage efficient restructuring of private debts through exclusive reliance on collective action clauses."[38] It seems obvious, therefore, that if CACs are insufficient for private bankruptcies, they are even more inadequate for sovereign bankruptcies, where the context and issues are far more complex.

There is an additional problem with CACs, known as the "aggregation" problem. A collective action clause applies to only one bond series. [39] Countries, over time, issue many different series of bonds. If the country should default, the issue arises as to how to calculate majorities for the CAC to take effect. If a majority for each bond series has to give approval for a restructuring offer, then one single series with a majority that opposes the restructuring process—a holdout series—could effectively block the entire restructuring process.

As Weidemaier and Gulati (2013) show, modification and acceleration CACs have been used for a long time, and financial market participants did not seem to assign to these clauses much value. In other words, if historically CACs were not valued as tools to avoid holdout complications during debt restructuring processes, it must

33 It is interesting to note that the IMF made its support explicit for this proposal following the approval in the United Nation's General Assembly of the G77+China proposal to move forward on an international debt workout mechanism. The EU has also explicitly supported "market solutions" by requiring EU sovereign bonds to include CACs and, more recently, by voting against the G77+China proposal. It is also worth noting that those promoting "market solutions" at the international level do not do so for corporations operating within national boundaries, where bankruptcy courts and legislation are ubiquitous.

34 Weidemaier and Gulati (2013:54).

35 Weidemaier and Gulati (2013).

36 For the IMF's statement, see: http://www.imf.org/external/np/pp/eng/2014/090214.pdf. For ICMA's proposal, see: http://www.icmagroup.org/assets/documents/Resources/ICMA-Standard-CACs-August-2014.pdf.

37 Stiglitz (2014:9-10).

38 Stiglitz (2014:10).

39 Over time, a government will typically issue bonds depending on specific funding needs. Each bond issue, referred to as a bond series, will have specific characteristics (maturity, rate of return, currency denomination and legislation under which it is issued, etc.).

be shown why now the situation is different. Indeed, as Gelpern and Gulati's (2006) case study shows, there is little reason to believe that they would be useful now. [40]

There is, therefore, good reason to believe that it is unlikely that market solutions will provide a meaningful solution to the holdout problem in general, and vulture fund problem in particular.

Statutory Solutions

What are the alternatives? Barring a desirable but unlikely complete overhaul of the international financial architecture, there are two broad alternatives. The first is for individual national states, especially those with internationalised financial markets, such as the U.S., the UK, Germany and Japan, to implement some sort of vulture fund restrictions. The second alternative is an international legal framework to deal with sovereign defaults and debt restructuring. We will discuss each in turn.

National vulture fund legislation: Faced with the lack of a global sovereign debt restructuring framework and the inadequacy of CACs, some civil society organizations Europe and the US have promoted legislation at the national level to curtail vulture fund activity. The intention behind these initiatives is to limit vulture fund legal options in countries under whose legislation sovereign bonds are issued and in countries with strong economic aid programs to poor countries. Belgium and the UK are two examples of successful, if limited, vulture fund legislation. There were proposals presented to the national legislative bodies in the US and France which have not been turned into law as of this writing.[41]

The Belgian law was the first national legislation curtailing the range of action of vulture funds. According to Sookun, this 2008, the law "provides that no monies granted by the Belgian authorities can be seized by or transferred to vulture funds or any other creditor. This legislation has automatically barred any vulture fund from pursuing any Belgian money or companies investing in the sovereign debtor country to obtain repayment."[42] In other words, the Belgian law prevents vulture funds from seizing official government aid to poor countries.

The UK "Debt Relief (Developing Countries) Act" went into force in 2010.[43] The bill's purpose was to curtail vulture fund legal action in UK courts against heavily indebted poor countries (HIPCs).[44] The UK law applies to qualifying debt contracted before the date when the law went into effect (8 June 2010). How does the UK law limit vulture funds? It limits the "recoverable amount" of "qualifying debts" to a "relevant proportion." The relevant proportion is the proportion established by the HIPC formula, determined on a country by country basis. In other words, vulture funds are obliged to take the same reduction as the rest of HIPC creditors.

In addition to the Belgian and UK laws, bills were introduced to the US Congress (2008 and 2009) and to the French Assembly (2007). Neither the US nor the French bills have made it into law at the time of this writing since they have not yet garnered sufficient congressional support.

While the Belgian and UK laws are clearly an important step in the right direction, they are still quite limited in scope and would need to be broadened in order to effectively deal with vulture funds. First, they only apply to HIPCs, clearly excluding other periphery countries from the benefits of protection from vulture fund attacks. Second, in the case of the UK law, only HIPC debt contracted prior to 2010 is protected, while debt contracted since is potentially a vulture fund target. Third, in the case of the Belgian law, it applies only to official Belgian government aid, other debt or financial flows are not included.

Existing legislation needs to be broadened, and more countries need to enact such legislation—especially countries like the US, France, Germany and Japan, whose financial markets and laws are used to issue sovereign debt and whose courts can be used by vulture funds to litigate.

International debt work-out mechanisms: Over the last decades, debate on the desirability and need for an international framework to resolve sovereign debt crises has intensified. Most proposals fuelling this debate have come from civil society organisations and academics working with these organisations. The unifying thread of these proposals is the realisation that sovereign defaults are extremely complex, much more so than private sector bankruptcies, and therefore there is a need for an inter-

40 The authors conducted over 100 interviews with sovereign debt market participants, including investors, lawyers, economists and government officials on the issue of contract reform promoting collective action clauses in sovereign bond issues. The authors found that most of those interviewed viewed these changes as "simply unimportant" and ineffective for dealing with financial crises.

41 See Sookun (2010) and Wautelet (2011) for brief accounts of these experiences.

42 Sookun (2010:88).

43 The law originally had a duration of one year, after which the UK Treasury made it permanent. The bill and the explanatory notes can be accessed at: http://www.legislation.gov.uk/ukpga/2010/22/contents.

44 HIPCs are an IMF and World Bank category, with 40 countries currently qualifying of which two are in Asia, four in Latin America, and the rest in Africa.

Opportunities and Risks of United Nations' action on a debt workout framework

The UNGA resolution presents an important array of opportunities but also important risks and uncertainties. Among the opportunities, it is important to highlight:

International forum: By placing the debate in an international forum and moving it away from the IMF and the IFIs, the UNGA proposal suggests a more supportive and impartial environment for debtor nations to work out and resolve debt issues.

Legal framework: The UNGA resolution provides a unique opportunity to elaborate an international legal framework for the resolution of sovereign debt defaults providing a more objective and secure environment for nations and creditors to arrive at a solution. Additionally, if an international financial code were developed (as Acosta and Ugarteche have proposed), this could add further stability and predictability to the international financial system. Such a legal code could be used by nations to issue new debt, avoiding developed nation legal systems and their biases, as clearly reflected in Judge Griesa's rulings against Argentina.

Build on existing expertise: A further opportunity of a United Nations framework for sovereign insolvencies is that it could build on the considerable expertise in civil society organisations and academia. Activists and experts have been debating these issues for several decades and as a result have developed proposals and principles on legitimacy, fairness and impartiality for a restructuring process, human rights guidelines to ensure sustainability of restructuring agreements, etc. It would be highly convenient that these points of view be included in the UN debt workout mechanism.

Flexibility for debtor nations: In the event that a debtor nation were to come to a legally binding debt restructuring agreement through the UN framework and it were eventually unable to continue to meet payments, default should always continue to be an option and a sovereign decision. In other words, a nation would still have the right to put the well-being of its people above debt service obligations if the latter implied undue hardship or the violation of a population's human rights.

In addition to these opportunities, the UNGA resolution poses potential risks and uncertainties that will require addressing. For example:

Institutional framework: There have been various proposals by CSOs regarding which international institution should arbitrate the debt workout process. UNCTAD and the International Court of Justice are two that have been proposed, while others have suggested creating an entirely new international court to specifically attend sovereign debt restructuring processes. Having an institution with specific expertise in financial crises and debt restructuring would be desirable, even if that meant creating it from scratch. In addition to expertise, the institution must guarantee impartiality and provide legitimacy to the process.

Trigger mechanism: An additional issue to be resolved is the mechanism by which the debt negotiation process is to begin. Will it be up to the court, the debtor nation or the creditors? Clearly, in order to have an orderly process, a mechanism needs to be defined.

Scope: For a debt restructuring process to be successful and avoid holdout problems, it needs to be binding for all creditors. The issue, then, becomes how to make the restructuring process legally binding for all involved. Will it require acceptance by a specified majority of creditors in order to be binding for all? What will be the process by which creditors participate and express their view? These issues need to be worked out for the debt workout mechanism to function.

Arbitration criteria: What will be the mechanisms to arbitrate between debtors and creditors? Will it be rule-based or will it be a case-by-case process? The former provides a process that will be less subject to manipulation and arbitrary results. However, developing a code to be used for the wide range of potential situations that could present themselves is an extremely complex task.

Debt classification: The UNGA resolution makes no mention of illegitimate or odious debt. Since illegitimate and/or odious debt are at the core of many debt crises, it becomes imperative that the debt workout framework acknowledge and deal with this problem. For this clear definitions and a debt audit will be needed in order to be able to determine which debt enters a restructuring process and which does not.

Distribution of outcomes: Will debt restructuring outcomes apply equally to all creditors? In other words, will capital reduction be equal across the board or will there be "favoured" creditors, as happens with the IFIs today? This is an important issue, because the existence of privileged creditors imposes larger capital reductions on the rest.

Fairness: Last, but certainly not least, the debt workout framework must ensure that powerful nations (where financial markets operate and financial interests dominate) do not control the debt restructuring process. Fair and equitable treatment must be insured if the new framework is to be successful.

national framework to deal with sovereign debt crises, defaults and debt restructuring.[45]

An early example is Kunibert Raffer's (1990) proposal to internationalise the municipal bankruptcy chapter of the US Code (so-called Chapter 9). According to Raffer, this piece of US legislation has the necessary regulatory instruments to deal with a sovereign insolvency. Since there is no existing international insolvency court, arbitration would be carried out by an ad-hoc arbitration panel. While the result of such a process would be informal, it would still have clear and pre-defined rules and principles, particularly regarding the protection of the debtor nation's sovereignty.

In 2001, the IMF presented a proposal for a Sovereign Debt Restructuring Mechanism (SDRM). While the proposal was not adopted due to lack of support from the US, it is significant because the IMF acknowledged the need for an internationally agreed-to mechanism to deal with sovereign debt crises. However, the proposal had a very substantial shortcoming: The IMF was to be a part of the tribunal with substantial decision-making power. This presented a clear conflict of interest since the IMF is often a creditor and its conditionality generally accelerates debt crises. Raffer (2006) wittily titled the IMF's SDRM proposal as "Simply Disastrous Rescheduling Management."
More recently, an alternative was put forth by Latin American economists Alberto Acosta and Oscar Ugarteche (2003).[46] They propose the creation of an International Board of Arbitration for Sovereign Debt (IBASD), that is, and international insolvency court, accompanied by an International Financial Code and full debt audits before any debt negotiation or restructuring. Finally, the United Nations Conference on Trade and Development (UNCTAD) has also been spearheading a process of broad consultations on the development of a debt workout mechanism.[47]

Debates on an international debt-workout framework were revitalised as a result of a resolution passed on September 9, 2014 by the United Nations General Assembly (UNGA) calling for the creation of a "multilateral legal framework for sovereign debt restructuring."[48] The initiative was triggered by Argentina's experience with vulture fund lawsuits and promoted by the G77 countries plus China. The resolution was supported by an overwhelming majority of countries: 124 voted in favour, 41 abstained and only 11 voted against (17 countries were not present for the vote).[49]

Beyond Debt Issues: Questions About the International Financial Order

Discussions on sovereign defaults and debt restructuring can often be quite detailed and technical and tend to focus narrowly on the issues at stake. However, deeper questions need to be asked about the nature of the international financial architecture and international economic relations more generally if we are to address debt-related problems in a sustainable and lasting way.

Perhaps a good starting point is to analyse why it is that between 1944 and 1970 (when the Bretton Woods agreement was in force) there were no debt or financial crises in the world economy, whereas the periods before 1944 and after 1970 are riddled with such crises. The answer lies in the strict financial regulation that existed between 1944 and 1970, both for national economies and for international capital flows. During this period, financial capital was at the service of the needs of production, employment and economic development. Not surprisingly, this resulted in the longest running period of economic expansion since capitalism became the dominant economic system. Since the early 1970s, increasing deregulation of domestic and international financial systems has resulted in generalised economic instability and repeated financial and debt crises.

This begs the question: are we better off in a financially deregulated world? Since the mid 1970s, financial capital has become dominant, forcing substantial changes in economic policy objectives. While full employment was a central policy objective of the post-war period, since the mid 1970s price stability (low inflation) has become the overriding objective even at the cost of prolonged economic recessions. Low inflation worldwide insures that profits from financial investments around the globe will maintain their value. In other words, rather than guaranteeing full employment and welfare improvements, economic policy has become dominated by the need to guarantee financial investment profits world-wide. As a result, job insecurity has grown, real wages have fallen, and economic volatility has become the norm. Financial sector profits, however, have been ample despite repeated "bubbles" and crashes. And, when crashes occur, the State (in other word, workers and taxpayers) steps in with handsome bailouts.

45 See Kaiser (2013) for a discussion and comparison of strong and weak points of each proposal.
46 Published in English as Ugarteche and Acosta (2007), with some modifications to the original proposal.
47 For more information, including background papers, see: http://www.unctad.info/en/Debt-Portal/.
48 Resolution A/RES/68/304, available for download at: http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/68/304.
49 Surprisingly, Ireland was one of the 11 countries that voted against the initiative.

An important part of the global financial system's profits come from debt issued by periphery countries in the world's main financial markets. When periphery countries face difficulties servicing their debt, the IFIs step in with economic austerity policies that systematically make matters worse. Periphery countries are therefore in an impossible situation. First, they must implement austerity policies that result in recession, poverty and unemployment. The alleged purpose behind these policies is to get the country to be able to service its debt again, even if this rarely happens. Second, when default and/or a debt restructuring eventually ensues, countries have to deal with extremely complex and costly processes and the possibility of vulture funds suing them in Northern legal jurisdictions. Finally, if a restructuring is successful, countries are usually left with heavy debt burdens for decades and the real possibility of further debt crises. This inevitably results in having to postpone development objectives and policies aimed at improving the livelihoods of the periphery's majorities.

So, the picture should be clear: working people are not better off in a world dominated by deregulated finance. Financiers are bailed out, corporations evade taxes through tax havens and fiscal paradises, and working people are consistently forced to foot the bill. Unequal power relations between centre and periphery countries are enforced by the IFIs, guaranteeing that wealth and power concentration continue apace.

Clearly we need a new global financial architecture. But more than that, we need a new global economic architecture, where full employment, environmental sustainability, and respect for the full range of human rights are guaranteed.

#3 Recommendations for action

From the presentation above, it should be clear that, at least for the time being, no single proposal will provide a definitive solution in the transition to a more just and fair international order. Consequently, we suggest the following guidelines for action:

1**. Promote multiple and concurrent measures rather than focusing exclusively on "market solutions":** National governments should support more effective collective action clauses, national and/or regional legislation limiting vulture fund activity, and a multilateral approach that should ultimately aim to override the inadequacies and limitations of the former mechanisms. Tackling the problem of sovereign defaults and debt restructuring from these different angles will make it less likely that vulture funds will be able to intervene.

2. **Participate actively in multilateral framework negotiations:** The multi-lateral approach has many areas in need of greater clarity: institutional framework, trigger mechanisms, scope of the process, and arbitration criteria, to name a few (see section 2 above for more detail). Therefore, it is critical that a wide range of organizations participate in the process—especially those expressing the views of people affected by debt crises—through the available UN channels. The upcoming meetings of the ad-hoc committee should provide opportunities for such voices to be heard.

3. **Participate based on non-negotiable working principles:** Governments should use the following non-negotiable working principles in negotiations on a multi-lateral mechanism:

– *No decision-making role for the IMF and other international financial institutions.* These institutions are or have been creditors of many countries, with policy conditionality that usually makes debt crises unavoidable. Furthermore, the financial liberalisation policies they have promoted are a direct cause of the instability and volatility of the international financial system. They are not, therefore, neutral players and should have no decision-making role in the multilateral framework.

– *The resulting mechanism should be legitimate and impartial.* Lineau (2014) has identified three aspects of legitimacy: source, process and outcome. The same author has identified three aspects of impartiality: institutional, actor and informational. They are a good starting point to think about these issues.

– *Equality of all sovereign nations.* All nations should receive equal treatment and have equal rights, whether periphery or centre countries.

– *Protection of the entire range of human rights.* No population should be expected to have to forego fulfilment of their human rights in order to fulfil financial obligations.

4. Support sovereign nation prerogative to default: The international financial architecture being what it currently is means that debt will continue to be an issue, especially for periphery countries, for quite some time. Until lasting solutions are found, solidarity with national government decisions to not pay illegitimate and unsustainable debts must deepen. As we have learned from the experience of Argentina, default was the wisest choice even if the mainstream press demonised the country for taking this step. The media narrative and scaremongering of citizens and politicians currently dealing with debt crises must be challenged.

5. Work to bring about a more equitable and balanced international economic order: As highlighted in the last section, sovereign debt issues expose the power and economic imbalances that are at the core of the global economic system. New debt resolution tools and mechanisms may alleviate some suffering in times of debt crises, but will not ultimately change the international financial architecture nor solve its many profound problems. This is why much deeper changes are needed including:

– Putting and end to the macroeconomic policies of fiscal consolidation and austerity, often imposed through external policy conditionality. These policies cause deep recessions that hurt working people the most and turn debt burdens more unsustainable. Policies should be aimed at improving worker welfare and maintaining high levels of employment.

– Putting an end to fiscal benefits for economically powerful actors and the wealthy. Tax justice, meaning higher taxes for corporations and the wealthy sections of society, should be implemented to ensure support for achieving economies that serve the public good and not powerful minority interests.

– Implementing more detailed controls on lending practices to regulate the intense level of debt flows in the global economy.[50]

50 For example, Eurodad's Charter on Responsible Finance, available at: (http://eurodad.org/uploadedfiles/whats_new/reports/charter_final_23-11.pdf)

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further reading

Debt and Development Coalition-Ireland:
http://www.ddci.org

European Network on Debt and Development (Eurodad):
http://www.eurodad.org

Latin American Network on Debt and Development (Latindadd):
http://www.latindadd.org

Jubilee South/ Dialogo 2000:
http://dialogo2000.blogspot.com.ar/

Jubilee Debt Campaign United Kingdom:
http://jubileedebt.org.uk/

Jubilee USA Network:
http://www.jubileeusa.org/

Righting Finance / Centre of Concern:
http://www.rightingfinance.org/

United Nations Guiding Principles on Foreign Debt and Human Rights:
http://www.ohchr.org/en/Issues/Development/IEDebt/Pages/GuidingPrinciples.aspx

UNCTAD Debt Portal:
http://www.unctad.info/en/Debt-Portal/

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