2022

A Process for Politics

Anna Gelpern
Georgetown University Law Center, ag1348@law.georgetown.edu

This paper can be downloaded free of charge from:
https://scholarship.law.georgetown.edu/facpub/2543
https://ssrn.com/abstract=4576637


This open-access article is brought to you by the Georgetown Law Library. Posted with permission of the author. Follow this and additional works at: https://scholarship.law.georgetown.edu/facpub

Part of the Banking and Finance Law Commons, Bankruptcy Law Commons, Contracts Commons, and the Securities Law Commons
A Process for Politics

Anna Gelpern

Abstract

I argue that consistent and public process observance has a distinctly valuable function in sovereign debt restructuring, with no precise equivalent in national insolvency regimes. National regimes reflect the distribution bargains of their enactment, presumptively legitimate and binding. Debtors and creditors allocate insolvency losses in their shadow, with liquidation as a backstop and politics just outside the frame. All else equal, the restructuring process has a harder job with sovereign debt. There is no liquidation backstop and no default distribution scenario. Each crisis resolution episode must allocate losses from scratch among the country’s citizens, foreign and domestic creditors, and other stakeholders; it must generate legitimacy, secure compliance, and minimize spillovers and moral hazard ... within the constraints of sovereign immunity and non-dischargeability. Bargaining against this background can turn into an endless cat-and-mouse game, its outcome contingent on innumerable bespoke factors. Past bargains cast a faint shadow; at best, they might suggest a settlement range. A publicly visible, intelligible, consistent restructuring process can partly make up for the lack of prior settlement on loss allocation. It can anchor expectations, entrench channels of accountability, and keep sovereign debtors and creditors coming back to the negotiating table. Demand for such a public process might have been suppressed when a few governments and financial firms dominated the creditor pool in crisis after crisis, but those days are gone.

Among the elite corporate insolvency experts shaping sovereign debt crisis response, Christoph Paulus is unique for his passionate insistence on the centrality of process, and for the specificity with which he has set out—for more than two decades, in crisis after crisis—features of sovereign debt restructuring as a legal procedure (eg, Paulus 2001, Paulus and Kargman 2008, Paulus and Tirado (2013), Paulus (ed) 2014, Paulus 2017). In the three years leading up to the publication of this volume, events have conspired to amplify Professor Paulus’s message, although the institutional architecture for sovereign debt crisis response still falls far short of his vision. A global pandemic, a hot war in Europe, a climate crisis, and geopolitical realignment have exposed gaps in the architecture and their immense human cost. Reform prospects might have brightened as debt stocks have spiked, but the track record of institution-building in this area promises to keep Professor Paulus’s ideas at the cutting edge for years to come.

In this contribution to a volume in his honor, I argue that consistent and public process observance has a distinctly valuable function in sovereign debt restructuring, with no precise equivalent in national insolvency regimes. National regimes reflect the distribution bargains of their enactment, generally perceived as binding. Debtors and creditors allocate insolvency losses in their shadow, with liquidation as a backstop and politics just outside the frame. All else equal, the restructuring process has a bigger and harder job with sovereign debt. There is no liquidation backstop and no politically sanctioned default distribution scenario. Each crisis resolution episode must allocate losses starting from scratch among the country’s citizens, foreign and domestic creditors and other stakeholders; it must do so in a way that is accepted as legitimate (Lienau 2016), minimizing spillovers and moral hazard ... within the constraints of sovereign immunity and non-dischargeability. Negotiations against this background can turn into a cat-and-mouse game of uncertain duration, its outcome contingent on multiple economic, financial, political, and

1 Professor Paulus’s sovereign debt writings invoke two different kinds of process: first, a sequence of restructuring steps and second, an impartial adjudication procedure. Recognizing that the two partly coincide in national regimes with judicially supervised bankruptcy reorganization, I focus almost entirely on process as a sequence of restructuring steps.
historical factors. Past debtor-creditor and inter-creditor bargains barely cast a shadow here; at best, they might suggest a settlement range (weakly).

A publicly visible, intelligible, consistent restructuring process can help make up for the lack of prior political settlement on loss allocation. It can anchor expectations, entrench channels of accountability, and keep sovereign debtors and creditors coming back to the negotiating table. However, demand for a public process may be attenuated when a few repeat players that collaborate across multiple spheres of activity—such as the Group of Seven (G-7) governments and the institutions where they hold sway—dominate the creditor pool. Repeated interactions among them can supply a measure of predictability, while relational factors beyond the scope of a given sovereign debt crisis can motivate settlement negotiations. Whether the resulting agreement would be sustainable or broadly legitimate is a separate question. Too often, the answer is “no.”

I proceed as follows. In Part I, I suggest that sovereign debt restructuring institutions on the eve of the pandemic were in transition from a world where the G-7 more or less made the rules to one that was far more diverse, and in which the ground rules were unsettled to a greater degree than had been supposed. Part II reviews the short-run pandemic response and the architecture gaps it revealed. Part III takes preliminary stock of institutional innovations. Conclusions conclude.

I. Before COVID

Leaders and experts sounded alarm about rising sovereign debt levels for several years in the run-up to the COVID-19 outbreak. In one sense, this time was no different: countries with a history of debt crises were in trouble again (e.g. IMF 2018, Kose et al. 2019, IMF and World Bank 2020a), reviving debates over conditionality and autonomy, austerity and moral hazard, enforcement and immunity. In another sense, everything was different: by 2020, the late 20th century constellation of forces that had supported sovereign borrowing, lending, and restructuring had fractured beyond recognition. China eclipsed the G-7 as the largest bilateral official lender; the International Monetary Fund (IMF) was losing its place as the center of international financial gravity (eg Boughton 2015), and national and subnational governments that had barely borrowed abroad now boasted over-subscribed eurobond offerings. Foreign investors forgot about original sin and flocked into local-currency and local-law debt on the financial periphery (Fig. 1). Statistics designed for simpler times struggled to capture lender and borrower diversity, the variety and complexity of debt contracts, and the fuzzy boundaries between public and private, domestic and external debt.

Figure 1: Debt Composition and Financing Trends in Low-Income Economies
(excerpted from IMF and World Bank 2020)

---

2 Borrowing from the influential volume by Reinhart and Rogoff (2009)
4 Eg, Eichengreen, Hausmann, and Panizza (2007).
5 LIEs=Low-Income Economies, FMs=Frontier Markets, SSA=Sub-Saharan Africa, MENA=Middle East and North Africa.
On balance, these were welcome changes. Countries in urgent need of investment for basic necessities and poverty reduction could diversify their funding sources and terms. If they borrowed and spent wisely, and if all went well, they could build resilience to future shocks. On the other hand, new stakeholders could destabilize the fragile institutional consensus behind sovereign debt crisis resolution.

A. A Modular Process

When bankruptcy experts looked at sovereign debt restructuring at the start of the 21st century, they zeroed in on its informality and ad hoc operation (eg, Paulus 2001, p. 1). International officials and prominent market voices reinforced this impression when they insisted on maximum flexibility, inserting the phrase “case-by-case” in policy statements with Pavlovian predictability. Researchers described restructuring platforms such as the Paris Club of official bilateral (government-to-government) creditors and the Bank Advisory Committees of the London Club as exceptions to the rule, more ad hoc efforts to fill the institutional void in debt architecture (eg Lienau 2016, p. 177).
As I have noted elsewhere (Gelpern 2016), the description of sovereign debt restructuring as chaotic and unpredictable goes too far. At least from the mid-1980s through the mid-2000s, the Paris Club and the London Club were parts of an interlocking set of modular debt restructuring platforms anchored in the IMF (Fig. 2). The sovereign debt adjustment process, which had for a long time eschewed debt reduction in favor of debt rescheduling and new money, was loosely embedded in the process of negotiating and implementing an IMF program. This regime was at most soft law, intelligible to a small circle of insiders; it was at best indirectly accountable to voters in any country, and struggled to produce sustainable outcomes perceived as fair by its public or private constituents. Nonetheless, it was reasonably predictable, at least by the standards of technocratic processes implicating sovereign actors.

A government that had trouble paying its foreign creditors at the turn of the 21st century would most likely approach the IMF to negotiate an economic adjustment (pejoratively, austerity) program to generate budget savings and restore external balance. Interim funding for the program might come from a combination of new loans and rescheduled debt payments. If the IMF judged the country’s debt stock unsustainable—projected to grow indefinitely beyond its capacity to repay—the program would provide for debt reduction. Armed with the IMF’s assessment of the program’s “financing envelope,” the sovereign debtor would renegotiate its debt with the Paris Club (including the G-7, Norway, Russia, and South Korea, among others— but not China, India, or Saudi Arabia) and agree to seek “comparability of treatment” from its other creditors. Comparability would not normally apply to established multilateral organizations that made new loans to finance the program, by analogy with post-petition financing in bankruptcy. Armed with its Paris Club agreement, the debtor would approach its other creditors—bankers, bondholders, and/or governments outside the Paris Club (the creditor mix varied among countries and over time)—for comparable relief. Not

---

6 Comparability undertakings are supposed to protect Paris Club member governments from subsidizing other creditors with their taxpayer funds. For more background, see Paris Club, About Us: Permanent Members, and Paris Club, About Us: The Six Principles (last visited 9 January 2022)
all creditor categories functioned like relational clubs: commercial banks and governments generally renegotiated their loans directly with the debtor and among themselves. Bondholders exchanged their claims for new ones or agreed to amend them by supermajority vote, with varying amounts of investor outreach by investment banks and financial advisers hired by the debtor. If the debtor failed to secure financing for the program or comparable debt relief across creditor groups, the country’s IMF and Paris Club agreements could unravel, at least in theory. In practice, evidence of enforcement is missing to murky.

For all its messiness, this informal regime was more comprehensive than the treaty-based Sovereign Debt Restructuring Mechanism (SDRM) proposal developed by IMF staff in 2001-2003—and more observably binding than the sovereign debt restructuring principles adopted by the UN General Assembly in 2015. Both have been influential, and merit special mention to set the stage for today’s debt architecture challenge.

Since the mid-1970s, governments have repeatedly tried and failed to reach consensus on a more robust sovereign debt restructuring mechanism modeled after national insolvency laws (Rogoff and Zettelmeyer 2002). It has become commonplace to attribute lack of political support for such a mechanism to creditor venality, government capture, and myopic refusal to give up sovereignty. This is too simple: creditors learned to live with bankruptcy laws long ago, and governments have been compromising sovereignty for as long as they have made treaties. When it comes to sovereign bankruptcy, governments across the national income spectrum have expressed support for narrowly targeted statutes and treaties; many more have endorsed soft law measures covering all or most claims against a sovereign debtor. There seems to be little appetite for a mechanism that is both binding and comprehensive.

The SDRM proposal was detailed but narrow. At core, it was an aggregated majority voting procedure for a subset of the sovereign’s private creditors. For pragmatic reasons amply covered in Professor Paulus’s writings on the subject (eg Paulus 2015), the SDRM did not aspire to reach domestic, multilateral, secured, and possibly even government-to-government debt. If implemented, it might have improved coordination among foreign commercial banks and bondholders, who had to find other ways to coordinate instead (eg Bi et al. 2016). Despite its modest scope and majoritarian ethos, the SDRM was shelved in 2003 in the face of political opposition from the United States and large emerging market countries (Hagan 2005, 347-361; Setser 2010).

Almost a decade later, an international arbitration tribunal considering Argentina’s bond default described sovereign debt restructuring as a reasonably coherent principles-based regime. Arbitrators recognized that it fell short of a “formal legal framework establishing precise steps to be followed,” but went on to highlight four principles at its foundation: debtor-initiated restructuring negotiations, debtor-creditor communications, consensual resolution, and equitable burden-sharing. International organizations (eg, UNCTAD 2015, OECD 2018), the G-20 (eg, G-20 2017, IMF 2019), and industry bodies (eg, IIF 2004, 2004, 2021) put forward still more elaborate codes of conduct with all or portions dealing with sovereign debt restructuring. The UN Basic Principles on Sovereign Debt Restructuring Processes, adopted by the UN General Assembly in 2015, is arguably the most significant contribution to the genre—notwithstanding lack of support from major creditors. With a few exceptions, these initiatives tended to articulate standards of behavior, not a sequence of restructuring steps. All were nonbinding soft law

---

7 Abaclat and Others (Case formerly known as Giovanna A. Beccara and Others) (Claimants) and The Argentine Republic, Decision on Jurisdiction and Admissibility, 4 August 2011, ICSID CASE NO. ARB/07/5, ¶40, citing expert report by Profs. Anne-Marie Slaughter and William Burke-White dated 8 August 2008.

8 The roadmap and guide published by the UN Conference on Trade and Development (UNCTAD 2015) sets out a detailed sequence of restructuring steps. This author participated in the development and drafting of this UNCTAD document.
instruments, which could acquire specific prescriptive content and compliance pull over time with practice—but started at a disadvantage.

Against this background, the breadth, persistence and functionality of the informal modular regime depicted in Figure 2 look impressive. Compared to the recent principles initiatives, this soft law regime had a head start on practice: it had been in more-or-less constant use since 1982, which prompted it to adapt to financial market, economic, and political shifts, and promoted links among different restructuring processes and platforms. The soft law process incorporated familiar hard law instruments (contracts, treaties, lawsuits) and institutions such as the IMF, which reduced potential process frictions and in turn made it more useful to a broad range of stakeholders.

Modularity facilitated adaptation and contributed to longevity. When the “modules” such as the Paris or London clubs brought together similarly-situated creditors holding similar claims, they would coordinate internally in response to crises, policy shocks and market trends, for instance, adding to the menu of restructuring terms. When sovereign borrowing took new forms, as when tradable bonds substantially displaced commercial bank loans in the 1990s, new tools and modules would join the structure. The rise of sovereign debt exchange offers in the late 1990s and reforms of collective action clauses (CACs) in sovereign bonds all proceeded within the established regime (Bi et al. 2016), which could expand or contract as needed. For as long as sovereign debtors and creditors depended on financing from the IMF and Paris Club creditors, they had to follow their process norms.

B. Missing Substance

In sum, sovereign debt restructuring at the start of the 21st century was an informal, but mostly predictable affair. Cross-conditionality and negotiation sequencing among internally coherent restructuring platforms helped anchor expectations and reach agreement on overall loss allocation.9 Some features of the regime borrowed from corporate and personal insolvency, but one critical difference stood out: there was no default distribution, no liquidation, discharge, or imperial takeover backstop if debtors and creditors failed to agree. If debtors stopped paying, sovereign immunity would keep creditors at bay—but debtors committed to running from their creditors would eventually find themselves cut off from the international financial system and unable to perform basic government functions.

National bankruptcy laws are distribution bargains. They might include repayment priorities for tax, pension, and municipal bond claims, carve-outs from automatic stay for derivatives contracts, homestead exemptions for individuals, and many more subtle examples, such as the different treatment of contract and tort claims on the debtor’s estate. Some laws are more elaborate than others, but they all reflect societal value judgments mediated through each country’s respective political process.10 A distinct body of bankruptcy procedure implements the value judgments. It might extend, elaborate, or even alter statutory bargains at the margins (e.g., Jacoby 2016a, b); however, the norm is not to renegotiate distribution from scratch with each filing for bankruptcy protection.

Distribution hierarchies in sovereign debt restructuring are at best obscure, informal, and hard to enforce (Schlegl et al. 2019, Pitchford and Wright 2012). Sovereign immunity forecloses liquidation and effectively shields some foreign assets like embassies and military installations from creditors. On the other hand, there is no mechanism and no authority for discharging unsustainable sovereign debt. Getting rid of sovereign

---

9 I discuss internal coordination, sequencing and cross-conditionality at greater length in an earlier work (Gelpern 2016).

10 See Paulus (2001), pp. 4-5, on differences among the social goals of corporate insolvency in Argentina, France, Germany, Italy, and the United States,
debt overhang requires creditor consent. Enforcement limits and the promise of settlement eventually force creditors and debtors to negotiate, but the outcome is not predetermined. Each crisis presents an opportunity to distribute losses from scratch. Debtors and creditors might cite recent experience with claim hierarchies or haircuts (eg **Cruces and Trebesch 2013**), but the pull of precedent is weak in a committedly case-by-case approach.

Repeat players with a reservoir of trust among them can manage case-by-case negotiation without treaties or judicial sanctions. The same holds for creditors that hold similar claims on the debtor, share similar values and objectives, and participate in multiple common ventures apart from sovereign debt restructuring. The G-7 are a case in point. When these seven governments, together with the multilateral organizations in which they held the most votes and the private financial firms they regulated, were the biggest lenders to developing countries, they could use soft-law tools and private contracts to manage debt crises (compare **Truman 2020, Brooks 2019, and Brummer 2012**). These governments had developed over the second half of the 20th century ample channels and motives to coordinate restructuring policies among themselves, and to adjust them together over time (eg, **Aggarwal 1996, 84-100**). As noted earlier, soft law tools became entrenched with practice and linkages to “hard” instruments and institutions. Transactional technique and contract reform did a serviceable job of accommodating shifts in debt composition, for instance, from loans to bonds (**Bi et al. 2016**). “Deals got done” was the common refrain, even if those deals turned out to be inequitable or unsustainable (eg, **Lienau 2016, 184-190**). Sometimes debt resolution took multiple rounds of deals over a number of years, which resulted in higher debt burdens for already over-indebted governments before the eventual agreement on debt reduction (eg, **Buchheit 1992, Cline 1995**).

C. G-Next

The G-7 and other established creditors’ share of the debt stock in low-income countries began shrinking in the early 2000s with the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Reduction (MDRI) initiatives, which ultimately eliminated large stocks of bilateral and multilateral claims. Meanwhile, a different set of official creditors, most prominently China, India, Russia, and Gulf States, scaled up lending to developing countries. By 2020, China was the world’s top bilateral lender, and by far the largest creditor in some of the world’s poorest countries. Bondholders with different investment mandates, hybrid public-private lenders, and commodity traders were a large and growing share of the debt stock. Economic models predict that creditor heterogeneity would create incentives to delay and free ride, and reduce the utility of contractual coordination tools (eg, **Pitchford & Wright 2012**). Added to the complexity, asset-backed lending to sovereigns has become more prevalent, in a departure from late 20th century practice (**IMF and World Bank 2020**).

The newly prominent official creditors were not uniformly invested in the old debt restructuring norms, which had taken decades to emerge; some moreover saw themselves as operating at a disadvantage in an environment where the US dollar continued to dominate in trade and payments. As **Professor Paulus (2017)** pointed out, basic concepts and fundamental values were suddenly up for grabs.

Developments since March of 2020 have strengthened the case for a more formal and publicly accountable debt restructuring process. The pandemic exposed severe information and coordination problems in the existing debt architecture, and the human cost of ignoring them. But for the COVID shock, debt architecture might have tried to adapt to 21st century power shifts case-by-case, over decades, as it had done in the past. With the pandemic in the background exposing and exacerbating inequality, the adaptation window shrank. This crisis forced policy makers, market participants, and civil society to reckon with the prospect of more damaging financial, public health, and climate shocks destroying public debt payment capacity.

II. A COVID Test
More than US$80 billion rushed out of developing countries in March of 2020, surpassing all other recent periods of turbulence, including the global financial crisis of 2007-2009 (IIF 2020, Nelson and Weiss 2020). International trade froze, investment plummeted, business travel ground to a halt, and tourists vanished. The World Bank, the IMF, and leading sovereign debt experts predicted imminent government debt defaults on a scale not seen since the “Lost Decade” of the 1980s (eg, Sims 2013, Cline 1995). The year 2020 ended with six defaults and restructurings, of which four had been under way before the pandemic. Six was bad, but far less bad than the dozens predicted. By early 2021, several risky “frontier” market economies in Sub-Saharan Africa could boast of oversubscribed bond offering (eg Rashed and Zungu 2021, Fitch Ratings 2020). Sovereign debt stocks across the national income spectrum climbed to new heights during the pandemic (eg, Gaspar et al. 2021), alongside exhortations to fortify financial systems and reform debt architecture for the unravelings to come (eg, FES and CBI Roundtable Report 2021, Kharas and Dooley 2021).

Reforms so far amount to a fresh coat of paint, though not for lack of trying. A review of the pandemic response in this section suggests that at least part of the reason lies with the implicit assumption that the informal modular process that made case-by-case restructurings happen with a creditor pool comprising mostly trans-Atlantic creditors could easily assimilate a larger and more diverse group of actors, even if the new creditors wanted to assimilate.

A. Let Them Eat Spillovers

In April of 2020, the Group of Twenty (G-20) launched the Debt Service Suspension Initiative (DSSI), offering to defer sovereign debt payments that 73 low-income countries owed to them for the rest of that year (G-20 2020, World Bank 2021). Separately, the IMF activated a special catastrophe trust fund to replace payments that would otherwise be due to it from 29 of the world’s poorest and most vulnerable countries, estimated at US$1.4 billion over two years (IMF 2021). Multilateral organizations announced new and accelerated pandemic financing initiatives, but for most of 2020, these amounted to a small fraction of the funds that wealthy economies had mobilized at home (G-30 2020). The practical effect was to let spillovers from domestic stimulus in high-income countries take care of funding pandemic response and making up for the associated economic dislocations everywhere else.

The DSSI was among the most visible and most frustrating multilateral interventions of 2020. When it debuted at the first-ever virtual G-20 meetings, the DSSI promised to free up more than US$20 billion in 2020 alone, before it was extended through the end of 2021. It signaled important ambition and realized it immediately simply by virtue of the actors involved. Saudi Arabia presided over this G-20 cycle; along with China and India, it had not been part of the Paris Club. They all signed on to the communiqué and the term sheet together with the G-7 countries, and called on private creditors to suspend debt payments on comparable terms (G-20 2020). The Paris Club agreed to participate in parallel. The communiqué named the Institute of International Finance (IIF), an established industry group active since the 1980s crisis, as leading the private creditor coordination effort. The IMF and the World Bank undertook to support DSSI implementation. Countries requesting DSSI treatment would have to apply for an IMF program, commit to enhanced debt transparency, and (at least in theory) abide by IMF and World Bank policy limits on new borrowing (G-20 2020). All these features suggested a big step forward: gathering new and established creditors, debtors, and private sector stakeholders in a new, improved version of the old modular regime. If it worked during COVID for a subset of countries, it could serve as a model for a new, more inclusive and sustainable architecture.

By the end of 2021, this would-be model became a case study in sovereign debt process dysfunction with repercussions for future reforms. Forty-three of the 73 eligible governments sought help under the DSSI in
2020 and 2021; they received US$10-12 billion in relief, approximately half of what had been projected for the remainder of 2020 (Wheatley Oct. 2021, World Bank 2021). From the start, eligible countries were slow to apply, citing limited benefit and fears of losing access to market or Chinese financing (World Bank and IMF 2020a, Wheatley Dec. 2021). G-20 governments appeared to disagree publicly over the initiative’s scope and duration. While officials complained bitterly about private creditor inaction, the IIF’s repeated efforts to coordinate funds, banks, and commodities traders yielded a stream of exquisitely noncommittal statements, more lending to creditworthy governments, and US$24 million in payments suspended—compared to US$14.9 billion in payments made by DSSI-eligible governments to private creditors (eg, Wheatley Oct. 2021, Jubilee Debt Campaign 2021).

B. A Problem Prototype

Many factors beyond G-20 officials’ control were to blame for the DSSI’s disappointing record—most certainly the pandemic itself. Nonetheless, three DSSI design features look especially problematic in retrospect, and hold lessons for debt architecture going forward. First, its structure had a muddled relationship to its stated mission and facts on the ground. Second, despite the unusual specificity of the initial term sheet, major creditors and creditor groups lacked a shared understanding of fundamental concepts, and may have had limited interest in reaching any such understanding. Third, the debt treatment process was a bewildering mix of onerous, unintelligible, and ineffective. This [section] elaborates on the three features.

Pausing debt payments from low-income countries is not the most intuitive way to mobilize funds in a pandemic.11 A standstill makes sense in response to large-scale capital outflows and frozen credit markets. The underlying premise is that governments are solvent but temporarily illiquid through no fault of their own, and would otherwise pay their debts in full and on time. At least a dozen of the DSSI-eligible countries had virtually no bilateral official debt payments due over the suspension period; many more had low bilateral debt service burdens, but significant private and multilateral payments due (World Bank and IMF 2020b, Jubilee Debt Campaign 2021). More than half of the eligible countries entered the pandemic at risk of debt distress, with large scheduled payment spikes in the medium term (World Bank and IMF 2020a). A debt standstill would not help countries with no eligible payments due; they needed new money. A standstill could amplify debt vulnerabilities for countries already at risk of distress, adding to debt stocks and amplifying debt service spikes. For those low-income countries that needed debt reduction, the DSSI could turn into a costly distraction. Meanwhile, middle-income countries—including island states that had lost all tourism revenues and braced for cataclysmic climate events—were simply ineligible for DSSI relief, even if they suffered from massive liquidity shocks and had large debt payment flows. In sum, DSSI relief distribution was bound to be very lopsided even in the best case scenario: some estimates had more than half the benefit going to Angola and Pakistan (eg, G-30 2020).

The G-20 continued to negotiate and reinterpret basic DSSI parameters after launching the initiative. The initial 8-month duration of the suspension might have been a function of undue-if-understandable optimism about the pandemic path. It was nonetheless damaging: repeated extensions contributed to uncertainty and introduced unnecessary frictions into the process for eligible debtors and other stakeholders. Each DSSI extension had to be separately negotiated among the G-20, and required debtors to apply for relief. Automatic extensions triggered by public health benchmarks, or changing the default option to a two or

11 This author was among those advocating for a debt standstill in a co-authored policy brief (Gelpern, Hagan, and Mazarei 2020).
three-year extension would have been less disruptive, but would require a reservoir of trust between debtors and creditors, and among creditors and within creditor countries.

Public disagreements among the G-20 over the scope of eligible debt, the treatment of arrears, and the classification of participating creditors were arguably predictable and harder to justify. The most high-profile disagreement was over classifying China Development Bank (CDB), a large Chinese state-owned lender, and others like it. The G-7 had sought to treat the CDB as an official bilateral lender committed to participate directly in the DSSI, while China insisted that it was commercial, and at most within the scope of comparability. In substance, the CDB is probably a hybrid – it shares attributes with both public and private lenders in Western economies. Similar hybrid institutions are commonplace in economic systems where the state plays a large role, including some of the biggest new bilateral creditors. It would be presumptuous to assume that new creditors would simply accept classifications modeled on different economic systems and predating their arrival, yet fraught with substantive policy consequences. CDB reportedly suspended significant payment flows for some of its debtors “voluntarily” in parallel with DSSI. Nonetheless, leaving the status and participation of hybrid lenders unsettled, as it remains to this day, adds to the uncertainty about the magnitude and scope of available relief.

Sustainability and comparability concepts are on similarly shaky ground, as is the very meaning of debt suspension. The statement that launched the DSSI promised a net present value (NPV)-neutral postponement. Postponed payments would accrue interest at a rate sufficient to compensate creditors for the cost of the delay, but would neither penalize the debtors nor reduce their debts. The trouble with concepts like NPV-neutrality is that it can vary significantly among creditors depending on applicable accounting rules, among other factors. Where G-20 government creditors would use their own (low) cost of funds to set the suspension interest rate, private creditors would charge much higher rates reflecting the borrower’s credit risk and other market and regulatory factors to achieve NPV neutrality. While private creditors’ NPV calculus turned out to be moot for the most part (their DSSI participation was none to negligible), lack of clarity on this point could pose a problem in future cases.

The failure of private creditors to suspend payments in conjunction with the DSSI is politically salient, and has drawn considerable policy and media scrutiny. Even excluding the CDB, commercial debt payments were the largest single category of debt service for eligible countries during the DSSI term. On the one hand, this outcome was to be expected: the G-20 agreed to make suspension voluntary, and did not condition DSSI participation on the approval of an IMF program, which would have imported the Fund’s debt sustainability policies. On the other hand, participants in the old modular system might have gotten used to cajoling banks and bondholders into comparable treatment using nudges, contract tweaks, and informal pressure over the past two decades. In 2020 and 2021, the old toolkit was not enough. Private creditors were far more diverse than banks and bondholders; they included different kinds of investment funds, sovereign wealth funds, hybrid lenders like CDB, operating companies, and commodities traders. Far more than before held domestic claims and claims effectively secured by revenue flows. Both loans and bonds traded actively, which made it harder to ascertain who held what claims, and made modularity and trust harder to sustain. Against this background, making participation voluntary forced private creditors to choose between defying their governments and subsidizing likely free-riders.

Finally, the DSSI came with no discernible process. A joint DSSI implementation report prepared by the IMF and the World Bank painted a distressing picture of already-hesitant debtors struggling to approach their various creditors one by one, as they got pressured and cajoled into side deals, and with basic information beyond the reach of even the multilaterals supporting the initiative (World Bank and IMF 2020a). This was far messier than the modular regime of old, and far more prone to information problems and coordination failures. In one incident that drew media attention, Zambia’s bondholders abandoned
negotiations when Zambia refused to hand over information about the terms of its Chinese bank debt restructuring.\textsuperscript{12}

Abstracting from that incident, the decision to put the onus of obtaining relief on cash-strapped debtors looks questionable in retrospect. To be sure, it is customary for debtors to initiate insolvency proceedings under national regimes, but those regimes are fundamentally settled in ways that sovereign debt restructuring is not. With the DSSI, debtors had to apply for short-term payment relief on continuously changing terms, with no guarantee of a favorable outcome and no IMF-endorsed debt sustainability analysis to fall back on. Officials worried that an application would signal distress or weak commitment to repay. Some creditors amplified signaling and rating downgrade fears when they counseled governments not to apply for DSSI. Governments that stood to benefit the most from DSSI—those that had recently gained market access and feared losing it—were precisely those that would worry the most about sending the wrong market signal.

It is worth briefly comparing the DSSI to a high-profile proposal that would have temporarily redirected scheduled debt payments from vulnerable countries to private creditors into a multilateral facility to pay for public health expenditures, and would have given debtors a legal defense against creditor lawsuits (Bolton et al. 2020a, b). Such a structure would have avoided most of the signaling and process problems with the DSSI, and would have taken considerable pressure off distressed debtors. With broad or universal mandatory application, no debtor could signal particular distress or unwillingness to pay, which seems appropriate in a global pandemic. On the other hand, the facility was unlikely to generate sufficient resources from low-income countries alone—they did not owe enough debt—and would have had to convince middle-income countries with large debt payments due to hand control over their public health budgets to a multilateral agency.

\section*{III. A Common Framework in Search of Common Ground\textsuperscript{13}}}

The G-20 launched the Common Framework for Debt Treatments beyond the DSSI (the Common Framework) in November of 2020, in large part to complement the DSSI and compensate for some of its shortcomings (G-20 2020c). Unlike the DSSI, the Common Framework could offer eligible countries debt reduction, not just an NPV-neutral payment pause, albeit only as a last resort. It would import IMF and World Bank debt sustainability analysis, and the Paris Club’s requirement that debtors seek comparability, partly mitigating the voluntary participation problem. A Memorandum of Understanding (MOU) between the debtor and all its creditors, and a creditor committee structure, promised to introduce more process clarity.

In the year after its announcement, three countries applied for relief under the Common Framework: Chad, Ethiopia, and Zambia. Chad was the first to see a creditor committee assemble, in April 2021 under the Common Framework, chaired by Saudi Arabia. Chad owed slightly more than a third of its external debt to the mining firm Glencore, and slightly less than a third to established multilaterals (IMF, the World Bank Group, the African Development Bank, and the International Fund for Agricultural Development). Its biggest bilateral creditors were China and Libya, followed by France, Angola, and India. Chad’s other big creditors include regional and Islamic development institutions. By January 2022, Chad had secured an

\textsuperscript{12} Confidentiality provisions in debt contracts with Chinese lenders tend to be unusually restrictive (see eg, Gelpert, Horn, Morris, Parks, and Trebesch 2021).

\textsuperscript{13} Portions of this section are based on this author’s testimony before the US House of Representatives Committee on Financial Services, Subcommittee on National Security, International Development and Monetary Policy, Hearing on “Examining Belt and Road: The Lending Practices of the People’s Republic of China and Impact on the International Debt Architecture” (May 18, 2021).
IMF program, but its debt talks stalled over comparability with Glencore’s secured and syndicated claims (Paris Club 2022). Ethiopia’s creditors formed a committee in September 2021; Zambia’s took until spring 2022 (Georgieva and Pazarbasioglu 2021).

The Common Framework improves on the DSSI in a number of ways, and could yet become a genuinely “architectural” step forward in sovereign debt restructuring architecture. Yet it suffers from some of the DSSI’s problems: eligibility limited to the most distressed and dysfunctional economies, which risks adding to the stigma associated with participation; opaque and excruciatingly slow implementation, which can become especially damaging without an automatic stay or agreed-upon payment suspension; limited tools to enforce comparability; and persistent lack of agreement on core concepts (including comparability and creditor classification). In short, the Common Framework is short on process, with no substantive common ground to fall back on.

In an effort to speed up relief under the Common Framework, the IMF and World Bank leaders have called for additional reforms. These include clear and more compressed implementation timelines, a debt standstill for applicant countries, clarifying comparability and its enforcement, and expanding the Common Framework beyond DSSI-eligible low-income countries (eg, Shalal 2021). Incremental steps in the direction of process clarity and China’s willingness to take a leadership role in Zambia’s debt talks in the summer of 2022 were hopeful signs for the architecture project. Abstracting from weeds of the pandemic response experience, this is the closest the international community has come to political consensus on bankruptcy for sovereigns since the days of the SDRM.

**Conclusion**

Sovereign borrowing and sovereign debt restructuring are fundamentally political projects (Hamilton 1790). Allocating losses from a sovereign debt crisis requires domestic and international political settlement. Government debtors and their creditors must negotiate that settlement from scratch each time; there is no default liquidation bargain to fall back on. For as long as the G-7 governments led the creditor cohort and exercised substantial control over the negotiations, they could take advantage of their multifaceted diplomatic and commercial relations, and a reservoir of trust, to compensate for the absence of a default distribution scenario. Informality and flexibility in the restructuring process was not a significant problem in this context, and may have helped institutions adapt to political and economic change.

The COVID-19 shock forced the international community to consider how it might respond to a sovereign debt crisis implicating dozens of governments and the imperative of funding public health and other basic human needs, in a world where the G-7 and institutions like the Paris Club held less than 10 per cent of the claims and could not realistically call the shots. The DSSI experience strongly suggests that the modular debt restructuring regime and IMF-centered process, which came of age in the 1990s and early 2000s, would adapt organic to the rising importance of China and other non-traditional creditors from diverse economic and political systems.

Today’s debt architecture is short on both trust and process. It will require a serious and sustained commitment to institutional design to meet the coming health, climate, financial and political challenges. The quest for a comprehensive, collective and binding legal process to channel sovereign debt politics and minimize the human cost of debt crises is more urgent than ever. Professor Paulus’s contributions will continue to inform this quest.