

## New sovereign debt management regime should be G20 focus

*By Kevin P Gallagher*

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Developing a sovereign debt crisis management regime should be at the top of the G20's agenda.

As Carmen Reinhart and Kenneth Rogoff show in *This Time is Different: Eight Centuries of Financial Folly* banking crises are often followed by sovereign debt crises. Europe's debt crisis might be topping the headlines now, but the problem won't end here.

Reinhart and Rogoff find that the debt/GDP threshold where nations slip into crises has historically been 30-35 per cent of GDP. According to the [World Bank](#) more than 60, mostly developing, countries reached that threshold in 2008. A [2009 IMF report](#), which examined 71 low-income countries, suggested 28 of the poorest nations are at high risk of debt crises.

But a nation need not have a high debt/GDP ratio now to tailspin; even nations with low budget deficits can quickly be affected as governments borrow for bailouts or stimuli and then experience slow growth and low tax revenue. All of a sudden then, debt burdens can look difficult to service.

Many countries, if not this time then the next, will need to reschedule, restructure, or even default on their debt. At present there exists no adequate forum for nations to workout their debt problems. Thus more often than not, debt workouts result in crisis-stricken debtors and disgruntled creditors.

The absence of a restructuring mechanism is both costly, unfair and, as argued in Barry Herman, Jose Antonio Ocampo, and Shari Spiegel new book *Overcoming developing country debt crises*, a glaring gap in international financial architecture.

This systemic lack has resulted in enormous IMF and national government bailouts, from [\\$50bn for Mexico's peso crisis](#) to a staggering [\\$1,000bn for Europe's current crisis](#). These bailouts go the pockets of private creditors and are paid for by taxpayers and citizens across the world.

Additionally, the economic losses of today's ad-hoc restructuring system are significant. Restructuring is often long and drawn out, often causing panic and capital flight all while creditors receive no interest payments and debtors have no access to finance.

As Eric Helleiner of the University of Waterloo [has shown](#), the idea of a global system for excessive creditors and lenders to negotiate debt problems is not new.

Mexico proposed a mechanism in 1933, Harry Dexter White included such a function in his initial drafts of the IMF articles in the 1940s, UNCTAD saw such a regime as core to a "New International Economic Order" in the 1970s and most recently the IMF issued a call for a '[Sovereign Debt Restructuring Mechanism](#)' in 2001 in the wake of Argentina's financial crisis.

Common elements of many of these past attempts include proposals for a fair forum for negotiation; a standstill clause whereby bondholders cannot rapidly pull their investments out of a debtor nation; and clauses that limit the ability of disgruntled minority bondholders to file lawsuits against creditor nations.

These proposals have never matured partly because debtors' fears that voicing support would signal that a nation was prone to default and affect its creditworthiness and creditors contentment with the status quo. Helleiner rightly characterises this conundrum as a classic collective action problem given that an orderly restructuring is clearly in the interests of both creditors and debtors alike.

We are left with an ad-hoc system where some bonds have interesting but limited 'collective action clauses' that spell out terms for restructuring and voluntary codes of conduct with no teeth.

[Collective action problems](#) of this nature can only be solved by leadership. That's where the G20 should come in. The G20 prides itself as a cooperative global

steward for financial stability. The overarching goal of such an effort should be to strike a single global standard for balanced and timely restructuring that satisfies the needs of creditors while enabling debtor nations the ability to recover and grow. This is where the G20 can make its mark.