# Governing Sovereign Bankruptcy
## Writing International Rules for Rewriting National Debts

by

Skylar Brooks

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# Examining Committee Membership

The following served on the Examining Committee for this thesis. The decision of the Examining Committee is by majority vote.

| | |
|---|---|
| External Examiner | Daniel McDowell<br>Associate Professor |
| Supervisor(s) | Eric Helleiner<br>Professor |
| Internal Member | Bessma Momani<br>Professor |
| Internal Member | John Ravenhill<br>Professor |
| Internal-external Member | Heather Whiteside<br>Assistant Professor |

# Author's Declaration

I hereby declare that I am the sole author of this thesis. This is a true copy of the thesis, including any required final revisions, as accepted by my examiners.

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# Abstract

This thesis examines three sets of recent initiatives aimed at reforming the international regime for sovereign debt restructuring. The first involved changes to the rules governing IMF lending and their role in triggering debt restructurings. The second entailed reforms to sovereign bond contracts in order to facilitate smoother restructuring processes. The third took place within the UN, where states advanced the idea of an international hard-law approach to debt restructuring but settled for a set of soft-law principles. Taken together, these initiatives had a mixed impact on the regime. Contract reforms strengthened bond restructuring processes; IMF reforms weakened the mechanism designed to trigger necessary restructurings; and UN reform efforts had little concrete impact in either direction.

What explains the variation in these recent regulatory outcomes? I argue that this variation can be understood according to two dimensions: the *process-trigger distinction* and the *legal-institutional design* of process-oriented mechanisms. A trigger mechanism is hard to institutionalize because of the time-inconsistent preferences of powerful states and their more general desire—supported by sovereign debtors and private creditors and amplified by recent experiences—for case-by-case decision-making when it comes to if and when to trigger a debt restructuring. Compared to the trigger, some *but not all* process mechanisms have greater odds of success, depending on their design. Hard-law designs face huge political opposition, whereas soft-law tools can encounter political challenges but are also of limited effectiveness in this issue area. By contrast, private-law contracts provide useful mechanisms for navigating the trade-offs of regulating debt restructuring processes, especially for dominant states. I also argue that *historical legacies and processes* have influenced recent reform outcomes, but mainly through their ability to further enhance or diminish the prospects of mechanisms whose political utility had already been determined by the process-trigger distinction and/or their legal-institutional design.

This thesis makes an empirical contribution to IPE and global governance literatures by providing the first comprehensive analysis of recent sovereign debt restructuring reforms. It makes important theoretical contributions to these literatures by developing an analytical framework for understanding the politics of regulatory reform within the sovereign debt restructuring regime. It also offers insights that contribute to wider debates about institutional design and development, including those related to the choice of international hard-law or soft-law governance instruments, the use of contracts in global governance, and the role of historical legacies and processes in shaping regulatory outcomes.

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# List of Abbreviations

| | |
|---|---|
| BRICS | Brazil, Russia, India, China, South Africa |
| CACs | Collective Action Clauses |
| DSA | Debt Sustainability Analysis |
| EA | Exceptional Access |
| EB | Executive Board |
| EC | European |
| ED | Executive Director |
| EMDE | Emerging Market and Developing Economy |
| EU | European Union |
| FSIA | Foreign Sovereign Immunities Act |
| G5 | Group of Five |
| G7 | Group of Seven |
| G10 | Group of Ten |
| G20 | Group of Twenty |
| G77 | Group of 77 |
| HIPC | Heavily Indebted Poor Countries |
| IEO | Independent Evaluation Office |
| IIF | Institute of International Finance |
| IMF | International Monetary Fund |
| IO | International Organization |
| IPE | International Political Economy |
| NGOs | Non-Governmental Organizations |
| PSI | Private-Sector Involvement |
| SDRM | Sovereign Debt Restructuring Mechanism |
| SDRR | Sovereign Debt Restructuring Regime |
| UK | United Kingdom |
| UN | United Nations |
| UNGA | United Nations General Assembly |
| UNCTAD | United Nations Conference on Trade and Development |
| US | United States |

# CHAPTER 1

## Introduction and Overview

### 1. The Topic and Research Question

In May 2010, the International Monetary Fund (IMF or Fund) changed its lending rules so that it could provide Greece with a €30 billion loan without first requiring the country to restructure its debt, as the old rules would have done. The move was controversial, largely because it helped only to delay and complicate much-needed debt relief. When Greece finally did restructure its debt in the spring of 2012—writing down roughly €200 billion worth of bonds owed to private investors—the operation failed to deliver sufficient debt relief, was marred by free riders, and created massive uncertainty about how future debt crises would be resolved, particularly in Eurozone countries. Months later, on the other side of the Atlantic, a controversial New York-court ruling against Argentina delivered a landmark victory to a group of litigious private creditors, in turn threatening to unleash cascades of litigation and make future debt restructurings "virtually impossible" under New York law, where the majority of international sovereign bonds are issued.[1] These two episodes, unique as they were, highlighted what many had long considered to be the Achilles' heel of debt restructuring: the lack of an adequate global framework or set of institutional arrangements capable of shepherding heavily-indebted sovereigns through a timely, orderly, and predictable bankruptcy procedure.[2] Previous attempts to address this governance gap had made some progress, particularly in the early 2000s, but the Greek and Argentine cases disavowed any illusions that these earlier efforts would be sufficient.

These cases and the complications they created for a range of state and market actors generated new pressures and opportunities for change, giving rise not to a single reform process but rather to three separate sets of initiatives aimed at strengthening the 'sovereign debt restructuring regime' (SDRR): the mélange of formal and informal arrangements for reducing or rescheduling the debts of states that fail to meet their payment obligations.[3] The first involved changes to the rules governing IMF lending

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[1] Martin Guzman and Joseph E. Stiglitz, 'How Hedge Funds Held Argentina for Ransom,' *The New York Times*. April 1, 2013.

[2] See Kenneth Rogoff and Jeromin Zettelmeyer, 'Bankruptcy Procedures for Sovereigns: A History of Ideas, 1975-2001,' IMF Staff Papers 49(3)(2002): 470-507.

[3] Sovereign debt restructuring can take one or both of two forms. The first is a debt rescheduling, which involves a lengthening of maturities on existing debt, extending the repayment of principal further into the future and, in some cases, lowering interest rates. The second is debt reduction, which involves an outright reduction in the nominal face value of

and their role in triggering necessary debt restructurings. The second comprised two separate initiatives both focused on revising the standard language in sovereign bond contracts—one concerned with the bonds of Eurozone states, the other with those of emerging market and developing economies (EMDEs)—in order to facilitate smoother and more equitable restructuring processes. The third took place within the United Nations (UN), where the Group of 77 (G77) and China called for an ambitious "multilateral legal framework for sovereign debt restructuring" but settled in the end for a more modest set of non-binding restructuring principles.[4]

These reform initiatives set out to build new institutional arrangements and fortify existing ones, but their overall impact on the SDRR has been decidedly mixed. Compared to the reforms introduced in the early 2000s, when the regime was last updated, the recent initiatives described above have—as a whole—simultaneously strengthened, weakened, and left unchanged important elements of the SDRR. Contract reforms have strengthened the bond restructuring process, providing more robust mechanisms for binding a wider group of private creditors to a common restructuring agreement; IMF reforms have weakened the regime by eroding both the credibility and content of the IMF's previous lending framework, which promised to encourage necessary debt restructurings by preventing the Fund from lending to countries with unsustainable debt burdens; and the UN initiative has had little concrete impact in either direction. Scholars have long emphasized the difficulties of building more muscular mechanisms for sovereign debt restructuring, raising the question of why some recent initiatives succeeded in strengthening the regime where others failed, especially given that all took place within the same broad issue area and historical context.

What explains the variation in reform outcomes? In other words, why did contract reforms flourish while the other initiatives floundered, failing to advance meaningful change (the UN case) or even weakening existing arrangements (the IMF case)? And what does this tell us about the politics of reform in this particular area of financial governance and in the global political economy more broadly? While scholars of International Political Economy (IPE) have examined a wide range of reforms to global financial governance since the 2008 global financial crisis, they have neglected these important

existing debt instruments (e.g., from $100 to $75). Both provide debt relief to the country in crisis, and both involved losses for creditors. However, rescheduling is typically milder than reduction in terms of the debt of debt relief.

[4] UN, 'Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes,' UNGA Resolution (A/RES/68/304). September 9, 2014.

questions and the reforms that motivate them. This dissertation fills this gap, making a clear empirical contribution to IPE and global governance literatures by providing the first comprehensive analysis of recent sovereign debt restructuring reforms. It also makes important theoretical contributions to these literatures by developing an analytical framework for understanding the politics of regulatory reform within the SDRR—specifically, for making sense of why certain types of institutional or regulatory designs have succeeded in securing sufficient political support while others have failed. This framework provides a lens through which to view more systematically the countless reform proposals and initiatives that animate debt restructuring debates, shedding new light on an important substantive topic that has not received enough attention from IPE scholars. It also offers insights that contribute to wider debates about institutional design and development, including those related to the choice of international hard-law or soft-law governance instruments, the use of private-law contracts in global governance, and the role of historical legacies and processes in shaping global regulatory outcomes.

## 2. Existing Accounts of Regulatory Reform in the SDRR

What do existing accounts tell us about the politics of reform in the SDRR and the determinants of regulatory variation in this governance domain? Although IPE and global governance scholars have largely ignored recent developments in the SDRR, there is a small body of literature that sheds light on previous episodes of cooperation, conflict, and regulatory reform in this issue area. Much of this work is focused on explaining patterns of creditor coordination and debtor-creditor bargaining outcomes *during* debt restructuring negotiations and processes.[5] But a handful of scholars have also examined the politics of reform initiatives aimed at building new mechanisms to govern sovereign debt workouts.[6] These accounts focus mostly on individual initiatives, such as the IMF's high-profile plan for a treaty-based Sovereign Debt Restructuring Mechanism (SDRM) in the early 2000s.[7] A few

[5] For example, see Charles Lipson, 'Bankers' Dilemmas: Private Cooperation in Rescheduling Sovereign Debts,' *World Politics* 38(1)(1985): 200-225; Daphne Josselin, 'Regime Interplay in Public-Private Governance: Taking Stock of the Relationship Between the Paris Club and Private Creditors Between 1982 and 2005,' *Global Governance* 15(4)(2009): 521-538; Christian Suter, *Debt Cycles in the World-Economy: Foreign Loans, Financial Crises, and Debt Settlements, 1820-1990* (Westview, 1992); Vinod K. Aggarwal, *Debt Games: Strategic in International Debt Rescheduling* (Cambridge University Press, 1996).

[6] A debt 'workout' is another commonly used term for debt restructuring. A number of other terms are also often used as synonyms for restructuring, including: haircut, write-off, write-down, and 'private-sector involvement' (PSI). These terms will be used interchangeably throughout this dissertation.

[7] Brad Setser, 'The Political Economy of the SDRM,' in: Barry Herman, Jose Antonio Ocampo, and Shari Spiegel (eds.), *Overcoming Developing Country Debt Crises* (Oxford University Press, 2010). Sean Hagan, 'Designing a Legal Framework to Restructure Sovereign Debt,' *Georgetown Journal of International Law* 36(2)(2005): 299-402. Susanne Soederberg, 'The international dimensions of the Argentine default,' *Canadian Journal of Latin American & Caribbean Studies* 28(55/6)(2003): 97-125.

scholars also consider the fate of particular types of proposals throughout history. For example, Eric Helleiner asks why attempts to establish a formal international debt restructuring mechanism have repeatedly failed, documenting efforts to promote such a mechanism in the 1930s, 1940s, 1970s, and early 2000s.[8] He and others point to several obstacles that have frustrated efforts to reform the SDRR, including the opposition of powerful states and private creditors concerned about the distributional consequences of reform,[9] collective action problems among both sovereign debtors and private creditors,[10] and the reluctance of key states to accept the sovereignty costs of a supranational regime.[11]

The few brief, mostly policy-oriented accounts of the recent UN and IMF initiatives reinforce the impression that attempts to institutionalize debt restructuring face enormous political challenges. Documenting the UN case, Yuefen Li notes that private creditors and the states in which they reside resisted reform because they feared that "the introduction of the legal framework would lead to a loss by private creditors from the developed countries and a gain for debtors from the developing ones."[12] She also points to the type of sovereignty concerns and collective action problems that frustrated previous initiatives. Likewise, existing accounts suggest that the weakening of the IMF's lending framework and its role as a pillar of the SDRR reflects political power realities that make restructuring rules difficult to uphold. As Susan Schadler describes, political pressures to bailout Greece in 2010 trumped existing IMF rules, resulting in an impromptu reform that undermined the credibility of its commitment not to lend to countries with unsustainable debt burdens.[13] Barry Eichengreen and Ngaire Woods agree that this 2010 reform highlighted a 'credible commitments' problem with the Fund's lending rules,[14] while Paul Blustein notes that efforts to fix this problem and reinvigorate the

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[8] Eric Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism,' *Contributions to Political Economy* 27(2008): 91-113. For an analysis of initiatives in the 1970s and early 2000s, see also Susanne Soederberg, 'The Transnational Debt Architecture and Emerging Markets: the politics of paradoxes and punishment,' *Third World Quarterly* 26(6)(2005): 927-949.

[9] Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism'; Soederberg, 'The Transnational Debt Architecture and Emerging Markets.'

[10] Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism.'

[11] Anna Gelpern, Ben Heller, and Brad Setser, 'Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Bonds,' in: Martin Guzman, Jose Antonio Ocampo, and Joseph E. Stiglitz (eds.), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016): 109-143. Hagan, 'Designing a Legal Framework'; Setser, 'The Political Economy of the SDRM.'

[12] Yuefen Li, 'The Long March towards an International Legal Framework for Sovereign Debt Restructuring,' *Journal of Globalization and Development* 6(2)(2015): 329-341, p. 335.

[13] Susan Schadler, 'Unsustainable Debt and the Political Economy of Lending: Constraining the IMF's Role in Sovereign Debt Crises,' CIGI Papers No. 19, October 2013; Susan Schadler, 'Living with Rules: The IMF's Exceptional Access Framework and the 2010 Stand-By Arrangement with Greece,' IEO Background Paper BP/16-02/08, Independent Evaluation Office of the International Monetary Fund, 2016.

[14] Barry Eichengreen and Ngaire Woods, 'The IMF's Unmet Challenges,' *Journal of Economic Perspectives* 30(1) (2015): 29-52.

rules from 2013-2016 were hamstrung by opposition from powerful actors, notably US officials.[15] These accounts resonate with Susan Strange's view that the nature of world politics prevented states from cooperating to institutionalize a sovereign debt restructuring system,[16] as well as Odette Lienau's observation that "private creditor groups have historically been resistant to the establishment of a DWM [debt workout mechanism] or indeed any greater institutionalization of debt restructuring."[17]

Yet despite these seemingly insurmountable obstacles, not all attempts to institutionalize sovereign debt restructuring have failed. Recent contract reforms are a prime example of successful regulatory change in this area, as are previous contract changes in the early 2000s, both of which focused on replicating key features of a bankruptcy process within the contract terms of sovereign bonds. Why did these initiatives prevail? Scholars who analyzed the reforms of the early 2000s present contract change largely as a one-off event shaped by a number of idiosyncratic factors.[18] Important as they may have been to that earlier episode, these context-specific factors fail to anticipate and explain the re-emergence and strengthening of contract-based restructuring mechanisms more recently. Up-to-date explanations of these newer developments are scarce, though a few analysts have weighed in. Looking at recent changes to Eurozone bonds, Anna Gelpern and Mitu Gulati emphasize the role of contracts as a symbolic—rather than substantive—tool, which served the interests of European political elites looking to signal a new approach to crisis management in the wake of the Greek crisis.[19] By contrast, reforms to EMDE bonds have been framed largely as a functional solution to the growing problem of holdout creditors.[20] These recent interpretations provide useful insights but fail to explain why contracts would be a more effective symbolic or functional fix than other regulatory arrangements.

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[15] Paul Blustein, *Laid Low: Inside the Crisis that Overwhelmed Europe and the IMF* (CIGI Press, 2016).

[16] Susan Strange, *Mad Money: When Markets Outgrow Governments* (University of Michigan Press, 1998), p. 173.

[17] Odette Lienau, 'Legitimacy and Impartiality in a Sovereign Debt Workout Mechanism,' Discussion Paper Prepared for the Fourth Session of the UNCTAD Working Group on a Debt Workout Mechanism (July 2014), p. 40. Available at: https://unctad.org/en/PublicationsLibrary/gdsddf2014misc2_en.pdf.

[18] Anna Gelpern and Mitu Gulati, 'Public Symbol in Private Contract: A Case Study,' *Washington University Law Review* 84(7)(2006): 1627-1715; Eric Helleiner, 'Filling a Hole in Global Financial Governance? The Politics of Regulating Sovereign Debt Restructuring,' in: Walter Mattli and Ngaire Woods (eds.), *The Politics of Global Regulation* (Princeton University Press, 2009): 89-120.

[19] Anna Gelpern and Mitu Gulati, 'The wonder-clause,' *Journal of Comparative Economics* 41 (2013): 367-385.

[20] Chanda DeLong and Nikita Aggarwal, 'Strengthening the contractual framework for sovereign debt restructuring—the IMF's perspective,' *Capital Markets Law Journal* 11(1)(2016): 25-37. Gregory Makoff and Robert Kahn, 'Sovereign Bond Contract Reform: Implementing the New ICMA *Pari Passu* and Collective Action Clauses,' CIGI Papers No. 56 (February 2015). See also Gelpern, Heller, and Setser, 'Count the Limbs.'

The literature surveyed above points to a number of important factors that have helped shape the fate of different reform initiatives in the SDRR, but it provides a poor basis for understanding variation in regulatory outcomes. Existing analyses leave one with the impression that regulatory reform is either practically impossible or largely random. Virtually none of the studies reviewed above provide the kind of comparative analysis of failed and successful initiatives that would allow them to generate broader insights about the determinants of variation in this domain.[21] To an extent, the absence of comparative research likely reflects the relatively small number of cases—especially of successful initiatives—available to scholars studying earlier reform efforts, combined with the fact that more recent cases have received little scholarly attention. In any event, the lack of a more systematic and generalized understanding of the types of governance arrangements that are politically possible in the SDRR remains a regrettable gap in our knowledge of this important area of global financial governance. My aim is to fill this gap by analyzing and comparing recent reform initiatives, which reveal new insights and reinforce existing ones in ways that are especially useful for generating broader inferences about the politics of sovereign debt restructuring reform.

What exactly do existing analyses miss? What factors need to be taken into account to provide a fuller view of regulatory variation in the SDRR? The existing literature suffers from three major blind spots that limit its ability to explain variation in recent reform outcomes. The first stems from the tendency among analysts to treat debt restructuring as a single issue or phenomenon, with the implication being that different reform initiatives or proposals are essentially looking to govern the same set of issues and relationships and thus face the same challenges. This totalizing tendency has led scholars to overlook important distinctions that are critical to grasping variation in sovereign debt reform outcomes. Specifically, they have failed to disaggregate the temporal stages of sovereign debt restructuring into two basic categories: the *trigger* stage, concerning decisions about whether and when to restructure debt in the first place, and the *process* stage, concerning the renegotiation of payment terms among a debtor and its creditors once the decision to restructure has already been made. Policy

[21] To be sure, Soederberg ('The Transnational Debt Architecture and Emerging Markets') and Helleiner ('Filling a Hole in Global Financial Governance?'), respectively, discuss both the failure of the SDRM and the emergence of CACs within the context of a single article or book chapter. But neither provide the kind of systematic or in-depth comparison that generates broader insights about regulatory variation in this domain. The only other exception is an article I co-authored which outlined my earlier views on this issue. While it looked to address the question of regulatory variation directly, the article provided little in the way of a broader framework through which to understand different reform outcomes. See Skylar Brooks and Eric Helleiner, 'Debt politics as usual? Reforming the sovereign debt restructuring regime after 2008,' *International Affairs* 93(5)(2017): 1085-1105.

practitioners have designed mechanisms for both the trigger and process stage—at times seeing them as mutually-reinforcing pillars of the SDRR[22]—but analysts have overlooked the fact that trigger and process mechanisms aim to govern different aspects of debt restructuring and, as such, face distinct political challenges and opportunities that help to determine their relative prospects for success.

The second major blind spot of the existing literature is its failure to appreciate the political implications of different process-oriented mechanisms on the basis of their compatibility with the existing legal arrangements that govern international sovereign debt markets. Bringing these implications into plain view points us toward another dimension through which to understand variation in reform outcomes: the *legal-institutional design* of different process-oriented proposals (whether they take the form of public international law (especially hard law but also soft law) or domestic private-law contracts). The third and final blind spot of the current literature is its inattention to the important role of historical legacies and processes—particularly related to the reform initiatives of the early 2000s—in shaping recent reform initiatives. Taking these omissions into account is crucial to understanding variation in the regulatory outcomes that motivate this research project.

## 3. The Argument

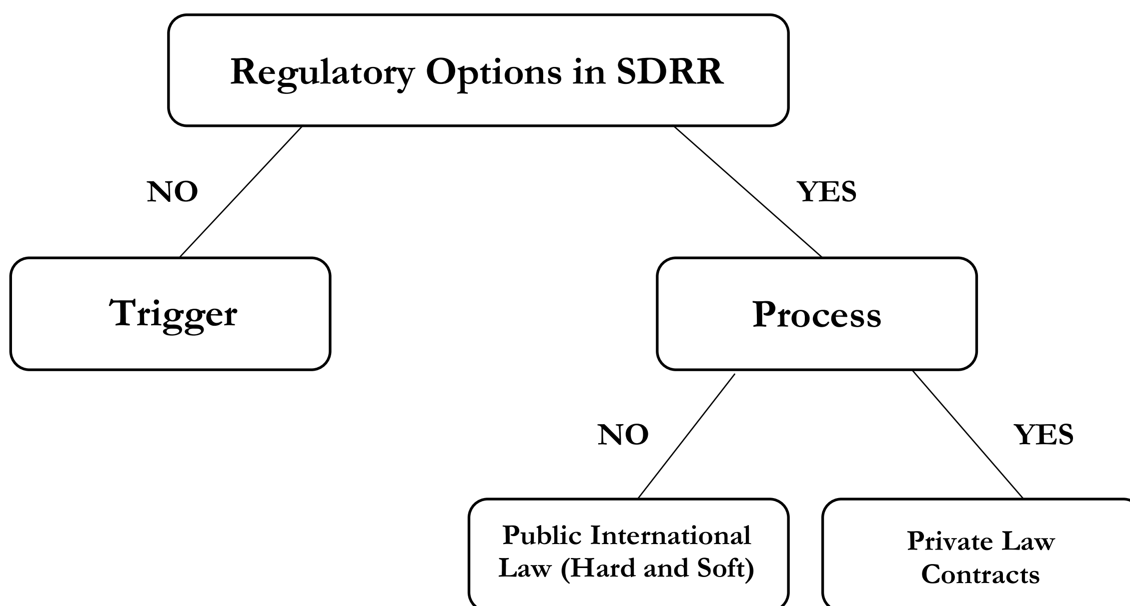
My argument addresses these major blind spots in the existing literature. It starts with the core contention that regulatory variation in the SDRR can be understood according to two dimensions: the *trigger versus process distinction* and the *legal-institutional design* of different process-oriented mechanisms. More specifically, I argue that an effective trigger mechanism is hard to institutionalize because of the time-inconsistent preferences of powerful capital-exporting states, as well as their more general desire—expressed most vigorously by the US, supported by sovereign debtors and private creditors, and amplified by recent experiences—for case-by-case decision-making when it comes to whether and when to trigger a debt restructuring. Compared to the trigger, I argue that some *but not all* process mechanisms have greater odds of success. Here I focus on three alternative kinds of mechanisms with different legal-institutional designs: public international hard-law instruments, public international soft-law instruments, and private-law contract instruments. I argue that hard-law mechanisms face huge political opposition from capital-exporting states, whereas soft-law tools can encounter political

[22] For example, see John B. Taylor, *Global Financial Warriors: The Untold Story of International Finance in the Post-9/11 World* (New York: W.W. Norton & Company, 2007), chapter 4.

challenges but are also of limited effectiveness in the SDRR. By contrast, private-law contracts provide useful mechanisms for navigating the trade-offs of regulating debt restructuring processes, especially for the dominant states that disproportionately shape outcomes in this arena. In addition to these core points, I also argue that *historical legacies and processes* have influenced recent reform outcomes, but mainly through their ability to further enhance or diminish the prospects of mechanisms whose political utility had already been determined by the process-trigger distinction and/or their legal-institutional design.

Figure 1 depicts the overarching argument in the form of a decision tree, which might be better understood as a feasibility tree in the context of the current study. It is important to note that while the figure depicts the choice of feasible regulatory options in the SDRR according to, first, the trigger-process distinction and, second, the legal-institutional design of different process mechanisms, it does not explicitly provide a visualization for the role of historical legacies and processes. The reason for this is simple: historical factors play an important but secondary role that only reinforces the feasibility (or lack thereof) of the different regulatory options shown in figure 1. Put simply, in the context of recent reform outcomes, historical legacies and processes can be seen as having reinforced both the "YES" and the "NO" pathways that lead to different regulatory options in figure 1. As a separate issue, it should also be noted that hard law and soft law have been grouped together under the heading of "public international law" in the feasibility tree displayed below and throughout this dissertation.

**Figure 1: The Feasibility of Different Regulatory Options in the SDRR**



The remainder of this section unpacks the argument in greater detail, showing how it applies to the reform cases examined in this dissertation. Before proceeding, however, it is important to clarify the trigger-process distinction and the meaning of the terms hard law, soft law, and private law. The trigger stage of a debt restructuring is defined by the initial decision of whether and/or when to restructure debt. A trigger mechanism is thus one that can push or encourage a debtor to initiate a restructuring according to some pre-defined rules. The process stage of debt restructuring is separate from any mechanism that might trigger that restructuring in the first place. It involves the renegotiation of debt between the sovereign and its creditors and occurs only *after* the decision to initiate a debt workout has been made. A process mechanism is thus one that seeks to regulate debtor and creditor behaviour during the restructuring process in order to produce a more orderly and efficient debt settlement.

A further distinction involves the legal-institutional design of different process mechanisms: namely, whether they constitute hard-law, soft-law, or private-law arrangements. Following standard discourse within IPE and global governance, the key distinction between international hard law and soft law concerns the extent to which an institutional arrangement is legally binding—that is, the degree of obligation to adhere to explicit commitments and the presence of formal enforcement mechanisms.[23] Hard-law agreements entail binding obligations, whereas soft law involves voluntary, non-binding commitments. Kenneth Abbott and Duncan Snidal offer a wider definition that sees hard- and soft-law arrangements along a spectrum defined by three dimensions of legalization: obligation, precision, and delegation.[24] In their view, the stronger the obligation to act in specific ways, the more precise the terms of the agreement, and the more that enforcement has been delegated to a third party, the closer an arrangement is to the hard-law ideal. While there is no single definition of hard or soft law, scholars agree on the basic distinction between legally-binding and voluntary commitments.[25] They also tend to agree on what counts as hard and soft law when they see it. The classic example of hard law is the formal intergovernmental treaty. Examples of soft law include voluntary standards, best practices, and recommended guidelines, which can be promulgated and adopted by both state and non-state actors.[26]

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[23] Abraham L. Newman and Elliot Posner, *Voluntary Disruptions: International Soft Law, Finance, and Power* (Oxford University Press, 2018); Gregory C. Shaffer and Mark C. Pollack, 'Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance', *Minnesota Law Review* 94(3) (2010): 706-799; Chris Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century* (Cambridge University Press, 2011).
[24] Kenneth W. Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance', *International Organization* 54(3) (2000): 421-456.
[25] Newman and Posner, *Voluntary Disruptions*.
[26] Ibid.

Private law is best understood within the context of domestic legal systems. In contrast to public law, which governs relationships between individuals (including organizations) and the state, private law deals with relationships between different individuals or organizations within the shadow of the state.[27] Examples of private law include contract, tort, and property law. Despite involving government debt obligations, the sovereign bond contracts examined in this dissertation constitute private agreements between consenting parties and are governed by the domestic contract laws of the jurisdictions in which they were issued. They are thus a form of private law, one with transnational dimensions insofar as they involve cross-border relationships governed by domestic jurisdictions and authorities.

I now turn to the task of unpacking the argument stated above and depicted in figure 1. Starting with the trigger, I argue that *efforts to institutionalize an effective trigger mechanism for sovereign debt restructuring face powerful political barriers that have made this objective nearly impossible*. The recent weakening of the Fund's lending framework, which was originally designed in 2002 to trigger debt write-downs under certain pre-defined circumstances, reflects and provides a window through which to view these barriers. Due to its role as the gatekeeper of multilateral emergency financing, the IMF is uniquely placed to trigger necessary or desired restructurings by refusing to lend to countries with unsustainable debt burdens unless and until they obtain a certain level of debt relief from their creditors. The 2002 rules sought to institutionalize this role by laying out the specific circumstances under which the Fund would be required to condition its lending upon debt restructuring, but reforms in 2010 and 2016 significantly weakened the capacity of these rules to serve as an effective trigger mechanism going forward.

The most significant obstacle to an effective trigger mechanism stems from the power and preferences of the leading capital-exporting states—namely the US and the major European powers. These states do not always and everywhere have a uniform set of preferences toward this type of institutional arrangement, but the nature of their structural position within global finance means that, at certain key moments, debt restructuring in a foreign country can threaten to unleash financial instability in their domestic economies.[28] When such moments arise, these states will likely use their institutional power within the Fund to shape lending decisions in ways that discourage or delay restructuring,

[27] Ernest J. Weinrib, *The Idea of Private Law* (Oxford University Press, 2012).

[28] The fact that foreign debt difficulties can threaten domestic financial interests is not, of course, a novel point. For example, see Daniel McDowell, *Brother, Can You Spare a Billion? The United States, the IMF, and the International Lender of Last Resort* (Oxford University Press, 2017).

regardless of what the rules say or how desperately the country in question needs debt relief. This is the key lesson of the IMF's 2010 reform, as states that had been strong proponents of the 2002 rules insisted on ignoring those rules once they became a constraint on protecting national financial interests—a time-inconsistency problem that undermines the credibility of the Fund's commitment not to lend.

While the credibility of a trigger mechanism is perpetually in question due to these time-inconsistent preferences that diverge from the rule-creation to the rule-implementation stage of the policy process, I also argue that experience related to rule (non)implementation can change the direction and/or intensity of state preferences in ways that feed back into subsequent rule-creation processes. In the IMF case, experience with recent crises and the controversial 2010 episode only reinforced the preference for a more case-by-case approach to lending among those who traditionally held that position, and diminished enthusiasm for reintroducing firm lending rules among those who previously promoted them. When the Fund's lending rules came up for reconsideration in 2013, the balance of forces—led by US officials but incorporating a wider array of state and market actors—had shifted decisively in favour of greater flexibility and discretion over lending decisions, leading to rule changes in 2016 that significantly watered down the content of the trigger mechanism compared to its 2002 incarnation. The new framework provides enough flexibility to allow dominant states to protect their financial interests without having to change or break the rules, locking-in a much weaker institutional arrangement that is likely to persist precisely because of its inability to constrain powerful interests. Seen as a reflection and indication of the political limitations of a trigger mechanism, the weakening of the IMF's lending framework is the first puzzle piece in our story and the subject of Chapter 2.

In contrast to the trigger, *the debt restructuring process is subject to a different set of governance challenges but also, I argue, a different and less constraining set of political considerations that make possible the establishment of more effective regulatory mechanisms to deal with these challenges*. The lack of major financial stability concerns among capital-exporting states, the greater prospect of mutually-beneficial efficiency gains for sovereign debtors and their private creditors, and a collective interest among all three actors in dealing with increasingly disruptive 'holdout creditors'—minority creditors that refuse to participate in and

can block restructurings that the majority of creditors accept—combine to make the process stage of restructuring more amenable to effective governance mechanisms than the trigger stage.[29]

But there is a major caveat here. The lower barriers to establishing robust regulation for the *process* of debt restructuring in general *do not mean* that any kind of process-oriented mechanism will provide a politically feasible or functionally effective governance solution. Both the UN initiative covered in Chapter 3 and the bond reforms examined in Chapter 4 focused on institutionalizing the restructuring process, yet, as we shall see, one fizzled out while the other flourished. To make sense of variation *within* the category of process regulation, we need to make a further set of distinctions based on the *legal-institutional design* of the specific mechanisms that different regulatory initiatives seek to promote. In a sentence, public international law techniques face enormous obstacles that hinder their emergence in the case of *hard-law designs* and their effectiveness in the case of *soft-law designs*, whereas *private-law contract designs* possess characteristics that have enabled their emergence and strengthening as debt restructuring mechanisms. These basic design distinctions are critical to understanding the relative failure of the UN initiative, which sought to advance a hard-law framework before settling for a set of soft-law principles, and the relative success of recent bond reforms, which managed to replicate key features of a bankruptcy process within the private-law contracts that govern sovereign debt obligations.

The divergent prospects of these different designs rest largely on their compatibility with the current legal foundations of international sovereign debt markets and thus, by extension, their compatibility with the interests of the dominant states that benefit from existing legal arrangements. Today, over 95 percent of international sovereign bonds are issued in either New York or London and thus governed by American and British laws and courts.[30] In an important sense, the US and UK have not developed international property law to protect sovereign debt investments but rather made available, and thus internationalized, their own domestic contract laws. This situation provides the US and UK with economic benefits as well as a potent but previously overlooked form of structural power over key

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[29] For a discussion of the rise of holdout creditors and sovereign debt litigation in recent years, see Julian Schumacher, Christoph Trebesch, and Henrik Enderlein, 'What explains sovereign debt litigation?' *The Journal of Law and Economics* 58(3)(2015): 585-623; Julian Schumacher, Christoph Trebesch, and Henrik Enderlein, "Sovereign Defaults in Court," ECB Working Paper No. 2135 (February 2018).

[30] IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts', IMF Policy Papers (2017).

legal and policy developments within the SDRR. It also serves their interests as the leading capital exporters by providing a relatively stable legal basis for routine cross-border sovereign bond investments. While US and UK contract law does not guarantee the enforcement of international sovereign debt agreements, it does help stabilize market expectations by embedding complex debt relations within clear and seemingly apolitical rights and obligations and providing predictable—and creditor-friendly—legal avenues for dispute settlement. Even within the Eurozone, where governments issue most of their bonds under their own laws, domestic contract law plays an important role in anchoring the legal rights and obligations surrounding sovereign debt.

By establishing international legal procedures that authorize breaking or changing the payment terms of debt contracts, hard-law restructuring mechanisms would trump the domestic legal foundations of the debt regime, threatening the power and privileges that dominant states derive from the current order. Key capital-exporting states—principally the US and UK—have thus rejected and used their power to undermine hard-law initiatives such as the recent UN proposal, as discussed in Chapter 3. Students of global financial governance might expect soft-law arrangements to fill the remaining governance gap. Indeed, the UN initiative advanced a set of voluntary principles once its loftier ambitions had been extinguished, but as I argue in Chapter 3, these principles are unlikely to have much impact due to both a lack of support from key political actors and the broader functional limitations of soft law in this particular issue area.

Now consider a third regulatory option: writing the rules for a restructuring into sovereign debt contracts themselves. By embedding the ability to restructure debt into existing systems of contractual rights and obligations, contract reforms allow capital-exporting states to create stronger restructuring processes without undermining the authority of their own laws and courts or creating new forms of uncertainty around sovereign bond investments. The compatibility between existing legal structures and contract-based restructuring tools has made the latter a politically useful regulatory mechanism—not only for the US and UK but also for Eurozone states—and is key to explaining the success of the bond reforms detailed in Chapter 4.

The main actors shaping outcomes across all of the reform cases examined in this dissertation are the leading capital-exporting states—principally the US but also the UK, France, and Germany. At certain key moments, however, private creditors and debtor governments (mostly from the global South)

have played a decisive role in bringing about institutional changes already favoured by more powerful states, or have helped to further stifle reform efforts that these states already opposed. To an important degree, sovereign debtors and private creditor preferences are also informed by their roles and positions within the global economy, and by the anticipated effects of different regulatory designs on their material wellbeing. For example, both lobbied against a formal trigger mechanism for fear it would force them into more debt restructurings, which can be enormously costly for sovereign debtors and private creditors alike.[31] Both have also been more willing to accept contract change over other process-oriented reforms for reasons of legal-institutional design. Even the debtor states driving the UN initiative found it difficult to come to terms with the sovereignty implications of a hard-law restructuring mechanism—a further obstacle to the emergence of this type of regulatory arrangement. But debtor and creditor preferences have been far from static, especially regarding contract reforms. Here, their views have changed fairly drastically over time and in ways that facilitated the recent emergence of substantial bond contract reforms. This observation points to the role of earlier historical developments in shaping subsequent preferences and reform processes.

This brings me to the final major element of my argument: that historical legacies and processes—particularly those related to the reform initiatives of the early 2000s—have played an important part in shaping recent outcomes. Earlier contract reforms laid the groundwork for the strengthening and spreading of this model more recently, reinforcing the US policy position, providing US and Eurozone officials with a ready-made blueprint for reform, shifting sovereign debtor and private creditor preferences in favour of more substantial contract innovation, and enhancing the utility of contracts as a tool for responding to the uncertainty generated by recent shocks. At the same time, US officials had no desire to relive some of the controversial debates of the early 2000s and refused to even discuss the merits of a hard-law regime, further suffocating efforts to establish this type of arrangement.[32] The fact that the contractual approach had established a foothold in the early 2000s did not automatically lead to its recent strengthening. The IMF framework created in 2002 has been incrementally weakened over time, with historical experience and policy sequencing also playing an important role. *Inter alia,*

[31] While the losses that creditors suffer from having their financial claims written-down may be obvious, there is a vast literature that points to the steep costs of sovereign defaults and debt restructurings for debtor countries. This literature is reviewed in Chapter 3, but for an example see: Eduardo Borensztein and Ugo Panizza, 'The Costs of Sovereign Default,' IMF Working Paper 238 (October 2008).

[32] Mark Sobel, 'Strengthening collective action clauses: catalysing change — the back story', *Capital Markets Law Journal* 11(1) (2016): 3-11.

the failure of this framework in 2010 further eroded political support for strong lending rules in ways fed back into subsequent reform processes, weakening the trigger mechanism by locking-in less constraining rules.

To summarize, I present an analytical framework for understanding regulatory variation in the SDRR according to, first, the *process versus trigger distinction* and, second, the *legal-institutional design* of different process-focused regulatory mechanisms. I also argue that historical factors have played an important but supplementary role in shaping recent reform outcomes along the lines described above.

## 4. Scholarly Contributions

The regulatory politics of sovereign debt restructuring is an important but poorly understood facet of global financial governance. Scholars have paid little attention to recent reform initiatives in this area, and scholarly accounts of previous outcomes in the SDRR—while helpful—are limited in their ability to explain newer developments. This dissertation makes an important empirical contribution to our understanding of contemporary debt politics by drawing on extensive primary material to present the first in-depth study of recent efforts to reform the international debt restructuring regime. It also makes a key theoretical contribution, using concrete case studies to develop a broader analytical framework for making sense of regulatory variation in this global governance arena. By explicating the role of earlier regime developments in shaping later reform outcomes, this study sheds light not only on the politics of different regulatory options at a given moment in time, but also on the evolutionary trajectory of the SDRR since the turn of the century. For years, scholars, activists, and practitioners have called for a whole host of new arrangements to govern debt restructuring, but their proposals often pay little attention to the political prospects and limits of different reforms to the debt regime.[33]

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[33] For example, see: Christopher G. Oechsli, 'Procedural Guidelines for Renegotiating LDC Debts: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act,' *Virginia Journal of International Law* 21(2)(1981): 305-341; Barry C. Barnett, Sergio J. Galvis, and Ghislain Gouraige Jr., 'On Third World Debt,' *Harvard International Law Journal* 25(1984): 83-151; Benjamin J. Cohen, 'A Global Chapter 11,' *Foreign Policy* 75(1989): 109-111; Kunibert Raffer, 'Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face,' *World Development* 18(2)(1990): 301-311; Steven L. Schwarcz, 'Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach,' *Cornell Law Review* 85(2000): 101-187; Anne Krueger, 'A new approach to sovereign debt restructuring,' address given at the National Economists' Club annual members' dinner, American Enterprise Institute, Washington DC (November 26, 2001); Anne Pettifor, *Chapter 9/11? Resolving International Debt Crises—The Jubilee Framework for International Insolvency* (New Economics Foundation, 2002); Eurodad, 'A fair and transparent debt work-out procedure: 10 core civil society principles,' A report from the European Network on Debt and Development (December 2009); Joseph E. Stiglitz et al., *The Stiglitz Report: Reforming the International Monetary and Financial Systems in the Wake of the Global Financial Crisis* (New Press, 2010); Lee C. Buchheit, Anna Gelpern, Mitu Gulati, Ugo Panizza, Beatrice Weder di Mauro, and Jeromin Zettelmeyer, 'Revisiting Sovereign Bankruptcy,' Committee on International Economic Policy and Reform. Brookings Institute (October 2013); Richard Gitlin and Brett

This study provides something of a guide for anyone interested not primarily in the economic and legal rationale behind different reform options, but rather in the politics of regulatory choice.

In constructing the framework described above, this dissertation builds upon existing IPE literature on the political economy of SDRR reform, particularly the rich trove of studies focused on the early 2000s.[34] It marshals new evidence that reinforces some of the key insights of earlier analyses, including the significance of US power and preferences and the role of sovereignty-related concerns in shaping American government views on the hard-law SDRM proposal.[35] But it also highlights the analytical limitations of existing literature by pointing to three previously overlooked factors that are critical to explaining recent reform outcomes: the process-trigger distinction, the importance of compatibility between new international mechanisms and the existing domestic legal foundations of the debt regime, and the role of historical legacies and processes in further enhancing or diminishing the prospects of certain reform options. The analysis also devotes more attention to the role of IMF lending rules in the SDRR, an issue that received less attention in the work on SDRR reforms in the early 2000s (which paid little mind to the establishment of the IMF's 2002 lending framework). Indeed, even the vast IPE literature on the IMF has largely ignored the role of the Fund's lending framework as a mechanism for triggering restructurings.[36] This study calls attention to the IMF's central role in the SDRR, and shows that dominant states disproportionately shape the organization's approach to debt restructuring—reinforcing state power interpretations of IMF behaviour.[37] It also identifies other

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House, 'A Blueprint for a Sovereign Debt Forum,' CIGI Papers No. 27 (March 2014); UNCTAD, 'Sovereign Debt Workouts: Going Forward. Roadmap and Guide', United Nations (April 2015); Barry Herman, 'Toward a Multilateral Framework for Recovery from Sovereign Insolvency,' in: Martin Guzman, Jose Antonio Ocampo, and Joseph E. Stiglitz (eds.), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016): 206-222.

[34] For example: Gelpern and Gulati, 'Public Symbol in Private Contract'; Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism'; Helleiner, 'Filling a Hole in Global Financial Governance?'; Setser, 'The Political Economy of the SDRM'; Soederberg, 'The Transnational Debt Architecture and Emerging Markets.'

[35] In addition to the references cited in the previous note, see Hagan, 'Designing a Legal Framework to Restructure Sovereign Debt'; Gelpern et al., 'Count the Limbs.'

[36] The exception to this rule includes a small number of policy-oriented papers that understand the IMF lending rules as a trigger mechanism and an integral part of the broader SDRR. See Beatrice Weder Di Mauro, 'For the Agenda of the German G20 Presidency: A Global Sovereign Debt Restructuring Regime,' CIGI Policy Brief No. 85 (September 2016); Jeromin Zettelmeyer, 'Managing Deep Debt Crises in the Euro Area: Towards a Feasible Regime,' *Global Policy* 9(1)(2018): 70-79; Ross Leckow and Julianne Ams, 'Sovereign debt restructuring in the IMF experience,' ESCB Legal Conference 2016, European Central Bank (January 2017): 14-22.

[37] Strom C. Thacker, 'The High Politics of IMF Lending,' *World Politics* 52(1)(1999): 38-75; Thomas Oatley and Jason Yackee, 'American Interests and IMF Lending,' *International Politics* 41(3)(2004): 415-429; Randall W. Stone, 'The scope of IMF conditionality,' *International Organization* 62(4)(2008): 589-620; Robert J. Barro and Jong-Wha Lee, 'IMF Programs: Who is chosen and what are the effects?' *Journal of Monetary Economics* 52(7)(2005): 1245-1269; Axel Dreher and Nathan Jensen, 'Independent Actor or Agent? An Empirical Analysis of the Impact of US Interests on IMF Conditions,' *The Journal of Law and Economics* 50(1)(2007): 105-124; Mark S. Copelovitch, *The International Monetary Fund in the Global Economy: Banks, Bonds, and Bailouts* (Cambridge University Press, 2010); Michael Breen, *The Politics of IMF Lending* (Palgrave

previously neglected elements of sovereign debt politics, including the *structural power* of the US and UK in the SDRR and the sovereignty considerations that constrain the debtor countries that would presumably benefit most from a hard-law restructuring regime.

This dissertation also contributes to broader IPE and global governance debates about the design and development of international institutions. It shows how existing institutional design literature can be helpful in understanding aspects of the regulatory outcomes in question, but also highlights important limitations of rationalist and functionalist work in this tradition.[38] A fuller picture of debt politics can be gained by combining insights from this tradition with historical institutionalist perspectives, which emphasize the importance of prior institutional developments—including, for example, the domestically-rooted contract laws that govern cross-border sovereign debt obligations—in shaping subsequent preferences and political processes.[39] But I also suggest that the significance of historical institutionalist insights should not be overstated, nor should the direction of change promoted by historical forces be assumed—a tendency of IPE scholarship focused on the incremental, rather than transformative, bolstering of global financial governance after 2008.[40] In the cases that animate this project, historical factors play an important but decidedly supplementary role in explaining outcomes, which themselves display both incremental strengthening (contract reforms) and incremental weakening (IMF reforms) as a result of policy sequencing and feedback over time.

Finally, this thesis challenges the focus of global governance debates that analyze institutional design along a spectrum of international hard and soft law,[41] and that see the latter as the natural option for

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Macmillan, 2013); Daniel McDowell, 'Need for speed: The lending responsiveness of the IMF,' *The Review of International Organizations* 12(1)(2017): 39-73.

[38] Particularly useful are neoliberal institutionalist theories that emphasize the collective action problems that define world politics and the role of international institutions in providing mutually-beneficial solutions to these problems. See Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton University Press, 1984). Also helpful are analyses that highlight the impact of distribution and uncertainty on institutional choice. See Barbara Koremenos, Charles Lipson, and Duncan Snidal, 'The Rational Design of International Institutions,' *International Organization* 55(4)(2001): 761-799. Kenneth W. Abbott and Duncan Snidal, 'Hard and Soft Law in International Governance', *International Organization* 54(3)(2000): 421-456; Joseph Jupille, Walter Mattli, and Duncan Snidal, *Institutional Choice and Global Commerce* (Cambridge University Press, 2013).

[39] See Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (Princeton University Press, 2004); James Mahoney and Kathleen Thelen (eds), *Explaining Institutional Change: Ambiguity, Agency, and Power* (Cambridge University Press, 2009); Orfeo Fioretos, 'Historical Institutionalism in International Relations,' *International Organization* 65(2)(2011): 367-399.

[40] See Orfeo Fioretos, 'Retrofitting Financial Globalization: The Politics of Intense Incrementalism After 2008," in: Thomas Rixen, Lora Anne Viola, and Michael Zurn (eds.), *Historical Institutionalism and International Relations* (Oxford University Press, 2016); Manuela Moschella and Eleni Tsingou (eds.), *Great Expectations, Slow Transformations: Incremental Change in Post-Crisis Regulation* (ECPR Press, 2013).

[41] Abbott and Snidal, 'Hard and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law.'

governing global finance.[42] It highlights the political utility of an alternative—private-law contracts—that does not fit into the hard law-soft law dichotomy. To be sure, there are already strands of literature that examine the role of contracts in global politics, and some of these contributions can help to make sense of the cases that motivate this study.[43] At the same time, existing literature is somewhat limited by its tendency to treat contracts as either generic agreements[44]—hard- and soft-law arrangements could both be 'contracts' from this perspective—or as tools of private order.[45] By showcasing the role of private-law contracts in public and public-private hybrid reform initiatives, this study expands current understandings of the use and purpose of contracts in global governance.

## 5. Situating the Project and Setting the Stage

As the above discussion suggests, this dissertation situates itself within the multidisciplinary fields of IPE and global governance. IPE research has traditionally been concerned with questions of power and prosperity in the world economy. Global governance, as both a concept and field of inquiry, has typically focused on the variably institutionalized arrangements that regulate and/or constitute global relations, often stressing the variety of actors—including and beyond the state—that play significant roles in shaping these arrangements.[46] Building on these foundations, I adopt a multi-actor framework for understanding rulemaking and regulatory change in the SDRR—one that recognizes the distinct roles of different actors but also acknowledges that some are more consequential than others.

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[42] Brummer, *Soft Law and the Global Financial System*.

[43] For example, constructivist-oriented perspectives that see contracts as 'legal fictions' can shed light on the recent use of contract reform as a response to uncertainty. See Stephen Nelson, 'Market Rules: Social Conventions, Legal Fictions, and the Organization of Sovereign Debt Markets in the Long Twentieth Century', in: Gregoire Mallard and Jerome Sgard (eds), *Contractual Knowledge: One Hundred Years of Legal Experimentation in Global Markets* (Cambridge University Press, 2016): 118-150; Annalise Riles, 'Collateral Expertise: Legal Knowledge in the Global Financial Markets,' *Current Anthropology* 51(6)(2010): 795-818.

[44] Alexander Cooley, 'Rationalist theories of institutions in American IPE', in: Mark Blyth (ed), *Routledge Handbook of International Political Economy (IPE): IPE as a global conversation* (Routledge, 2009); Alexander Cooley and Hendrik Spruyt, *Contracting States: Sovereign Transfers in International Relations* (Princeton University Press, 2009).

[45] A. Claire Cutler and Thomas Dietz (eds.), *The Politics of Private Transnational Governance by Contract* (Routledge, 2017).

[46] Scholars have shown how, in addition to states, global governance involves a range of actors, including: sub-state entities such as cities and provinces (Michele M. Betsill and Harriet Bulkeley, 'Cities and Multilevel Governance of Global Climate Change,' *Global Governance* 12(2006): 141-159), supra-state actors such as regional and global intergovernmental institutions (Bjorn Hettne, 'Beyond the 'New' Regionalism,' *New Political Economy* 10(4)(2005): 543-571; Michael Barnett and Martha Finnemore, *Rules for the World: International Organizations in Global Politics* (Cornell University Press, 2004)), non-governmental organizations (NGOs) (John Boli and George M. Thomas (eds.), *Constructing World Culture: International Nongovernmental Organization Since 1875* (Stanford University Press, 1999)), transnational corporations (Tim Buthe and Walter Mattli, *The New Global Rulers: The Privatization of Regulation in the World Economy* (Princeton University Press, 2011)), and transnational networks of activists (Margaret E. Keck and Kathryn Sikkink, *Activists beyond Borders: Advocacy Networks in International Politics* (Cornell University Press, 1998)), government officials (Anne-Marie Slaughter, *A New World Order* (Princeton University Press, 2004)), and knowledge-based experts (Peter M. Haas, 'Introduction: Epistemic Communities and International Policy Coordination,' *International Organization* 46(1)(1992): 1-35).

The idea that a wider range of actors increasingly contributes to governing global affairs rests on the premise that, as globalization processes have produced new interdependencies and empowered new actors, global decision-making forums have proliferated and become more permeable.[47] It is important not to overstate the extent and importance of these transformations for sovereign debt governance. While private financial interests and NGOs have undoubtedly become better organized and more influential in international debt politics over the past several decades, the overall shape and trajectory of the SDRR continue to be determined primarily by states and their preferences. And although one of the reform initiatives I examine (contract reform) proceeded through the type of informal and decentralized process associated with 'new governance,'[48] the remainder took place within traditional intergovernmental organizations: the IMF, the UN, and the European Union (EU). Still, given that these initiatives played out in different venues and involved different combinations of actors, it can be useful to think about the politics of SDRR reform as a multi-player game that unfolds within and across multiple venues.

An analogy might sharpen the point. Think of the sovereign debt governance arena as a vast casino, populated by an array of actors who play various games. The main players we will see navigating this arena throughout the case study chapters are the leading capital-exporting states (primarily the US but also the UK, France, and Germany), transnational private creditors and their representatives, and sovereign debtors (mainly those from the global South but also some peripheral Eurozone countries). The games they play are the institutional venues and assemblages through which collective decisions are made—the prize is to have one's regulatory preferences realized. Each game has its own set of rules and logic. Just as the rules and logic of poker, roulette, and craps differ, so too do the rules and decision-making norms of the IMF, the UN General Assembly, and the EU—not to mention more informal governance forums. Each player also has its own set of skills and resources—or capabilities in the terminology of international relations—especially within the context of certain games. The US, for example, has structural and relational power capabilities that transcend specific venues, but it also has special institutional advantages within the IMF. To varying degrees, the players can float around the casino trying their hands at different games. But not all games are equally open to all players. Some

[47] For example, see Jan Aart Scholte, *Globalization: A Critical Introduction* (Palgrave Macmillan, 2005), chapter 6; Jonathan GS Koppell, *World Rule: Accountability, Legitimacy, and the Design of Global Governance* (University of Chicago Press, 2010); Philip G. Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism* (Oxford University Press, 2010).
[48] For a discussion of new governance, see John Gerard Ruggie, 'Global Governance and "New Governance Theory": Lessons from Business and Human Rights,' *Global Governance* 20(2014): 5-17.

are exclusive, invite-only affairs (e.g., the EMDE bond reform process) or occur behind closed doors (e.g., IMF decision-making), while others are more open and inclusive (e.g., UN processes).

This analogy can help to set the stage and illustrate the preponderant power and influence of the US and other capital-exporting states within and across the different rulemaking venues examined in this thesis. These states have a seat at the table for each game and are better positioned than others to use both their inherent capabilities and their privileged positions within specific games to shape outcomes within the SDRR. The claim is thus that a select group of powerful states—the US paramount among them—matter the most, with their influence being felt across all major reform initiatives, while private creditors and debtor states are of secondary importance, impacting the SDRR at particular times and places. For this reason, the three core actors—or actor groups—do not receive equal attention across the different case studies. Institutional actors such as IMF staff and select UN agencies also make appearances and play a role in particular reform initiatives, but their influence is more limited to the specific international forum in which they have a mandate to operate. And even within their operational domains, these actors are no match for dominant states when their preferences clash.

The casino analogy should not be stretched too far. I avoid the temptation to designate any one actor or set of actors—even the US or a broader group of dominant states—as 'the house,' given the degree of structural control and dominance this implies and the connotation that all other actors are therefore engaged in a zero-sum, and in the long run hopeless, battle against this all-powerful ruler. The casino comparison is intended simply to help the reader visualize the politics of SDRR reform as a set of distinct but related political processes—or games—played out across a variegated institutional terrain. But it also raises a bigger set of questions about the relationship between structures and agents in this governance domain. While a deep ontological discussion of the structure-agent debate is unnecessary and beyond the scope of this dissertation, a few words on this subject are warranted. As the analogy suggests, the institutional venues in which reform initiatives take place are structures that provide some actors with greater voice and power to achieve their objectives than others. Broader structural features of the global political economy also condition the power capabilities of certain actors in ways that transcend specific forums. As will be discussed in Chapter 5, US and UK structural power in the sovereign debt regime allowed these states to decisively influence the UN initiative despite having no formal veto or in-built institutional advantage within the General Assembly.

Moreover, a consistent theme of this dissertation is that the preferences of the core actors introduced above are closely connected to their material structural positions in the global financial order. The use of the terms 'capital-exporting states,' 'private creditors,' and 'sovereign debtors' indeed implies that identifying these actors according to their economic status or position conveys useful information. But I do not go as far as to suggest that such positions determine preferences, let alone strategies for trying to realize them. Instead, actors have significant agency and, as will be shown at different points in this thesis, their preferences can shift despite little change in their material structural positions. That is because, in my reading, these positions are mediated by ideas—often shared perceptions—that translate them into actionable policy positions, and these mental filters can change as a result of lived experiences, changed circumstances (not related to one's fundamental place in global finance), and so forth.[49] In the pages that follow, the core actors are thus assumed to be agents making choices about what they want based on ideas about how specific outcomes will affect their interests, and acting upon those choices in an environment that both enables and constrains different actors in different ways. It should, therefore, not be surprising when actors behave in ways we would expect based on their material positions, nor should it shock us when they re-evaluate how specific regulatory arrangements affect their interests.

In emphasizing the central role played by the leading capital-exporting states, this thesis resonates with state-centric perspectives on global financial governance and international regulatory regimes.[50] It would not be inaccurate to say that recent outcomes in the SDRR largely reflect, in Daniel Drezner's phrasing, "the preferences and capabilities of great power governments."[51] As discussed above, however, I also see an important though less pervasive role for debtor states and private creditors in shaping key aspects of this regime, making mine a multi-actor framework that privileges powerful states—particularly the US.

[49] For a discussion on the role of ideas as filters through which material facts in the international political economy are interpreted, see Rawi Abdelal, Mark Blyth, and Craig Parsons (eds.), *Constructing the International Economy* (Cornell University Press, 2010).

[50] Thomas Oatley and Robert Nabors, 'Redistributive Cooperation: Market Failure, Wealth Transfers, and the Basle Accord,' *International Organization* 52(1)(1998): 35-54; Beth A. Simmons, 'The International Politics of Harmonization: The Case of Capital Market Regulation,' *International Organization* 55(3)(2001): 589-620; Daniel W. Drezner, *All Politics is Global: Explaining International Regulatory Regimes* (Princeton University Press, 2007); Eric Helleiner, *The Status Quo Crisis: Global Financial Governance After the 2008 Meltdown* (Oxford University Press, 2014).

[51] Drezner, *All Politics is Global*, p. 32.

I conceive of dominant states as being motivated to pursue their national interests in international economic relations, as defined and understood by political elites. This does not mean that state officials are immune to pressures from powerful societal groups, but it does imply that the state is not simply an instrument of private capitalist interests. That said, we should still expect capital-exporting states—the US and UK in particular—to promote global financial arrangements that benefit their domestic financial sectors, given the importance of these sectors to their national political economies and privileged positions on the world stage. Sometimes, promoting domestic financial interests can be seen as a means of advancing national objectives. Other times, a by-product of protecting the national public interest can be to protect the private interests of banks and bondholders as well—a dynamic on clear display in Chapter 4. Daniel McDowell makes this point eloquently when he says: "US foreign rescues reflect a joint product model where two outputs are produced by the same process: protecting the private financial interests of major banks while also protecting the stability of the national financial system."[52] In short, capital-exporting states are likely to see the health of their financial markets and firms as being inseparably tied up with the strength and stability of the nation. This is especially true for finance ministry officials whose job it is to promote and protect the country's financial interests.[53]

## 6. The Methodology

This study relies on a qualitative, case study methodology. A case study approach is appropriate given the intrinsic interest of the cases in question. It also makes sense in light of the small universe of SDRR reform cases—ruling out large-N statistical analysis as a viable method—as well as the need to explore each of the recent cases in considerable depth to locate the causes of its failure or success. Exploring the cases in this way is all-the-more important because each initiative represents an attempt to establish a different type of governance arrangement, the distinct politics of which need to be understood in order to grasp the broader determinants of regulatory variation in this domain. The fact that each case plays a specific role in the broader explanation of variation points to a particular strength of case study research: its capacity to facilitate theory development as much as theory testing.[54] In an important sense, the analytical framework developed in Chapter 3 emerged out of a detailed, more inductive interrogation of a set of empirically-rich cases. This framework can now be used as a lens not only for

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[52] McDowell, *Brother, Can You Spare a Billion?*, p. 91.

[53] McDowell makes this point with respect to US Treasury and Federal Reserve officials. See McDowell, *Brother, Can You Spare a Billion?*, pp. 90-91.

[54] Alexander L. George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (The MIT Press, 2005).

understanding the cases examined herein, but also for viewing past and future reform initiatives, allowing for further testing and refining of the core ideas developed in this study.

To pinpoint the drivers of outcomes within cases, I rely mostly on a process-tracing method, unfolding each reform process sequentially in order to identify specific causal variables when they arise and trace their effects throughout the remainder of the episode in question.[55] This approach is well-established within the tradition of case study research and particularly well-suited for what is often called 'historical explanation'—that is, drawing "inferences about the causes of specific outcomes in particular cases."[56] In some cases, however, one of the key causal variables is a broader structural factor that conditions power capabilities and/or preferences from the beginning of the reform initiative, making it difficult to detect at some discrete moment of the process. In these few instances, deductive forms of reasoning are used in conjunction with supporting evidence to assess the significance of certain factors.

To support my claims, I draw on several sources of evidence. The most important source consists of archival materials from the organizations in which reform processes played out. Archives are used most extensively in the UN and especially IMF cases, due to the fact that these formal organizations often document their meetings and decision-making processes and make these documents available to the public (with a time delay in the case of documents that detail the positions taken during IMF executive board meetings). The types of archives I draw from are mainly the recorded minutes of IMF executive board meetings and ad hoc UN meetings, and the written statements that country representatives submit in advance or at the time of these meetings. These sources are particularly useful in identifying or clarifying policy preferences and pinpointing key moments that subsequent developments turned upon.

To supplement my archival evidence, I also conducted one-on-one interviews with key informants. The interviews were few in number but rich in content and insight. They involved lengthy discussions with key individuals who played critical roles in one or more of the initiatives I examine. These interviews were used most extensively to shine light on the bond reform episodes, particularly the process of changing EMDE debt contracts, which took place through a small, informal working group

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[55] Andrew Bennett and Jeffrey T. Checkel (eds.), *Process Tracing: From Metaphor to Analytical Tool* (Cambridge University Press, 2014).

[56] James Mahoney, Erin Kimball, and Kendra L. Koivu, 'The Logic of Historical Explanation in the Social Sciences,' *Comparative Political Studies* 42(1)(2009): 114-146, p. 116.

led by US Treasury officials. In addition to having insider knowledge of this contract reform process, some of the individuals interviewed also participated as key insiders in recent IMF reform processes and one of them participated in aspects of the UN initiative. Interview materials are thus used to support elements of all three case study chapters.

In total, I carried out four long-form interviews.[57] These were conducted at a late stage in the research process. Their purpose was not primarily to identify the who, what, where, and when of the initiatives in question—as interviews at earlier stages are often used to do[58]—but rather to establish motivations and test hypotheses among select individuals with unparalleled knowledge of my subject. Earlier interviews were unnecessary because I had acquired sufficient information about the basic facts of my cases through background research as well as my pre-PhD experience as a think tank researcher, where I worked on sovereign debt restructuring and was exposed to high-level policy circles and discussions—often as a 'fly on the wall'—in Washington DC, New York, Mexico City, and elsewhere. At the later stage when interviews were conducted, I found that it did not take many discussions to fill key research gaps and begin to see diminishing informational returns on additional interviews.[59] The questions I asked were open-ended in order to allow interviewees to give detailed answers about their particular knowledge and experience vis-à-vis recent reforms. Interviews were conducted on the basis that interviewees would remain anonymous unless they agreed to be identified. These individuals approved the limited information provided about them in this thesis. All interviews were conducted in accordance with the rules and protocols of the University of Waterloo's Office of Research Ethics.

In addition to archival and interview-based evidence, I draw heavily on so-called 'grey literature.' Here, sources consist mostly of primary policy and advocacy documents from key organizations such as the IMF, the UN, and the private-sector Institute of International Finance (IIF). News articles from the financial press are also used to provide contextual details or fill small gaps in certain areas. Lastly, the

[57] Interviews were conducted on the basis of anonymity, although one interviewee agreed to be named and limited information can be provided about the others. Interview 138790 was conducted on October 19, 2018 with an undisclosed sovereign debt expert who, among other things, participated in the US Treasury-led working group that led to recent EMDE bond reforms. Interview 107122 took place on October 31, 2018 with Leland Goss of the International Capital Market Association (or ICMA). Goss and his organization also played a key role in the recent EMDE bond reform process. Interview 114203 took place on January 22, 2019 with a former US Treasury official, and interview 138785 was conducted on February 1, 2019 with a former IMF official.
[58] Layna Mosley (ed.), *Interview Research in Political Science* (Cornell University Press, 2013).
[59] These diminishing returns are often called 'data saturation' in qualitative research. See Patricia I. Fusch and Lawrence R. Ness, 'Are We There Yet? Data Saturation in Qualitative Research,' *Qualitative Report* 20(9)(2015): 1408-1416.

dissertation draws on numerous books and journal articles to back up select claims. Much of this is academic literature, but I also benefit from a few more anecdotal articles written by practitioners who share their first-hand experience with sovereign debt restructuring reforms.

## 7. Limitations of the Study

This project has two notable limitations. First, the argument developed in this dissertation is informed by the specific characteristics and regulatory challenges of the SDRR, and while it generates insights that contribute to wider debates in IPE and global governance, its capacity to explain broader global governance dynamics or specific sovereign debt crises is much more limited. In short, this study is interested only in the politics of a particular international economic regime, not in global financial governance or world politics more broadly. Moreover, it does not seek to explain the causes and consequences of sovereign debt restructurings themselves.

Second, the sovereign debt regime is made up of various markets, relationships, and arrangements, and the regulatory mechanisms examined in this project—at least the successful ones—do not apply to all aspects and corners of the broader sovereign debt landscape. Changes to EMDE debt contracts apply only to the bonds that debtor states issue in foreign jurisdictions. The outstanding stock of bonds in this category is valued at roughly $900 billion.[60] Recent reforms to Eurozone debt contracts affect both the domestic and international bonds of all countries within the currency bloc—a much larger market worth tens of trillions of euros.[61] But the contract mechanisms introduced through recent reforms—both to the international bonds of EMDEs and to the domestic and international bonds of Eurozone governments—do not cover the bonds that EMDEs issue under their domestic laws, nor do they apply to non-bond loans provided by commercial banks or other governments.

The fact that considerable effort has been directed at reforming international and European sovereign bond markets makes sense given that private lending largely replaced government-to-government loans starting in the 1970s and bonds largely replaced bank loans starting in the early 1990s, and considering that the most troubling recent restructuring episodes—involving Greece and Argentina—

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[60] IMF, 'Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts,' IMF Policy Papers (September 2015).

[61] Elena Carletti, Paolo Colla, and Mitu Gulati, 'Evaluating the 2013 Euro CAC Experiment,' in: Franklin Allen, Elena Carletti, and Joanna Gray (eds.), *The New Financial Architecture in the Eurozone* (European University Institute, 2015): 123-136.

occurred within these markets. But there has also been a significant recent expansion in domestically-issued EMDE debt and new bilateral lending from China.[62] The rise of China as a major international public creditor has also raised questions about how future debt restructurings will play out in cases where China has lent substantial amounts to the country in question, and where its lending contributes to a more complex and unruly creditor base.[63] It is important to acknowledge that the bond reforms examined in Chapter 6 do not apply to these expanding forms of debt and that this study does not concern itself with how the latter might be restructured in the future. The UN and IMF reform efforts considered in chapters 4 and 5 were more universal, in the sense that Fund lending rules apply to all 189 of the organization's member states and the UN's proposed multilateral framework, if established, would have presumably covered the gamut of sovereign debt. But the UN initiative failed to produce much change, while IMF reforms actually weakened existing arrangements. Specifying the scope of successful reform helps to draw boundaries around the extent of change we have seen without diminishing the importance of understanding why some initiatives have fared better than others.

## 8. The Organization of the Thesis

The remainder of this dissertation unfolds as follows. Chapter 2 reviews previous reform debates and initiatives in the SDRR, with a particular focus on the early 2000s when the regime was last updated. This episode is especially important because it established ideas and institutions that recent initiatives have built upon or departed from. The purpose of this review is to provide a benchmark against which to assess recent reforms, to introduce the reader to earlier changes whose significance to recent outcomes will become apparent later, and to survey explanations of the early 2000s in search of insights into the initiatives examined in subsequent chapters. Having identified key gaps in this existing literature, Chapter 3 outlines an analytical framework for recent reform outcomes and the variation they display. It maps out the core players, their powers, and their preferences, pointing to how these factors relate to the trigger-process distinction, the politics of a trigger mechanism, the politics of

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[62] For a discussion of growing domestic debt markets in EMDEs, see Aaron Metrotra, Ken Miyajima, and Agustin Villar, 'Developments of domestic government bond markets in EMEs and their implications,' BIS Papers 67(2012). For updated numbers, see BIS statistics, 'Debt securities statistics,' updated March 5, 2019. For discussions of China's increased sovereign lending, see Kevin P. Gallagher and Amos Irwin, 'China's Economic Statecraft in Latin America: Evidence from China's Policy Banks,' *Pacific Affairs* 88(1)(2015): 99-121; *The Economist*, 'China's financial diplomacy: Rich but rash,' (January 31, 2015); Kevin P. Gallagher, 'Latin America's China Boom,' *NACLA Report on the Americas* 48(3)(2016): 265-270; Christian Shepherd, Lucy Hornby, and James Kynge, 'China rethinks approach after surge in lending to risky countries,' *Financial Times* (October 13, 2016).

[63] For an example of these questions in the context of a discussion about how Venezuela might restructure its debt, see Robert Kahn, 'Venezuela after the Fall: Financing, Debt Relief and Geopolitics,' CIGI Papers No. 147 (October 2017).

different legal-institutional designs for process mechanisms, and the importance of prior developments in shaping subsequent preferences and political processes. The chapter then turns to a discussion of the ways in which this basic framework fits within and contributes to various IPE and global governance debates.

Chapters 4, 5, and 6 present and analyze the empirical cases that animate this project. Chapter 4 looks at the 2010 and 2016 reforms to the IMF's lending framework, elucidating the factors that led to its weakening and that stand in the way of an effective trigger mechanism more generally. Turning to the UN initiative, Chapter 5 sheds light on the political obstacles that roadblocked the G77 and China's ambitious proposal for an international hard-law approach to the debt restructuring process. It then discusses the soft-law principles that ultimately emerged from the reform process, arguing that they face political and functional barriers that will limit their impact on the SDRR. Analysis of both aspects of the UN initiative suggest that public international law techniques face enormous challenges and are unlikely to succeed as regulatory devices for debt restructuring processes.

By contrast, Chapter 6 focuses on the successful emergence of sovereign bond contract reforms, which produced tangible and meaningful—albeit not transformative—improvements to debt restructuring processes. The chapter first analyzes contract changes in the Eurozone and then explores the US Treasury-led effort to revamp the bonds that EMDE governments issue abroad, almost exclusively in New York and London. In both episodes, I show how the legal-institutional design of contract mechanisms made them a politically useful tool for navigating the trade-offs of regulating sovereign debt restructuring, especially for powerful capital-exporting states. Both episodes also reveal the ways in which earlier contract reforms helped pave the way for the spreading and strengthening of the contractual approach more recently. Chapter 7 concludes by relating these cases back to the broader framework this dissertation develops for understanding regulatory variation in the SDRR, and highlighting the relevance of this framework for scholarly debates in IPE and global governance.

# CHAPTER 2

## What Came Before: A Review of Earlier Initiatives and Explanations

### 1. Introduction

This chapter reviews earlier reform outcomes in the SDRR that took place before the recent initiatives that motivate this thesis. It focuses particularly on the early 2000s, when the regime was last updated. This earlier episode is especially important because it established ideas and institutional arrangements that recent initiatives have built upon or departed from.

Reviewing this episode serves three purposes. First, it provides a benchmark against which to assess recent reforms and the degree/direction of change they represent. To substantiate the claim that recent IMF reforms weakened the Fund's lending framework as a trigger mechanism, or that recent contract reforms strengthened the debt restructuring process, it is important for the reader to have a sense of the baseline from which I am assessing change. Second, reviewing the early 2000s introduces the reader to previous developments whose significance to recent outcomes will become apparent as this dissertation unfolds. It is worth putting these previous initiatives in the reader's mind at this early stage. The final purpose of this chapter is to survey explanations of the early 2000s in search of insights into the initiatives examined in subsequent chapters. The chapter also moves beyond the early 2000s to review the small handful of works that examine the recent reforms at the core of this project. Surveying the existing literature reveals important gaps that limit our ability to understand variation in recent outcomes. Chapter 3 takes up the task of constructing a framework that fills these gaps and provides a fuller understanding of SDRR reform outcomes.

Although this chapter focuses mainly on reform outcomes between 2001 and 2004, the historical review starts with a quick look at IMF reform debates of the 1990s, which set the stage for the SDRR reforms of the early 2000s. In order to properly frame these debates and initiatives, the chapter begins with a brief conceptual overview of IMF lending and how it can serve as either a substitute or trigger for sovereign debt restructuring. Not only does this overview of IMF lending help to illuminate key motivations of reform efforts in the early 2000s, and to later contrast this earlier reform context with

the more recent one, but it also provides important background information for understanding the arguments laid out in chapter 3 and, especially, chapter 4.

After discussing the effects of IMF lending in the next section, this chapter moves on to review the debates of the 1990s and the reform initiatives of the early 2000s. It shows how, during this earlier episode, trigger and process mechanisms were seen as two necessary components in a larger regime change, inseparably connected both conceptually and practically. In terms of specific outcomes, a trigger mechanism was established via the creation of new IMF lending rules, while two competing process-oriented proposals (the SDRM and CACs) were hotly debated, with the contractual approach prevailing over the international treaty-based alternative. A set of soft-law restructuring principles were also unveiled in this context. After outlining these initiatives, the next section probes the existing literature for explanations that could shed light on recent reform outcomes. It reviews accounts of the early 2000s as well as the few analyses of recent initiatives themselves. The final section identifies three major omissions in the literature and briefly outlines how my argument seeks to fill these gaps.

## 2. IMF Lending and the Reform Debates of the 1990s

### *2.1 IMF Lending as Substitute or Trigger for Sovereign Debt Restructuring*

When a debtor state finds itself unable to continue servicing its debts to foreign creditors, it will typically seek emergency financial assistance from the IMF. Since the organization's inception in 1944, and especially since the early days of financial globalization in the 1970s, few viable alternatives have existed for struggling sovereigns looking to regain their financial footing. To be sure, crisis-stricken countries can and often do secure supplemental sources of financing from other public and private lenders, but these contributions are usually conditional upon a country first being approved for IMF lending.[64] The Fund has thus been the gatekeeper of emergency financing for debtor governments, giving it enormous power to shape crisis responses and extract policy reforms from loan recipients.

One crucial element of this power is the Fund's capacity to shape decisions about whether and when distressed debtors restructure the debt they owe to private creditors. The organization provides the financing that debtors use to remain current on their payments to creditors. When this financing helps

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[64] Erica R. Gould, *Money Talks: The International Monetary Fund, Conditionality, and Supplementary Financiers* (Stanford University Press, 2006).

countries overcome short-term difficulties and restore their independent capacity to service debt, it allows them to avoid an otherwise probable restructuring. But when countries face deeper problems that require some form of debt relief, IMF lending can postpone necessary restructurings, which tends to exacerbate and extend crises and undermine the effectiveness of Fund programs.[65] If the IMF anticipates the need for debt relief from the outset, it can condition its support on the completion of an upfront restructuring that puts the debtor's finances on a more sustainable trajectory.[66] It is in this sense that IMF lending decisions have the capacity to trigger sovereign debt restructurings.

When should the Fund use its lending tools to encourage debt restructuring? The IMF recognizes that there are different types of financial crises that require different types of responses. The key distinction that first has to be made is whether a crisis is one of liquidity or solvency.[67] For a country in a liquidity crisis, the key problem is a short-term shortage of the hard currency used in cross-border transactions. In such cases, the Fund's optimal solution, from its own perspective, is to provide a bailout package conditional on the country's implementation of key policy adjustments. If the crisis has been accurately diagnosed and the Fund's program is credible in the eyes of global financial markets, the combination of financing and adjustment should be sufficient to resolve the crisis by restoring market confidence and 'catalyzing' the return of private lending to the country.[68] In the Fund's view, debt restructuring is neither necessary nor desirable in liquidity crises. Solvency crises, which occur when a state has become so indebted it can no longer afford to service its obligations over the medium to long term, are a different story. They generally cannot be resolved without some degree of debt relief. In these cases, the optimal approach for the Fund is to condition its financial support not just on a set of policy changes—as it does in all lending programs—but also on an upfront debt restructuring operation that is sufficiently deep and comprehensive to restore the sovereign's debt-servicing capacities.[69]

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[65] David Vines and Christopher L. Gilbert (eds.), *The IMF and its Critics: Reform of Global Financial Architecture* (Cambridge University Press, 2004).

[66] Countries do not have to ask the IMF for help if they want to restructure their debt. But negotiating with creditors can prove more challenging without the Fund's backing. For example, starting in the 1980s, Paris Club and London Club creditors made clear that they would only negotiate debt relief with countries that already had IMF programs. Moreover, without the Fund's seal of approval, creditors can be more skeptical that the losses they are being asked to take are necessary, in turn making them more reluctant to go along with a debtor's restructuring proposal. For these reasons, countries that cannot pay their debts almost always end up at the IMF.

[67] See Andrew G. Haldane, Gregor Irwin, and Victoria Saporta, 'Bail out or Work Out? Theoretical Considerations,' *The Economic Journal* 114(494)(2004): 130-148.

[68] IMF, 'The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations', Policy Papers, June 2014.

[69] Ibid.

As the checkered history of IMF lending shows, failing to condition Fund financing on early or large enough debt workouts in cases of sovereign insolvency tends to produce perverse outcomes for the debtor country, a portion of its creditors, the IMF, and the international system as a whole. At best, bailout loans do little to resolve insolvency crises; at worst, they deepen them by adding more debt to an already-unpayable financial burden.[70] In either case, bailouts simply delay the need for restructuring and prolong painful economic crises.[71] They also have the effect of bailing out private creditors, as debtor states use Fund resources to avoid default by repaying banks and bondholders whose claims are reaching maturity.[72] This has allowed large swathes of private lenders to exit from many crises scot-free, shifting the burden of adjustment squarely onto the debtor country and, according to some critics, sowing the seeds of future crises by creating creditor moral hazard.[73] Replacing a large portion of private-sector claims with IMF loans, which cannot be restructured because of the Fund's 'preferred creditor status,' also reduces the amount of debt that can be written-down when delayed restructurings do occur. As a result, a debtor may receive less debt relief than if it had restructured before accepting IMF assistance, and its remaining non-IMF creditors will have to take larger haircuts to provide the same level of relief that could have been achieved earlier through moderate haircuts spread over a wider creditor base.[74] These outcomes undermine the success of Fund programs and erode the organization's legitimacy as an impartial and effective crisis manager.

Despite these suboptimal outcomes, the Fund has lent without requiring or even encouraging early or adequate debt restructuring in numerous cases where debtor countries were effectively insolvent. A certain amount of error is to be expected and can be explained by the fact that, while the liquidity-solvency distinction is, in theory, relatively clear, in reality it can be notoriously difficult to distinguish

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[70] IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework', Policy Paper, 2013.
[71] Hagan, 'Designing a Legal Framework to Restructure Sovereign Debt.'
[72] Patrick Bolton and David A. Skeel, Jr., 'Redesigning the International Lender of Last Resort,' *Chicago Journal of International Law* 6(1)(2005): 177-201.
[73] Adam Lerrick and Allan H. Meltzer, 'Blueprint for an international lender of last resort,' *Journal of Monetary Economics* 50(2003): 289-303; Andrew Haldane and Jorg Scheibe, 'IMF Lending and Creditor Moral Hazard,' Bank of England Working Paper No. 216 (2004). For a review of debates on the moral hazard effects of IMF lending, see Larry Li, Malick Sy, and Adela McMurray, 'Insights into the IMF bailout debate: A review and research agenda,' *Journal of Policy Modeling* 37(6)(2015): 891-914.
[74] Christophe Chamley and Brian Pinto, 'Sovereign Bailouts and Senior Loans,' *NBER International Seminar on Macroeconomics* 9(1)(2012): 269-291. Susan Schadler, 'The IMF's Preferred Creditor Status: Does it Still Make Sense After the Euro Crisis?' CIGI Policy Brief No. 37 (March 2014).

between these two ideal types.[75] What begins as a liquidity problem can mutate into a solvency one. More fundamentally, whether or not a government can pay its external debts over a given period of time depends not only on economic factors but also on its political will and ability to impose certain levels of austerity and adjustment on domestic society. And there is no formula for determining how the politics of adjustment will play out in different countries and contexts. The difficulties of distinguishing between different types of crises are only compounded by a bigger challenge: persistent political pressures to lend to countries without requiring restructuring, even when the underlying problem is clearly or probably one of insolvency. Because restructurings can be enormously costly and destabilizing for debtor states, their transnational private creditors, and the key capital-exporting states in which the majority of those creditors reside, one or more of these actors will often press the IMF to lend in ways that avoid, or at least delay, a large debt write-down. As the IMF has acknowledged, "pressures to delay a restructuring of unsustainable debt have historically been commonplace."[76]

### *2.2 The Need for Rules? The IMF Reform Debates of the 1990s*

The significance of IMF lending as a determinant of sovereign debt repayment and restructuring decisions began to attract widespread international attention during the Latin American debt crisis of the 1980s. It was then that the Fund cemented its role as the chief architect of international responses to large-scale sovereign debt crises. Initially, the organization was under immense pressure at the time from its largest shareholder—the US—to orchestrate a response that allowed debtor countries to avoid defaulting on or writing-off a significant amount of their external debt.[77] In this context, the Fund's approach was to mobilize new financing which allowed indebted countries to continue servicing their interest payments, impose macroeconomic and structural adjustments on debtors in hopes of restoring their independent capacity to pay, and encourage the rescheduling of the payment of principal on outstanding loans.[78] Despite the fact that it failed to acknowledge the underlying problem—that debtors were effectively insolvent and would need substantial debt relief—this strategy was maintained from roughly 1982 until 1989, at which point deeper debt restructuring had become politically acceptable to the US and was delivered via the Brady Plan. In the end, critics accused the

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[75] Otaviano Canuto, Brian Pinto, and Mona Prasad, 'Orderly Sovereign Debt Restructuring: Missing in Action! (And Likely to Remain So),' *The World Bank Research Observer* 29(1)(2014): 109-135.
[76] IMF, 'Sovereign Debt Restructuring,' p. 20.
[77] Jeffrey Sachs, 'Managing the LDC Debt Crisis,' *Brookings Papers on Economic Activity* 2(1986): 397-440; Stephen S. Golub, 'The Political Economy of the Latin American Debt Crisis,' *Latin American Research Review* 26(1)(1991): 175-215.
[78] James M. Boughton, *Silent Revolution: The International Monetary Fund, 1979-1989* (International Monetary Fund, 2001).

Fund of contributing to Latin America's 'lost decade' by delaying the resolution of the crisis.[79] The episode was an early and powerful example of how IMF bailouts could exacerbate solvency crises and delay restructurings, and how political pressures could encourage questionable lending choices.

The 1990s saw an uptick in the size and intensity of financial crises and IMF rescue loans. In this context, IMF lending became increasingly controversial and heated debates emerged, particularly among US and European policymakers, about the appropriate role and size of bailouts and whether there should be rules governing the Fund's lending decisions. These debates were triggered first by the 1994 Mexican financial crisis. Unable to service its short-term domestic dollar-linked debt, Mexico secured a bailout of $20 billion from the US and an additional $18 billion from the IMF—more than the Fund had previously made available to any other country—to pay off its maturing debt and avoid default.[80] The US contribution to the Mexican bailout had been controversial in domestic politics, and the Clinton Administration wanted to bolster the IMF's lending capacity so that it would not have to make such large bilateral loans to supplement Fund financing in future crises. But the major European powers were already uncomfortable with the scale of IMF lending to Mexico, as well as the fact that private creditors were not asked to contribute to resolving the crisis via private financing or debt restructuring—also referred to at the time as "private-sector involvement" (PSI) or "bail-ins."[81] European officials saw the IMF contribution to Mexico as serving American financial interests, and they wanted to limit and impose stricter rules on large-scale multilateral lending.[82]

In response to these competing pressures, the G7's 1995 Halifax Summit focused mainly on ways to increase the size and speed of IMF lending, while the G10's 1996 Rey Report tackled the issue of how to encourage the restructuring of sovereign bonds when necessary.[83] Among other things, the Rey Report recommended that debtor states insert 'collective action clauses' (CACs)—a contract-based mechanism to facilitate debt restructuring processes—into their sovereign bonds, but debtors and their private creditors showed little enthusiasm for this idea (despite the fact that CACs were already

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[79] Federico Sturzenegger and Jeromin Zettelmeyer, *Debt Defaults and Lessons from a Decade of Crises* (MIT Press, 2007).
[80] Nouriel Roubini and Brad Setser, *Bailouts or Bail-Ins? Responding to Financial Crises in Emerging Economies* (Peterson Institute for International Economics, 2004).
[81] Roubini and Setser, *Bailouts or Bail-Ins?*
[82] For a discussion of European (particularly German and British) criticism of the Mexico bailout, see Paul Blustein, *The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF* (Public Affairs, 2001).
[83] Group of Ten, 'The Resolution of Sovereign Liquidity Crises: A report to the Ministers and Governors prepared under the auspices of the Deputies,' (May 1996).

a common feature of the sovereign bonds issued in London under English law). American and European concerns were thus both on the agenda, but major questions remained about how IMF resources should be deployed, and when large-scale lending should be accompanied or preceded by debt restructuring. Debate over these questions only intensified over the next few years with the outbreak of the 1997-98 East Asian financial crisis, which resulted in record-sized IMF loans. Normally, countries can borrow up to 100 percent of the size of their IMF quotas in a year. Thailand, Indonesia, and South Korea were given loans worth 600, 490, and 1,939 percent of their respective quotas.[84] These crises were followed shortly after by Russia's financial meltdown of 1998, prompting another large IMF loan. In this case, Fund lending failed to prevent subsequent default, which in turn triggered the collapse of the US hedge fund Long-Term Capital Management.[85]

In this context, the US Congress agreed to expand the IMF's lending capacity. Beefing up the Fund's financial firepower focused attention again on "the need to define the circumstances when the IMF should mobilize its expanded lending capacity."[86] The US and Europe remained divided on the key questions of whether different types of crises required fundamentally different IMF policy responses, and the extent to which those responses should be governed by rules versus discretion. US officials believed that a combination of financing and adjustment was an appropriate response to liquidity crises, but that solvency crises called for debt restructuring. They supported the creation of an informal lending framework based on this distinction, but one that still provided significant room for discretion and case-by-case decision-making in determining how to define and respond to individual crises.[87]

European policymakers, especially the Germans, wanted to make large-scale IMF lending conditional on private creditors taking at least some financial losses in *all* crises. Moreover, they preferred a rules-based framework to prevent politically-motivated bailouts and limit moral hazard by making a credible commitment not to rescue private creditors. Some movement toward compromise was made at the IMF's Annual Meetings in 2000, where countries agreed on the Prague Framework outlining three possible approaches to crisis management: one where catalytic financing plus policy adjustment was sufficient; one where private creditors should be encouraged to voluntarily roll-over their debt and

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[84] Hagan, 'Designing a Legal Framework.'
[85] Franklin R. Edwards, 'Hedge Funds and the Collapse of Long-Term Capital Management, *Journal of Economic Perspectives* 13(2)(1999): 189-210.
[86] Roubini and Setser, *Bailouts or Bail-Ins?*, pp. 186-187.
[87] Roubini and Setser, *Bailouts or Bail-Ins?*

maintain their exposure to countries; and one where circumstances called for a comprehensive debt restructuring.[88] While the framework made important distinctions, it did not go as far as specifying hard rules or precise circumstances for when each of these different approaches should be employed.

While agreement was difficult to reach, there was a growing sense that private creditors should have to bear more of the burden of sovereign debt crises, and that bailouts should therefore be replaced or accompanied in many cases by debt restructurings. This sentiment was not confined to high-level policy circles. By the early 2000s, the international management of financial crises had become intensely politicized in Western countries, particularly the US. Critics on both the left and right took issue with the distributional implications of giving massive taxpayer-funded loans to crisis-stricken governments to help them rescue failing firms and service debts owed to foreign private creditors.[89] Conservative voices in particular also complained about the moral hazard that bailouts generated.[90]

## 3. The Reform Initiatives of the Early 2000s

The US position on the "bailouts versus bail-ins" and "rules versus discretion" debates took a sharp turn in 2001 with the arrival of George W. Bush to the White House, which brought to power a US administration committed to limiting the use of big IMF bailouts and encouraging, in their place, a greater reliance on sovereign debt restructuring to resolve crises.[91] For key officials on the new US Treasury team, the objective of limiting bailouts required firm rules to govern IMF lending—as the Europeans had been advocating—as well as a more institutionalized process for debt restructuring. In their view, a lot of the pressure to provide bailouts in the first place came from the fact that the alternative of letting debtors and creditors work out debt problems among themselves through a negotiated restructuring was often chaotic, conflictual, time-consuming, and unnecessarily costly for the parties involved.[92] It was believed that this pressure could only be relieved by establishing a more orderly and predictable bankruptcy-like system to facilitate smoother restructuring processes. The twin-task of establishing new IMF lending rules and a better restructuring process began to look even

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[88] IMF, 'Communique of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund,' Prague, Czech Republic (September 24, 2000).
[89] Barry Eichengreen and Bradford Delong, 'Between Meltdown and Moral Hazard: Clinton Administration International Monetary and Financial Policy,' in: Jeffrey Frankel and Peter Orszag (eds.), *American Economic Policy in the 1990s* (MIT Press, 2002).
[90] Ibid.
[91] Taylor, *Global Financial Warriors*.
[92] See Hagan, 'Designing a Legal Framework.'

more urgent late in 2001, when Argentina underwent a massive default that highlighted both the limits of IMF bailouts—the default occurred despite prior IMF lending that failed to recognize the need for restructuring—and the need for predictable rules to facilitate more orderly debt restructurings.[93]

### *3.1 Debating the Design of a Process Mechanism*

While discussions about IMF lending rules had been ongoing and continued largely in the background, the idea of an international sovereign bankruptcy procedure captured widespread attention and quickly moved into the foreground of sovereign debt debates. The first major reform proposal for a better debt workout process to emerge in this context involved establishing a formal sovereign debt restructuring framework under international law. Paul O'Neill, then US Treasury Secretary, had become fond of the idea of creating something akin to Chapter 11 of the US Bankruptcy Code but for sovereign states, and he encouraged the two top officials at the IMF to start developing this kind of framework.[94] In November 2001, then IMF deputy managing director Anne Krueger used a high-profile keynote address to launch her proposal for a treaty-based 'Sovereign Debt Restructuring Mechanism' (SDRM).[95] The proposal attracted enormous attention and gained momentum within the Fund, where staff developed detailed blueprints for how the SDRM would work in practice.[96]

The new mechanism was to be housed within the IMF. For debtors that requested and were granted support, the earliest and most ambitious versions of the SDRM proposal envisioned a supranational entity with the power to authorize and/or enforce: temporary payment standstills (to give the sovereign breathing space and prevent a run on its debt), stays on litigation (to stop creditors from suing debtors during the restructuring process), 'debtor-in-possession' financing (to encourage fresh financing during the crisis by giving new loans seniority over existing claims), and settlements agreed to by a qualified majority of creditors (to prevent holdouts from undermining restructuring deals).[97] The SDRM would thus be able to override existing debt contracts and the domestic legal jurisdictions that governed them in order to provide the global public good of orderly and equitable sovereign debt

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[93] Paul Blustein, *And the Money Kept Rolling In (And Out): Wall Street, the IMF, and the Bankrupting of Argentina* (Public Affairs, 2005).

[94] Hagan, 'Designing a Legal Framework.'

[95] Krueger, 'A new approach to sovereign debt restructuring.'

[96] The SDRM proposal echoed an idea laid out years earlier in an influential speech by Jeffrey Sachs, who argued that the IMF should transform itself from an international lender of last resort into an international bankruptcy court. Jeffrey Sachs, 'Do We Need an International Lender of Last Resort,' Frank D. Graham Lecture at Princeton University (April 20, 1995).

[97] Ibid. See also IMF, 'The Design of the Sovereign Debt Restructuring Mechanism—Further Considerations,' IMF Policy Papers (November 2002).

restructuring. This ambitious plan would require an amendment to the Fund's Articles of Agreement to establish a legal basis for the IMF to act as an international bankruptcy court.

The SDRM—known also as the 'statutory approach'—enjoyed the support of the major European powers. As described above, European officials, led by the Germans, had become strong critics of large IMF bailouts and wanted private creditors to share more of the burden of crisis resolution via sovereign debt restructurings. But their support for the Fund's proposed reform was contingent on the introduction of IMF lending rules that would deny financing to insolvent countries and thus push them to initiative a restructuring under the SDRM. As Gelpern and Gulati note, the Europeans wanted "firm crisis management rules" and the "SDRM was their chance."[98] In a sense, getting IMF lending rules that could limit bailouts and thus *trigger* debt restructurings in the first place was their primary goal, and establishing a more robust restructuring process was a means to that end and a way of making it operative.[99] The Europeans supported process reform only if coupled with the creation of a formal trigger mechanism; the Americans and IMF staff stressed that a trigger mechanism could only work if accompanied by a reform to the debt restructuring process. The trigger (represented by IMF lending policies) and process (represented at first by the SDRM) were politically inseparable.[100]

Meanwhile, private creditors and EMDE debtors were virulent critics of the SDRM. Creditors worried that this reform would not only encourage more restructurings and thus shift the burden of crisis resolution from debtors and the official sector onto themselves, but also institutionalize a process by which their contracts could be subordinated and their ability to seek legal remedy curtailed.[101] Essentially, they feared that a SDRM would result in a more debtor-friendly international regime. Sovereign borrowers, for their part, "had to choose whether to represent their interest as debtors seeking to raise money on capital markets at the lowest possible cost and their interest as countries that might benefit from an efficient process for restructuring sovereign debt should they ever be

[98] Gelpern and Gulati, 'Public Symbol in Private Contract,' p. 1656.
[99] A former Fund official interviewed for this project said that, for the Europeans especially, "A big motivation for the SDRM was a way of basically having firm access limits." The term access limits refers to terms and conditions under which countries can access IMF financing. Interview 138785.
[100] In some ways, one could see the SDRM itself as implying or embodying aspects of a trigger mechanism (especially if it had the capacity to authorize payment standstills at the outset of a debtor's announcement to restructure), but not in the way envisioned by European and American officials or understood in this dissertation—a point to which I return later in this chapter.
[101] Gelpern and Gulati, 'Public Symbol in Private Contract.'

forced to default."[102] Concerned that creditors would respond to the risks of a SDRM by charging higher borrowing costs and curtailing capital to the developing world, many debtors—especially large international bond issuers like Mexico and Brazil—choose the former and railed against the SDRM.[103] As Sean Hagan, director of the IMF's Legal Department from 2004 to 2018, recalled: "The private sector consistently warned that the SDRM, if adopted, would adversely affect the volume and price of capital to these countries."[104] For debtor states and the private creditors with whom their interests were entangled, the SDRM was a risky proposition with potentially large distributional consequences.

As the SDRM proposal continued to be discussed, it also became increasingly clear that the US Treasury Department was not on board with the IMF's idea. Despite the fact that Paul O'Neill had encouraged the IMF to work on a sovereign bankruptcy framework, it turned out that most of his colleagues did not share his enthusiasm for this plan. On this issue and others, O'Neill had been out of sync with other senior officials at the Treasury Department and within the Bush Administration more broadly, leaving him marginalized and isolated.[105] The consensus view that gained support and soon emerged as the US Treasury position was that, while a more orderly restructuring process was indeed needed, an international hard-law SDRM would be an inappropriate means of achieving that objective. The details of the SDRM proposal were revised more than once between 2001 and 2003 to address concerns that had been raised and soften the opposition. Later iterations of the proposal had abandoned the idea of enforcing payment standstills, stays on litigation, and priority financing. They focused instead on the SDRM's role in bringing together creditors, allowing them to vote on proposed restructurings as a supermajority, and binding any minority holdout creditors to the agreed deal.[106] For the US, however, the problem was less the content and more the hard-law form of the proposal.

Seeing little promise in a treaty-based scheme, US Treasury authorities—led by undersecretary for international affairs, John Taylor—began to promote a less centralized alternative approach that called upon debtor governments to voluntarily adopt CACs, an idea that had been endorsed a few years earlier in the G10's 1996 Rey Report. CACs were legal provisions that debtors could insert into their

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102 Setser, 'The Political Economy of the SDRM,' p. 322.

103 Alejandro Diaz de Leon, 'Mexico's adoption of new standards in international sovereign debt contracts: CACs, *pari passu* and a trust indenture', *Capital Markets Law Journal* 11(1) (2016): 12-24.

104 Hagan, 'Designing a Legal Framework,' pp. 391-392.

105 Ron Suskind, *The Price of Loyalty: George W. Bush, the White House, and the Education of Paul O'Neill* (Simon & Schuster, 2004).

106 Setser, 'The Political Economy of the SDRM.'

international bond contracts. If invoked, these provisions would allow a supermajority of bondholders (typically 75 percent, occasionally 85) to amend the payment terms of their bonds and bind dissenting minorities to the agreed restructuring. Despite involving government debt obligations, these restructuring clauses and the bond contracts in which they were embedded would be governed not by public international law but rather by the domestic contract laws of the jurisdiction in which they were issued—typically New York or English law for internationally-issued bonds. A form of private law governed by domestic legal institutions, CACs would constitute a commercial contractual agreement between the sovereign and its creditors.

The ability to amend contract terms via supermajority voting was already a standard feature of the sovereign bonds issued in London, not because of some earlier policy initiative but rather because of the particular historical development of that market. But the standard bonds issued under New York law were different. At the time, they could be amended only with the unanimous consent of bondholders. Unanimity protected the rights of individual bondholders, but it also meant that a single non-cooperative creditor could block a restructuring deal that was supported by every other creditor. Workouts could still get done—for example, by exchanging old bonds for new ones rather than changing the terms of existing bonds—but the processes for doing so were *ad hoc*, and there was nothing to prevent holdout creditors from refusing to participate and litigating for full repayment. A few landmark cases around the turn of the century—notably *Elliott Associates v Republic of Peru*—demonstrated that holding-out could be a profitable strategy, thus strengthening the incentive for creditors to holdout from future restructurings.[107] CACs, it was believed, would create a more predictable and efficient process by allowing creditors vote on a debtor's restructuring offer as a supermajority and force potential holdouts to go along with their collective decision.

Although the US had tremendous power in global financial governance, including the power to veto the SDRM, the nature of its preferred solution to debt restructuring called upon EMDE debtors and their private creditors to voluntarily adopt and accept CACs. But debtor governments were worried that these new clauses would undermine the credibility of their commitment to repay and therefore raise their borrowing costs, much as they feared the SDRM would do.[108] Transnational private creditor

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[107] Deborah Zandstra, 'New Aggregated Collective Action Clauses and evolution in the restructuring of sovereign debt securities,' *Capital Markets Law Journal* 12(2)(2017): 180-203.
[108] Gelpern and Gulati, 'Public Symbol in Private Contract'; Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism.'

groups were similarly skeptical of CACs, which had been framed as part of an overall international policy shift toward more sovereign debt restructurings, which translated into more creditor losses.[109] Debtors and creditors thus both feared the adverse distributional consequences of CACs.

### *3.2 The Blueprint for an IMF Trigger Mechanism*

Meanwhile, as the CACs versus SDRM debate raged, moves were being made within the IMF to establish a formal lending framework that defined the circumstances under which the Fund could provide 'exceptional access' (EA) financing—that is, large-scale loans that exceeded a country's normal borrowing limit according to its quota. In July 2002, Fund staff produced a paper for the Executive Board (EB) outlining a proposed EA lending framework based on the following four criteria, each of which would have to be met to justify EA financing: (1) "The member is experiencing exceptional balance of payments pressures on the capital account resulting in the need for Fund financing that cannot be met within the normal limits"; (2) "There is a high probability that debt will remain sustainable, based on rigorous and systematic analysis"; (3) "The member has good prospects of regaining market access, so that the Fund financing would provide a bridge"; and (4) "The policy program of the member country provides a reasonably strong prospect of success."[110]

The second criterion was particularly crucial to the framework and its ability to trigger restructurings. On the basis of debt sustainability assessments, it differentiated between two broad scenarios. Under the first scenario, when an IMF Debt Sustainability Analysis (DSA) indicated with high probability that a country's debt would remain sustainable, the situation would be seen as a liquidity crisis and a combination of financing and adjustment via IMF conditionality would be considered the appropriate response. Under the second scenario, when a DSA indicated that a country's debt was unsustainable, or when it could *not* establish with high probability that the country's debt *was* sustainable, the situation would be treated as more of a solvency crisis and EA financing could only be justified if the country also underwent a restructuring that was large enough to restore sustainability with a high probability.[111]

There was a strong technocratic rationale for this kind of lending framework. By continuing to lend to countries with sustainable debt burdens, the Fund would send a clear and credible signal to markets

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[109] Gelpern and Gulati, 'Public Symbol in Private Contract.'
[110] IMF, 'Access Policy in Capital Account Crises', IMF staff paper (2002), p. 13.
[111] IMF, 'Access Policy in Capital Account Crises.'

that the country did not need debt restructuring, which would help to maintain or restore the country's market access. In other words, by lending only to countries with clearly sustainable debt, the IMF would preserve the effectiveness of 'catalytic financing' in resolving liquidity crises. By refusing to lend to countries without clearly sustainable debt burdens, Fund policy would have the effect of triggering or at least strongly encouraging debt restructurings, which were seen as both a necessary and more equitable approach to resolving solvency crises. As the IMF and its members had learned from experience, lending to countries with unsustainable debt burdens was not simply ineffective; it also produced new winners and losers and routinely made the actual debt situation worse.

The proposed framework aimed at improving not only crisis resolution but also crisis prevention. By credibly committing not to lend in certain, well-defined circumstances, the framework would signal to creditors and debtors that they would not be bailed out from particular types of crises. This would, in principle, lead to more prudent lending and borrowing decisions and fewer crises in the first place. This objective of improving market discipline had been a key priority for many European officials, particularly the Germans, and now found support among US rule-makers who also believed strongly in the imperative of eliminating moral hazard through credible constraints on lending.[112]

For these constraints to be credible, they had to be embedded in formal rules that could not be ignored when a crisis erupted. There had frequently been strong political pressures on the IMF to lend precisely to avoid, delay, and/or minimize restructurings because of their distributional impacts and potential implications for financial stability. Institutionalizing a rules-based approach that minimized the scope for political influence over IMF lending was thus a key motivation for embedding lending criteria within a formal framework. As staff noted in their proposal for a new approach, "the degree of discretion and flexibility in the present framework may make the Fund more vulnerable to pressure to provide exceptional access even when prospects for success are quite poor and [the] debt burden of the sovereign is likely to be unsustainable."[113] As mentioned earlier, many also believed that the credibility of the commitment not to lend hinged on the viability of the debt restructuring process. If the IMF's framework was going to have the effect of triggering restructurings, then there had to be a more orderly and predictable debt restructuring process available to debtor countries. If restructurings remained chaotic and unpredictable, strong pressures to avoid them through bailouts would persist.

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[112] Taylor, *Global Financial Warriors*.
[113] IMF, 'Access Policy in Capital Account Crises', p. 7.

### *3.3 Establishing the Pillars of a New SDRR*

In September 2002, the EB held a meeting to discuss the staff's proposed lending framework. There was a general consensus among the most powerful member-states in favour of the four criteria and the idea of embedding them within a formal set of rules. Executive Directors (EDs) from these states agreed that decisions of when to condition lending upon upfront debt restructuring should be based on assessments of debt sustainability. The German ED was particularly adamant on this point, stating:

> In cases where the balance of probabilities indicates that the sustainability condition is not met, the onus should be on debt restructuring, in addition to domestic adjustment, to address the underlying program […] we would argue that "Capital Account Crisis *plus* Uncertain Debt Sustainability *requires* Debt Restructuring.""[114]

Directors also noted that for the proposed IMF framework to become an effective trigger for debt restructurings, it would have to be complemented by a more institutionalized process for restructuring. As the US representatives put it, "we believe that efforts to create a more orderly process for sovereign debt restructurings will allow the official sector to be less reliant on official sector lending to help stabilize the international financial markets."[115] The German ED echoed the point, noting that "[t]he discussion on access policy in capital account crises has to be seen in close conjunction with […] our discussions on PSI, SDRM, and CACs."[116] A number of EDs stressed that the EA framework could only function as an effective trigger if the commitment not to lend was credible. According to the German Director, "any attempt to tie the hands of the official sector, in the sense of constrained discretion, in responding to such crises needs, however, to be extremely credible, otherwise the desired effect of preventing moral hazard and inducing PSI could, as already noted above, not be achieved."[117] The UK representatives agreed: "If the policy on exceptional access is not sufficiently clear and credible, and not applied in a consistent manner, the other pillars of our crisis prevention framework are likely to be much less effective."[118] The importance of making a credible commitment underpinned the case both for establishing the four criteria as formal lending rules rather than voluntary guidelines, and for making debt workouts a viable alternative to bailouts by improving the restructuring process.

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[114] Statement by Mr. Bischofberger on Access Policy in Capital Account Crises. Executive Board Meeting 02/94, September 6, 2002. GRAY/02/1222, p. 3.
[115] Statement by Ms. Lundsager and Mr. Baukol on Access Policy in Capital Account Crises. Executive Board Meeting 02/94, September 6, 2002. GRAY/02/1236, p. 1.
[116] Statement by Mr. Bischofberger, p. 1.
[117] Statement by Mr. Bischofberger, p. 2.
[118] Statement by Mr. Scholar and Ms. Stuart on Access Policy in Capital Account Crises. Executive Board Meeting 02/94, September 6, 2002. GRAY/02/1250, p. 2.

Directors also discussed whether considerations regarding contagion should be included in the new framework. Large-scale lending had, in the past, been justified on the grounds of stemming systemic spillover effects, and it was highly likely that, in a world of globalized financial flows, cross-border contagion would be a prominent potential feature of future crises. Despite this, representatives from the leading capital-exporting countries agreed that prospects of contagion, while always important considerations, would be inappropriate criteria upon which to base decisions about EA financing—a view that reflected the staff's position on this issue. As US representatives put it, "contagion and systemic issues can play a role in the justification for exceptional access, but it is critical that neither be viewed as a necessary condition for exceptional access."[119] Their British counterparts concurred.[120] Japanese officials also agreed,[121] as did the German ED who, in dismissing the case for special treatment to deal with potential spillovers, stated: "Experience seems to indicate that in many if not most cases of "contagion", the countries in question had pursued unsustainable policies."[122] In other words, countries that faced the prospect of systemic spillovers had only themselves to blame.

The EMDE debtors that had been at the center of many debt crises were more critical of the Fund's proposed lending framework. They feared a world in which their access to emergency financing and their ability to avoid painful debt restructurings were curtailed. Some of the larger debt issuers argued that, in the words of Brazil's ED, "a curtailment of the Fund's ability to lend in capital account crises would be a severe blow to the prospects of further global integration,"[123] and, according to Mexico's representatives at the Fund, "the lack of official financial support other than the Fund and other IFIs calls for greater not less flexibility in the institution's lending policies."[124] Private creditor groups were surprisingly silent on the issue of IMF reform, although they had opposed efforts to institutionalize restructuring via either CACs or a SDRM. Creditors likely focused their lobbying efforts on these mechanisms because they were much more visible in public debates and the financial press, whereas discussions of the Fund's lending framework happened behind-the-scenes and were barely publicized. Moreover, because CACs and the SDRM had been framed as part of a broader policy shift toward

[119] Statement by Ms. Lundsager and Mr. Baukol, p. 1.
[120] Statement by Mr. Scholar and Ms. Stuart, p. 3.
[121] Statement by Mr. Magi and Mr. Miyoshi On Access Policy in Capital Account Crises. Executive Board Meeting 02/94, September 6, 2002. GRAY/02/1240, p. 2.
[122] Statement by Mr. Bischofberger, p. 3.
[123] Statement by Mr. Portugal on Access Policy in Capital Account Crises. Executive Board Meeting 02/94, September 6, 2002. GRAY/02/1209, p. 1.
[124] Statement by Mr. Oyarzabal and Mr. Beauregard on Access Policy in Capital Account Crises. Executive Board Meeting 02/94, September 6, 2002. GRAY/02/1210.

fewer bailouts and more restructurings, creditor resistance to these process-oriented mechanisms was essentially pushback against the idea of a debt restructuring trigger too. The two pillars had been so tightly linked in reform discussions that creditors did not really distinguish between the two.[125]

Despite the direct opposition of EMDE debtors and the more implicit resistance of private creditors, the leading capital-exporting states were committed to establishing firm multilateral lending rules. With the US and Europe on board, the staff's proposal was approved and became operationalized as Fund policy in September 2002.[126] For the first time, large-scale lending would be governed by a set of pre-defined rules that specified the conditions under which EA financing could be justified and, in doing so, *created a mechanism for triggering debt restructurings* when those conditions could not be met.

With the new IMF rules in place, efforts to establish an international mechanism to facilitate the debt restructuring process intensified. Under the leadership of John Taylor, US Treasury staff stepped up what they had already started in early 2002: a behind-the-scenes outreach campaign to persuade EMDE debtors and their creditors of the merits of CACs and to find a debtor willing to be the 'first mover' to adopt these new contract terms. Treasury officials met with key investors and bankers on both the buy-side and sell-side of sovereign bond markets to raise awareness about CACs and promote them as a market-friendly mechanism.[127] They also made intensive efforts to persuade their EMDE counterparts of the benefits of these clauses, repeatedly calling ministers, organizing meetings, and promoting CACs in speeches and at public events.[128] For some time, market participants and EMDE finance officials remained unconvinced. Neither saw CACs as being in their interest for the reasons discussed above.[129]

Eventually, however, the private sector began to soften its position on contract reform, and a coalition of leading financial industry associations—including the IIF—even endorsed a model set of CACs in

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125 Interview 138785. This interview with a then-senior IMF staffer confirmed that private creditors conflated the process and trigger and sought to push back on all attempts to impose new debt restructuring mechanisms.
126 This iteration of the EA rules is referred to here and elsewhere as the 2002 framework. Some also refer to it as the 2003 framework, as February 2003 marked the end of a broader review process of EA lending. Decisions on other elements of the EA toolkit, including the Fund's Supplemental Reserve Facility, were concluded in 2003, but the decision to approve the four lending criteria for EA financing was made in September 2002.
127 Taylor, *Global Financial Warriors*.
128 Ibid.
129 See Gelpern and Gulati, 'Public Symbol in Private Contract,' who interviewed over 100 individuals involved in this earlier episode.

hopes that their version would become the market standard. This newfound support was considered a major policy reversal for the transnational creditor community.[130] In March 2003, after receiving assurance from creditors that CACs would not raise its borrowing costs, Mexico issued bonds containing CACs under New York law.[131] When other EMDEs saw that the new contract terms had no effect on Mexico's borrowing costs, they quickly embraced CACs, which rapidly became a standard feature of EMDE international bonds.[132] The widespread adoption of CACs put to rest any further discussion of the need for a SDRM, which until that point was still being developed and promoted within the IMF. Despite the strong initial resistance and the implicit quid pro quo that it took to get contract change, the original CACs were a relatively modest reform. While they were novel in New York, supermajority voting procedures had been a standard feature of sovereign bonds issued in London under English law for nearly a century.[133]

Within a relatively short period of time, a new SDRR had emerged through the creation of a rules-based IMF lending framework and the widespread adoption of CACs in international sovereign bonds. In the eyes of their proponents, the Fund's new lending rules would reduce bailouts and trigger more restructurings, and CACs would provide a predictable and efficient process for these restructurings to proceed. As emphasized above, trigger and process reforms were thus seen as mutually-reinforcing pillars of a new regime and a broader international policy shift toward fewer bailouts and more debt restructurings. Not only were these two elements portrayed as highly complementary; according to their advocates, one hardly made sense without the other. As John Taylor later put it: "*a rules-based reform of the IMF was inseparably linked to a reform of the process for sovereign debt restructuring.*"[134]

While new contract terms and IMF lending rules were the core innovations of the early 2000s, one other reform emerged in that earlier era and is worth mentioning. Before the SDRM was abandoned, private creditor and debtor-country representatives had begun working on a self-regulatory initiative they hoped could win support as part of a less radical approach to debt restructuring. Launched in 2002 and led by the private-sector IIF, the initiative aimed to develop and promote a voluntary code

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130 Martin Crutsinger, 'US Bankruptcy Proposal Wins Backing,' *Midland Reporter-Telegram*, April 8, 2002.
131 Lex Rieffel, *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery* (Brookings Institution Press, 2003).
132 W. Mark C. Weidemaier and Mitu Gulati, 'A People's History of Collective Action Clauses', *Virginia Journal of International Law* 54(1)(2013): 51-95.
133 Ibid.
134 Taylor, *Global Financial Warriors*, p. 110. Emphasis in original.

of conduct to help debtors and their private creditors work together to prevent and manage sovereign debt workouts. In 2004, the IIF unveiled the *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets*, a soft-law governance framework whose content revolves around four core principles: transparency and information sharing, close debtor-creditor dialogue and cooperation to avoid restructuring, good-faith actions during restructuring, and the equal treatment of all creditors.[135] Soon after their release, the Principles were endorsed by a number of emerging-market debtors, as well as by several major capital-exporting states, the Paris Club of official creditors, and the G20 finance ministers and central bank governors as a whole.[136]

## 4. How Do Scholars Explain Reform Outcomes in the SDRR?

There are strong parallels between the regulatory initiatives reviewed above and the more recent reform efforts analyzed in later chapters. Both the early 2000s and the recent UN episode saw the emergence of a regulatory initiative aimed at establishing an international hard-law mechanism to govern the debt restructuring process. In both cases, the initiative gained intellectual and institutional support within a prominent international organization but ultimately fizzled out. In lieu of a hard-law mechanism, contract reforms were again promoted as the preferred approach to debt restructuring among the leading capital-exporting states, as discussed in Chapter 6. Moreover, a set of soft-law principles was created both in 2004 and as the culminating act of UN reform efforts in 2015. Finally, recent reforms included changes to the IMF's lending framework and its role as a trigger mechanism—albeit in the opposite direction to the changes of 2002. Because of these parallels, any attempt to understand recent reforms in the SDRR should thus first consider explanations of what happened in the early 2000s. What lessons emerge from existing accounts of these earlier reform outcomes?

### *4.1 Explanations of the Early 2000s*

A number of scholars have attempted to explain the failure of the SDRM. Soederberg attributes it to the power of transnational private creditors and the US government.[137] In her account, creditors opposed this approach because they feared it would lead to more applications for debt relief and shift bargaining power toward debtors—a source of creditor opposition that others have also pointed to.[138]

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[135] IIF, 'Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets' (November 2004).
[136] Helleiner, 'Filling a Hole in Global Financial Governance?'
[137] Soederberg, 'The Transnational Debt Architecture and Emerging Markets.'
[138] See Ross P. Buckley, 'The Bankruptcy of Nations: An Idea Whose Time Has Come,' *The International Lawyer* 43(3)(2009): 1189-1216.

They lobbied the US government to block the SDRM, which it could unilaterally do as a result of its veto power within the IMF. Others concur that US opposition doomed the SDRM—given American power within the Fund—but disagree that US preferences were simply the product of creditor influence. Hagan and Gelpern et al. note that the SDRM threatened to curtail US sovereignty in ways that were unacceptable to American officials.[139] And Helleiner notes that the market-oriented ideology of Bush-era Treasury officials was antithetical to the type of top-down, bureaucratic solution implied by the SDRM.[140]

In a separate piece analyzing the SDRM and earlier reform initiatives in the 1930s, 1940s, and 1970s, Helleiner highlights another important obstacle that has frustrated efforts to create a formal debt restructuring mechanism.[141] His analysis shows that although private creditors and the US government have frequently opposed such a mechanism, debtors have also consistently failed to unite in favour of substantial reform for fear that their actions would be seen by creditors as increasing the likelihood of default, in turn raising their borrowing costs. Indeed, large debtors such as Mexico and Brazil were hostile to the SDRM for this reason. Kathryn Lavelle attributes the failure of this initiative to the confluence of interests between sovereign borrowers, who wanted to preserve their access to global financial markets, and private lenders, who "sought to maximize the likelihood they would be repaid."[142] With the US, private creditors, and the largest debtors all opposed to the SDRM, the great surprise, concludes Brad Setser, was not that the proposal failed but rather that the IMF found sufficient political space to develop it in the first place.[143]

Why, then, did CACs succeed where the SDRM failed? US preferences were again central, as Treasury officials emerged as the leading proponents of contract reform. Soederberg argues that CACs were preferred by US officials because they were more market-friendly and therefore less threatening to creditor interests than the SDRM.[144] Likewise, Helleiner suggests that the more market-oriented CACs

139 Hagan, 'Designing a Legal Framework'; Anna Gelpern, Ben Heller, and Brad Setser, 'Count the Limbs: Designing Robust Aggregation Clauses in Sovereign Bonds', in: Martin Guzman, Jose Antonio Ocampo, and Joseph E. Stiglitz (eds), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016): 109-143.
140 Helleiner, 'Filling a Hole in Global Financial Governance?'
141 Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism.'
142 Kathryn C. Lavelle, 'Sovereign Debt Restructuring: Alliances Crossing the Financial Services Industry, States, and Nongovernmental Organizations,' in: Tony Porter and Karsten Ronit (eds.), *The Challenges of Global Business Authority: Democratic Renewal, Stalemate, or Decay?* (SUNY Press, 2010), p. 271.
143 Setser, 'The Political Economy of the SDRM.'
144 Soederberg, 'The Transnational Debt Architecture and Emerging Markets.'

were favoured by Bush-era officials for ideological reasons.[145] Gelpern and Gulati (legal scholars who write extensively about sovereign debt) offer an alternative perspective on US motives, arguing that CACs served a largely symbolic—rather than substantive—purpose.[146] Committed to reigning-in the large IMF bailouts and ensuring a greater role for private creditors in sharing the burden of crises, US policymakers touted CACs as a mechanism that would limit the need for bailouts by providing an alternative: a predictable and orderly restructuring process. CACs thus symbolized the policy shift toward fewer/smaller bailouts and more/bigger restructurings, even if private contracts themselves could not affect such broad policy change.

The US position is the first part of the equation, but what about the preferences of sovereign debtors and private creditors? Why did they perform a U-turn and come to accept contract reform after initially rejecting it? Here, scholars agree that debtors and creditors changed course because they came to see the adoption of CACs as a strategic move to pre-empt the even-more-hated SDRM.[147] Although debtors and creditors initially opposed both hard-law and contractual reforms and were generally of the view that debt restructuring was not a problem in need of fixing, they saw CACs as a lesser evil compared to the SDRM. Creditors saw the latter as a bigger threat to creditor rights and a bigger source of uncertainty than the former. Large EMDE debt issuers complained that even continued talk of the SDRM was starting to destabilize debt markets. From a strategic perspective, they rightly believed that getting contract reform done would extinguish any remaining support or argument in favour of the hard-law approach. As Gelpern and Gulati noted:

> [T]he investment community and Mexico deployed CACs to preempt official initiatives, notably SDRM. Preemption was an instrumental use of clauses, albeit not one readily discernable from reading their language. Adopting CACs sent the message that the market solved the collective action problem on its own; the contractual solution obviated the need for SDRM.

Guillermo Ortiz, then president of the Mexican central bank, was not shy in confirming that Mexico issued CACs as "a way to get rid of the SDRM."[148]

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145 Helleiner, 'Filling a Hole in Global Financial Governance?'
146 Gelpern and Gulati, 'Public Symbol in Private Contract.'
147 Ibid; Helliner, 'Filling a Hold in Global Financial Governance?'; Hagan, 'Designing a Legal Framework'; Blustein, *And the Money Kept Rolling In (And Out).*
148 Quoted in Lavelle, 'Sovereign Debt Restructuring,' p. 271.

Based on these political dynamics, scholars have been keen to highlight the historically-contingent nature of contract reform in the early 2000s. CACs were adopted, after all, not primarily to improve the efficiency of debt restructuring processes but rather to pre-empt a historically-specific sovereign bankruptcy proposal. The fact that the SDRM made it into global financial governance debates in the first place was highly contingent and, in Setser's view, surprising.[149] Gelpern and Gulati describe the SDRM as being "in large part a product of the idiosyncratic leadership at the U.S. Treasury and the IMF, the U.S. political transition, Argentina's debt crisis, and even the attacks of 9/11."[150] They conclude that "CACs owed their success to a peculiar confluence of events and personalities."[151] In sum, although proponents of contract reform trumpeted CACs as an important technical device for resolving coordination problems, existing accounts suggest that some cocktail of distributional, ideological, symbolic, and strategic motivations—all within a contingent historical context—was more important than functionalist factors in explaining contract reform in the early 2000s.[152]

Compared to the SDRM and CACs, there is little written about the IMF's 2002 lending framework or the IIF's 2004 Principles. Analysis of IMF reform is in fact so scarce that the above description of this initiative is based largely on archival material. As for the IIF Principles, scholars who have analyzed them generally agree that the creation of this soft-law arrangement was—like the embrace of CACs—a self-regulatory move aimed at pre-empting the SDRM.[153] Private creditor and EMDE debtor representatives wanted to show that action was already being taken to improve the system and that a more heavy-handed approach was thus unnecessary. Helleiner notes that the IIF Principles were also intended to promote debtor-creditor cooperation and creditor-friendly norms at a time when Argentina's aggressive approach to bondholders and the official sector's efforts to encourage bail-ins seemed to be steering the sovereign debt regime in a more uncertain and debtor-friendly direction.[154] Support for these Principles, he suggests, was likely aided by their voluntary and relatively ambiguous nature. But have they had any impact on actual debt restructuring processes? Raymond Ritter claims

[149] Setser, 'The Political Economy of the SDRM.'
[150] Anna Gelpern and Mitu Gulati, 'The wonder-clause,' *Journal of Comparative Economics* 41(2013): 367-385, p. 372.
[151] Ibid, p. 371.
[152] Taylor, *Global Financial Warriors*.
[153] Raymond Ritter, 'Transnational Governance in Global Finance: The Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets', *International Studies Perspectives* 11(2010): 222-241. See also Helleiner, 'Filling a Hole in Global Financial Governance?'
[154] Ibid.

that the Principles have been an effective governance tool, but his faith that this true is based on little evidence beyond what the IIF itself has said.[155]

These accounts point to several factors that also played a role in recent initiatives. Most importantly, US power and preferences remained central in both constraining the hard-law ambitions of the UN proposal and promoting recent contract reforms. US opposition to a hard-law framework also continued to reflect some of the concerns identified in the early 2000s, such as sovereignty concerns. Moreover, despite the UN initiative being driven by debtors, these states ultimately failed to forge a coherent vision for reform—a problem Helleiner identified in past initiatives.

But existing accounts also fail to explain important aspects of recent outcomes. By focusing on US power within the IMF as the key source of American leverage over the SDRR, they do not tell us how the US (not to mention the UK) was able to constrain an initiative that took place within the UN General Assembly, where it lacked veto power. And although debtor states were unable to establish a coherent vision for reform in the UN case, they were held back mostly by sovereignty considerations rather than the borrowing-cost concerns highlighted in previous accounts. Moreover, while a few scholars have analyzed the IIF's Principles, these accounts stress contextual factors, offering little guidance on the 2015 UN Principles and whether we should expect this soft-law arrangement to have an impact on future debt restructurings. The lack of literature on the Fund's 2002 reform leaves even less of a path to follow for understanding recent changes to IMF lending rules. The best one can do here is use the actions and statements of officials involved in that earlier episode as a guide.

Existing literature also struggles considerably to make sense of recent contract reforms. Scholars treat the emergence of the original CACs largely as a one-off event shaped by idiosyncratic factors—the conservative ideology of Bush-era officials, the need for a symbolic solution to big bailouts, the strategic action of debtors and creditors in response to the SDRM. These factors fail to explain the re-emergence and strengthening of contracts in the more recent historical context and in response to new challenges. To the extent that existing accounts point to a particular aspect of CACs that might have made them attractive both in the early 2000s and recently, it is their market-oriented nature,

155 Ritter, 'Transnational Governance in Global Finance.'

which resonates with broader regulatory preferences in the neoliberal era.[156] But these explanations fail to capture the specific *legal* characteristics that make private-law contract mechanisms—rather than some other market-based approach—particularly well-suited for governing the SDRR.

In sum, explanations of the early 2000s provide some important foundations to build upon, but they also leave many questions unanswered. They offer useful but partial guidance on the UN initiative, no explanation of IMF reforms, and limited insight into recent contract changes. As emphasized in the introductory chapter, few scholars have analyzed the recent SDRR reforms themselves. But there are a small number of analyses that speak to these initiatives. What do they tell us about the cases examined in this dissertation?

### *4.2 Explanations of Recent Reform Outcomes*

To my knowledge, there are no books or articles dedicated to explaining the recent UN and IMF reform outcomes.[157] What exists instead are a few policy-oriented papers as well as brief discussions within more broadly focused works. These sources reinforce the idea that private creditors and the states in which they reside oppose the type of hard-law restructuring regime proposed within the UN, pointing to the sort of distributional, sovereignty, and collective action issues that frustrated previous initiatives.[158] They also suggest that recent IMF reforms were driven by the political preferences of powerful states rather than the sort of technocratic considerations often associated with Fund policy.[159] Eichengreen and Woods also note, more specifically, that IMF lending rules face a 'credible commitments' problem—a diagnosis supported by the analysis laid out in chapters 3 and 4.[160]

There is slightly more written about recent contract changes, thanks mostly to Gelpern and her co-authors. Analyzing the introduction of the new Eurozone CACs (discussed in Chapter 6), Gelpern and Gulati again emphasize the role of contracts as a symbolic rather than technical tool, this time serving the interests of Eurozone political elites looking to signal a new approach to crisis management

156 Soederberg, 'The Transnational Debt Architecture and Emerging Markets'; Helleiner, 'Filling a Hole in Global Financial Governance?'
157 The one exception here is an article I co-authored which outlines some of my earlier thinking on these reform initiatives. See Brooks and Helleiner, 'Debt politics as usual?'
158 Li, 'The Long March towards an International Legal Framework for Sovereign Debt Restructuring.'
159 Schadler, 'Unsustainable Debt and the Political Economy of Lending'; Schadler, 'Living with Rules'; Blustein, *Laid Low*.
160 Eichengreen and Woods, 'The IMF's Unmet Challenges.'

in the wake of the Greek debt debacle.[161] From their perspective, CACs were deployed in Europe—where they previously did not exist—not to end bailouts and solve the technical challenges of restructuring, but instead to send multiple messages to different audiences simultaneously. For voters in surplus states such as Germany, CACs symbolized a new burden-sharing agreement whereby private creditors would be made to contribute more to the resolution of future crises. In sending the same message to private creditors, policymakers hoped that CACs would also instill greater discipline in European sovereign debt markets, particularly those in periphery countries. At the same time, CACs were framed as a pragmatic, market-friendly approach to restructuring, signaling to investors that more radical alternatives, such as a SDRM-style bankruptcy framework, would not be pursued.

Gelpern, Heller, and Setser also examine the recent Treasury-led contract initiative, which resulted in the implementation of the most robust CACs to date in the international bonds of dozens of EMDE debtors.[162] A striking feature of this initiative was that, despite introducing a significantly stronger mechanism than the original CACs, the political process of reform was much smoother and more cooperative than the early 2000s, with debtors and creditors quickly embracing contract reform this time around. While Gelpern and colleagues are predominately concerned with describing this reform process and the technical features of these new CACs, they briefly suggest a few possible explanations for "the relatively smooth introduction of potent contract changes."[163] Their analysis points first to functionalist factors, noting that contract change was a logical response to governance gaps highlighted by the recent Greek and Argentine episodes. This reading of events resonates with the dominant narrative expounded by the policy practitioners involved in the reform initiative.[164] But Gelpern et al. also point to what they call 'substance learning' and 'process learning.' Substance learning came from markets and governments having over a decade of experience with the original CACs, which taught them that this mechanism was "hardly revolutionary" and diminished hardcore resistance to further improvements to the model.[165] Process learning stemmed from the experience of the early 2000s and the lessons for how to successfully bring about a shift in standard contract terms. While both sources

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[161] Gelpern and Gulati, 'The wonder-clause.'
[162] Gelpern, Heller, and Setser, 'Count the Limbs.'
[163] Ibid, p. 111.
[164] DeLong and Aggarwal, 'Strengthening the contractual framework for sovereign debt restructuring'; Zandstra, 'New Aggregated Collective Action Clauses'; Sobel, 'Strengthening collective action clauses.'
[165] Gelpern, Heller, and Setser, 'Count the Limbs,' p. 111.

of learning appear to be promising explanatory factors in this case, the authors dedicate just a single paragraph to each. They also consider learning only in the context of Treasury-led contract reform.

These explanations identify important factors behind recent contract reforms, but they are not fully satisfactory. There is clearly something specific about contract mechanisms like CACs that has enabled them to emerge at different times and in different places where other SDRR reform initiatives have failed or been rolled back. But existing accounts treat each contract reform episode separately and do little to draw systematic connections between them. Nobody, for example, has tried to explain both the Eurozone and the US Treasury-led contract initiatives within an overarching analytical framework. Moreover, if we take the main explanations of contract reform and apply them across cases, they do not provide a sufficiently compelling set of reasons for why contract mechanisms have prevailed rather than some other regulatory arrangement. Purely functionalist explanations ignore the fact that hard-law mechanisms are equally justified on technical grounds but have been ruled-out for deeper political reasons. Symbolic explanations fail to specify what it is that makes contracts, as opposed to some other arrangement such as soft-law principles, a particularly potent symbol in the SDRR.

The lack of a satisfactory explanation of contract reforms, combined with patchy accounts of the UN and IMF initiatives, points to a larger shortcoming in the existing literature as a whole: it provides an inadequate basis for understanding variation in reform outcomes. As observed in Chapter 1, existing studies do not offer the type of in-depth comparison of failed and successful initiatives that would allow them to generate broader insights about the determinants of variation in this domain. But what exactly do current explanations miss? What are the broader blind spots in the literature that prevent us from gaining a clearer picture of variation in recent reform outcomes and the SDRR more generally?

## 5. Larger Gaps in the Literature

In addition to the various gaps identified above, I argue that existing explanations of SDRR reform suffer from three blind spots that limit their ability to explain variation in recent outcomes. First, they fail to distinguish analytically between the *ex ante* mechanisms aimed at triggering debt restructurings, such as the IMF's lending rules, and the *ex post* mechanisms that seek to facilitate the restructuring process once the decision to renegotiate debt has already been made, such as the SDRM and CACs. Scholarly attention has focused overwhelmingly on the latter, to which the lack of analysis of previous or recent reforms to the IMF's lending rules attests. This analytical distinction is crucial to

understanding an important dimension of variation, because trigger and process mechanisms face distinct political challenges and opportunities that go a long way to determining their relative prospects for success. The claim that scholars have neglected the process-trigger distinction requires some unpacking before moving on to the second major omission of the existing literature.

Contrary to my claim, one could argue that the SDRM implied both a trigger and process and that scholars were analyzing both when assessing this proposal. Indeed, one of the features of early SDRM proposals was the ability to authorize payment standstills, which some might interpret as a kind of trigger insofar as it would halt debt repayments at the outset of the announcement to restructure. I maintain, however, that the SDRM was not a trigger mechanism in the way the concept is used here. In my analysis, a trigger mechanism is one that can push or encourage an otherwise reluctant debtor to initiate a restructuring in the first place. The SDRM, as it was proposed, could only be activated at a debtor country's request. In the absence of lending rules that prevented the IMF from financing insolvent states, a debtor government could still request and be granted an IMF loan, allowing it to avoid (or delay) a potentially costly and reputation-damaging debt restructuring. IMF rules were designed to be a trigger insofar as they would take away the bailout option under certain circumstances, effectively forcing debtors to accept the reality of a restructuring and avail themselves of the SDRM—or, as it turned out, use their CACs. Even though early SDRM proposals envisioned a debt moratorium as soon as a government announced its plan to restructure, this would still have been part of the restructuring process because it would have come after the initial decision to pursue debt relief.

Although it is true that private creditors and debtor states opposed the SDRM partly because they thought it would lead to more restructurings—an outcome that should be associated with a trigger—that is not because the SDRM was in fact a trigger mechanism. Instead, it was because the trigger and process were so tightly coupled in the policy discussions and objectives of the early 2000s that all reform initiatives in this context implied both elements of restructuring, at least to some extent. Recall that creditors also feared that CACs would result in more restructurings, and Gelpern and Gulati's argument that CACs symbolized as much only makes sense in a context where the trigger and process were seen as inseparable and were thus conflated. This context was likely an important part of why scholars did not draw the trigger-process distinction in clearer and more explicit terms. As we will see in the chapters that follow, recent reform initiatives have taken place in a very different context, one in which the trigger and process elements of restructuring have been pulled apart and treated as distinct

aspects of the SDRR that do not necessarily move in tandem. It is therefore increasingly important to understand the distinctive political implications and dynamics of trigger and process mechanisms.

The SDRM did not fail because it was seen as a trigger mechanism (even the debt standstill feature had been dropped from the final proposal that was ultimately rejected), but rather because of its legal-institutional design as an international hard-law restructuring arrangement. This observation brings us to the second significant blind spot of existing literature: its inattention to how different process-oriented mechanisms would complement or clash with the current legal foundations of the sovereign debt regime. Understanding the degree of compatibility between prospective and existing institutional arrangements is key, I argue, to making sense of variation *within* the category of process mechanisms. While hard-law schemes clash with existing legal arrangements in ways that are politically unacceptable to powerful capital-exporting states, private-law contract mechanisms like CACs are compatible with prevailing arrangements—like clicking new Lego blocks onto an existing Lego structure—which makes them a politically useful tool for institutionalizing the debt restructuring process. Beyond the contrasting political prospects of hard-law and private-law contract designs, I also suggest that soft-law restructuring arrangements can, depending on their content, clash with existing legal structures in ways that provoke political opposition from dominant states. (But soft-law restructuring rules also face functional challenges unrelated to their fit with the existing legal foundations of the debt regime.)

The third and final major gap in the existing literature relates to the role of historical legacies and processes—particularly surrounding the reform initiatives of the early 2000s—in shaping recent outcomes. While we would not expect scholars studying the early 2000s to have anticipated the significance of that period for later reform initiatives, historical and temporal factors are nevertheless important to understanding variation in recent regulatory outcomes. As I show in subsequent chapters, contract reforms in the early 2000s laid the groundwork for the strengthening and spreading of this model more recently, while the earlier SDRM debate only reinforced US opposition to a hard-law regime. Historical experience and policy sequencing also played an important role in incrementally weakening the 2002 IMF lending rules and their capacity to serve as an effective trigger mechanism. To be sure, Gelpern et al. point to elements of policy learning that link earlier contract reforms to the recent Treasury-led initiative to strengthen EMDE bond contracts. I build on their basic insight by examining the broader role of historical legacies, including learning effects, and extending the analysis to Eurozone reforms as well as, to a lesser but important extent, the UN and IMF initiatives.

## 6. Conclusion: What Lies Ahead

The next chapter develops an analytical framework for understanding regulatory variation in recent reform outcomes—and the SDRR more generally—by filling these three gaps in the existing literature. Rooted in the power and preferences of the core actors outlined in Chapter 1, this framework explains variation in terms of first, the *process versus trigger distinction* and, second, the *legal-institutional design* of different process-focused regulatory mechanisms. It suggests that an effective trigger mechanism is hard to institutionalize because of the time-inconsistent preferences of powerful capital-exporting states, as well as their more general desire—expressed most strongly by the US, supported by debtors and creditors, and amplified by recent experiences—for case-by-case decision-making when it comes to whether and when to trigger a debt restructuring. Compared to the trigger, it argues that some, but not all, process mechanisms have greater odds of success. Hard-law designs face huge political opposition from capital-exporting states. Soft-law tools too can encounter political challenges—as did the UN principles—but are also of dubious effectiveness in the SDRR. By contrast, private-law contracts provide politically useful mechanisms for navigating the trade-offs of regulating debt restructuring, especially for the dominant states that disproportionately shape outcomes in this arena. I also argue that historical factors have played an important role in shaping recent reform outcomes, most notably in the contract reform episodes. But I suggest that historical legacies and processes have exerted influenced mainly through their ability to further enhance or diminish the prospects of mechanisms whose political palatability had already been determined by their underlying attributes.

# CHAPTER 3

## Players, Preferences, and Power in the SDRR

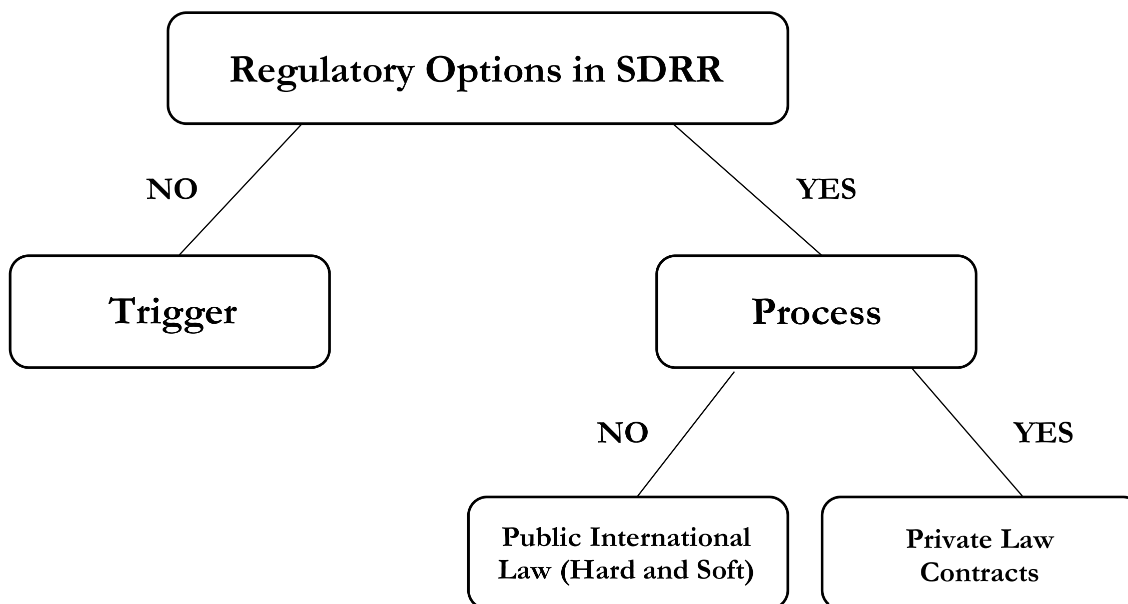
### 1. Introduction

This chapter provides an in-depth discussion of the core players in the SDRR, their preferences regarding different regulatory options, and their power to promote their desired outcomes within and across international decision-making venues. In doing so, it lays a theoretical basis for understanding the determinants of variation in the outcomes of recent sovereign debt restructuring reform initiatives. It highlights the power and preferences of the leading capital-exporting states—most importantly the US—as the primary determinants of outcomes within and across regulatory initiatives, and the power and preferences of sovereign debtors and private creditors as secondary factors that take on greater importance at particular moments. I also include a brief discussion of IMF staff preferences and power within the Fund, for they play a notable role in the reform processes analyzed in Chapter 4.

The various sections of this chapter represent pieces of a bigger puzzle that, when put together, provide a framework for understanding regulatory variation in the SDRR. The chapter thus provides the foundations for understanding the different branches of the feasibility tree presented in Chapter 1 and reproduced below, through which each case study can be visualized and understood. It supports the broader argument that: (1) efforts to institutionalize an effective *trigger* mechanism for sovereign debt restructuring face powerful political barriers that frustrate this objective, whereas (2) the debt restructuring *process* is subject to a different and less constraining set of political considerations that make possible the establishment of more effective process-oriented regulatory mechanisms, but (3) there remains variation in the relative success/failure of different process-oriented mechanisms, which can be explained by the *legal-institutional design* of the specific mechanism in question. The weakening of the IMF trigger mechanism through reforms examined in Chapter 4 reflect this reality, as does the failure of the UN reform initiative studied in Chapter 5 (which failed because of the legal-institutional design of the reforms in question) and the success of bond contract reforms analyzed in Chapter 6 (which succeeded due to both their process-orientation and their design features). This chapter also specifies the role that historical legacies and processes have played in helping to steer reform initiatives toward the outcomes described above (and in line with what we would expect based on the process-trigger distinction and the role of legal-institutional design). In unpacking the players, preferences, and

power dynamics that underpin my argument, I draw upon and contribute to broader conversations within IPE and global governance, engagements which are highlighted near the end of the chapter.

**Figure 2: The Feasibility of Different Regulatory Options in the SDRR**




The regulatory preferences of the various actors are informed by, but not directly derived from, their material positions in the global financial order. Actors evaluate regulatory arrangements in terms of the anticipated impact on their material interests, but perceptions of how particular rules and mechanisms serve or threaten their interests can change over time as a result of historical experience and/or changes in the context in which existing rules are implemented or new rules are made. How do we know what different actors want in the first place? In this chapter and in the dissertation more generally, preferences are derived from a combination of deduction and 'revealed preferences.' The preferences of sovereign debtors, private creditors, and capital-exporting states are deduced from theory and empirical evidence on the impacts of sovereign debt restructuring and the incentives these impacts produce in terms of regulatory arrangements. (IMF staff preferences are also deduced from prior literature on the IMF.) What we would expect these different actors to want is then generally reinforced by their revealed preferences—that is, what they do and what they say they want.

The next section of this chapter unpacks the preferences of capital-exporting states with respect to, first, a trigger mechanism and, second, different process mechanisms. After that, the chapter turns to

the preferences of sovereign debtors and private creditors, looking first at factors relevant to their policy stances on trigger arrangements and then moving on to process mechanisms. The preferences of IMF staff regarding an IMF trigger mechanism are then briefly considered. The following section discusses the power that various actors have to shape reform outcomes in line with their preferences. It organizes the discussion around the specific decision-making venues in which recent SDRR reform initiatives took place, recognizing that the venue and type of initiative unfolding within it can influence the roles and capabilities of different actors. I then highlight how the analysis of power and preferences draws upon and contributes to IPE and global governance literatures, and a final section concludes.

Before proceeding, it is worth briefly reiterating the trigger-process distinction. The trigger stage is defined by the initial decision of whether and/or when to restructure debt. A trigger mechanism is one that can push or encourage a debtor to initiate a restructuring on the basis of some pre-defined rules that justify such debt relief. The process of restructuring sovereign debt is separate from any mechanism or set of considerations that might trigger that restructuring in the first place. The process involves the renegotiation of debt between the sovereign and its creditors and the legal procedure that finalizes any agreement they reach. It occurs *after* the decision to initiate a debt workout has been made and constitutes a distinct stage in the overall debt restructuring operation. This distinction between the process and the trigger has been overlooked by IPE scholars but, as this dissertation highlights, it is an important one that bears fruitful insights for the study of regulatory variation in the SDRR.[166] It is not, of course, the only important distinction. The political implications of different types of process mechanisms are equally important to understanding the failure and success of recent reform initiatives.

## 2. Preferences

### *2.1 Capital-Exporting States*

#### 2.1.1 Preferences Toward a Trigger Mechanism

The interests of the leading capital-exporting states in whether and/or when particular countries restructure their debt are inseparably linked to their structural position in the global financial system. Starting in the 1960s and accelerating in the 1970s, these states—predominately the US but also the

[166] I am not the first to make the distinction between process and trigger. Leckow and Ams, two IMF staff members, do so in a conference paper on the IMF's experience with debt restructuring. To my knowledge, however, no scholars have yet made this distinction or used any similar classification to analyze the politics of different aspects of debt restructuring. See Ross Leckow and Julianne Ams, 'Sovereign debt restructuring in the IMF experience,' ESCB Legal Conference 2016, European Central Bank (January 2017): 14-22.

UK, Germany, France, and Japan—saw their banking sectors internationalize and become increasingly enmeshed and invested in foreign markets.[167] One of the first major activities through which domestic banking sectors in the West became directly exposed to financial developments in EMDEs was sovereign lending, fueled especially by the petrodollar recycling following the 1973 and 1979 oil shocks.[168] The funding of foreign governments by big banks in New York and London—as well as Frankfurt, Paris, and Tokyo—created direct transmission channels through which sovereign defaults and debt restructurings in distant countries could spread to and destabilize the domestic financial systems of the major capital-exporting states.

These channels and the threats they posed to the financial stability of dominant states became painfully clear with the outbreak of the Latin American debt crisis in the early 1980s.[169] Starting with Mexico in 1982, Latin American states that had borrowed large sums from foreign banks during the 1970s found themselves, one after another, unable to continue servicing their external debts.[170] The prospect of mass defaults or debt write-downs across the region threatened to imperil not only the debtors but also their commercial creditors, particularly a handful of highly vulnerable and systemically important US banks. American officials worried that financial losses for these banks could precipitate their collapse, in turn generating massive financial instability and a broader economic downturn within the US. In this context, protecting the banks by preventing debtor states, especially large borrowers like Mexico and Brazil, from defaulting or writing-off significant portions of their debt became politically imperative for US policymakers.[171] To protect its financial interests, the US government gave bridging loans to debtor states to prevent defaults while they worked out longer-term programs with the IMF.[172] But it was critically important for the US that these IMF programs also help to facilitate debt repayment to private creditors and avoid substantial restructuring.[173]

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[167] Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Cornell University Press, 1996).
[168] David E. Spiro, *The Hidden Hand of American Hegemony: Petrodollar Recycling and International Markets* (Cornell University Press, 1999).
[169] Miles Kahler, 'Politics and international debt: explaining the crisis,' *International Organization* 39(3)(1985): 357-382.
[170] Jeffrey D. Sachs (ed.), *Developing Country Debt and the World Economy* (University of Chicago Press, 1989).
[171] Jeffrey Sachs, 'Managing the LDC Debt Crisis,' *Brookings Papers on Economic Activity* 2(1986): 397-440. See also Stephen S. Golub, 'The Political Economy of the Latin American Debt Crisis,' *Latin American Research Review* 26(1)(1991): 175-215.
[172] McDowell, *Brother, Can You Spare a Billion?*
[173] As McDowell (*Brother, Can You Spare a Billion?*) has pointed out, the US state has often acted more like a true international lender of last resort than the IMF because the latter cannot always provide loans with sufficient speed and/or of sufficient size to protect US financial interests. This does not imply, however, that the IMF's role in addressing sovereign debt crises is any less important in terms of influencing a country's decision of whether and when to restructure its debt. Even when US loans have served as a bridge to longer-term IMF programs, it has been critically important to the US that these IMF programs remain aligned with core US interests. If, for example, the Fund insisted on deep debt relief at a time when US

The Fund prioritized core-country stability over the need for substantial debt relief in borrowing countries. It mobilized new financing that allowed debtors to continue servicing their interest payments but permitted only minimal debt relief through the rescheduling of principal payments. This approach helped protect American and other Western banks, but the debt relief provided by reschedulings was far too shallow to resolve the debt sustainability problems that countries faced, especially as new IMF loans were added to existing debt stocks. After years of repeated reschedulings, the resolution of the crisis finally came via the 1989 Brady Plan, which provided significant debt reduction only after the risk of financial instability in capital-exporting states had subsided. In the end, the IMF's role in the 1980s helped safeguard the financial interests of its largest shareholders, but it damaged the organization's image as a neutral and effective crisis manager. Critics accused the Fund of being an instrument of American power and serving as a "bill collector for the banks."[174]

The 1980s debt crisis is an instructive episode, but it is not the only time that major capital-exporting states have sought to discourage or delay debt restructurings in foreign countries to safeguard their own financial stability. Most recently, France and Germany deemed it imperative that Greece not restructure its debt at the outset of its crisis, fearing that write-downs on Greek debt would endanger French and German banks and unleash financial mayhem in their domestic economies and throughout Europe more broadly. These episodes underscore the more general point: because the leading capital-exporting states are home to many of the largest and most important banks and investors that provide credit to foreign governments, they are bound to face situations in which debt restructuring abroad threatens to trigger financial instability at home by inflicting losses on domestic firms.[175]

To be sure, there are additional reasons why dominant states might want to spare a sovereign borrower from a restructuring. Debt write-downs act as a wealth transfer from creditors to debtors and thus

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bank exposure to the debtor country in question remained high, it would present a challenge to the overall crisis management strategy designed to preserve US domestic financial stability. The US or other major capital-exporting states with such stability concerns could, in principle, seek to sideline the IMF altogether if the organization refused to accommodate their interests, but this would involve foregoing the benefits of 'multilateralizing' sovereign debt crisis management and the conditionalities that go along with it. Moreover, sidelining the Fund in this way has not been necessary for major capital-exporting states, for they have sufficient power to influence IMF decisions from inside the organization.

[174] Sturzenegger and Zettelmeyer, *Debt Defaults and Lessons from a Decade of Crises*, p. 23.

[175] IPE scholars have made similar points about the domestic financial stability implications of foreign financial crises. Focusing largely on large-scale liquidity crises, McDowell argues that domestic financial stability concerns have been the key motivating factor behind US emergency loans to foreign governments and central banks. See McDowell, *Brother, Can You Spare a Billion?*

have negative distributional consequences for lenders and the societies in which they are located. There might also be a geopolitical rationale for trying to avoid the financial turmoil associated with debt workouts. These factors likely influence responses to certain crises, but there is little reason to believe that distributional and geopolitical concerns systematically make restructuring unacceptable to capital-exporting states in the way that financial stability concerns do. Moreover, given the degree of economic interdependence among the major advanced economies, we would expect the preferences of capital exporters to more-consistently converge when it comes to issues of systemic stability, even if the stakes are higher for some than others. This convergence, in turn, raises the odds that dominant states will cooperate in shaping the terms of IMF lending in such critical cases. Although stability issues may arise less frequently than distributional or geopolitical ones, they provide a much stronger rationale and set of political pressures to avoid, delay, or minimize restructuring when they do spring up. For these reasons, I focus on the financial stability implications of the IMF's trigger mechanism.

How do the structural factors described above shape the preferences of capital-exporting states vis-à-vis a trigger mechanism? Based on preceding discussion, we might expect all capital exporters to prefer a case-by-case approach to IMF lending, one that would allow the Fund to deploy resources in ways that helped protect their financial interests when needed. Indeed, the US has historically preferred this kind of discretionary approach. Yet as the debates of the 1990s showed, European officials have not always shared this preference. Moreover, American policymakers broke from their historical preference and moved toward the European position in favour of lending rules in 2002. Material positions in the global economy thus do not automatically translate into policy preferences that are fully consistent across all major capital-exporting states or across time.

Nor do capital-exporting states look to prevent debt restructurings everywhere and always. In many cases, a debt workout poses little risk to financial stability in these states and is recognized as necessary for resolving otherwise intractable crises. Moreover, capital exporters are not all alike. They have different levels of exposure to different countries at different times, contributing to sometimes divergent conceptions of the costs and benefits of restructuring, whether at a particular moment or over a longer period of time. Their views on the desirability of debt restructuring can also be influenced by distinct ideational factors. For example, compared to other capital exporters, Germany has more consistently emphasized the costs of bailouts in terms of taxpayer resources and moral hazard and the benefits of making the private sector share the burden of crisis resolution through debt restructuring.

Material conditions do not directly map onto preferences because they are mediated by ideas that translate them into actionable policy positions.[176] For example, US and European (especially German) support for firm lending rules in the early 2000s was motivated by causal convictions about how these rules would impact the likelihood of future crises. Officials believed that IMF bailouts had market-distorting effects and that credible lending constraints could correct these distortions. If the new rules succeeded in introducing greater market discipline, they would help prevent financial crises from occurring in the first place and thus diminish demand for IMF bailouts.[177] For Europeans, these beliefs dovetailed with perceptions of their interests vis-à-vis the US. From their perspective, IMF bailouts had primarily benefitted American financial interests and thus tying their hands through stricter lending rules would be worth it if it also meant constraining the US.[178] European states had different domestic political economies and different levels of exposure to different countries compared to the US. Thus, despite being large capital exporters, they did not see themselves as susceptible to the same risks and destabilizing tendencies as American finance.

However, how officials believe a given institutional arrangement will affect their interests and how it actually does or appears to at some future point in time can be very different. When such dissonance occurs, it can give rise to preferences that are inconsistent at different moments in time. This *time-inconsistency* problem is a particularly acute feature of IMF lending rules because of the structural position of capital-exporting states and the intensity of their occasional short-term interests in averting or delaying foreign debt write-downs to preserve domestic financial stability.[179] Lending rules are bound to sometimes prescribe restructurings in cases where dominant states would prefer to prevent or postpone them. When such cases arise, these states will seek to influence IMF lending in ways that accommodate their short-term interests.

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[176] Abdelal, Blyth, and Parsons (eds.), *Constructing the International Economy*.
[177] See Taylor, *Global Financial Warriors*.
[178] Roubini and Setser, *Bailouts or Bail-Ins?*
[179] The concept of time inconsistency, sometimes called dynamic inconsistency, has been used to analyze various domains of social life but is best known in the field of economics, particularly as it relates to monetary policy debates. For the classic text on this issue, see Finn E. Kydland and Edward C. Prescott, 'Rules Rather than Discretion: The Inconsistency of Optimal Plans,' *Journal of Political Economy* 85(3)(1977): 473-492. For a broader discussion of time inconsistency and its application to monetary policy, see Yves Mersch, 'Monetary policy and time inconsistency in an uncertain environment.' Speech given at the NOBELUX Seminar, Luxembourg, September 11, 2006. For an application of the concept to international politics, see Jon Hovi, Detlef F. Sprinz, and Arild Underdal, 'Implementing Long-Term Climate Policy: Time Inconsistency, Domestic Politics, International Anarchy,' *Global Environmental Politics* 9(3)(2009): 20-39.

The issue of time inconsistency was recognized by policymakers involved in creating the 2002 rules. As John Taylor acknowledged after the 2002 framework had been established:

> applying the [IMF lending] limits in actual cases would be the most difficult part of all, for in reality policymakers would be under heavy pressure to provide a bailout in a given situation even if they had agreed earlier not to provide such a bailout in those same circumstances.[180]

But policymakers like Taylor hoped that the constraint imposed by the 2002 lending rules would be made credible if they simultaneously improved the debt restructuring process. Their theory was that the pressure to avoid debt workouts came largely from the messy and unpredictable nature of the restructuring process, and that this pressure could be substantially mitigated by smoothing that process through a SDRM or CACs.[181] While this thinking addressed one source of pressure, it ignored the less constant but much bigger source that came not from debtors and creditors wanting to avoid an unruly process but from capital-exporting states whose financial sectors could be put at risk from the very act of writing-down debt in the first place—no matter how quickly or smoothly the restructuring went.[182] Without addressing the latter pressures, the 2002 mechanism and its commitment to trigger restructurings was bound to face strong political headwinds when it eventually ran up against the interests of dominant states. The 2002 rules thus faced what institutional theorists call a 'credible commitment' problem.[183]

In 2010, the time-inconsistency problem materialized as powerful European states that had been strong proponents of the 2002 lending rules insisted on ignoring those rules to avoid/delay a Greek debt restructuring that threatened their domestic financial interests. In this context, the IMF created a loophole in the rules that allowed it to lend without requiring a debt restructuring in Greece. As Chapter 4 argues, this fateful episode significantly weakened the credibility of IMF lending rules and their capacity to trigger restructurings when powerful states oppose debt relief. It forcefully revealed

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180 Taylor, *Global Financial Warriors*, pp. 106-107.
181 Ibid.
182 It is important to note that creating a more orderly restructuring process would not really quell pressures from debtors and creditors to avoid restructuring, which would remain costly even in the context of a smoother process.
183 Eichengreen and Woods made this point in a recent article about the various challenges the Fund faces. See Eichengreen and Woods, 'The IMF's Unmet Challenges.' For a more general discussion of credible commitment issues, see: Douglass C. North, 'Institutions and Credible Commitment,' *Journal of Institutional and Theoretical Economics* 149(1)(1993): 11-23; Brett Ashley Leeds, 'Credible Commitments and International Cooperation: Guaranteeing Contracts Without External Enforcement,' *Conflict Management and Peace Science* 18(1)(2000); Michael Breen and Iain McMenamin, 'Political Institutions, Credible Commitment, and Sovereign Debt in Advanced Economies,' *International Studies Quarterly* 57(4)(2013): 842-854.

that, based on their structural position in the global financial order, major capital-exporting states—not only the US but also European powers—are occasionally exposed to spillovers from foreign debt workouts, and that when such moments arise, these states will look to shape Fund lending decisions in ways that discourage or delay debt restructuring, no matter how clear the restructuring rules or how desperate the crisis country's need for debt relief. These structural realities and the pressures they sometimes generate imply that any commitment to a rules-based trigger mechanism will be subject to time-inconsistent preferences that undermine its credibility, especially after the 2010 reform episode.

The 2010 clash between the IMF's lending rules and the material interests of states that had previously advocated for those rules did not simply reflect time-inconsistent preferences that diverged from the rule-creation (2002) to the rule-implementation (2010) stage of the policy process; it also shifted state preferences in ways that came to inform subsequent IMF reform processes and outcomes. More specifically, I argue that experience with the IMF rules—including the 2010 decision to change those rules to avoid debt restructuring—in the context of unprecedented financial crises only reinforced the preference for a more flexible, case-by-case approach to lending among those who traditionally held that position (namely the US), and diminished the enthusiasm for re-introducing strict lending rules among those who had previously promoted them. Even the staunchest advocates of strong rules had gained a new appreciation for the value of assessing crises on a case-by-case basis. While some states and domestic factions within states remained stronger proponents of firm rules than others, the balance of forces had very much shifted in favour of greater flexibility and discretion. Thus, when the design of the IMF's lending rules was revisited from 2013-2016, the end result of the reform process was to weaken the content of the trigger mechanism compared to its 2002 incarnation. New rules unveiled in 2016 provide enough room to maneuver that powerful states will be able to influence IMF lending in ways that protect their financial sectors and interests without formally breaking the rules.

In sum, the potential for sovereign debt restructurings to generate financial instability in core capital-exporting states has shaped the latter's preferences toward IMF lending reforms in 2010 and 2016, underscoring the enormous political difficulties of institutionalizing an effective trigger mechanism.

#### *2.1.2 Preferences Toward Different Process Mechanisms*

The leading capital-exporting states have an interest not only in whether and when foreign states restructure their debts, but also in the legal-institutional arrangements that govern global investments

during normal times, including sovereign debt investments. Here, I follow in the footsteps of scholars who argue that the leading exporters of private capital—particularly the US and UK—have a longstanding interest in establishing and maintaining transnational contract law and private property rights. Charles Lipson demonstrated this in his study of British and American efforts in the nineteenth and twentieth centuries to forge international property rules to protect their overseas investments.[184] Jeffry Frieden put the point in more general terms, arguing that the main capital exporters have an interest in maintaining a financial order characterized by the free movement of capital across borders. To maintain confidence in the safety of overseas investments, capital-exporting states thus seek to ensure "the adjudication and enforcement of property rights across borders" and, as such, take the lead in "developing international contract law and a mechanism to enforce it."[185] Critical political economists make a similar but broader point. Leo Panitch and Sam Gindin, for example, showed how the US took the lead in creating the conditions for global capitalism in the post-World War Two era, including through the establishment of institutional frameworks to "maintain property rights, oversee contracts, stabilize currencies, reproduce class relations, and contain crises on a global scale."[186]

In sovereign debt relations, the leading capital-exporting states have not developed international contract law but rather made available, and thus internationalized, their own domestic contract laws and enforcement mechanisms. Today, roughly 96 percent of international sovereign bonds are issued in either New York or London and thus governed by American or English laws and courts.[187] While the centrality of these jurisdictions is linked to their historical evolution as global financial centers, American and British governments have also cultivated the role of their legal systems in anchoring transnational property rights in the sovereign debt regime. In the late 1970s, both passed legislation—the US Foreign Sovereign Immunities Act (FSIA) of 1976 and the United Kingdom State Immunity Act of 1978—that allowed foreign governments to be sued in their domestic courts when such governments had engaged in commercial transactions or waived their immunity in a contract. Mark Weidemaier shows that one of the main purposes of the FSIA was to depoliticize sovereign bond

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[184] Charles Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (University of California Press, 1985).

[185] Jeffry A. Frieden, 'Capital Politics: Creditors and the International Political Economy', *Journal of Public Policy* 8(3/4) (1988): 265-286, 272.

[186] Sam Gindin and Leo Panitch, *The Making of Global Capitalism: The Political Economy of American Empire* (Verso, 2012), p. 1.

[187] IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts.'

disputes by channeling them into the courts.[188] Debtors responded in a way that further depoliticized debt disputes: by waiving their sovereign immunity from lawsuit in virtually all new bonds issued in New York and thus agreeing to be treated like private commercial actors.[189]

The resulting system was one in which New York and English laws and courts came to anchor transnational property rights in sovereign debt contracts. This situation benefits the US and UK in three ways. First, it attracts business to New York and London and thus provides economic benefits. EMDE governments issue debt and waive their immunity to be sued in these foreign jurisdictions because doing so bolsters their commitment to repay and allows investors to seek legal remedies in the event of a default.[190] This makes sovereign bonds issued under New York or English law a safer and more attractive investment for global investors, which in turn lowers a sovereign's borrowing costs compared to issuing debt under its own local laws.[191] Issuing, paying, and rolling over bonds placed in New York or London then generates significant business for a number of actors in these financial centers, including the corporate law firms that write contracts and structure deals, the multinational banks that serve as underwriters and trustees/fiscal agents, and a variety of asset managers and institutional investors that buy and trade sovereign debt securities. In short, the legal and market configuration of the sovereign debt regime provides commercial gains for the US and UK.

Second, existing legal structures provide a solid basis for cross-border contract rights and thus serve US and UK interests as leading exporters of private capital. While this legal regime does not guarantee the enforcement of sovereign debt contracts, it does help stabilize market expectations by embedding complex debt relations within clear and seemingly apolitical rights and obligations and providing predictable legal avenues for dispute settlement. The fact that "politics is barely visible in today's sovereign debt restructuring regime" is important and largely intentional.[192] The US government has long sought to remove politics from the SDRR, both to insulate politicians from having to deal with debt disputes and because, in the sovereign debt regime, "politics can be a source of uncertainty."[193]

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[188] W. Mark C. Weidemaier, 'Sovereign Immunity and Sovereign Debt', *University of Illinois Law Review* 1 (2014): 67-114.
[189] Ibid.
[190] Ibid. See also Schumacher, Trebesch, and Enderlein, 'Sovereign Defaults in Court.'
[191] Marcos Chamon, Julian Schumacher, and Christoph Trebesch, 'Foreign-Law Bonds: Can They Reduce Sovereign Borrowing Costs?' ECB Working Paper No. 2162 (2018).
[192] Anna Gelpern, 'The Strained Marriage of Public Debts and Private Contracts', *Current History* 117(795) (2018): 22-28, p. 22.
[193] Ibid, p. 28.

Of course, sovereign debt disputes and restructuring decisions are intensely political, but US and UK courts sweep politics under the rug by ruling according to a straightforward application of domestic contract law.[194] A judge's job here is not to adjudicate a sovereign bankruptcy process; it is simply to enforce the terms of the debt contract, typically ruling in favour of creditors who litigate for full repayment after a sovereign default or debt restructuring.[195] In short, US and UK domestic laws and courts provide useful legal foundations for transnational property rights in the sovereign debt regime, giving investors a greater sense of predictability and protection vis-à-vis their cross-border bond investments. In providing a stable basis for profitable sovereign debt markets, existing legal structures benefit investors and the main capital-exporting states in which many of them are located.

The third broad benefit that the US and UK derive from current legal and market arrangements is *structural power* over important developments in the SDRR. Susan Strange described this form of power as the capacity to shape the global structures within which other states and market actors have to operate.[196] In sovereign debt, the centrality of New York and English law enables legislators in the US and UK to unilaterally shape the rules of the international sovereign debt regime by changing domestic laws. For example, in 2010 the UK parliament enacted a law that prohibited creditors from using British courts to sue states that had received debt relief via the Heavily Indebted Poor Countries (HIPC) Initiative.[197] The US and the UK's structural position also allows their policymakers to block unwanted initiatives aimed at governing international sovereign debt simply by refusing to participate in them. A regulatory agreement that did not include these two states would fail to cover the vast majority of internationally-issued sovereign bonds, making it a rather useless tool for governing these markets. While scholars have written about structural power in other areas of global money and finance, this dissertation is the first to highlight its foundations and implications in the SDRR.[198]

These features of the current system shape US and UK preferences toward different process-oriented restructuring mechanisms. First consider hard-law arrangements such as the SDRM or the framework

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[194] Michael Waibel, *Sovereign Defaults before International Courts and Tribunals* (Cambridge University Press, 2011).
[195] Lee Buchheit, 'Sovereign debt restructurings: the legal context,' BIS Papers (January 8, 2013).
[196] Susan Strange, *States and Markets* (Pinter Publishers, 1988).
[197] Debt Relief (Developing Countries) Act 2010, c. 22 (UK).
[198] For example, see Eric Helleiner, 'Structural Power in International Monetary Relations,' EUI Working Papers RSCAS No. 2005/10. Martijn Konings, 'The institutional foundations of US structural power in international finance: From the re-emergence of global finance to the monetarist turn', *Review of International Political Economy* 15(1)(2007): 35-61. Matthias Kaelberer, 'Structural Power and the Politics of International Monetary Relations,' *The Journal of Social, Political, and Economic Studies* 30(3)(2005): 333-359.

recently proposed in the UN. By establishing international legal procedures for breaking or changing the original payment terms of debt contracts, these kinds of mechanisms would override the existing domestic legal foundations of the debt regime, thereby threatening the power and privileges that the US and UK derive from the current order. They would trump the sovereign authority of the states in which debt contracts are governed, but also the legal frameworks that anchor investor rights in the debt regime, introducing new sources of legal and political uncertainty in important financial markets.

As discussed earlier, some scholars noted that the US opposed the SDRM because of its sovereignty implications.[199] As Gelpern and colleagues note: "For most U.S. officials, the idea that a treaty could trump financial contracts under New York law or that an international body could trump U.S. courts was simply unacceptable."[200] But they did not elaborate on what sovereignty meant for the US in the context of the sovereign debt regime. Here, sovereignty is not about autonomy from international forces. It is instead about maintaining the dominant position of one's national systems within broader global structures and processes. As globalization scholars have stressed, global processes are embedded and articulated within distinct national spaces, which act as nodes in broader transboundary networks.[201] In globalized sovereign debt markets, sovereignty for the US and the UK is about defending the privileged position of the two most critical nodes: New York and London.

But preserving the domestic legal foundations of the international debt regime is about more than sovereignty. It is also about maintaining a regime governed by commercial law and not politics—one that provided predictability about the legal status of cross-border investments and thus a stable backdrop of expectations against which US and other investors could transact. The leading capital-exporting states—the US in particular—have worried that an international hard-law mechanism would overly politicize debt restructuring and create new legal uncertainty in sovereign bond markets because of its ability to trump private contracts and authorize debt write-downs based on a process that creditors had not directly consented to. For these states, treaties are a useful mechanism in other areas of investment and trade, where they help entrench investor rights in international law.[202] But they are

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[199] Hagan, 'Designing a Legal Framework'; Gelpern, Heller, and Setser, 'Count the Limbs.'
[200] Gelpern, Heller, and Setser, 'Count the Limbs,' p. 114.
[201] Jan Aart Scholte, *Globalization: A Critical Introduction* (Palgrave Macmillan, 2000); Saskia Sassen, *The Global City: New York, London, Tokyo* (Princeton University Press, 2001); Saskia Sassen, 'Embedded borderings: making new geographies of centrality,' *Territory, Politics, Governance* 6(1)(2018): 5-15.
[202] Several scholars analyze and document the proliferation of international trade and investment treaties that protect cross-border investor rights. For example, see Zachary Elkins, Andrew T. Guzman, and Beth A. Simmons, 'Competing for

inappropriate for sovereign debt restructuring, where they would provide an international legal basis for trumping those rights and the domestic legal systems that uphold them.[203]

For the capital-exporting states that look to protect cross-border investor rights, the task of regulating the restructuring process presents a basic dilemma. By its nature, debt restructuring involves changing or breaking contract terms and challenging creditor property rights, so efforts to institutionalize this process through new legal mechanisms could contradict or supersede the sources of law that safeguard those contract terms and property rights in the first place. The problem is that of a clash between two separate legal systems with their own distinct objectives: a domestic/transnational contract law system, and an international debt restructuring system. A supranational sovereign bankruptcy process might improve the latter but at the expense of the former, which US and UK decision-makers are bound to prioritize due to the benefits they derive from the current order. These states are thus likely to oppose hard-law reforms to the SDRR—as seen during the UN initiative examined in Chapter 5.

And yet, the US government and other capital exporters have long expressed an interest in improving the efficiency and predictability of the sovereign debt restructuring process.[204] For American officials, dealing with deficiencies in the current system has become even more pressing in recent years, as some have grown concerned that recent holdout creditor litigation against Argentina could set destabilizing legal precedents that undermine New York's central position in international sovereign debt markets.[205] So how have capital exporters reconciled their interest in preserving existing legal structures with their objective of creating a more orderly and predictable debt restructuring process? They have

Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000,' *International Organization* 60(2006): 811-846; Tim Buthe and Helen V. Milner, 'The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements?' *American Journal of Political Science* 52(4)(2008): 741-762; Yoram Z. Haftel, 'Ratification counts: US investment treaties and FDI flows into developing countries,' *Review of International Political Economy* 17(2)(2010): 348-377; Tom Chodor, 'The rise and fall and rise of the trans-pacific partnership: 21st century trade politics through a new constitutionalist lens,' *Review of International Political Economy* (forthcoming); Stefanie Schacherer, 'TPP, CETA and TTIP Between Innovation and Consolidation—Resolving Investor-State Disputes under Mega-regionals,' *Journal of International Dispute Settlement* 7(3)(2016): 628-653; David Schneiderman, 'Investment Rules and the New Constitutionalism,' *Law & Social Inquiry* 25(3)(2000): 757-787.

[203] Rachel Thrasher and Kevin Gallagher even worry that international investment agreements might stifle attempts to restructure sovereign debt by providing private creditors with additional legal protections and avenues to sue debtor governments that go beyond domestic courts and contract laws. See Rachel D. Thrasher and Kevin P. Gallagher, 'Mission Creep: The Emerging Role of International Investment Agreements in Sovereign Debt Restructuring,' *Journal of Globalization and Development* 6(2)(2015): 257-285.

[204] Lee C. Buchheit and G. Mitu Gulati, 'Sovereign debt restructuring and US executive power,' *Capital Markets Law Journal* 14(1)(2019): 114-130.

[205] Sobel, 'Strengthening collective action clauses.'

done so, I argue, through the use of private-law contract mechanisms such as CACs, which provide a politically useful tool for navigating the trade-offs of regulating debt workouts. By embedding the ability to restructure debt into the existing system of contractual rights and obligations, they allow capital-exporting states to create more robust restructuring processes without undermining the authority of their own laws and courts or creating significant legal uncertainty in the system of transnational investor rights. The fact that contract reforms provide restructuring tools that are *embedded within—not located above—existing legal structures* is thus key to understanding the regulatory preferences of the US and other major capital-exporting states in the SDRR. This legally-embedded quality has been a necessary condition enabling the emergence of contract mechanisms in the various reform episodes.

So far, analysis of capital exporters' preferences vis-à-vis different process mechanisms has focused on the US and UK, the former of which remains particularly important for the Treasury-led contract reforms explored in Chapter 6. But it was a different set of capital-exporting states—namely France and Germany—that predominately shaped the Eurozone reform outcome (also examined in Chapter 6). Because German and French laws and courts do not occupy the same central position within the international sovereign debt regime, their governments are not motivated by the same need to select restructuring mechanisms that protect their national power and sovereignty within this regime (although giving up control over questions related to national public debt can raise sensitive sovereignty issues for any country).

These states continue, however, to have a stake in the creation and maintenance of clear and consistent cross-border property rights, especially within the context of *European* sovereign debt markets. Clear investor rights help to stabilize market expectations and calculations about risk, providing a degree of legal predictability around cross-border investments in the absence of a supranational authority to enforce payment obligations. For France and Germany, having well-functioning and highly-integrated financial markets in Europe is important to the regional integration project and to their interests as the Eurozone's leading capital exporters. Both are home to a number of large banks with expansive financial interests and heavy involvement in European bond markets. We would thus expect French and German officials to seek legal-institutional arrangements whose anticipated effects are to stabilize and encourage, rather than destabilize and stifle, the profit-seeking activities of their financial firms.

What we see in Chapter 6 is that the legally-embedded nature of CACs was indeed crucial in shaping US, UK, and Eurozone preferences for contracts over alternative design options. But the role of France and Germany as capital exporters did not lead automatically and immediately to contracts. Germany initially flirted with the idea of a statutory regime while France remained more concerned about the market reaction to any new restructuring mechanism. What made a contract-based approach particularly useful in the end was the crisis context in which Eurozone reform efforts took place. This context further eroded political appetite for a hard-law mechanism that would sow substantial uncertainty in already-shaky European debt markets and bolstered the appeal of a contract mechanism that would rearticulate—rather than trump—private investor rights and thus generate less market turmoil. The European reform process was also complicated by the large number of diverse states—both creditor and debtor states operating in the context of a live crisis—that had to agree upon any change to the Eurozone's financial architecture. In the end, both the legally-embedded and process-oriented nature of CACs were key to securing sufficient political support for this mechanism.

For the leading capital-exporting states, the preference for contract mechanisms and against hard-law arrangements in recent reform initiatives was thus informed by their contrasting legal-institutional designs and how they either complemented or clashed with the existing legal foundations of sovereign debt markets. But the preferences of these states and the reform processes they impacted were also influenced by the historical legacy of the early 2000s. As a result of the debates and outcomes of that earlier episode, US officials knew their preferences toward specific legal-institutional designs as soon as reform discussions arose more recently. As such, they moved immediately to promote contract reforms and refused to even discuss the merits of a hard-law regime, mobilizing political capital in favour of the former and further stifling efforts to establish the latter. Existing CACs established in the early 2000s also provided both US and Eurozone officials with a regulatory model or blueprint they could quickly and easily adopt and adapt to their current challenges. For Eurozone reformers, the fact that CACs were already a well-known mechanism in EMDE debt and were thus less likely to roil already-turbulent European markets compared to more radical reform was also important. Finally, for both US and Eurozone officials, market familiarity with the original CACs increased the utility of further contract reforms as a tool for responding to the uncertainty generated by recent shocks.

The preferences outlined above help to make sense of the weakening of the IMF's trigger mechanism, the failure of the UN initiative to establish a hard-law debt restructuring process, and the success of

contract reforms in strengthening the process dimensions of the SDRR. But what about the soft-law principles that came out of the UN reform process? In Chapter 5, I argue that these principles are unlikely to have much impact because they face both political challenges related to their specific content and functional challenges related to the limitations of soft-law arrangements in the SDRR. The political impediments come from the opposition of powerful capital-exporting states, which have rejected the UN Principles because their normative content questions creditor rights and the authority of US and UK courts—even if only at a rhetorical rather than substantive level. The broader functional limitations of soft law in the SDRR has little to do with preferences and power capabilities and more to do with the specific characteristics of the issue area—a point to which I return in Chapter 5.

### *2.2 Sovereign Debtors and Private Creditors*

Capital-exporting states are not the only actors that matter in the regulatory politics of the SDRR, even if they are the most consequential. Sovereign debtors and the international private creditor community have also impacted recent reform initiatives and outcomes in important ways. Both lobbied for and reinforced the strength of the policy position that ultimately prevailed in recent IMF reforms. Debtor states also played an important role in the UN initiative, leading the charge in favour of a more ambitious hard-law SDRR but also revealing important limitations in their willingness to pursue this kind of regulatory arrangement. Nowhere, however, were the preferences of debtors and creditors more critical than recent contract reforms. Eurozone reforms required the buy-in of the Eurozone's debtor countries and were sensitive to the reaction of creditors, and the US Treasury-led initiative relied heavily upon the cooperation of EMDE debtors and private creditors to bring about contract change. For these reasons, it is important to understand the broad preferences of sovereign debtors and private creditors regarding trigger and process mechanisms for sovereign debt restructuring.

#### *2.2.1 Preferences Toward a Trigger Mechanism*

Debtor states have a strong incentive to avoid defaults and restructurings because of their enormous economic and political costs. This observation is supported by an extensive literature dating back to the early 1980s. Since then, the central question of sovereign debt research has been: in the absence of a formal global enforcement mechanism, why do sovereigns repay their external debts? Starting with Jonathan Eaton and Mark Gersovitz, a number of scholars argued that sovereigns repay in order to establish a good reputation with foreign creditors and thus maintain access to international capital

markets.[206] An alternative explanation, articulated most notably by Jeremy Bulow and Kenneth Rogoff, holds that the threat of sanctions from powerful creditor-country governments is what gives debtors an incentive to repay.[207] If sovereigns refuse to honour their debt obligations, it is not foreign private creditors but rather their governments that will retaliate, with costly sanctions such as the blockage of trade credit and international aid to the debtor country. Whether the mechanism is reputation or sanctions, the message is similar: sovereigns pay their debts because not doing so is extremely costly.

This message is also supported by several empirical studies detailing the consequences of sovereign default, including restructuring, which this literature generally treats as a form of default since it entails not paying the full value of the original obligation. Here, scholars point to the high costs of default for the debtor country's domestic banking system,[208] its broader corporate sector,[209] its productivity,[210] and its general economic output.[211] Research also suggests that defaults have dire consequences for the political survival of incumbent politicians, especially finance ministers.[212] Most of these costs stem from the financial losses and market reaction generated by default. But there is also evidence that the debt restructuring process itself can be inefficient and unpredictable, especially with the recent rise of holdout litigation. Because of these high costs and unpredictable consequences, scholars have argued that political elites in debtor countries will look to exhaust all possible options to avoid restructuring, even when debt relief seems all but inevitable to outside observers.[213] The most promising option for debtor states in this situation is to 'gamble for redemption' by requesting an IMF loan and insisting

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[206] Jonathan Eaton and Mark Gersovitz, 'Debt with Potential Repudiation: Theoretical and Empirical Analysis,' *Review of Economic Studies* 48 (1981): 289-309; Harold L. Cole, James Dow, and William B. English, 'Default, Settlement, and Signalling: Lending Resumption in a Reputational Model of Sovereign Debt,' *International Economic Review* 36 (1995): 365-85; William R. Cline, *International Debt Reexamined* (Washington: Institute for International Economics, 1995); Jonathan Eaton, Mark Gersovitz, and Joseph E. Stiglitz, 'The Pure Theory of Country Risk,' NBER Working Paper No. 1894 (1986); Anatole Kaletsky, *The Costs of Default* (New York: Priority Press, 1985); Mark L.J. Wright, 'Reputations and Sovereign Debt,' Manuscript, Stanford University; Michael Tomz, *Reputation and International Cooperation: Sovereign Debt across Three Centuries* (Princeton University Press, 2007).

[207] Jeremy Bulow and Kenneth Rogoff, 'Sovereign Debt: Is to Forgive to Forget?,' *American Economic Review* 79(1)(1989): 43-50.

[208] Guido Sandleris, 'The Costs of Sovereign Default: Theory and Empirical Evidence,' *Economia* 16(2)(2016): 1-27.

[209] Benjamin Hebert and Jesse Schreger, 'The Costs of Sovereign Default: Evidence from Argentina,' *American Economic Review* 107(10)(2017): 3119-3145; Sandro C. Andrade and Vidhi Chhaochharia, 'The Costs of Sovereign Default: Evidence from the Stock Market,' *The Review of Financial Studies* 31(5)(2018): 1707-1751.

[210] Jorge Alonso-Ortiz, Esteban Colla, and Jose-Maria Da-Rocha, 'The productivity cost of sovereign default: evidence from the European debt crisis,' 64(4)(2017): 611-633.

[211] Christoph Trebesch and Michael Zabel, 'The output costs of hard and soft sovereign default,' *European Economic Review* 92(2017): 416-432.

[212] Eduardo Borensztein and Ugo Panizza, 'The Costs of Sovereign Default,' IMF Working Paper 238 (October 2008).

[213] See, for example, Samuel W. Malone, 'Sovereign indebtedness, default, and gambling for redemption,' *Oxford Economic Papers* 63(2)(2010): 331-354.

that restructuring is unnecessary and would do more harm than good. Due to the uncertainty of the liquidity-solvency distinction and the costly and potentially destabilizing effects of debt workouts, the IMF may be inclined to agree and go along with debtor efforts to avert restructuring. These debtor dynamics are a frequent source of pressure on the IMF to lend in ways that seek to avoid, but often end up delaying, debt restructurings.

Debt restructuring is not, of course, all bad for debtors. Debt relief can benefit heavily indebted states because it acts as a one-time transfer of resources from creditors to debtors and, more importantly, can provide the fiscal space needed to jumpstart economic growth. But based on its significant downsides, debtors will want to retain flexibility to decide if and when restructuring should happen. And contrary to longstanding creditor concerns that debtors seek debt relief too much and too soon, recent research suggests that the opposite is true: debtors tend to put off dealing with unsustainable debt burdens and when they do restructure, it is often too little, too late.[214]

Based on these factors, we would expect debtor states to oppose IMF lending rules that increased their odds of being forced to restructure their debts and decreased the Fund's latitude to decide when special circumstances warranted a bailout *sans* restructuring. For example, although the IMF's 2002 framework prohibited lending to Greece in 2010 unless the country first restructured its debt, Greek authorities insisted at the time that debt restructuring was not necessary and that they could complete a successful adjustment program without debt relief.[215] Debtors would also be expected to oppose rules that appear to make restructurings more likely because of the potential negative impact on their market access and borrowing costs. If the question is not about the existence but rather the strength and precision of such rules, we would likewise expect debtors to prefer weaker, more flexible, and more ambiguous rules. These expectations are reinforced by the revealed preferences of debtor states. In 2002, debtors argued against the creation of strict IMF lending rules, and as demonstrated in Chapter 4, many supported the relaxation of lending rules in 2010 and pushed for greater flexibility in the Fund's EA framework between 2013 and 2016. This is neither to suggest that debtor countries have identical preferences, nor that they will always look to avoid restructuring. Rather, the implication

[214] IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework.' See also Richard Gitlin and Brett House, 'A Blueprint for a Sovereign Debt Forum,' CIGI Papers No. 27 (March 2014).
[215] See IMF, Minutes of Executive Board Meeting 10/45-1. Greece – Request for Stand-By Arrangement; Rule K-1 Report on Breach of Obligations Under Article VIII, Section 5 of the Articles of Agreement. May 9, 2010.

is that, as a general rule, debtor states will want to retain a significant degree of discretion over whether and when they restructure, given the stakes for them and their populations.

Private creditors have even clearer reasons to avoid debt restructuring. They invariably suffer financial losses from write-downs on sovereign bond or bank debt and therefore have a strong group interest in avoiding restructurings in as many cases as possible. To this end, IMF lending has generally benefitted private creditors by providing crisis-stricken governments with the resources they need to continue servicing their debts. Before the Fund came to play this role, there were few reliable mechanisms to shield transnational creditors from losses when foreign financial crises arose. The change in global financial relations brought about by the creation of the IMF as a permanent rescue Fund led Christian Suter to observe: "institutionalization enhances the resilience of the international financial system against the outbreak of open debt crises [i.e., uncontained crises in which debtors default and shift the burden onto their creditors] and favors the bargaining power of creditors vis-à-vis debtor countries. As a consequence, an open crisis may be averted or postponed, and the burden of debt crisis has to be carried mainly by the debtors."[216] Because creditors often benefit from bailouts, they often seek to influence IMF lending in ways that are favourable to their interests.[217]

We would therefore expect private creditors to oppose lending rules that limit the number of cases in which the IMF can provide bailouts without conditioning its assistance on upfront debt restructuring. When the question is about the strength and precision, rather than existence, of lending constraints, creditors should also prefer looser, more ambiguous rules that give the Fund more latitude. As with debtors, what we would expect creditors to want is broadly supported by their revealed preferences in this domain. Time and again, the private creditor community has articulated its support for a flexible, case-by-case approach to sovereign debt restructuring rather than a rules-based approach that outlines in advance how particular types of debt crises will be dealt with.[218]

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[216] Suter, *Debt Cycles in the World Economy*, p. 41.
[217] Gould, *Money Talks*.
[218] For example, see IIF, 'Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets,' (March 2005); IIF, 'Principles for Stable Capital Flows and Fair Debt Restructuring: Report on Implementation by the Consultative Group,' (October 2015). The creditor reaction to IMF proposals between 2013 and 2016, discussed in Chapter 4, also makes this point clear.

These claims do not imply that private creditors have identical interests in how specific crises are resolved. Far from it. For example, when debt relief cannot be avoided, the specific terms and timing of IMF lending can have sharply uneven impacts on differently positioned creditors, with some taking large losses and others escaping unscathed. Yet it remains true that when it comes to the question of crises in general, creditors have a common interest in avoiding defaults and debt workouts if possible. This group interest translates into a general preference for the IMF to take a flexible, case-by-case approach to debt crises—one that preserves the Fund's capacity to avert restructurings, or minimize their impact on private creditors, in a wide range of circumstances.

For the reasons discussed above, sovereign debtors and private creditors should oppose international rules that make debt restructurings more likely and/or diminish their capacity to influence whether and when a given restructuring happens in the first place. In other words, we would expect debtors and creditors to encourage a case-by-case approach to IMF lending and oppose a formal mechanism designed to trigger restructurings according to pre-defined rules—an expectation borne out by the evidence provided in Chapter 4. But how do these actors feel about various mechanisms that aim to govern the debt renegotiation process?

#### *2.2.2 Preferences Toward Different Process Mechanisms*

Although debtors and private creditors want to maintain control over their fate and often have an incentive to avoid debt restructuring if possible, once they have accepted that a debt workout is necessary or inevitable, both have an interest in a smooth and speedy restructuring process. The longer a debtor spends in the financial limbo of a restructuring negotiation—without access to international capital markets—the more its growth prospects suffer and the harder it becomes to generate the fiscal surpluses from which to repay creditors. Like divorce negotiations, restructurings that drag on or are marred by conflict tend to drain the collective pool of resources available to be divided up among the parties, representing a potentially large efficiency loss.[219] While there is also always a distributional bargaining game that determines how the gains/losses of a debt renegotiation are shared between the debtor and its creditors and among different types of creditors, the potential for joint efficiency gains

[219] Sturzenegger and Zettelmeyer, *Debt Defaults and Lessons from a Decade of Crises.*

for these actors as a whole provides a reason for debtors and creditors to support mechanisms aimed at creating a more timely and orderly restructuring *process*.[220]

The prospect of mutual gains has only become more apparent in the last several years with the rise of increasingly disruptive holdout creditors who can hijack restructuring negotiations and drag debtors through years of costly litigation. Not only do these minority creditors exacerbate the efficiency problems mentioned above; they also gain at the expense of the majority of creditors, generating distributional discontent among the wider creditor community.[221] As chapters 5 and 6 show, the recent quest for stronger institutional arrangements to govern the debt restructuring process—whether in the context of the UN initiative or bond contract reforms—has been motivated largely by a desire to neutralize holdout creditors to the broad and joint benefit of debtors and creditors as a whole.

The positive-sum potential of an improved debt restructuring process does not mean that all process-oriented mechanisms will be equally attractive to debtors and private creditors. Different mechanisms can have different distributional and power implications that outweigh potential efficiency gains and make them unacceptable to these actors. What matters in shaping debtor and creditor preferences toward different process mechanisms is the legal-institutional design of a given arrangement, as well as the ways in which historical experience and context shape understandings of these mechanisms.

Before moving on to discuss these factors, it is worth asking whether an IMF trigger mechanism could also provide joint gains to debtors and creditors. Indeed, we could imagine scenarios where rules that triggered early debt relief produced such benefits. As described in Section 2.1 of Chapter 2, when IMF lending delays *rather than triggers* a necessary restructuring, it often leaves the debtor and a portion of its creditors (those with claims maturing in the medium to long term) worse off. However, a significant segment of creditors (those with claims maturing in the short term) will likely be paid in full and on time and thus benefit from the bailout, adding a distributional dynamic that exists in every 'bail-in or bailout' decision and complicates the efficiency payoffs of a trigger. Moreover, it is not clear to debtors and private creditors that a trigger mechanism would provide mutual gains more often than it would

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[220] This claim resonates with the expectations of neoliberal institutionalist thinkers. For description and analysis of neoliberal institutional thought, see Keohane, *After Hegemony*; Robert O. Keohane (ed.), Neorealism and its Critics (Columbia University Press, 1986); David A. Baldwin, *Neorealism and Neoliberalism: The Contemporary Debate* (Columbia University Press, 1993).
[221] Schumacher, Trebesch, and Enderlein, 'Sovereign defaults in court.'

result in otherwise avoidable losses. These actors—especially private creditors— are likely to worry that trigger rules would result in restructurings that may have been avoidable, or in larger losses than may have been necessary (if the IMF conditions its support on a certain level of debt relief). Finally, because the stakes are so high, debtors and creditors will generally want to maintain as much control and influence as possible over decisions of whether and when to restructure—an element of agency that is bound to be diminished by strong trigger rules. For debtors and private creditors, the clear risks of a trigger mechanism are not worth the unclear rewards. Process mechanisms, by contrast, can offer clearer rewards and smaller risks, depending on their design features—a topic to which we now turn.

Although trigger and process mechanisms seek to govern different elements of debt restructuring, debtors and creditors may not always distinguish between the two and their distinct implications—as seen in the early 2000s when trigger and process reforms were deeply intertwined. In that earlier era, private creditors and EMDE debtors initially opposed both hard-law and contractual *process* reforms for fear that they would lead to more restructurings and thus higher borrowing costs—outcomes more aptly associated with a trigger arrangement. However, the fact that they saw CACs as a lesser evil compared to the SDRM was nonetheless based on the different legal-institutional designs of the two alternatives. Creditors preferred CACs over a SDRM because the latter threatened to institutionalize a process through which their contracts could be trumped and their ability to seek legal remedy curtailed.[222] The result, from their perspective, would be a gross violation of creditor rights and greater investment uncertainty in sovereign debt markets.[223] As voluntary contract terms, CACs also had the advantage of being open to re-negotiation if creditors became displeased with them. Because contract change was preferred by creditors and seen as a move that would generate less policy uncertainty than a SDRM, debtors also saw it as being less likely to substantially raise their borrowing costs.

But while debtor states are *borrowers* that have an interest in maintaining access to cross-border finance at the lowest possible cost, they are also occasionally *debt restructurers* that might benefit from a more robust and comprehensive international legal framework to govern the restructuring process. These competing incentives have led to the observation that debtors face a collective action problem: even though it is collectively optimal for them to band together to establish a stronger sovereign bankruptcy process, individual debtors will defect as they come to fear the financial market reaction to their reform

[222] Gelpern and Gulati, 'Public Symbol in Private Contract.' Also, interview 138785.
[223] Lavelle, 'Sovereign Debt Restructuring.'

initiative.[224] But this pattern of behaviour did not hold during the recent UN initiative. A broad coalition of debtor states articulated an ambitious hard-law reform agenda and showed no signs of wavering because of credit-related concerns.[225] These states did, however, hesitate to follow their proposal to its logical conclusion for a different reason: concern about how an international hard-law mechanism might curtail their sovereignty. In the debt regime, sovereignty means something different to debtors than it does to capital exporters. For the former, it is about maintaining policy autonomy in the event of debt crisis. As highlighted in Chapter 5, these sovereignty concerns represent an additional barrier to a statutory regime—one that previous analyses failed to appreciate.[226]

Creditors thus oppose hard-law designs because of their anticipated impact on investor rights and market uncertainty, while debtors oppose them—or at least fail to fully support them—because of their anticipated effect on borrowing costs and/or policy autonomy. While debtor concerns over sovereignty were evident during the later stages of the recent UN reform efforts, private creditors remained relatively silent in response to the UN initiative, perhaps relying on their home governments to quash its ambitious agenda. Since the early 2000s, it had become even clearer that the US and other major capital exporters were not interested in a statutory framework for sovereign debt restructuring.

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[224] Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism'; Setser, 'The Political Economy of the SDRM.'

[225] It is not my goal to explain why debtor states were more collectively assertive during the recent UN initiative than they were during previous initiatives. However, it is likely that shifting sources of sovereign credit, among other things, have bolstered the relative autonomy and influence of EMDEs and gave them the confidence to more forcefully assert themselves and their collective interests in the politics of sovereign debt reform. More specifically, the growth of domestic sovereign debt markets in many EMDEs and the rise of China as a bilateral creditor have helped to diversify the sources of credit available to EMDEs and make them somewhat less reliant on Western public and private creditors. This, in turn, may have made EMDEs more willing to pursue policy arrangements that Western creditors have historically opposed, especially in the context of the UN initiative, which was explicitly supported by China, an increasingly important creditor to many debtor countries. But while new sources of credit may have empowered EMDEs to some extent, it is important not to overstate the case or understate the continued importance of international bond markets, which remain a significant source of finance for many countries. Even countries that have diversified their sources of *new* finance carry a significant amount of *existing* debt in the form of international bonds. In Argentina's case, domestic and Chinese financing helped the state remain economically viable after being cut off from international capital markets in 2001, but it was the country's New York bonds issued prior to 2001 that were recently used to wreak havoc for the country and its creditors. Indeed, the main problems that catalyzed the UN and other recent reforms originated under the laws of New York and the UK.

[226] To be sure, Setser does mention very briefly that, in addition to borrowing cost-concerns, debtors considering the SDRM proposal "were also keen to protect their sovereignty, and to prevent an international organization from gaining jurisdiction over their domestic law debt." See Setser, 'The Political Economy of the SDRM,' p. 322. Hagan also notes that, with respect to the SDRM, "A number of countries could not accept the possibility that debt issued within their own territories and subject to their own laws could be restructured under a legal framework that would be administered by an international dispute resolution body." See Hagan, 'Designing a Legal Framework,' p. 352. However, neither Setser nor Hagan elaborate on this point or provide evidence that sovereignty concerns were a significant stumbling block that prevented debtor states from supporting or pursuing a hard-law debt restructuring mechanism. The conventional wisdom has been that debtors are much more concerned about how a statutory restructuring process would affect their access to affordable finance.

While a hard-law restructuring arrangement remains objectionable due to its design features, debtor and creditor preferences toward contract mechanisms have changed rather dramatically since the early 2000s. Debtors and private creditors went from accepting contract change as a lesser evil in the early 2000s to embracing it as desirable in its own right more recently, laying the groundwork for the rapid emergence of robust contract reforms. Particularly apparent and important in the context of the recent Treasury-led initiative, this change in preferences owes primarily to the historical legacy of the original CACs and the changed political context of regulatory reform in recent years.

As a result of their experience with CACs since 2003, debtors and creditors went from seeing contract change in the early 2000s as something that could disrupt the distributional status quo to seeing recent bond reforms largely as efficiency-enhancing, Pareto-improving moves. Experience taught creditors that CACs were a process mechanism that did nothing to trigger or make debt restructurings more likely in the first place, and it taught debtors that the borrowing-cost concerns associated with contract reform had been overblown. Moreover, in the recent reform context, capital-exporting states were no longer framing trigger and process mechanisms as an inseparable package deal. In fact, their actions suggested that trigger and process mechanisms were distinct, separable, and capable of being driven in opposite directions, with the trigger being weakened and the process being strengthened. The context therefore reinforced what had been learned over time: that contract reforms were strictly about improving the restructuring process, but in a relatively limited way that did not substantially alter the distributional bargaining game between debtors and creditors.

The fact that recent contract reforms were understood purely as a process-oriented change, that their effects were relatively predictable due to experience with the original CACs, and that they had less intrusive design features than hard-law alternatives all contributed to debtor and creditor preferences in favour of recent contract reforms capable of significantly neutralizing holdout creditors. Aided by history and context, sovereign issuers and their private lenders came to embrace contract-based restructuring mechanisms because of their process orientation and legal-institutional design.

### *2.3 IMF Staff Preferences Toward a Trigger Mechanism*

IMF staff preferences toward an IMF trigger mechanism are also worth briefly reviewing because they play a role in the next chapter. An important strand of IMF literature emphasizes that the organization

is a bureaucratic technocracy populated by a large and technically-savvy staff, which carries out all the economic analysis, surveillance, and program design.[227] Although IMF employees work for the organization's member states and have little formal decision-making power, the bureaucracy does have considerable influence through the authority it wields. As Barnett and Finnemore note, international organizations (IOs) often possess forms of authority that go beyond what is delegated to them by their member states.[228] As bureaucracies, IOs have a certain rational-legal authority. They also have moral and expert authority, which derive from the perception that IOs pursue socially-valued goals "by means that are mostly rational, technocratic, impartial."[229] "To be authoritative, ergo powerful," note Barnett and Finnemore, bureaucracies "must be seen to serve some valued and legitimate social purpose […] in an impartial and technocratic way using their impersonal rules."[230] And as Best notes, "The IMF is in many ways an archetypal bureaucratic international organization in Michael Barnett and Martha Finnemore's terms: Its authority depends in considerable measure on its claims to neutral economic expertise."[231] These insights suggest that the means (expertise, impartial rules) and goals (global public goods) that animate IO activities are key to their legitimacy and authority. But so too are the outcomes they deliver. Scholars have shown that the effectiveness of IMF lending is crucial to the organization's legitimacy and the career advancement prospects of individual staff members.[232]

We would therefore expect IMF staff to prefer policies and programs that enhance the organization's legitimacy and effectiveness and thus their own expert authority and career prospects. When it comes to the Fund's lending framework, I argue that staff prefer well-defined lending rules that are rational, technical, and seemingly immune to political interference for three reasons. First, rules add legitimacy to IMF lending by conveying that key decisions which can trigger or avoid debt restructuring will be made according to objective criteria and expertise rather than powerful political interests. Second, such rules give staff more influence over lending, since technical rules require technical measurements

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[227] Bessma Momani, 'IMF staff: Missing link in fund reform proposals,' *The Review of International Organizations* 2(1)(2007): 39-57. Jeffrey M. Chwieroth, *Capital Ideas: The IMF and the Rise of Financial Liberalization* (Princeton University Press, 2010). Michael Barnett and Martha Finnemore, *Rules for the World: International Organizations in Global Politics* (Cornell University Press, 2004). Sarah Babb, 'The IMF in sociological perspective: A tale of organizational slippage,' *Studies in Comparative International Development* 38(1)(2003): 3-27.
[228] Barnett and Finnemore, *Rules for the World.*
[229] Ibid, p. 5.
[230] Ibid, p. 21.
[231] Jacqueline Best, 'Ambiguity and Uncertainty in International Organizations: A History of Debating IMF Conditionality,' *International Studies Quarterly* 56(4)(2012): 674-688, 675.
[232] Ngaire Woods, *The Globalizers: The IMF, the World Bank, and their Borrowers* (Cornell University Press, 2006). Chwieroth, "'The silent revolution.'"

and assessments to determine their applicability, and the Fund's staff are uniquely qualified to provide such measurements and assessments, such as the DSAs that determine whether or not a country's debt is deemed sustainable. Third, insofar as lending large sums to countries that are insolvent often results in program failure, rules that insulate the Fund from political pressures to lend in such circumstances can also enhance the IMF's effectiveness. For these reasons, we would expect staff to prefer relatively precise and objective lending rules that insulate decision-making from political pressures to avoid, postpone, or minimize debt restructurings.

## 3. Power Within the SDRR

Having laid out the preferences of the key players in the SDRR, we now turn to the question of power. What capabilities do these actors have to promote their preferred outcomes within different venues? As noted in Chapter 1, the venue in which reform efforts take place matters insofar as it can determine who has a seat at the table, who gets to set agendas and veto proposals, and whose cooperation is needed for a given initiative to succeed. The following discussion is thus organized around the institutional forums in which the reform initiatives analyzed in this dissertation played out. I focus on the dimensions of power that are most relevant to understanding the case studies featured in chapters 4, 5, and 6. Not all are linked to specific venues. Some, for example, are broader forms of structural power that actually underscore how little decision-making forums matter to certain outcomes. In the end, it is the capacity of key capital-exporting states—especially the US—to influence outcomes within and across the various venues and reform initiatives that makes them particularly powerful in shaping the overall contours and trajectory of the SDRR.

### *3.1 Power Within and Over the IMF*

Who has the power to shape IMF lending decisions and policies? This question has been the subject of extensive debate among IPE scholars. One prominent view is that the Fund's member states—especially the most powerful of them—determine the contours of lending, particularly when their vital economic and/or geopolitical interests are on the line.[233] Another perspective points to the influential role of the Fund's technocratic staff, whose authority and influence over lending decisions stem from

[233] Breen, *The Politics of IMF Lending*; Copelovitch, *The International Monetary Fund in the Global Economy*; Oatley and Yackee, 'American Interests and IMF Lending'; Stone, 'The scope of IMF conditionality'; McDowell, 'Need for speed.'

their expert ideas and ability to operate through informal channels of governance.[234] A third view sees private transnational creditors as having influence over key aspects of IMF lending.[235]

The question is not *whether* but *when* and *how much* these different actors matter. Some scholars suggest that IMF staff control a wide range of issues and activities because member states have little interest in governing these aspects of Fund life. As Stone observes, "In ordinary times, the United States and other shareholders have no compelling interest in intervening in the details of conditionality."[236] The implication is that powerful states assert themselves when they care about an issue. As highlighted above, the US and other powerful states have crucial interests in whether and when certain countries restructure their external debts, and we would therefore expect them to care a great deal about rules designed to trigger restructurings. We would also anticipate, for reasons outlined earlier, that sovereign debtors and private creditors would have strong views about the development of a trigger mechanism. Finally, there are good reasons to believe that IMF staff have much at stake in the Fund's lending framework and its impact on how large-scale sovereign debt crises are resolved.

If all actors want a say in shaping outcomes, whose preferences will prevail in the institutional context of the IMF? I argue that the major capital-exporting states—the US and the European powers—are best positioned to shape the IMF's lending framework in line with their preferences.[237] Based on the Fund's organizational structure, these states have enormous control over organizational policies. IMF staff are also uniquely placed to shape the details and initial direction of policy reforms, since they write the technical papers that define problems and propose solutions. However, when dominant states reject these solutions and articulate alternative preferences, it forces staff to change course and adapt their proposals in ways that are acceptable to the Fund's largest shareholders. Staff operate largely within the parameters set by powerful states.[238]

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[234] Jeffrey M. Chwieroth, '"The silent revolution:" How the staff exercise informal governance over IMF lending,' *Review of International Organizations* 8(2013): 265-290. Ben Clift, *The IMF and the Politics of Austerity in the Wake of the Global Financial Crisis* (Oxford University Press, 2018).
[235] Gould, *Money Talks*.
[236] Stone, The scope of IMF conditionality, p. 593.
[237] This argument resonates with state power perspectives on IMF behaviour, particularly McDowell's argument that powerful states shape IMF lending decisions when their commercial banks are exposed to the economies of crisis-stricken countries seeking IMF support. See McDowell, 'Need for speed.'
[238] Chwieroth, '"The silent revolution."'

The capacity of these states to set the parameters of staff influence and approve or reject organizational policy changes stems directly from the Fund's governance structure. Formally, power within the IMF rests with its 189 member states, each of which appoints a representative to the Board of Governors. Although it is the top decision-making body, this Board meets only twice a year to make decisions on issues such as quota increases, the admittance and expulsion of members, and amendments to the Articles of Agreement and By-Laws. Power over day-to-day operations is delegated to the 24-member Executive Board. Representation and voting shares on the EB have changed over time. The IMF reforms explored in Chapter 4 were put in place just before the most recent change in January 2016, which shifted some power to previously underrepresented countries like China. The figures presented below reflect the current configuration of the EB, which continues to favour the US and Europe. Of the 24 Executive Directors that sit on the EB, seven represent individual countries (the US, Japan, China, Germany, France, the UK, and Saudi Arabia each have their own director) and the remaining 19 represent broader constituencies. The EB is *de facto* the Fund's governing body, as it meets daily to decide on the organization's main operations regarding program approval, lending and conditionality, surveillance, technical assistance, and policy frameworks such as the IMF's lending rules.

The EB often makes decisions by consensus, but when universal agreement cannot be reached, it votes. Here, the US remains in a dominant position to influence Fund policy, holding 16.52 percent of the total voting share. Germany, France, and the UK also have significant power, with a combined voting share of 13.38 percent. Japan and China each hold roughly 6 percent of the total vote. But the reforms examined in Chapter 4 took place before China was given considerable voting power, and, in any case, Chinese officials have remained relatively silent on sovereign debt debates within the Fund. Moreover, scholars suggest that the US, the three leading European powers, and Japan—a bloc some refer to as the G5—tend to cooperate on the EB when their interests do not clash.[239] Because Japanese officials have been less concerned about debt restructuring and IMF lending rules than their American and European counterparts, they have generally let the latter take the lead on these issues.

Since the most consequential decisions, such as those involving amendment of the Fund's Articles of Agreement, require the approval of an 85 percent supermajority, the US is in a position to unilaterally veto any major proposal it does not like. Other crucial but less weighty decisions—including those

[239] Breen, *The Politics of IMF Lending*; McDowell, 'Need for speed.'

related to lending—require 50 percent approval. If the US, the major European powers, and Japan vote together, they hold roughly 35 percent (40 percent before 2016) of the total vote and need support from a mere 15 percent of the remaining votes to win such approval. If a lending decision goes to a vote, these states are often able to forge a 50 percent coalition by obtaining the support of the potential loan recipient and any others that would be negatively affected by an economic crisis in that country.[240] Given the Fund's formal decision-making structure, it is not surprising that many observers argue that the most powerful member states—particularly the US—determine IMF lending decisions.[241] However, it is important to recognize that the power of dominant states over EB decisions typically does not need to be formally exercised through a vote. As Michael Breen explains, powerful states prefer "informal decision-making procedures, leading to the appearance of consensus. That the organization proceeds by consensus gives the other member-states an incentive to participate, as long as they do not form coalitions to block programs that are favourable to G5 interests."[242] Most EB decisions are thus made via consensus, yet one that is forged in the shadows of power.[243]

To be sure, private creditors can also influence Fund lending decisions, as the success of its programs often hinges on how they are seen and acted upon by private international financiers.[244] Because creditor behaviour is crucial to Fund effectiveness, the IMF carefully considers private-sector views when formulating policies such as its formal lending framework.[245] But private power over the Fund's policy frameworks is more indirect and circumscribed than that of dominant states. Debtor states arguably have even less influence over IMF policy frameworks. While they have formal representation within the EB, it is through larger constituencies that have little voting power. Debtor voices should not be completely overlooked though. As the main recipients of IMF loans, debtors are the ones that have to accept and take 'ownership' of Fund programs. If debtor states disagree with the parameters of IMF lending, they might turn away from the Fund, especially if alternative sources of emergency financing are available. Although many debtor governments may continue to see the Fund as the most viable or desirable option, the point is that their response to changes in the Fund's lending framework

[240] Breen, *The Politics of IMF Lending*.
[241] For a view that puts particular emphasis on US dominance, see Randall W. Stone, *Controlling Institutions: International Organizations and the Global Economy* (Cambridge University Press, 2011).
[242] Breen, *The Politics of IMF Lending*, p. 6.
[243] As Chwieroth ("'The silent revolution," p. 266) notes, "formal voting rights shape the way in which informal state influence operates."
[244] Gould, *Money Talks*.
[245] Interview 138785.

can matter. IMF staff are thus likely to take debtor concerns into account when formulating policy proposals, but at the margins. When debtor preferences over Fund policies clash with those of capital-exporting states, the latter will prevail—as seen during the creation of the 2002 lending rules.

This assessment of power suggests that when it comes to IMF lending practices and policies, we should pay most attention to the preferences of the US and the leading European states—particularly the former if the preferences of powerful states diverge. When the preferences of dominant states clash with those of debtors, creditors, or IMF staff, we should expect the former to prevail. However, coalitions with other actors could be expected to further strengthen the position of these states. When, for example, their preferences broadly align with those of IMF staff (e.g., 2002) or transnational private creditors and debtor governments (e.g., 2013-2016), it only reinforces the strength of their particular policy position and the likelihood that their collective preference will be realized.

### *3.2 Power Within and Over the UN*

Because of the enormous *institutional power* of the US and the leading European states within the IMF, less privileged actors might choose to pursue preferences that diverge from those of dominant states within alternative venues where power disparities are less pronounced. This type of 'forum shopping' or 'regime shifting' strategy was indeed evident during the recent UN initiative. Before the initiative took off in 2014, the US had already insisted that a SDRM-style arrangement should not be pursued or even discussed within the IMF or the working group it organized to promote contract reform. In this context, developing-country debtors who were interested in exploring the idea of a more formal, hard-law restructuring regime decided to shift reform debates into the UN General Assembly, where the 'one country, one vote' organizational structure prevented capital-exporting states from vetoing their proposals. Debtor states from the global South could also benefit from the institutional support that debtor-friendly UN agencies such as the United Nations Conference on Trade and Development (UNCTAD) could provide within the UN context.

Although capital-exporting states had no veto power or special institutional clout within the General Assembly, the US and UK were still able to effectively undermine the hard-law ambitions of the UN initiative via their *structural power* within the SDRR—the source and nature of which was described above. In the UN context, it allowed the US and UK to block the creation of a viable hard-law framework simply by refusing to participate in it. Due to the centrality of New York and London in

the international sovereign debt regime, any restructuring mechanism that did not apply to these two countries would fail to cover 96 percent of international sovereign bonds, making it a rather useless tool for governing these markets. Because the main problems that motivated the UN initiative—namely those related to Argentina's recent restructuring difficulties and prolonged legal battle within US courts—originated in US markets under US laws and courts, the importance of American actions to the success or failure of reform efforts was particularly apparent. In the end, American and British structural power within the debt regime nullified the effects of the institutional strategy aimed at moving reform debates away from US and European-dominated international forums.

While the decision to pursue reform within the UN allowed debtors to set the agenda and later adopt a set of soft-law restructuring principles that were opposed by the US and other key capital exporters, their power to achieve meaningful change to the SDRR was clearly circumscribed by the structural capabilities of the US and UK. But the ambitions of debtor countries were also limited by their own contradictory preferences. Although they called for a multilateral sovereign bankruptcy regime, debtor states showed little willingness in the end to make the kind of commitments that such a regime would entail, owing mostly to the sovereignty-related concerns. While US and UK power was thus sufficient to prevent the emergence of a hard-law restructuring framework, it may not have been fully necessary. The potential power of private lenders within or over the UN is not considered in any depth because of their general lack of engagement with the recent UN initiative. Moreover, their preferences toward a hard-law restructuring regime point in the same direction as those of the US and UK, making their power superfluous even if it had been exercised in the UN context.

### *3.3 Power Within and Over Bond Reform Initiatives*

The two bond reform initiatives examined in Chapter 6 took place within very different institutional settings. One played out within the institutional context of the European Union (EU) and Eurozone, while the other occurred within and around an informal public-private working group organized by US Treasury officials. In both cases, dominant states clearly enjoyed a high degree of agenda-setting power, with France and Germany spearheading the reform agenda in Europe and the US doing so for international sovereign bonds. But in neither case could these states achieve their policy objectives without the support of others. While disproportionately shaped by Germany and France, European bond reforms had to be agreed upon and ratified by every member of the Eurozone, a number of which were peripheral debtor states whose interests differed from their capital-exporting counterparts

in appreciable ways. Eurozone reformers were also sensitive to how their policy designs would be seen and responded to by international financial markets, suggesting that reform decisions were made in light of the perceived structural or disciplinary power of private investors. Meanwhile, the success of the US Treasury-led initiative depended on the active cooperation of EMDE debtors and private creditors, who had to accept and adopt the new bond contract terms for them to become the voluntary market standard US policymakers envisioned. Opposite the UN initiative, US power was necessary but not sufficient to bring about its regulatory preference. Since these reforms were purely voluntary, debtors and creditors had the ability to make or break contract change.

The capacity of the US to steer successful contract reform processes might be thought about through the lens of what some have called *compulsory power*—though others have used the terms 'relational power' and 'instrumental power' to describe a similar concept.[246] The classic definition of compulsory power is the ability of A to get B to do what B would otherwise not do.[247] States that exercise this form of power can do so through a variety of means, including the provision of material incentives or deployment of "normative resources."[248] Deirdre Kamlani argues that, in the history of sovereign debt restructurings, compulsory power has been utilized often by "creditor country governments"—the same actors I refer to as capital-exporting states.[249] But while Kamlani points to instances in which great powers seized political or economic control over debtor countries, the focus here is on the power of the US to get private creditors and EMDE debtor governments to adopt regulatory changes in the SDRR that they otherwise would not. In the early 2000s, the US capacity to persuade hinged on the looming SDRM threat, which American officials did not formally quash until contract reforms had been rolled out. By contrast, debtors and creditors needed little persuasion to see the merits of recent contract reforms. While this indicates a more muted role for US power, it is difficult to imagine debtors and creditors pursuing contract reform in the absence of American leadership, suggesting that a non-coercive form of compulsory power remains important in producing the outcomes we observe.

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[246] For a review of the term compulsory power, see Michael Barnett and Raymond Duvall, 'Power in International Politics,' *International Organization* 59(1)(2005): 39-75. For a discussion of relational power, see Strange, *States and Markets*. For a discussion of instrumental power, see Doris Fuchs, *Business Power in Global Governance* (Lynne Rienner Publishers, 2007).
[247] Robert A. Dahl, 'The concept of power,' *Behavioral Science* 2(3)(1957): 201-215.
[248] Barnett and Duvall, 'Power in International Politics,' p. 50.
[249] Deirdre Shay Kamlani, *The four faces of power in sovereign debt restructuring: Explaining bargaining outcomes between debtor states and private creditors since 1870*, p. 54. PhD thesis, London School of Economics and Political Science, 2008.

## 4. Engagements with Broader IPE and Global Governance Literatures

Beyond the main contribution of better illuminating the politics of regulatory reform and variation in the SDRR, the arguments outlined above draw upon and contribute to broader IPE and global governance literatures. This section highlights these engagements.

The discussion of power and preferences within the IMF draws on a rich IPE literature focused on this particular international organization, but it also sheds light on neglected aspects of the Fund's role in global financial governance. Specifically, the role of Fund's lending framework in triggering restructurings have received very little scholarly attention in general. The vast literature on IMF lending tends to focus on variation in the size or conditionality of IMF loans rather than the broader policy frameworks that govern lending decisions. Research on the global governance of sovereign debt restructuring is equally neglectful of IMF lending rules and fails to appreciate their role as an integral part of the SDRR. Most of the literature in this area is concerned with *ex post* mechanisms designed to facilitate the debt restructuring *process* rather than *ex ante* mechanisms designed to *trigger* restructurings in the first place. This study calls attention to the Fund's central role in the SDRR, filling gaps in the respective literatures on IMF lending and sovereign debt governance and bringing these two related but separate strands of research into closer conversation. In doing so, it also reinforces a particular interpretation of IMF behaviour by showing how dominant states disproportionately shape the organization's approach to debt restructuring.[250]

The analysis of IMF lending reforms also speaks to broader scholarly discussions about international institutional design and development. It suggests that rational choice approaches offer useful insights into some areas of institutional life but remain unable to explain other fundamental features of institutional design and change. For example, rationalists have argued that states often prefer softer and/or less precise rules to deal with issues characterized by high degrees of uncertainty, such as those related to global financial crisis management.[251] In this sense, the preference for greater flexibility in the IMF's lending rules can be understood within a rational design framework. But if flexibility was

[250] Thacker, 'The High Politics of IMF Lending'; Oatley and Yackee, 'American Interests and IMF Lending'; Stone, 'The scope of IMF conditionality'; Barro and Lee, 'IMF Programs'; Dreher and Jensen, 'Independent Actor or Agent?'; Copelovitch, *The International Monetary Fund in the Global Economy*; Breen, *The Politics of IMF Lending*; McDowell, 'Need for speed.'

[251] Koremenos et al., 'The Rational Design of International Institutions'; Abbott and Snidal, 'Hard and Soft Law in International Governance.'

rational for major capital-exporting states, why did they not retain a case-by-case approach or adopt a sufficiently flexible lending framework in the first place? And why did state preferences toward IMF lending rules change over time? While rationalist perspectives can help us understand part of the answer by focusing on changes in the material circumstances facing particular states, a fuller understanding of recent IMF reform outcomes requires an appreciation of the role of timing and sequencing in politics—specifically the way in which past institutional developments and experiences feed into subsequent rule-making preferences and processes.[252] Moreover, rational institutionalist approaches to IPE—including the long-dominant neoliberal institutionalist perspective—often pay insufficient attention to the power-laden and sometimes perverse implications of the institutional arrangements produced by international cooperation.[253] As the Greek crisis and previous episodes such as the 1980s debt crisis showed, attempts to avoid or delay necessary debt relief generate a range of dysfunctional outcomes and often produce distinct winners (dominant states and their financial institutions) and losers (debtor countries and their populations). Perspectives that call attention to the power and interests of dominant states are thus needed.[254]

Moving from trigger to process mechanisms, the discussion of different legal-institutional designs and their political economy implications speaks to broader literature on legalization and institutional choice in global governance. For students of global governance, it may not be surprising that hard-law mechanisms have not emerged in the SDRR. One of the key impediments to a treaty-based SDRR is the sovereignty cost to which scholars of institutional design point.[255] Because hard-law arrangements can infringe upon sovereign autonomy and authority in sensitive areas, the inter-state bargaining process to establish this sort of arrangement is likely to be hard-fought and time-consuming, leading scholars to argue that these high negotiation costs can also deter states from pursuing international treaties.[256] Finally, analysts have noted that treaty-based agreements tend to be rigid and difficult to adapt, and that issue areas characterized by high levels of change and uncertainty, such as global

[252] For a comprehensive analysis of the role of time in politics and institutional development, see Pierson, *Politics in Time*. See also Orfeo Fioretos (ed.), *International Politics and Institutions in Time* (Oxford University Press, 2017).
[253] For a review of (mostly liberal) theories of international cooperation, see Xinyuan Dai, Duncan Snidal, and Michael Sampson, 'International Cooperation Theory and International Institutions,' *Oxford Research Encyclopedia of International Studies* (2017).
[254] For such perspectives within contemporary IPE debates, see Drezner, *All Politics is Global*; Helleiner, *The Status Quo Crisis*. For analyses of US power within IOs, see Rosemary Foot, S. Neil MacFarlane, and Michael Mastanduno (eds.), *US Hegemony and International Organizations: The United States and Multilateral Institutions* (Oxford University Press, 2003).
[255] Abbott and Snidal, 'Hard Law and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law.'
[256] Ibid.

finance, call for more flexible arrangements.[257] But this study highlights other important barriers that differ from the more generic factors these scholars identify. Most notably, an important objection to hard-law solutions among key capital-exporting states relates not to their sovereignty, negotiation, or flexibility costs but to their potential to erode certain transnational legal and market structures, which in turn uphold particular forms of power, privilege, and market governance. Among other things, these structures sustain the structural power of the US and UK in the SDRR—an important dimension of power that scholars have identified in other domains but not yet in sovereign debt politics.

When scholars write about the pros and cons of international hard law, it is almost always in comparison to soft law, such that the weakness of harder forms of governance are seen as the strengths of softer forms. For example, authors point out that soft-law arrangements have lower sovereignty and negotiation costs and are more flexible than their hard-law counterparts, making them easier to agree upon and more desirable in certain policy domains or for certain regulatory purposes. It is certainly true that the UN Principles examined in Chapter 5 were able to emerge because of their soft-law status and the fewer veto points for powerful oppositional actors to block soft-law agreements. But much of the existing literature suggests that hard-law and soft-law tools are selected from a broader governance toolkit based on the functional needs of a given problem or issue area, and that when soft law is selected, it is often because it provides a more effective option for dealing with the issue in question.[258] In the UN case, hard law was not rejected and soft law was not chosen primarily for these functional reasons. Although the sovereignty concerns of debtor states could be interpreted more from this functionalist perspective, regulatory outcomes were shaped, first and foremost, by a political contest between two coalitions with divergent preferences and power capabilities. Moreover, the UN Principles were not adopted because of their anticipated functional superiority to the hard-law alternative. As Chapter 5 suggests, there are few reasons to expect these non-binding principles, or any other purely soft-law arrangement, to be a very effective functional mechanism in the SDRR.

Because of these limitations, the main regulatory alternative to a hard-law framework in the SDRR has not been soft law—as the literature would predict—but rather private-law contracts, the subject of Chapter 6. This dissertation thus challenges the dominant view that global governance tools exist

[257] See also Brummer, *Soft Law in the Global Financial System*.
[258] For example, see Kal Raustiala, 'Compliance & Effectiveness in International Regulatory Cooperation,' *Case Western Reserve Journal of International Law* 32(3)(2000): 387-440.

along a spectrum of international hard and soft law, and that soft law is the only feasible option for governing global finance.[259] It highlights the political utility of an alternative—private-law contracts—that does not fit into the hard law-soft law dichotomy. How does the analysis of contract reforms presented in this thesis fit within and contribute to broader theoretical debates about institutional design and development and the role of contracts in global governance? An important part of the contract reform story, particularly in the Treasury-led case, can be understood through the lens of what Alexander Cooley calls rational contractualist approaches.[260] These approaches view contracts and other institutions as coordinating devices used by rational actors to solve collective action problems in ways that advance their mutual interests. CACs can be seen, from this perspective, as a functional solution to creditor coordination problems—particularly those that arise when free-riding holdouts are able to defect from and spoil cooperative solutions. They can also be viewed as a response to the 'incomplete contracts' that governed previous sovereign bond debt. Writing new clauses that better deal with future contingencies is, in a sense, an effort to make contracts more 'complete.'

Seeing contracts as optimal solutions to collective action problems resonates with the official narrative promoted by contract reformers, and, as I show in Chapter 6, the fact that debtors and creditors saw Treasury-led reforms as Pareto-improving was key to their success. But these actors viewed contract change as a distributional issue in the early 2000s and only recently came to see it in more positive-sum terms. The role of prior institutional developments is critical to understanding this shift in preferences and its impact of recent policy processes. Over time, the nature of a previously unknown contract mechanism was revealed in a way that rendered the further strengthening of that mechanism Pareto-improving for important actors in the reform process.

There is therefore a role for functionalist explanations, when combined with historical institutionalist insights, in explaining certain aspects of recent contract reforms, particularly sovereign debtor and private creditor preferences in favour of strengthening a positive-sum collective action device. But these perspectives, which tend to see contracts as generic agreements, cannot explain why contract tools rather than other institutional designs, equally justified on functional grounds, emerged as the preferred approach to debt restructuring, especially among powerful capital-exporting states. To solve

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[259] Abbott and Snidal, 'Hard Law and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law'; Brummer, *Soft Law in the Global Financial System.*

[260] Cooley, 'Rationalist theories of institutions in American IPE.'

this puzzle, contracts have to be understood as private-law tools in specific jurisdictions rather than generic coordination devices. After all, it is the legally-embedded character of contracts that make them a particularly useful mechanism for regulating the restructuring process. By showing that CACs are preferred not because their design characteristics are more functional but rather because they allow important actors to improve the restructuring process while maintaining certain structures of power and privilege, my argument resonates with certain critical theory approaches that treat private contracts as embodiments of power relations.[261] However, I build on this literature by demonstrating that contracts can be useful not simply as instruments of private power and order, as the literature on contracts as power relations suggests, but also as tools of international public policy and public-private hybrid governance.

My argument also resonates with and contributes to constructivist-oriented analyses that treat contracts as 'legal fictions' that spell out how contingencies will be dealt with and thus "enable transacting parties to act "as if" the ambiguity about what will happen in the (unknowable) future has been mapped out so that the deal can be completed."[262] These fictions are particularly useful in environments characterized by deep uncertainty, such as global finance, where they provide the foundations for relatively stable and routine global market transactions. The notion of legal fictions resonates with the view advanced in this thesis that clear and consistent property rights are valued in the debt regime for their ability to stabilize market expectations regarding cross-border bond investments. But scholars largely expect these fictions to persist because of their stabilizing nature. Chapter 6 shows that the ability of contract terms to serve as stabilizing fictions is not dependent on their unchanging persistence; *changes* in contract terms can also stabilize expectations when older clauses have themselves become sources of uncertainty.

In addition to highlighting the importance of the trigger-process distinction and the legal-institutional design of process mechanisms in determining the prospects for success of different reform initiatives, this dissertation also argues that historical legacies and policy sequencing played an important role in shaping recent reform preferences and processes. This resonates with historical institutionalist perspectives, which emphasize the importance of prior institutional developments in shaping

[261] Cutler and Dietz, *The Politics of Private Transnational Governance by Contract*.
[262] Nelson, 'Market Rules,' p. 120.

subsequent preferences and political processes.[263] The legacy of previous reform initiatives in the early 2000s both diminished (in the UN case) and enhanced (in the contract cases) the prospects of mechanisms whose politically palatability and utility had been determined by their underlying legal-institutional design. Similarly, in the IMF case I highlight the ways in which, given the underlying limitations of the mechanism in question, policy sequencing and feedback can lead to institutional weakening over time. Although the role of prior policy developments is not the primary explanatory factor in these cases, it provides additional analytical leverage not available to scholars who may have studied earlier reform efforts in the SDRR but have not examined the more recent initiatives detailed in this dissertation.

Historical institutionalist insights can also help to make sense of US and UK preferences for regulatory arrangements that are compatible with the existing legal foundations of the sovereign debt regime. As Orfeo Fioretos points out, rational choice scholars think of institutional preferences as the product of 'end-point' comparisons—that is, if reforms can improve upon the status quo, actors adjust their preferences in favour of reform.[264] Since a SDRM-style arrangement could improve debt restructuring outcomes compared to current arrangements, we might expect actors to shift their preferences in favour of hard-law reform from a rational choice perspective. Historical institutionalists take a different approach. According to Fioretos, many such scholars see preferences as being informed by 'point-to-point' comparisons, meaning that actors judge the costs and benefits of change in terms of the costs and benefits of retaining or losing their investments in past institutional arrangements.[265] From this perspective, we can see that US (and UK) policymakers judge hard-law institutional arrangements not in terms of how much they might improve the restructuring regime, but rather in terms of how they might jeopardize the domestically-rooted institutional arrangements that govern cross-border sovereign debt obligations.

While drawing on this important tradition of institutional thought, I also suggest that the significance of historical institutionalist insights should not be overstated, nor should the direction of change promoted by historical forces be assumed—a tendency of IPE scholarship focused on the

263 See Pierson, *Politics in Time*; Mahoney and Thelen (eds.), *Explaining Institutional Change*; Rixen, Viola, and Zurn (eds.), *Historical Institutionalism and International Relations*.
264 Fioretos, 'Historical Institutionalism in International Relations.'
265 Ibid. See also Kathleen Thelen, *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan* (Cambridge University Press, 2004), and Pierson, *Politics in Time*.

incremental, rather than transformative, bolstering of global financial governance after 2008.[266] In the cases that animate this project, historical factors play an important but decidedly supplementary role in explaining outcomes, which themselves display both incremental strengthening (contract reforms) and incremental weakening (IMF reforms) as a result of policy sequencing and feedback over time.

## 5. Conclusion

The power and preferences of the key players discussed in this chapter—especially the leading capital-exporting states—provide the theoretical basis for understanding variation in recent reform outcomes in the SDRR. They help to explain the weakening of the IMF trigger mechanism, the failure of the UN initiative to produce meaningful change, and the successful strengthening of the debt restructuring process through bond contract reforms.

The potential for foreign debt restructurings to generate financial instability in core capital-exporting states is the biggest political obstacle to institutionalizing an effective trigger mechanism. When such financial interests are at stake, these states will use their institutional power within the Fund to shape lending decisions in ways that discourage or delay debt restructurings, no matter how clear the trigger rules or the crisis country's need for debt relief—as seen in 2010. But the 2010 episode did not simply indicate the weakness of the Fund's trigger mechanism. For dominant states, it also underscored the benefits of a more discretionary rather than rules-based approach to debt restructuring and shifted their preferences in favour of looser and more flexible lending rules going forward. This paved the way for a further weakening of the trigger mechanism, watering down its content through reforms unveiled in 2016. The push for a more flexible and ambiguous framework was led by the US but also supported by private creditors, debtor states, and other key capital exporters. While the US likely had sufficient power obtain its preferences despite pushback from IMF staff, the strength of its policy position was only reinforced by this broader group of like-minded actors.

Compared to the trigger, the debt restructuring process is subject to a different set of governance challenges but also a different and less constraining set of political considerations that make possible the establishment of more effective regulatory mechanisms to deal with these challenges. The stakes for powerful capital-exporting states are lower at the process stage, particularly when it comes to

[266] See Fioretos, 'Retrofitting Financial Globalization'; Moschella and Tsingou (eds.), *Great Expectations, Slow Transformations*.

concerns about financial stability. These concerns can be acute during the initial phase of a debt crisis when decisions are being made about whether a country should be given a bailout or first restructure its debt. But because powerful states can and do effectively postpone debt restructurings that threaten their financial interests, by the time the debt renegotiation process gets underway, even in these high-stakes cases, steps have usually been taken to contain or mitigate the cross-border spillover effects of debt write-downs. There is therefore less risk that institutionalized rules and procedures at the process stage will jeopardize these key financial interests of capital-exporting states. Creating a smoother and more orderly debt restructuring process can also deliver joint efficiency gains to debtors and private creditors. And for debtors, the majority of their creditors, and key capital-exporting states, the costs of not doing something to improve the restructuring process have only grown in recent years because of the rise of increasingly disruptive holdout creditors.

Muted financial stability concerns, the prospect of mutually-beneficial efficiency gains, and the collective interest in dealing with holdout creditors all combine to make the process stage of restructuring more amenable to effective governance mechanisms than the trigger stage. But this does not mean that any kind of institutional arrangement focused on this aspect of debt restructuring will provide a politically feasible or functionally effective governance solution. The preferences of the key actors toward different process mechanisms depends largely on their legal-institutional design features, which have different distributional and power implications.

For the leading capital-exporting states—particularly the US and UK—hard-law mechanisms are politically unacceptable because they would override the existing legal foundations of the sovereign debt regime, thereby threatening the power and privileges that these states derive from the current order. By contrast, contract mechanisms such as CACs provide politically useful tools for navigating the trade-offs of regulating restructuring. By embedding the ability to restructure debt into the existing system of contractual rights and obligations, they allow capital-exporting states to create more robust restructuring processes without undermining the authority of their own laws and courts or creating significant legal uncertainty in the system of transnational investor rights. Moreover, the historical legacy of the original CACs has only made further contract reforms a more attractive and useful option for capital-exporting states, both in the context of the recent Eurozone and Treasury-led initiatives. These preferences are backed up by impressive power capabilities. The US and UK have the structural power to block the creation of a hard-law mechanism that could govern the international sovereign

bond markets anchored in New York and London, and the US has demonstrated its capacity to lead and promote successful contract reforms in those markets. In the Eurozone context, Germany and France have significant power to set reform agendas and influence outcomes.

Sovereign debtors and private creditors also have significant misgivings about an international hard-law approach to governing debt restructuring processes, further reinforcing the barriers to establishing this kind of regulatory arrangement. For creditors, a treaty-based mechanism would threaten their property rights and introduce greater uncertainty in sovereign debt markets. Debtors have expressed concern that such a mechanism lead to higher borrowing costs, but they also worry that it would curtail their sovereign policy autonomy in the event of a debt crisis. By contrast, both debtors and creditors have embraced the less intrusive contractual approach as a way of enhancing the efficiency of debt restructuring processes without decisively altering the distributional status quo for the majority of actors. Although both worried about contract reform when it was originally pressed upon them over a decade ago, their historical experience with CACs and the more recent reform context shifted their perceptions of and preferences toward contract mechanisms, paving the way for a significant strengthening of the restructuring process. Among other things, history and context taught debtors and creditors that contract change was a process-oriented reform with minimal distributional effects.

The dissertation now turns to the IMF, UN, and contract reform cases, which substantiate the power and preferences discussed in this chapter and ground their theoretical implications for regulatory variation in the SDRR.

# CHAPTER 4

## IMF Reform
## The Limitations of a Trigger Mechanism for Sovereign Debt Restructuring

### 1. Introduction

The IMF plays a central role in the SDRR. As the gatekeeper of emergency financing for most countries experiencing balance of payments problems, the Fund's lending decisions have a large, often determinative impact on whether and when a crisis-stricken country restructures its debt. If the IMF provides a financial bailout at the outset of a crisis, the recipient government will have the resources to continue making short-term payments to its creditors, which could resolve the crisis and forestall debt restructuring if the problem is a temporary liquidity shortage, or it could exacerbate the crisis and delay restructuring if the sovereign is effectively insolvent. But if the Fund believes a debtor state is insolvent and refuses to lend unless and until it has reduced its debt, that state will lack the resources to meet its financial obligations and will have little choice but to restructure its debt at an earlier stage—that is, if it wants to avoid the more disruptive option of an unmitigated default. It is for this reason that IMF staff members Ross Leckow and Julianne Ams note: "the IMF makes financing decisions that, in practice, act as the trigger for many debt restructurings."[267]

For most of its history, the IMF has made these decisions on a case-by-case basis, giving it substantial discretion in choosing how to respond to crises.[268] But as discussed in Chapter 2, this approach came under scrutiny in the 1990s, as financial crises and international rescue loans grew larger and more frequent and the negative impacts of IMF bailouts became more visible. In this context, officials from G7 countries began to debate the need for explicit rules to constrain IMF lending and encourage early debt restructurings in more cases.[269] These debates culminated in 2002 with the establishment of a rules-based framework designed to regulate the IMF's use of large-scale, exceptional access (or EA) loans. The framework permitted the Fund to provide EA financing only when there was a high probability that the recipient country's debt burden would remain sustainable.[270] Otherwise, the

[267] Leckow and Ams, 'Sovereign debt restructuring in the IMF experience,' p. 15.
[268] James M. Boughton, Skylar Brooks, and Domenico Lombardi, 'IMF Lending Practices and Sovereign Debt Restructuring,' CIGI Policy Brief No. 41 (June 2014).
[269] Roubini and Setser, *Bailouts or Bail-Ins?*
[270] IMF, 'Access Policy in Capital Account Crises', 2002, p. 13.

organization would be prohibited from lending unless the country first underwent a restructuring that was substantial enough to restore its debt sustainability. While the Fund's lending decisions had always had the potential to trigger restructurings, the 2002 framework sought to institutionalize this trigger function according to a pre-defined set of rules.

The new lending rules faced their first real test in 2010 when the Fund was called upon to help save the ailing Greek economy. IMF staff could not declare that Greece's debt would remain sustainable, implying the country would have to first restructure if it wanted the Fund's financial support. But key European states—notably France and Germany—vehemently opposed debt restructuring, fearing it would generate financial instability in their own banking systems. The Fund succumbed to pressures to lend in the absence of a restructuring and created a loophole in its lending framework that sanctioned this move. Known as the 'systemic exemption,' this loophole permitted the Fund to waive its debt sustainability rule and lend large sums without a restructuring in cases where debt write-downs posed systemic spillover risks. This 2010 episode underscored the impotence of a trigger mechanism in the face of powerful political interests. Facing criticism over its decision, the Fund launched a reform process in 2013 aimed at re-establishing a more coherent and credible lending framework. In 2016, it unveiled two changes: the first was to remove the systemic exemption, but the second gave the Fund considerable new flexibility in responding to cases where the sustainability of a country's debt is unclear. Taken together, reforms to the IMF's framework in 2010 and 2016 weakened both the credibility and content of the international rules designed to trigger necessary debt restructurings.

What explains this outcome? Why did recent reforms weaken the trigger mechanism for sovereign debt restructuring? These questions have not yet been addressed by IPE scholars. As noted in Chapter 3, the Fund's lending framework and its role in triggering restructurings have received little scholarly attention. The vast literature on IMF lending tends to focus on variation in the size or conditionality of IMF loans rather than the broader policy frameworks that govern lending decisions. Research on the global governance of sovereign debt restructuring, for its part, also neglects IMF lending rules and fails to appreciate their role as an integral part of the SDRR. Most of the literature in this area is concerned with mechanisms designed to facilitate the debt restructuring *process* rather than those designed to *trigger* restructurings in the first place. By answering the questions posed above, this chapter helps fill these gaps in the respective literatures on IMF lending and sovereign debt governance, as well as bring these two related but separate strands of research into closer conversation.

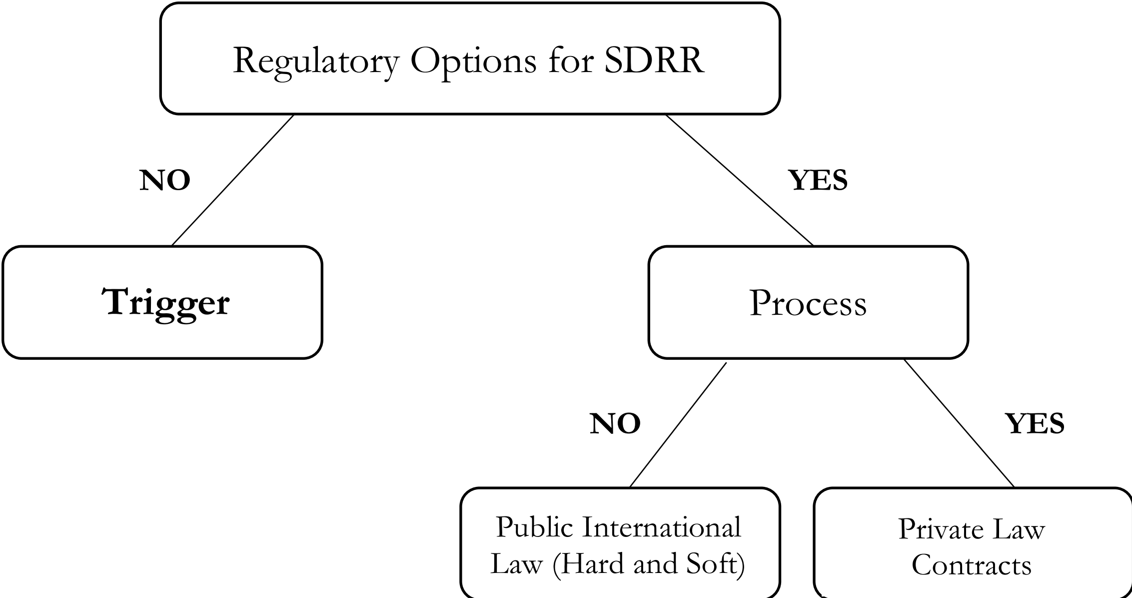
This chapter argues that the 2010 and 2016 reforms reflect deeper political realities that make it extremely difficult to institutionalize an effective trigger mechanism for debt restructuring. The biggest obstacle stems from the power and preferences of the leading capital-exporting states—the US and the major European powers. While these states do not always and everywhere have a uniform set of preferences regarding a trigger mechanism, they do sometimes have a strong interest in avoiding, postponing, or minimizing sovereign debt restructurings in foreign countries because of the costly geopolitical, distributional, and financial stability implications of such events. In key cases, these states will want the Fund to lend without conditioning its support on a large upfront debt write-down. For reasons noted in Chapter 3, I focus on the interests and governance challenges that stem from the financial spillover risks of restructuring. For capital-exporting states, the nature of their position within the global financial order means that, at certain critical moments, decisions of whether and when a particular country restructures its debt can threaten to generate financial instability domestically. When such moments arise, these states will use their institutional power within the Fund to shape lending decisions in ways that discourage or delay debt restructuring, no matter how clear the restructuring rules or the crisis country's need for debt relief. This is the key lesson of the IMF's 2010 reform. States that had been strong proponents of the 2002 lending rules insisted on ignoring those rules once they became a constraint on protecting their national financial interests—a time-inconsistency problem that undermines the credibility of the Fund's commitment not to lend.

The 2010 clash between the IMF's lending rules and the material interests of states that had previously advocated for those rules did not simply reflect time-inconsistent preferences that diverged from the rule-creation (2002) to the rule-implementation (2010) stage of the policy process; it also shifted state preferences in ways that came to inform subsequent IMF reform processes and outcomes. Specifically, I argue that experience with the IMF rules—including the 2010 decision to change those rules to avoid a Greek restructuring—in the context of unprecedented financial crises only reinforced the preference for a more flexible, case-by-case approach to lending among those who traditionally held that position (namely the US), and diminished enthusiasm for re-introducing strict lending rules among the European states that had previously promoted them. While some states and domestic factions within states remained stronger proponents of firm rules than others, the balance of forces had shifted in favour of greater flexibility and discretion when IMF lending rules came up for reconsideration in 2013. Led by US officials but supported by a wider range of state and market actors, the pro-flexibility

camp managed to override key IMF staff proposals and promote a more open-ended approach that weakened the content of the trigger mechanism compared to its 2002 incarnation. The new rules unveiled in 2016 provide enough room to maneuver that powerful states will be able to influence IMF lending in ways that protect their financial interests without having to change or break the rules.

In terms of how this chapter fits with the broader argument, it addresses the lone left-hand branch of the feasibility tree presented in chapters 1 and 3. Figure 2 highlights the reproduces this tree with the relevant box ("Trigger") in bold.

**Figure 3: The Feasibility Tree and the Trigger Option**




This chapter contributes to debates on sovereign debt governance by analyzing a neglected aspect of restructuring—the factors that encourage or discourage debt workouts in the first place—and highlighting the political limitations of efforts to establish an effective mechanism to trigger debt write-downs. It also contributes to debates on IMF lending, shedding light on an overlooked element of Fund policy and reinforcing perspectives that see the power and preferences of dominant states as the driving forces behind crucial IMF financing decisions. Moreover, the chapter speaks to broader discussions about institutional design and development. It suggests that rational choice approaches are useful but incomplete, and that a fuller understanding of the reforms in question requires consideration of how policy sequencing and previous institutional developments shape subsequent

political processes. But unlike many of the historical institutionalist thinkers who stress the role of positive feedback in gradually strengthening institutional arrangements, I show how—given the underlying limitations of the mechanism in question—policy sequencing and feedback can also lead to institutional weakening over time. Empirically, these contributions are supported by extensive new archival and primary document evidence used to trace the IMF reform processes in significant detail.

Chapter 3 provided a detailed analysis of preferences toward a trigger mechanism and power within and over the IMF. Building on this foundation, the remainder of the current chapter shows how the power and preferences of key actors played out and shaped the outcomes of the 2010 and 2013-2016 reform episodes. Section 2 takes us inside the decision to amend the lending rules in 2010 to permit a Greek bailout, which I argue reflected the time-inconsistent preferences of capital-exporting states looking to protect national financial interests. After that, Section 3 documents the 2013-2016 reform process that resulted in a watering down of the Fund's lending rules as a result of, first and foremost, shifts in state preferences compared to 2002. The final section offers conclusions and sums up the chapter's research contributions.

## 2. The Greek Crisis and the 2010 Amendment to the Fund's Lending Framework

For the first half decade of their existence, the IMF's 2002 lending rules were relatively uncontroversial and uncontested. But those were calm years in the world of global finance, and so the EA framework was never really put to the test. The first major challenge to the IMF's lending rules emerged with the onset of the Greek debt crisis. With the country headed toward a default in early 2010, the Fund was called upon to participate in an unprecedentedly large rescue program, and to do so through an unorthodox arrangement in which it would join the European Central Bank and the European Commission as a junior partner in a three-way creditor group referred to as the Troika.

Initially, the Europeans had rejected the idea of IMF involvement in responding to the Greek crisis. But their position quickly changed, as the German government in particular came to insist on IMF participation and its European partners acquiesced.[271] By the time the Europeans invited the Fund into their broader rescue operation, however, they had already decided that debt restructuring should

[271] Dermot Hodson, "The IMF as a de facto institution of the EU: A multiple supervisor approach," *Review of International Political Economy* 22(3), 2015, pp. 570-598.

not be an option for Greece. Germany and France were strongly opposed to debt restructuring, which they worried could have massive, destabilizing spillover effects throughout Europe. The risk of systemic spillovers also had adverse distributional implications for these core states. French and German banks were highly exposed to Greek debt and would likely suffer large losses in the event of a restructuring.[272] As Thompson confirms, "German banks were structurally hugely vulnerable to crisis once the financial boom ended because of their funding models and high leverage."[273] French banks were in a similar position, heavily exposed to Greek government bonds and highly vulnerable to even small losses due to their high leverage ratios.[274] And these banks were not small players in European and global finance. A number were systemically important institutions whose collapse could trigger a full-blown financial and economic meltdown in their home countries and beyond.[275] It was in this context that the major European powers—notably France and Germany—came to fear the implications of a Greek restructuring, particularly for their own financial systems. As then German finance minister Wolfgang Schauble put it in the lead up to the Greek rescue: "We cannot allow the bankruptcy of a euro member state like Greece to turn into a second Lehman Brothers."[276]

The European insistence on avoiding debt restructuring in Greece put the Fund in an awkward position. Staff had run various DSAs and were unable to state that Greek debt was sustainable with a high probability, which meant that, according to the 2002 rules, the IMF would be prohibited from lending to the country unless it also undertook a debt restructuring sufficiently large to restore sustainability. Fund management stood little chance of convincing their European shareholders that upfront restructuring was the correct approach. "The train had already left the station," said one IMF staff member reflecting on Europe's early commitment to avoid restructuring.[277] The Fund was thus confronted with the choice of either refusing to lend to Greece and honouring the rules designed to

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[272]Helen Thompson, 'Germany and the Euro-Zone Crisis', *New Political Economy* 20(6), 2015, pp. 851-870; Jeromin Zettelmeyer, Christoph Trebesch, and Mitu Gulati, 'The Greek debt restructuring: an autopsy', *Economic Policy* 28(75), 2014, pp. 513-563.

[273] Thompson, 'Germany and the Euro-Zone Crisis', p. 6.

[274] For a list of Greece's largest foreign creditors and their estimated bond holdings, see Zettelmeyer et al., "The Greek debt restructuring."

[275] Among the largest holders of Greek government debt were France's BNP Paribas, Société Générale, Crédit Agricole, BPCE, and Franco-German Dexia, and Germany's Deutsche Bank and Commerzbank — all of which were listed by the Financial Stability Board (FSB) as 'systemically important financial institutions' in 2011. See FSB, "Policy Measures to Address Systemically Important Financial Institutions," November 2011.

[276] In *Spiegel Online,* 'We Cannot Allow Greece to Turn into a Second Lehman Brothers,' April 19, 2010. http://www.spiegel.de/international/europe/german-finance-minister-wolfgang-schaeuble-we-cannot-allow-greece-to-turn-into-a-second-lehman-brothers-a-689766.html

[277] In Schadler, 'Living with Rules.'

constrain it from piling more debt on top of already bankrupt countries, or breaking/changing those rules and going ahead with a bailout that did not include debt relief. With IMF management eager to get involved and demonstrate the organization's relevance at a time when few countries were asking for its help, the Fund opted for the latter.[278] At the end of the day, however, member states had the power to rewrite Fund rules and approve lending programs, which implied that IMF agency was severely circumscribed in a context where powerful state interests were at stake.

While an internal debate had divided staff members over how to address the situation, the compromise that emerged from within the organization was to declare Greek debt sustainable but not with a high probability, and create an exemption in the 2002 rules that allowed the second criterion of the Fund's lending framework to be waived in cases where debt restructuring posed "a high risk of international systemic spillovers."[279] The second criterion, as discussed in Chapter 2 (Section 3.2), stated that the IMF could provide large-scale loans *only* if there was a *high probability* that the recipient country's debt would remain sustainable. If a rigorous and systematic DSA said otherwise, the country would have to restructure its debt first before it could receive the Fund's financial support. Waiving this criterion thus allowed the Fund to accommodate the interests and dictates of two of its most powerful shareholders (France and Germany) by creating a convenient loophole in its lending rules. Contrary to virtually all significant changes to IMF legal and policy frameworks, this amendment to the Fund's lending rules was not discussed as a stand-alone issue but rather wrapped-up with the decision to lend to Greece, such that approving the Greek program would also trigger the introduction of what came to be called the "systemic exemption" in the Fund's EA framework. While IMF staff involved in designing the Greek program helped to engineer this loophole, they did so to justify a bailout program whose broad terms and conditions had already been decided by powerful European states determined to protect their national and regional financial interests.

Going along with the European directive that debt restructuring was not to be contemplated, the staff paper outlining the proposed Greek program did not even discuss restructuring. Instead, it skirted the issue and invoked the idea of the systemic exemption. When the EB met on May 9, 2010, to decide on whether or not to approve the program, many Directors were both alarmed by the omission of debt restructuring in a case where debt sustainability appeared doubtful, and surprised by the hasty

[278] Blustein, *Laid Low*.
[279] IMF, 'The Fund's Mandate—The Future Financing Role: Reform Proposals', July 29, 2010, p. 7.

attempt to change IMF rules to avoid a restructuring that to many seemed necessary. Several Directors openly doubted the sustainability of Greek debt and argued that restructuring would thus be an appropriate option or, at least, consideration.[280] As the ED representing Switzerland and its constituency noted, "serious consideration should be given to debt restructuring as a means to achieve fiscal sustainability and make private creditors shoulder some of the adjustment burden."[281] Drawing on his own country's experiences, the Argentinian ED added, "we know all too well what the real consequences are of making believe that solvency crises are liquidity crises." [282] The risk, he noted, was that IMF lending would be "postponing, and maybe, worsening the inevitable."[283] Criticizing the distributional implications of the proposed bailout, the Brazilian Director stated bluntly: the program "may be seen not as a rescue of Greece, which will have to undergo a wrenching adjustment, but as a bailout of Greece's private debt holders, mainly European financial institutions."[284]

European states, staff from the IMF's European Department, and the Fund's senior management all defended the program. Responding to the chorus of voices calling for greater consideration of debt restructuring, Poul Thomsen, deputy director of the European Department, underscored that Greek authorities were "firmly of the view that debt restructuring is not on the table"—as if the preferences of borrowing countries had ever determined Fund policy.[285] A joint statement from the EDs of Germany, France, Sweden, Spain, and the Netherlands expressed their strong support for the Greek government and its commitment to implement the tough adjustment measures laid out in the program, adding that "the current situation makes hardship unavoidable and this program is the only alternative left to prevent a significantly worse scenario from happening."[286] Importantly, the US also supported a Greek bailout that avoided upfront debt restructuring. As a then Treasury official later put it: "We clearly took the view that had there been haircuts at the time there would have been tremendous contagion in global financial markets, and this is just as we were getting our heads above water from the crisis of Lehman Brothers."[287] British officials also supported the program, noting the potential

[280] IMF, Minutes of Executive Board Meeting 10/45-1. Greece – Request for Stand-By Arrangement; Rule K-1 Report on Breach of Obligations Under Article VIII, Section 5 of the Articles of Agreement. May 9, 2010.
[281] IMF, Minutes of Executive Board Meeting, p. 44.
[282] Ibid, p. 52.
[283] Ibid, p. 52.
[284] Ibid, p. 49.
[285] Ibid, p. 76.
[286] Ibid, p. 8.
[287] Interview 114203.

for contagion within but also, due to financial linkages, well beyond the Eurozone.[288] The interconnectedness of global financial markets thus made the prospect of Greek restructuring a financial stability risk not only for the French and Germans but also, to a lesser degree, for the British and Americans as well.

While European and US EDs declared their support for the Greek bailout, less enthusiastic Directors continued to question whether restructuring might be the right approach. Several argued that markets remained unconvinced that Greek debt was sustainable and therefore would not be surprised by the announcement of debt relief. But the avoidance of debt restructuring was not the only controversy of the May 2010 Board meeting. A number of Directors also took issue with the unorthodox and less than transparent process for changing the Fund's EA lending rules. As Blustein put it:

> Normally, a policy change of this sort would be subject to careful deliberation, as it had been in 2003, perhaps over the course of several board meetings. Instead, it had been inserted into a jargon-filled passage of the staff report [on the Greek program], apparently without providing directors with advance briefing.[289]

Most Board members did not even realize they were being asked to approve a permanent change in Fund lending policy until the Swiss ED raised a question about the issue. The US Director, among others, admitted that she had not been aware of this, and the Brazilian ED complained that the Board would not have even known it was changing the EA framework if the Swiss Director had not asked about it. "Should we not have had a separate decision altering the exceptional access criteria, instead of just a sentence on page 19 of the staff report, which would then be used as a precedent?" he asked. A number of other EDs agreed that it would be appropriate to make an exception to the rules for Greece but did not see the need to change the rules themselves, especially in such a hasty fashion. Sean Hagan, the Fund's general counsel, explained that this was not possible. Because of the IMF's "uniformity of treatment" principle, the general policies like the EA lending rules had to apply to all members equally. The rules were a formal constraint and the Board did not have the authority to make an ad hoc exception to them. As Hagan explained, the Board had two choices if it wanted to grant EA financing to Greece in the absence of a debt restructuring: it could either determine that the debt

288 IMF, Minutes of Executive Board Meeting, p. 58.
289 Blustein, *Laid Low*, p. 139.

sustainability criterion has been met, or it could change the rules to allow for the 'systemic exemption', which would then apply to all future cases.[290]

Despite significant misgivings about the substantive and procedural aspects of the decision, in the end all EDs agreed to approve the Greek program and, by extension, the introduction of the systemic exemption as a new feature of the EA lending framework. With the US and most of Europe (including Greece) united in favour of the program, other EDs would not have been able to block approval even if they had wanted to. In this context, it is likely that even skeptical Directors went along and adhered to the EB's social custom of voting by consensus. As noted in Section 3.1 of Chapter 3, consensus within the IMF Executive Board is often forged in the context of clear power relations. In the case at hand, those relations were defined by the interests and agenda-setting power of the Fund's largest European shareholders, with the explicit backing of the US. Many EDs may have also felt conflicted between concerns about the need for debt restructuring and concerns about the potential effects of a French and German financial meltdown on the world economy. These dueling concerns were well captured by India's Director who said: "There is concern that default/restructuring is inevitable" and "that trying to avoid default with the program simply increases the debt load and actually increases the probability of default. On the other hand, it is argued that Greece is the sovereign version of Lehman Brothers and, therefore, it is advisable to put off restructuring for some time."[291]

With the Board's approval and the old rules out of the way, the IMF and its European partners initiated a €110 billion program for Greece, with the IMF's contribution equalling €30 billion (more than 3,200 percent of Greece's quota)—the largest program in Fund history.[292] The IMF's bailout was enormously controversial not just because it broke the 2002 lending rules, and did so under pressure from European governments, but also because it produced disastrous outcomes. The initial program did little to alleviate the crisis. As many at the May 2010 IMF Board meeting had feared, it simply delayed restructuring and made debt relief less effective when it finally did occur. In March and April 2012, Greece restructured roughly €200 billion worth of bonds in what amounted to the largest ever debt write-down in terms of volume and aggregate creditor losses.[293]

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[290] IMF, Minutes of Executive Board Meeting, pp. 92-94.
[291] Ibid, p. 15.
[292] Anna Gelpern, 'Sovereign Debt: Now What?', *Yale Journal of International Law* 41(2)(2016): 45-95.
[293] Zettelmeyer, Trebesch, and Gulati, 'The Greek debt restructuring'.

Conveniently for creditors with short-term claims (many of whom were French and German banks), the two-year delay between the 2010 program and the 2012 restructuring provided enough time for the IMF and its European partners to bailout Greek bondholders to the tune of $150 billion.[294] But the replacing of private-sector claims with official-sector debt between 2010 and 2012 had left Greece in a situation where a growing portion of its debt could not be restructured for political reasons. The IMF enjoyed its super-senior 'preferred creditor status' and the European governments claimed their debts to be senior to private claims, refusing to accept write-downs on the bailout funds they had provided. This meant that the terms and timing of 2012 debt workout, which excluded Greece's now substantial official-sector liabilities, did little to reduce the country's overall debt level and improve its sustainability. In the end, the restructuring was, as the IMF later put it, "too little and too late."[295]

The 2010 Greek bailout was about, in the words of former Bundesbank President Karl Otto Pohl, "protecting the German banks, but especially the French banks, from debt write offs."[296] But while the banks clearly benefitted from the bailout, their governments were motivated by the need to protect a critical public interest: national financial stability. As noted in Chapter 1, capital-exporting states—especially the finance officials responsible for safeguarding their country's financial interests—are likely to see the health of their financial markets and firms as tightly linked to the strength and stability of the country as a whole. When financial crises—including foreign debt crises—loom large, a by-product of protecting national public interests can be to also protect the private interests of banks and bondholders.[297] But efforts to protect national interests in this way still generated highly-dysfunctional outcomes in the case at hand. In a candid evaluation of its 2010 bailout, the IMF admitted:

> An upfront debt restructuring would have been better for Greece although it was not acceptable to the euro partners. A delayed debt restructuring also provided a window for private creditors to reduce their exposures and shift debt into official hands […] this shift occurred on a significant scale and limited the bail-in of creditors when PSI eventually took place, leaving taxpayers and the official sector on the hook.[298]

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[294] Gelpern, 'Sovereign Debt: Now What?'

[295] IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework', p. 1.

[296] In *Spiegel Online*, 'Bailout Plan Is All About 'Rescuing Banks and Rich Greeks," May 18, 2010. https://www.crottaz-finance.ch/blog/wp-content/uploads/2010/06/spiegel.de-.pdf?id=pdf

[297] As noted in Chapter 1, McDowell makes this point with respect to how US emergency loans to foreign countries resemble a joint product that simultaneously serves public and private financial interests. See McDowell, *Brother, Can You Spare a Billion?*, p. 91.

[298] IMF, 'Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement', IMF Country Report No. 13/156, 2013, p. 28.

This quote describes the exact outcome the IMF's 2002 framework was designed to avoid. While the framework was supposed to insulate lending decisions from political pressures in order to avoid such outcomes, when the vital economic interests of powerful European states were on the line, the rules were simply changed to accommodate their concerns. As Susan Schadler, former deputy director of the Fund's European Department, concludes: "the criteria for exceptional access did not hold up under political pressure: the criteria were adjusted and weakened."[299] A report from the IMF's Independent Evaluation Office (IEO) concurred that IMF policy decisions were constrained by political pressures to avoid debt restructuring.[300] Political interference to change the Fund's lending rules might have looked more justified if the 2010 bailout had not simply saved German and French banks at the expense of Greek citizens, and if more had been done to substantiate the claim that an upfront restructuring would have resulted in calamitous contagion. However, as another IEO report points out, claims about systemic spillovers were not supported by rigorous analysis seeking to define and identify the potential sources of contagion, or even examine the counterfactual scenarios whereby contagion might stem from delaying restructuring rather than dealing with it up front.[301] With the benefit of hindsight, some analysts believe that the contagion risks may have been overstated.[302]

The 2010 decision to lend to Greece resulted in a significant weakening of the Fund's lending rules and their ability to trigger necessary sovereign debt restructurings. Not only did the systemic exemption represent "a major softening of the lending framework."[303] By disregarding the 2002 rules when they became inconvenient for powerful states, the 2010 decision dealt a much bigger and more lasting blow to the credibility of IMF lending rules to constrain political discretion and thus serve as an effective and consistent trigger mechanism. As comments from scholars, market participants, and Fund staff themselves reveal, there is a general belief after the Greek episode that if the IMF's lending rules—as technically sound and appropriate as they might be—ever again present an obstacle to the organization's most powerful members, they can and will simply be changed.[304]

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299 Susan Schadler, 'Sovereign Debtors in Distress: Are Our Institutions Up to the Challenge?', CIGI Papers No. 6, 2012.
300 Independent Evaluation Office of the IMF, *The IMF and the Crises in Greece, Ireland, and Portugal*, 2016.
301 Schadler, 'Living with Rules.'
302 Lee C. Buchheit and G. Mitu Gulati, 'Sovereign Debt Restructuring in Europe', *Global Policy* 9(2018): 65-69.
303 Julian Schumacher and Beatrice Weder di Mauro, 'Greek Debt Sustainability and Official Crisis Lending', *Brookings Papers on Economic Activity* 46(2)(2015): 279-305, p. 284.
304 For example, see Eichengreen and Woods, 'The IMF's Unmet Challenges.' See also IMF, 'The Fund's Lending Framework and Sovereign Debt—Further Considerations', Policy Papers, April 2015, p. 22.

In sum, with the outbreak of the Greek debt crisis in 2010, European preferences articulated in the 1990s and early 2000s for a rules-based framework to trigger restructurings ran up against the reality of what following that framework would mean for their material interests—the financial losses their banks would have to incur and the consequent potential for domestic and regional instability. In this new crisis context, European powers—namely France and Germany—set the parameters for Fund involvement and pressured for IMF lending to Greece without an upfront debt restructuring. This move was supported by US officials who also worried about instability in Europe. Unwilling to blatantly flout the rules, Fund staff proposed changing the lending framework to accommodate the Greek program, resulting in the systemic exemption reform.

The 2010 episode revealed the enormous political difficulties of trying to uphold a credible trigger mechanism in light of the power and structural position of the leading capital-exporting states in the global financial order. Although their structural position did not automatically lead to a uniform set of preferences over the creation of an IMF trigger mechanism in 2002, it did eventually lead to a clash between the Fund's lending rules and the material interests of states that had previously advocated for those rules. The fact that state preferences were different at the rule-creation (2002) and the rule-implementation (2010) stage of the policy process largely reflected the time-inconsistency problem discussed in Chapter 3, which plagues the credibility of a rules-based trigger mechanism in the SDRR.

Some will argue that the Eurozone crisis was unique and that such conditions are unlikely to arise again. But financial crises, aside from being "a hardy perennial," are unpredictable, and unless global financial linkages dissipate or the financial sectors of dominant states become much more resilient to cross-border shocks, it is difficult to imagine that pressures from powerful states to avert or delay foreign debt restructurings will no longer arise.[305] So long as IMF lending remains a convenient tool for averting or delaying debt workouts, capital-exporting states will continue to use their leverage within the organization to do just that. Moreover, the 2010 episode itself dealt a massive blow to the credibility of the Fund's framework, suggesting that creditors and debtors will not take the trigger commitment seriously—if they ever did before—and it is therefore unlikely to have any impact on reducing moral hazard and preventing future crises. Lastly, the fallout from the 2010 decision led to a further re-evaluation and eventually a watering down of the Fund's framework, making it easier to

[305] Charles Kindleberger famously called financial crises a hardy perennial. See Charles P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises* (Wiley, 2005).

sidestep restructuring in a wider range of cases without having to formally break or change the rules. It is this latter reform process and outcome to which the chapter now turns.

## 3. Reforming the Lending Rules After Greece: 2013-2016

In response to mounting concerns about its effectiveness and legitimacy, the Fund launched a formal review process aimed at strengthening its approach to sovereign debt restructuring. The reform process played out between April 2013 and January 2016, with proposals and discussions centering around a series of IMF staff papers. This section analyzes this process. It shows how, in the wake of the 2010 reform discussed above and the most intense years of the Eurozone crisis, the preferences of the leading capital-exporting states had, as a whole, shifted toward endorsing a more flexible and discretionary lending framework than was established in 2002. The US was the most vocal and also the most powerful proponent of greater flexibility, but key European states were also either strongly in favour of flexibility or less enthusiastic about firm rules than they had been in the 1990s and early 2000s. For the US, the desire for a more flexible framework represented a return to the historical norm, but it was also bolstered by recent experience with extraordinary crises. The shift in preferences among European powers also reflected recent experiences. Among other things, the Eurozone and specifically Greek crisis forced France and Germany to come to terms with their structural position and exposure to foreign debt restructurings, impacting their policy views on subsequent reforms to Fund lending rules. Private creditors and sovereign debtors also lobbied in favour of a more flexible and case-by-case approach to debt restructuring. Although these actors lack the power to shape IMF lending rules against the wishes of dominant states, the fact that their preferences aligned with those of the US and other key states only reinforced the strength of their collective position.

Not all actors involved in the reform process agreed that the Fund's framework should be as flexible and discretionary as the US and others preferred. IMF staff wanted to establish a more credible and precise set of rules that, while being more nuanced than the 2002 framework, would still serve as a restructuring trigger when a country's debt was not clearly sustainable. US Congress also managed to intervene in the reform process and force the IMF to remove the systemic exemption introduced in 2010, which US and French officials in particular wanted to keep as a source of flexibility. But IMF staff could only do so much within the parameters set by their political masters, and the elimination of the systemic exemption simply led US representatives within the Fund to push for greater flexibility in other areas and aspects of the rules, offsetting Congress's attempt to introduce more discipline to

the EA framework. In the end, the power of the pro-flexibility camp—led by US officials—and the lack of a sufficiently strong counterweight led to the introduction of a new lending framework in 2016 that weakened the content of the international rules designed to trigger sovereign debt restructurings.

### *3.1 The 2013 Staff Paper and the Response*

The first staff paper to kick-off reform discussions was released in April 2013. It outlined the existing problems with sovereign debt restructurings and the Fund's tools for addressing them, and established a reform agenda for resolving these problems. The first and most crucial shortcoming that staff identified was the fact that "debt restructurings have often been too little, too late, thus failing to re-establish debt sustainability and market access in a durable way."[306] For staff, this concern called for a rethinking of the EA lending framework in light of the Greek experience, which highlighted the importance of again "exploring ways to prevent the use of Fund resources to simply bail out private creditors."[307] The paper reiterated the consensus view held in 2002: that debt sustainability should be a precondition for large-scale IMF lending in the absence of a debt restructuring, and that concerns about contagion, while important to the design of a Fund program, should not trump sustainability considerations and their role in triggering necessary restructurings. As staff noted, "when a member's sovereign debt is unsustainable and there are concerns regarding the contagion effects of a restructuring, providing large-scale financing without debt relief would only postpone the need to address the debt problem."[308] For this reason, the paper encouraged the EB to consider removing the 'systemic exemption' created in 2010.

But the 2013 paper was also aware of the strong political pressures to avoid or delay restructurings, regardless of IMF rules designed to trigger them (pressures described in Chapter 3 and seen in the context of the Greek bailout discussed in the previous section). Describing the incentives that debtor governments, official creditors, and private creditors all have to put off a restructuring, staff wrote:

> Authorities [in debtor countries] are also concerned with a restructuring's impact on market reaccess and spillover effects on the private sector. In addition, official creditors

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[306] IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework,' p. 1.

[307] IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework,' p. 1.

[308] IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework,' p. 23.

> have sometimes contributed to delays, out of concern that a restructuring would reduce incentives for the debtor country to adjust, force banks located in the official lenders' countries to recognize losses, and trigger market turmoil in similarly-situated countries […] Private creditors will also naturally wish to avoid a debt restructuring if at all possible, and will therefore press for a bailout by the official sector.[309]

Removing the systemic exemption would restore the EA framework of 2002. Clearly, however, that version of the rules failed to withstand political pressures in 2010, and there was little reason to believe it would fare better when confronted with similar situations in the future. For reasons outlined in Section 2.3 of Chapter 3, Fund staff had an interest in re-establishing a tighter and more credible set of lending rules, but ones that could withstand a challenge of the sort thrown up by Greece. For them, there was thus a need to go beyond the 2002 framework by considering a wider range of policy responses to different debt sustainability scenarios. Staff continued to believe that clear-cut cases where debt was sustainable justified EA financing, while clear-cut cases where it was unsustainable required restructuring. But they began to consider whether there should be a third option for dealing with the more uncertain cases where debt was deemed sustainable but not with a high probability. The 2013 paper suggested that this third option might take the form of a lighter restructuring involving debt rescheduling rather than debt reduction. A key excerpt from the paper reads:

> There may be a case for exploring additional ways to limit the risk that Fund resources will simply be used to bail out private creditors. For example, *a presumption could be established that some form of creditor bail-in measure would be implemented as a condition for Fund lending in cases where, although no clear-cut determination has been made that the debt is unsustainable, the member has lost market access and prospects for regaining market access are uncertain*. In such cases, the primary objective of creditor bail-in would be designed to ensure that creditors would not exit during the period while the Fund is providing financial assistance. This would also give more time for the Fund to determine whether the problem is one of liquidity or solvency. Accordingly, the measures would typically involve a rescheduling of debt, rather than the type of debt stock reduction that is normally required in circumstances where debt is judged to be unsustainable.[310]

The staff's suggestion of conditioning IMF financing on a debt rescheduling when the sustainability of a country's debt is uncertain can be read as an attempt to re-establish clear and credible lending rules that would prevent private-creditor bailouts without necessarily requiring the type of substantial

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309 IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework,' p. 21.

310 IMF, 'Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework,' p. 26. Emphasis added.

restructurings that would be more likely to raise financial stability concerns among capital exporters. If such concerns could be muted, staff might succeed in restoring a rules-based trigger mechanism that was less likely to be broken or abandoned the next time fears of systemic contagion flared up. This, in turn, could help to rehabilitate the Fund's image as an impartial, technocratic organization whose lending decisions are based on rules and expert analysis rather than the political interests of its most powerful members. In short, the staff's ideas for reforming the lending framework can be viewed through the prism of their own interests in preserving the Fund's legitimacy and expert authority.

But when the Board met in May 2013 to discuss the first paper, representatives of the most powerful states were less supportive of the staff's early ideas than they had been back in 2002. Indeed, the tone of the debate over rules versus discretion had seemingly swung back in favour of the latter, particularly for the US but also among major European powers. American representatives appreciated the flexibility provided by the systemic exemption and were unconvinced of the need to remove it. They were also extremely skeptical of the staff's suggestion of conditioning IMF lending on even a relatively soft creditor bail-in, such as a rescheduling, in cases where the sustainability of a country's debt was unclear. Voicing their concerns with the idea of "a presumption that financing should be conditioned on creditor bail-ins when market access is not certain," US representatives stated:

> the paper's recommendations would make sovereign debt reschedulings and restructurings a much more central feature of crisis management, including in cases where debt levels are not obviously unsustainable but prospects for returning to market access are uncertain. We would strongly caution against moving towards a more prescriptive and centralized crisis management regime based on a limited set of cases.[311]

The contrast between this view and the one advocated by the US in the early 2000s could not have been starker. In 2002, the very purpose of creating a more formal EA framework was to create a more prescriptive, rules-based regime that would make debt restructurings a more central feature of crisis management. The comments from 2013 suggest that rules resulting in more restructurings, even relatively light forms of rescheduling, would be extremely undesirable and should not be pursued.

The shift in US preferences relative to 2002 partly reflected an ideological chasm between recent

[311] Statement by Ms. Lundsager, Mr. E. Meyer, and Ms. Douglass Kochman on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework. Executive Board Meeting, May 20, 2013. GRAY/13/1471, p. 2.

Republican and Democratic US Treasury teams. The Bush-era officials who helped establish the 2002 EA framework were intellectually committed to rules-based approaches, whereas the Obama-era officials—many of whom had also served in the Clinton Administration—preferred discretion and case-by-case crisis management. But the shift also represented a return to the historical norm for the US.[312] As a former senior IMF official put it: "As a general rule, the US tends to favour flexibility and case-by-case discretion, at least in this area."[313] The desire not to be bound by rules that specify in advance how certain crises should be resolved, including when debt restructuring should take place, makes sense given the centrality of the US in the global financial system. The extensive global activities and connections of American financial firms had exposed the country to situations in which foreign defaults and restructurings threatened to damage and destabilize US firms and markets, underpinning the preference for a case-by-case crisis management regime that could help to avoid or delay debt write-downs when vital American interests were at stake. But the recent US return to promoting a more discretionary approach to lending and debt restructuring was about more than just snapping back to normal. The preference for greater flexibility was, in fact, reinforced by recent experience and the crisis context in which US policymakers found themselves. With reform discussions taking place on the heels of extraordinary and unforeseen financial meltdowns in the US and Europe, and with massive uncertainty remaining about the prospect of financial shocks in the Eurozone, the broad view among Treasury decision-makers was that "you don't tie your hands down in the middle of a crisis."[314]

Board members from powerful European states expressed similar, though somewhat less strong, reservations about the staff paper and the idea of a clear trigger mechanism for restructurings more generally. French officials came out strongly in favour of considerable flexibility and discretion in the Fund's approach to debt restructuring. The French representative on the EB expressed skepticism that IMF debt sustainability assessments could be an appropriate trigger for restructuring, arguing that "the DSA tool cannot be considered as the only signal for any situation at any time, systematically triggering the final assessment for policy action."[315] He also noted that the French were inclined to keep the systemic exemption introduced in 2010, noting "the potential for damaging spillovers."[316]

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[312] Interview 138785.
[313] Ibid.
[314] Interview 114203.
[315] Statement by Mr. Cumenge on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework. Executive Board Meeting, May 20, 2013. GRAY/13/1477, p. 1.
[316] Statement by Mr. Cumenge, p. 2.

The Germans, who had been the most ardent supporters of firm restructuring rules in the early 2000s, took a somewhat mixed position on the subject, reflecting both their longstanding ideological concerns about moral hazard and their recent interests in postponing debt restructuring in Greece and avoiding it elsewhere in the Eurozone. In a sharp break from their conviction at the September 2002 Board meeting that "Capital Account Crisis *plus* Uncertain Debt Sustainability *requires* Debt Restructuring,"[317] German representatives took a more nuanced approach at the May 2013 meeting, noting that "the desirability of an early and large upfront debt restructuring is seldom a clear-cut decision and must factor in a number of delicate trade-offs," including "consideration of country-specific circumstances."[318] At the same time, however, German officials signaled their support for further exploration of creditor bail-in options as well as a review of the 2010 systemic exemption.

UK officials were not outwardly opposed to the staff's ideas but wondered whether changing the exceptional access criteria would matter if expectations of IMF bailouts were left unchanged. Here, they were referring to the fact that, after the Greek bailout shattered the 2002 lending rules, further changes to the EA framework would not be seen as a credible constraint on the Fund. In this vein, they added: "we look forward to hearing staff's view, in due course, on ideas that could help provide credible commitments for the official sector not to err on the side of bailing out, rather than restructuring sovereign debt."[319] Japanese representatives, for their part, encouraged staff to continue thinking about these issues but cautioned that removing the systemic exemption could make it more difficult for the Fund to fight systemic crises.

As a whole, the Europeans were less hostile to the staff's suggestions and less adamant about the need for greater flexibility than the Americans. But, compared to 2002, they were no longer united around the need for hard lending constraints that could trigger restructurings when a country's debt was not clearly sustainable. The French were closest to the Americans in their support for greater flexibility, the British were somewhat indifferent, and the Germans, while still stronger proponents of rules than their counterparts, were less enthusiastic about IMF lending reform than they had been in the 1990s and early 2000s. In a relatively short period of time, the direction and/or intensity of European

[317] Statement by Mr. Bischofberger, p. 3.
[318] Statement by Mr. Meyer and Mr. Engelen on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework. Executive Board Meeting, May 20, 2013. GRAY/13/1475, p. 1.
[319] Statement by Mr. Yeates and Mr. Meads on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework. Executive Board Meeting, May 20, 2013. GRAY/13/1479, p. 1.

preferences had shifted in a significant way.

The change in European preferences largely reflected the recent experience of the Eurozone crisis in general, and the controversial decision to break with existing IMF rules to facilitate the Greek bailout in 2010 in particular. For France and Germany, the crisis exposed their vulnerability and fragility to events previously considered a material concern only for emerging markets and, occasionally, the US. It made their own national interests in avoiding/delaying foreign restructurings impossible to ignore, leading them to contradict previous policy positions and push for a bailout of Greece and its private creditors. For the French, this difficult episode showed that "it is and will generally prove difficult to establish in a clear-cut way the necessity of debt restructuring and its "optimal" timing" before the fact, thus underscoring the need for case-by-case assessments to make such tricky judgments.[320] German preferences did not change direction in this way, but they seemed to soften as a result of the crisis and the reconciling of long-held ideological commitments with recent existential experiences.

Moreover, neither Germany nor France wanted to re-live the experience of pressuring the IMF to break its lending rules—rules they had previously endorsed—in order to approve a controversial program that benefitted their financial interests at the expense of the debtor country. One way to avoid ending up in a similar situation again would be to strengthen the crisis prevention regime. Another, however, would be to avoid setting up rigid crisis management rules that might need be broken the next time an unpredictable 'tail risk' materializes. To some extent, diminished support for strong and precise lending rules may have also reflected this desire—among France and Germany but also other capital-exporting states that learned from the Greek episode—to avoid having to break or amend the rules in the future.

The political difficulties of sustaining strict lending rules—crystalized by the Greek episode—also affected the strength of British preferences. British officials saw the 2010 systemic exemption, rightly so, as a massive blow to the credibility of the commitment not to lend under certain conditions. They wondered, after 2010, if re-establishing firm restructuring rules would really matter if such rules could simply be rewritten when they became inconvenient. Somewhat disillusioned, the British went from being strong proponents of a trigger mechanism in the 1990s and early 2000s to being less willing to

[320] Statement by Mr. Cumenge, p. 2.

champion this cause in 2013. While the effects of recent events varied across states, the aggregate impact of the European crisis and the 2010 episode was to diminish the previously strong European support for hard lending constraints to limit IMF bailouts and trigger more debt restructurings.

With powerful states—especially the US but also the Europeans—either strongly against or less committed to a robust trigger mechanism, the balance of power had swung in favour of more flexible rules open to wider interpretation and application. This preference for looser rules was then reinforced by the transnational private creditor community, who also voiced strong concerns with staff's ideas regarding the Fund's framework and its role in encouraging debt restructurings. This was in contrast to the early 2000s, when private creditor groups lobbied against the SDRM (and CACs at first) but were relatively silent on the issue of IMF reform (likely owing to the fuzziness of the trigger-process distinction at that time and the fact that the SDRM and CACs were much higher-profile initiatives than the Fund's behind-the-scenes reform to its own internal rules).

In response to the staff's 2013 paper, the IIF released a document in January 2014 outlining the views of its "Special Committee on Financial Crisis Prevention and Resolution"—a group comprising high-level representatives from leading global banks, investment funds, and corporate law firms. Their reaction to the paper was hostile. Echoing the US ED, they took particular issue with the idea of any "presumption" of a creditor bail-in. In their words:

> we are concerned that adoption of the "presumption" of creditor involvement at the outset of new IMF programs would signal a new, more demanding and rigid policy rule. Such a perception, would present the Fund as henceforth more likely to ask for debt restructuring (maturity extensions), or not to be sufficiently objective in coming to judgments about the outlook for debt sustainability, erring on the side of asking for private sector involvement.[321]

Such staunch opposition seemed to suggest that this kind of presumption did not already exist, when in fact it did and was the central premise of the 2002 framework, which established a much more "rigid policy rule" than the more nuanced approach staff were now suggesting. Moreover, the 2002 rules had not resulted in larger losses for creditors. As Gelpern noted, "[t]here is no evidence that the 2002 policy made large programs any more exceptional, nor that it made debt restructuring more

[321] IIF Special Committee on Financial Crisis Prevention and Resolution, 'Views on the Way Forward for Strengthening the Framework for Sovereign Debt Restructuring', January 2014, p. 3.

common."[322] When the rules met their first major challenge, they were changed to enable a bailout that allowed multinational creditor banks to avoid losses and quietly exit from the crisis. Yet the IIF committee's feedback suggested that the IMF's proposal, which in many cases would presume less or lighter restructuring than the 2002 framework, would be disastrous:

> The private creditor and investor community is concerned about the potential adverse implications if the IMF staff suggestions were to be adopted. Acceptance of these suggestions could seriously jeopardize the current contractual, market-based approach. Such an outcome would undermine creditor property rights and lead to a confrontational rather than a cooperative approach to addressing legitimate concerns about debt sustainability, with far-reaching adverse consequences for all stakeholders, thus potentially posing systemic risks.[323]

Despite its hyperbolic language about the dire consequences of the 2013 paper's proposed rule changes, the IIF committee simultaneously suggested that new IMF rules would not matter, arguing that "[f]irm rules would also not be credible, as the IMF Executive Board would retain the right to modify IMF policies if it deems it necessary."[324] In a final move to convince IMF staff to drop the idea of a rules-based trigger for debt restructuring, the committee made clear that its preferences were fully aligned with those of the US and other large shareholders, stating: "Major IMF shareholders have frequently expressed strong preference for a pragmatic case-by-case approach with adequate flexibility to accommodate the diversity of country circumstances. We share fully this preference."[325]

Private creditor preferences toward IMF lending rules reflected their opposition to any policy that might make debt restructuring more likely and/or diminish their capacity to influence restructuring decisions, as discussed in Chapter 3 (Section 2.2.1). Assessing the influence of creditor views on IMF deliberations is somewhat difficult, especially because their preferences were aligned with those of the US. Some might wonder whether US views on this issue were themselves a product of IIF lobbying. But as discussed above, the US stance reflected longstanding and recently reinforced preferences for case-by-case crisis management, related to America's structural position in global finance and its national interests in safeguarding financial stability. When asked about the influence of the IIF on US preferences, a former Treasury official responded: "Nothing we did had anything to do with the

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322 Gelpern, 'Sovereign Debt: Now What?' p. 77.
323 IIF Special Committee, p. 2.
324 Ibid, p. 2.
325 Ibid, p. 3.

IIF."[326] Although the IIF's strong views on IMF staff's reform ideas had little impact on US thinking, there are good reasons to believe that they further strengthened the pro-flexibility message that was already being sent to Fund staff. As a former senior IMF employee remarked: "clearly, we listen to the private sector and consult with the private sector, and it's important because what we don't want to do is have a [lending] framework which ends up, you know, scaring the markets."[327] Judging by the IIF's reaction, market representatives had been sufficiently scared by the Fund's early reform ideas.

A number of debtor states also took issue with staff's ideas. Responding to the idea of a presumed creditor bail-in, representatives of the constituency that spoke for Spain, Mexico, and several other debtors warned, "[c]areful attention should be paid to possible consequences of this measure, such as a substantial increase in debt restructurings and an intensification of the stigma associated to Fund's programs."[328] Their concern as debtors was that if they ever had to borrow from the Fund, they might be forced into a debt restructuring. The timing of reform discussions also raised sensitivities for Europe's Southern debtors who remained at risk of debt distress. According to a then senior IMF official, Southern European officials felt "that they were still vulnerable, and they were worried that the removal of systemic exemption could signal that their debt is going to be restructured."[329] Like the IIF's views, debtor preferences to avoid a strict restructuring rule and preserve the flexibility inherent in the systemic exemption reflected the considerations outlined in Section 2.2.1 of Chapter 3, and they only reinforced the chorus of powerful voices already calling for a more case-by-case approach.

Despite reservations about the desirability and effectiveness of stronger IMF lending rules, private creditors and the EDs from capital-exporting and debtor states alike strongly endorsed further efforts to improve the contractual approach to debt restructuring via strengthened CACs. Thus, unlike the early 2000s when many viewed lending rules and an improved restructuring process as inseparably linked, many now saw the restructuring trigger and process as very separable.[330] Rejecting the idea of an institutionalized trigger but embracing the need for a more robust process, the US ED remarked: "We continue to see merit in a case-by-case approach, allowing for appropriate flexibility, and have

[326] Interview 114203.
[327] Interview 138785.
[328] Statement by Mr. Varela, Mrs. Arbelaez, and Mr. Zuniga Villasenor on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework. Executive Board Meeting, May 16, 2013. GRAY/13/1481, p. 2.
[329] Interview 138785.
[330] Taylor, *Global Financial Warriors*, p. 110.

concerns with some of the staff's suggestions. Separately, the paper raises important issues about refining the contractual approach to orderly sovereign debt restructuring, and we strongly support the staff's proposals for further work on aggregation clauses."[331] Echoing this sentiment, the IIF sought to further divorce the process from the trigger by stating: "we believe that the nature and extent of private sector involvement can best be considered in the context of a cooperative process under the contractual approach rather than be triggered through either unilateral or prescribed procedures."[332]

### *3.2 The 2014 Staff Paper and the Response*

IMF staff did not abandon their efforts to strengthen the EA framework, but the reaction of the US, other shareholders, and the private financial community to the 2013 paper had a clear impact on the subsequent development of staff proposals. In June 2014, staff released a second paper that revised and elaborated upon their earlier proposals. Responding to US and IIF criticism, the paper walked back the language used in 2013, noting that "[t]here should be no "presumption" that any Fund assistance will be made conditional on any form of debt restructuring."[333] Staff maintained, however, that situations in which a country's debt is neither sustainable nor unsustainable with high probability—that is, cases of genuine uncertainty—should be treated differently from the binary solutions currently available: large-scale financing or deep debt restructuring. For cases in this unclear 'gray zone,' the paper recommends making Fund financing conditional upon a 'debt reprofiling'—a relatively short extension of maturities without any reduction in principal or coupon payments. This option would minimize the risk that large and costly debt reductions were imposed in cases where, in the end, they may not have been necessary, but it would also reduce the risk that large-scale financing was provided in cases where debt relief was in fact needed, leading to costly delays in debt restructuring and unjustified bailouts of private creditors. Debt reprofiling was a compromise designed to lower the prospects of arriving at either one of two bad outcomes.

But debt reprofiling was simply another term for debt rescheduling, which is a form of restructuring. And in advocating for reprofiling in gray zone cases, staff continued to push for an approach that would make Fund financing conditional on some form of restructuring when debt sustainability was anything other than highly probable, even as they tried to combat the criticism levelled by shareholders

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331 Statement by Ms. Lundsager, Mr. E. Meyer, and Ms. Douglass Kochman, p. 1.
332 IIF Special Committee, p. 3.
333 IMF, The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations,' p. 7.

and the private sector. In what amounted to a semantic maneuver to distance staff's preferred option from the word "presumption," the 2014 paper argued:

> there would be no "presumption" that a member who approaches the Fund for a program after having lost market access would need to undertake any form of debt restructuring, including a reprofiling. Rather, even when a member has lost market access, the Fund would be able to rely on its traditional catalytic approach if it can make the determination that there is a high probability that debt is sustainable and that, accordingly, the loss of market access is very likely to be temporary. Only if the Fund cannot make this determination would some form of debt restructuring be expected, the nature of which would depend on the circumstances.[334]

Staff went on to argue that it would be appropriate to require two criteria to be met before the IMF determined that reprofiling would be a condition of exceptional access financing: (1) the member must have already lost market access, and (2) a rigorous DSA suggests that there is considerable uncertainty regarding the sustainability of the member's debt situation. In addition to advocating debt reprofiling as a third option for the EA framework, the 2014 paper also argued for an elimination of the systemic exemption, which staff continued to see as an arbitrary loophole that could be invoked to avoid or delay necessary restructurings regardless of sustainability considerations. In adding reprofiling and removing the exemption, staff's proposal was designed to make IMF lending rules more coherent than the 2010 framework but more resilient than the 2002 version, allowing them to bend and flex without breaking under pressure. Reprofiling would not trigger steep creditor losses and would therefore be less likely to have major systemic spillover effects, making it an easier pill to swallow for powerful political and financial actors.

Despite staff's best efforts to convince them, important EDs remained skeptical of the merits of making EA financing conditional on reprofiling in gray zone cases. After the EB met in June 2014 to discuss staff's newest paper, the acting Chairman of the meeting noted: "A few Directors, noting the operational difficulty in judging if both conditions for reprofiling have been met and the risk that the reprofiling option could trigger market volatility, preferred to maintain the current framework, which they considered more pragmatic and flexible."[335] The summary statements also revealed that while some Board members supported eliminating the systemic exemption, others—including the US—

[334] IMF, The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations,' pp. 11-12.
[335] IMF, 'The Chairman's Summing Up: The Fund's Lending Framework and Sovereign Debt—Preliminary Considerations'. Executive Board Meeting 14/54, June 13, 2014. BUFF/14/54, p. 1.

preferred to retain it as a flexible and "pragmatic way to safeguard financial stability in an increasingly integrated world."[336]

This back and forth between the Fund's staff and its most powerful states between 2013 and 2014 represented a struggle between competing interests and conceptions of appropriate governance. As noted in Chapter 3, staff had an interest in restoring coherent rules that would still be capable of triggering restructurings according to objective criteria. Such rules, if credible and seemingly free from political interference, would help to enhance the legitimacy and authority of the Fund as a technocratic body driven by impartial expertise. At the same time, well-constructed rules could improve program outcomes by constraining the IMF from bailing out private creditors, from contributing to moral hazard, and from delaying necessary restructurings. More successful programs would also translate into greater legitimacy, authority, and prestige for the IMF and its staff. Lastly, precise technical rules whose application relied on expert rather than broad political judgments would also shift some decision-making power over debt restructuring away from states and into the hands of Fund staff.

Although the IMF's largest shareholders also have a stake in the organization's legitimacy, they value the political discretion to shape IMF crisis responses in ways that avoid or delay debt write-downs when doing so protects their core interests, for reasons detailed in Chapter 3. Even states that have professed their desire for stricter rules have revealed the time inconsistency of their preferences when their financial stability was at stake. In the aftermath of the 2010 Greek crisis, dominant states have seen it as even less desirable to paint themselves into a corner from which they might again choose to step out. Given the power of the EB to approve or reject staff's proposals, the Fund's largest shareholders, particularly the US, clearly had the upper hand in this struggle over the shape of reforms.

### *3.3 The 2015 Staff Paper and the Intervention of US Congress*

The next step for staff was to take the Board's feedback on the first two papers and translate it into concrete proposals that could command the support of shareholders, especially the US, which had outlined and maintained its opposition to staff's earlier ideas. In April 2015, staff released a third paper with updated proposals.[337] Its proposed reforms watered-down their preferred approach of making Fund support conditional on debt reprofiling in gray zone cases. While the paper presented debt

[336] Ibid, p. 2.
[337] IMF, 'The Fund's Lending Framework and Sovereign Debt—Further Considerations.'

reprofiling as an attractive option in such cases, it also allowed for other responses that did not involve debt restructuring at all. The key proposed passage on uncertain cases in the 2015 paper reads:

> Where a member's debt is considered sustainable but not with a high probability, exceptional access would be justified if financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability and sufficiently enhances safeguards for Fund resources. For purposes of this criterion, financing provided from sources other than the Fund may include, inter alia, financing obtained through any intended restructuring.[338]

Under this approach, debt reprofiling would become just one potential option, rather than a necessary condition, for dealing with cases where debt was not clearly sustainable. As staff reiterate throughout the paper, "it is possible [under the new approach] that external financing in uncertain cases will not always involve a debt restructuring."[339] The other main option would be to provide an indebted country with financing from sources other than the Fund—mainly bilateral creditors—on terms that were concessional enough to improve the country's debt sustainability. The problem with this approach, as staff had noted back in their 2014 paper, was that "while it addresses the problem of sustainability, the use of official sector financing to bail out the private sector will exacerbate the moral hazard problem that the possible reform considered in this paper is trying to address."[340] The revised framework would thus fail to mitigate the tendency to bail out creditors and delay debt restructurings, leaving unaddressed the 'too little, too late' problem that motivated staff proposals in the first place.

As for the systemic exemption, the 2015 paper proposed removing it from the EA framework. In fact, staff made clear that, from their perspective, "the proposals to (i) increase the flexibility of the general framework, and (ii) remove the systemic exemption should be seen as a 'package.'"[341] To support this recommendation, staff drew on their consultations with market participants, emphasizing that several market actors supported this aspect of their proposal. While staff listed several reasons for this, their comments also suggested—somewhat problematically—that markets did not view removal of the exemption as a credible commitment in any case. Reflecting on their market outreach, staff noted: some market participants "observed that, even if the systemic exemption is removed, the Executive

[338] Ibid, p. 8.
[339] Ibid, p. 11.
[340] Ibid, p. 21.
[341] Ibid, p. 12.

Board can, by a majority of votes, re-introduce the escape clause, if it deems it necessary."[342]

But the more important source of support for removing the exemption came from the US Congress. While officials in the Obama Administration remained reluctant to remove the exemption, voices within the then Republican majority Congress began to insist on its elimination.[343] Congress also had a key source of leverage over the US Treasury and its representatives at the IMF. For years, it had refused to ratify the 'governance reforms' to increase and redistribute IMF quotas and voting shares, which had been agreed at the G20's Seoul Summit in 2010. In 2015, Congress began to signal that it would finally approve these reforms, but only if the Fund eliminated the systemic exemption. The importance of removing the exemption was given intellectual support by John Taylor, the former Treasury undersecretary for international affairs and one of the leading US proponents of the EA framework back in 2002. Taylor saw the 2002 rules as responsible for much of the global financial stability of the 2000s, and blamed the depth and length of the Greek crisis on the Fund's decision to break those rules in 2010. As he wrote in a Wall Street Journal op-ed on July 9, 2015:

> Though the IMF's loan to Greece in 2010 was presumably made under political pressure from the banks and other private holders of Greek debt, the purported reason was a high risk of international spillover. But systemic risk is often in the eye of the beholder. If that standard holds, IMF loan decisions will continue to be largely discretionary. More bailouts and instability remain likely.[344]

In Taylor's view, restoring the integrity and effectiveness of the IMF's lending framework required removing the systemic exemption. Invited to testify on this issue before the US House of Representatives' Subcommittee on Monetary Policy and Trade, Taylor expounded on the merits of the 2002 framework, arguing that "[w]ithout such a framework decisions become highly uncertain—influenced more by politics than economics—and create perverse incentives, including moral hazard […] For institutions like the IMF that can lend exceptionally large amounts supported by taxpayer funds, such a framework is essential for transparency, accountability, and preventing public bailouts

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342 Ibid, p. 22.

343 The Republicans took majority control in the US House of Representatives in January 2011 and maintained it until the end of 2018. They also gained a majority in the US Senate in January 2015 and have thus far (at the time of writing) maintained it.

344 John B. Taylor, 'The Lesson Greece's Lenders Forgot', *Wall Street Journal*, July 9, 2015. https://www.wsj.com/articles/the-lesson-greeces-lenders-forgot-1436482117

of the private sector."[345] He then argued that Congress should pass legislation approving the Fund's governance reforms in exchange for an elimination of the systemic exemption.[346]

When Congress began to signal that they would force the removal of the exemption in this way, US representatives within the Fund started to push for even greater flexibility in other areas of the Fund's framework—principally for more options for addressing gray zone cases—in order to offset the diminished discretion brought about by the loss of the systemic exemption. While Congress had thus gained leverage over the process and was one of the few voices still pushing for stricter lending limits, Treasury officials had a more direct line into the Fund and were able to use this privileged position to ensure that, despite the elimination of the systemic exemption, the final policy framework would be sufficiently flexible to satisfy their preferences. A Treasury official at the time described in the following way the US Treasury's view on accepting the removal of the systemic exemption in exchange for US Congressional approval of the IMF quota reform:

> For us, getting the quota legislation was far more important than our position on the sovereign debt lending framework. Further, in the course of the discussions, the Fund staff had worked to make their sovereign debt lending framework proposal more flexible, and the international community has always been willing to break rules when needed in times of exigency.[347]

In other words, removing the systemic exemption was a price worth paying for IMF quota reform, especially because other aspects of the Fund's lending framework (those related to the treatment of gray zone cases) were being adjusted to allow for a more flexible approach to lending and debt restructuring decisions, and because the new rules could also always be broken if need be.

### *3.4 The Final Framework and Its Diminished Capacity to Trigger Debt Restructurings*

On January 20, 2016, the EB approved the final reforms to the IMF's EA framework. These reforms comprised two important changes. First, the systemic exemption was repealed, as US Congress—heeding Taylor's advice—passed legislation making this change conditional upon their approval of the

[345] John B. Taylor, 'IMF Reforms and Global Economic Stability', Testimony before the Subcommittee on Monetary Policy and Trade, Committee on Financial Services, U.S. House of Representatives. June 17, 2015.
[346] Ibid.
[347] Interview 114203.

Fund's governance reforms.[348] Second, more flexibility was introduced for dealing with 'gray zone' cases. The new framework outlined three possible approaches each linked to a different assessment of debt sustainability. When the Fund was confident that debt was sustainable with a high probability, it would continue to rely on catalytic financing. When debt was clearly unsustainable, EA financing would continue to be conditional on a debt restructuring sufficiently deep to restore sustainability with a high probability. However, when debt was assessed to be sustainable but not with a high probability, the new framework would provide a more flexible range of options for dealing with the situation. Debt reprofiling would be one option, but the Fund could also grant financing without requiring debt restructuring of any kind, as long as the member receives financing from other creditors (official or private), and this financing helps to improve its debt sustainability prospects—without necessarily restoring debt sustainability with a high probability—and sufficiently safeguards IMF resources. Figure 4 depicts the key differences between the Fund's 2002, 2010, and 2016 EA frameworks.

**Figure 4: The Fund's Exceptional Access Lending Frameworks**[349]

| | 2002 Framework | 2010 Framework | 2016 Framework |
|---|---|---|---|
| Debt is unsustainable | Definitive debt restructuring/ official concessional financing | Definitive debt restructuring/ official concessional financing | Definitive debt restructuring/ official concessional financing |
| Debt is sustainable but not with high probability | | Definitive debt restructuring/ official concessional financing OR Invoke systemic exemption | Maintain non-Fund exposure (e.g., reprofiling or official financing) to improve debt sustainability and enhance safeguards for Fund resources |
| Debt is sustainable with high probability | Exceptional access without debt restructuring | Exceptional access without debt restructuring | Exceptional access without debt restructuring |

[348] See Rebecca M. Nelson, 'Lessons from the IMF's Bailout of Greece', statement before Committee on Financial Services Subcommittee on Monetary Policy and Trade, U.S. House of Representatives. May 18, 2017.
[349] This figure comes from: IMF Survey, 'IMF Reforms Policy for Exceptional Access Lending', January 29, 2016. https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol012916a

While the Fund boasts that the new policy "gives the IMF appropriate flexibility to make its financing conditional on a broader range of debt operations, including the less disruptive option of a "debt reprofiling," it also makes abundantly clear that "[t]he new policy does not automatically presume that a reprofiling or any other particular option would be implemented at the outset when debt is in the gray zone,"[350] and that "the reformed framework creates the flexibility for the Fund to approve exceptional access to Fund resources without such a restructuring."[351] In gray zone cases where the reprofiling option is rejected, the new framework makes Fund financing conditional on the provision of funds from other creditors. In such situations, it is thus likely that IMF lending will simply be supplemented by contributions from other official-sector creditors—individual governments but also, increasingly, regional financial arrangements such as the European Stability Mechanism (ESM)—with the greatest stake in avoiding or delaying sovereign debt restructuring. This does little to encourage early restructurings, prevent the bailout of private interests, or discourage moral hazard—the core goals the EA lending framework was designed to achieve.

In the end, the EA framework reforms fell short of staff's hopes for a credible and consistent framework that could serve as a trigger for necessary restructurings and thus address the incentives and expectations that lead to costly delays in debt restructuring, unjustified bailouts of private creditors, and moral hazard. The new rules provide an enormous amount of flexibility and discretion in deciding how to respond to uncertain, gray zone cases, which are arguably the majority of cases. Greece was about as clear-cut an example of unsustainable debt as one could imagine, yet, under pressure to support the 2010 bailout plan, staff determined that its debt was sustainable but not with a high probability. If Greece was a gray zone case, what would it take to actually declare a country's debt clearly unsustainable? If political pressures were strong to avoid restructuring, it seems likely that unsustainable debt burdens would simply be deemed sustainable without high probability, giving the Fund the green light to lend in the absence of a debt restructuring. How would this new framework have changed the way the Fund dealt with Greece? The answer is, not much. Greece would have been declared a gray zone case and private creditors would have been promptly bailed out, buying time for them to exit, as they did, before restructuring commenced in 2012.

[350] Ibid.
[351] IMF, 'IMF Executive Board Approves Exceptional Access Lending Framework Reforms', Press Release No. 16/31, January 29, 2016.

Since its creation in 2016, the new EA framework has had one significant test case. In June 2018, the Fund approved a three-year Stand-By Arrangement for Argentina worth $50 billion (equivalent to about 1,110 percent of Argentina's quota), making it the new largest loan in IMF history.[352] According to staff analysis, Argentina's debt was deemed sustainable but not with a high probability—it was in the gray zone. But rather than require the country to re-profile its private-sector debt, the program was approved without any condition of upfront restructuring.

The Fund defended its decision by arguing that the long maturity of Argentina's privately-held foreign currency-denominated debt could be considered a non-IMF source of financing that improved the country's debt sustainability prospects—a necessary condition for avoiding debt restructuring in unclear cases under the new rules.[353] It is difficult, however, to see how existing debt obligations serviced at market interest rates—rather than new financing on concessional terms—could improve a sovereign's debt sustainability. Sources of financing that *improve* sustainability are those that make a country's long-term debt outlook *better than when it arrived at the Fund for help*. Argentina's existing obligations were part of the problem that led it to seek IMF assistance, not some new source of support that helped it solve that problem. Moreover, if the country's debt burden was not a concern it would have been deemed sustainable in the first place, rather than put in the more questionable gray zone. IMF staff justified their argument by pointing out that only a quarter of Argentina's roughly $150 billion worth of privately-held external debt was expected to mature by the end of the Fund's program in 2020.[354] The implication is that Fund resources can only be used to bailout creditors whose claims mature during the program period. But that still means IMF funding will be available to help repay the roughly $40 billion in private-sector claims that are set to mature before the program ends.

While the decision to lend to Argentina without any kind of debt restructuring does not mean that the program is destined to fail, it does highlight just how ambiguous and flexible the Fund's new lending rules have become. As one US Treasury official put it, "if you look at the Argentine program, where the Fund said the exceptional access criteria are met, I could have made the case that they were met,

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352 IMF, 'IMF Executive Board Approves US$50 Billion Stand-By Arrangement for Argentina,' Press Release No. 18/245. June 20, 2018.

353 IMF, 'Argentina: First Review Under the Stand-By Arrangement,' IMF Country Report No. 18/297 (October 2018). See pp. 25-26.

354 Ibid.

I could have made the case that they weren't met."[355] This type of ambiguity is not necessarily a bad thing in and of itself, but it does allow the Fund to circumvent the very outcomes that the 2002 framework was designed to promote: a more constrained use of large loans, greater private-sector burden-sharing in crisis resolution, and reduced moral hazard. It is also important to note that the room to maneuver built into the new rules can be used to avert or delay debt restructuring not only when the financial interests of dominant states are on the line, but in all future gray zone cases, making the Fund more susceptible to pressures from debtor governments and their private creditors, who will look to persuade the organization that debt write-downs are not necessary in their particular case.[356]

One sovereign debt expert interviewed for this project aptly described the development of the EA lending framework since 2010 as a series of policy blunders, stating:

> The [systemic] exemption is just a complete fricking travesty…totally like the 80s where, you know, we're going to screw the debtors to avoid a banking crisis in London, New York, and Frankfurt. So it's exactly sort of the burden shifting move. How do they get rid of it? They get rid of it with this completely, in my view, non-credible, you know you replace a two-part framework with a three-part framework. And then your defense is, when you're being challenged on it in the latest Argentina program, is like: 'oh well, you know, debt sustainability is an art not a science.'[357]

## 4. Conclusion

IMF lending decisions play a crucial role in determining whether and when a sovereign borrower restructures its debt. The Fund's EA lending framework—established in 2002 and amended in 2010 and 2016—promised to institutionalize this role by establishing clear rules that specified when Fund financing had to be conditioned upon upfront debt restructuring. To date, this framework and its function within the SDRR have received very little scholarly attention. It has been overlooked by IMF scholars who focus on patterns of lending rather than the policy frameworks designed to shape loan decisions, and ignored by sovereign debt analysts preoccupied by higher-profile initiatives aimed at reforming the debt workout process (e.g., the SDRM and CACs). In this chapter, I fill this gap by analyzing two recent sets of reforms to the Fund's lending rules, one of which created a loophole in 2010 to avoid having to implement the original rules, the other of which eliminated that loophole but

[355] Interview 114203.
[356] Ibid. The same interviewee said that there was "wiggle room" in the new EA framework and ways of "navigating around it."
[357] Interview 138790.

also revamped the original rules in 2016. Taken together, I argue that these changes have weakened both the credibility and the content of the IMF's lending framework, undermining its ability to serve as an effective and consistent trigger mechanism for necessary debt restructurings. The implications of this argument for understanding the politics and policy possibilities of the SDRR are significant. In a sentence, it suggests that attempts to institutionalize an effective trigger mechanism face unforgiving political realities that render this type of governance arrangements a technocratic fantasy.

Building on the foundations laid down in Chapter 3, the current chapter showed how the biggest obstacle to a credible trigger mechanism stems from the power and preferences of the leading capital-exporting states. These states do not always and everywhere have a uniform set of preferences toward this type of mechanism, but the nature of their position within the global financial order means that, at certain critical moments, decisions of whether and when a particular country restructures its debt can destabilize their domestic financial systems. When such moments arise, they will use their institutional power within the Fund to shape lending decisions in ways that discourage or delay debt restructuring, no matter how clear the restructuring rules or the crisis country's need for debt relief. In short, while the structural position of capital exporters does not automatically determine their preferences over the creation of an IMF trigger mechanism, it does eventually lead to time-inconsistent preferences that diverge from the rule-creation to the rule-implementation stage of the policy process. This is the key lesson of the IMF's impromptu 2010 reform, as states that had been strong proponents of the 2002 lending rules insisted on ignoring those rules once they became a constraint on protecting national interests—a move that undermined the credibility of the Fund's commitment not to lend.

The chapter also argued that experience related to rule implementation can change the direction and/or intensity of state preferences in ways that feed back into subsequent rule-creation processes. Here, experience with extraordinary financial crises and the controversial decision to change IMF rules to bail-out Greece only reinforced the preference for a more flexible, case-by-case approach to lending among those who traditionally held that position, and diminished the enthusiasm for re-introducing strict lending rules among those who had previously promoted them. While some states (e.g., Germany) and factions within states (e.g., Congressional Republicans in the US) remained stronger proponents of firm rules than others, the balance of forces had shifted in favour of greater flexibility and discretion by the time the IMF's lending rules came up for reconsideration in 2013. Led by US officials but supported by private creditors and several debtor and capital-exporting governments, the

pro-flexibility camp managed to bulldoze key IMF staff proposals and promote a more open-ended approach that weakens the content of the trigger mechanism compared to its 2002 incarnation. The new rules unveiled in 2016 are much looser and more ambiguous about when debt restructuring will be a necessary condition of Fund financing. Given the strong pressures to avoid or delay debt write-downs, it is unlikely that the 2016 rules will have the desired effect of protecting public resources, promoting more public-private burden-sharing, and reigning in moral hazard. This is not to say that IMF lending decisions will no longer trigger restructurings, but rather that they will continue to do so on the more discretionary, politically-suffused basis that has historically guided such decisions.

This chapter contributes to debates on sovereign debt governance by analyzing a neglected aspect of restructuring—the factors that encourage or discourage debt workouts in the first place—and highlighting the political limitations of efforts to establish an effective mechanism to trigger necessary debt write-downs. It also speaks to debates on IMF lending, shedding light on an overlooked element of Fund policy and reinforcing perspectives that see the power and preferences of dominant states as the driving forces behind crucial IMF financing decisions. While private creditors and debtor states have much less influence than the leading capital exporters over the Fund's framework, the fact that their preferences point largely in the same direction as those of dominant states only reinforces the political obstacles to institutionalizing an effective trigger mechanism for sovereign debt restructuring. IMF staff preferences have little impact when they diverge from the dictates of their political masters, especially when the latter is backed by a wider coalition of influential actors. Empirically, this chapter and its contributions to IMF and sovereign debt debates are supported by extensive new archival and primary document evidence used to trace the process of IMF lending reform in significant detail.

The chapter also speaks to broader scholarly discussions about international institutional design and development. It suggests that rational choice approaches offer useful insights into some areas of institutional life but remain unable to explain other fundamental features of institutional design and change. For example, rationalists have argued that states often prefer softer and/or less precise rules to deal with issues characterized by high degrees of uncertainty, such as those related to global financial crisis management.[358] In this sense, the preference for greater flexibility in the IMF's lending rules can be understood within a rational design framework. But this kind of perspective would assume that if

[358] Koremenos, Lipson, and Snidal, 'The Rational Design of International Institutions.' Abbott and Snidal, 'Hard and Soft Law in International Governance.'

flexibility was rational for states with significantly internationalized financial sectors, they would have retained a case-by-case approach or adopted a sufficiently flexible lending framework in the first place. Moreover, mainstream liberal versions of institutionalist thought pay insufficient attention to the perverse and power-laden implications of the institutional arrangements produced by international cooperation.[359] For example, neoliberal institutionalist scholars might treat recent reforms to the IMF's lending framework as instances of mutually-beneficial cooperation aimed at averting disruptive debt restructurings. However, as the Greek debacle and previous episodes such as 1980s debt crisis showed, attempts to avoid or delay necessary debt relief generate a range of dysfunctional outcomes and often produce distinct winners (dominant states and their financial institutions) and losers (debtor countries and their populations). A power-oriented perspective more attuned to these dynamics is thus needed.

An area where both rational institutionalist and power-oriented perspectives struggle is in making sense of shifts in state preferences, particularly the dramatic change in preferences over the design of the IMF's lending framework between 2002 and the 2013-2016 period. To be sure, these shifts came about partly because of changes in the material circumstances facing key capital-exporting states. But they were also heavily influenced by experience with the challenges and limitations of the Fund's lending framework in the context of large-scale sovereign debt crises. The leading proponent of a more flexible set of rules—the US—was no more susceptible to the spillovers generated by debt restructurings than it had been in the past, including when the original lending rules were introduced in 2002. A fuller understanding of recent IMF reform outcomes requires an appreciation of the role of timing and sequencing in politics—specifically the way in which past institutional developments and experiences feed into subsequent rule-making preferences and processes (a point highlighted in Section 3).[360] This point resonates with historical institutionalist accounts of IPE, but scholars working in this tradition tend to highlight the incremental strengthening of global financial governance arrangements after 2008—often in contrast to expectations of more rapid or radical change—whereas I highlight the ways in which, given the underlying political limitations of the mechanism in question, policy sequencing and feedback can also lead to institutional weakening over time.[361]

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[359] For a review of international cooperation theories, see Dai, Snidal, and Sampson, 'International Cooperation Theory and International Institutions.'

[360] See Pierson, *Politics in Time*; Fioretos (ed.), *International Politics and Institutions in Time*.

[361] Fioretos, 'Retrofitting Financial Globalization'; Moschella and Tsingou (eds.), *Great Expectations, Slow Transformations*.

# CHAPTER 5

## UN Reform
## The Restructuring Process and The Pitfalls of Public International Law

### 1. Introduction

On 9 September 2014, the United Nations General Assembly (UNGA) passed a resolution calling for "the establishment of a multilateral legal framework for sovereign debt restructuring processes."[362] The initiative sought to create a more robust international mechanism not to trigger debt workouts, but rather to facilitate the sovereign debt restructuring process once it was underway. The lack of a formal bankruptcy process for sovereign debtors had long been considered a "gaping hole" in global financial governance.[363] And for many observers, this governance gap had only grown larger in the wake of the 2012 Greek debt restructuring and a controversial New York-court ruling against Argentina that same year, both of which highlighted the growing capacity of holdout creditors to obstruct orderly debt restructuring processes. To fill this gap, the UNGA resolution launched a reform process to create an international treaty-based sovereign bankruptcy regime. But after a year of discussions, UN members had abandoned all talk of a hard-law regime and chosen instead to adopt a set of soft-law debt restructuring principles. Despite its lofty ambition, the initiative flamed out.

This UN initiative was fundamentally different from the IMF reforms discussed in Chapter 4 because, as mentioned above, it focused on the debt restructuring process and not the trigger. One of the key ideas advanced in this dissertation is that the restructuring *process* is distinct from the *trigger* in ways that make the former more amenable to effective regulation. Why, then, did the UN reform initiative fail? In this chapter and the next, I show that even if the process is easier to institutionalize than the trigger, different types of process mechanisms face different prospects for success based on their specific *legal-institutional design*. I examine three broad design types: international hard law, international soft law, and domestic private-law contracts. The first two, which together can be called 'public international law,' are the subject of the current chapter, while contract mechanisms take center stage in Chapter 6.

[362] UN, 'Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes.'
[363] Krueger, 'A new approach to sovereign debt restructuring.'

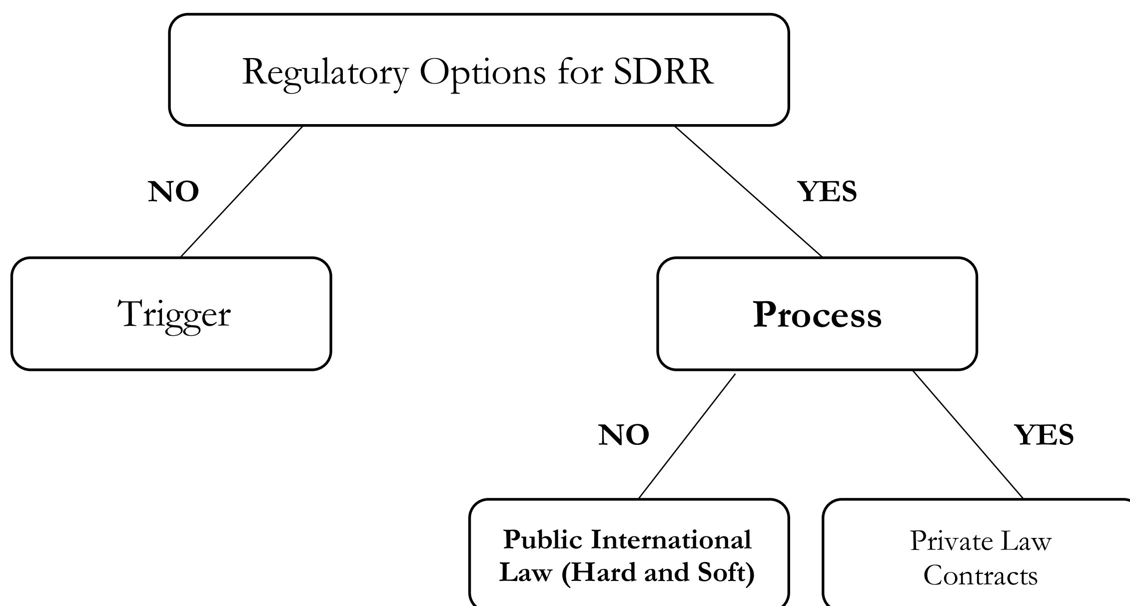
In this chapter, I argue that international hard-law mechanisms face enormous political obstacles that make their realization unlikely, and that the fate of the 2014 UN reform proposal can be understood as a product of its hard-law design. The most important obstacles stem from the preferences and power of the leading capital-exporting states—principally the US and the UK—which used their capabilities to thwart the UN proposal because of its anticipated impact on their national sovereignty and power but also, importantly, on the transnational property rights regime as it pertains to sovereign debt. In short, the fact that a hard-law mechanism could contradict and supersede the existing legal foundations of international sovereign debt markets made it politically unacceptable to the states that primarily benefit from the current order and that have the structural power to block this kind of regulatory change. Their emphatic rejection of a formal multilateral framework in the UN case was only strengthened by the historical legacy of reform debates in the early 2000s. Beyond these dominant states, I argue that debtor governments are also unlikely to commit to an international mechanism that could impinge upon their ability to determine their own debt repayment and restructuring decisions. Despite the fact that debtors spearheaded the UN initiative, many were unprepared to relinquish sovereignty for the sake of a stronger SDRR. Private creditors also tend to oppose hard-law initiatives but receive little attention in this chapter because they played little role in the UN case, and because they are neither necessary nor sufficient to prevent the emergence of a treaty-based SDRR.

While the UN initiative failed to deliver on its original ambition, it did generate a set of non-binding principles designed to guide debt restructuring processes. Some have suggested that these principles can serve as an important soft-law governance tool. At a broader theoretical level, many scholars point to the advantages of soft law, especially in global financial governance, and argue that softer forms of legalization often provide a better or second-best alternative to more binding forms of global regulation.[364] My analysis of the UN's new debt restructuring principles is less optimistic. I argue that they are unlikely to have much concrete impact due to both political challenges related to their specific content and functional challenges related to the general limitations of soft-law tools in the SDRR. It is somewhat telling that the main alternative to hard law in the SDRR has not been soft law but rather the type of contract mechanisms examined in Chapter 6, which actors have gravitated toward because of their ability to provide functions that soft law cannot without incurring the steep political costs of a hard-law framework. Through an analysis of the recent UN initiative, this chapter illuminates the

364 Abbott and Snidal, 'Hard and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law'; Brummer, *Soft Law and the Global Financial System.*

political and functional limitations of hard- and soft-law arrangements for governing the sovereign debt restructuring process. It thus addresses the emboldened boxes within the feasibility tree presented below, particularly the lower left box entitled "Public International Law."

**Figure 5: The Process Branch of the Feasibility Tree and the Public International Law Option**




Explanations of previous reform initiatives point to key factors that also played a role in the UN case. As noted in Chapter 2, scholars emphasized the role of US power and preferences in constraining the hard-law SDRM initiative of the early 2000s.[365] Some also identified sovereignty concerns as an important reason for US opposition to the SDRM.[366] Moreover, analysts pointed out that even debtor states had either opposed or failed to collectively support previous initiatives to construct a formal sovereign bankruptcy regime.[367] But existing analyses are also limited in their ability to explain key aspects of the UN initiative. Building upon existing contributions, this chapter highlights additional barriers to hard-law reform that earlier studies failed to identify or appreciate: notably, overlooked sources of US and UK preferences, the structural power of these states within the SDRR, and the

[365] Soederberg, 'The Transnational Debt Architecture and Emerging Markets'; Helleiner, 'Filling a Hole in Global Financial Governance?'; Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism'; Setser, 'The Political Economy of the SDRM'; Hagan, 'Designing a Legal Framework'; Gelpern, Heller, and Setser, 'Count the Limbs.'
[366] Hagan, 'Designing a Legal Framework'; Gelpern, Heller, and Setser, 'Count the Limbs.'
[367] Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism'; Setser, 'The Political Economy of the SDRM'; Lavelle, 'Sovereign Debt Restructuring.'

sovereignty-related concerns of debtor governments—all of which were discussed in Chapter 3. It also advances new arguments about the limitations of the UN principles and soft-law arrangements in the SDRR more generally, expanding upon earlier discussions that emerged around the IIF's 2004 principles.[368] Taken together, the limits of hard- and soft-law techniques suggest that public international law mechanisms are unlikely to succeed in this policy domain.

This chapter makes important contributions to IPE and global governance literatures. It fills an empirical gap in our understanding of sovereign debt governance by describing and analyzing a significant reform initiative that has not yet received detailed scholarly attention. In explaining this initiative and its outcomes, the chapter also provides another puzzle piece in the framework used to understand regulatory variation in the SDRR, thus contributing to the theoretical advancement of an important but overlooked area of interest in global financial governance. In addition, the argument developed here has important implications for broader global governance debates that focus on institutional design along a spectrum of international hard and soft law, and that see the latter as the natural option for governing global finance.[369]

After describing the Greek and Argentine episodes that prompted recent initiatives to improve the sovereign debt restructuring process, the chapter proceeds to analyze the UN initiative in two sections. The first of which, Section 3, focuses on the politics of its international hard-law component. Section 4 then examines the political and functional facets of its soft-law component. A final section concludes and briefly discusses the implications of the chapter for broader IPE and global governance literature.

## 2. Greece, Argentina, and Renewed Demand for a Better Restructuring Process

In the wake of the 2008 global financial crisis, new sovereign debt difficulties emerged, as did renewed debates about how to improve the SDRR. The Greek debt crisis catalyzed these debates, demonstrating the need for better mechanisms to facilitate sovereign debt workouts. As Chapter 4 detailed, the Greek case exposed a fatal flaw in the IMF's lending rules and their role as a trigger mechanism. But when the Greek government eventually did restructure its debt in 2012, it also highlighted significant weaknesses in the restructuring process. Most of the country's bonds were

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[368] Helleiner, 'Filling a Hole in Global Financial Governance?'; Ritter, 'Transnational Governance in Global Finance.'

[369] Abbott and Snidal, 'Hard and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law'; Brummer, *Soft Law and the Global Financial System*.

governed by its own domestic law and contained no legal mechanism to facilitate a restructuring of sovereign liabilities. Another portion of its debt had been issued under foreign jurisdictions, primarily under English law where CACs were commonplace. But even these contract features failed to shield the restructuring of foreign bonds from the disruptive actions of determined holdout creditors. Only 17 of Greece's 36 English-law bonds were successfully renegotiated, with holdouts managing to block restructuring of the remaining 19.[370] Some creditors thus escaped unscathed while others took deep haircuts on their claims, raising concerns about inter-creditor equity and the potential impact of this lopsided outcome on creditor incentives to participate in future write-downs. Observers predicted that the success of Greek holdouts would encourage similar behaviour going forward—among both predatory investors and creditors who did not wish to be taken advantage of—further complicating future debt workouts.[371] This partial restructuring also meant less debt relief for Greece. An additional €3 billion would have been written-off if holdouts could have been forced to participate.[372]

Months after the Greek restructuring, a controversial New York-court ruling revealed further pitfalls in the restructuring process. The case involved a small group of holdout creditors—referred to pejoratively as 'vulture funds'—who held bonds that Argentina defaulted on in 2001 and, having refused to participate in either of the country's 2005 or 2010 restructurings, were suing for full repayment in New York, where the bonds were issued. In November 2012, US District Judge Thomas P. Griesa ordered Argentina to pay these holdouts, claiming it had violated the *pari passu* clause in its bonds by paying bondholders who participated in restructuring but not those who held out—a 'ratable payments' interpretation that critics argued was misguided, as most took *pari passu* to mean equal treatment of, rather than equal payments to, creditors.[373] To enforce this ruling, the judge issued an injunction prohibiting Argentina from making payments to those with restructured claims (93 percent of all bondholders) unless it also paid the holdouts the full value of their claims, estimated to be around $4.65 billion.[374] He also threatened to hold in contempt of court third-parties that assisted Argentina in violating the injunction. (The injunction was later upheld by the US Court of Appeals for the Second

[370] Sobel, 'Strengthening collective action clauses.'
[371] Zettelmeyer, Trebesch, and Gulati, 'The Greek Debt Restructuring.'
[372] Ibid.
[373] Sobel, 'Strengthening collective action clauses.'
[374] Guzman and Stiglitz, 'How Hedge Funds Held Argentina for Ransom.'

Circuit). This prevented Argentina's trustee from disbursing payments on the restructured bonds, causing the country to default in July 2014.[375]

Arcane as it seemed, the ruling had implications that went far beyond the case at hand. While it benefited vulture investors, others in the private creditor community worried that the ruling set a legal precedent that subordinated the interests of majority creditors to those of minority holdouts, undermining inter-creditor equity and creating uncertainty around sovereign debt investments. US Treasury officials were also concerned that this ruling and any precedent it set could diminish the attractiveness of New York as a place to issue sovereign bonds, causing business to move elsewhere and eroding the economic and political benefits the US derives from its central role in the international debt regime (described in Section 2.1.2 of Chapter 3).[376] At the IMF, Blustein notes that "anguish was profound" at the implications of the ruling for future efforts to foster orderly debt restructurings.[377]

For debtors who issued bonds under New York law, the ruling also threatened to make future restructurings vastly more challenging. In Blustein's words, the "pro-creditor fundamentalism" of the judge's ruling "handed a resounding victory to vulture investors, transforming the balance of power between sovereign governments and the creditors. For the first time since the era of gunboat diplomacy, when militaries were dispatched to enforce financial claims abroad, lenders were getting a useful remedy against the traditional rights of sovereigns to protect their assets from seizure."[378] In setting a legal precedent under New York law—the law governing a vast portion of developing country and emerging market sovereign bonds—the court's decision created both an incentive and strategy for creditors to hold out from future restructurings and litigate for full repayment. As Blustein puts it, "What sane bondholder would go along with a debt-restructuring offer in the future, given the risk that a single holdout might be able to block payments under the new terms?"[379]

In response to the Greek crisis and the challenges it flagged for Eurozone governments that might need to reorganize their debts in the future, European officials agreed to introduce standardized CACs into the sovereign bonds of all Eurozone states starting in 2013. Responding to both the Greek and

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375 Peter Coy, 'What Happens Now That Argentina Is in 'Selective Default", *Bloomberg* (July 30, 2014).
376 Sobel, 'Strengthening collective action clauses.'
377 Blustein, *Laid Low*, p. 470.
378 Ibid, p.470.
379 Ibid, p.470.

Argentine episodes, US Treasury officials launched a separate reform effort in 2013 aimed at strengthening the contractual approach to debt restructuring for EMDEs. (These contract reform initiatives are the focus of the next chapter).

Determined not to re-live the debates of the early 2000s, US policymakers explicitly rejected re-opening discussions of a SDRM-style arrangement at the outset of their contract reform initiative. As a senior US Treasury official put it, they had "no appetite for pursuing an international agreement that could result in a supranational authority to supplant core US sovereign decision making or judicial authority."[380] Despite the fact that US domestic judges have neither the specific mandate nor the expertise to deal with complex sovereign debt cases, US authorities remained firmly opposed to the creation of a specialized international bankruptcy court that could replace or trump their own courts vis-à-vis sovereign debt disputes and restructuring decisions, regardless of the functional merits of a supranational regime. The IMF, which had begun its own lending reform process in 2013 and was participating in the Treasury-led initiative, also made clear that it had no interest in pursuing another SDRM, which in any event would have been pointless given the clear opposition of its largest and only veto-wielding shareholder.[381] It too would support the development of new contractual mechanisms as the main approach to strengthening the restructuring process.[382]

A number of outside observers saw contract reforms as a positive step, but one that was insufficient to solve the underlying problems plaguing the restructuring process. Leading this camp were debtor states from the global South, many of whom had become increasingly concerned and outspoken about the need for reform. Their general sentiment was well summarized by Axel Kicillof, Argentina's then finance minister, who said in 2015: "We know that many hope that contract clauses will resolve the issue of sovereign debt restructuring. However, we believe that the international financial structure and architecture have to be changed."[383]

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380 Sobel, 'Strengthening collective action clauses,' p. 5.
381 Ibid.
382 See IMF, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring,' IMF Policy Papers (October 2014).
383 Axel Kicillof, remarks during sixty-ninth session of the UNGA (September 10, 2015). https://www.youtube.com/watch?v=f8TTfOCTsS0

### 3. The UN Initiative: The Political Limits of Hard Law

With the US and the IMF having rejected the idea of such transformative change, dissatisfied debtors had to find an alternative venue in which to pursue reform. The clear choice was the UN, where sovereign debt debates were already taking place. As early as 2008, the UNGA had sponsored the creation of the Stiglitz Commission, whose 2009 report recommended the establishment of an "International Debt Restructuring Court."[384] The idea was similar to the earlier SDRM proposal. In terms of the court's legal design, the report called for a "single statutory framework for debt relief"—that is, a hard-law agreement brought into force through the establishment of an international treaty.[385] It also discussed a number of functions the court could perform. While the Commission stopped short of enumerating a detailed set of prescriptions, it noted that an international debt restructuring court would ensure that agreed international principles regarding the amount of necessary debt relief, the sharing of losses among creditors, and the priority of different creditor claims were followed. The Commission also envisioned a role for the court in authorizing debtor-in-possession financing and possibly even in determining what debts might be considered "odious." While the remaining details were somewhat vague, it was clear that the proposed court was to have significant powers under international law, with the report stating: "National courts would have to recognize the legitimacy of the international court, and both creditors and debtors will therefore follow its rulings."[386]

Around the same time as the release of the Stiglitz Commission's report, the developing-country coalition known as the Group of 77 (G77) was encouraging the UNCTAD (which has long served as a *de facto* secretariat for the G77) to expand its role in sovereign debt governance.[387] In 2009, the UNCTAD launched a project to establish new principles for sovereign lending and borrowing, and in 2013 it created a working group tasked with designing a sovereign debt workout mechanism. At its inaugural meeting, the working group considered the priorities and legal options for a workout mechanism. It discussed, among other things, the idea of establishing a statutory sovereign debt tribunal with various capacities, including a wide purview to oversee comprehensive restructurings involving multiple types of creditors, as well as the power to authorize debt standstills to facilitate a

[384] Joseph E. Stiglitz et al., 'Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System,' United Nations (September 21, 2009).
[385] Ibid, p. 123.
[386] Ibid, p. 124.
[387] On the relationship between the G77 and the UNCTAD, see John Toye, 'Assessing the G77: 50 years after UNCTAD and 40 years after the NIEO,' *Third World Quarterly* 35(10)(2014): 1759-1774.

less chaotic negotiation process among this wider collection of actors.[388] To guide its subsequent meetings and discussions, the group commissioned a number of technical papers from sovereign debt experts, the first of which addressed the necessity and feasibility of a standstill rule for debt restructuring processes.[389] The active workstream on sovereign debt restructuring meant that, when debtors became frustrated with the SDRR and the limitations of Western efforts to improve it, the foundations on which to launch a more ambitious initiative already existed within the UN. Because of the asymmetric power relations within the IMF, where far-reaching reforms had already been rejected, it also made sense for debtors to operate within the UNGA's 'one country, one vote' system.

In pursuing reform within the UN, debtor states—operating under the G77 moniker—found a powerful creditor ally in China. In the short time since the SDRM initiative, China had become a leading lender to developing countries, transforming itself since the mid-2000s "from a marginal presence to the dominant player in international development finance."[390] China's support meant that debtor states and their vision for a more robust sovereign bankruptcy regime had the backing of the single largest creditor to sovereign states. Ostensibly, Chinese support would bolster the strength of a debtor-driven initiative that the US and Europe were sure to oppose. Chinese officials also had their own concerns with the SDRR. In their view, the Argentine situation highlighted the weakness of a market-based system for restructuring, while management of the Greek crisis exposed inter-creditor equity problems that affected China directly.[391] Regarding the latter, Chinese officials were frustrated that while Greek bonds held by Eurozone central banks were excluded from the 2012 restructuring, all other central banks—including the People's Bank of China—had been forced to accept the same haircut inflicted on private bondholders.[392] This concern about unfair treatment was only amplified by China's ongoing frustrations with the IMF's Western-dominated governance structure.

Chinese endorsement of the UN reform initiative may also have been motivated by China's interests as a creditor and its desire to establish a debt restructuring framework to rival or create strategic

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[388] UNCTAD, 'Brainstorming Meeting on a Debt Workout Mechanism,' Meeting Summary. February 1, 2013. Available at: https://unctad.org/meetings/en/SessionalDocuments/gds_sd_2013-02-01_summary_en.pdf
[389] Matthias Goldmann, 'Necessity and Feasibility of a Standstill Rule for Sovereign Debt Workouts.' Paper prepared for the First Session of the Debt Workout Mechanism Working Group. January 23, 2014. Available at: https://unctad.org/meetings/en/Contribution/gds_sd_2013-07-02_bp_en.pdf
[390] *Financial Times*, 'China rethinks developing world largesse as deals sour', (October 13, 2016).
[391] Hongying Wang, 'China and Sovereign Debt Restructuring', CIGI Papers No. 45, 2014.
[392] Brett House, Hongying Wang, and Miranda Xafa, 'Chinese Perspectives on Sovereign Debt Restructuring', CIGI Commentary, 2014.

ambiguity vis-à-vis the Western-dominated SDRR. To the extent that American opposition to a hard-law mechanism was informed by a desire to preserve the central position of US laws and courts in the debt regime, Chinese support for more transformative change might have been driven by an interest in disrupting existing structures of US power and privilege. The country's support also fit a more generic pattern whereby China sides with developing countries in multilateral political arenas as a show of South-South solidarity.[393] The degree to which China's actions were motivated by symbolic versus substantive or strategic considerations is difficult to know due to the opacity of Chinese policy processes.[394] But the idea that China's rise might bolster the strength of debtor states in international debt politics fits with broader theories about the influence of the international balance-of-power on sovereign debt relations. As Christian Suter and Hanspeter Stamm argued:

> the existence of several leading powers improves the bargaining position of individual debtor countries at the periphery. Therefore, the situation most favourable for debtors is during the transition phase from an old and decaying hegemonic power […] to a new and rising world leading power trying to integrate debtor countries at the periphery into its own newly emerging power system at the expense of the old hegemonic power.[395]

On 9 September 2014, the G77 and China introduced a resolution into the UNGA calling for "the establishment of a multilateral legal framework for sovereign debt restructuring processes."[396] What exactly a 'multilateral legal framework' entailed was not entirely evident, partly because the aim of the resolution was to initiate a reform process through which UN member states would negotiate the precise "modalities" of the new international legal arrangement.[397] But the call for a *multilateral legal* approach was widely interpreted as promoting a statutory (i.e., hard law) framework along the lines of the SDRM or the Stiglitz Commission's International Debt Restructuring Court proposal—ideas that attracted growing attention and support in the wake of the Greek and Argentine episodes. The language of the UNGA's resolution largely supported this interpretation. It acknowledged "the work carried out by the International Monetary Fund in 2003 […] to formulate a proposal for a sovereign

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[393] Lei Yu, "China's strategic partnership with Latin America: a fulcrum in China's rise," *International Affairs* 91(5)(2015): 1047-1068.

[394] See Thomas Christiansem, Emil Kirchner, and Uwe Wissenbach, *The European Union and China* (Red Globe Press, 2018). See also Jessica Batke and Oliver Melton, 'Why Do We Keep Writing About Chinese Politics As if We Know More Than We Do?' ChinaFile, Viewpoint. October 16, 2017.

[395] Christian Suter and Hanspeter Stamm, 'Coping with Global Debt Crises: Debt Settlements, 1820 to 1986,' *Comparative Studies in Society and History* 34(4)(1992): 645-678, p. 649.

[396] UN, 'Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes.'

[397] Ibid, p. 4.

debt restructuring mechanism," and noted its "concern that the international financial system does not have a sound legal framework for the orderly and predictable restructuring of sovereign debt."[398] It also stated that "in the restructuring of sovereign debt, the progressive development and codification of international law are necessary."[399] For these reasons, the resolution concluded, the UNGA has decided "to elaborate and adopt through a process of intergovernmental negotiations […] a multilateral legal framework for sovereign debt restructuring processes with a view, inter alia, to increasing the efficiency, stability and predictability of the international financial system."[400] In short, while the G77 and China's exact vision for reform was somewhat fuzzy, it clearly implied a shift in the locus of authority over restructuring processes to the international or supranational level.

The resolution received widespread support, with 124 countries voting in favour, 11 against, and 41 abstaining.[401] But the detractors included the US, the UK, Germany, Japan, and a handful of others.[402] Predictably, American and British (and other European) delegates objected to the idea of a multilateral framework because it sounded too much like a hard-law SDRM-style arrangement. US delegates were particularly hostile. As a close observer of the events remarked, the US was the only country that "explicitly rejected the very prospect of negotiating for a multilateral legal framework."[403] When the US representative in the UNGA explained her government's position, she emphasized the anticipated effects of a hard-law mechanism on international debt markets, stating: "The establishment of a statutory mechanism for debt restructurings would create uncertainty in financial markets. If lenders face higher uncertainty regarding repayment, they may be less likely to provide financing and will likely charge higher risk premiums, potentially stifling financing to developing countries."[404] These concerns reflected not the sovereignty but rather the market implications of a hard-law mechanism that could trump debt contracts and the legal systems within which they are embedded, and that US officials worried would therefore generate uncertainty and disrupt cross-border financial flows.

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[398] Ibid, p. 3.
[399] Ibid, p. 4.
[400] Ibid, p. 4.
[401] Almost all European countries that did not vote against the resolution abstained from voting altogether. See Bhumika Muchhala, 'Historic UN General Assembly vote on a multilateral sovereign debt mechanism,' Third World Network. 19 September, 2014. Available at: https://www.twn.my/title2/unsd/2014/unsd140903.htm
[402] The other states that voted no are Australia, Canada, the Czech Republic, Finland, Hungary, Ireland, and Israel.
[403] Muchhala, 'Historic UN General Assembly vote on a multilateral sovereign debt mechanism.'
[404] Terri Robl, explanation of US vote on UNGA resolution A/RES/68/304 (September 9, 2014). Available at https://2009-2017-usun.state.gov/remarks/6145

A pressing issue for American decision-makers was thus the lack of compatibility between a hard-law mechanism and the (American and British) domestic legal foundations of international sovereign debt markets—an important factor discussed in Chapter 3 but overlooked in the existing literature. Among other things, US and UK contract law provided a degree of predictability and legal certainty for cross-border sovereign debt investments that are, by nature, characterized by considerable risk and uncertainty. A supranational bankruptcy court would move beyond the narrow purview of contract law and make decisions according to a wider range of economic and political considerations. Even if this type of institution could improve the debt restructuring process, US officials were concerned that it would come at too high a cost in terms of politicizing and creating uncertainty in debt markets themselves.[405] As went their thinking: if investors knew their contractual agreements could be overridden by a higher authority making decisions according to various factors they had not directly agreed to, they might be more reluctant to lend to foreign governments—at least at manageable interest rates. Underscoring that US views on this issue had not changed from where they had been a decade earlier, the American delegate to the UNGA noted: "Experience from the debate on the SDRM in the early-2000s reflected these concerns and concluded that the creation of such a mechanism would have highly uncertain results."[406] In referencing the early 2000s, this statement alluded to the fact that the earlier SDRM debate had helped crystallize US views on a hard-law debt restructuring mechanism.

US and European officials opposed not only the legal-institutional design of the proposed multilateral framework, but also the very idea of discussing sovereign debt issues within the UN, insisting that such technical matters were better left to the IMF or the Treasury-led working group on contract reform.[407] The private creditors who weighed in on this issue agreed. In the words of one sovereign debt investor: "I don't see how the UN thought it had any perspective on this."[408] Officials from several G77 countries pushed back, arguing that the UNGA's more democratic voting system made it a legitimate forum in which to discuss issues of global significance such as sovereign debt.[409] Various debt relief NGOs and individual 'policy entrepreneurs' also defended the choice of the UN over the

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405 Randal Quarles, 'Herding Cats: Collective-Action Clauses in Sovereign Debt - The Genesis of the Project to Change Market Practice in 2001 through 2003', *Law and Contemporary Problems* 73 (2010): 29-38.
406 Robl, explanation of US vote on UNGA resolution A/RES/68/304.
407 EU common position on the UN draft resolution A/69/L.84," Council of the European Union (September 7, 2015). Available at http://data.consilium.europa.eu/doc/document/ST-11705-2015-INIT/en/pdf
408 In Silvia Pavoni, "On the Ropes: Argentina," *The Banker* (October 2014): 124.
409 See Muchhala, 'Historic UN General Assembly vote on a multilateral sovereign debt mechanism.'

IMF.[410] In addition to the more open and inclusive nature of the UN system, G77 states and their supporters argued that the IMF had a conflict of interest over the rules of sovereign debt restructuring, since the organization was itself a creditor and thus had a stake in how its members solved their debt crises—a point that had also been made about the SDRM proposal a decade earlier.[411]

But conflict over the choice between the UN and the IMF or the Treasury working group was about more than finding the 'optimal' institutional venue. It reflected a deeper struggle over who gets to write the rules of debt restructuring. As Hector Timerman, Argentina's then minister of foreign affairs, observed: "the United States and the UK wanted to move the issue of the debt away from the only place where they could not impose an undemocratic right: the General Assembly."[412] When asked about why these countries rejected the UN initiative and sought to shift debt discussions into the IMF, Timerman alluded to their interests as capital exporters, noting: "Countries that export capital are the ones voting against it."[413] Robert Wade argued that these core capital exporters did not want the UN to become a relevant forum for discussing any major financial governance issues after the 2008 global financial crisis, noting that "western states, with the UK and the US in the lead, tried hard to ensure that the UN did not become a forum for discussion on the crisis," and documenting the strategic moves that US and UK officials made to obstruct the Stiglitz Commission and present UN regulatory efforts as a "farce" in the mainstream media.[414]

Seen in this light, the UN initiative reflected the type of strategic 'chessboard politics' that often arise in complex and/or fragmented international regimes characterized by divergent preferences and highly asymmetric power relations.[415] More specifically, pursuing reform within the UN can be viewed as an attempt at what Julia Morse and Robert Keohane call *regime shifting*, "which occurs when challengers to a set of rules or practices shift to an alternative multilateral forum with a more favorable

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410 For example, see Bodo Ellmers, 'The UN's work towards faster and better resolution of debt crises: a tale of legal frameworks and basic principles for debt restructurings,' Eurodad. December 9, 2015. Available at: https://eurodad.org/UNandDebtCrises

411 Ibid. For articles that document criticism of the IMF's proposed role in the SDRM, see for example: A. Mechele Dickerson, 'A Politically Viable Approach to Sovereign Debt Restructuring,' *Emory Law Journal* 53(2004): 997-1041.

412 In: BBC Monitoring Latin America, 'Argentine foreign minister praises sovereign debt restructuring resolution.' January 5, 2015. Source: Pagina 12 website, Buenos Aires, in Spanish 31 December, 2014.

413 Ibid.

414 Robert H. Wade, 'The G192 report,' *Le Monde diplomatique* (August 2012). Available at: https://mondediplo.com/2012/08/09un

415 See Karen J. Alter and Sophie Meunier, 'The Politics of International Regime Complexity', *Perspectives on Politics* 7(1)(2009): 13-24.

mandate and decision rules, and then use this new forum to challenge standards in the original institution or reduce the authority of that institution."[416] The position of the US and Europe as 'veto players' within the IMF had made it impossible for G77 states to pursue their more ambitious agenda in that forum. Regime shifting into the UN was thus a strategic move to bypass Western power. This strategy was bolstered by the fact that the UNGA proposal was backed by the majority of the world's countries, including China and the other BRICS (Brazil, Russia, India, China, South Africa).

In the end, however, the structural power of the US and the UK within the sovereign debt regime imposed hard limitations on the effectiveness of this strategy. At the time, roughly 50 percent of the total outstanding stock of international sovereign bonds were governed by New York law and around 46 percent were governed by English law.[417] Any restructuring mechanism that did not apply to these jurisdictions would thus fail to govern 96 percent of international sovereign bonds. Indeed, the main problems that catalyzed the UNGA and Treasury initiatives originated under US and English laws—Argentina's battle with holdouts in New York and Greece's failure to restructure many of its English-law bonds—further underscoring the futility of pursuing a framework that failed to incorporate these jurisdictions. The US and the UK thus had the structural power to block the creation of a viable hard-law framework simply by refusing to participate in it. In the early 2000s, when the SDRM's prospects depended on IMF approval, scholars focused on American institutional power within the Fund as a major obstacle to reform. But they failed to consider the deeper sources of structural power in this arena of global finance—power that persists even after institutional roadblocks have be cleared.

US officials were aware of the power their market position gave them over the fate of the UN initiative.[418] Others also had a sense of this power, even if they could not always put their finger on its exact workings. Asked about how the US and other Western states were able to undercut the UN proposal, Timerman replied: "What I am going to say will sound too simple, but there is no other answer: when creditor countries do not want something, that is it."[419] Although US policymakers were thus confident in their ability to block the initiative at the end of the day, they were eager to get rid of

[416] Julia C. Morse and Robert O. Keohane, "Contested multilateralism," *Review of International Organizations* 9(4)(2014): 385-412, p. 392. See also Laurence R. Helfer, 'Regime Shifting in the International Intellectual Property System', *Perspectives on Politics* 7(1) (2009): 39-44.
[417] IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts.'
[418] Interview 114203.
[419] In: BBC Monitoring Latin America, 'Argentine foreign minister praises sovereign debt restructuring resolution.'

it as soon as possible. US officials disliked not only the prospect of a hard-law framework that could destabilize debt markets, but also the idea of a high-profile reform initiative that could send confusing signals to markets about the international political appetite for this kind of framework. As a then US Treasury official put it, the UN initiative was "[market] noise and we could have done without it…there was no reason for us to like having this work go forward in the UN because we didn't support the initiative and moreover, the IMF is the competent body for international finance."[420]

The September 2014 UNGA resolution established an Ad Hoc Committee on Sovereign Debt Restructuring Processes to guide the creation of a multilateral legal framework. While the Committee was open to all UN members and observers, a number of the states that voted against the initial resolution—including the US, the UK, Japan, and Canada—refused to participate, as did the rest of the European Union and the IMF observers. One month after the September 2014 resolution, before the Ad Hoc Committee had held its first meeting, the UN's Economic and Social Council (ECOSOC) organized a special event that brought together several UN and IMF officials, among others, to discuss the ongoing work on sovereign debt restructuring reform. Reza Baqir, then chief of the IMF's Debt Policies Division, took the opportunity to remind participants of the futility of going forward with a hard-law approach to debt restructuring. As the summary document from the event notes: "Mr. Baqir made it clear that the majority of the IMF board does not support a treaty approach going forward and that a treaty approach that does not include issue law countries (US/UK) would not address the collective action or holdout creditor problems."[421] Despite the opposition of key capital-exporting states and what it meant for the prospects of a statutory framework, G77 countries and their supporters within the UN did not immediately or fully abandon their reform initiative.

The reform process unfolded via three Ad Hoc Committee meetings throughout 2015. The first meeting featured presentations from outside experts and statements from participating states. Many of the most vocal participants—including Argentina, Brazil, Russia, and South Africa—reaffirmed their support for a debt restructuring framework that would, in the words of Brazil's delegate, "better safeguard the interest of debtor countries and the social and economic development needs and

[420] Interview 114203.
[421] 'Summary note on: Lesson learned from the debt crisis and ongoing work on sovereign debt restructuring and debt resolution mechanisms,' Special joint meeting of the UN GA Second Committee and the Economic and Social Council. October 14, 2014. Available at: https://unctad.org/meetings/en/SessionalDocuments/gds_sd_2014-10-14_summary_en.pdf

priorities of their populations."[422] As the country that had spearheaded the UN initiative, Argentina used the first Committee meeting to take the lead in outlining its vision for a multilateral mechanism and a set of legal principles to guide it.

A key theme emanating from these principles was the importance of sovereignty. The first principle stated that "sovereign debt restructuring is a right of a State and a sovereign decision under international law."[423] Another emphasized the sanctity of sovereign immunity—an international legal doctrine no longer so effective in shielding sovereigns from litigation in American and British courts. As specific as these sovereignty concerns were to Argentina in light of its recent experience, they resonated with a broader range of debtors, anxious about the "wave of litigation expected in the wake of the controversial US ruling against Argentina."[424] They also found support among emerging powers, which consistently emphasize national sovereignty as the guiding principle of international relations. China in particular spoke out in support of principles emphasizing sovereignty, noting that government debtors, because of their sovereign status and their consequent obligations to their citizens, are fundamentally different from commercial debtors and should be treated as such.

While the emphasis on sovereignty was understandable, it sat uncomfortably with the goal of creating a 'multilateral legal framework,' which—by definition—would entail a certain loss of sovereignty. This contradiction became apparent throughout the Committee's discussions. For example, the Russian representative noted that his country was "not ready to support the "statutory" approach, because it touches on renouncing sovereignty," but added that Russia wanted to make "a mandatory set of rules and principles the basis of sovereign debt restructuring" and considered it "very important that the above-mentioned rules and principles at some point could be considered legally binding for all stakeholders."[425] Even while declaring support for a binding framework, many of the most troubled debtors, including Argentina and Venezuela, continued to stress the importance of preserving

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[422] Brazil, 'Ad Hoc Committee on Sovereign Debt Restructuring Processes: First Working Session.' Available at: http://unctad.org/en/pages/MeetingDetails.aspx?meetingid=725

[423] Argentina, 'Towards a Multilateral Legal Framework for Sovereign Debt Restructuring Processes: Proposal by Argentina' (Feb. 5, 2015), p. 3. Available at http://unctad.org/en/pages/MeetingDetails.aspx?meetingid=725

[424] Pavoni, 'On the Ropes: Argentina,' p. 123. For evidence of the rising tide of sovereign debt litigation, see Schumacher, Trebesch, and Enderlein, 'What Explains Sovereign Debt Litigation?'

[425] Russia, 'Russian Federation at the first working session of the Ad Hoc Committee on Sovereign Debt Restructuring Processes', (Feb. 3, 2015), p. 3. Available at http://unctad.org/en/pages/MeetingDetails.aspx?meetingid=725

sovereignty.[426] Although debtors seemed convinced of the virtues of a legally-binding approach, many were clearly not prepared to sacrifice their sovereignty in any meaningful way. Thus, while American and British resistance was sufficient to limit the ambitions of the UN initiative, it was not fully necessary. Debtor states had their own reservations about committing to a binding framework.

Previous studies illustrate the difficulties debtor states have faced in forging a coherent and durable reform coalition, but they focus on collective action problems that arise when some debtors—particularly the wealthier and larger ones that issue lots of foreign bonds—start to worry about how a given debt restructuring framework might impact their access to affordable credit, eroding their support for reform and preventing debtors from realizing their collective long-term interests.[427] A prime example of this dynamic, one with parallels to the UN initiative, can be found in the late 1970s when the G77 last tried to establish a more formal international arrangement to deal with sovereign debt problems. In that episode, the G77's proposal for an "International Debt Commission"—comprising impartial experts that would oversee and arbitrate debt restructurings—collapsed because it was rejected by the US and Western multinational banks, but also because "divisions emerged amongst the debtor countries, as a number of the wealthier developing countries expressed concerns that the endorsement of debt restructuring and debt relief might discourage future capital flows to the developing world."[428] By contrast, such divisions were not an issue for countries during the recent UN initiative, despite attempts by the US and Europe to "break unity" and divide the G77.[429] Concerns about access to global capital markets were imperceptible this time.

Debtor states hesitated to follow their 2014 UNGA proposal for a multilateral framework to its logical conclusion not because of credit concerns, as existing literature might lead us to expect, but rather for the sovereignty-related reasons alluded to above and in Chapter 3. Yuefen Li, who led the UNCTAD's work on sovereign debt and played a central role in coordinating elements of the UN reform process, noted afterward that such sovereignty concerns had been an important obstacle that kept debtors from committing to a binding bankruptcy mechanism.[430] Previously, sovereignty concerns in this

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[426] See UNCTAD, 'Ad hoc Committee on a multilateral legal framework for sovereign debt restructuring processes,' second working session, draft minutes of the first day (April 28, 2015). Available at: https://unctad.org/meetings/en/SessionalDocuments/gds_sd_2015-04-28-30_summary_en.pdf
[427] Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism.'
[428] Ibid, p. 105.
[429] In: BBC Monitoring Latin America, 'Argentine foreign minister praises sovereign debt restructuring resolution.'
[430] Li, 'The Long March towards an International Legal Framework for Sovereign Debt Restructuring.'

domain were assumed to be a consideration only for powerful states that feared losing their privileged position in the global debt regime. However, as discussed in Chapter 3 (Section 2.2), defaults and debt restructurings are often extremely costly for debtors, and so it makes sense that these states would want to maintain maximum discretion over as many aspects of their debt situation as possible.[431] This reality, highlighted by the UN initiative, presents an additional obstacle to the emergence of a hard-law SDRR—one that has been largely neglected by the existing literature. The implication for the politics of reform in the SDRR is that even if borrowing-cost concerns can be mitigated, and even if US and UK power were to fade, sovereign debtors would likely remain reluctant to cede decision-making power over sensitive choices that could impact their international debt payments.

## 4. The UN Principles: Political and Functional Limitations

In light of American and British opposition as well as their own sovereignty concerns, the G77 and China were forced to scale-back any ambition of establishing a multilateral framework with formal standing or authority under international law. In other words, the political constraints described above dashed any remaining dreams of a hard-law mechanism that could supersede national laws and empower a supranational bankruptcy authority to guide debtors and their creditors toward more cooperative and comprehensive debt solutions. As reform debates continued in this political context, discussions of a hard-law framework faded and were replaced by a greater focus on building consensus around a set of soft-law principles that could guide sovereign debt restructuring processes. The second Ad Hoc Committee meeting featured a presentation from the UNCTAD highlighting its recently published Roadmap and Guide for Sovereign Debt Workouts.[432] The Roadmap contained five principles for debt restructuring: legitimacy, impartiality, transparency, good faith, and sustainability. A number of countries welcomed these principles as providing a solid basis to build "a working instrument" that "could enjoy broad consensus."[433] The Committee's final meeting produced consensus on a set of principles. Among the benefits of these principles, India's Permanent Representative to the UN noted that their non-binding nature preserved the sovereign policy space of debtor countries to design their own borrowing and repayment plans.[434]

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[431] For example, see Borensztein and Panizza, 'The Costs of Sovereign Default.'
[432] UNCTAD, 'Sovereign Debt Workouts: Going Forward. Roadmap and Guide', United Nations (April 2015).
[433] UNCTAD, "Ad hoc Committee on a multilateral legal framework for sovereign debt restructuring processes.'
[434] In: *The Economic Times*, 'India backs draft resolution in UN on sovereign debt principles,' September 11, 2015. Available: https://economictimes.indiatimes.com/news/economy/foreign-trade/india-backs-draft-resolution-in-un-on-sovereign-debt-principles/articleshow/48910833.cms

On 10 September 2015, the UNGA voted to adopt the *Basic Principles on Sovereign Debt Restructuring Processes*.[435] The nine principles agreed upon reflected a fusion between those proposed by Argentina and those outlined in UNCTAD's Roadmap. International support for these UN Principles was widespread, with 136 countries voting in favour, 41 abstaining, and only six voting against (the US, the UK, Germany, Japan, Canada, and Israel). The full version of the Principles is reproduced below.

**UN Basic Principles on Sovereign Debt Restructuring Processes**

1. A Sovereign State has the right, in the exercise of its discretion, to design its macroeconomic policy, including restructuring its sovereign debt, which should not be frustrated or impeded by any abusive measures. Restructuring should be done as the last resort and preserving at the outset creditors' rights.

2. Good faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations and other stages of the process with the aim of a prompt and durable re-establishment of debt sustainability and debt servicing, as well as achieving the support of a critical mass of creditors through a constructive dialogue regarding the restructuring terms.

3. Transparency should be promoted in order to enhance the accountability of the actors concerned, which can be achieved through the timely sharing of both data and processes related to sovereign debt workouts.

4. Impartiality requires that all institutions and actors involved in sovereign debt restructuring workouts, including at the regional level, in accordance with their respective mandates, enjoy independence and refrain from exercising any undue influence over the process and other stakeholders or engaging in actions that would give rise to conflicts of interest or corruption or both.

5. Equitable treatment imposes on States the duty to refrain from arbitrarily discriminating among creditors, unless a different treatment is justified under the law, is reasonable, and is correlated to the characteristics of the credit, guaranteeing inter-creditor equality, discussed among all creditors. Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics. No creditors or creditor groups should be excluded ex ante from the sovereign debt restructuring process.

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

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

8. Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.

9. Majority restructuring implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be affected, jeopardized or otherwise impeded by other States or a non-representative minority of creditors, who must respect the decisions adopted by the majority of the creditors. States should be encouraged to include collective action clauses in their sovereign debt to be issued.

[435] UN, 'Basic Principles on Sovereign Debt Restructuring Processes', UNGA (A/69/319) (September 10, 2015).

These 2015 UN Principles were hailed by some as "an historic breakthrough"[436] and "the most important international action since the failed 2002-2003 IMF-led initiative on the Sovereign Debt Restructuring Mechanism."[437] Joseph Stiglitz and Martin Guzman called the UN Principles "a big step toward filling the void" in sovereign debt governance, arguing that they could form the basis of an effective soft-law framework.[438] Some even see the Principles as a potential stepping-stone to harder forms of international law. Gelpern, for example, notes that "[i]f governments and their creditors use and invoke these principles when they restructure, they can infuse them with practical meaning and make them effectively binding."[439] Despite this optimism about the role the Principles can play in promoting better restructuring outcomes, it is unlikely that this or any other soft-law arrangement will serve on its own as an effective governance mechanism for sovereign debt restructuring.

To be sure, there are understandable reasons for seeing practical potential in the UN Principles, despite their non-binding character. Scholars have already shown that informal norms play an important role in the SDRR, although these norms are backed-up by powerful disciplinary mechanisms.[440] Soft-law standards are also widely considered to be the backbone of global financial governance more generally. However, the UN Principles face two broad obstacles that are likely to limit their impact on the debt restructuring regime. The first is political and relates specifically to the Principles and their content. Here, the issue is that the strength of non-binding mechanisms often depends on the degree of consensus surrounding them, and particularly on the extent to which powerful states and market actors buy into them. In the case of the UN Principles, the support of powerful capital-exporting states and private creditors does not exist and is unlikely to emerge in the foreseeable future. Although some of the individual tenets of the UN Principles—particularly good faith, transparency, and equitable treatment, which echo the content of the IIF's 2004 Principles—could conceivably command support from these actors, others are much more contentious.

Particularly contentious is the first of the nine principles. It declares that states have a right to restructure their debt as part of their broader sovereign right to self-determine national economic

436 Bhumika Muchhala, "UN adopts landmark debt resolution on principles for sovereign debt restructuring," Third World Network. September 11, 2015.
437 Li, 'The Long March towards an International Legal Framework for Sovereign Debt Restructuring,' p. 338.
438 Joseph E. Stiglitz and Martin Guzman, "A Step Forward For Sovereign Debt," *Project Syndicate*. November 9, 2015.
439 Gelpern, "Sovereign Debt: Now What?' p. 90.
440 Odette Lienau, *Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance* (Harvard University Press, 2014).

policy. While this principle does not, of course, establish a higher international authority that could trump contracts governed by New York or English law, it does challenge these legal foundations of transnational debt markets rhetorically. It suggests, contrary to domestic contract law in the US and the UK, that private contracts are not sacrosanct; that there are higher political priorities and principles that come before contractual obligations. The idea of a right to restructure also challenges what Odette Lienau calls the debt 'repayment norm'—the deeply entrenched idea that sovereign debt must always be repaid, regardless of how it was contracted or used.[441] Backed by the powerful belief that anything less than full repayment will be punished via higher borrowing costs, the repayment norm works in tandem with the role of US/UK contract law in the sovereign debt regime to promote a state of affairs in which creditors have some degree of confidence in the security and predictability of their cross-border sovereign bond investments. Anything that throws into question the legal and/or normative underpinnings of this regime is unlikely to gain the support of powerful capital exporters and the private financial markets that benefit from the relatively predictable, apolitical, and creditor-friendly status quo. In short, the UN Principles faced political backlash from powerful actors because they also clashed with the established legal foundations of sovereign debt markets, if only at a rhetorical level.

It is hardly surprising, then, that US and European officials—the latter representing UK interests in particular—not only rejected the UN Principles, but also attacked their legal validity. Jill Derderian, the US Counselor for Economic and Social Affairs, criticized the Principles for being problematic "in several respects, including language that could be construed as acknowledging a certain 'right' to restructure sovereign debt, which does not exist." The EU common position largely echoed this view, arguing that the Principles contained "a number of statements that do not accurately reflect existing law or international practices."[442] It also denounced the UN Principles' assertion that "[s]overeign immunity from jurisdiction and executive regarding sovereign debt restructurings is a right of States before foreign domestic courts,"[443] noting "the need to respect the decisions of competent Courts for the restructuring of Sovereign bonds issued under foreign jurisdiction."[444] The fact that the Principles indirectly challenged the legal sanctity of debt contracts (via principle 1: the right to restructure) and directly challenged the authority of US and UK domestic courts in the SDRR (via principle 6:

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441 Ibid.

442 EU common position on the UN draft resolution A/69/L.84, p. 6.

443 UN, 'Basic Principles on Sovereign Debt Restructuring Processes.' This text is from principle number six regarding sovereign immunity.

444 EU common position on the UN draft resolution A/69/L.84, p. 6.

sovereign immunity) obliterated any hope of winning the approval of capital-exporting states or private creditors even for a soft-law set of commitments. And without the support of these powerful actors, the Principles lack the buy-in necessary to promote their use and acceptance among creditors and debtors alike, as well as within the key jurisdictions of the international sovereign debt market.

Beyond these specific political constraints, there are functional limitations for soft-law arrangements in the SDRR more generally that will prevent the UN Principles from having much impact on future debt workout processes. Although soft law is the dominant form of global financial regulation, the characteristics of sovereign debt restructuring as an issue area challenge the effectiveness of soft modes of governance in this domain. With the regulation of the banking, insurance, and accounting industries, soft law operates through international standards adopted by self-regulating firms or applied by regulatory authorities at the domestic level. When it comes to regulating global 'systemically important financial institutions' (SIFIs), for example, there are a relatively small number of firms concentrated in an even smaller number of countries. While it may be politically difficult to write and enforce robust regulation, it is easy enough in a functional sense to imagine SIFIs and/or their national regulatory authorities adopting common standards.

To be sure, EMDE debtors have voluntarily adopted relatively standardized CACs in their bonds to facilitate debt restructuring, and private creditors have gone along with these standards by purchasing bonds that contain CACs. But this particular mode of anchoring international standards in domestic private-law contracts only works for specific commitments with precise legal meanings. The type of broad normative commitments outlined in the UN Principles—for example, legitimacy, sustainability, and impartiality—would never be inserted into sovereign bond contracts for this reason. They are too vague and ambiguous to offer useful guidance to domestic judges, and they would introduce far too much uncertainty for both debtors and creditors. Considering that the recent New York-court ruling against Argentina hinged on the judge's particular interpretation of the otherwise relatively technical *pari passu* clause, it would be quite risky to introduce far more ambiguous terms into debt contracts. Moreover, in the UN case, one of the political objectives was to reduce, not expand, the influence of domestic courts over the resolution of sovereign debt disputes. Finally, even if debtors felt like they could benefit from including broad principles in their contracts, they would almost surely be deterred by the interest-rate premiums they would have to pay for issuing bonds with terms whose meanings

were highly uncertain and contestable. As has been well documented, the authorities that issue and manage sovereign debt tend to see their overarching priority as minimizing borrowing costs.[445]

International soft law has little weight on its own. It needs a delivery mechanism, such as domestic legislation or contracts, to ground it and give it legal force. In the sovereign debt realm, the contract mechanism can be useful in operationalizing certain precise commitments, but is limited in its ability to translate a range of broader norms and ideas into effective governance mechanisms. Beyond inserting the UN Principles into their bond contracts, national governments could always simply invoke principles such as sustainability or good faith to justify their approach during a debt restructuring. But this would not protect them from litigation or ensure that a speedy and sustainable debt reduction was achieved without alienating creditors and leading to steeper future borrowing costs.

What about private creditors themselves? Could they be relied upon to adhere to soft-law principles on their own accord, much as firms and industry bodies in other areas of global finance self-regulate? It seems unlikely. In the world of sovereign debt, creditors are too disparate and heterogenous to be expected to universally and voluntarily adopt common standards. Even if some creditors wanted to endorse certain principles to demonstrate their cooperative spirit, why would specialized investors that pursue holdout strategies voluntarily adopt and adhere to, say, principle 9 of the UN Principles, which states that minority creditors must respect the decisions of the majority? And the problem is that anything less than full creditor participation with a soft-law framework would leave sovereigns exposed, as it only takes one holdout to disrupt a restructuring. Sovereign debt restructuring is thus characterized, in the terminology of global public goods, by a 'weakest link' logic.[446] Even with the cooperation of most creditors, restructurings can be spoiled by a single weak link: holdout creditors. Moreover, the fact that no creditor group has yet endorsed the UN Principles should not inspire much confidence in the self-regulatory model of soft law.

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[445] For example, see Anna Gelpern, Mitu Gulati, and Jeromin Zettelmeyer, 'If Boilerplate Could Talk: The Work of Standard Terms in Sovereign Bond Contracts,' *Law & Social Inquiry* (forthcoming 2019).

[446] See Daniel Bodansky, 'What's in a Concept? Global Public Goods, International Law, and Legitimacy,' *European Journal of International Law* 23(3)(2012): 651-668. For a broader discussion of the cooperation problems surrounding different types of global public goods, see Inge Kaul, Isabelle Grunberg, and Marc Stern (eds.), *Global Public Goods: International Cooperation in the 21st Century* (Oxford University Press, 1999).

The UN Principles are not, of course, the first soft-law mechanism in the SDRR. In important ways, they follow the template and even mimic some of the content of the IIF's 2004 Principles. But the UN Principles also differ from the IIF version in ways that would lead us to expect that, if anything, the latter should be stronger and more impactful than the former. Despite their soft-law character, the IIF Principles were designed to induce debtor compliance via market discipline. To oversee the Principles, the IIF set up a 'Group of Trustees' and a 'Principles Consultative Group,' the latter of which releases a report each year assessing whether countries have followed the Principles. This document serves as something of a report card, scoring debtor countries on their performance in areas such as data transparency and investor relations. Because getting a poor score from the leading global financial industry association could damage a country's creditworthiness in the eyes of foreign investors, it has been argued that debtors are likely to adhere closely to the IIF Principles.[447]

Some commentators even worried that such compliance would further tilt the SDRR in favour of creditor interests, since the Principles themselves emphasized creditor priorities. For example, the IIF Principles encouraged debtors to do whatever they could to return to financial markets as soon and with as little disruption as possible, rather than doing what might be needed—including large debt write-downs—to resolve deep solvency crises. As Barry Herman wrote, adherence to the Principles is "bound to produce creditor-friendly debt workouts that debtor governments will accept if they feel they have no choice but to quickly normalize access to foreign credit, even if it does little to ameliorate the economic and social consequences of excessive debt servicing."[448]

Yet, despite all of this, there is little evidence that the IIF Principles have had any impact on making debt restructuring processes smoother, quicker, fairer, or more orderly. In the IIF's own evaluations, activities that debtors would have done otherwise, and have done with no reference to the IIF Principles, are treated as evidence of compliance with this soft-law framework, overstating its significance. In the reform debates since 2012, it is striking just how little the IIF Principles have even been mentioned. In 2012, the IIF even updated its Principles in light of recent experience in the Eurozone, adding an Addendum that builds on the original content in minor ways. This act was largely ignored by the official sector, sovereign debtors, and the broader community of policy practitioners

[447] Ritter, 'Transnational Governance in Global Finance.'
[448] Barry Herman, 'Why the Code of Conduct for Resolving Sovereign Debt Crises Falls Short,' in: Barry Herman, Jose Antonio Ocampo, and Shari Spiegel (eds.), *Overcoming Developing Country Debt Crises* (Oxford University Press, 2010), p. 390.

and academics involved in debt restructuring debates. Unlike the original version, the Addendum was not endorsed by the G20 or any major capital-exporting countries. When the IIF asked the IMF to endorse its updated Principles, the Fund's members—including major capital exporters and large debt-issuing countries—saw little value in doing so and refused.[449] None of this bodes well for the new UN principles, which have neither the backing of the most powerful actors in the system nor the market incentives that could conceivably lead to voluntary compliance. As a result, their significance is likely to be more symbolic than practical.

## 5. Conclusion

Analyzing the reform processes and outcomes of the recent UN initiative, this chapter has argued that international *hard-law mechanisms* designed to govern the sovereign debt restructuring process face enormous political obstacles that make their realization unlikely. Several of these obstacles have been identified by previous studies, but this chapter highlights additional barriers: notably, overlooked sources of US and UK preferences (stemming from their concerns about how a hard-law framework would impact transnational property rights and the functioning of sovereign debt markets), the structural power of these states within the SDRR, and the sovereignty-related concerns of debtor governments. I also argued that, contrary to optimistic prognostications, the non-binding principles that ultimately emerged from the UN reform initiative are unlikely to have much concrete impact, due to specific political challenges but also, importantly, the general functional limitations of *soft-law mechanisms* in the SDRR. Taken together, these arguments suggest that public international law techniques—along the hard law-soft law spectrum—are unlikely to succeed as regulatory devices for sovereign debt restructuring processes, mainly for political but also for functional reasons.

It is not entirely surprising that hard-law mechanisms have not emerged in the SDRR. One of the key impediments to a treaty-based SDRR is the sovereignty cost to which scholars of institutional design point.[450] Because hard-law arrangements can infringe upon sovereign autonomy and authority in sensitive areas, the inter-state bargaining process to establish this sort of arrangement is likely to be

[449] This issue was discussed at an IMF executive board meeting in May 2013. A number of states, including Germany, were explicit in their view that the IMF should not endorse the IIF Principles. The Brazilian director was most outspoken in rejecting the Principles on political grounds, stating: "it is important for us to recall that the IIF is a creditor-lobbying group and that is "principles" necessarily reflect their interests." See: Statement by Mr. Torres and Ms. Florestal on Sovereign Debt Restructuring—Recent Developments and Implications for the Fund's Legal and Policy Framework,' p. 2.
[450] Abbott and Snidal, 'Hard Law and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law.'

hard-fought and time-consuming, leading scholars to argue that these high negotiation costs can also be a deterrent from the pursuit of international treaties.[451] Finally, analysts have noted that treaty-based agreements tend to be rigid and difficult to adapt, making them a tough sell in issue areas, such as global finance, that are characterized by high levels of change and uncertainty and thus require more flexible governance arrangements.[452] But this chapter highlighted other important barriers that differ from the more generic factors these scholars identify. Most notably, an important objection to hard-law solutions among key capital-exporting states relates not to their sovereignty, negotiation, or flexibility costs but to their potential to erode certain transnational legal and market structures, which in turn uphold particular forms of power, privilege, and market governance.

When scholars write about the pros and cons of international hard law, it is almost always in comparison to soft law, such that the weakness of harder forms of governance are seen as the strengths of softer forms. For example, authors point out that soft-law arrangements have lower sovereignty and negotiation costs and are more flexible than their hard-law counterparts, making them easier to agree upon and more desirable in certain policy domains or for certain regulatory purposes. It is certainly true that the UN Principles were able to emerge because of their soft-law status and the fewer veto points for powerful oppositional actors to block soft-law agreements. But much of the existing literature suggests that hard-law and soft-law tools are selected from a broader governance toolkit based on the functional needs of a given problem or issue area, and that when soft law is selected, it is often because it provides a more effective option for dealing with the issue in question.[453] In the UN case, however, hard law was not rejected and soft law was not chosen primarily for these functional reasons. Although the sovereignty concerns of debtor states could be interpreted more from this functionalist perspective, regulatory outcomes were shaped, first and foremost, by a political contest between two coalitions with divergent preferences and power capabilities. Moreover, the UN Principles were clearly not adopted because of their anticipated functional superiority to the hard-law alternative. As this chapter has emphasized, there are few reasons to expect these non-binding principles, or any other soft-law arrangement for that matter, to be a very effective functional mechanism in the SDRR.

[451] Ibid.
[452] See also Brummer, *Soft Law in the Global Financial System*.
[453] For example, see Kal Raustiala, 'Compliance & Effectiveness in International Regulatory Cooperation,' *Case Western Reserve Journal of International Law* 32(3)(2000): 387-440.

Because of these limitations, the main regulatory alternative to a hard-law framework in the SDRR has not been soft law—as existing literature would predict—but rather private-law contracts, the subject of the next chapter. This and the subsequent chapter thus challenge the dominant view that global governance tools exist along a spectrum of international hard and soft law, and that soft law is the only feasible option for global finance. In addition to highlighting the importance of legal-institutional design in determining the political (and functional) prospects for success of different reform initiatives, these chapters also argue that the *historical legacy* of earlier initiatives played a supplemental role in shaping recent reform preferences and processes, but mainly in a way that further diminished or enhanced the prospects of mechanisms whose political utility had already been determined by their design features. Legacy effects were seen in a relatively minor way during the UN initiative—notably through US officials' immediate rejection of a reform idea that harkened back to the SDRM proposal—but played a more significant role in the contract reforms analyzed in following chapter. Although the role of the early 2000s is not the primary explanatory factor in these cases, it provides additional analytical leverage not available to scholars who studied earlier reform efforts in the SDRR but have not examined the more recent initiatives detailed in this dissertation.

This chapter constitutes an important puzzle piece in the broader explanation of regulatory variation advanced in this dissertation. It reinforces the claim that the process-trigger distinction is only the first dimension of regulatory variation, and that to understand why certain process-oriented reforms fail while others succeed, it is necessary to look at their specific *legal-institutional design* features. This chapter discussed and showed the political and functional limitations of two such design options: international hard law and international soft law. The next chapter moves on to analyze recent reform initiatives that advanced a process-oriented mechanism with a very different regulatory design: private-law contracts. In doing so, it helps to complete our analytical framework for understanding regulatory variation in the debt restructuring regime according to, first, the process versus trigger distinction and, second, the legal-institutional design of different regulatory mechanisms.

# CHAPTER 6

## Sovereign Bond Reform
## The Restructuring Process and the Promise of Contract Mechanisms

### 1. Introduction

Before the UN initiative took off, efforts were already being made to improve sovereign debt restructuring processes. In response to Greece and Europe's broader debt crisis, Eurozone leaders agreed that all members of the currency bloc should have some mechanism for rewriting their debts in the event of a crisis and mandated the inclusion of a standardized CAC in all Eurozone sovereign bonds issued after 2012. Overnight, new restructuring rules were applied to bond markets worth trillions of euros.[454] Meanwhile, Greece's restructuring of its English-law bonds in 2012 and Argentina's legal defeat in New York courts that same year highlighted the growing capacity of holdout creditors to disrupt debt workouts in the key jurisdictions where foreign debt was issued, prompting a separate reform initiative. Led by US Treasury officials, this initiative unfolded through a series of working-group meetings among representatives of EMDE debtor states, capital-exporting countries, and private creditors. Within a year, the group had agreed on new 'super-CACs' capable of significantly neutralizing holdouts in EMDE foreign debt. Since October 2014, these clauses have been widely adopted by debtor states.[455] Importantly, they introduce a key bankruptcy feature that motivated past proposals for a more centralized system: the ability to bring together all bondholders and restructure debt through a single supermajority vote that forces any minority holdouts to go along with the deal.

Both reforms focused not on establishing a sovereign bankruptcy regime under public international law, as the UN initiative had, but rather on replicating key features of a bankruptcy process within the contract terms of the bonds that governments issued under domestic private-law regimes. They also succeeded in strengthening the debt restructuring process where the UN initiative had failed. What explains the success of these contract reform initiatives? As noted in Chapter 2 (Section 4), the existing literature provides few clues as to why private-law contracts flourished where public international law floundered. Although the early 2000s saw the introduction of an earlier, more basic version of CACs,

[454] Carletti, Colla, and Gulati, 'Evaluating the 2013 Euro CAC Experiment.'
[455] IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts.'

that episode has been treated as a one-off event shaped by idiosyncratic and context-specific factors, thus failing to explain the return and strengthening of contracts in the more recent context and in response to new challenges. The few accounts of recent contract reforms offer useful guidance, but they overlook politically-salient aspects of regulatory design by treating the new CACs as either a symbolic solution (discounting material motivations) or a functional one (ignoring the fact that other mechanisms, including hard-law arrangements, are equally justified on functionalist grounds).

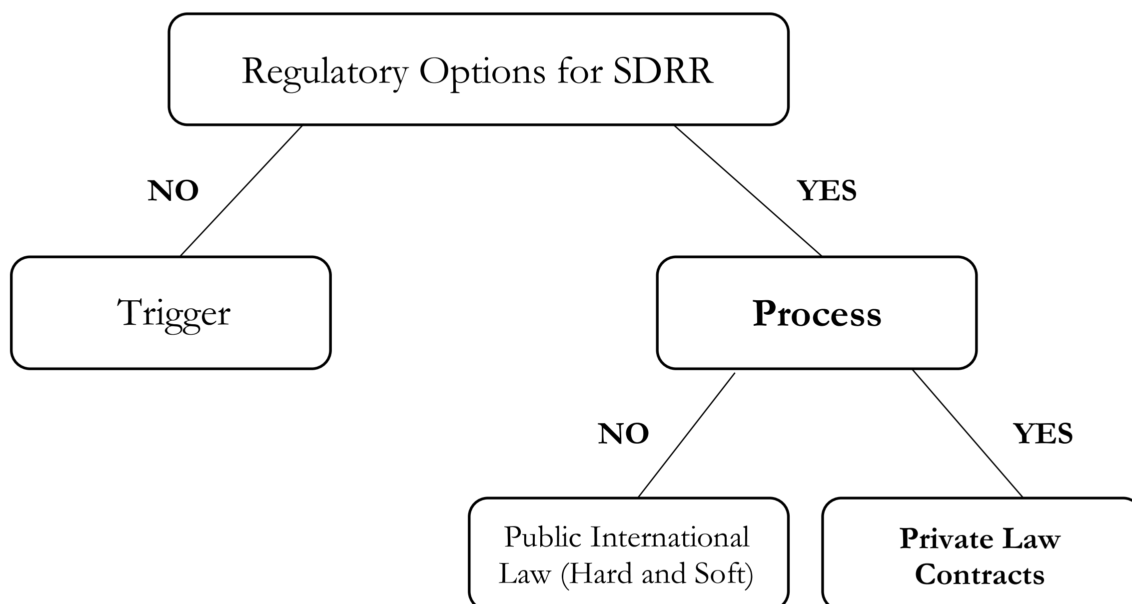
This chapter argues that private-law contract mechanisms possess two key qualities that set them apart from the regulatory arrangements discussed in previous chapters and that have enabled their success in the SDRR. First, unlike the IMF lending rules analyzed in Chapter 4, they are designed to govern the debt workout *process* rather than *trigger* restructurings. The fact that process mechanisms provide an opportunity for joint gains without making restructurings more likely in the first place was crucial in mobilizing political support for contract reforms, especially during the Treasury-led initiative. Second, in contrast to the other process mechanisms examined in Chapter 5, their *legal-institutional design* is politically acceptable and functionally effective. That is because contract tools are embedded within—rather than located above—existing domestic legal structures, thus avoiding the political pitfalls of international hard-law mechanisms. They are also precise and legally binding, making contracts functionally superior to international arrangements of a purely soft-law variety. Private-law contract mechanisms like CACs can enhance the efficiency of the restructuring process without overriding state sovereignty or the legal foundations of transnational property rights, making them a unique and politically useful device for navigating the trade-offs of regulating debt restructuring, especially for the leading capital-exporting states but also for EMDE debtors and private creditors.

I also argue that the *historical legacy* of the original CACs introduced in the early 2000s was important in shaping and reinforcing preferences in favour of further contract innovation more recently. I point to four reasons for this historical effect. First, the debates of the early 2000s clarified and reinforced US regulatory preferences. When the need for further improvements to the debt restructuring process arose recently, US officials moved immediately to promote the contractual approach as their preferred option. Second, both US and Eurozone officials found it easier to adopt and adapt an existing governance tool rather than construct a brand new one. The original CACs provided reformers with a blueprint to follow. In the case of US Treasury-led reforms, the blueprint included instructions on how to engineer a voluntary shift in contract terms, and the presence of 'repeat players' from the early

2000s made these instructions easier to follow. Third, experience with the original CACs shifted debtor and creditor preferences, such that they went from accepting contract reform as a lesser evil in the early 2000s to embracing it as desirable in its own right after 2012. This shift was particularly important to the Treasury-led contract reform initiative, whose success hinged on the active cooperation of debtors and creditors. Fourth, in the recent crisis and reform context, familiarity with CACs increased the political utility of contract mechanisms as a tool for enhancing legal and market certainty around the debt restructuring process. The role of historical legacies resonates with historical institutionalist approaches, which recognize the importance of prior institutional developments in shaping subsequent preferences and processes.[456] But it is important to stress that these legacies play a supplemental explanatory role: they enhanced the prospects of a regulatory mechanism whose politically utility had already been determined by its process-orientation and legal-institutional design.

To represent it visually, this chapter advances the broader argument of the dissertation by addressing the remaining branch of the feasibility tree presented below: the "Private Law Contracts" branch situated on the lower right-hand side under the broader "Process" heading.

**Figure 6: The Process Branch of the Feasibility Tree and the Private Law Contracts Option**




[456] For example, Mahoney and Thelen (eds.), *Explaining Institutional Change*.

This chapter contributes to IPE and global governance literatures by filling important empirical gaps in our understanding of sovereign debt governance. The reforms analyzed in this chapter have received little scholarly attention and, despite their similarities, have not yet been examined within the same analysis. The argument developed here makes sense of both initiatives and also lays down the third and final puzzle piece that, when combined with the insights of the previous two chapters, completes a novel framework for understanding regulatory variation in the SDRR, thus contributing to the theoretical development of an important but overlooked area of global financial governance.

The arguments advanced in this chapter also contribute to broader theoretical debates about institutional design and development and the role of contracts in global governance. While the last chapter emphasized the limitations of public international law mechanisms in the SDRR, this one highlights the political utility of an alternative—private-law contracts—that does not fit within the hard law-soft law dichotomy and is generally ignored as an instrument of global governance. When contracts *are* analyzed by scholars of world politics, they are often treated as generic agreements—hard-law and soft-law arrangements could be understood as contracts from this perspective—or as tools of private order.[457] In showcasing the use of contracts as regulatory mechanisms in public-private reform initiatives, this chapter also helps to broaden current understandings of the use and purpose of contracts in global governance. Finally, the chapter highlights the role of historical legacies and processes not as stand-alone explanations but as factors that interact with, and shape understandings of, regulatory design features in ways that have shifted the politics of reform in the SDRR over time. In doing so, it contributes to discussions of where, when, and how—rather than if—history matters to contemporary political developments.

In the next section of this chapter, I analyze the initiative that led to the introduction of Eurozone CACs, showing how the key characteristics of contract mechanisms, combined with the historical legacy of the original CACs, made a contractual solution politically easier, more acceptable, and more useful than alternative arrangements, especially given the delicate context in which European decision-makers found themselves. I then describe the US Treasury-led initiative and explain how continued US preferences for a contract approach, also combined with the historical legacy of the original CACs and, in particular, its impact on debtor and creditor preferences, paved the way for the speedy

[457] Cooley, 'Rationalist theories of institutions in American IPE'; Cutler and Dietz (eds.), *The Politics of Private Transnational Governance by Contract*.

introduction of robust contract reforms in EMDE bonds. The following section briefly evaluates the effectiveness of CACs and suggests that new contract mechanisms represent a tangible and significant—though not transformative—strengthening of the SDRR. The final section concludes.

## 2. Eurozone Contract Reform

Debates about reforming Europe's financial governance architecture began in 2010, shortly after the 2010 Greek bailout discussed in Chapter 4. In addition to the controversies surrounding the IMF's role, the Greek rescue generated a political backlash in the core surplus Eurozone countries, notably Germany, where citizens complained that their taxes were being used to rescue profligate countries and private investors from their own mistakes. In response, European leaders quickly launched discussions about creating new institutions to better safeguard financial stability and facilitate burden-sharing in the resolution of future crises. In October 2010, French President Nicolas Sarkozy and German Chancellor Angela Merkel met in Deauville France, where they agreed to pursue a permanent European crisis resolution regime, including a debt restructuring mechanism for Eurozone states. The declaration that emerged from that Franco-German summit noted that treaty amendments would be required to establish "a robust crisis resolution framework," but it was extremely vague about what the new restructuring mechanism might look like, stating only that it would secure "adequate participation from private creditors" in the resolution of future crises.[458]

Around that time, the idea of a treaty-based sovereign bankruptcy framework had gained renewed attention and was being discussed in the context of Europe.[459] In November 2010, Anne Krueger and colleagues published a paper arguing that Europe should adopt its own version of the IMF's earlier SDRM proposal.[460] Many speculated that this kind of arrangement might indeed be what Germany had in mind. Shortly after the Deauville summit *The Economist* published an article titled, "What do

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458 Franco-German Declaration: Statement for the France-Germany-Russia Summit. Deauville, France. October 18, 2010. Available at: https://www.eu.dk/~/media/files/eu/franco_german_declaration.ashx?la=da

459 For example, see Beatrice Weder di Mauro and Jeromin Zettelmeyer, 'European debt restructuring mechanism as a tool for crisis prevention,' VoxEU. November 26, 2010. Available at: http://www.voxeu.org/article/european-debt-restructuring-mechanism-tool-crisis-prevention?quicktabs_tabbed_recent_articles_block=1. Scholarly discussions of a European SDRM continued throughout the reform process documented in this section. For later contributions to this debate, see: Elizabeth H. Dahill, 'As Greece Goes, So Goes the E.U.: Defending Europe with a Sovereign Debt Restructuring Framework,' *International Law & Management Review* (9)(2012); Buchheit, Gelpern, Gulati, Panizza, Weder di Mauro, and Zettelmeyer, 'Revisiting Sovereign Bankruptcy.'

460 Francois Gianviti, Anne O. Krueger, Jean Pisani-Ferry, Andre Sapir, and Jurgen von Hagen, *A European Mechanism for Sovereign Debt Restructuring: A Proposal* (Bruegel, Brussels: 2010).

German calls for an orderly sovereign-default scheme mean in practice?"[461] Other major news outlets reported that the new framework would likely include CACs but might also involve the creation of a European SDRM.[462] The speculation and uncertainty about the details of a mechanism designed to facilitate creditor losses roiled financial markets, triggering a dramatic spike in sovereign bond yields referred to as the "Deauville effect."[463] As Beatrice Weder di Mauro and Jeromin Zettelmeyer reported roughly a month after the Deauville summit, "proponents of a European Sovereign Debt Restructuring Mechanism are currently facing a backlash. Calls for a European-wide mechanism are viewed as the principle cause for the escalation of the crisis in Ireland and contagion within the Eurozone."[464]

On November 28, 2010, under immense pressure from financial markets to reveal their plans, Eurozone finance ministers announced their intention to introduce standardized CACs in the sovereign bonds of all Eurozone states, starting January 1, 2013.[465] The task of drafting these new clauses was delegated to the Sub-Committee on EU Government Bonds and Bills, a technical group under the Economic and Financial Committee of the EU.[466] Their objective was to create a uniform set of restructuring terms that could be inserted into otherwise non-standardized bond contracts and applied across substantially variegated domestic jurisdictions. To help with the design challenge, the Sub-Committee hired Cleary Gottlieb—the law firm that represented Mexico when it first issued CACs in 2003. The drafting process involved extensive consultations with the financial industry, which gave feedback on the design of the new mechanism.[467] Roughly two years after the announcement to move toward CACs, the reform process culminated in September 2012 with the ratification of the treaty establishing the European Stability Mechanism (ESM). Among other things, the ESM treaty mandated Eurozone states to include identical CACs in all international and domestic sovereign bonds

[461] *The Economist*, 'What do German calls for an orderly sovereign-default scheme mean in practice?' November 4, 2010. Available at: https://www.economist.com/finance-and-economics/2010/11/04/fail-safe
[462] Ambrose Evans-Pritchard and Bruno Waterfield, 'Germany's 'haircut' plans rattle eurozone bondholders,' *The Daily Telegraph*. October 29, 2010.
[463] Ashoka Mody, 'The ghost of Deauville,' VoxEU. January 7, 2014. Available at: https://voxeu.org/article/ghost-deauville
[464] Weder di Mauro and Zettelmeyer, 'European debt restructuring mechanism as a tool for crisis prevention.'
[465] *Business World (Digest)*, 'EU plan to break default taboo; EU Default Plan.' November 29, 2010.
[466] Gelpern and Gulati, 'The wonder-clause.'
[467] Ibid.

that had a maturity of more than one year and were issued after 2012.[468] Overnight, uniform debt restructuring rules were imposed on government bond markets worth trillions of euros.[469]

The CACs adopted in Europe differed from the traditional ones in a few important respects. Unlike the contract terms adopted by EMDEs starting in the early 2000s, euro CACs were mandated by an intergovernmental treaty. This approach did not fit with the dichotomous debates of a decade prior, which consistently emphasized the voluntary nature of contracts and contrasted them with top-down, government-imposed measures. Mandating contract reform in this way reflected the power and desire of European institutions to implement standardized rules across all Eurozone countries. It also changed the dynamic of the reform process compared to the early 2000s or the US Treasury-led initiative that came later, both of which relied on the voluntary adoption of new contract terms by debtors and their private creditors. That said, Eurozone officials from different countries—including debtors—had to strike bargains amongst themselves before settling on their collective approach, and they remained attuned to how their plans would impact private financial markets.

At this point, one might quip that Europe's restructuring rules were introduced through an international hard-law mechanism, therefore invalidating the claims made in the previous chapter. But this reading would be mistaken. In no way did the ESM treaty establish sovereign bankruptcy rules and procedures under international law, as the UN initiative and the SDRM proposal before it sought to do. It simply gave an authoritative directive to Eurozone states to embed standard CACs into the private-law bond contracts they issued under domestic and foreign jurisdictions. The bonds themselves would continue to be governed by the local laws and courts of these jurisdictions—not a supranational bankruptcy court.

The content of euro CACs also differed from the original model, with the former being simultaneously more and less ambitious than the latter. On one hand, euro CACs contain an aggregation feature that enables more comprehensive debt restructuring than traditional CACs. Bonds with first-generation CACs can only be restructured on a series-by-series basis—that is, with each individual bond series being restructured separately, provided it achieves the consent of a qualified majority (typically 75

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468 Michael Bradley and Mitu Gulati, 'Collective Action Clauses for the Eurozone,' *Review of Finance* 18(6)(2014): 2045-2102.

469 Carletti, Colla, and Gulati, 'Evaluating the 2013 Euro CAC Experiment.'

percent) within that particular series. By contrast, euro CACs allow for cross-series modification (also known as aggregation), which brings together bondholders from different series, allows them to vote as a collective, and, if a threshold of consent is achieved, binds them to a more comprehensive restructuring agreement. On the other hand, this aggregation feature is hamstrung by a key limitation: it relies on a 'two-limb' voting structure, which means that amending the bonds requires a minimum threshold of support both (a) in each individual series (66 2/3 percent of outstanding principal) and (b) across all series being restructured.[470] The implication is that, under euro CACs, no individual bond series can be restructured without a minimum level of support (75 percent) across all series.[471] This 'two-limb' voting structure thus introduces a new obstacle to restructuring—one that did not exist in the original CACs—while at the same time helping to remedy an old one: the inability to effectively aggregate bondholders.

Introducing CACs in Europe made some intuitive sense. Before the Eurozone crisis, the conventional wisdom had been that sovereign bankruptcies only happen in the developing world. Advanced economies had done little contingency planning for their own potential debt difficulties. Although European governments had agreed to include first-generation CACs in their international bonds back in 2003 as a show of solidarity with their EMDE counterparts, the vast majority of their debt took the form of domestic-law bonds, which did not include CACs or any other mechanism to coordinate debtor-creditor action in the event of a restructuring. When the Greek crisis erupted and debt restructuring in Europe began to look like a distinct possibility, the policy response was thus to fill this gap by importing the contractual framework into the Eurozone where it previously did not exist. But the lack of a mechanism to facilitate the restructuring of both domestic and international bonds could have equally been solved, from a functional or technical perspective, by establishing a European SDRM. As some observers pointed out, creating a hard-law sovereign bankruptcy regime might also be more politically feasible in Europe, "where the practice of ceding some national legal powers to a larger entity is long established."[472] Why, then, did Eurozone leaders opt for contract mechanisms?

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[470] IMF, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring,' IMF Policy Papers (October 2014).
[471] Ibid.
[472] *The Economist*, 'What do German calls for an orderly sovereign-default scheme mean in practice?' See also Odette Lienau, 'Extending the European Debt Discussion to Broader International Governance,' Cornell Law Faculty Publications (2011). At: http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2018&context=facpub

The first and simplest answer is that an earlier form of CACs already existed and thus provided a template for Eurozone policymakers to build upon. Rather than re-inventing the wheel, Eurozone reformers turned to CACs as a ready-made solution that could quickly and easily be adapted and transplanted to Europe. As a then senior IMF official put it:

> Even though intellectually many of the Europeans would have liked to have a European SDRM, there was just no appetite to basically have that fight again. They needed to come up with some practical reforms that they could implement. So I think, not surprisingly, they reached for a collective action framework. They looked around, and they took what was the most ambitious framework in place at that time.[473]

Indeed, when European officials presented the idea of Eurozone CACs, they explicitly framed them as an extension of earlier reforms and existing market practice, stating that they would "be based on those commonly used in the UK and US."[474] Asked about the origins of euro CACs, a former US Treasury official responded: "I think that some of the people, the Germans and the French staff, may have reverted to the IMF playbook, or things they were familiar with from their IMF background, and that's where they may have come up with euro CACs."[475]

Although Eurozone reformers modified the existing CACs in a number of ways to fit their needs and context, some observers argued that CACs looked like an ill-fitting solution in Europe. As Gelpern and Gulati pointed out, "in contrast to the 1990s and 2000s, no policy maker had identified a collective action problem for Collective Action Clauses to solve in Europe."[476] The authors use this point to support their argument that euro CACs were more symbolic than substantial. But the lack of a perfect fit between the problem and solution can equally be seen as a reflection of the fact that CACs were borrowed from a different context rather than designed for post-2010 Europe specifically. Moreover, euro CACs were not a response to collective action problems in Europe because no Eurozone country had yet restructured its debt. Policymakers could, however, anticipate such problems, since they were a consistent feature of debt restructurings—one that indeed materialized during the later Greek debt workout. This does not imply that CACs were a functionally optimal solution from a rational design perspective, or that they were devoid of any symbolic content. The point, rather, is that European

[473] Interview 138785.
[474] EFC Sub-Committee on EU Sovereign Debt Markets Collective Action Clause Explanatory Note. July 26, 2011. At: https://europa.eu/efc/sites/efc/files/docs/pages/explanatory_note_draft_on_the_model_cac_-_26_july.pdf
[475] Interview 114203.
[476] Gelpern and Gulati, 'The wonder-clause,' p. 375.

officials were guided by previous regulatory developments in their decision to adopt and adapt an existing governance tool that, while imperfect in various ways, could prove useful in future restructurings and in setting out a predictable framework for such events *ex ante*. Building upon an established and fairly market-friendly framework was also a particularly useful regulatory approach given the fragile financial-market conditions in Europe at the time and the desire of Eurozone policymakers not to further destabilize markets via more radical and unknown reforms.

This account is consistent with historical institutionalist perspectives that emphasize the importance of prior institutional choices in shaping the trajectory of later policy developments. In the language of historical institutionalism, the emergence of CACs in the early 2000s was a 'critical juncture' that established definitive grooves along which subsequent reform efforts were more likely to travel.[477] Rather than a brand-new arrangement, Eurozone CACs resemble the type of institutional 'layering' that occurs when new rules are attached to existing ones.[478] The historical legacy of Eurozone contract reforms is also consistent with insights from Nikhil Kalyanpur and Abraham Newman's 'design by bricolage' approach, which argues that institutional design "is often driven by the means available to the designer rather than the problem that the designer faces."[479] Instead of designing an optimal solution from scratch to precisely fit the problem at hand, as rational design theory suggests, reformers typically use and reconfigure instruments from the existing stock of governance tools.

The role of historical processes in this episode did not diminish the importance of the underlying characteristics that made contract reforms politically acceptable and useful in the first place: their process-orientation and their legally-embedded design. The fact that euro CACs were a mechanism that would govern the restructuring process but play no role in triggering debt write-downs in the first place was an important aspect of their success, relative to the IMF reforms of Chapter 4 but also to other proposals in the European context. When reform debates first got underway among European officials, reports circulated that German policymakers envisioned a new Eurozone SDRR comprising both a trigger and process element.[480] Their idea was to make private creditor haircuts a condition of

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[477] See Pierson, *Politics in Time: History*.
[478] Jeroen van der Heijden, 'Institutional Layering: A Review of the Use of the Concept,' *Politics* 31(1)(2011): 9-18. See also Mahoney and Thelen (eds.), *Explaining Institutional Change*.
[479] Nikhil Kalyanpur and Abraham Newman, 'Form over function in finance: international institutional design by bricolage,' *Review of International Political Economy* 24(3)(2017): 363-392.
[480] *Business World (Digest)*, 'EU plan to break default taboo; EU Default Plan."

all ESM financing. When countries requested and were approved for financial support from the ESM, it would automatically trigger a restructuring, the modalities of which would then be worked out between the debtor and its creditors through a process facilitated by CACs. The idea of automatic haircuts was extremely sensitive at the time. The IMF's trigger mechanism had just been undermined to pave the way for the 2010 Greek bailout. Many peripheral Eurozone countries were teetering and feared the market reaction to such proposals. And France, the main counterweight to Germany in Eurozone politics, was strongly in favour of case-by-case decision-making when it came to questions of whether and when countries—especially European ones—should go through a debt restructuring.

By their own account, French officials managed to convince their German counterparts that plans for an automatic trigger mechanism had to be scrapped to keep financial markets stable and avoid undermining the euro.[481] In subsequent discussions and documents, Eurozone representatives went out of their way to clarify that CACs were simply about the process and big decisions about bailouts and restructurings would proceed on a case-by-case basis without any 'automaticity.'[482] In a December 2010 memo, the European Commission made a point of emphasizing that "[t]he insertion of collective action clauses does not per se increase the risk of restructuring. The clause is a simple tool to facilitate the discussion between a debtor and its creditors."[483] A July 2011 explanatory note from the Sub-Committee on EU Sovereign Debt Markets reiterated that the standardized CACs to be implemented in 2013 will "not increase the probability of a euro area issuer defaulting on or modifying its debt securities."[484] Unlike the early 2000s when the trigger and process were tightly and intentionally coupled, European officials were now making efforts to de-couple these two concepts and reassure financial markets that their reforms would not result in more debt restructurings.

Beyond fears of an adverse market reaction, Europe's rejection of an ESM-based trigger mechanism reflected a deeper set of preferences within France, as well as Italy and other southern European countries, which were keenly aware of the financial instability that restructurings could generate. For them, a key lesson of the IMF's 2010 systemic exemption reform was that trigger mechanisms could

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[481] Ibid.
[482] For example, see *Business World (Digest)*, 'EU agrees "case-by-case" future haircuts; Future Haircuts.' November 29, 2010.
[483] European Commission, 'European Stability Mechanism (ESM) — Q&A,' Press Release Database. December 1, 2010. Available at: http://europa.eu/rapid/press-release_MEMO-10-636_en.htm
[484] EFC Sub-Committee on EU Sovereign Debt Markets Collective Action Clause Explanatory Note.

prove highly undesirable in certain crisis situations and that discretion and case-by-case decision-making were thus preferable. German policymakers, who were also weary of provoking market turmoil and whose views had also been somewhat tempered by the systemic exemption episode, accepted that the automatic trigger proposal had to be dropped to maintain broad political support among Eurozone countries for the ESM treaty, including its commitment to a new restructuring process based on CACs. Getting the political bargain right mattered, because the ESM treaty would have to be approved by all member states and ratified by national parliaments before taking effect.

Process orientation was therefore important, but so too was the fact that Eurozone CACs were embedded within—not located above—existing systems of contractual rights and obligations. As Chapter 5 showed, the idea of a treaty-based regime was not just a sovereignty issue; capital-exporting states also worried it would contradict and clash with the domestic legal foundations of cross-border property rights in ways that politicized and increased uncertainty in sovereign debt markets. The context in which European leaders were operating in 2010 was already one of intense market turmoil. *Any* announcement related to debt restructuring was bound to arouse concerns among market participants. But these concerns could be mitigated through the use of a contract mechanism that rearticulated—rather than trumped—investor rights, that was relatively clear and predictable in its workings, and that shared the same name as an already well-known instrument in EMDE bonds. In fact, introducing euro CACs could even reduce uncertainty in some areas by spelling out for investors how the sovereign debt restructuring process would work in Europe after 2012.

Here, the legal-institutional design of contracts combined with the historical legacy of the original CACs in a way that only enhanced the political acceptability and utility of further contract reforms, especially in the precarious context of an ongoing debt crisis in Europe. The market reaction to Deauville was a forceful reminder of the uncertainty and instability that even speculation about a SDRM-style arrangement could sow. The Franco-German decision to open this Pandora's Box was heavily criticized by other Eurozone governments, particularly those struggling to maintain market access, as well as officials outside the currency bloc.[485] Financial press and market participants further stressed the uncertainty that vague discussions of a new debt restructuring mechanism were creating.

[485] A private interview with a US government official confirmed that American decision-makers were critical of the Deauville summit and the ambiguous pronouncements of a new European debt restructuring regime that emerged from it.

As one financial daily put it: "Markets can deal with tough decisions. Even debt restructuring can be orderly and planned for. The one thing markets do not like is policy uncertainty."[486] The chief economist at IHS Markit, a global financial information company, confirmed: "This whole scenario of burden-sharing for bondholders is scaring people. The plans have changed so many times, investors don't know what to believe any more."[487] At the same time, high-profile market actors were indicating that, in their view, CACs could be an appropriate and useful compromise for resolving the situation. Josef Ackermann, then president of Deutsche Bank and chairman of the IIF, expressed his support for euro CACs shortly before Eurozone leaders announced their plans for contract reform.[488] So did the International Capital Market Association (ICMA), which noted that the inclusion of CACs and other standard bond terms would give Eurozone debt securities greater appeal by clarifying their legal terms and conditions.[489] Observers suggest that these developments indeed shaped the decision to go with CACs and abandon the more radical proposals that had been floated.[490]

Familiarity with the original CACs made the prospect of contract reforms less frightening to markets than it was in the early 2000s. Since that earlier episode, private creditors had learned that CACs did not lead to more debt restructurings or undermine investor rights. Efforts to frame euro CACs as simply an extension of the existing contractual model—even though they differed from those issued in the US and UK—was both an indication of where the idea for CACs came from and a tactic to convince markets that this reform was not a radical departure from the status quo. "Markets would accept CACs," noted Gelpern and Gulati, "if they remembered them as the benign reform that had diffused the last PSI flare-up and ended SDRM."[491] In short, the fact that euro CACs could provide a debt workout mechanism that neither triggered restructurings nor trumped investor rights—and that market actors could understand this as a result of their experience with the original collective action approach—made contract reform a particularly useful approach for Eurozone leaders looking to strengthen the SDRR at a time of tremendous market sensitivity.

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486 *The Business Times Singapore*, 'EU's fog of uncertainty not tenable.' November 18, 2010.

487 In: Ambrose Evans-Pritchard, 'Germany fuels EMU debt crisis with haircut demands,' *The Daily Telegraph*. November 25, 2010. Available at: https://www.telegraph.co.uk/finance/financialcrisis/8158298/Germany-fuels-EMU-debt-crisis-with-haircut-demands.html

488 In: Derek Scally, 'Top German banker rules out discount on liabilities,' *The Irish Times*. November 27, 2010.

489 *Global Capital Euroweek*, 'ICMA calls for transparent docs as Euro-geddon looms.' November 26, 2010.

490 See Mody, 'The ghost of Deauville.' Former assistant director of the IMF's European Department, Mody argues that "The criticisms [of Deauville] took their toll. Although the Deauville proposal was subsequently adopted by the European Council, it was eventually watered down."

491 Gelpern and Gulati, 'The wonder-clause,' p. 376.

Even after euro CACs were announced, Eurozone governments continued to debate their merits. In late 2011, with market confidence in Eurozone debt fading, France, Italy, and Spain even tried to convince Germany and other northern countries that CACs should be dropped from the draft text of the ESM treaty.[492] But the potential for euro CACs to serve as a stabilizing rather than disruptive force in European debt markets became clearer after the spring of 2012, when Greece restructured roughly €200 billion worth of bonds owed to private investors.[493] The majority of Greek government debt was in the form of domestic-law bonds that did not yet include the new CACs. However, because the debt was governed by domestic law, the government was able to apply CACs retroactively through legislative fiat—a move that proved crucial to achieving a very high level of creditor participation in the domestic portion of its debt exchange. Scholars who saw euro CACs as symbolic pointed to the Greek restructuring as evidence that new contracts were not actually needed.[494] After all, if most Eurozone debt was governed by domestic law that states could retroactively change to include CACs if needed, why write CACs into the bonds in the first place?

But this assessment misses a key point: Greece's retrofitting of CACs trampled on the private contracts governing Greek debt obligations, generating market outrage as well as uncertainty about whether other Eurozone governments might do the same in the future.[495] In this context, creating a predictable restructuring process through the *ex ante* adoption of Eurozone CACs began to look like a market-friendly solution to what one German official called "ex-post blackmail" in reference to the Greek restructuring.[496] Coming into force in 2013 and providing a fresh start after Greece, CACs could help reduce market uncertainty by spelling out how future restructurings would be handled. In this context, CACs could be seen by market actors not as a lesser evil to an international hard-law arrangement, as they were in the early 2000s, but as a genuine market improvement, "providing greater transparency to debt holders with regard to the effects of a sovereign debt crisis on their property rights."[497]

After the Greek restructuring, market attitudes toward the introduction of Eurozone CACs turned decidedly favorable, indicating that they did indeed have a positive effect on market expectations. As

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[492] *Business World (Digest)*, 'Germany may move on new terms for ESM.' November 25, 2011.
[493] Gelpern, 'Sovereign Debt: Now What?'
[494] Gelpern and Gulati, 'The wonder-clause.'
[495] Robin Wigglesworth and Elaine Moore, 'Sovereign debt: Curing defaults', *Financial Times*. June 7, 2016.
[496] Gelpern and Gulati, 'The wonder-clause,' p. 377.
[497] Christoph Grobe Steffen, Sebastian Grund, and Julian Schumacher, 'Collective action clauses in the euro area: a law and economic analysis of the first five years, *Capital Markets Law Journal* 14(2)(2019): 134-154, p. 137

a memo from PIMCO stated in October 2012: "On balance, the introduction of CACs in European government bond markets in 2013 is positive for investors."[498] Likewise, a Credit Suisse memo called the Eurozone CACs "an important first step" to "increase transparency in the Eurozone sovereign debt markets" and "provide clarity to sovereign bondholders regarding their rights."[499] It also ranked the attractiveness of different categories of bonds in terms of bondholder rights, from most to least attractive, in the following way: (1) foreign-law bonds without CACs, (2) foreign-law bonds with CACs, (3) domestic-law bonds with CACs, and (4) domestic-law bonds without CACs."[500] In foreign-law bonds, having no CACs is most desirable because they are harder to restructure, but in domestic-law bonds, those without CACs are the least desirable because they are shrouded in the most uncertainty in terms of how they might be restructured.

Since being rolled-out at the start of 2013, evidence suggests that euro CACs have indeed reduced the perceived risk and uncertainty of Eurozone sovereign bonds in the eyes of private investors. A recent study on the market treatment of Eurozone CACs finds that "CAC bonds trade at lower yields than otherwise similar no-CAC bonds" because "markets see CACs as reducing the legal risk embedded in domestic law sovereign bonds."[501] The finding that CAC provisions are viewed favorably by market participants is directly linked to market perceptions in the aftermath of the Greek restructuring. As the authors explain, compared to bonds without CACs, bonds with CACs are viewed as carrying a lower "legal risk" of "being subject to a Greek-style retrofit."[502]

It would have been impossible for European policymakers to predict the impact of euro CACs when they first proposed and were subsequently developing this approach. But there are good reasons to believe that the idea that Greece would change its domestic laws to facilitate debt restructuring was well-known to European reformers as they were discussing and drafting their new contract terms. In 2010, the preeminent sovereign debt lawyer Lee Buchheit had co-authored a widely discussed paper

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[498] Pimco, 'Collective Action Clauses: No Panacea for Sovereign Debt Restructurings,' Viewpoints. October 2012. Available at: https://www.pimco.com/en-us/insights/viewpoints/collective-action-clauses-no-panacea-for-sovereign-debt-restructurings

[499] Helen Haworth, 'CAC'ed! Implications of the introduction of Collective Action Clauses into Eurozone debt,' Credit Suisse, Fixed Income Research, p. 8. November 1, 2012. Available at: https://research-doc.credit-suisse.com/docView?language=ENG&format=PDF&document_id=1002417251&source_id=emcmt&serialid=dVcvhyHd1dxmK3oZrOF8bP1L9YKK%2bc8oNt11Jd%2bpq3M%3d

[500] Ibid, p. 13.

[501] Elena Carletti, Paolo Colla, Mitu Gulati, and Steven Ongena, 'The Price of Law: The Case of the Eurozone's Collective Action Clauses,' unpublished manuscript 2017, p. 1.

[502] Ibid, p. 3.

describing how to restructure Greek debt by retroactively applying very strong CACs to the domestic bonds through an act of legislation.[503] Signs that this strategy might indeed be used became significantly stronger when the Greek government hired Buchheit in 2011 in preparation for their 2012 debt exchange.[504] Surveying this landscape, European decision-makers likely saw the introduction of uniform and market-friendly restructuring rules throughout the Eurozone starting in 2013 as, among other things, a useful way to enhance legal predictability for bondholders once the Greek mess had been cleaned up, and in the wake of any fallout from that the tactics of that clean-up.

So what explains the introduction of Eurozone CACs? In sum, I argue that the process-oriented and legally-embedded nature of this contract mechanism, combined with the historical legacy of the original CACs, made a contractual solution politically easier, more acceptable both to governments and financial markets, and thus more useful than the main alternative (a European SDRM), especially given the sensitive context in which European policymakers were operating. Not only were contracts expected to be less disruptive than a hard-law arrangement; in the midst of heightened market uncertainty about how restructurings in Eurozone countries might shake out, deploying now-familiar and relatively non-threatening contract changes could even be seen as a way of introducing greater predictability and legal certainty for bondholders.

It is useful to briefly clarify what this argument does not explain. It does not explain the exhaustive range of motivations behind the decision to pursue and promote SDRR reform in Europe in the first place. Of course, some of these motivations are relatively straightforward in light of the challenges Europe was facing and the pressures to resolve them through institutional innovations. But other potential driving forces include, as Gelpern and Gulati have outlined, the desire to both promote and signal greater debtor-creditor burden sharing in crisis resolution, the demand for an explicit rulebook for European crisis management, and the need to introduce more market discipline by indicating that not all Eurozone sovereign bonds were risk-free assets.[505] These factors speak to the various reasons for pursuing reform but not to the choice of the specific institutional mechanism for the task. My claim is that CACs were chosen because of their design and history, which *enabled* the emergence of a contract fix where alternative arrangements faced major roadblocks. Contracts were more politically

[503] Mitu Gulati and Lee C. Buchheit, 'How to Restructure Greek Debt,' *Duke Law Working Papers* 47(2010).
[504] Brian Baxter, 'Get Him to the Greeks: Distressed Nation Taps Cleary's Buchheit,' *The AM Law Daily*. August 2, 2011. Available at: https://amlawdaily.typepad.com/amlawdaily/2011/08/cleary-gottlieb-greece.html
[505] Gelpern and Gulati, 'The wonder-clause.'

feasible than alternative options, but they were also more useful in light of some of the motivations for pursuing reform. For example, the desire to lay out a consistent and predictable restructuring rulebook was better served by layering new rules onto existing legal frameworks rather than creating a separate framework whose relation to existing legal obligations was ambiguous or even antagonistic.

### 3. US Treasury-Led Contract Reform

If the Greek episode showed that CACs could be useful in the domestic debt markets of Eurozone economies, it simultaneously highlighted a significant weakness of traditional CACs: their inability to prevent holdout creditors from derailing debt restructurings. This shortcoming became apparent during the restructuring of Greece's English-law bonds—a smaller segment of the country's overall debt but one that already included CACs as a standard feature of bonds issued in the English market. Despite the inclusion of these contract terms, attempts to restructure the bonds were marred by holdout creditors. As noted in Chapter 5, only 17 of Greece's 36 English-law bonds were successfully renegotiated. The remainder were obstructed by specialized holdouts who bought 'blocking positions' (16 percent in series requiring 85 percent supermajority approval, and 26 percent in those requiring 75 percent approval) in individual bond series that were sufficient to unilaterally prevent their restructuring.[506] This outcome highlighted an important design flaw with the original CACs. Because these clauses applied to each individual bond series rather than the total stock of outstanding bonds, restructuring had to be done on a series-by-series basis, allowing for a situation where some bonds achieved the supermajority approval to restructure while others did not.

From a technical standpoint, this issue could be resolved by writing new CACs that applied to all outstanding bonds rather than each series individually. This type of 'aggregation' would pool all bondholders and have them vote as a single group, making it prohibitively costly for a lone holdout to establish a blocking position (say 26 percent) over the entire stock of a country's bond debt. When a restructuring offer was rejected, it would be more likely that a large portion of creditors were unhappy with the deal than that a strategic holdout had interfered to spoil an otherwise widely accepted agreement. The potential pitfalls of a series-by-series collective action mechanism had been recognized as far back as the early 2000s, but introducing bond aggregation in the original CACs was seen as

[506] Typically, CACs require a 75 percent supermajority of bondholders to amend bond terms but some debt-issuing governments have set this threshold at 85 percent.

politically unrealistic at the time—more than the already-recalcitrant market would be willing to accept—and was not shown to be clearly necessary until the Greek restructuring. As discussed earlier, the Europeans had decided to build upon the traditional template by including an aggregation feature in their new CACs. One will recall, however, that their 'two-limb' approach, while opening up a pathway to a single restructuring across all bonds, in some ways created more blocking opportunities along the way. Votes at the level of the individual bond series could block the aggregate level; the aggregate vote could likewise block the modification of individual bonds.

The lack of aggregation in traditional CACs had non-trivial consequences in the Greek episode. As mentioned in Chapter 5, the only-partial restructuring of Greece's English-law bonds provided less debt relief to the country than it could have, produced highly unequal distributional results for different creditors, and strengthened incentives for all creditors to holdout from future sovereign debt workouts.[507]

An even bigger shock to the debt restructuring system came in the form of a controversial New York-court ruling against Argentina just months after the Greek restructuring. As Chapter 5 noted, the case was driven by a small group of vulture fund holdouts—led by NML Capital, a subsidiary of the hedge fund Elliott Management—and the judge's ruling turned on his interpretation of the *pari passu* clause in Argentina's bonds. These bonds had been defaulted on since 2001 and, as a result of their age, did not contain CACs that could be used to sweep the holdouts into restructuring deals that had been accepted by 93 percent of the country's bondholders. The vultures were free to litigate for full repayment. The New York judge's 2012 ruling ordered Argentina to repay the holdouts the full original value of the bonds plus accrued interest and damages and forbade the country from making payments to creditors whose claims had been restructured until it did so. To enforce his ruling, the judge threatened to hold in contempt of court any third parties that helped Argentina circumvent the judgment. When Argentina tried to pay restructured bondholders in the summer of 2014, the money was frozen at the Bank of New York Mellon, triggering another default and piling an additional $29 billion atop the mountain of Argentina's unpaid debt. US courts even managed to prevent the Argentine government from issuing local-law bonds in Buenos Aires, where the local branch of the

[507] See Zettelmeyer, Trebesch, and Gulati, 'The Greek Debt Restructuring.'

American Citibank served as the trustee. "The net effect," wrote Gelpern, "was a court-imposed financial boycott of the government."[508]

In response to the Greek and Argentine shocks, US Treasury officials convened a working group in April 2013—the 'Sovereign Debt Roundtable'—with the aim of reforming the SDRR to address the issues described above. The group comprised select debtor states (including Mexico, Uruguay, Brazil, and Turkey), capital-exporting countries (including the UK, France, and Germany), private creditors (including the IIF and the ICMA), IMF representatives, and sovereign debt experts.[509] From the outset, it was clear that American officials were only interested in reforms that built upon the contractual framework, which remained politically palatable compared to other process mechanisms because of its legal-institutional design. Mark Sobel, the Treasury official who chaired the Roundtable, continued to frame contract reform in opposition to the statutory approach of a SDRM—as in the early 2000s—and explicitly rejected the latter. In his words, "[t]he [reform] effort was premised on the US retaining its long-standing reservations about statutory approaches and instead examining what changes in the '*pari passu* clause' and in 'bond aggregation' could strengthen and impact renewed vigor to the contractual framework."[510]

The enduring US preference for contracts over treaties thus continued to reflect American interests in maintaining the primacy of US laws and courts in the debt regime.[511] But it also reflected US interests in maintaining predictable investor rights even as officials sought to strengthen the capacity of debtors to re-write the terms of their bonds. As US officials had pointed out in the early 2000s, CACs would produce less market uncertainty than a SDRM because they would embed restructuring procedures within a transparent, apolitical, and voluntary system of contracts, rather than create a supranational system that could trump contracts on the basis of broader economic considerations. Reflecting upon US thinking at the time, Randal Quarles, the former Treasury official who led the development of model CACs in the early 2000s, remarked that "providing a mechanism in the debt contracts themselves for modifying the terms of the foreign bonds […] would be a better alternative than creating an external, supranational legal regime that would override the terms of those contracts."[512]

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508 Gelpern, 'Sovereign Debt: Now What?'
509 Sobel, 'Strengthening collective action clauses.'
510 Ibid, p. 4.
511 Ibid, p. 5.
512 Quarles, 'Herding Cats: Collective-Action Clauses in Sovereign Debt,' pp. 35-36.

Even if the SDRM could have been agreed upon, he noted, "the ability to avoid politicization of such a tribunal's decisions was slim […] so the benefit of additional restructuring flexibility in distress would be bought at too high a cost in increased uncertainty about the outcomes of the insolvency process."[513]

Not only did this remain true for US officials in 2013, but, in this context, contract reforms started to look like a useful way to actively stabilize expectations and respond to the heightened uncertainty stemming from the Greek and Argentine episodes—similar to the effects of Eurozone CACs. If a SDRM was seen as something that would rock the boat, and the original CACs had been viewed as more neutral, contract reforms now looked like a potential stabilizer. This owed to a combination of their legal-institutional design and the historical legacy of the original CACs. Prior to 2003, there was a degree of uncertainty associated with regulatory change of any sort, despite it being lower for CACs than for the SDRM.[514] But once CACs were implemented, the question marks largely vanished along with much of the opposition to this approach, making further incremental contract reform capable of enhancing the predictability of restructuring procedures without generating major concerns about upsetting the status quo.[515]

The potential capacity of contract reforms to mitigate uncertainty only enhanced their political utility after 2012. By strengthening incentives for creditors to hold-out and litigate for full repayment, both the Greek and Argentine episodes generated major questions about the future of debt restructuring. Creditors worried that rampant holdouts would lead to more unequal outcomes among creditors and less predictability in sovereign debt investments. They were especially agitated by the injunction against Argentina, which took the majority of its creditors hostage and hijacked the international payments system to enforce a favorable judgment for a small group of holdouts. The American Bankers Association noted that "permitting injunctions that preclude pre-existing obligations whenever expedient to enforce a judgment against the debtor will have significantly adverse consequences for the financial system."[516] A representative for the Bank of New York Mellon warned that the judgment

513 Ibid, p. 35.
514 Interview 138790.
515 Gelpern, Heller, and Setser, 'Count the Limbs.'
516 In: Bob Van Voris, 'Bankers' Group Supports Bond Trustee in Argentina Appeal', *Bloomberg* (January 5, 2013). Available at: https://www.bloomberg.com/news/articles/2013-01-04/bankers-group-supports-bond-trustee-in-argentina-appeal-1-

would "create unrest in the credit markets and result in cascades of litigation."[517] Debtors were concerned about falling victim to this rising tide of litigation, particularly under New York law where the Argentine case had set a precedent. US Treasury officials worried that debtors might respond by issuing more of their bonds in alternative jurisdictions, chipping away at New York's role as a leading center for the issuance of foreign-law bonds.[518] This could begin to erode the central position of the US legal, financial, and monetary systems in the sovereign debt regime, in turn diminishing the benefits the US derives from this position (those described in Section 2.1.2 of Chapter 3). A Treasury official interviewed for this project summarized US thinking at the time in the following terms:

> this is not good for New York as a financial center. Would people then take the business to London? Because we had indications that London courts would not rule as the US courts had. And would issuers denominate in euro to avoid being ensnared in the dollar's global network?[519]

Evidence suggests that participants in the Treasury-led Roundtable saw contract reforms as a response to uncertainty—something that could quell the fears described above and keep the business of sovereign lending and borrowing moving as usual—as well as an attempt to solve the anticipated concrete problems of future restructurings. Leland Goss, ICMA's representative in the Roundtable, described the impetus for reform as such: "People were very, very frightened and concerned at the time. So as a result, something had to be changed in the global financial architecture."[520] Another Roundtable participant remarked, "the truth of the matter is that there was massive uncertainty at the time," noting that contract change "could help introduce some certainty."[521] The IMF agreed that contract reforms could "enhance legal certainty and consistency across jurisdictions."[522]

The US commitment to contract reform set the parameters for discussion within the Roundtable, which held three meetings between April 2013 and April 2014. During the first, participants discussed the technical issues that had plagued Greece and Argentina and agreed on the need to deploy new contractual mechanisms to address these challenges. Two main reform ideas were put forward: one

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517 In: Peter Eavis, 'Banks Fear Court Ruling in Argentina Bond Debt,' *The New York Times*. February 25, 2013. Available at: https://dealbook.nytimes.com/2013/02/25/banks-fear-court-ruling-in-argentina-bond-debt/?_r=0
518 Sobel, 'Strengthening collective action clauses.'
519 Interview 114203.
520 In Wigglesworth and Moore, 'Sovereign debt: Curing defaults.'
521 Interview 138790.
522 DeLong and Aggarwal, 'Strengthening the contractual framework for sovereign debt restructuring,' p. 29.

focused on removing or changing the standard *pari passu* clause on which US courts had ruled against Argentina; the other focused on introducing 'aggregation clauses' that would replace series-by-series restructuring with a single vote for all bondholders, thus making it difficult for minority creditors to establish blocking positions and undermine restructuring efforts as they had during Greece's restructuring of its English-law bonds. How to operationalize these proposals was the subject of the second meeting, which took place in October 2013. During the third and final meeting in April 2014, the group agreed to support a new model *pari passu* clause that disavowed the 'ratable payments' interpretation taken by US courts, as well as new model CACs that included a robust aggregation feature. The London-based ICMA—a leading financial industry association—agreed to take responsibility for drafting and marketing the new contract terms, a move welcomed by the rest of the working group. In August 2014, the ICMA published Standard Aggregated CACs and a Standard *Pari Passu* Provision to serve as models for EMDE debtors to emulate.[523]

The new ICMA CACs, which have been called super-CACs, provide a menu of options sovereigns can use to modify their bond contracts in the event of a restructuring. One is series-by-series voting, as in traditional CACs. Another is the two-limb approach to aggregation used in Eurozone CACs, which requires a vote both at the individual series level and among the wider universe of bondholders. The final and most innovative option is the 'single-limb' approach, allowing sovereigns to overcome the aggregation problem by bringing together all bondholders and binding them to a common restructuring agreement "on the basis of a single vote across all affected instruments."[524] The new super-CACs thus managed to replicate a key feature of corporate debt restructuring under domestic bankruptcy regimes: the ability of a supermajority of creditors from a particular asset class to agree to new debt payment terms and bind any dissenting minorities to that agreement. This type of aggregation had been a key objective of the SDRM initiative. Setser notes that "[i]n the end [that is, after revisions to its proposal], the IMF's case for the SDRM rested almost entirely on the need to allow a sovereign to restructure its international sovereign bonds through a single aggregated vote."[525] In substance, then, Treasury-led reform achieved through private-law contract change something many had argued a hard-law solution was needed for a decade earlier.

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523 Makoff and Kahn, 'Sovereign Bond Contract Reform.'
524 IMF, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring,' p. 1.
525 Setser, 'The Political Economy of the SDRM,' p. 327.

After receiving endorsement from the IMF, the G20, and the IIF, these new clauses were quickly adopted.[526] In October 2014, Kazakhstan became the first to issue bonds with the new clauses under English law. In November, Mexico was the first to do so under New York law, pioneering the new standard as it had first-generation CACs in 2003.[527] These early moves paved the way for the rapid and widespread adoption of these mechanisms. Since Kazakhstan's issuance, roughly 60 countries from five continents have issued bonds in New York or London that contain the new CACs (most have also included the new ICMA *pari passu* provision), amounting to approximately 85 percent (in nominal principal amount) of all new international sovereign bond issuances.[528] To be sure, it will take several years to replace the entire outstanding stock of bonds with new ones that include these clauses, due to the volume and lengthy maturities of existing bonds.[529] But once operative, the new clauses provide stronger tools for neutralizing holdouts and achieving more comprehensive restructurings. Gelpern, Heller, and Setser—all of whom participated in the Roundtable—described the new tools as generating a "far bigger change in sovereign bond documentation than what had emerged from the public debates of the 1990s and early 2000s."[530]

As in the early 2000s, Treasury officials were crucial in setting the agenda and orchestrating the process of contract reform. But then as now, realizing the Treasury's preferred reforms depended heavily on the cooperation of sovereign debtors and their private creditors, who would have to actually adopt and accept the new contract terms. In that earlier episode, creditors and debtors initially opposed CACs because of their expected distributional consequences. Eventually both came around to supporting CACs, but mainly as a way of strategically killing the even-more-hated SDRM rather than because of any inherent appeal of CACs on their own. This time around, however, creditors and debtors embraced contract reform from the beginning, paving the way for a swift and uncontroversial introduction of new CACs that are significantly stronger than the original model. Importantly, their

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526 IMF, 'Strengthening the Contractual Framework to Address Collective Action Problems in Sovereign Debt Restructuring.' IIF, 'Statement in support of full adoption of ICMA recommendations for enhanced CACs in sovereign bond contracts,' November 30, 2015. G20 support for development and adoption of the ICMA's new CACs and *pari passu* provision was articulated in each communique issued by the G20 finance ministers and central bank governors between 2014 and 2016.
527 Diaz de Leon, 'Mexico's adoption of new standards in international sovereign debt contracts.'
528 IMF, 'Third Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts.'
529 Makoff and Kahn, 'Sovereign Bond Contract Reform.'
530 Gelpern, Heller, and Setser, 'Count the Limbs,' p. 120.

support was not a strategic move to pre-empt a more threatening alternative—the UN initiative had not yet been launched and no such alternative existed.

What changed between the early 2000s and the post-2012 period? Why did creditors and debtors support reforms that went substantially further than the original CACs? There are two key reasons. The first was that their need for reforms that could neutralize holdout creditors increased in the aftermath of the Greek and Argentine episodes. In the early 2000s, the push for CACs was driven more by US interests in finding an alternative to bailouts than by intractable collective action problems that threatened the interests of debtor governments and their creditors. From a technical standpoint, the original CACs had been "a solution in search of a problem."[531] In the aftermath of Greece and Argentina, by contrast, the threat posed by free-riding holdouts had become very real and costly to debtors and creditors alike.

Second, debtor and creditor perceptions of CACs had changed after a decade of experience with them, shifting preferences in favour of further contract reforms and changing the political dynamics of reform substantially compared to the early 2000s. During that earlier episode, debates about SDRR reform framed the restructuring trigger and the process as "inseparably linked" and even conflated the two, such that, as Gelpern and Gulati argued, CACs became a symbol for more bail-ins and fewer bailouts.[532] In this earlier context, creditors understandably saw contract reform as something that could result in more restructurings and thus shift distributional outcomes in favour of debtors. In short, creditors did not view CACs as a process mechanism that was separate and distinct from decisions about whether and when to trigger restructurings. The trigger and process were deeply entangled. While creditors saw CACs as raising the odds of financial losses, debtor states worried that adopting them would lead to higher borrowing costs, a distributional loss for states that would have to either borrow less or transfer more money in the form of interest payments to foreign creditors.

By 2013, as a result of their actual experience with CACs, debtors had learned that this mechanism did not in fact increase their borrowing costs—a conclusion supported by numerous bond pricing studies.[533] More importantly, private creditors had learned that CACs did not mean more debt

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[531] Ibid, p. 113.
[532] For the claim that the trigger and process were inseparably linked, see Taylor, *Global Financial Warriors*, p. 110. For the symbolic argument, see Gelpern and Gulati, 'Public Symbol in Private Contract.'
[533] Diaz de Leon, 'Mexico's adoption of new standards in international sovereign debt contracts.'

restructurings, as these contract terms "went from being a symbol of "bail-ins" to being a symbol of market-friendly reasonableness."[534] As a senior IMF official who was involved in both the earlier and more recent reform episodes commented: "The reason why they [private creditors] were worried about the collective action clause originally was that they thought that it was going to be used to increase the frequency of debt restructuring. I think that this time around they knew that that wasn't going to happen."[535] The notion that CACs would make debt write-downs more frequent, and the resistance this engendered, was directly related to the conceptual and practical linking of process and trigger mechanisms in 2001-2003. As explained by the same ex-IMF senior staffer, in the early 2000s the official sector's message was:

> You cannot look at CACs or the SDRM in isolation. You have to view it as an integral part of an overall reform process, which the private sector interpreted as meaning: the official sector wants to shift the burden to the private sector, there's going to be an increase in debt restructuring, we have to push back on everything. That dynamic wasn't there in 2011-2012.[536]

In short, resistance to contract reform had faded because, over time, the process and the trigger had become de-linked and CACs had come to be understood as a tool that could increase the efficiency of the restructuring process without making it any more likely that these events would happen in the first place. As one participant in the Treasury-led Roundtable put it, "CACs kind of become this stand-alone tool that is de-linked at this point from both SDRM and from the access policy [i.e., the IMF trigger rules] … All the sudden CACs become a tool that's political-context neutral almost, that gets de-coupled from all these things that it was a product of."[537] This de-coupling was informed by historical experience but also reinforced by the context of reform debates in and around 2013. As Chapter 4 highlighted, the IMF's trigger mechanism had been exposed as faulty in 2010, and when the Fund launched discussions about how to fix it in 2013, many important state officials articulated a very different preference than their predecessors in 2002: they wanted much more discretion and case-by-case decision-making going forward. At the same time, however, all expressed their full-fledged support for strengthening the restructuring process via new collective action and *pari passu* clauses.

[534] Gelpern and Gulati, 'Public Symbol in Private Contract,' p. 1667.
[535] Interview 138785.
[536] Ibid.
[537] Interview 138790.

This context thus reinforced the idea that the process and trigger were separate and that one could support a more robust restructuring process while opposing a stronger trigger mechanism.

As a result of these historical and contextual factors, when Treasury officials launched their recent reform initiative, the contractual approach had become familiar and non-threatening. In contrast to the early 2000s, when CACs were pressed upon the market, this time around, noted one participant in the Treasury Roundtable, "you really did have kind of industry ownership very early on, and I think partly because it was a known product."[538] Not only were CACs a known product, but it was now known what exactly this product did and, perhaps more importantly, did not do—that is, it did not trigger more debt write-downs.

In this new context, contract reforms were seen as a way to improve the efficiency of restructuring processes to the benefit of debtors and creditors alike, rather than altering the distributional status quo. As ICMA's Leland Goss put it: "what we were striving for was a Pareto-optimality; we were going to make at least one or more things better without making anything or anyone else worse off."[539] Contrasting this attitude with the more zero-sum mentality that pervaded the early 2000s, another Roundtable participant remarked: "All of a sudden by 2012-2014 a much more aggressive form of CACs than anybody had ever contemplated was becoming a win-win."[540] To the extent there remained a distributional impact of the new enhanced CACs, it was not one that shifted power from creditors to debtors—as creditors had initially feared of the original CACs—but rather one that shifted power from minority holdouts to the majority of creditors as a broader group. Within a decade, debtor and creditors preferences toward deeper institutionalization of debt restructuring via contractual mechanisms had changed as a result of their greater desire for reform and the positive historical legacy of first-generation CACs.

This legacy also made it more likely that officials would look to contracts when the need for further reforms arose. This owed partly to the role of 'repeat players' involved in the both the original shift to CACs and the recent reform process, including key individuals from the US Treasury Department, the IMF, the Mexican government, and leading law firms that specialize in sovereign debt. None of

[538] Ibid.
[539] Interview 107122.
[540] Interview 138790.

these players were more important than Mark Sobel. Having worked at the Treasury Department since 1978, Sobel was "part of a group of influential career officials who have worked in the administrations of both parties" and who made up 'the institutional memory' of the Treasury's international affairs office.[541] He had been on hand during the first contract reform initiative and believed strongly in the capacity of the contractual approach to deliver further improvements to the SDRR. As one Roundtable participant remarked: "The interesting thing to me is how quickly everybody went to contract reform as a fix for Argentina and Greece—that was very much a Mark Sobel move."[542] As a Treasury insider during the 2001-2003 CACs versus SDRM debate, Sobel had a very clear sense of US interests when new challenges to the SDRR emerged in 2012. It was not necessary to relive that debate, and he wasted no time in presenting contract reforms as the US's preferred solution.

Finally, the original CACs episode and the presence of repeat players—who formed something of a transnational regulatory network—also helped facilitate the reform process by providing a ready-made blueprint for how to achieve a market shift in contract terms and a number of experienced individuals who knew how to implement it. As Gelpern and others put it, "the adoption of CACs beginning in 2003 had created a process playbook."[543] Following this playbook in 2013-2014, it was again Treasury officials that called for contract reform and brought together creditor and debtor representatives to implement the change, with Mexico again acting as the first mover to issue the new bonds under New York law. The prior experience of some of the lawyers that draft standard bond contracts—the so-called 'boilerplate' documents that, according to legal theory, almost never change—also helped to smooth out and speed up the contract change process. In the words of a former Treasury official involved in the process, "we spent a lot of time behind the scenes, talking to lawyers and some of the deal-makers, and they knew what they were doing and they just started cutting and pasting the new clauses and throwing them into their prospectuses and contracts."[544] In short, the early 2000s provided US policymakers with a roadmap for how to bring about contract change as well as a more established transnational support network with which to do it.

[541] Ian Katz and Sandrine Rastello, 'Sobel Plays Bad Cop as Treasury's Lew Debates G-7 Austerity,' *Bloomberg*. May 10, 2013. Available at: https://www.bloomberg.com/news/articles/2013-05-10/sobel-plays-bad-cop-to-treasury-s-lew-as-g-7-debates-austerity

[542] Interview 138790.

[543] Gelpern, Heller, and Setser, 'Count the Limbs,' p. 112.

[544] Interview 114203.

In sum, contract reforms prevailed as the leading regulatory response to recent challenges in debt restructuring for many of the same reasons they did in 2003. Crucially, this approach was preferred by US officials because it embeds restructuring mechanisms within private-law contracts, allowing the US to strengthen the SDRR without undermining either the authority of its own laws and courts or, by extension, the foundations of transnational contract law in the sovereign debt regime. The legally-embedded quality of contracts should be considered a necessary condition for successful reform in both the early 2000s and more recently. So too should the fact that contract mechanisms govern the process rather than the trigger component of sovereign debt restructuring.

But recent reforms also benefited from the historical legacy of the original CACs, which rendered reform a useful response to uncertainty and substantially reduced creditor and debtor opposition to contract change based on the realization, over time and in the new reform context, that these contracts only affected the restructuring process and, in that domain, could actually be useful. The experience of the early 2000s also provided a roadmap and a network of actors who knew how to follow it to the destination of a market-wide shift in standard contract terms. Thus, if contract reform emerged and succeeded in 2003 because of the mixture of the legally-embedded nature of CACs and a number of highly contingent factors such as the threat of a SDRM, that initial episode laid the foundations for the further locking-in of the contractual model once the need for additional reforms arose.

## 4. The Question of Efficacy

Do contract mechanisms such as CACs actually improve debt restructuring outcomes? Most of the literature on the impact of CACs has focused on the question of borrowing costs. For example, since the early 2000s, there have been numerous empirical studies on how these clauses affects sovereign bond prices. Several concluded that they did not meaningfully raise borrowing costs.[545] Others argued that there was a pricing impact but it differed depending on the creditworthiness of the borrower: CACs raised borrowing costs for less creditworthy issuers but lowered them for more creditworthy debtors, "who benefit from the ability to avail themselves of an orderly restructuring process.[546] As

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[545] Torbjorn I. Becker, Anthony J. Richards, and Yunyong Thaicharoen, 'Bond Restructuring and Moral Hazard: Are Collective Action Clauses Costly,' IMF Working Paper No. 01/92(2001); Anthony Richards and Mark Gugiatti, 'Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets,' *International Finance* 6(3)(2003): 415-447.
[546] Barry Eichengreen and Ashoka Mody, 'Do Collective Action Clauses Raise Borrowing Costs?' *The Economic Journal* 114(495)(2004): 247-264, p. 262.

early as 2003, Barry Eichengreen and Ashoka Mody also found evidence of an aggregation problem, showing that spreading debt across a larger number of bond instruments that cannot be aggregated in the event of a restructuring increased sovereign borrowing costs.[547] While these results suggest that CACs could enhance the anticipated efficiency of debt restructuring processes as long as they did not raise the anticipated probability of default, there are few direct studies about the actual impact of CACs on *ex post* outcomes. Those that exist are predominately theoretical modelling exercises. In this vein, Kenneth Kletzer argues that CACs produce welfare gains by reducing the inefficiency caused by holdouts.[548] Others also contend that CACs help to coordinate creditors in ways that deliver efficiency gains.[549]

Anecdotal evidence also suggests that contract mechanisms have been helpful in a number of cases. The use of CACs under New York law in the cases of Belize (2006, 2012) and Cote d'Ivoire (2012), under English law in the cases of Moldova (2002) and Seychelles (2009), and under a mixture of jurisdictions in the case of Uruguay (2003) was associated with extremely high creditor participation rates in the restructuring and zero creditor litigation.[550] The two problem cases since the widespread adoption of CACs have been Argentina, whose bonds were issued under New York law before 2003 and therefore did not contain these clauses, and Greece, whose efforts to restructure English-law bonds in 2012 revealed the limitations of series-by-series voting. These episodes catalyzed reforms that led to the introduction of much stronger contract mechanisms with robust aggregation features. Although these newer contracts have yet to be tested in an actual restructuring, there are good reasons to believe that they will have a significant impact on eliminating opportunistic holdout behaviour, to the benefit of debtors and the majority of their creditors. Greece's restructuring of its domestic-law debt in 2012 is instructive. Here, the retroactive insertion of a single-limb CAC in Greek bonds proved critical to securing near-universal creditor participation in the domestic portion of its debt exchange.[551]

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547 Barry Eichengreen and Ashoka Mody, 'Is Aggregation a Problem for Sovereign Debt Restructuring?' *The American Economic Review* 93(2)(2003): 80-84.

548 Kenneth M. Kletzer, 'Sovereign Bond Restructuring: Collective Action Clauses and Official Crisis Intervention,' IMF Working Paper No. 03/134(2003): 1-24.

549 Federico Weinschelbaum and Jose Wynne, 'Renegotiation, collective action clauses and sovereign debt markets,' *Journal of International Economics* 67(2005): 47-72; Sayantan Ghosal and Kannika Thampanishvong, 'Does strengthening Collective Action Clauses (CACs) help?' *Journal of International Economics* 89(2013): 68-78.

550 See Juan J. Cruces and Christoph Trebesch, 'Sovereign Defaults: The Price of Haircuts,' *American Economic Journal: Macroeconomics* 5(3)(2013): 85-117.

551 Zettelmeyer, Trebesch, and Gulati, 'The Greek debt restructuring.'

To be sure, my claim is not that contract mechanisms are a panacea and have solved the myriad problems associated with sovereign debt restructuring. Among other things, CACs do not guarantee that an indebted country will receive fast enough or deep enough debt relief, since they provide no means of triggering debt restructuring in the first place and no higher authority to dictate new payment terms to the debtor and its creditors. Indeed, the decision of how much debt to write-down will remain a matter of debtor-creditor bargaining. Moreover, the new CACs can aggregate bondholders but they do not apply to the loans provided by commercial banks, foreign governments, and multilateral institutions.[552] In cases where these other forms of debt are significant, CACs will be less effective in delivering a comprehensive and equitable restructuring broadly shared across the creditor base. That said, in contrast to the other reforms examined in this dissertation, recent contract changes represent a significant and tangible—though not transformative—strengthening of the institutional toolkit for rewriting sovereign debt in European and international bond markets, where the lack of sufficiently strong restructuring rules and procedures has caused a great deal of financial pain and uncertainty.

## 5. Conclusion

This chapter has argued that private-law contract mechanisms have two key qualities that have enabled their success in the SDRR relative to the regulatory arrangements discussed in previous chapters. First, they are designed to govern the debt workout *process* rather than *trigger* restructurings, which is key to understanding their fate compared to the IMF lending rules analyzed in Chapter 4. As noted in Chapter 3, the stakes for powerful capital-exporting states are generally lower at the process stage, particularly when it comes to concerns about financial stability, and the prospects for joint efficiency gains for debtors and private creditors are generally higher at this stage. Moreover, debtors, creditors, and capital exporters all have a growing interest in process mechanisms that can neutralize holdout creditors. These factors are key to understanding the recent strengthening of the debt restructuring process via enhanced CACs, compared to the weakening of the restructuring trigger via IMF reforms documented in Chapter 4 (as well as the decision not to pursue an automatic trigger mechanism in the Eurozone).

Second, in contrast to the other process mechanisms examined in Chapter 5, their *legal-institutional design* is more politically acceptable than hard-law arrangements and more functionally effective than

[552] Martin Guzman and Joseph E. Stiglitz, 'Creating a Framework for Sovereign Debt Restructuring That Works,' in: Martin Guzman, Jose Antonio Ocampo, and Joseph E. Stiglitz (eds), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016): 3-32.

soft-law mechanisms. As discussed in Chapter 3 and shown throughout the current chapter, private-law contract mechanisms like CACs can enhance the efficiency of the restructuring process without overriding state sovereignty or the legal foundations of transnational property rights, making them a politically useful device for navigating the trade-offs of regulating debt restructuring, especially for the leading capital-exporting states, but also for EMDE debtors and private creditors. For the US and the UK in particular, the fact that contract mechanisms were fully compatible with the existing (American and British) domestic legal arrangements that anchor international sovereign debt markets was critical. It allowed these states to strengthen the restructuring process while preserving the privileges they derive from their centrality in the current order (as discussed in Section 2.1.2 of Chapter 3). But leading Eurozone states also preferred contract tools in part because of their consistency with domestically-rooted cross-border property rights. In contrast to a hard-law European SDRM, euro CACs could be expected to generate less legal uncertainty within the already-delicate Eurozone bond markets.

The chapter also argued that the *historical legacy* of the first-generation CACs introduced in the early 2000s was important in shaping preferences in favour of further contract innovation more recently. There are four reasons for this historical effect. First, the debates of the early 2000s had clarified and reinforced US regulatory preferences when the need for further improvements to the SDRR arose. Second, the original CACs provided a blueprint for reformers, making it relatively quick and easy to adapt existing governance tools. Third, experience with the original CACs shifted debtor and creditor preferences, such that contract change came to be understood less as a distributional issue and more as a Pareto-improving one (particularly in the context of the Treasury-led initiative). Fourth, in the recent crisis and reform context, familiarity with CACs increased the political utility of contract mechanisms as a tool for enhancing legal and market certainty around the debt restructuring process. While significant emphasis on put on the role of historical factors, the chapter argues that these factors play a supplemental explanatory role: they enhanced the prospects of a regulatory mechanism whose politically utility had already been determined by its process-orientation and legal-institutional design.

How do these arguments contribute to the fields of IPE and global governance? Most immediately, they help to fill important empirical gaps in our understanding of sovereign debt governance. The reforms analyzed in this chapter have received little scholarly attention and, despite their similarities, have not yet been examined within the same analysis. The argument developed here makes sense of both initiatives and also sheds light on the underlying design features that enabled the emergence of

CACs in the early 2000s. It also lays down the third and final puzzle piece that, when combined with the insights of the previous chapters, completes a novel framework for understanding regulatory variation in the SDRR according to, first, the process-trigger distinction and, second, the legal-institutional design of different mechanisms.

But the arguments advanced in this chapter also contribute to broader theoretical debates about institutional design and development and the role of contracts in global governance. While the last chapter emphasized the limitations of public international law mechanisms in the SDRR, this one showcased the political utility of an alternative—private-law contracts—that does not fit within the hard law-soft law dichotomy and is generally ignored as an instrument of global governance. When contracts *are* analyzed by scholars of world politics, they are often treated as generic agreements—hard-law and soft-law arrangements could be understood as contracts from this perspective—rather than specific legal tools within particular jurisdictions. That does not mean, however, that these broader conceptions of contracts have nothing to offer our understanding sovereign bond contract change. Important aspects of contract reform can be seen through a family of rational functionalist perspectives referred to as contractualist approaches.[553]

In the tradition of neoliberal and rational design institutionalism in international relations theory, these approaches view contracts and other institutions as coordinating devices used by rational actors to solve collective action problems in ways that advance their mutual interests. From this perspective, CACs were a functional solution to the unique coordination problems posed by sovereign bond restructuring—namely, the difficulties of coordinating dispersed creditors and preventing holdouts from free riding. CACs can also be viewed as a response to the 'incomplete contracts' governing sovereign debt. Because pre-CAC contracts lacked provisions for majority restructuring and for constraining costly litigation, "the key to more orderly restructuring," as Eichengreen put it in 2003, "is to encourage lenders and borrowers to specify more complete contracts that lay out the procedures for restructuring at the time the debt obligation is incurred."[554] Recent contract reforms can be seen as making bond contracts even more 'complete' than the original CACs by providing aggregation features and clarifying the meaning of *pari passu*.

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[553] Cooley, 'Rationalist theories of institutions in American IPE.'
[554] Barry Eichengreen, 'Restructuring Sovereign Debt', *Journal of Economic Perspectives* 17(4)(2003): 75-98, p. 83.

This view of contracts as positive-sum solutions to coordination problems fits the official narrative promoted by those involved in contract reforms, and, as I have argued in this chapter, the fact that debtors and creditors saw the recent Treasury-led contract changes as producing joint gains was crucial to the success of this initiative. However, it is important to remember that sovereign borrowers and their financiers did not always see contract innovation in this light. In the early 2000s they viewed it as a distributional issue whose risks outweighed potential efficiency gains. CACs came to be understood as Pareto-improving coordination devices largely as a result of historical factors, which changed the preferences of debtors and creditors and the political dynamics of contract reform. The role of prior institutional developments is thus crucial to understanding subsequent preferences and policy processes. Here, the role of history was to reveal something about the nature of a previously unknown mechanism in a way that rendered the further strengthening of that mechanism Pareto-improving in the minds of key actors in the reform process.

Insights from socio-legal contract theories can also help make sense of this shift in preferences and reconcile aspects of my explanation with symbolic accounts of bond contract reform. Mark Suchman argues that contracts can be both technical devices that order and govern relationships and symbolic tools that communicate bigger ideas.[555] Although I have argued that symbolic arguments do not capture the specific design features that make contracts a particularly useful tool for regulating this area of global finance, I do not deny that contracts can have symbolic content in addition to the specific commitments they spell out. In fact, this dual functionality of contracts and the connection between their symbolic and technical characteristics may be a useful way of thinking about the change in debtor and creditor preferences toward CACs over time. As these actors learned from their experience with CACs, the symbolic content of this mechanism as something that would encourage more debt restructurings was stripped away and replaced by a clearer understanding of its technical meaning as something that simply facilitates the restructuring *process* when it gets underway.

There is therefore a role for functionalist explanations, when combined with historical institutionalist and other eclectic insights, in explaining certain aspects of recent contract reforms, particularly debtor and creditor preferences in favour of strengthening a positive-sum collective action device. But these perspectives—as well as any theories that see contracts as generic agreements—are more limited in

[555] Mark Suchman, 'The Contract as Social Artifact,' *Law & Society Review* 37(1)(2003): 91-142.

their ability to explain why contract tools rather than other institutional designs, which could be equally justified on functionalist grounds, emerged as the preferred approach to debt workouts, especially for the powerful capital-exporting states that play a leading regulatory role but are not directly involved in restructurings in the same way as debtors and creditors. To solve this puzzle, contracts have to be understood as private-law tools in specific jurisdictions instead of as generic coordination devices. As I have argued throughout this chapter, it is the legally-embedded character of contracts that make them a particularly useful mechanism for governing the debt restructuring process.

By showing that CACs are preferred not because their design characteristics are more functional but rather because they allow important actors to improve the restructuring process while maintaining certain structures of power and privilege, my argument resonates with critical theory approaches that treat private contracts as embodiments of power relations. For example, Claire Cutler and Thomas Dietz focus on the rise and power dynamics of *private* transnational governance by contract, departing from the observation that "[p]ublic policy and collective decision making have thus largely been replaced by contractual modes of governance."[556] While their approach usefully highlights the power dimensions of contracts—often seen as neutral due to their voluntary and seemingly apolitical nature—it is unable to account for the type of contract governance described here. In the cases at hand, contract governance has not replaced policy; contract reform *is* international policy-making and reflects public (euro CACs) and public-private hybrid (Treasury-led reforms) modes of governance rather than simply the rise of private authority. In showcasing the use of private-law contracts as a form and instrument of global public rule-making rather than a substitute for it, this chapter expands current understandings of the use and purpose of contracts in global governance.

Another strand of theory that aspects of this chapter draw upon and contribute to comes from more constructivist-oriented scholars who write about contracts as 'legal fictions' that stabilize expectations by spelling out in advance how certain contingencies such as debt restructurings will be dealt with if and when they arise. The idea of contracts as legal fictions complements the argument that clear and consistent property rights—especially but not exclusively those embedded in US and UK contract law—are valued in the debt regime for their ability to stabilize market expectations regarding cross-border bond investments. This view is quite different from the idea of contracts as symbols of broad

[556] Cutler and Dietz, *The Politics of Private Transnational Governance by Contract*, p. 5.

policy significance. A legal fiction can only be compelling because it rests on specific technical language that spells out contingencies. This observation also reminds us that the legal fictions interpretation of contracts, while ideational, is not separate from questions of legal-institutional design. The capacity of contracts to serve as convincing fictions is directly linked to their design as legally-binding agreements backed up by strong domestic juridical institutions. For example, Elena Carletti et al. find that while euro CAC bonds are associated with lower borrowing costs than similar Eurozone bonds with no CACs, the price impact is more pronounced in countries with perceived high-quality legal systems.[557]

Stephen Nelson even writes about the *pari passu* clause as one such legal fiction but sees it as a tool of private governance arising from the norms and practices of market actors—one that is likely to persist due to its stabilizing nature.[558] He does not envision the changing of this standard contract term through an elaborate public-private regulatory initiative that uses reform to clarify the meaning of this legal fiction and thus address market uncertainty. The implications of this case are that stabilizing legal fictions can be useful not just for market actors but also for the public authorities that regulate and oversee markets. Moreover, the ability of contract terms to serve as stabilizing fictions is not dependent on their unchanging persistence; changes in contract terms can also stabilize expectations when older clauses have themselves become sources of uncertainty.

Nelson's analysis thus exhibits a tendency for which constructivist and sociological institutionalist approaches are often criticized: viewing social norms and institutions as persistent and under-theorizing how they might change. Rational design approaches are, of course, accused of having the opposite problem. They see a world of sharp, punctuated changes that occur when existing institutions are no longer optimal, which often does not depict the reality that scholars observe and does not really describe the contract reforms analyzed in this chapter. Although these reforms were responses to discrete shocks that precipitated institutional change, the form of change was more incremental and built upon earlier institutional developments. By highlighting the role of prior institutional developments in promoting outcomes that fall somewhere between stasis and radical reform, historical institutionalist accounts can again enhance our understanding of recent initiatives in the SDRR. So too, as argued earlier in the chapter, can related but more specific theories that see the adaptation of

[557] Carletti, Colla, Gulati, and Ongena, 'The Price of Law.'
[558] Nelson, 'Market Rules.'

existing institutional arrangements as more probable than the creation of new arrangements from scratch, even if the latter could be designed in a functionally superior way.

# CHAPTER 7

## Summing Up and Looking Ahead

### 1. Summarizing the Question and Argument

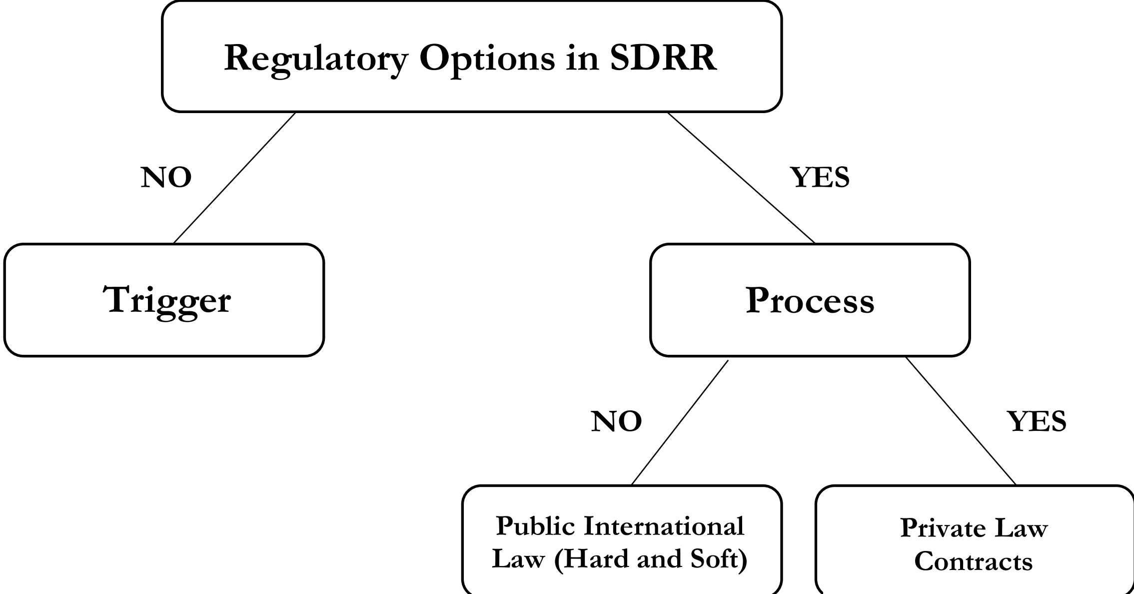
The regulatory politics of sovereign debt restructuring is an important but poorly understood facet of global financial governance. Scholars have paid little attention to recent reform initiatives in this area, and scholarly accounts of previous outcomes in the SDRR—while helpful—are limited in their ability to explain newer developments. This dissertation provides the first in-depth analysis of these recent initiatives, filling an important empirical gap in our knowledge of the global governance of sovereign debt restructuring. For students of IPE who want to know what has happened in the SDRR since the initiatives of the early 2000s, which received considerable attention, this dissertation paints a more up-to-date picture of regulatory efforts and outcomes aimed at governing sovereign bankruptcies.

The dissertation set out to explain variation in the outcomes of recent reform initiatives. I wanted to know why IMF reforms weakened the existing regime, why sovereign bond reforms strengthened it, and why the UN initiative failed to produce much change in either direction. All of these initiatives took place in the same historical context and sought to govern the same issue area, so why did they turn out so differently? The existing literature has only limited answers to this question. It offers useful insights into certain aspects of recent initiatives but is unable to explain other important outcomes. Beyond its inability to account for specific outcomes, the literature is not well set up to explain variation in any kind of systematic way. As noted in Section 2 of Chapter 1, existing analyses tend to focus on a single initiative or, at most, consider a specific type of reform proposal at different historical moments. They do not engage in the kind of comparative analysis of failed and successful initiatives that can help to generate broader insights about the patterns and determinants of variation in this domain. Accounts of individual initiatives do point to important reasons why the reform in question either failed or succeeded, but when assembled and read as a broader body of work, they do not add up to a coherent or systematic picture of variation. Rather, they leave the reader with the misleading impression that regulatory reform in the SDRR is either virtually impossible or largely random.

Analyzing and comparing recent regulatory initiatives revealed new insights and reinforced existing ones in ways that were particularly useful for generating broader inferences about the politics of sovereign debt restructuring reform. What emerged was a more systematic and generalized framework for understanding which types of governance arrangements are feasible in the SDRR and why. It became clear, in developing this framework, that existing explanations of SDRR reform suffered from three significant blind spots that hindered their ability to explain variation in recent outcomes, as noted in chapters 1 and 2. First, they failed to distinguish analytically between mechanisms aimed at triggering debt restructurings, such as the IMF's lending rules, and mechanisms that seek to facilitate the restructuring process once the decision to renegotiate debt has already been made, such as contract reforms and the arrangements pursued within the context of the UN initiative. Second, they pay insufficient attention to how different process-oriented mechanisms would complement or clash with the current legal foundations of the sovereign debt regime—mainly but not exclusively US and UK laws and courts. Third, they overlook the role of historical legacies and processes—particularly surrounding the reform initiatives of the early 2000s—in shaping recent outcomes (an understandable omission given that many accounts of SDRR reform are focused on the early 2000s themselves).

Filling these gaps, this dissertation presents an analytical framework for understanding recent variation in the SDRR according to, first, the *process versus trigger distinction* and, second, the *legal-institutional design* of different process-focused regulatory mechanisms. For a visual representation, see figure 7 below.

**Figure 7: The Feasibility of Different Regulatory Options in the SDRR**



The framework suggests that an effective trigger mechanism is hard to institutionalize because of the time-inconsistent preferences of powerful capital-exporting states, as well as their more general desire—expressed most strongly by the US, supported by debtors and creditors, and amplified by recent experiences—for case-by-case decision-making when it comes to the question of if and when to trigger debt restructurings. First and foremost, it was the potential for foreign debt restructurings to generate financial instability in core capital-exporting states that shaped their preferences toward IMF lending reforms in 2010 and 2016, weakening the Fund's trigger mechanism and underscoring the political difficulties of institutionalizing this kind of regulatory arrangement. The preferences of sovereign debtors and private creditor groups for a case-by-case approach to IMF lending only strengthened the policy position of the US and other powerful states, further reinforcing the political obstacles to an effective trigger mechanism.

Compared to the trigger, I argue that some *but not all* process mechanisms have greater odds of success. It depends on their *legal-institutional design*. International hard-law designs face huge political opposition from capital-exporting states, whereas soft-law tools can encounter political challenges—as did the 2015 UN Principles—but are also of limited effectiveness in the SDRR. By establishing international legal procedures that authorize breaking or changing the payment terms of sovereign debt contracts, hard-law restructuring mechanisms would trump the domestic legal foundations of the current debt regime, threatening the power and privileges that dominant states—principally the US and UK—derive from the current order, as explained in Chapter 3. Key capital-exporting states have thus rejected and used their power to block hard-law initiatives, as seen in the context of the recent UN initiative examined in Chapter 5. Beyond the power and preferences of dominant states, many of the EMDE debtor governments driving the UN initiative were also unprepared to relinquish sovereignty over their repayment and restructuring decisions for the sake of an international treaty-based sovereign bankruptcy process—a further obstacle to the emergence of this type of regulatory arrangement.

In contrast to public international law, private-law contract tools such as CACs provide functions that soft law cannot without incurring the same political costs of a hard-law framework. By embedding the ability to restructure debt into existing systems of contractual rights and obligations, contract reforms allow capital-exporting states to create stronger restructuring processes without undermining the authority of their own laws and courts or creating new forms of uncertainty around sovereign bond investments. The compatibility between existing legal structures and contract-based restructuring tools

has made the latter a politically useful regulatory mechanism—not only for the US and UK but also for Eurozone states—and is key to explaining the success of the sovereign bond reforms detailed in Chapter 6. Legal-institutional design features also made contract change more attractive than hard-law alternatives to debtors and especially private creditors, whose cooperation was necessary to the success of recent bond reforms (especially in the context of the Treasury-led initiative). But debtor and creditor preferences toward contract reform have not stayed the same over time; they have changed fairly drastically and in ways that were important in shaping recent outcomes. This observation points to one other factor that is crucial to explaining recent regulatory variation along the lines discussed above: the role of earlier policy developments in shaping subsequent preferences and reform processes.

As shown throughout this dissertation, historical processes and policy sequencing played important roles in shaping recent reform outcomes, most notably but not exclusively in the context of contract reforms. The original CACs episode laid the groundwork for the strengthening and spreading of this model more recently, reinforcing the US position, providing US and Eurozone officials with a tried-and-true reform option that would be relatively quick and easy to implement (and less likely unsettle already-shaky markets in the Eurozone context), shifting debtor and creditor preferences in favour of substantial contract innovation, and enhancing the utility of contracts as a tool for responding to the uncertainty generated by recent shocks. At the same time, US officials had no desire to relive the some of the heated debates of the early 2000s and refused to even discuss the merits of a hard-law regime, further suffocating efforts to establish this type of arrangement.

But the fact that the contractual approach had established a foothold in the early 2000s did not automatically lead to its recent strengthening. The IMF lending framework created in 2002 has been incrementally weakened over time, with historical experience and policy sequencing also playing an important role. Experience with this framework in 2010 eroded political support for strong lending rules in ways that fed back into subsequent reform processes, weakening the trigger mechanism by locking-in less constraining rules. The fact that CACs and IMF lending rules were pushed in opposite directions only reinforces the qualification about historical factors made throughout this dissertation: that they are an important but supplementary explanatory factor. They have exerted influence mainly through their ability to further enhance or diminish the prospects of mechanisms whose political acceptability or utility had already been determined by their underlying attributes.

The reform initiatives examined in this thesis played out in different venues and involved different combinations of actors. The politics of SDRR reform can thus be thought of as a multi-player game that unfolds within and across multiple venues. As detailed in Chapter 3, the core players are the key capital-exporting states, sovereign debtors, and private creditors. Their preferences toward different regulatory options are informed by, but not directly derived from, their material positions within the global financial order. As suggested above and at various points throughout this dissertation, interpretations of how a particular reform might affect one's material interests can shift over time in response to historical developments and changes in the regulatory context. In terms of power, the capacity of the leading capital-exporting states—principally the US but also the UK, France, and Germany—to influence outcomes within and across the gamut of venues and reform initiatives examined in the preceding pages makes them particularly powerful in shaping the overall contours and trajectory of the SDRR. In emphasizing the central role played by these dominant states, this study resonates with state-centric perspectives on global financial governance and international regulatory regimes. But it also stresses the decisive role that private creditors and debtor governments played in bringing about institutional changes already favoured by more powerful states, as well as their role in helping to further stifle reform efforts that key states already opposed. The dissertation is thus cast within a multi-actor framework that privileges powerful states.

## 2. Summarizing the Research Contributions

This dissertation makes a number of important contributions to knowledge within the fields of IPE and global governance. As alluded to at the outset of this chapter, the project advances our empirical understanding of contemporary debt politics by drawing on extensive primary material to present the first in-depth study of recent efforts to reform the SDRR. It also makes a key theoretical contribution by developing a broader analytical framework for making sense of regulatory variation in this important but often overlooked area of global financial governance. By delineating the role of earlier regime developments in shaping recent reform outcomes, this study sheds light not only on the politics of reform at a given moment in time, but also on the evolution and development of the SDRR since the turn of the century. The academic and policy literature on sovereign debt has been dominated by lawyers and economists, many of whom contribute to a massive and growing collection of proposals

calling for new and improved debt restructuring mechanisms.[559] The analysis offered here complements this literature by shedding light on the political prospects of different regulatory options.

In developing the framework described in Chapter 3 and substantiated throughout the case chapters, this dissertation builds upon existing IPE literature on SDRR reform, particularly the studies focused on the early 2000s.[560] It deploys new evidence that reinforces important earlier insights, including the significance of US power and preferences and the role of sovereignty-related concerns in shaping American government views on the SDRM proposal.[561] But it also highlights the analytical limitations of existing literature, particularly by pointing to the three previously overlooked factors mentioned above: the process-trigger distinction, the importance of compatibility between new international process mechanisms and the existing domestic legal foundations of the debt regime, and the role of historical legacies and processes in enhancing or diminishing the prospects of certain reform options. Even the vast IPE literature on the IMF overlooks the Fund's lending framework and its role as a mechanism for triggering restructurings.[562] This study calls attention to the Fund's central role in the SDRR, while also reinforcing power-political interpretations of IMF behaviour by showing that dominant states disproportionately shape the organization's approach to debt restructuring.[563] It also identifies other previously neglected elements of sovereign debt politics, including the structural power of the US and UK in the SDRR and the sovereignty considerations that constrain debtor states from pursuing a hard-law restructuring regime, which would otherwise presumably benefit them.

The current study also contributes to broader IPE and global governance debates about the design and development of international institutions. It shows how mainstream institutionalist literature can illuminate aspects of the regulatory outcomes in question. Particularly useful for understanding recent US Treasury-led contract reforms, for example, are neoliberal institutionalist theories that emphasize

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559 For an example of these proposals, see Chapter 1, footnote 27.
560 For example: Gelpern and Gulati, 'Public Symbol in Private Contract'; Helleiner, 'The Mystery of the Missing Sovereign Debt Restructuring Mechanism'; Helleiner, 'Filling a Hole in Global Financial Governance?'; Setser, 'The Political Economy of the SDRM'; Soederberg, 'The Transnational Debt Architecture and Emerging Markets.'
561 In addition to the references cited in the previous note, see Hagan, 'Designing a Legal Framework to Restructure Sovereign Debt'; Gelpern, Heller, and Setser, 'Count the Limbs.'
562 The exception is a small number of policy-oriented papers, including: Weder Di Mauro, 'For the Agenda of the German G20 Presidency'; Zettelmeyer, 'Managing Deep Debt Crises in the Euro Area'; Leckow and Ams, 'Sovereign debt restructuring in the IMF experience.'
563 For this perspective, see Thacker, 'The High Politics of IMF Lending'; Oatley and Yackee, 'American Interests and IMF Lending'; Stone, 'The scope of IMF conditionality'; Barro and Lee, 'IMF Programs'; Dreher and Jensen, 'Independent Actor or Agent?'; Copelovitch, *The International Monetary Fund in the Global Economy*; Breen, *The Politics of IMF Lending*.

the collective action problems that define world politics and the role of institutions in providing mutually-beneficial solutions to these problems.[564] Also helpful are analyses that highlight the impact of distribution and uncertainty on institutional choice.[565] The anticipated distributional implications of a hard-law restructuring mechanism—particularly in terms of disrupting the power and privileges accruing to capital-exporting states—played an important role in shaping reform preferences, as did concerns about the uncertainty such a mechanism would generate. IMF reforms were also shaped by a desire for flexible lending arrangements in light of the uncertainty inherent in global financial markets and future sovereign debt crises. Flexibility would accommodate the interests of key capital exporters. While their interests were defined more in terms of preserving financial stability than maximizing distributional gains, they also included a distributional component insofar as lending to countries with unsustainable debt burdens tends to produce distinct winners and losers.

The analysis of SDRR reform advanced here thus resonates with elements of institutionalist theory, but it also highlights the limits of rationalist and functionalist work in this tradition. A fuller picture of international debt politics can be gained by combining insights from this tradition with historical institutionalist perspectives, which emphasize the importance of prior institutional developments—including the emergence of US and UK laws and courts as legal anchors of the international sovereign bond regime—in shaping subsequent preferences and political processes.[566] But I also suggest that the significance of historical institutionalist insights should not be overstated, nor should the direction of change promoted by historical forces be assumed—a tendency of IPE scholarship focused on the incremental, rather than radical, bolstering of global financial governance after 2008.[567] As noted above, historical factors play an important but supplementary role in explaining outcomes, which themselves display both incremental strengthening (contract reforms) and weakening (IMF reforms) as a result of policy sequencing and feedback over time.

Finally, this dissertation challenges global governance debates that focus on institutional design along a spectrum of international hard and soft law,[568] as well as accounts that see soft law as the only option

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564 Keohane, *After Hegemony*.
565 Koremenos, Lipson, and Snidal, 'The Rational Design of International Institutions'; Abbott and Snidal, 'Hard and Soft Law in International Governance'; Jupille, Mattli, and Snidal, *Institutional Choice and Global Commerce*.
566 See Pierson, *Politics in Time: History, Institutions, and Social Analysis*; Mahoney and Thelen (eds.), *Explaining Institutional Change*; Fioretos, 'Historical Institutionalism in International Relations.'
567 Fioretos, 'Retrofitting Financial Globalization'; Moschella and Tsingou (eds.), *Great Expectations, Slow Transformations*.
568 Abbott and Snidal, 'Hard and Soft Law in International Governance'; Shaffer and Pollack, 'Hard vs. Soft Law.'

for global financial governance.[569] It highlights the utility of an alternative—private-law contracts—that does not fit into the hard law-soft law dichotomy. To be sure, there are already strands of literature that examine the role of contracts in global politics, and some of these contributions can help to make sense of the cases that motivate this study.[570] At the same time, existing literature is somewhat limited by its tendency to treat contracts as either generic agreements[571]—hard- and soft-law arrangements could both be 'contracts' from this perspective—or as tools of private order and governance.[572] Studies that focus on the latter do tend to emphasize the power dimensions of contract governance, which resonate with a central claim of this dissertation: that choosing contracts over hard-law mechanisms was about preserving existing structures of power and privilege for dominant states. But they also tend to view contracts as tools of private authority that are coming to replace public governance functions. This study expands current understandings of the use and purpose of private-law contracts in global governance by showcasing their central role in public and public-private hybrid regulatory initiatives.

## 3. The State of the SDRR and Future Research Directions

Sovereign debt restructuring is a common and recurrent feature of global finance. Between 1950 and 2010, there were over 600 individual restructurings in some 95 countries.[573] Since 2010 alone, there has been a handful of major debt write-downs. Greece's 2012 debt exchange claimed the title of the largest debt restructuring in history. Ukraine restructured roughly $15 billion worth of privately-held bonds a few years later in 2015.[574] And at the time of writing, it is widely expected that Venezuela is destined for a large-scale debt restructuring, which many analysts believe has the potential to be one of the most complicated and messy debt workouts to date. In addition to the enormously complex web of creditors (including China and Russia) and asset claims, a number of bondholder groups have already filed lawsuits in US courts over debt the country defaulted on in 2017.[575] Because Venezuela has not issued international bonds since the broad shift to the new CACs in 2014, none of its debt will enjoy the type of protection from holdout creditors that the new instruments discussed in Chapter

569 Brummer, *Soft Law and the Global Financial System*.
570 Nelson, 'Market Rules'; Riles, 'Collateral Expertise.'
571 Cooley, 'Rationalist theories of institutions in American IPE'; Cooley and Spruyt, *Contracting States*.
572 Cutler and Dietz (eds.), *The Politics of Private Transnational Governance by Contract*.
573 Christoph Trebesch, Michael G. Papaioannou, and Udaibir S. Das, 'Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts,' IMF Working Paper No. 12/203 (August 2012).
574 *Reuters*, 'Ukraine completes debt restructuring of around $15 billion,' November 12, 2015.
575 Patricia Laya and Ben Bartenstein, 'Venezuela Bondholders Are Gearing Up for Battle After Futile Year,' *Bloomberg*, December 26, 2018.

6 afford. The point is that sovereign debt restructurings are not going away in the foreseeable future, and they will remain complicated.

The recent reform initiatives analyzed in this dissertation are clearly insufficient to "fix" the various problems associated with sovereign debt restructuring. Indeed, only bond reforms even strengthened the SDRR compared to its configuration after the last round of regime updates in the early 2000s. Most EMDEs that issue sovereign bonds have adopted the new CACs and *pari passu* clause, and all Eurozone states have incorporated CACs into their bonds since 2013. These states will thus have an important tool for dealing with holdout creditors should they have to restructure their new CAC bonds in the future. But many other problems remain unresolved. The tendency to delay necessary restructurings, bail-out private creditors from sovereign solvency crises, and—in doing so—generate moral hazard will continue thanks to the recent weakening of the IMF's lending framework, which was designed to address these issues. Moreover, there remains no single comprehensive sovereign bankruptcy mechanism—one that could deal with creditors as diverse as Chinese state-owned banks, dispersed private bondholders, and multilateral lenders all within the same restructuring process—in light of the persistent political obstacles to establishing a multilateral treaty-based framework capable of governing global debt claims in this far-reaching manner.

But this is not the end of the line for the SDRR. As long as sovereign debt restructurings continue to highlight new and existing gaps in the regime, we can expect more reform initiatives and governance innovations of the sort examined in this study. This is indeed how international debt restructuring arrangements have developed over time, not proactively and comprehensively but as a set of piecemeal responses to new challenges and changing conditions. Contrary to depictions of debt restructuring as a "non-system"[576] that relies only on "ad hoc machinery"[577] or, at the other end of the extreme, as taking place within a "formal framework,"[578] this dissertation reveals a more nuanced picture of the SDRR are characterized by partial and uneven institutionalization. The reactionary, piecemeal, partial, and uneven nature of regime construction does not mean that the development of the SDRR has been

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[576] Jose Antonio Ocampo, 'A Brief History of Sovereign Debt Resolution and a Proposal for a Multilateral Instrument,' in: Martin Guzman, Jose Antonio Ocampo, and Joseph E. Stiglitz (eds.), *Too Little, Too Late: The Quest to Resolve Sovereign Debt Crises* (New York: Columbia University Press, 2016): 189-205, p. 189.
[577] Rieffel, *Restructuring Sovereign Debt*.
[578] Pamela Blackmon, 'Ad hoc machinery in debt restructuring? Rethinking the lock-in of institutional agreements,' *International Politics* (2018): 1-19.

random, of course. As we have seen, there has been a certain consistency to the type of institutional arrangements that have emerged and succeeded, as it has generally served powerful interests to institutionalize some aspects of debt restructuring more than others. The most successfully and strongly institutionalized regime elements have had two key qualities: they have looked to govern only the debt restructuring process that occurs after the decision to restructure has been made, and they have been embedded in the domestic legal systems and tools that already govern sovereign debt claims.

Looking ahead, the arguments and framework laid out in this dissertation can be used to anticipate and analyze further regulatory developments in the SDRR. Future reform initiatives can be assessed in terms of whether they conform to or deviate from the expectations of this analytical framework, which should help to reinforce and/or refine the insights of this project. For example, Eurozone leaders agreed in December 2018 to further strengthen their contractual framework for sovereign bond restructuring, aiming to replace the two-limb CACs introduced in 2013 with the type of single-limb CACs advanced by the US Treasury-led initiative by 2022.[579] This incremental improvement of a contract-based process mechanism clearly fits with the explanation of regulatory variation developed throughout this study. But there are likely to be larger regime disruptions and reform initiatives on the horizon, perhaps in the wake of a future Venezuelan debt restructuring. It is not uncommon for a large and particularly difficult debt restructuring, even a "deviant case" such as Argentina's recent legal battle, to become a "trend setter" by demonstrating weaknesses in the regime and catalyzing the move to a new regulatory normal, as seen in the case of the contract reforms analyzed in Chapter 6.[580]

Whenever and wherever the next major efforts to reform the SDRR spring up, the ideas developed in this dissertation should serve as a useful lens through which to anticipate their outcomes, analyze their shape and nature, and make sense of the overall trajectory of this international regime as it continues to change and develop throughout history. These real-world changes will, in turn, help to revise and refine the ideas outlined here, making them an even more useful guide going forward.

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[579] *Reuters*, 'Euro zone debates rules for simpler debt restructuring,' November 29, 2018; Gregory Claeys and Antoine Mathieu Collin, 'Does the Eurogroup's reform of the ESM toolkit represent real progress?' Bruegel Blog Post, December 13, 2018.

[580] This point is made by Giselle Datz and Katharine Corcoran, 'Deviant Debt: Reputation, Litigation, and Outlier Effects in Argentina's Debt Restructuring Saga,' *New Political Economy* (forthcoming 2019), p. 1.

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