Symposium

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Sovereign Debt Restructuring: The Way Forward

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Abstract: The timely and orderly resolution of sovereign debt crises has long been a key challenge facing the global financial architecture. The framework for crisis resolution evolved in response to the capital account crises of the 1990s (Mexico, Russia, Southeast Asia), the Argentine crisis of 2001 and its aftermath, and the Global Financial Crisis of 2008–9 which morphed into the Euro area debt crisis of 2010–12. Efforts to expedite crisis resolution involved a two-pronged approach, one focusing on IMF policies and lending facilities and the other on ways to overcome the collective action problems involved in restructuring securitized debt. This paper examines these efforts in the context of the crises that triggered them and provides some guidance for the future. It argues that the way forward involves action on several fronts, including restoration of the essential principle that IMF programs should aim at reaching a manageable debt position within the program period with a high probability.

Keywords: Sovereign debt, IMF, DSSI, Common Framework

1 Introduction

The timely and orderly resolution of sovereign debt crises has long been a key challenge facing the global financial architecture. The framework for crisis resolution evolved in response to the debt crisis of the 1980s, the capital account crises of the 1990s (Mexico, Russia, Southeast Asia), the Argentine crisis of 2001 and its aftermath, and the Global Financial Crisis of 2008–9 which morphed into the Euro area debt crisis of 2010–12. The coronavirus outbreak in 2020 gave new impetus to this debate due to its severe economic and social consequences, which left the world's poorer countries to cope with record debt burdens. The resolution of the

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resulting debt distress in emerging markets and developing countries (EMDCs) provided the motivation for this paper.

Our discussion begins with a historical overview of efforts to expedite crisis resolution in order to avoid prolonged defaults that delay the debtor's economic recovery and deepen creditor losses. These efforts involved a two-pronged approach, one focusing on IMF policies and lending facilities, including the statutory approach of the Sovereign Debt Resolution Mechanism (SDRM); and the other on the contractual approach to overcoming the collective action problems involved in restructuring bond debt. The paper examines these efforts in the context of the crises that triggered them and attempts to distill the lessons of experience and their relevance for the resolution of today's debt overhang. The IMF's evolving lending policies are discussed, with a focus on their central role in the management and resolution of sovereign debt problems, including the Exceptional Access Framework as applied to Greece (2010) and Argentina (2018). In the 1990s, the Fund supported members' debt- and debt-service-reduction (DDSR) operations by setting aside part of the Fund's financing to assist such members in making buybacks and collateral purchases. The paper reexamines the economic case for such support in the present, post-COVID context and lay out some informal guidance that could help members and staff decide when such support is economically justified and what form it should take.

Next, the paper examines recent efforts to address COVID-related challenges that triggered a near-doubling in the number of low-income countries (LICs) facing debt distress or high risk of debt distress. The G20 Debt Service Suspension Initiative (DSSI) provided temporary debt relief to the LICs by pausing official debt payments through the end of 2021. With debt payments resuming in 2022, attempts to decisively address debt vulnerabilities through comprehensive debt restructuring under the Common Framework (CF) appear to have stalled. The tightening of international financial conditions that has already started adds to the challenge. The paper discusses the obstacles to quick resolution of debt distress and provides some guidance for the way forward.

The paper concludes that no single plan is a panacea, as sovereign debt contracts are ultimately unenforceable. The most promising way forward involves action on four fronts: (1) incremental improvements in bond contracts, possibly including automatic stays, and majority restructuring provisions for modifying payment terms in loan agreements; contingent features to address elevated uncertainty post-pandemic and to reduce the probability of repeat restructurings, though significant challenges remain to make them attractive to investors; (2) increased transparency through concrete steps, to accurately monitor and manage debt risks; (3) provision of cash or credit enhancements by IFIs in debt restructurings involving a debt exchange, to incentivize creditor participation; and (4) restoration of the essential principle that IMF programs should aim at reaching a manageable debt position within the program period with a high probability.

2 The Statutory Approach

Sovereign debt contracted in international capital markets is the only type of debt that is not subject to a bankruptcy procedure. Supporters of the statutory approach to debt workouts view the absence of a mechanism for orderly resolution of unsustainable sovereign debts as a missing piece in the international financial architecture. They have proposed various versions of an internationally sanctioned mechanism to resolve sovereign insolvency, comparable to the domestic bankruptcy laws governing private debt.

Yet the key principles of domestic bankruptcy cannot be fully replicated at the international level because, unlike firms, sovereigns enjoy immunity, can hide assets, and do not operate under the threat of liquidation. The absence of collateral complicates the enforcement of claims against sovereign governments. According to Bulow and Rogoff (1989), "whereas domestic loans are generally supported by substantial collateral, the assets that can be appropriated in the event of a sovereign's default are generally negligible. For this reason, one must look beyond collateral to find incentives for repayment." A treaty obligation under the statutory approach may provide such an incentive, but falls short of an enforcement mechanism as it imposes no penalty beyond what any defaulting country would suffer: reputational damage, costly litigation, loss of market access and output losses due to lack of foreign capital.

2.1 The SDRM Proposal

The origin of the SDRM was the belief that the scope of the voluntary debt restructuring mechanisms used in the past had been greatly diminished by the shift from syndicated bank loans to bonds in sovereign borrowing. This shift led to a wider dispersion of creditors with different objectives (including holdouts) and a larger variety of debt contracts, complicating the problem of collective action. In the aftermath of Argentina's 2001 default, the IMF proposed a statutory Sovereign Debt Restructuring Mechanism (SDRM) to promote an orderly and timely restructuring that could overcome the coordination failures of ad hoc debt negotiations (Krueger 2002).

The key objective of the SDRM was to facilitate debt restructurings on a timely basis, while protecting asset values and creditors' rights. The main gaps it identified in the existing architecture for sovereign debt restructuring were (a) the absence of a mechanism to prevent creditors from "disrupting negotiations" by seeking full payment, given that sovereign defaults –unlike domestic bankruptcy– did not include a stay on enforcement, and (b) the absence of a way to bind a minority of creditors to a restructuring approved by a large majority of creditors. To address these concerns and to encourage active and early creditor participation in the restructuring process, the SDRM called for a representative creditors' committee to define the claims eligible for debt restructuring and address both debtor-creditor and intercreditor issues. Any disputes would be resolved by a Sovereign Debt Dispute Resolution Forum (SDDRF), which would play a critical role in ensuring that the collective framework that aggregates claims for voting purposes is predictable and equitable. It would do so by verifying the claims, ensuring the integrity of the creditor voting process, and setting procedural rules for resolution of disputes. The timing and scope of the debt restructuring would be left to the debtor country, though its choices would be influenced by the IMF's willingness to support a program based on such a restructuring. Housed at the IMF, the SDRM would have required an amendment to the Fund's Articles of Agreement to broaden the scope of the Fund's mandate (IMF 2002a). Since the amendment would establish new treaty obligations that would affect the rights of private parties under domestic legal systems, member countries would need to incorporate the new provisions in domestic laws.

Support from the official sector was initially strong. Several IMF creditor countries saw an international bankruptcy regime as an alternative to large IMF bailouts, insofar as it would provide legal protection from creditors during a debt restructuring. They thus viewed sovereign bankruptcy as a means of scaling back large IMF rescue packages and forcing the Fund to return to its traditional lending limits. But they also acknowledged that sovereign bankruptcy was no panacea: sovereign circumstances differed from a corporate default insofar as a stay on enforcement of bond contracts could not prevent a bank run or a currency crisis in the debtor country – the usual triggers for a debt default. Moreover, the SDRM proposal was never intended by the IMF to replace large financing packages.[1] Rather, it was intended to provide an orderly framework for the restructuring of

1 However, the IMF did argue that legal protection from holdouts would reduce the odds that the IMF would feel compelled to back "bad" bailouts; Hagan (2005) states: "It was recognized that it [the SDRM] would make it easier for the IMF to resist pressure to provide financing to a member whose debt is judged to be unsustainable. By establishing a legal framework […] that made the restructuring process more rapid, orderly and predictable –and therefore less costly– the assumption underlying the SDRM proposal was that it would produce a credible alternative to unsustainable debt that would need to be restructured irrespective of how much financing was made available (Hagan 2005). Borrowing countries, for their part, were keen to protect their sovereignty and prevent an international organization from gaining jurisdiction over their domestic-law debt (Setser 2008). Market participants were almost unanimously against the proposed sovereign bankruptcy procedure, arguing that the existing market-based, case-by-case approach had worked well and that the SDRM, if adopted, would adversely affect the availability and cost of capital to emerging countries. Steadfast opposition to the SDRM proposal by the major U.S. financial industry associations was a critical factor in turning the United States –which has veto power in the IMF Executive Board– against the proposal. Ultimately, both creditors and debtors were reluctant to delegate decision-making power to a supranational body, preferring to rely instead on the existing case-by-case approach for crisis resolution. They also questioned the IMF's role in the functioning of an international bankruptcy regime, noting that the IMF was an interested party as a creditor, and therefore should not have a role.

After a vigorous debate on its desirability and design, the statutory approach - akin to an international bankruptcy regime - was abandoned in favor of a contractual, market-based approach based on collective action clauses. Mexico's inclusion of collective action clauses (CACs) in its bond contracts in 2003 precipitated a rapid shift toward widespread use of CACs in emerging markets' bond debt governed by New York law (English law bonds having had CACs since the late 19th century). Viewed as an alternative to the SDRM, the contractual approach prevailed and was subsequently strengthened to facilitate timely and comprehensive debt restructurings.

2.2 Other Statutory Proposals

There has been no shortage of proposed alternatives that incorporate at least some of the features of the SDRM. To mention only some of the most notable, the UN General Assembly passed a resolution in September 2014 calling for the creation of a "multilateral legal framework for sovereign debt restructuring". A large majority of UN members voted in favor of the resolution, but countries with major financial centers, including the US, UK, Germany and Japan, voted against it. Proposals for SDRM-type facilities also failed to gain acceptance, including a Dispute Resolution Forum designed to arbitrate disputes arising in the restructuring process (Paulus and Kargman 2008), and a Sovereign Debt Forum conceived as a building block

continued financing, on the one hand, and an uncertain and potentially chaotic restructuring process, on the other."

toward the eventual establishment of a statutory framework (Gitlin and House 2014). By contrast, some of the proposals of a committee of prominent experts have been at least partially adopted, including enhanced aggregation clauses in CACs and a commitment device to avoid IMF bailouts of countries with unsustainable debts (Buchheit et al. 2013). But the committee's proposal for a European Sovereign Debt Restructuring Regime housed in the European Stability Mechanism (ESM) – a statutory approach limited in scope to the Euro area – proved more controversial. Debated as part of the evolution of the ESM into a European Monetary Fund, a debt restructuring framework has been rejected by a group of countries, led by Italy and France, which argue that the mere existence of such a framework could trigger or deepen a confidence crisis. More broadly, it is questionable whether the Europeans need their own statutory debt resolution framework when there is an agreed market-based framework for resolving debt crises globally.

3 Strengthening the Contractual Framework

The failure of the SDRM to garner sufficient international support shifted the attention of the international financial community toward strengthening the contractual framework. This section briefly reviews the results of these efforts over the past two decades.

3.1 The Use of CACs, 2003–13

Ever since Mexico's "Tequila" crisis of 1994–5, the subsequent Asian crisis of 1997–8 and Argentina's default of 2001, policymakers and market participants have debated how best to facilitate the resolution of sovereign debt crises. Reform efforts under the contractual approach in the 2000s and early 2010s focused on CACs.

Overcoming the "first mover" problem, Mexico successfully launched a $1 billion global bond in New York that included series-by-series CACs in March 2003. Unlike bonds issued under English law, New York law bonds did not include CACs previously. In light of the market's acceptance of the Mexican issue, Korea, South Africa and Brazil followed suit, and within a few years the use of CACs in bond contracts became widespread. However, witnessing the problem of holdouts in a single series, policymakers and market participants continued to search for more viable solutions. The experience with the Argentine and Greek sovereign debt restructurings (in 2005–10 and 2012 respectively) provided the impetus to strengthen the contractual framework and to decisively address collective action problems.

The debt restructurings of Greece (2012) and Argentina (2005 and 2010) focused attention on the potential of holdout creditors to block or disrupt the process (Guzman 2016). In the case of Argentina, a lawsuit by a group of holdout creditors resulted in the country defaulting on $30 billion of debt issued in connection with the 2005 and 2010 restructurings. The holdouts received a favorable ruling in New York courts on the interpretation of the *pari passu* clause included in the bond contracts, and a "no pay-out" injunction against servicing the restructured bonds without pro rata payments to the holdouts. The success of the lawsuit and the granting of the injunction were facilitated by Argentina's over-aggressive tactics, including the introduction of the "Lock Law" which prevented the Argentine government from reopening the exchange process or making any kind of settlement with respect to the bonds that were subject to the exchange offer. The Argentine government eventually settled with holdout creditors with a $9.3 billion payment in 2016, paving the way for Argentina's return to international capital markets.

In the case of Greece, CACs were retrofitted in the Greek-law bonds by an act of parliament, requiring two-thirds majority aggregated across all bond series to accept the new terms, subject to a 50% quorum. Acceptance of the new terms by a supermajority of bondholders led to the successful completion of the debt exchange in March 2012, with 100% of local law bonds tendered in the exchange and overall creditor participation (including on English law bonds) well in excess of the 90% minimum required for the deal to go through. The single-limb aggregation clause was crucial to the success of the restructuring, as no single investor could acquire a blocking minority on €177 billion of eligible debt. By contrast, English law bonds amounting to €28 billion typically required a majority of 75% of the face value of the bonds, with voting conducted series-by-series. Indeed, investors acquired blocking positions in just over half of these bonds (19 out of 36 series) with a nominal value of €6.4 billion, demanding a full pay-out. To avoid a lengthy litigation, Greece paid the holdouts in full while all other bondholders suffered a 53.5% nominal haircut, inviting criticism for setting an undesirable precedent by diverting official support to the benefit of non-cooperating creditors. It is noteworthy that the ECB and national euro area central banks resisted any debt write-downs and did not participate in the debt restructuring, based on the argument that they were not allowed to provide financing to the government. Had they accepted the same terms as private bondholders, the additional debt reduction would have been roughly equal to the gain from introducing the PSI earlier, in May 2010 instead of March 2012 (Xafa 2014a).

3.2 Voluntary Code of Conduct

The Principles for Stable Capital Flows and Fair Debt Restructuring is a voluntary code of conduct, developed jointly by creditors and debtors under the auspices of the IIF. Initially adopted in 2004, and later revised in light of the 2012 Greek debt restructuring, the Code of Conduct promotes crisis prevention through the pursuit of strong policies, data and policy transparency, and open dialogue with investors (IIF 2012). It also promotes effective crisis resolution through good-faith negotiations with representative groups of creditors and nondiscriminatory treatment of all creditors.[2] The G20 leaders endorsed the voluntary Code of Conduct in their November 2004 ministerial meeting in Berlin and have provided continued support for this initiative, most recently in their Osaka Communiqué.[3] However, the IMF has not endorsed the Code of Conduct because of certain differences with its own policies. For example, while the Code calls for partial debt service payments as a gesture of goodwill to facilitate a restructuring, the Fund's good faith criterion under its Lending into Arrears (LIA) policy does not include such a feature.

A structured forum for consultation between a sovereign debtor and its investor base can be useful, judging from the experience of several major emerging market countries that have adopted such practices in the context of an investor relations program. Regular consultations between debtors and their creditors facilitate a better understanding of policymaker's intentions, while feedback from investors can help guide policymakers' actions. Initially the Principles applied only to sovereign issuers in emerging markets, but their applicability was subsequently broadened to encompass all sovereign issuers and non-sovereign entities where the state plays a major role in the debt restructuring negotiations. The growing diversity of the creditor base in sovereign debt markets, including the rise in non-concessional debt and collateralized financing to emerging markets and developing countries, enhance the premium placed on transparency, information disclosure and cooperation for early crisis prevention.

The Code of Conduct is a useful complement to the contractual approach insofar as it identifies best practices and promotes early consultation between debtors and their creditors. Given its voluntary nature, however, the Code of Conduct cannot resolve collective action difficulties.

2 The Principles are monitored by two oversight bodies—the Group of Trustees and the Principles Consultative Group (PCG), which includes senior officials from developed and emerging-market countries, as well as senior bankers and investors.

3 G20 Osaka Leaders' Declaration, §15, June 29, 2019.

3.3 The ICMA 2014 Contractual Reforms

While the holdout problem had been debated for years, the Argentine and Greek restructurings provided the impetus for a redesign of the CACs and *pari passu* clauses in bond contracts. In August 2014, after extensive consultations with all interested parties, the International Capital Market Association (ICMA) published proposed standard clauses to serve as models for the documentation of sovereign bond issues (ICMA 2014).

Under the new aggregated CACs, a supermajority of bondholders can force non-participating creditors to accept the terms of a debt restructuring while minimizing potential holdout investors. Similarly, the new *pari passu* clause is designed to prevent legal rulings that result in a disruption in debt payments to investors (as was the case with Argentina in the mid-2010s), by explicitly excluding the obligation of the debtor to make ratable payments to creditors. Both clauses aim to limit the potential for a minority holdout creditor to block or frustrate a restructuring, thus facilitating a timely, orderly and fair resolution of sovereign stress.

The enhanced CACs proposed by ICMA included a menu of voting procedures: (a) a "single-limb" aggregated voting procedure that enables bonds to be restructured on the basis of a single vote across all affected bonds (75% of total principal), (b) a "two-limb" aggregated voting procedure requiring agreement by two-thirds of total principal and 50% of the aggregate principal amount of each series, and (c) a "series-by-series" voting procedure requiring agreement by the holders of 75% of the bonds in each series to agree to the new terms. These options are designed to address the inter-creditor equity issues that robust aggregation clauses may raise, notably differences in NPV losses between short- and longer-term creditors. The major innovation of the ICMA 2014 reforms was the single-limb voting mechanism, which would permit a supermajority across all individual series to bind a dissenting minority even if holders of some individual series opposed the offer. The two-limb voting procedure had been used previously (notably in the 2003 Uruguay debt restructuring), but the voting thresholds were reduced substantially in the ICMA model clauses to facilitate restructurings. A key consideration was that making bonds too hard to restructure would not prevent sovereign defaults, while it risked delaying the restructuring process if the debtor opted to remain in default until creditors relented.

The IIF fully endorsed and helped promote the ICMA contract reforms among market participants, highlighting the benefits of their adoption. G20 leaders welcomed the reforms and asked the IMF "to continue promoting the use of such clauses and to further explore market-based ways to speed up their incorporation in the outstanding stock of international sovereign debt".[4] Issuers adopted the new contractual clauses right away, starting with a Kazakhstan Eurobond issued under English law in October 2014 and a Mexico sovereign bond under New York law in November 2014, both of which included the new CAC and *pari passu* clauses.[5] In its last report monitoring the implementation of the ICMA model clauses (IMF 2019a), the IMF reported that the inclusion of enhanced clauses had become the norm for bonds issued since 2014, but a significant percentage of the stock still did not include these clauses. This percentage amounted to 60% as of October 2018, but had declined to 50% by mid-2020 through amortization (IMF 2020a). Makoff and Kahn (2015) and others have proposed accelerating the adoption of the new contractual framework through bond amendments or exchange offers, but this proposal has not been implemented primarily due to issuer concerns, namely: (a) premia paid to their bondholders for such liability management exercises and (b) possible signaling that the change is driven by an anticipation of restructuring.

Overall, the ICMA standard clauses represent a significant improvement in the contractual approach to debt restructuring. As noted by the IMF, "compared with previous periods, recent restructurings have generally proceeded smoothly, were largely preemptive, and had a shorter average duration and higher average creditor participation, mainly due to the use of collective action clauses" (IMF 2020a). The recent debt restructurings of Argentina and Ecuador in 2020 –the first to use the two-limb aggregated voting mechanism– were successful in dissuading holdouts and avoiding costly litigation. Empirical analysis using secondary-market bond yield spreads concludes that the inclusion of CACs and enhanced CACs did not have an observable pricing effect (Chung and Papaioannou 2020). This result suggests that market participants do not consider that the use of CACs increases debtors' moral hazard.

4 The Fund's Evolving Lending Framework

The lending policies of the International Monetary Fund, the principal multilateral institution responsible for international economic and financial stability, play a central role in the management and resolution of sovereign debt problems. Its policies have evolved over time in response to changing circumstances. The aim has always been to strike a balance between the need to help borrowers to resolve debt problems and restore growth with the right of lenders to enforce contractual

4 G20 Antalya Leaders' Declaration, §18, November 16, 2015.

5 The Ecuador and Argentina restructurings of 2020 both included enhanced CACs.

obligations. This section briefly reviews the Fund's lending policies in severe debt crises since the 1980s.

4.1 The Debt Crisis of the 1980s

The moratorium on Mexico's debt in 1982 triggered the onset of the crisis in Latin America –the main focus of the crisis– whose aftermath was dubbed "the lost decade". With the ensuing retrenchment of external financing, many emerging markets with large external imbalances turned to the IMF for support. Initially the Fund's strategy relied on "concerted lending" packages, with creditor banks required to reschedule principal and provide new loans to fund full interest payments, while official bilateral creditors rescheduled both principal and interest via the Paris Club as a precondition for IMF lending. IMF financing played a "catalytic" role, with private sector involvement (PSI) contributing the bulk of the financing. Banks cooperated while their exposure was large enough that a default would threaten their own solvency, but became reluctant to extend new loans once they managed to reduce their exposures and build up loan loss provisions. The significant wedge between market and contractual values of the debt added to their reluctance to throw new money in the same basket. Five years into crisis the majority of debtor countries were no closer to achieving sustained growth or regaining access to voluntary finance.

The growing recognition that debtor countries faced solvency rather than liquidity issues triggered a shift in the Fund's strategy toward debt relief in 1987. IMF arrangements supported small-scale debt reduction operations (Bolivia's debt buyback, Chile's debt-equity swaps, and Mexico's first bond-exchange offer – a precursor to the Brady discount bonds), though it did not provide funding for these operations. This approach was formally endorsed under the 1989 Brady strategy, involving the exchange of bank loans for marketable securities issued by the debtors and backed by zero-coupon U.S. treasuries. Principal rescheduling and concerted lending by banks gave way to debt relief involving a reduction in the present value of contractual obligations. The IMF provided financial support for market-based debt operations to help debtor countries reduce their debt burden by capturing the large discounts prevailing in the secondary market for sovereign debt.[6] At the same time, the Fund adopted a "lending into arrears" policy (LIA) to

6 Financial support was provided through "set-asides" (up to 25% of access under an arrangement) and "augmentation" to support debt-reduction operations (up to 30% of quota), whereby a portion of an IMF loan was earmarked for cash buybacks or principal enhancement through the purchase of zero-coupon U.S. Treasuries. The first Fund programs incorporating set-asides for debt reduction were for Costa Rica, Mexico, the Philippines, and Venezuela.

reduce the ability of private creditors to block or delay IMF support. The temporary accumulation of arrears to private creditors was tolerated in order to expedite program approval and send a message to the banks, provided the debtor country was making "good faith" efforts to negotiate with reluctant creditors and the program remained on track.[7]

Brady bonds offered a menu of options to creditors, including the exchange of existing obligations with discount bonds at market interest rates or par bonds at below-market rates. Mexico was the first to conclude a Brady deal in 1989, securing a 35% reduction in the face value of its bank debt. The Brady bonds were collateralized by zero-coupon U.S. Treasury bonds, with the IMF and the World Bank contributing $3.3 billion in credit enhancements. As a sweetener, the agreement provided that 30% of any increase in oil prices above $14 per barrel would be distributed to bondholders. Seventeen other countries followed Mexico's lead, with the solution to the debt overhang adapted to each country's specific situation. The discount differed widely across countries, in line with the secondary market prices of their debt. The typical agreement included a discount bond, a par bond, and a new money option; cash buybacks were offered by smaller countries with minimal debt.

4.2 Exceptional Access Framework

Syndicated bank loans largely disappeared in the 1990s and emerging markets turned to bond issues for their external financing needs. Financial globalization helped increase the flow of funds to emerging markets, but also exposed these countries to the risk of rapid reversals of capital flows. Capital account crises were typically triggered by investor concerns about excessive reliance on short-term debt, currency mismatches or weaknesses in the financial sector. Until the crises of the 1990s, the vast majority of IMF lending was within "normal" access limits, set in relation to each country's quota. Starting with Mexico's "Tequila" crisis of 1994–5, the sheer volume and virulence of private capital outflows in crisis countries necessitated "exceptional access" to IMF resources, which was typically frontloaded. After Mexico, large-scale exceptional access was granted to Indonesia, Korea and Thailand during the 1997–8 Asian crisis, Russia (1998), Brazil (1998–9)

7 A "Lending into Official Arrears" policy was established in 2015 (essentially an extension of the LIA policy to official creditors), to strengthen incentives for collective action among official bilateral creditors and prevent minority sovereign lenders (notably Russia) from acting as holdout creditors.

and Argentina (2000–1). Private sector involvement was not sought in many cases for fear of exacerbating capital outflows and triggering contagion.

In providing exceptional access above the normal limits,[8] the Fund appealed to "exceptional circumstances," or lent through the Supplemental Reserve Facility (SRF), created in 1997 with no defined access limits. Following the 2001 Argentine default, concerns grew that large-scale IMF support gave rise to moral hazard, while the ample room for discretion in invoking "exceptional circumstances" created uncertainty and made the Fund more vulnerable to pressure to provide exceptional access even when prospects for success were poor (IMF 2002b). Moreover, the Fund's large and front-loaded disbursements deterred private investors from lending due to concerns that their claims would be subordinated to the large stock of senior official claims, undermining the catalytic role of IMF lending.

These concerns gave rise to a stricter rules-based framework in 2002, the Fund's Exceptional Access Policy (EAP). The EAP set out four criteria, including a requirement that debt be judged as sustainable with a "high probability", designed to ensure that the borrower's adjustment plans were viable.[9] This was in line with the "Prague framework", endorsed by the Fund's International Monetary and Financial Committee (IMFC) at its Prague meeting in September 2000, which called for debt restructuring if needed to ensure adequate program financing and a viable payments profile (IMF 2000).

Yet in 2010 the IMF approved its largest-ever loan – to Greece (3212% of quota), co-financed by euro-area governments, even though it did not assess the debt as being sustainable with a high probability (IMF 2010). To permit the loan to go ahead, the Fund modified the 2002 criteria by introducing an exemption from the debt sustainability criterion in case a debt restructuring involving the private sector was considered likely to have adverse international spillover effects. Schadler (2013) criticized the "systemic exemption" as a failure of the EAP on its first major test, insofar as systemic spillover risks do not justify exceptional access to IMF resources regardless of prospects for debt sustainability. In its ex-post evaluation of the 2010 Greek program, IMF staff concluded that the 2012 debt restructuring was "too little, too late" (IMF 2013).

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8 Defined as 300% of quota at that time.

9 The criteria were: (i) exceptional balance of payments pressures in the capital account; (ii) rigorous and systematic debt sustainability analysis indicating that there is a high probability that the debt will remain sustainable; (iii) early expected resumption of access to private capital markets; and (iv) reasonably strong program design and implementation prospects. An independent ex-post assessment became a requirement for all exceptional access programs. The criteria were revised in 2009 to permit exceptional access as long as there was a credible strategy to restore debt sustainability through adjustment and/or debt restructuring. They were modified again in 2016, as discussed below.

In an effort to restore credibility and consistency to the policies underpinning its crisis-driven lending, IMF staff proposed ditching the systemic risk exemption in favor of a new approach to addressing spillover risks in exceptional access programs (IMF 2014). Given the inherent difficulty in assessing whether the borrower faces liquidity or solvency problems, a "reprofiling" of private claims would be required for borrowers that did not fulfill the debt sustainability requirement with a high probability. For countries whose debt was judged to be in a "grey zone" —neither sustainable with a high probability nor unsustainable— private creditors would be asked to grant an extension of maturities to provide the breathing space needed to determine whether a restructuring was necessary. Reprofiling would help maintain creditors' exposure and thus avoid a decline in the stock of debt eligible for restructuring.[10] It would also help market re-access by reducing the scale of IMF funding and the attendant subordination risk. If it subsequently became clear that the reprofiling had not achieved debt sustainability, further Fund support under the program would be conditioned on debt relief. The proposed framework would apply irrespective of whether there was a risk of international systemic spillovers or not.

The 2014 IMF paper argued that replacing the "systemic exemption" by a debt reprofiling requirement in "gray zone" cases between sustainability and unsustainability would introduce greater flexibility in the 2002 exceptional access framework by avoiding the costs of an up-front debt reduction operation that might turn out to be unnecessary. A subsequent paper offered further insights on the issue of managing contagion and addressed specific implementation issues (IMF 2015). To minimize any disruptive effects, reprofiling would be required only if the debtor had already lost market access. Although a reprofiling could have cross-border contagion effects by triggering a credit event,[11] IMF staff correctly argued that these consequences would likely be less severe than if the debt problem were left unresolved and uncertainty about the end game persisted. In the case of Greece, the use of the systemic exemption only deferred the recognition that the debt sustainability issue had to be addressed, and ultimately failed to contain contagion. The proposed revisions to the exceptional access framework were accompanied by efforts to standardize and refine debt sustainability exercises as a core analytical tool.

After much debate this framework was eventually adopted by the IMF Executive Board, though the debt sustainability criterion was modified, at the insistence of European Board members, by broadening the range of policy responses in "gray zone" cases. Specifically, policy responses were broadened to include,

10 Official creditors also would be expected to maintain their exposures either through reprofiling or new financing commitments.

11 A credit event relating to sovereign debt is defined by the International Swaps and Derivatives Association (ISDA) as defaulting on payment or restructuring debt.

besides debt reprofiling, financing provided by sources other than the IMF that would not necessarily restore debt sustainability with high probability: *"Where the 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 the 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 debt restructuring"* (IMF 2015, 2016). A commitment by official creditors to provide or maintain financing during the program period was thus viewed as providing the same assurances as those provided through a reprofiling of private claims. However, the two are not equivalent: in the context of the euro area crisis, "*intended debt restructuring*" by official creditors should be understood as a reprofiling (the only type of debt relief European official creditors offered during the crisis, namely to Greece), rather than as a reduction in the face value of the debt (haircut). "Intended reprofiling" by official creditors is thus not equivalent to actual reprofiling of private claims.[12]

Despite the solid rationale behind the reprofiling option, the revised exceptional access framework also failed in its first major test, as the 2018 Argentine program demonstrated.

4.3 The IMF and Argentina, 2018–9

An opportunity to use the new exceptional access framework was missed in June 2018, when Argentina requested IMF assistance and the Fund approved a three-year, $50 billion stand-by arrangement for Argentina (1110% of quota) – the largest in the Fund's history in nominal terms. The program was initially treated as precautionary, with the exception of a $15 billion first installment disbursed up front, without prior actions. The aim was to catalyze funding from other sources and reverse capital flight by providing the assurance of IMF financial and policy support. The IMF did not require debt reprofiling even though the debt was not considered sustainable with a high probability, the country had essentially lost

12 The policy of "official reprofiling" commits the Euro area lenders to assuming in essence a long-term "quasi-equity" position in Greece's capital structure. Specifically, official loans constitute a contingent type of debt, as evidenced by the Eurogroup's decision in June 2018 to cap –subject to conditions– Greece's gross financing requirements and to offer further debt relief if needed. See Heinemann (2021) for a discussion of the political economy of Euro area sovereign debt restructuring.

market access,[13] rollover needs were significant,[14] and little financing was forthcoming from multilateral or bilateral official sources other than the Fund. The decision to provide exceptional access was based on the assessment that "*financing from sources other than the Fund improves debt sustainability and sufficiently enhances the safeguards for Fund resources*". An optimistic assessment of the rollover rate of privately held sovereign debt (75–90%) underpinned this decision (IMF 2018). On the official side, there was little more than a commitment by other IFIs, notably the World Bank and the Interamerican Development Bank, to maintain their exposures – a low bar for granting exceptional access.

The program was converted to fully disbursing with augmented access ($57 billion, 1277% of quota) at the first review in October 2018, to cover a financing gap arising mainly from much lower rollover rates of sovereign debt than originally assumed. However, the augmentation and frontloading failed to restore confidence, the recession deepened, and debt indicators worsened. In the context of the Argentine crisis, the exceptional access criteria would have required the IMF to withhold financial support in the absence of a debt restructuring when prospects for the success of the program faltered. Yet a further IMF disbursement of $5.4 billion was approved at the program's fourth review in July 2019, when a vicious circle of depreciation and deepening insolvency was well under way. Though acknowledging that the risks to the program were elevated, the IMF approved the disbursement based on the argument that the performance criteria were met (IMF 2019b). With presidential elections due in October 2019 and pressures on the currency mounting, the country was "gambling for redemption" even as a sovereign default loomed. IMF resources amounting to $44 billion disbursed in 2018–19 essentially bailed out private investors and funded capital flight.

There is an eerie resemblance between the 2018–9 and the 2000–1 IMF-supported programs for Argentina that ended in tears. Both programs were initially treated as precautionary, both were based on the assessment that Argentina faced a liquidity problem that was manageable with strong action on the fiscal front, and both were augmented when the outlook deteriorated. Both were followed by debt restructuring involving a haircut after the program went off track and before a new program was negotiated. The two key mistakes made by the Fund in 2000–1 were repeated in 2018–9: failing to insist on much stricter fiscal and

13 Argentina had issued dollar-denominated bonds in the domestic market (governed by Argentine law, and mostly held by public sector entities and provinces) in the period just prior to the program, but had not accessed international capital markets since January 2018.

14 One-fifth of the federal government's FX-denominated debt held outside the public sector was due to mature by end-2020, amounting to $31 billion.

monetary policies, augmenting the program when prospects for success were dim, and allowing a private creditor restructuring in the absence of a new program".

A debt reprofiling was announced in August 2019, when Argentine markets tumbled on the expectation of a Peronist return to power, but was not implemented. The newly-elected Peronist government cancelled the IMF arrangement in July 2020 and concluded a debt exchange in September 2020 involving a haircut on the debt, lower interest rates, and a moratorium on amortization until 2024. As the economy struggled with the pandemic without the comfort of IMF conditionality and monitoring, the newly-issued Argentine bonds traded at distressed levels since the exchange. New program discussions with the IMF dragged on ahead of mid-term elections due in October 2021.

Presumably a debt reprofiling at the outset of the program, when debt sustainability already was in doubt, was not in tune with political realities ahead of presidential elections. But there was little economic justification for not acting sooner: (a) official multilateral or bilateral financing at below-market rates that could have buttressed debt sustainability was scarce, a point underlined by Ms. Lagarde's statement that "*we were the only game in town*" (FT 2019a); (b) Argentina's economic problems were largely idiosyncratic, posing little risk of contagion; and (c) a debt reprofiling would not have disrupted market access;[15] Argentina had not issued any international bonds since January 2018, relying instead on the issuance of dollar- or peso-denominated local-law bonds, held mostly by state-controlled entities or by private investors attracted by a "carry trade" which becomes more attractive when monetary policy is tightened. Market access should have been strictly defined as access to FX-denominated debt, excluding local currency debt that attracts short-term inflows that can be quickly unwound if confidence evaporates, making the economy vulnerable to a sudden stop. With secondary market yields on the 10- and 30-year bonds issued in January 2018 at double-digit levels, it is highly unlikely that the country could have tapped international capital markets at interest rates compatible with medium term growth prospects. Reprofiling to extend debt maturities and reduce amortization payments would have eased pressures on the exchange rate – possibly combined with capital controls – and on the authorities' policy dilemma: On one hand, currency depreciation raised the local currency value of foreign debt and increased the fiscal adjustment needed to restore sustainability.

15 The IMF defines the market access criterion as follows: "*An assessment of whether a member continues to have market access would require the exercise of judgment, and would be based on a case-by-case assessment of whether the member can tap international capital on a sustained basis through the contracting of loans or issuance of securities across a range of maturities (in both local and foreign currencies) at interest rates compatible with reasonable medium term growth rates and an achievable primary fiscal position*" (IMF 2014).

On the other, interventions to resist depreciation were constrained by inadequate foreign exchange reserves. Doubts about how this dilemma would be resolved, in the face of the authorities' insistence on an open capital account and no debt reprofiling, probably accelerated capital flight and made the economy vulnerable to a sudden stop.[16]

The IMF's ex-post evaluation of Argentina's 2018 program, published in December 2021, broadly confirms the above assessment (IMF 2021b). The report's assessment is that the Exceptional Access Framework (EAF) was followed in this occasion, but that "*its application was not straightforward. The SBA with Argentina was the first test of the revised EAF adopted in 2016. It was clear that the balance of payments need criterion was met but applying the other three criteria—on debt sustainability, market access, and capacity to implement the program—came down to finely balanced judgments.*" (§71). The ex-post evaluation concluded that the program did not fulfil the objectives of restoring confidence in fiscal and external viability while fostering economic growth. The high priority attached to government ownership of the program ruled out potentially critical measures — notably a debt operation and reintroduction of capital controls. Ultimately, "*the program's strategy proved too fragile for the deep-seated structural challenges and the political realities of Argentina*", thus failing to deliver on its objectives. A debt reprofiling at the outset would have improved the chance of success: "*The short-term maturity structure of the public debt, combined with the non-trivial dollar amount of public debt falling due during the program, pointed to a debt reprofiling as envisaged in the 2016 Exceptional Access Framework reform*" (§48).

The report recommended that future IMF programs use more conservative macroeconomic assumptions, include unconventional measures (such as capital controls) if necessary, sharpen the assessment of whether a country has access to capital markets,[17] and consider burden-sharing with private creditors in exceptional access cases. It correctly concluded that "*being the largest creditor to a relatively large country is both exceptionally risky to the Fund and potentially self-defeating to the purpose of catalyzing a return to market access*". Indeed, the seniority of official creditors over private bondholders creates subordination risk that would imply sizable haircuts on junior debt in a future restructuring.

16 The Ex-post Evaluation Report of the 2018 SBA criticizes only mildly the folly of retaining (at least initially) the inflation targeting framework, which relegates the exchange rate to "benign neglect" in a dollarized economy with extensive indexation and huge balance sheet mismatches. It does admit, however, that the "preconditions for success" of inflation targeting were not in place (idem, §64).

17 For example, market access should be strictly defined as access to FX-denominated debt, i.e., it should exclude domestic currency debt that attracts foreign inflows as "carry trades" which can be quickly unwound if confidence falters, making the economy vulnerable to a sudden stop.

Subordination risk thus undermines the Fund's catalytic role by making a return to market financing more difficult. Following the above recommendations would clearly lead to better IMF lending decisions.

Argentina and the IMF reached a $44 billion (1000% of quota) 30-month Extended Fund Facility in March 2022 to address the country's most pressing challenges, shortly before repayments to the Fund on the 2018 loan fell due (IMF 2022a). Failure to reach agreement on a new program by end-March 2022 would have resulted in Argentina falling into arrears with the Fund, a move that would have cut off credit from other multilateral lenders and delayed market re-access.

While acknowledging that "risks to the program are exceptionally high" and that Argentina's debt was not considered sustainable with a high probability, the IMF did not require a reprofiling as only limited debt service to the private sector fell due during the program period following the 2020 debt restructuring with private bondholders.

5 Dealing with the Post-Pandemic Debt Crisis in Developing Countries

The COVID-19 crisis triggered a global recession as entire sectors of the global economy were closed down to prevent the spread of the pandemic. Commodity-exporting LICs faced debt service difficulties long before the COVID-19 pandemic, as a result of tumbling oil and natural resources prices since 2014. During the pandemic the loss of export receipts was compounded by a sharp drop in remittances, capital outflows and depreciating currencies. As a result, a record number of developing countries facing debt distress obtained emergency concessional loans from the IMF and the World Bank in 2020–2 to ease financing pressures and protect essential public spending. To further support global liquidity, in August 2021 the IMF approved a $650 billion allocation of Special Drawing Rights to its members – by far the largest in history. Of this amount, $21 billion were allocated directly to low-income countries, while the G20 leaders committed to onlend $100 billion of their SDRs to LICs.

5.1 The DSSI Initiative

Acknowledging the urgent financing needs and uncertain outlook of developing countries, in April 2020 the G20 agreed to a temporary debt moratorium on bilateral official debt under the Debt Service Suspension Initiative (DSSI), in response to a call by the IMF and the World Bank.

The DSSI initially covered interest and principal payments estimated at $12 billion due in May-December 2020, but was later extended twice by six months, through June and December 2021. The extensions provided breathing space to help the debtor countries overcome the hardship caused by the pandemic until a more structural approach to address debt vulnerabilities –such as the CF– could be implemented. No further extension was proposed, as the resulting cash flow relief had to be set against the risk of unsustainable debt accumulation through interest capitalization. The initiative offered an NPV-neutral, temporary liquidity relief by suspending debt service payments for 73 eligible low-income and lower middle-income countries, with repayments due over 3–5 years after a one-year grace period. Between May 1, 2020, when it took effect, and December 31, 2021 when it expired, the initiative delivered $12.9 billion in debt relief to 48 eligible countries by suspending debt service payments due to official creditors (World Bank 2022).

To expedite their emergency response, the G20 encouraged but did not require comparable treatment of privately held debt. Private creditors did not participate in the DSSI on a voluntary basis, limiting the impact of the initiative. NPV neutrality using the prevailing contractual interest rate as the discount rate implied a loss relative to market interest rates, making private creditors reluctant to reschedule debt service on comparable terms. On the debtor side, most DSSI-eligible countries were reluctant to request a debt service rescheduling from their private creditors fearing credit downgrades and wider credit spreads.

5.2 Common Framework for Debt Treatments Beyond the DSSI

As the pandemic crisis deepened, the G20 recognized that several low-income countries would require debt treatments beyond the blanket liquidity relief provided by the DSSI, which did not affect the net present value of the debt. In November 2020, the G20 and the Paris Club jointly endorsed the “Common Framework for Debt Treatments beyond the DSSI”, an initiative to coordinate and cooperate on debt treatments for the 73 low-income countries that are eligible for the DSSI. The Common Framework (CF) is aimed at restoring debt sustainability by providing multi-year deferral of a portion of debt service payments, or –for countries with unsustainable debt– a reduction in the net present value of debt sufficient to restore sustainability. In contrast to the DSSI, official debt relief under the CF requires an IMF program and comparable treatment from private creditors. The role of the IMF is to define the country’s financing requirement (or debt relief) consistent with the parameters of the IMF-supported program and the accompanying debt sustainability analysis (DSA).

Chad, Ethiopia and Zambia[18] were the first to request a debt treatment under the CF (IMF 2021a), but implementation has been slow. Delays were caused by coordination problems between official and private creditors, as well as among multiple lenders within a creditor country – the typical problems the CF was meant to minimize. In the case of Chad, there were complications with a collateralized obligation held by a private creditor that was syndicated to a large number of banks and funds. Nevertheless, CF implementation in Chad has been advancing but it has been slow, with an IMF-supported program approved in December 2021 following financing assurance from the Chad Creditor Committee.[19] In the case of Ethiopia, domestic events have prevented further progress. On the positive side, China has announced its intention to join the Zambia creditor committee.[20]

It is noteworthy that no further requests for debt relief under the CF have been forthcoming, despite mounting debt service challenges as the DSSI expired at end-2021 and U.S. interest rates are set to rise further. There are probably both "pull" and "push" factors at work: to some extent, this apparent lack of interest may reflect the fact that most CF-eligible countries are not so far convinced of the need for restructuring or for an IMF-supported program. At the same time, the IMF points to needed improvements in the CF framework itself, in four areas: (a) greater clarity on the steps and timelines in the CF process, including earlier engagement of official creditors with the debtor and with private creditors; (b) a comprehensive debt service payment standstill for the duration of the negotiation would provide relief to the debtor and incentives to the creditors to expedite the negotiations; (c) the CF should clarify further how the comparability of treatment will be effectively enforced, including, as needed, through implementation of the IMF arrears policies[21] to expedite the process (Georgieva and Pazarbasioglu 2021). Moreover, the IMF proposed expanding the CF perimeter to include other highly-indebted countries that can benefit from creditor coordination, beyond the 73 original low-income countries, as timely and orderly debt resolution is in the interest of both

18 Zambia's debt was under restructuring before the introduction of the CF.

19 See "Indonesian G20 Presidency welcomes the statement of the Creditor Committee for Chad", January 7, 2022.

20 See "China committed to joining Zambia creditor committee -IMF's Georgieva | Reuters", April 21, 2022.

21 The IMF's "lending into arrears" (LIA) policies permit the IMF to lend to member countries that have accumulated arrears to private or official creditors. Though the LIA policies relevant for official creditors differ somewhat from those relevant to private creditors, they both require that good faith negotiations with creditors are underway and that prompt Fund support is considered essential for the program's success.

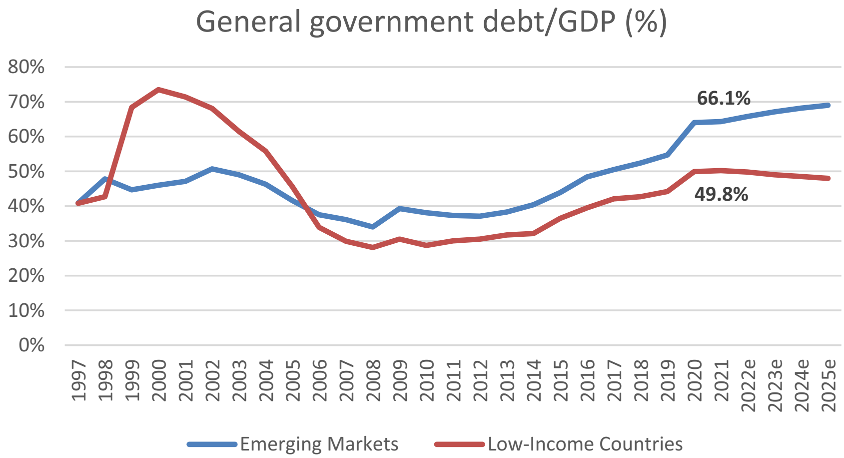

Chart 1: General government debt/GDP, EMs and LICs 1997–2025.
Source: IMF Fiscal Monitor, April 2022.

debtors and creditors. Sri Lanka, which actually defaulted on its external debt service in April 2022, is not eligible for the CF. Noting that the share of low-income countries at high risk or already in debt distress has doubled from 30 to 60% since 2015, the IMF has stressed the need for urgent action to facilitate timely debt restructuring (IMF 2022b). If it gains traction, the CF would help resolve the chronic problem of lack of transparency, as its implementation requires comprehensive and reliable public debt information to assess the debtor's financing requirements and debt restructuring needs, as well as to ensure intercreditor equity.

According to the joint Bank-Fund Debt Sustainability Framework for Low-income Countries, 52% (36 out of 69 countries) of eligible LICs were already classified either in, or at high risk of, debt distress at end-2019, even before the onset of the pandemic. Several of these countries had benefited from HIPC debt relief a quarter of a century ago, but restarted accumulating debt after the global financial crisis. Their debt-to-GDP ratio jumped from a post-HIPC low of 28% in 2008 to 49.8% in 2021 (Chart 1). The LICs would need further comprehensive debt relief to avoid reverting to the practice of incurring further debt to pay interest on older debt.

The CF makes more urgent the resolution of the chronic problem of lack of transparency, as its implementation requires comprehensive and reliable public debt information to assess the debtor's financing requirements and ensure inter-creditor equity. China's willingness to disclose accurate and timely data, and to provide debt relief, would be crucial to the success of this effort. By some estimates, China is now a larger official bilateral creditor than all Paris Club countries combined, yet roughly half of China's lending to developing countries is unreported (Horn, Reinhart, and Trebesch 2019). Operationalizing the CF would necessitate full disclosure of debt data by the debtor country and reconciliation with creditor-reported data on a timely basis. This initiative is still unfolding and requires careful monitoring.

The DSSI and CF include only the world's poorest countries, but a broader framework is needed to encompass emerging market countries (EMs), many of which are also in debt distress or at risk of debt distress. Argentina and Ecuador have recently restructured their debts, while Lebanon, Surinam and Venezuela remain in default. The IMF Fiscal Monitor indicates a 11.5-percentage point jump in the debt ratio of EMs from 2019 to 2021 (from 54.6 to 66.1% of GDP) with the upward trend projected to continue through 2025 (to 74.2%). The current and projected debt ratios are far above the level reached in the aftermath of the global financial crisis in 2009 (39.3%). While interest costs remained low during the benign interest rate environment that prevailed until 2021, the tightening of global financial conditions in 2022 increases the risk of debt distress.

6 Remaining Gaps in the Debt Architecture

Improving the framework for resolving sovereign insolvency should rank high on the agenda of policymakers and market participants in light of the gathering storm that will likely result in an avalanche of debt restructurings post-pandemic. This section reviews the gaps in the debt architecture revealed by the recent debt restructurings, the changing composition of lenders, and the increased uncertainty associated with the aftermath of the COVID-19 pandemic.

6.1 Debt Transparency

After the HIPC conditional debt relief initiative introduced in 1996, many low-income countries (LICs) accumulated non-transparent debts to official bilateral creditors, notably China (Horn, Reinhart, and Trebesch 2019). External borrowing by state-owned enterprises, which went unrecorded in debt databases, also increased. Many of these "frontier markets" in Africa and Asia started issuing international bonds held by investors who mispriced the credit risk involved in debtor countries that under-report their external debt. Debt issued under local law, for which data are only sketchy, contributed to the debt buildup. The result of these developments is that many developing countries now face a more complex and varied group of creditors than the Paris Club and commercial banks of the 1980s, complicating the debt restructuring process. Without transparency on the types and terms of the debt involved, efforts to restructure will stall and may ultimately fail to succeed.

IFIs have stressed the critical role of debt transparency in ensuring sustainable borrowing and lending practices and in assessing emerging risks.[22] The IMF and the World Bank have been collaborating with other stakeholders in identifying the gaps in data reporting and in supporting capacity building through technical assistance to developing countries. Despite these efforts, a recent World Bank report indicates that debt management policies and institutions fall short of minimum standards and outlines policy reforms to address shortfalls in debt recording, monitoring, and reporting capacity (World Bank 2021). The report draws upon new databases and surveys to take stock of the gaps in debt reporting, borrowing practices and legal frameworks, offering a detailed and timely view on the current state of debt transparency in LICs.

Key findings include: (a) 40% of LICs have not disclosed any debt data in the past two years; (b) when available, debt data typically cover only central government loans and securities issued, omitting other public sector entities and debt instruments; (c) lack of transparency is not necessarily the result of deliberate action, but of weak legal and operational frameworks. The result of these shortcomings is a distorted reporting system with different definitions, coverage, and evaluation methods. Public debt data published in different sources show discrepancies of up to 30% of GDP across sources. Examples of under-reported debt include: (a) domestic debt, including arrears that go unreported, and debt that is issued in non-transparent ways (i.e., not through market-based auctions); (b) resource-backed loans, which go unreported because debt collateralized by natural resources is not classified as debt; (c) non-tradable external debt, including central bank operations used to facilitate external borrowing and bilateral loans that may be privately restructured.

The report's key recommendations are addressed to all stakeholders: (a) borrowers need to invest in capacity and systems to produce solid data according to international standards, and to require regular audits; (b) creditors need to limit the scope of confidentiality clauses and refrain from those that require secrecy; they should also publish detailed information on their lending portfolio, as encouraged by the G20 operational guidelines for sustainable financing; (c) IFIs should streamline and consolidate data collection processes and the resulting data bases. They should also provide regular assessment of countries' adherence to international accounting and statistical standards. Progress on these recommendations would obviously be subject to the willingness of debtors and creditors to cooperate.

22 The "Tuna Bond" corruption scandal in Mozambique highlighted the risks of inadequate debt transparency.

The same applies to IMF efforts to improve debt transparency by asking debtors to report creditor composition, as part of the Fund's "Debt Limits Policy"[23] (IMF 2020d).

6.2 Creditor Coordination

Transparency and disclosure are key to promoting creditor coordination. In their absence, individual creditors may be unwilling to participate in debt renegotiations that do not ensure fair burden sharing. Assuming broad-based participation of eligible countries, CF implementation can contribute significantly to transparency and debt relief efforts. The CF requirement of "comparable treatment" of official bilateral creditors (whether Paris Club members or not) and private creditors can go a long way towards expediting the debt restructuring process by ensuring even-handedness. Full disclosure is also essential for effective program design, including accurate assessment of the financing gap that needs to be covered by new loans and debt relief.

As noted above, China is not a member of the Paris Club, preferring instead to deal bilaterally with distressed debtors without disclosing the terms of any restructuring. Given its dominant position, China is unlikely to voluntarily participate in a creditor club that makes decisions by consensus, in close cooperation with the IMF.[24] Its behavior as a creditor would thus significantly impact the effectiveness of any debt restructuring initiative.[25] China does not systematically publish data on its overseas lending, but the China-Africa Research Initiative at Johns Hopkins University has tracked loan commitments amounting to $153 billion to African governments and state-owned enterprises disbursed over the 20 years to 2019, with 80% of this amount committed over the last decade (Acker and Brautigam 2021). These are not debt data because loans may still be in the pipeline and amortizations are not tracked, but they provide an idea of the scale involved. China's official credit agency (Eximbank) has the largest exposure, but loans are also provided by the Bank of China, China Development Bank, Industrial and Commercial Bank of China, and syndicated loans by Chinese and non-Chinese commercial banks, typically to fund infrastructure projects.

23 The IMF's Debt Limits Policy (DLP), dating back to the 1960s, establishes the framework for using quantitative conditionality to address debt vulnerabilities in IMF-supported programs. The 2020 DLP review introduced reforms aimed at improving debt disclosure and tailoring debt conditionality for LICs with market access.

24 China nevertheless understands the value of creditor coordination, as evidenced by the fact that it avoids granting debt relief without similar action by other creditors, who would otherwise become *de facto* senior. See Gardner et al. (2020).

25 Although China agreed to participate in DSSI, there is a fundamental disagreement over what constitutes an official credit or an official lender. For example, China Development Bank does not appear to be participating, although it is a state-owned financial institution (Gardner et al. 2020).

About a quarter of these loans are collateralized by oil and other natural resources in opaque or undisclosed contracts that create major fiscal risks for the debtor countries. Resource-secured lending also raises inter-creditor equity concerns in the event of a debt workout, as repayment is guaranteed by a natural resource (payment in kind), a resource-related income stream, or a natural resource asset that serves as collateral.

Non-bonded debt, such as syndicated loans or sub-sovereign debt, also raises potential complications insofar as it often lacks majority restructuring provisions for payment terms.[26] Restructuring the growing proportion of loans in the public debt of LICs will thus pose challenges insofar as any modification of the payment terms would require unanimity. In response to the call from the official sector for private sector participation in the DSSI, the IIF has released Terms of Reference (ToR), tailored to the circumstances of each debtor, to facilitate voluntary private sector involvement in the DSSI, after extensive consultation with private sector creditors. The ToR provides waivers of certain provisions in the relevant loan agreements (such as events of default) that may otherwise be breached as a result of the deferral of debt service payments originally due in May 2020-December 2021 (IIF 2020a, 2020b).

Private creditors consider that any "one-size-fits-all" solution would be counterproductive as it would risk loss of market access for participating debtors and heightened risk aversion that could raise the cost of capital for all emerging market borrowers. Sovereign debtors, for their part, have been reluctant to request DSSI treatment from private creditors out of fear of being downgraded to default status by rating agencies, leading to cross-defaults on other debts and impairing their market access. The three major rating agencies have said that a request for DSSI treatment from official bilateral creditors would not prompt a credit review/downgrade, but a similar request from private creditors would certainly trigger a credit event unless the debtor obtains a default waiver from all creditors to avoid triggering cross-default clauses. These complications, which prevented private creditor participation in the NPV-neutral DSSI, do not augur well for future restructurings involving debt relief under the "Common Framework for Debt Treatments beyond the DSSI" initiative.

6.3 State-Contingent Debt

The increased debt levels and uncertainty associated with the COVID-19 pandemic have brought proposals for state-contingent debt instruments to the forefront of the

26 It is virtually impossible for regulated credit institutions to agree to delegate their capital loss allocation to a third party, therefore modification of the payment terms requires unanimity. Non-bonded debt also lacks aggregation across loans – it is impossible to aggregate a short term bridge-to-bond loan, a commodity export finance loan and a project finance loan.

policy debate on how to facilitate debt restructuring and avoid costly repeat defaults. Brook et al. (2013) were among the first to argue that GDP-linked bonds could help governments reduce both the cyclicality of fiscal policy and default risk by improving risk sharing with international creditors. Despite these widely accepted benefits, the use of state-contingent debt instruments has been limited in practice and debtor countries have not been able to issue such instruments at a reasonable premium (Roch and Rodan 2021). The lack of standardized contingent clauses leads to fragmented and illiquid markets. Contingent clauses are also unattractive to investors because they are complex and hard to value, in contrast to plain-vanilla bonds that constitute the overwhelming majority of sovereign bonds (FT 2019b). As a result, contingent clauses have been inserted only in restructured debt, typically in the form of hurricane or natural disaster clauses, not in the primary market.

An IMF working paper (Igan et al. 2021) quantifies the risk premia attached to the GDP-linked warrants issued in connection with debt restructurings of Argentina (2005), Greece (2012) and Ukraine (2015). After netting out the default premium (implied by the CDS spread of a plain-vanilla bond) and the liquidity premium (implied by the bid-offer price spread), the residual is considered as the State-Contingent Debt Instrument (SCDI) premium. The empirical analysis finds that (a) SCDI risk premium is high and persistent, ranging from 4.25 to 12.50% in the three cases above; (b) it exhibits a pro-cyclical pattern, i.e., the premium is lower in a recession, presumably because SCDI instruments have more upside than vanilla bonds in a recession. This time-varying risk premium provides an explanation of why most GDP-linked warrants were issued when the debtor underwent a debt restructuring process. Finally, the study finds that the liquidity premium is higher and more volatile than that for plain-vanilla government bonds issued by the same sovereign, confirming that lack of liquidity is an unattractive feature of SCDIs.

In a restructuring situation, state-contingent features include Value Recovery Instruments (VRIs) that offer upside to creditors. Examples of VRI "sweeteners" to boost creditor participation include GDP-linked warrants, used in the restructurings of Argentina (2005), Greece (2012) and Ukraine (2015), or warrants offering payouts to creditors linked to commodity prices (as in the Mexican Brady deal of 1989). However, warrants are detachable instruments, traded separately from the renegotiated debt securities, and their lack of standardization and liquidity make them unattractive to investors. There are also data risks associated with the measurement of GDP, including misreporting concerns.[27] These factors have limited the role of VRIs in facilitating past debt restructuring.

27 In February 2013, the IMF Executive board issued a declaration of censure against Argentina in connection with the breach of its obligation to provide accurate GDP and inflation data to the Fund.

A possible wave of restructuring cases post-pandemic could offer the opportunity to standardize the use of well-designed SCDIs. However, the IMF notes the substantial challenges involved in overcoming the obstacles that have led to a relatively poor track record for these instruments. Developing deeper markets would require standardizing SCDIs by linking them to a common state variable and a relatively simple payment structure that can facilitate market pricing. On the other hand, the differing debtor circumstances make it unlikely that a single state variable can accurately measure the repayment capacity of all (IMF 2020b). The most promising avenue to accommodate both debtor and creditor concerns appears to be the issuance of restructuring exchange bonds with state-contingent payouts linked to a state variable that is closely correlated with repayment capacity and is not under the debtor government's control. Under such an instrument, principal repayments would be deferred for an agreed period (1–3 years) if a trigger level of the state variable is reached. Alternatively, a floating-rate bond could be issued, with coupons linked to an appropriate state variable. Most EMDCs are fuel- or non-fuel commodity exporters, therefore global commodity price indices, tailored to individual cases, would be an appropriate state variable for them. More broadly, SCDIs are most useful in a restructuring situation, where the exchange bonds issued in connection with the restructuring –incorporating downside protection– account for a large part of the country's sovereign debt. By contrast, SCDIs included in new issuance would take several years to replace maturing debt, and would thus provide limited protection against default.

Beyond upside for creditors, state-contingent features also include instruments that offer downside protection to debtors, such as clauses providing for automatic maturity extensions in case of natural disasters. Hurricane and natural disaster clauses were built into the recent debt restructurings of Grenada (2015) and Barbados (2018). To standardize the process, ICMA attempted to develop model clauses for sovereign bonds and loans that include a debt reprofiling feature in case of natural disasters (ICMA 2018), but this effort appears to have been abandoned. The escalating climate-related natural disasters provide a strong incentive to reconsider the use sovereign state-contingent clauses in vulnerable countries, in a form that is attractive to markets, to mitigate climate risks and build resilience. Catastrophic risk bonds, similar to those issued by insurers to raise funds to pay claims arising from natural disasters, could be considered by sovereigns to transfer part of the financial risk arising from natural disasters to the capital markets.

7 The Way Forward

The old SDRM debate has faded away, yet ongoing discussions in various fora are still framed in terms of the statutory versus contractual approach. Though still being debated in academic circles, the statutory approach is unlikely to be embraced by G20 countries. Ultimately the SDRM proposal failed to be adopted because policymakers are reluctant to subordinate national objectives to international disciplines. The US and other advanced countries prefer to have the flexibility to deal with debtor countries on a case-by-case basis under the contractual approach than to grant an international body the power to override domestic courts under the statutory approach.

Recent research has shown that delaying a restructuring until after a default occurs leads to larger declines in GDP, investment, private sector credit, and capital inflows compared with restructurings that take place pre-emptively, without missing payments to creditors (Asonuma et al. 2021). Early action to address debt distress would thus help achieve a relatively rapid return to a sustainable growth path. At the same time, creditors fear that making debt easier to restructure would adversely affect the interests of both borrowers and lenders by raising borrowing costs in emerging markets and developing countries (EMDCs). Striking a balance between these considerations, the most promising way forward involves action on four fronts:

1. **Incremental improvements in bond contracts, possibly including automatic stays.** The 2014 ICMA model clauses for CACs and *pari passu* provisions constitute important advances to the contractual approach, which have limited the ability of a minority to impede a restructuring that is acceptable to a large majority of creditors. The enhanced CACs facilitated the modification of payment terms and protected debtors from holdouts and litigation in recent restructurings (notably the Argentina and Ecuador restructurings in 2020). Although most of the debt issued after the ICMA reforms includes the new model clauses, the bulk of the outstanding stock of debt does not. The conversion the old bonds to the new format would be a major undertaking, given that the outstanding stock of sovereign debt now exceeds the US$1 trillion mark. Makoff and Kahn (2015) have argued that the G20 is well placed to endorse the conversion effort, given its broad membership, its central role in global policymaking, and its visibility with markets. However, the debtors' concerns mentioned above –namely premia payments and negative signaling– have so far prevented any conversion effort. The IMF has proposed strengthening the current contractual approach by: (a) inclusion of majority restructuring provisions for modifying payment terms in loan agreements, (b) stronger negative pledge clauses and more rigorous enforcement to avoid

excessive collateralization, and (c) state-contingent features that reduce uncertainty and protect debtors from downside risks (IMF 2020a).[28] Though in the right direction, these proposals are fraught with difficulties: (a) majority restructuring provisions would be helpful in syndicated loan agreements, but not in bilateral loans, which constitute a significant part of developing country debt. However, the introduction of these clauses risks fragmenting the loan market further, by turning syndicated lending into bilateral, given the difficulty regulated financial institutions have to delegate the decision for capital losses to third parties (i.e. syndicate members); (b) strong negative pledge clauses in loan contracts of the World Bank and other multilaterals have not prevented the collateralized lending which is being criticized; and (c) contingent features are a promising avenue to address elevated uncertainty post-pandemic and to reduce the probability of repeat restructurings, but significant challenges remain to make them attractive to investors. Finally, contingent clauses could be included in debt contracts that trigger automatic stays if certain indicators of debt distress exceed an agreed level. These indicators could include GDP growth, export earnings, commodity prices, or other variables that are strongly correlated with the debtor's ability to pay and are outside the control of the debtor government. An automatic stay on debt payments would provide short-term debt relief but, unlike the IMF's reprofiling option, activation of the contingent clause would not automatically lead to credit downgrades since it would not violate the terms of the debt contract.[29] It would thus address the procrastination problem and alleviate pressures on the IMF to avoid triggering a credit event through a reprofiling. Automatic stays triggered by indicators of debt distress are similar to the hurricane and natural disaster clauses built into the debt restructurings of Grenada (2015) and Barbados (2018). Similar clauses could apply in cases of debt distress triggered by other types of shocks. To minimize debtor moral hazard, an IMF program could be a prerequisite for activation of the contingent clauses, just as an ESM program is a prerequisite for bond purchases under the ECB's Outright Monetary Transactions program (OMT) in the euro area.

2. **Increased transparency, a prerequisite to accurately monitor and manage debt risks.** There is no shortage of initiatives to strengthen transparency:

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28 The IMF also discusses statutory measures that could be used to complement the contractual approach, but cautions against important legal and policy issues that these measures raise. Statutory provisions may include "anti-vulture fund" legislation that limits holdout creditor recovery, or immunizes specified assets from attachment. It recommends using such measures only as a last resort and on a time-bound basis to address the unique challenges posed by the crisis.

29 For rating agencies, any private sector payment suspension that violates the terms of the debt contract is viewed as a default.

creditor outreach and debtor capacity development by the Fund and the Bank can contribute significantly to transparency and sustainable financing practices. Progress in this direction already has been achieved under the "Multi-Pronged Approach" (MPA) endorsed by the Development Committee and the IMF and World Bank Boards in late 2018 (IMF 2020c). Complementing the MPA, the IIF has issued new set of voluntary Principles for Debt Transparency –a follow-up on the 2004 "Principles"– intended to apply to the private sector (IIF 2019). In parallel, the G20 Operational Guidelines for Sustainable Lending, adopted in 2018, aim at strengthening ex ante debt management capacity and information sharing among debtors, creditors and IFIs.

3. **Provision of cash or credit enhancements by IFIs in debt restructurings involving a debt exchange**, to facilitate agreement by increasing its attractiveness to creditors. A key lesson of the 1980s' debt crisis was that delay in debt write-downs in solvency crises is costly for both debtors and creditors. Once the need for creditors to accept NPV losses was recognized, the crisis was resolved through the exchange of existing obligations at a discount from face value for Brady bonds. As noted, the IMF and other IFIs facilitated market-based debt operations by providing financing for cash buybacks or principal enhancement. This enabled debtor countries to purchase risk-free, zero-coupon bonds issued by the US Treasury, which were pledged to guarantee repayment of the principal of the Brady bonds they issued. Would such an approach work today? The double-digit interest rates prevailing in the late 1980s made the zero-coupon bonds exceptionally cheap in NPV terms. The cost of securing the collateral appeared prohibitive in the environment of ultra-low interest rates that prevailed during the pandemic, but is worth considering as global interest rates rise. Cash buybacks funded by IFIs may well be the way forward in some cases, provided the IFI share of outstanding debt remains small enough to minimize subordination risk that could complicate future market access. This constraint limits the funding IFIs could provide in debt restructurings involving a debt exchange. Priority should be attached to IFI-funded buybacks of hard-to-restructure debt, such as collateralized debt or debt without CACs, in order to expedite the debt exchange.

   Another example of the use of credit enhancements was the 2012 Greek debt exchange, which involved a 53.5% haircut on €198 billion of bonded debt. Bondholders received new Greek bonds equivalent to 31.5% of the nominal value of old bonds (€62 billion), plus 15% of AAA-rated European Financial Stability Facility (EFSF) bonds (€30 billion) as a credit enhancement (Xafa 2014a). The purchase of EFSF bonds by the debtor was funded by the 2012–4 EFSF-IMF rescue package, thus transferring the credit risk from the debtor to the official creditors. Additional comfort to creditors was provided by the fact that a portion of official loans in the 2012–4 rescue package were earmarked for debt service and disbursed into a "segregated account" at the Bank of Greece. Debt restructurings on the Greek scale –the largest ever in the history of sovereign defaults– are unlikely to be repeated.[30] Still, the use of this type of credit enhancement depends on the amounts involved and the availability of official creditors willing to take on the risk of non-payment.

A recent IMF policy note details the conditions under which the Fund should finance credit enhancements (IMF 2021c). The note concludes that the Fund could support a member's use of buybacks, cash sweeteners, or collateral in the context of a Fund-supported program, provided that (i) debt restructurings using such enhancements offer significant efficiency gains relative to debt restructurings that do not rely on such instruments, but are underpinned by a regular Fund-supported program; and (ii) an adequate cushion of non-multilateral debt remains after the operation.

The note claims that the conditions under which buybacks, cash sweeteners or collateral can be expected to deliver significant efficiency gains are narrow and specified in some detail. While theoretically correct, these conditions rely on unobservable variables (such as the discount rates of the debtors and the creditors, or the marginal utility of cash reserves) which are hard to assess in practice. While not rocket science, the need for enhancements is obvious in some cases. Creditors may value differently the instruments offered in a debt exchange; creditors with a relatively dim view of the debtor's long-term repayment prospects may value cash and collateralized instruments (such as AAA-rated third-party obligations, as in the 2012 Greek debt exchange) more highly than other creditors. Similarly, creditors who hold collateralized debt or debt with series-by-series CACs, which gives them significant bargaining power, may be incentivized to participate in the debt exchange only if cash or other enhancements are offered. When the debtor lacks the liquid reserves to fund the cash enhancements and collateral purchases, it may borrow from the Fund, up to a limit. The limit should aim to maintain an adequate amount of debt eligible for restructuring by keeping IMF funding –and the attendant subordination risk– relatively low, as discussed above in the context of the Exceptional Access Framework for IMF lending.

4. **Restoration of the essential principle that IMF programs should aim at reaching a manageable debt position within the program period with a**

30 The global financial crisis morphed into a severe debt crisis in the Euro area as a result of a combination of factors that is unlikely to be repeated: monumental market failure, as market participants underestimated credit risk in the euro area; regulatory failure, as all euro area sovereign bonds shared the same zero-risk weight in bank balance sheets; and institutional failure, as the Stability Pact failed to impose fiscal discipline.

high probability. In the case of Argentina, the IMF stretched the limits of responsible risk-taking by providing its largest-ever loan, without private sector involvement, to a member whose large rollover needs and chronic inability to restrain fiscal spending eventually doomed the program. Given the centrality of the IMF's role in sovereign debt restructurings, it is important for the IMF's authority and legitimacy to avoid the impression that the institution's major shareholders call the shots on lending decisions. Beyond internalizing the lessons of the 2018–9 Argentine program, further changes to the exceptional access framework could be considered, possibly in the context of the ongoing review of the IMF and World Bank policies to promote responsible borrowing and lending. In particular, in "gray zone" cases where the debt is considered sustainable but not with a high probability, a reprofiling should be required up front, as a prior action, instead of being conditional on program implementation.

As it stands, the exceptional access framework leaves open the possibility of requiring a reprofiling if the outlook becomes more uncertain during an existing arrangement.[31] This option introduces too much flexibility and keeps the Fund hostage to the "too little too late" problem, in response to pressures to avoid triggering a credit event through a reprofiling. It also aggravates debtor moral hazard concerns: IMF staff argue that the prospect of a reprofiling if the program is not successfully implemented would likely provide incentives for the member to effectively implement the program. But it is also possible that it would provide perverse incentives for the member to opt for gradualism in program implementation, eventually reaping the benefit of a reprofiling that would release resources for a more gradual adjustment path (Xafa 2014b).

The 2016 modification of the exceptional access framework further increased the room for discretion by accepting that "*financing provided from sources other than the Fund, although it may not restore sustainability with high probability, improves debt sustainability… [such] financing may include, inter alia, financing obtained through any intended debt restructuring*". In other words, a commitment by official bilateral creditors to provide or maintain financing during the program period (as in the euro area crisis) is viewed as providing the same assurances as those provided through a reprofiling of private claims. However, as discussed above, the two are not equivalent: fiscal transfers remain taboo in the euro area except in the context of an external shock that affects all members,

31 "While an assessment may be made that a reprofiling is needed when the member approaches the Fund for financial support, it could also be made in the context of an existing Fund-supported program. In circumstances where a member's debt outlook becomes considerably more uncertain during an existing exceptional access arrangement, continued Fund support would be made conditional upon the implementation of a reprofiling." (IMF 2014, #35) as in a pandemic.[32] If history is any guide, the term "*intended debt restructuring*" should therefore be understood as "*intended debt reprofiling*", not involving a haircut on the debt. As it stands, "*intended debt restructuring*" by official creditors serves to delay the reprofiling decision and is thus not equivalent to an actual, up front reprofiling of private claims. Financial support from official creditors should not be allowed to justify exceptional access to IMF resources on the basis of a promise to provide a reprofiling at a later stage, which may not credibly restore debt sustainability within the medium term.

Where the member's debt is considered sustainable but not with a high probability, exceptional access should be justified only if there is a debt reprofiling up front or if grant financing from official creditors is available. Such a policy would make it easier for the IMF to resist pressure to lend to a member whose debt sustainability is in doubt. It would also reduce the amount of financing needed, and the consequent subordination concerns of private investors. The uncertainty created by an underlying debt problem makes it less likely that the program would provide a path for market reaccess if downside risks materialize. Delaying the reprofiling could hold back investment and delay economic recovery, undermining the program's success. IMF programs should aim at reaching a manageable debt position within the program period with a high probability. In its absence, IMF support would not be fulfilling its mandate under the Articles of Agreement to address the member's underlying balance of payments problems. This principle remains relevant when the country is a member of a monetary union. Debt sustainability is unlikely to be achieved if the country needs to rely on other members of the union for financial support for a protracted period of time. Subordination of private creditors to official lenders would only make market reaccess more difficult.

In the case of Argentina, a debt reprofiling at the start of the program would have reduced considerably the needed level of access to Fund resources and would have maintained creditor exposures for a comprehensive debt restructuring. The same applies to the case of Greece, which eventually required a deep haircut to restore sustainability although it benefited from large-scale official bilateral support.

32 The bulk of the Next Generation EU initiative launched in the wake of the COVID-19 pandemic involves net transfers to the hardest-hit members. By contrast, official assistance to Greece during the 2010s debt crisis included a limited amount of transfers (of ECB profits on Greek bond purchases) and debt relief on the Greek Loan Facility (GLF) and European Financial Stability Facility (EFSF) loans that funded the first two adjustment programs (2010–14) through maturity extensions, interest capitalization and reductions in the interest rate margin, with no haircut on the nominal debt.

8 Conclusions

Issues of debt sustainability, restructuring, and default will remain acute in EMDCs post-pandemic. Advanced economies are less at risk of debt distress as long as they retain access to financing at low interest rates, which minimize the additional burden. Their debt ratios are expected to decline rapidly as they wind down pandemic-related support and growth resumes.

The contractual approach has worked well in recent restructurings, though several improvements could be considered. Admittedly, if a pandemic-related systemic sovereign debt crisis were to materialize, it could not be addressed by contractual improvements that take time to gain traction. Strengthening the architecture of sovereign debt resolutions would need to rely on ad hoc measures, such as the Common Framework for Debt Treatments beyond the DSSI (CF), which requires an IMF program and comparable treatment from private creditors as a prerequisite for official debt relief. Assuming broad-based participation of eligible countries, CF implementation can go a long way towards expediting the debt restructuring process by ensuring even-handedness, a necessary ingredient to an effective standstill. Credit enhancements or cash “sweeteners” funded by IFIs also could facilitate debt restructurings by increasing creditors’ willingness to participate.

Creditor coordination problems, resulting in holdouts and litigation, are just one of the obstacles to timely and adequate debt restructuring. Other key obstacles are creditor reluctance to offer significant debt relief up front and record losses, and debtor reluctance to suffer a credit event, especially ahead of an upcoming election. While these obstacles cannot be overcome solely by improvements in debt contracts, they do suggest the need for greater automaticity in triggering a restructuring. This could happen in one of two ways: (a) automatic stays in bond contracts triggered by indicators agreed in advance, or (b) an up-front debt reprofiling requirement on all IMF exceptional access programs in “gray zone” cases of debt sustainability. While the first option would take time to be incorporated in debt contracts, the second can be implemented relatively rapidly. The Fund’s evolving exceptional access framework has not withstood the test of time, raising concerns that the IMF is about to enter the next debt crisis without adequate protection from political pressures to kick the can down the road and gamble for redemption.

More drastic actions could be considered if the crisis becomes systemic, such as swapping existing debt into GDP-linked debt that protects debtors from downside risks while offering upside to creditors (Gallo et al. 2020). This option is subject to the same challenges that have limited the issuance of GDP-linked bonds in the first place, including data manipulation risks and lags in data availability.

No single plan is a panacea, as sovereign debt contacts are ultimately unenforceable. Even the best-designed crisis resolution mechanism needs to be politically imposed and enforced. As Eichengreen and Lindert (1989) concluded back in the 1980s, "neither official policies nor imaginative plans for debt settlement can eliminate the special risks of international lending". Risks exist on the debtor's side as well: unlike corporate borrowers, sovereign borrowers cannot seek a standstill protection from bankruptcy courts. As a last resort in a systemic crisis, Buchheit and Hagan (2020) propose various legal means of introducing "a standstill mechanism that would freeze the situation until the longer-term effects of this crisis can be assessed". While recognizing that there is neither time nor political support for a sovereign bankruptcy court, they propose two emergency statutory actions as a deterrent to litigation against afflicted debtors. First, amending the laws of the US and the UK (the two jurisdictions governing most international bond issues) to permit judges to halt lawsuits against countries where the IMF assesses debt to be unsustainable – an action similar to a temporary moratorium on mortgage foreclosures. Alternatively, shielding the assets of vulnerable debtors from attachment through UN-sanctioned worldwide legal immunity, as was done by a UN Security Council resolution in post-war Iraq in 2003. These are obviously extreme measures that could undermine the perceived sanctity of contracts are raise borrowing costs.

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