Book Review

Learning the Hardest Way: The Pedagogy of Sovereign Debt Crises

Juan Pablo Bohoslavsky and Kunibert Raffer, eds., *Sovereign Debt Crises: What Have We Learned?* December 2018, Paperback, 308 pages, £ 23.99, ISBN: 9781316649947

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<https://doi.org/10.1515/ael-2019-0005>

1 Introduction

Sovereign debt crises are episodes that leave long-term scars in countries and their population. Historically speaking, they are far from being recent phenomena, and the different ways in which these events have unfolded across time and space illustrate idiosyncratic institutional, financial, political, and legal conditions, and the sovereign-borrower and lender relationship reflects a broad spectrum of risk-taking appetites

In spite of such heterogeneous scenarios, *Sovereign Debt Crises. What Have We Learned?* aims to systematise experiences by meticulously delving into the particulars of a broad range of nations, but focusing at the same time on common denominators in order to draw key policy lessons. In fact, one of the most valuable aspects of the book is that it covers a wide array of cases regarding both, time and geographic dimensions: the former because it analyses cases that precede the Global Financial Crisis (and its EU mutation into a Sovereign Debt Crisis), and the latter given that it encompasses not only the recently beaten Western European countries, but also Latin American, African, and Asian cases as well.

In particular: Argentina and its proliferating debt built-up since the mid-1970s and latest saga against the so called *vulture funds*; Brazil and its key lesson that “growth should not be externally financed” and the need to strengthen the productive structure of developing countries; Ecuador and its official proclamation of illegitimacy of its obligations through the work of an *ad hoc* public debt commission; Greece as a quintessential example of an EU-induced crisis; Ireland, Portugal, and Spain as additional euroarea countries that exemplify the perils of one-size-fits-all measures; Grenada and the civil society involvement, especially from members of the Catholic and Protestant

churches; Iceland and the possibility to protect the core social welfare system, sowing the seeds of sustainable ways to overcome debt crisis; Indonesia and the power of Western narratives that impose policy programmes based on the assumption of domestic failings, leaving external factors untouched; Malaysia and its clear option for monetary policy autonomy, challenging orthodox IMF remedies; Mexico and its evolution of debt instruments since the late 1970s; South Africa and the case of odious debt from the apartheid system; and South Korea and the shared developmental mindset of its policymakers that fostered a debt-based development strategy, whose ideas remerged in the aftermath of the global financial crisis.

Such a compendious standpoint evinces two of the main takeaways from these disruptive episodes: on the one hand, the cases are a living example of the highly interconnectedness and feebleness of the financial sector, which denotes in turn a gradual but nevertheless escalating loss of sovereignty from the State's perspective, which has been deepening since the post Bretton Woods world order and the subsequent reforms in the international financial architecture. On the other, the variety of remedies that have been implemented in different jurisdictions enable the reader to scratch beneath the surface in order to understand deeper legal and economic cultural traditions, in an effort to strike a balance between singular cases and broader cross-country lessons.

The heterogeneity of cases further reveals some of the key shortcomings that prevent the international community from moving forward in the development of a sound and global sovereign debt restructuring regime. From a legal perspective, domestic laws (when and if ever applicable in some of these cases) are poorly designed to tackle statutory tensions that arise when, for instance, the principle of "sovereign policy space" collides with the principle of creditors' equal treatment, when such restructurings involve foreign creditors. This is the case of countries that lack such policy space; however, countries with a wider room for manoeuvre do not face this constraint, therefore, they can treat both domestic and foreign creditors equally. At all events, deciding upon sovereign debt restructuring matters entails a delicate exercise of balancing debtor and creditor interests, including foreign ones. From a technical perspective, and considering the sources of international law, a key challenge is "how to reconcile applicable principles whose implementation may lead to contradictory outcomes" (p. 280). These interpretative conundrums tend to leave aside, in most of the cases, human rights obligations that are not incorporated into the debt restructuring equation. Given the massive effects in the population and its welfare, the role of human rights law and the potential impact that its explicit inclusion in the restructuring procedures can have is one of the main messages from the edited volume.

With the advantage of hindsight, the historical sovereign default episodes reveal further deficiencies from both institutional and cognitive perspectives. For example, an influential and highly technical international organisation such as the International Monetary Fund (IMF), has been proved to make (largely) inaccurate forecasts on the effects of its debt restructuring remedies and policy recommendations.¹ But those inaccurate forecasts justified misplaced policy remedies that camouflaged more intrusive and long-term reforms (see e. g. the Indonesian case). A good dose of hubristic optimism accounts for an additional cognitive bias that drives either politicians or technocrats to make fallacious choices when it comes to exiting sovereign debt crisis – for the most part given the onerousness to hold any of these actors accountable for their reckless policy choices. Another important aspect hinted throughout the different cases that can act as a learning barrier stems from the group-think that characterises the epistemic communities involved in dealing with sovereign debt distress. The power of certain narratives and “taken-for-granted choices” prevent out-of-the-box thinking in order to find more equitable solutions. Given that, as the title of the book states, one of its main aims is to analyse “what we have learnt”, this essay hints to some concrete aspects related to the policy learning process, suggesting some avenues to explore the *who* learns and *how* questions.

2 Complementary pieces

In spite of insightfully delving into the causes of these episodes and describing the shortcomings of the current legal and institutional framework due to technical, cognitive, and politically wilful governments, the book does not fully engage in concrete propositions or policy alternatives in order to unblock the structural cul-de-sac that prevents from advancing towards a sovereign debt restructuring scheme at the global level.

As earlier alluded to, an interesting angle of analysis is the possible incorporation of human rights obligations to debt restructuring processes. This incorporation seems to be on the same wavelength as recent debates on “ethical” investing and sustainable finance, just to mention some. The key word here is *sustainability*. It is under this light that the claim “debts that might be repayable from a financial point of view, might not be so from a

¹ The forecast issue is certainly critical when the IMF intervenes in sovereign debt crises and restructuring processes; however, the book also points out to the unrealistic forecasts by the Fund when assessing countries’ sustainability as a broader methodological flaw.

social and human rights perspective” (p. 283) takes on concrete meaning. Hence, it is vital to sharpen this enchanting but nevertheless abstract concept of sustainability.²

If the idea is to open up “the narrow understanding of sustainability” (p. 285) that myopically focuses on an unreasonable optimistic view of the capacity of a country to repay its debt without entering into financial distress, then it would be advantageous to develop concrete sustainability indicators which include social and human rights dimensions. One step forward in this direction has been a recent contribution by Guzman (2018), who delves into the models, assumptions, and probabilistic essence of sovereign debt sustainability analyses (DSAs). Due to its probabilistic nature, the analysis of sustainability is intrinsically subjective, as it hinges on distributional assumptions that experts make for the shocks that affect the capacity of a given country to repay its obligations.³ He accurately points out that carrying out DSAs is already acknowledging that markets are not efficient, as on the contrary the market risk premium would be enough in order to estimate sustainability. It should be clarified though, that this price added to the distress event represented by the market risk premium does not replace the analysis of such event’s likelihood.⁴

Furthermore, Guzman (2018) highlights that an accurate assessment of the repayment capacity calls for a comprehensive analysis of the *constraints* that restrict how much of its debt a country can serve. One of these key constraints is based on the “Basic Principles on Sovereign Debt Restructuring Processes” (A/RES/69/319) adopted by the United Nations General Assembly (UNGA) on

² Before delving into the concept of *sustainability*, it is important to recall that, when it comes to specific analyses of sovereign debt issues, there are two related but distinguishable regimes. One deals with public debt management connected to public spending and monetary policy on an ongoing basis, backed by a “regular refinancing of sovereign debt” (Biondi, 2016, 184); the other, instead, concerns the possibility of public debt restructuring once default has occurred. It is under this latter scenario that repayment can take place through more disruptive means for the economies in distress, such as appropriation or liquidation of sovereigns’ assets. Such a repayment-at-all-costs-approach is theoretically endorsed by formalistic legal interpretations of the sovereign debt contracts, that fail to acknowledge the difference in nature between these situations and debt contracts under private law (Biondi, 2016).

³ The concept of repayment is in itself controversial since, provided that sovereign debt securities are made available on market trading, “sovereign issuers keep rolling them over at market conditions; that is, when one debt issuance comes to be repaid, a new one is issued to refinance the former.” (Biondi, 2016, 184). DSAs, in turn, are not only *ex post* exercises, but comprise prior evaluations by investors and analysts with the aim to trade on those markets.

⁴ As accurately suggested by one reviewer of this piece, this is the case because lenders can simply charge what the market would allow; If calculated properly, instead, spreads would cover the expectation value of losses.

September 10, 2015. From a technical point of view, the legal nature of the UNGA resolutions is not fully reflected by the hard and soft law dichotomy. In fact, given the broad range of issues covered by these Resolutions, it is important to clarify that in some cases these instruments do reflect international customary law.⁵ Given that sovereign debt restructuring is a sensitive and controversial issue, international consensus on the topic is not easy to achieve. However, the 2015 Resolution and the ongoing work carried out by the Human Rights Council in order to strengthen the relationship between foreign debt and human rights,⁶ mirror the dynamics of the international consensus, which is being gradually strengthened in sovereign debt restructuring matters.

In fact, the endorsement of the 2015 basic principles has contributed to reinforcing the idea that certain dimensions should be protected when performing sovereign debt restructuring procedures – areas to be considered when performing DSAs as well. The concrete application of these principles, however, requires a translation into economic terms. Such references to the capability of principles to set certain limits is exemplified by the “natural debt limit” debate (p. 96), applicable in very specific circumstances, v.gr. Caribbean islands such as Grenada –as per the case described in the book–, when destructive natural phenomena occurred. The natural debt limit is calculated based on the amount of debt these islands can *naturally* bear without being over-exposed to distress risk. This is an application of UNGA’s Resolution principles number two and eight on sustainability.

The book embodies a firm step in the path towards a more comprehensive systematization of experiences thanks to the case studies that are closely scrutinised. This is a valuable effort which contributes to the *learning process* that both editors and contributors highlight throughout the volume. Learning in this context is much more than a simple passive action. A first challenge in this enterprise is that the learning element requires an active effort to transform the current sovereign

⁵ “International custom” is one of the key sources of international law, as per the instruments enumerated in Article 38, subsection 1, para. b, of the Statute of the International Court of Justice.

⁶ On March 21, 2019, the Human Rights Council adopted a resolution on “The effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights” (A/HRC/RES/40/8). This resolution was based upon a comprehensive document entitled “Guiding principles on human rights impact assessments of economic reforms”, prepared by the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights, available at <https://documents-dds-ny.un.org/doc/UNDOC/GEN/G18/443/52/PDF/G1844352.pdf?OpenElement>.

debt paradigm into a new one, which goes beyond the mere financial analysis of a sovereign debtor's repayment capacity. This new criterion is meant to incorporate human rights, and social and environmental dimensions in order to comprehensively assess debt sustainability, as already explained in the precedent paragraphs.

Another challenge in this learning endeavour concerns the addressees. Since one of the aims of the book is to draw lessons, a valid question is who *is* or who *are* the main targets of this pedagogical effort. The question of who learns in such a vast public policy space is neither straightforward nor obvious. A first and slightly holistic response could be “the society as a whole”, given the wide spectrum of communitarian sectors affected by such episodes. However, a more targeted reply would specifically include politicians and policy makers, that actually have the power to change the course of events. Other relevant domestic institutions closely involved in controlling, supervising, and managing public debt include Central Banks, and Supreme Auditing Institutions. The problem, however, is that the benefits of the proposed paradigm change and learning process do not manifest themselves immediately; instead, they are long-term processes that might be at odds with politicians' thirst for popularity. And they may be at odds with the lenders' thirst to be refunded entirely and quickly notwithstanding the current and future state of the concerned economies and societies. For apparent reasons, this timing mismatch does not create the necessary incentives for some actors to actually get engaged in this learning path. Therefore, and with a view to avoiding past mistakes resulting from the dangerous connubium between the political establishment and powerful lobbying organisations, it is necessary to explore alternative learning channels, such as raising awareness and inform the civil society in order to allow for a healthy dose of public pressure on policy-makers.

From a theoretical perspective, the learning question has been posed by scholars that have analysed the mechanisms through which policy learning occurs. On the one hand, some explanations focus on individuals belonging to administrative or ministerial elites, thus emphasising the micro-foundations that shape individuals' incentives and motivations (Hecló, 1974, cited by Dunlop & Radaelli, 2017). On the other, and with its roots in Peter Hall's (1993) *third order change*, alternative accounts for the learning process have emphasised the notion of *social learning* as a “collective sense-making” (Dunlop & Radaelli, 2017, 309), hence highlighting the micro-macro relationships that underpin those discursive practices, which shape this definition of the ‘social’.⁷ In spite

⁷ The authors seem to understand these practices in a wide cultural and epistemic sense. Indeed, the article says: “Learning is collective sense-making, when a society at a certain moment in history converges through discursive practices towards a new understanding of what ‘good policy’ is. This is yet another way of considering the micro-macro relationship –

of the interesting scholarly debate about these competing explanations, it is outside the scope of the edited volume and the present essay to delve into the micro-macro foundations of the policy learning process.

On a different note, it is important to acknowledge that, when it comes to selecting case studies in order to highlight pedagogical elements that emerge from distress episodes, their choice involves a degree of subjectivity depending on the policy lessons the author wishes to draw. However, leaving aside the aspiration to create a global sovereign debt restructuring framework, the book also focuses on concrete jurisdictions that have recently faced severe debt afflictions, such as the eurozone. In fact, the chapters devoted to the analysis of the Greek, Irish, Portuguese, and Spanish cases emanate some clear sense of unease, and it is possible to perceive open wounds created by the largely-debated structural deficiencies in the architecture of the euro,⁸ austerity narratives, and the “dictates of the European Union (EU)” (p. 256) and its technocrats, who are not directly accountable for either the consequences of their policy choices, or the past or future financial agony of specific Member States.

Albeit such general unrest is understandable from the authors’ perspectives, a different historical, case-based, and more proactive approach would have been possible, following the spirit of the edited volume and its overarching aim of drawing concrete lessons from past experiences. For instance, when it comes to critically assessing the possibility of a debt relief in these countries, a landmark case has been that of West Germany’s debt relief through the 1953 London Debt Agreement (LDA), widely analysed amongst others by Galofré-Vilà, McKee, Meissner, and Stuckler (2019). It is important to be careful, however, when extrapolating lessons from momentous past events given that, as a matter of fact, the 1953 LDA was signed after the catastrophic consequences of World War II in a context in which each country still kept their monetary policy tools in order to autonomously calibrate their public finances and economic development. Apart from the different macroeconomic conditions, the specific political circumstances underpinning this post-war debt relief cannot be ignored: in fact, the need for a powerful Germany in the Cold War context and the fight against Communism can be seen as key political motivations, which are no longer present nowadays. Yet, “even if we were to ascribe the most cynical and

capturing the dynamics of public discourse and the ‘social’ widely defined. In this sense, micro-foundations direct us towards the citizen and how public discourse emerges in the interaction between elites and individuals” (Dunlop & Radaelli, 2017, 309).

8 Just to mention a small fraction of the scholarship that has dealt with such deficiencies see Irvin and Izurieta (2011), De Grauwe (2015), Stiglitz (2017); for a comprehensive summary of the economic and political science perspectives, and assumptions underlying Europe’s economic and monetary union see Jones (2019, forthcoming). A summary of contemporary public debt management and its regulatory treatment can be found in Biondi (2018).

instrumental motivations to the LDA” (Galofré-Vilà et al., 2019, 26), it could be possible to advance some of the implications that this case has for contemporary debt management. Indeed, in an interesting comparison of underlying debt philosophies, Galofré-Vilà et al. (2019) highlight a substantial difference: while the 1953 Agreement aimed not just to aid German finances but also “to make a contribution to the development of a prosperous community of nations” (Galofré-Vilà et al., 2019, 25 – citing the original document),⁹ the severe conditions imposed on those eurozone countries recently affected by the sovereign debt crisis are animated by a different logic, which focuses for the most part on the limitation of costs incurred by each individual creditor country and on full debt repayment by the debtor country, instead of emphasising the need to rehabilitate economies in distress that have lost part of their adjustment tools, due to the specific design of the Economic and Monetary Union.

An example of this different logic is epitomised by the treatment of debt relief towards Greece by European countries at the beginning and at the end of its crisis. In 2012, agreeing to a substantial write-off of privately-held debt through what became known as the Private Sector Involvement (PSI), was easily palatable to European leaders. As the exposure of European banks to Greek bonds was reduced from 2010 to 2012, the cost to European creditor countries was limited, and agreeing to a substantial up-front debt write-off of bonds held in private hands became an easy task. Zettelmeyer et al. (2013, 2) explain that “after a €200 billion debt exchange in March/April 2012 and a buyback of a large portion of the newly exchanged sovereign bonds in December, the amount of Greek bonds in the hands of private creditors was down to just €35 billion”.¹⁰

Following the PSI, the majority of Greek debt was held by the official sector, mainly in the form of newly-issued debt by European regional financial instruments guaranteed by euro area countries. The shift in the structure of the debt profile from private to official was accompanied by a different approach to debt-relief, since European countries had by then renewed vested interests in the country; they became Greece’s biggest creditor. An Official Sector Involvement (OSI), similar to a PSI write-off, proved less easy to agree. A debt write-off was ruled out at the very beginning given that, on one hand, the specific design of

⁹ Which was also in line with the overall spirit of the 1957 Treaty of Rome, partially lost in the current scenario dominated by global financial markets’ ideology and, at the EU level, by the increasing and steady efforts to deepen financial integration in line with the completion of the internal market project. One of its foundational documents is the European Commission’s White Paper “Completing the Internal Market”, COM (85) 310 final, June 14, 1985: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:51985DC0310&from=EN>.

¹⁰ For a detailed analysis of the Greek debt restructuring of 2012 and its implementation, see Zettelmeyer et al. (2013).

the Economic and Monetary Union prohibited fiscal transfers between Member States and, on the other, an outright debt write-off would not have guaranteed repayment of all the funds transferred to Greece. For these reasons, the remaining debt-relief came in the form of rescheduling; maturity extensions and grace periods to repay interest until 2070. These measures were agreed upon in the course of three years, which has reinforced the uncertainty in the country. First, the Eurogroup endorsed a set of short-term measures in December 2016,¹¹ and second, in June 2018, the same body agreed to implement medium to long-term measures. While in practice the agreed measures provided for a substantial debt relief in net present value terms,¹² the shift from an outright write-off in the nominal value of debt in 2012 to rescheduling the debt profile in 2018 suggests the approach of European creditor countries towards other European debtor countries once the former held the majority of the latter's debt; repayment came first and rehabilitation of distressed economies followed.

3 Conclusion

In all, after having commented on specific aspects that the edited collection could have considered in its analysis, the book is undoubtedly a useful instrument that should arouse regulators, politicians, and experts interest in a serious attempt to trigger a policy learning process that can, in turn, generate broader paradigm changes to develop more reliable and multi-dimensional concepts of sustainable debt to better ride the waves of sovereign debt crises. By highlighting the perverse effects of “undue liberalization and deregulation”, on the one hand, and positively stressing the potential for human rights law in both national and international efforts to balance creditors' and debtors' interest, on the other, the book unveils the main challenges ahead. Albeit realistically assessing that “very little

11 For further details of the December 2016 short-term debt measures, see Eurogroup statement on Greece, December 5, 2016 available at <https://www.consilium.europa.eu/en/press/press-releases/2016/12/05/eurogroup-statement-greece/>.

12 In concrete, a ten-year grace period and ten-year weighted-average maturity extension of the ESM/EFSF loans which means that the interest of Greece's loans would start to be paid to the ESM/EFSF from 2032 onwards, and the weighted maturity of the loans was increased from 32.5 to 42.5 years. For further details see the Eurogroup statement on Greece, June 22, 2018 available at <https://www.consilium.europa.eu/en/press/press-releases/2018/06/22/eurogroup-statement-on-greece-22-june-2018/>.

has been learned” (p. 272), the edited volume offers a path forward, by providing its intended audience with a compact and rich manual of *what not to do* in case of debt distress, and thus preventing the occurrence of historical vicious cycles.

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