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A Symposium on Sovereign Debt and Reputation: Introduction

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Abstract: This short article is an introduction to the Book Review Symposium on *Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance* (Harvard University Press, 2014, 331 pp.). Given that several of the symposium comments detail the basic contours of the book, I do not extensively summarize the arguments of each chapter. However, the essay briefly presents the central motivations, questions, and assertions of the project.

Keywords: sovereign debt, reputation, creditworthiness, odious debt, debt sustainability

List of Symposium Papers

1. “A Symposium on Sovereign Debt and Reputation” by Odette Lienau
2. “Sovereign Debt Restructuring, Refinancing and the Financial Market: A Comment on Lienau’s ‘Rethinking Sovereign Debt’” by Yuri Biondi
3. “The Rise of the Notion of Illegitimate Debt: a Comment on ‘Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance’ by Odette Lienau” by Tomoko Ishikawa
4. “A Role for Legitimacy in Sovereign Debt: A Review Essay on Odette Lienau, ‘Rethinking Sovereign Debt’” by Barry Herman
5. “Rethinking Sovereign Debt: Pleading for Human Rights, the Rule of Law, and Economic Sense” by Kunibert Raffer
6. “Embedded Contracts and a Continuum of Sovereign Debt” by Odette Lienau

It is an honor that my book, *Rethinking Sovereign Debt: Politics, Reputation, and Legitimacy in Modern Finance*, is the subject of this symposium, and I would like to thank the editors of *Convivium* for convening the discussion. I would also like to extend my great thanks to the symposium participants – each of whom have made incredibly important contributions in the sovereign debt arena – for their careful reading and their insightful comments on

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and extensions of the book's themes. I hope that my response to their comments, which closes the symposium, demonstrates the ways in which their essays have deepened my own thinking on how sovereign debt fits into increasingly complicated global social, political, and financial questions. Given that several of the comments detail the basic contours of the book, this introduction does not extensively summarize the arguments of each chapter. However, I would like to briefly present the central motivations, questions, and assertions of the project.¹

I have been struck by the strange dichotomy that sometimes exists between the political and the financial realms in international affairs. In particular, there can be a dichotomous understanding of legitimate sovereign state action in these two arenas. For example, in the "political" realm, we have reached a point in history where there is significant, if admittedly uneven, support for the idea that a nation's government should serve the interests of its people. As part of this, we may try to hold a state's fallen leaders accountable for crimes against the nation's population – an incredibly stark challenge to traditional ideas of sovereignty.² But these ideas have not filtered into most discussions of sovereign debt; in particular, it is easy to imagine the same state's population being asked to acknowledge the debts entered into by those now-fallen leaders. Perhaps the starkest example here is the way in which most Western democracies and commentators hailed the downfall of the apartheid regime in South Africa while simultaneously insisting that the new regime repay the debts of the old.

As such, the book considers how issues of debt and repudiation shine a light on the deep politics that in fact underpin the regime of sovereign finance. In particular, I interrogate what I call the norm of debt continuity: the assumption that sovereign debt must be repaid – even after a major regime change – in order to maintain country creditworthiness. This conventional rule effectively flattens any distinctions across debt, and especially ignores the sovereign character of sovereign debt. It treats sovereign debt as simply the debt that happens to be owed by a sovereign state acting as a commercial actor,³ and effectively assumes that all sovereign debt must be

¹ This description is based on elements of the book's introductory chapter.

² This is most clearly seen in the workings of the International Criminal Court and in tribunals to assess international crimes that may have been committed in places like Rwanda and the former Yugoslavia.

³ For the classic U.S. case characterizing a sovereign debtor as ultimately engaged in merely commercial borrowing action, separate from sovereign status, see *Allied Bank International v. Banco Credito Agrícola de Cartago*, 757 F.2d 516 (2d Cir. 1985), cert. dismissed 473 U.S. 934 (1985).

repaid, regardless of the circumstances of the original debt contract, the actual use of loan proceeds, or the exigencies of any potential default. The debt continuity norm receives particular support from the assumption that, without such a consistent (if not always followed) rule, the market discipline necessary for the functioning of sovereign debt markets would break down. As such, the repayment rule is treated like a virtually unchangeable market principle itself – one that disciplines debtors and creditors alike – supported by the mechanism of sovereign reputation.

In the book, I argue that this market narrative supporting the repayment norm is overly simplistic and in some respects entirely wrong. I suggest that the framing of repayment and reputation as a market principle blocks new thinking about sovereign debt in part by propagating the following three assumptions. First, the dominant approach implies that although creditors may assess a specific borrower's political characteristics through the lens of sovereign risk, judgments about a borrower's repayment decisions are not shaped by politics *per se*. Rather, they are simply the best objective assessment of a given set of material facts, and are therefore unchallengeable on the basis of political or moral principle. Second, the mechanism of sovereign reputation itself is assumed to be similarly free from subjective and historically variable political judgments, and therefore similarly immune from challenge. And third, all rational creditors are expected to respond in basically the same way to particular debt events, suggesting that efforts to understand or reshape their identities and interests would be futile.

The book contends that in fact none of these assumptions seem to hold up to closer scrutiny, which means that the strict debt repayment norm is more politically and historically variable than it first appears. To begin with, any discussion of sovereign debt or creditworthiness is rendered intelligible *only* by quietly incorporating *some* idea of “sovereignty” – one of the most highly politicized (and deeply contested) terms in international political history. Depending on the theory of sovereignty implicitly or explicitly adopted, the practices of sovereign debt and reputation could be expected to diverge significantly. For example, if you define sovereignty as grounded simply in territorial control, regardless of the internal character or purpose of the controlling government (a traditional definition, which I call “statist”), then it makes sense to insist on debt payment regardless of regime change or other exigencies. But this is hardly the only definition of sovereignty available. Actors sympathetic to a “non-statist” conception of sovereignty that attends more closely to the relationship between a government and its population should be able to distinguish (at least in principle) between more and less legitimate debt cancellations, including in making subsequent reputational assessments. Furthermore, creditor

uniformity cannot simply be assumed, and in fact different creditors may interpret – and historically *have* interpreted – the same politicized debt repudiation in opposing ways.

In brief, it is virtually impossible to think of sovereign debt and reputation as divorced from the fundamentally political question of sovereign statehood. This does not mean that politics is pushed forward in every debt policy decision or restructuring discussion – that is hardly the case. But politics and questions of sovereignty remain in the background. And acknowledging the political issue of sovereignty at the center of any definition of sovereign debt and reputation invites a consideration of questions and policy options that tend to be pushed to the side by conventional approaches: When is it appropriate and financially feasible (in terms of reasonable expectations of future debt issuance) to allow for debt cancellation or concessionary debt restructuring on the basis of an explicit sovereignty claim, and especially a change-in-sovereignty claim? For example, should black-African-led South Africa really have been expected to repay the apartheid-era debt? Or, if the Assad regime in Syria were to collapse altogether, would it be appropriate to require future generations to pay for amounts spent to oppress them militarily?

Highlighting how central the political concepts of sovereignty and statehood actually are to debt and reputation does not only raise key theoretical and policy questions. It also points to the way in which these practices are necessarily institutionally located, and suggests a series of inquiries that ground the book's historically based middle chapters. Why has the current framework become dominant, and where did it come from? Did alternative practices develop, or were there spaces in which they might have emerged? In presenting my own answers to these questions, the chapters look closely at the past interactions of institutional players including states, creditors, and other major political actors. I argue that, at each historical moment, both broader understandings of sovereignty and the degree to which creditor interactions are consolidated (as opposed to competitive) have impacted the strength of the debt continuity norm. The book also presents a long historical view, contending that alternative possible approaches to dealing with sovereign debt continuity emerged in the early twentieth century, and details how they were covered over by broader political and financial trends in the latter part of the century.

Of course it is hardly easy to operationalize these insights into specific policy recommendations – a theme I will return to in my response to the symposium comments. But by allowing an ostensibly “apolitical” understanding of sovereign debt and reputation to dominate, we effectively treat the current approach as unavoidable, if sometimes morally unfortunate. As such, it becomes harder to shift the moral high ground enough to make nonpayment or partial

payment of arguably politically illegitimate debt the rebuttable presumption and starting point for negotiations. It also becomes less likely that we ever have to take the technical institutional redesign suggestions seriously. Given that the current regime occasionally results in unfortunate distributional ramifications, this avoidance of the hard questions is deeply problematic. In important ways, then, the goal of the book is precisely to clear the air of oversimplified assumptions and narratives in order to open the policy space and force a serious engagement with those hard questions.