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Chapter

# Sustainability in Indebtedness: A Proposal for a Treaty-Based Framework in Sovereign Debt Restructuring

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## Abstract

The debate concerning reforms in sovereign debt restructuring (SDR) ranges from those which maximize flexibility (e.g. adoption of clauses in debt contracts) to those which maximize uniformity and predictability (e.g. enacting a fixed framework similar to a domestic bankruptcy regime). This paper proposes that the principles of SDR in the United Nations General Assembly Resolution 69/319 be broadly codified into a treaty. This includes the principle of sustainability which emphasizes "inclusive growth and sustainable development" of stakeholders in SDR. In the current unsystematized regime of SDR, this proposal seeks to bridge the value of flexibility in *ex post* negotiations and the values of uniformity and predictability in *ex ante* rules under fixed bankruptcy regimes.

**Keywords:** sovereign debt, bankruptcy, sustainability, inclusive growth, reform, resolution, restructuring

## 1. Introduction

The challenge of resolving a sovereign debt crisis becomes problematic when it has international dimensions. A State with purely domestic indebtedness has the flexibility to enact measures to address a debt problem that is entirely within its jurisdiction. It can, for example, enact laws that reduce the face value of its debts or lengthen their maturities to prevent the possibility of default. In this case, the State's creditors would normally be without any recourse because debt contracts are created, operationalized and sustained within the legal framework of the Debtor State.

Thus, the restructuring measure enacted by the State to preserve its fiscal health and the general well-being of the country would prevail over the creditors' rights to receive the "full value" of the debt. In short, a purely domestic sovereign debt would permit unilateral restructuring by the Debtor State. In the positivistic language of Justice Oliver Wendell Holmes, "there can be no legal right as against the authority that makes the law on which the right depends..." [1]. In economic terms, however, the creditors' lack of legal recourse is effectively part of sharing the burden (like everyone else) to address the collective problem of a sovereign debt crisis.

Once sovereign debt has international dimensions, the Debtor State has to contend with legal systems other than its own. Access to international debt markets



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made the resolution of sovereign debt crises an international affair. For their protection, creditors often demand that debt contracts contain provisions that introduce elements of foreign legal systems to them—e.g. provisions on governing law and the choice of a tribunal other than the domestic courts of the Debtor State. As in the Argentinian crisis that started in the early 2000s, Argentina had to contend with creditor holdouts carrying injunctions secured from New York courts (see generally [2]).

Thus, in the case of sovereign debt crises with international dimensions, their resolution involves the interaction between at least two legal systems. The protection given by a foreign legal system has a deterrent effect on unilateral debt restructuring by the concerned State. However, this situation also creates the opportunity for delays and holdout behavior by giving creditors protection contractually drawn from a legal system outside that of the Debtor State. This becomes a collective action problem that ultimately hinders the resolution of a sovereign debt crisis. The International Monetary Fund (IMF) has long acknowledged that "While private creditors as a group may recognize that support for rapid restructuring is in their own interest, they may hesitate to agree to a restructuring out of concern that other creditors may hold out and press for full payment on the original terms after the agreement has been reached" ([3], p. 12).

Proposals for a collective and multilateral proceeding for the resolution of sovereign debt crises have been fairly widespread in the literature (see [4], p. 87). These proposals usually draw from domestic bankruptcy rules which, among others, support a global stay on debt collection efforts, the application of the automatic acceleration principle, priority rules and variants of creditor equality treatments [4, 5]. However, the resolution of a sovereign debt crisis would not be as simple as, to paraphrase the legal positivist H.L.A. Hart, a "bankruptcy regime writ large."[1] [6, 7]. There are significant characteristics of sovereign debt restructuring (SDR) that are not found in domestic bankruptcy regimes such as the non-availability of an option to liquidate the Debtor State and the critical role of macroeconomic policy and economic growth in the restructuring process.

Given that the current resolution efforts primarily occur within a conflict of law regime, this paper argues that a minimum level of multilateralization is needed to universalize broad norms that channel collective behavior during a sovereign debt crisis. These norms should consider "inclusive economic growth and sustainable development" within the Debtor State as rational and viable strategy in SDR.

More concretely, this paper proposes that efforts should be exerted so that the principles of sovereignty, good faith, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, majority structuring and sustainability under the United Nations (UN) General Assembly Resolution 69/319 adopted on 10 September 2015 ("Basic Principles on Sovereign Debt Restructuring Processes") may be broadly codified into a treaty. Such codification may include changes in the articulation of these principles to accommodate the positions of States such as those in the European Union (EU) (see [8]). Significantly, the principle of sustainability should emphasize the concept of "inclusive growth and sustainable development" within the Debtor State as part of the SDR framework. This proposal is being made in the context of the lack of support from countries which have the "major financial centers from which most of the sovereign debt has been issued" ([9], p. 47).

While certainly not an easy feat, the foregoing follows the so-called Incremental Approach that "complement, rather than replace, existing mechanisms, including contractual approaches and the activities of the International Financial Institutions

[1] In criticizing John Austin's Command Theory of law, H.L.A. Hart described it as a "gunman situation writ large."

or the Paris Club, and guide their operation" ([10], p. 38). The thrust of this proposal is to broadly formalize the norms in UN General Assembly Resolution 69/319 that would give States the flexibility to negotiate and adopt specific measures in resolving a sovereign debt crisis. As such, this would not involve an unqualified "surrender of sovereignty" which has been part of the reason for States' reluctance to enter into a "hard law" approach in SDR.

In what follows, Part II of this essay describes the current conflicts of law regime where SDR occurs. Part III sets out the proposal to codify the principles embodied in UN General Assembly Resolution 69/319 into a treaty. Part IV discusses the principle of sustainability which emphasizes the concept of "inclusive growth and sustainable development" as a rational and viable strategy of SDR. Part V concludes.

## 2. The conflict of law regime of sovereign debt restructuring

The international dimension of SDR does not arise primarily from international law as set out in Article 38 of the Statute of the International Court of Justice, but by contractual provisions that incorporate laws other than the legal system of the Debtor State. In general, there are no "top-down" international norms that govern SDR in the form of treaties, custom or principles. Instead, there is a "bottom-up" normative system that arises from the number of debt contracts issued by Debtor States that contain provisions which introduce elements of a foreign legal system to them. While there are international laws that may apply to SDR such as the principle of sovereign immunity or the Hague Convention on the Recognition and Enforcement of Foreign Judgments [11], these international norms are limited to the extent that they do not dictate how SDR is implemented as a whole.

The legal environment where SDR presently operates is a regime of "conflict of laws" or "private international law." Conflict of laws does not principally concern itself with international law. Rather, it is the application of domestic law whenever a particular jurisdiction is "faced with a claim that contains a foreign element" ([12], p. 2). In other words, a conflict of law approach does not depend on the application of international law among States. Instead, it entails the operation of a particular domestic law in cases involving the interaction between at least two legal systems. Thus, "[t]he *raison d'être* of private international law is the existence in the world of a number of separate municipal systems of law—a number of separate legal units—that differ…from each other in the rules by which they regulate the various legal relations arising in daily life" ([12], p. 4).

As in the current regime of SDR, the rules that generally govern SDR are strictly not international law, but a State's domestic rules that apply when foreign laws that are incorporated in a debt contracts. The practice of SDR is therefore situated within a conflict of laws regime which recognizes that while a State may enact rules in the treatment of foreign laws, "[a] sovereign is supreme within [its] own territory…[It] can, if [it] chooses, refuse to consider any law but [its] own" ([12], p. 4). As discussed below, while the principle of State sovereignty is conceded in theory, its practical application in SDR is qualified by the set of debt contracts that a State has entered into in accessing capital.

The provisions that are often stipulated to introduce elements of a foreign legal system in debt contracts are (a) dispute settlement clauses that confer jurisdiction to a tribunal other than the domestic courts of the Debtor State; and (b) governing law clauses (see [13]). Incidentally, these contractual provisions mirror the scope of private international law which is "always concerned one or more of three questions, namely," (a) the jurisdiction of the domestic court; (b) recognition and

enforcement of foreign judgments; and (c) the choice of law ([12], p. 7). Governing law clauses in a debt instrument may include the specific choice of law provision designating, for instance, New York or English or Japanese Law; or a provision that references an international norm such as a particular treaty or the principle of State sovereignty. Moreover, the adjudicatory body constituted by the debt instrument applies the choice of law or the referenced international norm pursuant to the contract.

During a sovereign debt crisis, the Debtor State may unilaterally restructure its debts pursuant to its sovereign right to set its own macroeconomic policy. In this context, foreign creditors demand that such clauses be contained in debt instruments to effectively act as restraints against unilateral restructuring by a Debtor State. These clauses therefore imply a waiver of the Debtor State's sovereignty. By introducing elements of foreign laws in debt instruments, these clauses "internationalize" what would otherwise be purely domestic contracts that may be amended by the Debtor State. It has been said that "[m]any countries do not regard foreign creditors with great sympathy, especially when the country is bankrupt and the citizens are throwing stones in the street" ([13], p. 4). Thus, for instance, New York or English Law "continue to dominate sovereign and quasi-sovereign lending in large parts of the world[,] including many emerging markets" [14]. New York and English Law are often the choices of law in debt instruments because of their "insulating effect" against "legislative changes in the borrower's country" ([13], p. 4). It is also a factor that the United States and the United Kingdom are often the home States of creditors who hold sovereign bonds. On the other hand, Debtor States normally agree to these clauses in order to access capital from foreign creditors.

The present regime of SDR has also been described as "contractual" given that debt contracts are the primary sources of rights and obligations with respect to sovereign debt. In the case of purely domestic indebtedness, a State has wide leeway in dealing with its debts using its own legal system. However, when a State borrows capital from foreign markets, debt contracts trigger the interaction between two legal systems and, to a more limited extent, between the Debtor State's legal system and international law. This precisely characterizes a conflict of law regime which is principally concerned with the "existence in the world of a number of separate municipal systems of law" ([12], p. 4). As a consequence, without an overarching framework, SDR is necessarily based on the Debtor State's *ad hoc* negotiations with its creditors based on those contracts. The *ad hoc* nature of these negotiations is reinforced by the fact that the distressed Debtor State has to deal with a diverse set of creditors including hedge funds and institutional investors.

Thus, the myriad of sovereign debt contracts is the core operational legal framework in the resolution of a sovereign debt crisis. The application of the international principle of State sovereignty is, to a large extent, determined through the State's express and implied waivers of such principle contained in the debt contracts. In most cases, international law is applied in SDR if it is incorporated in these contracts. While sovereign debt contracts may be covered by an investment treaty as in *Abaclat v. Argentina* [15], this has not evolved into a consistent international norm in SDR. In the first place, whether debt contracts are considered protected under an investment treaty would depend on the specific definition of "investment" under such treaty. Second, such expansive interpretation of "investment" has been criticized as a departure from the common understanding of "investment" as long-term commitment of capital that contributes to the economic development of the host State (see [16], pp. 515–517). In any event, there are currently more than 3000 investment treaties in the world with varying definitions of investment [17]. This situation in international investment law is hardly one that reflects a consistent international norm in SDR.

According to Guzman and Stiglitz, the contractual regime of SDR is essentially a "*non-system*…characterized by bargaining based on decentralized and non-binding market-based instruments centered on collective action clauses and competing codes of conduct" ([18], p. 3). There is widespread literature which strongly criticizes this contractual regime as "disorderly, inefficient, and overly costly" especially with respect to creditor collective action problems, in particular debt runs, holdouts and litigation (Citations omitted. [14], p. 88). Thus, there have been calls for a "hard law" approach or a multilateral legal framework to address these problems (for an overview, see [14], pp. 87–96). On the other hand, there are those skeptical of these proposals because of fears of rigidity of rules and "regulatory overkill" ([14], p. 88). Thus, an *ex ante* SDR framework consisting of mandatory rules carries the risk of stifling the flexibility that is present in *ex post* negotiations. Thus, "[i]nstead of creating a statutory framework 'top-down,' it could suffice to alter the documentation of bond and loan contracts to regulate the restructuring process in a more efficient way" ([14], p. 88). This would be the contractual regime of SDR where the prevailing norms of conduct are based on the terms and conditions stipulated in contracts entered into by the parties.

As discussed below, one way to bridge these opposing views is to formalize norms that are broad enough to allow parties the flexibility to adopt certain measures in the resolution of sovereign debt crises. At the same time, the formalization of these norms should be effective enough to influence collective behavior in SDR. The next part will discuss this proposal through a treaty-based codification of the norms contained in UN General Assembly Resolution 69/319.

## 3. Establishing a treaty-based normative framework

When UN General Assembly Resolution 69/319 ("Basic Principles on Sovereign Debt Restructuring Processes") was adopted 10 September 2015, 136 States voted in favor, six States voted against, and 41 States abstained ([18], p. 4; [10], p. 37). Among those which opposed the resolution were the US and the UK, "the two major jurisdictions for sovereign debt issuances by emerging economies, as well as Canada, Germany, Israel and Japan" ([18], p. 4).

UN General Assembly Resolution 69/319 articulates nine principles in SDR:

1. The *principle of State sovereignty* which is the Debtor State's right "to design its macroeconomic policy, including restructuring its sovereign debt…"

2. *Good faith* which is the "engagement in a constructive sovereign debt restructuring workout negotiations and other stages…"

3. *Transparency* which is "accountability of the actors concerned…"

4. *Impartiality* which means "independence" and the prevention of "undue influence" and "conflicts of interest."

5. *Equitable treatment* which is a State duty to refrain from arbitrary discrimination among its creditors.

6. *Sovereign immunity* of States from jurisdiction and execution which includes courts' obligation to "restrictively interpret" it in favor of State immunity.

7. *Legitimacy* entails "inclusiveness and the rule of law" in SDR "at all levels."

8. *Sustainability* "implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State..."

9. *Majority restructuring* "implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be...impeded by other States or a non-representative minority of creditors..."

The thrust of this paper's proposal to codify UN General Assembly Resolution 69/319 into a treaty is to formalize the foregoing principles without necessarily adopting the resolution *in toto*. Its main objective is to introduce these norms as a multilateral framework in SDR without, at the moment, imposing any specific measure to implement them. If the voting of UN General Assembly Resolution 69/319 is any indication, only the 136 States which voted in favor of the resolution would probably regard its codification in a positive light. Thus, to improve chances of success, a proposal for codification should court the "no" and "abstain" votes by introducing changes that accommodate their positions.

It is not surprising that the influential developed economies voted against UN General Assembly Resolution 69/319 given that their citizens are mostly the creditors of distressed Debtor States and that they have an interest in protecting the sovereign debt market within their jurisdictions. One of their declared principal objections is that "the IMF as the primary forum to discuss sovereign debt restructuring issues" instead of the UN General Assembly [8]. Equally important are their objections against the specific manner by which the nine principles in SDR were articulated in the resolution.

The European Union, for instance, has declared its objections to a number of statements in the resolution:

> *Paragraph 4 requests "all institutions and actors involved in sovereign debt restructuring," including "at regional level," to "refrain from exercising any undue influence over the process and other stakeholders or engaging in actions that would give rise to conflicts of interest." Such a statement fits poorly with both the EU institutional setting and its practical situation, where possible discussions related to the stock of debt of a Member State take place primarily at regional level, against a background in which the Member States themselves are often the main creditors (directly or via the financial assistance mechanisms that they have established).*
>
> *Paragraph 5 states that "creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics" and that "no creditors or creditor groups should be excluded ex ante from the sovereign debt restructuring process." Such a statement denies the customary preferred creditor status recognized to the International Financial Institutions (IMF, ESM...) when lending to a Sovereign in distress, with possible major negative implications on their ability to fulfill their primary mission.*
>
> *Paragraph 9 states that "sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be affected, jeopardized or otherwise impeded by other States." This statement is very problematic for issuances under foreign jurisdiction (the overwhelmingly dominant case for developing and emerging countries). Issuing under a foreign jurisdiction does, by definition, involve accepting the competence of the courts of another State. This is a point of major importance for the EU, as a very large part of the world's sovereign issuances under foreign jurisdiction are made under the jurisdiction of one of its Member States (UK) [19].*

In codifying the SDR principles into a treaty, it is worthwhile to consider these objections which relate to the specific wording of UN General Assembly Resolution 69/319. In general, it is easier to accommodate concerns about specific wordings than the more fundamental objections premised on the market-based approach to SDR. This is driven by a pragmatic consideration of securing State support by postponing the imposition of concrete SDR measures and, at the same time, advancing the main objective of introducing a multilateral normative framework for SDR.

The broad codification of the norms contained in UN General Assembly Resolution 69/319 would be a compromise between a "soft law" approach (usually in the form of guidelines that may be adopted by States) and a "hard law" approach in the form of enforceable specific SDR measures. While the proposal takes the form of a treaty, the SDR norms to be articulated therein should be deliberately broad to give States the flexibility to implement them within specific contexts. As such, this would not be an unqualified "surrender of sovereignty" on the part of State parties that may be part of their reluctance towards UN General Assembly Resolution 69/319 (consider, for instance, the 41 abstaining votes). A degree of flexibility is needed in SDR especially in view of the rapidly changing nature of the sovereign debt market (see generally [20]).

This proposal is preliminary: it is designed to set the grounds for more concrete and "hard law" SDR measures in the future. It follows the so-called Incremental Approach that "complement, rather than replace, existing mechanisms, including contractual approaches and the activities of the International Financial Institutions or the Paris Club, and guide their operation" ([10], p. 38). Despite not codifying concrete SDR measures, a treaty-based multilateral normative framework would hopefully exert a "compliance pull" on the current SDR regime towards a shared understanding of these norms. A multilateral normative framework in SDR would reinforce the "use [of] the interpretive space between the factual and the normative, between apology and utopia, in order to highlight and strengthen trends in current practice that support debt sustainability" ([10], pp. 38–39).

The broad codification of the norms in UN General Assembly Resolution 69/319 would be a significant advancement in itself towards establishing a multilateral normative framework in SDR. Even from the perspective of market-based proponents, the efficiency and equity problems in the present regime of SDR is serious enough to warrant reform. It is the kind of reforms needed that is the subject of intense debate which straddles between, on one hand, the value of uniform and predetermined rules and, on the other, that of flexibility. This paper's proposal seeks to bridge those values by supporting a predetermined normative framework in SDR while retaining the flexibility needed to undertake the restructuring process.

As a political matter, there is no doubt that the support of influential developed countries like the US and the UK would considerably help the success of the proposed treaty. However, even if there are limited States which become parties to the treaty, it cannot be discounted that some actors might prefer to deal with States with a reasonably predictable SDR framework as forwarded by the proposal.

A treaty-based normative framework in SDR would also mean that domestic courts of State parties would be obligated to apply the norms embodied in the treaty. Howse observes that even with international arbitration, "domestic courts are the ultimate mechanism [in SDR], as is illustrated by international investment law." ([21], p. 244). This is because it is often the case that most of the Debtor State's assets are located within its jurisdiction. Moreover, it is not unlikely for treaty-based SDR norms to influence international arbitration (based on debt contracts) given that State parties to the arbitration now have a treaty obligation to follow the SDR norms. Thus, while treaty-based SDR norms are deliberately broad, there will be some measure of enforcement of those norms especially at the domestic level.

In sum, this treaty-based normative framework in SDR may set the course for a series of actions which may lead to more concrete and enforceable measures in SDR. This is the import of the Incremental Approach that "highlight[s] and strengthen[s] trends in current [and future] practice" ([10], p. 38) and which is designed to continuously build upon the broad normative framework set out at the start.

## 4. The principle of sustainability

The principles or norms provided in UN General Assembly Resolution 69/319 may be seen as addressing two aspects of SDR: first is the conduct of the relevant actors in the restructuring process; and second is the objective of the restructuring process itself. The principles of sovereignty, good faith, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy and majority structuring primarily relate to the behavior of States, creditors, tribunals and other relevant actors. These principles are meant to address the collective action problem in SDR—that is, the failure to coordinate among the Debtor State and its creditors even if all would be better off if they coordinate.

For instance, the end of Argentina's 15-year stand-off with the majority of its holdout creditors in April 2016 has been attributed to "good faith negotiations" ([22], p. 1). In lifting the injunction against Argentina's payment of its restructured bonds, the New York court judgment "indicated…that the election of Argentina's new government with its willingness to negotiate in good faith…was pivotal in [the] decision…" ([22], p. 2; [23]). In this case, "good faith" was used to characterize the conduct of negotiations between Argentina and its holdout creditors in reaching a settlement that allowed the recovery of 75% of the creditors' original claim. This would be an example of an application of the principle of good faith to address a collective action problem in SDR. Moreover, the principles of sovereignty, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy and majority structuring would have, in varying degrees, played a part in reaching the Argentine settlement as it is often necessary that these principles operate in concert to address a collective action problem.

On the other hand, the principle of sustainability would relate more to the objective of SDR. Guzman and Stiglitz, for instance, stated that "[t]he ultimate goal of sovereign debt restructuring is to restore the sustainability of public debt *with high probability*" ([18], p. 3). The articulation of the principle of sustainability in UN General Assembly Resolution 69/319, however, is noteworthy for its progressiveness:

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

The foregoing is not only concerned with the debt sustainability within the Debtor State, but also "inclusive economic growth and sustainable development… [which] respect[] human rights." This particular articulation is holistic in the sense that it considers the long-term social and economic welfare of the Debtor State which may very include the well-being of its citizens. Significantly, the mention of "human rights" may make SDR resonate with other international norms such as those embodied in the Universal Declaration of Human Rights [24] and the International Covenant on Civil and Political Rights [25].

The IMF has defined debt sustainability "as a situation in which a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure" ([26], p. 4). Compared to the UN General Assembly Resolution 69/319, the IMF's definition of "debt sustainability" has been described as being "in purely financial terms" ([10], p. 25).

The IMF's definition consists of two components: (1) that the Debtor State "cannot indefinitely accumulate debt faster than [its] capacity to service these debts" ([14], p. 71); and (2) that the service of debts should not require "an unrealistically large future correction to the balance of income and expenditure." The first relates to a financial aspect of sustainability whose objective is to prevent an unbounded accumulation of debts. On the other hand, the second component "implies that there are social and political limits to adjustment[s]" ([14], p. 71) needed to achieve debt sustainability. Thus, "[n]ot all fiscal adjustment paths are realistic, because political and other constraints will influence a country's willingness to pay (as opposed to ability to pay)" ([14], p. 71).

The recognition by the IMF of social and political limits to adjustment policies in SDR may be seen as going beyond a purely financial framework of sustainability. Although this recognition may be limited insofar as it affects a State's willingness to pay its debts, the IMF's definition is significant to the extent that it implies an assessment of the social and political situation of the debtor State in the context of a sovereign debt crisis. Thus, it may not be entirely accurate to say that the IMF's definition of "debt sustainability" is incompatible with the principle of sustainability in UN General Assembly Resolution 69/319. The IMF's willingness to recognize the social and political aspects of SDR has some kinship with UN General Assembly Resolution 69/319 in its emphasis on "inclusive economic growth and sustainable development." In fact, recent debt sustainability analysis of the IMF factors economic growth within the Debtor State as a contributing variable in assessing sustainability ([14], p. 75).

In short, there may be possible points of contact between the IMF's definition of "debt sustainability" and the principle of sustainability in UN General Assembly Resolution 69/319. These points of contact in the understanding of sustainability may play a role in gathering support for a proposal to include "inclusive economic growth and sustainable development" as part of a codified principle of sustainability. Indeed, there is significance in going beyond a purely financial assessment of whether a State's payment of its existing debts may lead to an unbounded accumulation of future debts.

Fostering "inclusive economic growth" within the Debtor State should be seen as rational and viable strategy in SDR because it addresses the following characteristics that is not found in domestic bankruptcy regimes:

1. Unlike corporations that are the subject of bankruptcy proceedings, there is no option of liquidation or dissolution of a Debtor State because the likelihood of such an event happening as result of a debt crisis is minimal. As such, the debt crisis is necessarily temporary. In most instances, the question to be addressed is not the survival of the State but the duration of the crisis given the measures that may be implemented to resolve it.

2. The assets of the Debtor State that may be used to service its debts are dynamic given a functioning economy that utilizes fiscal policies like raising revenue through taxation.

3. A distressed Debtor State is also accountable to its citizens who are beneficiaries of its social welfare programs such as "pensioners, those depending on the

> government for health benefits or education, etc." ([27], p. 9). Guzman and Stiglitz have called these beneficiaries as the State's informal creditors whose "benefits are part of the social contract" ([27], p. 9).

The lack of an option for "State dissolution" should shift an SDR framework towards economic growth rather than the common pool of assets (see [28]) problem in bankruptcy cases. This is a paradigm shift from a static understanding of a limited pool of assets in domestic bankruptcy proceedings to a dynamic one which accounts for the possibility of growth (or conversely, diminution) based on the macroeconomic conditions of the Debtor State. Thus, "inclusive economic growth" within the Debtor State shortens the duration of a sovereign debt crisis and expands the available pool of State assets that may be used to service its debts. The expansion of the State's asset base also prevents the unbounded accumulation of future debts.

Such endogenous growth implies a multiplier effect in the economy that increases a Debtor State's tax revenues, consumption, investments and expenditures. In the context of SDR, "inclusive economic growth" ultimately means the increased likelihood of the Debtor State to pay its debts. In this way, it benefits everyone: the Debtor State, the creditors and other stakeholders especially those who derive benefit from the Debtor State's social contract.

The project of fostering "inclusive economic growth" within the Debtor State would be seen in contradistinction to the imposition of austerity measures purportedly to set aside money to pay the State's creditors. Guzman and Stiglitz observes that "austerity policies are normally counterproductive *even from a creditors' perspective*" ([27], p. 8). Austerity measures may, in fact, decrease the State's ability to pay its debts by preventing it from spending money domestically to fix its economy.

There is also a question of social justice involved in prioritizing foreign creditors over the Debtor State's social welfare beneficiaries. Limited State assets are being used to pay wealthy investors (which include the so-called "vulture funds") over the State's citizens who may be invoking rights more closely related to value of human life—*e.g.* rights to public health and a sustainable environment. This arrangement in effect violates a hierarchy of values in international law which upholds the primacy of human life over property. Thus, the U.N. Commission on Human Rights issued a Resolution which "affirms that the exercise of the basic rights of the people of debtor countries to food, housing, clothing, employment, education, health services and a healthy environment cannot be subordinated to the implementation of structural adjustment policies and economic reforms arising from the debt" [29].

The treaty codification of "inclusive economic growth and sustainable development" as part of the principle of sustainability helps SDR move beyond a purely financial framework of sustainability. While it may be desirable to adopt more targeted measures to improve the human rights situation in SDR, an emphasis on the Debtor State's endogenous economic growth also addresses this aspect by improving the collective welfare of the relevant actors involved. In particular, an improved economic situation helps the Debtor State fulfill its social contract with its citizens through an increased ability to pay.

## 5. Conclusion

As shown above, there are not only efficiency and equity problems in the present regime of SDR but also fundamental questions of social justice. These problems are serious enough to be simply ignored. The literature in SDR reveals that there is hardly any dispute that reforms are needed to address these problems. There is dispute, however, in the *kind of reforms* needed in SDR which ranges from the

adoption of clauses in debt contracts (to maximize flexibility) to enacting a fixed framework similar to a domestic bankruptcy regime (to maximize uniformity and predictability). If anything, a pragmatic approach to reform in SDR would have to be between these two ends.

This paper's proposal to establish a treaty-based normative framework in SDR seeks to bridge the flexibility in *ex post* negotiations and the uniformity in *ex ante* rules. This proposal is not as ambitious as it sounds. By broadly codifying the norms in UN General Assembly Resolution 69/319, the proposal follows the Incremental Approach for reforms in SDR in the way it is *backward-looking*, because it builds on existing "soft law" approaches and other mechanisms and practices in SDR (for instance, it recognizes the role of *ad hoc* negotiations); and *forward-looking*, because it hopes to set the ground for more concrete and effective SDR measures in the future. As a whole, the approach of the proposal is to complement and improve the current conflicts of law regime of SDR.

Despite the proposal's declared strategy to accommodate the various positions of States, one thing that stands out is its call to codify the principle of sustainability that emphasizes "inclusive economic growth and sustainable development." This comes from the recognition that the articulation and implementation of this principle is a more effective way of undertaking SDR than a purely financial framework of preventing the State's unbounded accumulation of debts. It is premised on the idea that while there are no systematized rules, SDR is nevertheless situated in an international order that upholds a complexus of norms which includes human rights. Thus, this proposal is a call for a movement from SDR's current focus on the protection of debt markets to the broader economic, social and political context of the international order.

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