Conference paper for comments

From fragmentation towards universalism: Filling the institutional vacuum of dealing with sovereign debt[1]

Katarina Sehm Patomäki[2]

The euro, a result of the political project to consolidate peace in Europe, has now created new divisions between the peoples it was meant to unite. Countries with surpluses in their trade balances rule over the economic policies of those with deficits: and the decision-making process of the European Stability Mechanism even excludes those with overdue repayments. These unforeseen tensions bring along new and unpredictable risks, which will have to be addressed urgently.

Social unrest in the euro zone is a result of the limitations of democratic ways of dealing with problem debt. The hands of national governments are tied and foreign creditors decide on national economic policies. This paper argues that the setting can be derived to the international institutional framework, and to mend this deficiency, it proposes introducing an independent panel to arbitrate sovereign debt. Countries experiencing societal restlessness due to high levels of unemployment and sharp cuts in their basic societal infrastructure find themselves in a legal vacuum; there is no independent institution or mechanism to turn to; the separate roles of the judge, the juror and the executioner familiar from national market economy jurisdictions do not apply internationally.

In Europe, the fragmented and *ad hoc* ways of dealing with problem debt has continued the pattern familiar from earlier debt crises, in Latin America in the 1980s and in Africa in the 1990s. The lack of universal rules and a commonly shared framework has led to an imbalance in the relationship of economic obligations versus the protection of national human rights or, put differently, the creditors' rights versus the rights of the debtor. Meanwhile, as the unemployment rates approach 30 per cent, southern Europeans continue the marches started by the Latin Americans and the Africans.

There are two contending approaches to restructuring sovereign debt. The first is that debt relations are restructured in line with economic reason and sustainability, and the second is that restructuring should be assessed against considerations of justice and procedural fairness. While the framework of introducing an independent panel to arbitrate sovereign debt presented in this paper addresses this cross pressure, it will not prevent situations of problem debt to arise. But if and when this does take place, the framework will protect the basic human rights of the indebted peoples. This position is supported by the fact that most sovereign debt crises have resolved only after debt has been written off. On the road of diminishing human suffering, while promoting economic efficiency and introducing rule of law internationally, this paper argues that a debt arbitration mechanism provides a necessary and important first step. This argument is divided into five sections. The first section shows how current approaches to dealing with problem debt were devised in the 1980s, when the Latin American debt crisis broke out. But to understand sovereign default, it is important to place international lending and problem debt in a historical context, a setting that stretches further back in time than 1982, or when Mexico defaulted. This is what the second section is about. The third section looks at the gap in global governance regarding how to deal with sovereign debt. The

1 Paper presented at "Labor market design & policies, socio-ecological taxation and economic policy-making in the EU. New concepts in the current European crisis"/Economic Policy Making, Göttingen, 8-9 November, 2013.

2 Dr Katarina Sehm Patomäki, Associate Member, Centre for Applied Social Reserach, CASR, RMIT University, Melbourne. Currently placed in Helsinki, Finland. E mail: Katarina.sehmpatomaki@gmail.com

fourth section translates the principles behind ‘Chapter 9’ into the global framework. The fifth section adds final remarks.

The incremental institutionalization of dealings with sovereign debt

The political responses to the current euro crisis repeats in broad pattern much of what happened in the crises of problem debt in poor countries, a series of defaults that broke out nearly three decades ago, when Mexico first defaulted in 1982. Importantly, the pattern constitutes of treating crisis of insolvency as temporary crises of cash flow. The policy responses are to grant new loans, or rescue packages, for the indebted country to overcome its temporary problem of shortage of cash.

Such rescue packages, or debt relief measures can be characterized as a series of waves where governments and donors reluctantly, yet repeatedly, widen their understanding of what their policies stand for and aim at. In tandem, and with each new insight, the relief agendas are re-drafted. In developing countries, the most common form of debt relief, or at least its most prominent form, is managed by the international financial institutions through various partly intertwined programmes chronologically running from Strucural Adjustment Programmes, originating in the conditionalities that the Bretton Woods institutions attached to their loans in the 1950s, to the Multilateral Debt Relief Initiative, set up in 2005 to top up debt relief for countries graduating from the HIPC programme. In the developing world, debt relief is closely tied to development aid. This means that when the euro crisis broke out, debt relief was placed under the heading of development aid thus signifying a form of charity for those in debt.

But debt restructurings almost never provide enough relief for a ‘fresh start’ of the debtor economy (Herman *et al.* 2010*c*: 489). Actually, in poor countries, the crisis carries over into today and to a situation of chronic indebtedness and economic fragility where various economic shocks regularly lay bare economies. At least ten other insights regarding debt relief can be divided along national and international aspects (Sehm Patomäki 2011a: 52-61). Starting with the insights from the national level, one, *additionality* in the form of foreign aid or through veins of private capital creates a situation where creditors lend increasingly but do not forgive debts; additionality is as attractive in the short run as it is unattractive in the long run. Two, there may be a conflict between creditor dominance and the borrower’s political preferences in debt relief negotiations. This does not resonate with the rule of law where, in this context, the rights of the debtor would have to be addressed. Debt relief can thus serve as a political tool to reformulate conditionalities (Acosta and Ugarteche 2007:7). This also applies to the rolling over of loans, including loans claimed to be odious (Hanlon 2006a: 221). Three, such conditions are attached to debt relief, or to the servicing of debts, and are not necessarily connected to economic necessities of the peoples (Raffer 2007b:246; Stiglitz 2002a; Cheru 2006:35). Four, debt relief does not address particular circumstances of why and how nations have become indebted in the first place. Standard solutions as in the implementation of austerity policies or cuts in public sectors are not adequate for each indebted nation. Five, the issue of debt sustainability is mentioned in most debt relief assessments, yet this is an imprecise and contested concept in itself (Sehm Patomäki 2013). It may be possible that such a threshold is not only difficult to assess appropriately, but such a measurement may even be harmful in itself because of the negative and immediate effects a negative assessment may cause in the financial markets -- possibly even uncalled for.

Internationally, perhaps the most significant insight is that debt relief has not led to sufficiently decreased debt burdens (Mandel 2006: 7,8 and UNCTAD 2009a). This sixth point means that lenders, or international financial institutions, continue the irrational economic practice of throwing good money after bad. Throughout decades, the explanation for this is that the international financial institutions continue to do so to keep borrowers on a short leash to aim at restoring their capacity to make repayments (Suter and Stamm 1991: 661). While this is doubtful from a political perspective, it is also questionable from the point of view of economic rationality. Seven, the rationality of debt relief that would cover issues related to donor-recipient nations, the economic effects of institution building, public spending, investments, or growth is not yet well-researched (Addison et al 2004a: 3-4; Depetris Chauvin and Kray 2005; Presbytero 2009). More specifically, debt relief does not improve the distribution of wealth in a poor country, or, in the language of economics, it is never Pareto improving, and therefore, it cannot affect the long-run level of investment (Aguiar *et al.* 2009). Eight, debt relief programmes and rescue packages are always *ad hoc* measures, each implemented under a sense of urgency, which means that there is little time for rigorous specific national evaluation or careful overall analysis. A ninth set of considerations deriving from insights related to debt rescue packages relate to the assumption that large sums should be injected into the indebted nation for creditors to be compensated for their losses, or to avoid such losses. It is far from certain that new loans, thus adding to the overall credit burden, would facilitate repayments in the future. Finally, debt relief processes or rescue packages do not allow for the questioning of the accuracy or accountability of the policies practiced by the creditors in the first place.

Eventually, assessments of situations of sovereign overindebtedness resulting in default, or risking to do so, must include the possibility of writing down the levels of debt. Today, there is no structured, independent or orderly way to deal with sovereign default. Often, economists' analysis of sovereign indebtedness is placed in the present situation, with emphases on inter-temporal borrowing and lending models (Easterly 2002), theories of the financial markets (Stiglitz and Weiss 1981), the effects of debt on growth (see part II of Addison *et al.* 2004*b*), or poverty effects of debt relief (see part III of Addison *et al.* 2004*b*). With increasing frequency, these contributions either start from or conclude with the concept of 'debt sustainability', a somewhat troublesome concept, as mentioned. Rather, as a rule, and as seen in Europe today, repayment of debt is prioritized over human rights and human dignity (see Council of Europe 2013 for how this takes place in Europe).[3] For instance, what level of debt is sustainable for countries where the vast majority of the population lives under a dollar a day (in low-income countries) or when the unemployment rate approaches 30 per cent (as in Spain in connection to the euro crisis)?

The institutionalized policies of debt rescue packages in dealing with sovereign debt is most recently cemented with the European Stability Mechanism, aimed at granting further credits to countries otherwise threatened by default. ESM-members are unable to exercise their voting rights in case they fail to meet their financial obligations, including reimbursements (ESM 2012: Article 5: §8).

The history behind the build-up of problem debt

But by situating the onset of problem debt as a result of the crisis in the early 1980s, the fact that the international economic order was set in place much earlier, becomes blurred. The date is unhelpful in tracing the genealogy of how international debts are administered, a process where the policies have gone from creditors declaring war on the indebted nation (up until the early 1900s) to creditors pushing problem debt under its current heading of development aid

3 In addition to the Declaration of Human Rights articulating basic rights, subsequent documents of relevance are the International Covenant on Economic, Social and Cultural Rights (ICESCR) of 1966 stipulating that states have the right and the duty to articulate national development policies to implement the fundamental rights and the texts of the UN indicating that every country has the sovereign right to freely dispose of its natural resources for its development. Of course, the full International Bill of Human Rights, adding the two covenants to the Declaration only entered into force in 1976.

(in the 1980s). Specifically, the date distracts attention from the system put in place in the 1940s, an order that included the creation of the international financial institutions, or the structures of the world economy.

Less often is the build-up of problem debt put in a historical perspective relating it to the creation of and the principles behind the Bretton Woods institutions. The significant impact these principles have had in creating problem debt justifies a reflection on the history behind problem debt. The international financial institutions were designed in the planning and creation process of the Bretton Woods system in 1944, with the objective of securing international financial stability and facilitating world economic growth. In a broad sense, the Bretton Woods institutions, comprising the International Monetary Fund and the World Bank group, are based on the thinking of Keynes, the UK negotiator in defining the Bretton Woods agreements. But Keynes was not the sole institutional architect at the table and the negotiated outcome resulting in the economic order as we know it today is a compromise between the UK and US negotiation parties, personified in Keynes on the UK side and Harry Dexter White representing the US.[4]

Essentially, on almost every point where Keynes was overruled by the Americans, he was later proved correct (see for instance DeLong 2000). Among other issues, Keynes predicted that eventually, the adopted system would lead to a slippery slope of deficit for certain groups of countries, a prediction against which situations of sovereign debt crises of today should be mirrored.

To understand sovereign default, it is thus important to place international lending and problem debt in a historical context, a setting that stretches farther back in time than the Mexican default of 1982. In doing so, a pattern of reoccurring sovereign defaults emerges. Lending booms are followed by waves of defaults by nations. Often, these defaults were regional and they occurred throughout most decades in the 1800s, and during many decades of the 1900s. The debt crisis of the 1930s differed in being wider in geographical terms. Yet, during this time, Argentina, Australia, Canada and most of the Central American republics continued to service their national government debts (Eichengreen 1991: 155; see also Reinhart and Rogoff 2009). In observing this pattern, it is important to make connections with what has been alluded to above, namely that defaults are the surfacing signals of deeper structural causes. It is also of interest to note that in the 19th century, the leading borrowers were the US, Canada, Australia and Russia.[5] Simultaneously, though, beneath this relatively stable surface, a sea change was taking place. The US was transforming from debtor to creditor, and New York was taking up the competition with London as a leading financial centre. (Eichengreen 1991: 150-1)

This is also soon after the time where the temporal roots of the proposal for an international debt arbitration panel are set. The proposal builds on the experiences of the Great Depression in the USA, when a municipality, if it was unable to pay its creditors, was faced with pursuing an action of *mandamus*, or compelling the municipality to raise taxes. During the hard economic times, this approach proved hopeless so in 1934 the US Bankruptcy Act was amended to extend to municipalities, under ‘Chapter 9’ of Title 11 of the US Bankruptcy Code. This justifies the focus of this paper: the drawn-out and serious situation of problem debt of deficit countries, and the particular ways in which sovereign debt is being dealt with.

4 For accounts of the positions, negotiations and compromises in establishing the Bretton Woods Institutions, see for instance Boughton (2002); or George and Sabelli (1994: chapter 1) for an expanded, yet more critical, explanation.

5 None of these defaulted on their principal in the second half of the 19th century. During this time, European lending to these countries fluctuated in tune with lending to defaulting regions, Latin America and the Near East. Yet, somewhat unexpectedly, as signals from defaulting regions reached Europe, these affected Europe’s willingness to lend to *other* parts of the world.

This prolonged and unresolved situation, or aggregation of a series of crises in several countries, has transformed into a state of chronic indebtedness for many nations.

To advance, two main theoretical schools of orientation that concern sovereign debt must be separated out. One school represents the assumption that reasons for increased borrowing can derive from speculative or corrupt activities, or in national causes, such as growth performance and derive from particular choices of monetary and fiscal policies (see Cline 1995; Draghi *et al.* 2003).[6] Building on this assumption, Draghi *et al.* (2003) explain how risk exposures to sovereign debt especially in emerging markets can be measured, hedged and transferred through the use of derivatives, swap contracts, and other contractual agreements. High levels of indebtedness in a country are seen as a consequence of poor economic policy where a nation has lived beyond its means and therefore, the government must decrease its expenditure and raise its income (see Euronews 2011; Blanchard and Leigh 2013; Torry 2013). The central point uniting this school is that the causes of borrowing are national and that therefore, the duty to repay the loans are with the indebted nation. Accordingly, it is up to the creditors to decide whether they grant financial rescue packages to the indebted country or not, and under what conditions.

Others agree in seeing mounting debt as a consequence of economic policy, but their view is global, not national (see Krugman and Layard 2010; Raffer 2010; Stiglitz 2010b; see also Palley 2003; UNCTAD 2009b for complementary arguments). This school relates to global disequilibria causing virtually automatically sovereign debts in some countries (Keynes 1938; 1943; Raffer and Singer 2001; Raffer 2010). Global disequilibrium affect national accountancy by way of imbalances in trade and in doing so, it causes balance-of-trade deficits. The borrowing can relate to unexpected changes in the interest rates on international loans, or differences in capital market access. Importantly, this orientation departs from the one above in that according to this school, due to its particular composition of trade, nations are unable to autonomously control its national balances and thereby, its need for additional borrowing. This Keynesian view sees one nation’s current account deficit as another’s surplus and therefore, regards overindebtedness to be a common global concern. Importantly, the austerity measures proposed by those supporting unfettered capitalism stand in contrast to the prescriptions of the Keynesians, who argue for shifting the focus away from debt levels and toward promoting full employment by means of increasing domestic spending and investments.

We can debate the exact pressures of triggering factors and national circumstances in each case, but looking deeper into the systemic causes, we cannot escape the dynamics of global current-account deficits that centrally inform this proposal.

The issue of systemic deficits in the global economy opens up to the need to include philosophy and politics into the analysis of sovereign problem debt. Problem debt stands out as a particular definable global injustice and the focus is on how this injustice can be removed. This particular focus is different from addressing global justice at large. Rather, by way of its links to world poverty, problem debt is seen as a global concern that takes place beyond the sovereign nation state. In this vein, Amartya Sen’s (2010) approach to global justice goes beyond John Rawl’s (1971; 1993) classical conception of an original position, which aims at ‘perfect justice’.

Working towards global justice in this way, and partly relying on Adam Smith’s work, Sen (2010) speaks of the need for an impartial assessment by an overarching authority.

6 As David Felix (1987) does in his analysis of Latin American growth as associated with particular choices of monetary and fiscal policies. The contribution by Draghi *et al* (2003) is of central importance, not only in an academic sense, but also because in November 2011, in the midst of the Euro crisis, Mario Draghi was appointed president of the European Central Bank, a central position for devising the policies of dealing with the crisis.

Consequently, the theoretical frame covers also the principles for addressing appropriate institutional arrangements, perhaps most importantly the rule of law.

This approach intersects with some elements of theories of the accumulation of debt, and financial risk and uncertainty in particular. As problem debt spreads to the Western world, these theories have attracted new attention. Here, the accumulation of debt is seen as a key mechanism pushing an economy towards a crisis (Minsky 1982: 66-8; see also Hennigan 2008 for paralleling Minsky's teachings to the financial crisis of 2008). Elsewhere, financial crises in their full global scale have been addressed both historically (Reinhart and Rogoff 2009) and prescriptively (Roubini and Setser 2004; Roubini and Mihm 2010). Here, the focus remains on the global and the theoretical and leaves aside short-term financial speculation and cataloguing of financial crises fall (as carefully done by Reinhart and Rogoff 2009). The larger context of economies in depression provides inspiration in particular regarding the analysis of the consequences and subsequent policies for dealing with debt (Kindleberger and Aliber 2005; 1986). Lastly, a listing of financial theories would not be complete without the mentioning of Kutznets's swings, named after Simon Kuznets who detected a pattern of economic cycles repeating every 15-20 years (Eichengreen 1991: 150). In these cyclical processes, defaults are integral. It is the question of how we should deal with these defaults that constitutes the interest of this proposal.

Centrally, excessive debt accumulation unites a vast range of crises. Financial crises vary both in their causes and in their consequences and can, for instance, be divided into currency crises, stock market crashes – or sovereign defaults. It is important to point out that not all financial crises result necessarily in sovereign default. Nevertheless, this proposal builds on an interest in financial crises because of the common features they share. In an immediate sense, all crises are marked by a surge in demand for foreign currency (Roubini and Setser 2004: 16). The precise source of this surge varies, and so does the interpretation of the source, but importantly, this ties back to the previous features, and consequently, so does a country's ability to emerge from the crisis. This is, in turn, a function of not only the size and composition of debt, but also a result of the composition of the economy. This function leads us back to the dynamics of global current account balances, as introduced above.

Between these theories and approaches, one of the questions that arises forcefully is how, then, to deal with problem sovereign debt in practice.

The global vacuum of dealing with sovereign debt

It is noteworthy that in national financial systems, debt-restructuring procedures for individuals and corporations have some historical reach. But on the global level, the financial system lacks a commonly negotiated and shared framework for dealing with defaults of nations. Rather, governments usually borrow without posing collateral, and there is no legal mechanism to reinforce payments. The incentive is merely an assumption that governments will fully service their debts to ensure continued access to credit, an assumption that certainly is doubtful (Stiglitz 2010*a*: 51). A counter position to this can be found in historical sources. Looking back through time, attitudes towards debts and the forgiving of debt can be traced to religious sources providing backing for the non-payment of debt in cases where the livelihood or survival of the debtor is put in jeopardy. For instance, the Judeo-Christian concept is rooted in the recognition that there is a limit beyond which the debtor, the community or environment will withstand the pressure of collection (see Herman 2007; Veerkamp 2007). The preservation of the actors requires not only a stop to the collection but also that all which has been lost in debt bondage be reinstated. More contemporary legal principles — for instance the doctrines of *Forza Major* and that of *Rebus Sic Stantibus* — establish grounds for debtor protection in the event of overbearing or radically changed circumstances. These principles lend moral strength to applying the framework on negative duties to the policies of the present international financial framework.

In relation to global justice, are principles of justice and rule of law, including the rights of the indebted, applicable also internationally? A catalyst to this discussion is an understanding of the important role played by transnational webs of global forums, which means that in a way, we already have a global international framework. If this understanding is correct, then it means at least two things. First, the global framework must open up for democratic decision-making by those affected by its decisions – or the deficit, indebted nations. Two, such a global framework already eats off sovereignty of the nation state as we traditionally understand it. This means that an international arbitration panel would not put national sovereignty in jeopardy, but rather, a panel would strengthen it. Further, the proposal of putting sovereign debt up for arbitration is guided by the framework of negative duties by the rich countries toward the poor (Thomas Pogge's 2008*a*; 2008*b*). According to the view of negative duties, the rich have a *duty* to lift the current burdens of injustices pressing on the shoulders of the poor. Here, dealing with debt is seen as one of these burdens. Not only would arbitration ease the material burdens on the shoulders of poor nations, but to an extent, it would also open up to discussions about past injustices in the name of global finances. To what extent have the earlier mechanisms been just – and what about the present ones?
Narrowing the focus to insolvency procedures for nations alone, in *The Wealth of Nations*, Adam Smith was the first to propose bankruptcy for nations as the least dishonorable for the debtor and the least hurtful for the creditor. It would take a good 200 years, and the emergence of the debt crisis in the 1980s, before others developed an interest in insolvency procedures on national levels and discussions began to consider their application on an international level. Among the contemporary proposals, analogies to the US Bankruptcy Code are particularly popular. Interestingly, there have not been similar attempts sprouting from other countries' legislation. One explanation could be that most countries' insolvency laws are based on principles close to 'Chapter 11' of the US Code (see Schwarcz 2000: 119). The proposals reflecting international versions of the US Code can perhaps best be divided into two groups. On the one hand, there is a line of discussion referring to 'Chapter 11' of Title 11 of the Code on *business* restructuring (in addition to the already mentioned Oechli 1981; and Rogoff and Zettelmeyer 2002; see for instance Cohen 1989; and Dickerson 2007). Most of these contributions propose some kind of entity to deal with debts on a case-to-case basis. For instance, Cohen (1989) calls for a 'Chapter 11'-based International Debt Restructuring Agency (IDRA). But on the other hand, there is a discussion rooted in 'Chapter 9' of the same Code, where Raffer (1990) proposes a debt-arbitration panel to rule what debts should be repaid. 'Chapter 9' refers to insolvency procedures for *municipalities*, which, in comparison to 'Chapter 11', includes features more familiar to that of a state. One of the major differences between 'Chapter 9' and 'Chapter 11' is that the former respects the governmental powers of the indebted. Further, a 'Chapter 9' approach would cover all debts, private and public. However, from a practical-political standpoint, in order for a 'Chapter 9' type approach to be adopted, important connected reforms would have to be considered simultaneously, one example being that poor countries may not be likely to put their debts to the multilateral institutions up for arbitration unless they have access to funding from elsewhere.

Translating the principles behind 'Chapter 9' into a global framework

International arbitration implemented based on a certain set of principles would constitute one way of introducing global justice into the present *de facto* global order. Overall, and against the general aim of global justice, on its own, debt arbitration remains insufficient. However, it does serve as a positive step towards a process of global justice.

As for the practical-political dimension of this proposal, it goes beyond questioning the *status quo*. The political feasibility of arbitrating international debt shifted from the abstract to the concrete in 2001 when the IMF presented a Sovereign Debt Restructuring Mechanism, SDRM, later resurfaced in 2010 for the euro zone (Gianviti, Kreuger, Pisani-Ferry, Sapir and Hagen 2010) echoing elements of elsewhere presented proposals for insolvency mechanisms for indebted poor countries. The SDRM reflected academic discussions drawing analogies between principles for national insolvency and the US Bankruptcy Code.[7] In addition to the proposal of the SDRM, the euro zone crisis sparked *The Economist* (2011) and *The New York Times* (Williams Walsh 2011) to call for a permanent debt restructuring facility. This proposal makes the question of the political possibility of setting up an insolvency mechanism secondary. Rather, of essence are the features, principles and processes of which such a mechanism would be comprised. These considerations necessarily link to the justifications and arguments behind establishing the arbitration procedures. Consequently, the discussion is not about *whether* to introduce insolvency mechanisms, but *what kind of mechanism* to introduce. Or to be precise, according to *which principles* the mechanism should be introduced for it to be viable.

Arbitration of international loans is, of course, a balance between power and rights. This is an attempt at lining the factors of the equation in a way that will make the assessment of the operation feasible. Based on observations of systemic deficit for some countries, the threat debt poses to the protection of social and economic human rights and the challenge that debt relief policies pose on economic reason, it becomes valid to argue for the viability of debt arbitration in closing some of these gaps. By doing so, the framework proposed here closes the economic, political, legal, and normative gaps in the in different fields on problem debt. This framework would not determine outcomes, it would only establish what makes the procedure for determining debts payable or not. Instituting insolvency procedures for countries in a coordinated and formalized manner is not only viable but also necessary. Further, with certain qualifications, sovereign debt restructuring is not only necessary but also urgently desirable. This position stands on the interpretation of problem debt having its roots in chronic crises in the balances of payments, crises which are, in turn, a consequence of the principles behind the international economic system, as discussed above. It is essential to argue for principles that stand the test of universal scrutiny. This brings with it that while the euro crisis has brought topicality to the issue of problem debt, the focus must not be shifted away from poor countries and their outdrawn debt crises. This is because the historical distance to the acute crisis in combination with the empirical outcomes available today provides solid research material to draw from.

A form of coordinated negotiation of agreed principles to deal with sovereign debt restructurings would allow for equal treatment of all parties. It should not only be a process of arbitration based on rule of law, including debtor protection. It should also allow for the protection of governmental powers of the indebted. Further, the equal treatment of all parties stretches to include also all creditors. The procedure must address economic sustainability and justice − including procedural fairness and accountability of both lenders and borrowers. Introducing internationalizing the principles of ‘Chapter 9’ of Title 11 of the US Bankruptcy Code for determining the economic sustainability of problem debt would also allow for dealing with the alleged odiousness of certain debts, by way of a parallel, separate but connected procedure.[8] Arbitrating international debt proposes a formula intended to give effect to both those imperatives. However, because they are housed in different jurisdictions, it is of central importance to separate insolvency proceedings from measures of dealing with odious debts (Sehm Patomäki 2011b). It is neither economically nor legally convincing for an

7 For a discussion on the reasons of political timing and conflicting interests of various involved parties behind the SDRM falling through, see Setser (2010).

8 Compared to the deep entangled history of religious roots and debts, the particular notion of ‘odious debt’ is a fairly recent concept, dating back to the early 1900s (see Sack 1927).

insolvent country to excuse its economic woes by claiming its debts odious. Similarly, odious debts should not be argued for on grounds of economic sustainability. Odious debt should be dealt with regardless of a default. The viability lies in not confusing the arguments. Discussions without such a separation prove messy and confusing. Yet, an approach to solving problem debt without mechanisms for addressing both odious debt and economic insolvency remains incomplete. A debt arbitration panel would open up the possibility of addressing both insolvency and odiousness under one umbrella while respecting their different legislations. Yet, one of the features must be a temporal aspect, so that odious debt is dealt with first, and remaining problem debt are dealt with only following that. This is because odious debt is independent of a state's economic situation, and, therefore, suspicions of a debt being odious should first be eliminated.

In terms of economic unsustainability, the triggers of the process are a country's failure to meet its financial obligations upon finding itself in default. Although the practical difference between a state facing a liquidity crisis as opposed to an insolvency crisis is diffuse, and perhaps legally irrelevant, the argument is that economic analyses of the payment crises are important in order to assess the consequent options.

For a nation to declare insolvency, and if combining rule of law with principles for bankruptcy, among other considerations, there would need to be an independent entity adjudicating what and how much of the debts to repay. Also, odious debts would have to be dealt with by an impartial entity. In a sense, this leads to two sets of questions. Firstly, this opens up a question regarding the process itself and its potential institutionalization, or whether this matters. Further, would the most appropriate process be formal or informal, or put differently, would the process be institutionalized in principle, rather than in an organization? Importantly, arbitration of international debts is seen as a process of introducing certain principles, a process that may change shape over time. In focusing on the process, the detailed legal technicalities of arbitration fall outside the present scope. Secondly, different proposed models for arbitration provoke different consequences. Here, rule of law is seen as a prerequisite for fairness, and in its basic form, and in this particular context, rule of law stands for ensuring equality of the rights of the indebted to those of the creditors. Debt relief cannot be confined to charity alone. Fairness is also a minimal condition for democratization, including global democratization, a process that, in turn, may shift the dynamics of the global order perhaps even in a profound way.

In focusing on the international application of principles of bankruptcy procedure, and rather than concentrating on certain geographical regions, the scope must be global. It should go without saying that the focus of a universal standard does not mean nullifying specific historical or cultural national developments regarding the accumulation of debt. For the sake of the task at hand, the focus is on problem debt. This does not mean that the reasons behind the economic development in each country are identical, or even similar. However, the economies of these countries meet at a point where debt servicing constitutes an important part of the national budgets.

Final remarks

Introducing an independent panel to assess sovereign debt repayments would combine economic reason with what is the morally just. Until the early 2000s, global arbitration received limited attention, academically and in practice. In the last few years, however, an interest has surfaced both in the theory of global arbitration and in transforming the theory into practice. Mostly, this discussion takes place among legal scholars, and in isolation from economists. And often, the euro crisis is discussed in isolation from the earlier sovereign debt crisis of the poor countries. As attempt at furthering the outcomes reached in these different strands and fields together, a few final remarks are in order (Sehm Patomäki 2011a: 282-284).

An international arbitration panel would not prevent debts from building up, but it would, however, carry an implicit warning to creditors against unlawful or irresponsible behavior, or debts claimed to be odious.

Essentially, the decision for a nation to declare default is always political. The economics of the matter is that because the single creditor, or usually many together, is assumed to have a more restricted view into the overall financial situation of the indebted nation. Ultimately, declaring default is a political matter because in theory a nation has immense resources to draw from in the form of taxation and privatization. Yet, it is for the national government to judge when the threshold of austerity measures is passed, or when this becomes politically non-sustainable.

An arbitration panel would deal with debts on a case-to-case basis and in retrospect, and the panel rulings range from 1-100 per cent repayments of debts. This would mean than the policy of charity in the form of debt relief develops into a new phase where is replaced with fair dealings with both parties, creditors and debtors, as equal counterparts.

Transporting internationally the elements of 'Chapter 9' of declaring bankruptcy from a debtor with governmental powers, a municipality, according to the US Insolvency Code, would need only one addition, that of an international arbitration panel. Importantly, this panel must be a single entity and cannot exist in multiple formats. This is because multiple forums could cause conflicting rulings and jurisdiction shopping.

References

Acosta, Alberto and Oscar Ugarteche. 2007. 'Global economy issues and the international board of arbitration for sovereign debt. IBASD.', *El Norte – The Finnish Journal of Latin American Studies*, no. 2, December, pp. 1–19, available at http://www.elnorte.fi/archive/2007-1/2007_2_elnorte_ugarteche.pdf , accessed on 15 October 2013.

Addison, Tony, Henrik Hansen and Finn Tarp. 2004*a*. 'Introduction', Addison, Tony, Henrik Hansen and Finn Tarp (eds). *Debt Relief for Poor Countries, Studies in Development Economics and Policy Series*, Palgrave, in association with UNU-WIDER, Houndmills, Basinstoke, Hampshire and New York.

Addison, Tony, Henrik Hansen and Finn Tarp. 2004*b*. *Debt relief for poor countries, studies in development economics and policy series*, Palgrave, Houndmills, Basinstoke, Hampshire and New York in association with UNU-WIDER.

Aguiar, Mark, Manuel Amador and Gita Gopinath. 2009. 'Investment cycles and sovereign debt overhang', *Review of Economic Studies*, vol. 76, pp. 1–31.

Blanchard, Oliver and Daniel Leigh. 2013. 'Growth Forecast Errors and Financial Multipliers', *IMF Working Paper* 13/1, International Monetary Fund, IMF, Washington, D.C, January.

Boughton, James M. 2002. ‘Why White, not Keynes? Inventing the postwar international monetary system’, *IMF Working Paper WP/02/52*, Washington, D.C.

Cheru, Fantu. 2006. ‘Playing games with African lives the G7 debt relief strategy and the politics of indifference’, in *Jochnick Chris, and Fraser A. Preston. (eds.) Sovereign debt at the crossroad. Challenges and proposals for resolving the third world debt crisis, Oxford University Press, Oxford, pp. 35–54.*

Cline, William R. 1995. *International debt reexamined*, Peterson Institute for International Economics, Washington, D.C.

Cohen, Benjamin. 1989. ‘A global chapter 11’, *Foreign Policy*, no. 75, pp. 109–11.

Council of Europe. 2013. ‘Human rights protection is under strain in Europe’. *Press release* Comm DH011, 25 April. Council of Europe, Strasbourg.

DeLong, J. Bradford. 2000. *Review of Robert Skidelsky, John Maynard Keynes: fighting for Britain 1937-1946*, December, blog, no place, available at http://econ161.berkeley.edu/Econ_Articles/reviews/skidelsky3.html , accessed on 14 February 2013.

Depetris Chauvin, Nicholas, and Aart Kraay. 2005. ‘What has 100 billion dollars worth of debt relief done for low-income countries?’, *International Finance 0510001*, EconWPA.

Dickerson, A. Mechele. 2007. ‘Insolvency principles and the odious debt doctrine. The Missing Link in the debate’, *Law and Contemporary Problems*, vol. 7053, Summer, also available at http//law.duke.edu/journals/lcp, pp. 53–80.

Draghi, Mario, Giavazzi, Francesco and Merton, Robert C., (2003), “Transparencey, Risk Management and International Financial Fragility”, June 2, *Harvard Business School Finance Working Paper* No. 03-118.

The Economist. 2011. ‘Time for Plan B’, *the Economist*, on 13 January, available at http://www.economist.com/node/17902709 , accessed on 16 September 2013.

Easterly, William. 2002. *The Elusive Quest for Growth. Economists’ Adventures and Misadventures in the Tropics*. The MIT Press, Cambridge, Massachusetts.

Gianviti, François, Anne O. Krueger, Jean Pisani-Ferry, André Sapir and Jürgen von Hagen. 2010. ‘A European mechanism for sovereign debt crisis resolution: a proposal’, *Bruegel Blueprint Series*, vol. X, Brussels.

Eichengreen, Barry. 1991. ‘Historical research on international lending and debt’. *Journal of Economic Perspectives*, vol. 3, no. 2, Spring, pp. 141–69.

The Euronews. 2011. ‘Merkel ruft Jahre der schwäbischen Hausfrau aus’, Lyon, 28 October <http://de.euronews.com/2011/10/28/merkel-ruft-jahre-der-schwaebischen-hausfrau-aus/ >, visited on 30 April 2013.

European Stability Mechanism. ESM. 2012. *Treaty Establishing the European Stability Mechanism*, T/ESM 2012/en 1, available at http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf , accessed on 15 October 2013, Felix, David. 1987. ‘Alternative outcomes of the Latin American debt crisis: lessons from the past’, *Latin American Review*, vol. 11, pp. 3–46.

George, Susan and Fabio Sabelli. 1994. *Faith and credit. The World Bank’s secular empire,* Penguin, London.

Hanlon, Joseph. 2006. ‘”Illegitimate” Loans lenders, not borrowers, are responsible’, *Third World Quarterly*, vol. 27, no. 2, pp. 211–26.

Herman, Barry. 2007. ‘Sovereign debt − theology & philosophy’, *North Carolina Journal of International Law and Commercial Regulation*, vol. 32, no. 4, Summer, pp. 773–818.

Herman Barry, José Antonio Ocampo, and Shari Spiegel (eds). 2010. ‘Conclusion. Towards a comprehensive sovereign bankruptcy regime’, in Herman Barry, José Antonio Ocampo, and Shari Spiegel (eds). 2010*a*. *Overcoming Developing Country Debt Crises*. The Initiative for Policy Dialogue Series, Oxford University Press, Oxford, pp. 489–96.

Keynes, John Maynard. 1938. ‘The policy of government storage of food-stuffs and raw materials’, *The Economic Journal*, vol. 48, no. 191, September, pp. 449–60.

Keynes, John Maynard. 1943. *International Clearing Union*, House of Lords Hansard, *HL Deb 18 May, vol. 127, cc 520-64*, London, available at http//hansard.millbanksystems.com/lords/1943/may/18/international-clearing-union.

Kindleberger, Charles and Robert Aliber. 2005. *Manias, Panics and Crashes: A History of Financial Crashes.* Wiley 5th edition.

Krugman, Paul and Richard Layard. 2012. *A Manifesto for Economic Sense*, http://www.manifestoforeconomicsense.org/index.php?InTheNews=1 >, visited on 20 October 2013.

Mandel, Stephen. 2006. *Debt relief as if people mattered. A rights-based approach to debt sustainability*, Rethinking International Finance 1, New Economics Foundation, London.

Minsky, Hyman P. 1982. *Can ‘it’ happen again?,* M.E. Sharpe, Inc, Armok, New York.

Oechsli, Christopher. 1981. ‘Procedural guidelines for renegotiating LCD debt an analogy to Chapter 11 of the U.S. bankruptcy reform act’, *Virginia Journal of International Law*, vol. 21, no. 305, pp. 305–41.

Pogge, Thomas. 2008*a*. ‘Achieving democracy’, in Barry, Christian, Barry Herman and Lydia Tomitova (eds): *Dealing fairly with developing country debt*, Carnegie Council, Blackwell Publishing, Malden, MA and Oxford, UK, pp. 249–76.

Pogge, Thomas. 2008*b*. *World Poverty and Human Rights Cosmopolitan Responsibilities and Reforms*, second, expanded edition, Cambridge Polity Press, Cambridge, UK.

Presbitero, Andrea F. 2009. ‘Debt-relief effectiveness and institution-building’, *Development Policy Review*, vol. 27, no. 5, pp. 529–59.

Raffer, Kunibert. 1990. ‘Applying Chapter 9 insolvency to international debts an economically efficient solution with a human face’, *World Development*, vol. 18, no. 2, pp. 301–11.

Raffer, Kunibert. 2007. ‘Odious, illegitimate, illegal, or legal debts – what difference does it make for international chapter 9 debt arbitration?’, *Law and Contemporary Problems*, vol. 70, no. 4, Autumn, pp. 221–47.

Raffer, Kunibert. 2010. *Debt management for development: protection of the poor and the millennium development goals*, E Elgar, Cheltenham.

Raffer, Kunibert and Hans W. Singer. 2004 [2001]. *The economic north-south divide: six decades of unequal development*, E. Elgar, Cheltenham. Reprinted paperback version.

Rawls, John. 1971. *A theory of justice*, Oxford University Press, Oxford.

Rawls, John. 1993. ‘The law of peoples’, *Critical Inquiry*, vol. 20, no. 1, Autumn, pp. 36–68.

Rogoff, Kenneth and Jeromin Zettelmeyer. 2002. ‘Bankruptcy procedures for sovereigns a history of ideas’, 1976-2001, 1976-2001, 49 *IMF Staff Papers* 470, Washington, D.C.

Roubini, Nouriel and Brad Setser. 2004. *Bailouts or bail-ins? Responding to financial crises in emerging economies*, Institute for International Economics, Washington, D.C.

Roubini, Nouriel with Stephen Mihm. 2010. *Crisis economics. A crash course in the future of finance*. Penguin Group, London.

Reinhart, Carmen M and Kenneth S Rogoff. 2009. *This Time is Different. Eight Centuries of Financial Folly*, Princeton University Press, Princeton and Oxford.

Schwarcz, Steven L. 2000. ‘Sovereign debt restructuring: a bankruptcy reorganization approach’, *Cornell Law Review*, vol. 85, no. 956, pp. 1030–31.

Sehm Patomäki, Katarina, 2011a. *Is Global Arbitration of International Debt Viable?*, PhD Thesis, RMIT University, Melbourne.

Sehm Patomäki, Katarina. 2011b. “Towards global equity: disentangling odious debt from sovereign economic insolvency”, *Global Society*, vol. 25, no.4, October, pp. 493–512.

Sehm Patomäki, Katarina. 2013. “Revisiting Debt Sustainability”, *Dictatorship of Failure: The Discourse of Democratic Failure in the Current European Crisis*, Special Issue, COLLeGIUM, University of Helsinki, Helsinki (forthcoming).

Sen, Amartya. 2010. *The idea of justice*, Penguin Books, London.

Setser, Brad. 2010. ‘The political economy of the SDRM’, in Herman Barry, José Antonio Ocampo, and Shari Spiegel (eds). *Overcoming Developing Country Debt Crises*. The Initiative for Policy Dialogue Series, Oxford University Press, Oxford, pp. 317−46.

Stiglitz, Joseph. 2002*a*. ‘Don’t let America bankrupt international bankruptcy reform’, available at http://www.globalpolicy.org/component/content/article/209/42769.html ,New York, accessed on 15 October 2013.

Stiglitz, Joseph. 2010*a*. 'The analytical framework for debt policy', in Herman, Barry, José Antonio Ocampo, and Shari Spiegel (eds). *Overcoming developing country debt crises*. The Initiative for Policy Dialogue Series, Oxford University Press, Oxford, pp. 35–69.

Stiglitz, Joseph. 2010*b*. 'The Dangers of Deficit Reduction', *Project Syndicate*, Prague, 5 March.

Stiglitz, Joseph E. and Andrew Weiss. 1981. 'Credit rationing in markets with imperfect information', *American Economic Review*, vol. 71, no. 3, June, pp. 393–410.

Suter, Christian and Hanspeter Stamm. 1992. 'Coping with global debt crises debt settlements, 1820 to 1986', *Comparative Studies in Society and History*, vol. 34, no. 4, October, pp. 645–78.

Torry, Harriet. 2013. 'Chancellor Merkel tells Euro zone to stop being annoying', *Wall Street Journal*, April 11, internet edition, <http://blogs.wsj.com/eurocrisis/2013/04/11/chancellor-merkel-tells-euro-zone-to-stop-being-annoying/?KEYWORDS=merkel+austerity>, last visited 15 April 2013.

United Nations Conference on Trade and Development, UNCTAD. 2009a. *Compendium on debt sustainability and development*. United Nations Publication. UNCTAD/GDS/DDF/2008/1, Geneva.

United Nations Conference on Trade and Development. 2009*b*. 'The impact of the financial and economic crisis on debt sustainability in developing countries', UNCTAD Secretariat Note, Geneva.

Veerkamp, Ton. 2007. 'Judo-Christian tradition on debt: political, not just ethical', in Barry, Christian, Barry Herman and Lydia Tomitova (eds): *Dealing Fairly with Developing Country Debt*, Carnegie Council, Blackwell Publishing, Malden, MA and Oxford, UK, pp. 167–88.

Williams Walsh, Mary. 2011. 'State Bankruptcy Option Is Sought, Quietly', *the New York Times*, 21 January, available at http://www.nytimes.com/2011/01/21/business/economy/21bankruptcy.html?WT.mc_id=BU-SM-E-FB-SM-LIN-API-012111-NYT-NA&WT.mc_ev=click , accessed on 15 October 2013.