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Rethinking debt restructuring: A rights-aligned approach

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Rethinking debt restructuring: A rights-aligned approach

By Maria Ron Balsera, Maria Emilia Mamberti and Matthew Forgette

The global debt crisis has reached unprecedented levels with a disproportionate impact on developing countries, which exacerbates inequality and hinders social progress. Numerous attempts at debt restructurings have failed, perpetuating cycles of unsustainable debt. The absence of a coherent international legal framework further complicates these issues, leaving negotiations inequitable and opaque. In this chapter, we propose a transformative approach to debt restructuring reform that integrates soft law principles – such as transparency and sovereignty – with an independent statutory mechanism under the United Nations. Such reforms not only align with human rights standards but also promote fiscal justice by ensuring governments prioritize social spending over debt servicing. By addressing systemic flaws, the proposed reforms aim to establish a fair and sustainable global financial architecture that respects and realizes human rights while fostering equitable development worldwide.

Introduction

The world is in the midst of a global debt crisis. Global public debt-to-Gross Domestic Product (GDP) ratios have more than tripled since the 1970s and are continuing to rise.[1] In 2023, global public debt surged to a historic peak of US$ 97 trillion, growing by 90 percent since 2010. Simultaneously, there is a rising disparity between which countries hold this debt, with developing countries' debt levels rising twice as fast as their developed counterparts.[2]

Many countries have been forced into debt restructurings, negotiated agreements with creditors to cancel (usually just part of) the outstanding debt. However, these restructurings have often failed to achieve lasting results. Data from the International Monetary Fund (IMF) indicates that, between 1950 and 2010, up to 61 percent of countries defaulting on their debt service were repeat defaulters.[3] Restructurings are clearly failing to achieve their fundamental goal: to restore public debt to a sustainable level. Far too often, borrowing governments are forced to divert resources from social services that are essential for realizing human rights in order to pay onerous debts, leading to lower-income countries spending five times more on debt than they spend on dealing with climate change.[4]

This prevalence of repeated restructuring begs a few questions. Namely, what is the existing legal framework for sovereign debt restructuring? And why do these restructurings keep failing to deliver? There is currently no common international framework for sovereign debt restructuring. Instead, leading economists Martin Guzman and Joseph Stiglitz describe the global approach to debt restructuring as "a non-system" that "makes sovereign debt crisis resolution a

1 Gaspar/Poplawski-Ribeiro/Yoo (2023).
2 UN Global Crisis Response Group (2024).
3 Corkery et al. (2023).
4 https://debtjustice.org.uk/press-release/lower-income-countries-spend-five-times-more-on-debt-than-dealing-with-climate-change

complex process – marked by inefficiencies and inequities".[5] This absence of an international legal basis has led the IMF to assume the role of facilitator in many of these negotiations between debt-distressed nations and creditors. However, it has often fallen short in this capacity.

The legal vacuum regarding debt restructuring is most problematic for countries in the Global South. Perceived economic vulnerability means these countries pay significantly higher interest rates than their counterparts in the Global North. In 2022, countries in Africa borrowed at rates four times higher than those in the United States and eight times higher than those in Germany.[6] Countries in the Global North have also banded together to create informal institutions, such as the Paris Club, created in 1956, to collectively negotiate debt restructurings and enhance their bargaining power to serve the role of a "creditor cartel". Calls for the creation of a similar body for countries in the Global South to play the role of a "debtor cartel" exist but have yet to gain traction within the International Financial Architecture.[7]

Put simply, the current state of sovereign debt restructuring is inequitable, opaque, ineffective and undemocratic. The lack of a statutory regime means that each restructuring negotiation is undertaken separately. These independent negotiations are hampered by unequal bargaining power and the lack of an effective unbiased mediator. However, there are options for reform.

In the following chapter, a legal path is outlined on how the current "non-system" of debt restructuring can be transformed into a fair legal framework that prevents debt crises and promotes growth and development while respecting human rights. This approach involves using soft law, quasi-legal instruments such as principles or guidelines created by international organizations that regulate State behaviour. These principles should be incorporated into an independent debt restructuring mechanism under the auspices of the United Nations (UN), providing equal access to countries undergoing restructuring negotiations. Beyond this, a global debt restructuring reform has to be linked to fiscal justice more broadly, ensuring that governments invest public resources to tackle poverty, inequality and other social problems.

Human rights and soft law principles

Soft law is generally understood as rules that are not legally binding but are nonetheless adhered to due to moral sway, fear of adverse action, social norms or other incentives. These rules can be created by a variety of groups and actors, including the UN, the IMF, development banks and many others. Soft law is particularly prevalent in the field of international financial law, given the complexity of the international financial system and thereby the difficulty in designing and implementing hard rules to govern it.

A variety of sources contain relevant soft law standards on debt restructuring. These include the UN Guiding Principles on Business and Human Rights,[8] the G20 Operational Guidelines for Sustainable Financing[9] and the UN Trade and Development (UNCTAD) Principles on Promoting Responsible Sovereign Lending and Borrowing,[10] among many others. However, the most pertinent and specific document related to debt restructuring is the 2015 UN General Assembly Resolution 69/319, which established a set of nine principles to be observed in sovereign debt restructuring procedure: sovereignty, good faith, transparency, impartiality, equitable treatment of creditors, sovereign immunity, legitimacy, sustainability and the principle of majority restructuring.[11]

5 Guzman/Stiglitz (2016).
6 UN Global Crisis Response Group (2024).
7 Corkery et al. (2023).
8 United Nations (2011).
9 International Monetary Fund/World Bank (2019).
10 UNCTAD (2012).
11 UN General Assembly (2015).

Some of these principles, such as impartiality and equitable treatment, extend from the very core of international human rights law. The principles of equality and non-discrimination appear explicitly in the UN Charter and the Universal Declaration of Human Rights (which states that "all are equal before the law and are entitled without discrimination to equal protection"). These have subsequently featured in almost every major human rights instrument. In the context of debt restructuring, this principle restricts creditors from attaining inequitable outcomes through predatory methods. In the past, certain creditors have been able to secure disproportionately favourable outcomes by withholding from debt restructurings and demanding full repayment of the original debt.

The principle of **impartiality** also applies to the debt mediator. It restricts the set of institutions that could host a mechanism for sovereign debt restructuring, since institutions that have a biased representation of the stakeholders involved, or are creditors themselves, are not suitable. It is worth noting that many emerging market States have expressed their dissatisfaction with global financial tribunals (such as the International Centre for Settlement of Investment Disputes), which have been proposed as potential arbitral hosts, as well as with international financial institutions (IFIs), such as the IMF, which is currently playing a key role in facilitating restructuring processes.

Similarly, the principle of **transparency** is derived from the Universal Declaration of Human Rights, which guarantees the right to "seek, receive, and impart information and ideas". Similar language has later been reflected in the International Covenant on Civil and Political Rights (Art. 19). In debt restructuring, transparency is essential. As noted by Guzman and Stiglitz, debt restructuring negotiations often give rise to "perverse incentives for those at the negotiation table [...] transparent negotiations require disclosure of any potential conflict of incentives that could undermine the outcome of a restructuring process".[12]

In the current debt restructuring regime, investors can engage in sovereign credit default swaps, allowing them to swap their credit risk with that of another investor. Unfortunately, the markets for these swaps are currently opaque and do not require public disclosure. The responsibility of creditors under the principle of transparency is spelled out explicitly in the G20 Operational Guidelines for Sustainable Financing, which states, "creditors should facilitate information sharing among themselves and with the IFIs by disclosing comprehensive and updated information on their existing and new lending operations".[13]

Creditors must take measures to ensure that they are publicly disclosing their investment positions so that restructurings take place fairly. Additionally, the bias of major credit rating agencies such as Moody, S&P and Fitch towards countries in the Global South has been a longstanding transparency problem. The methodologies of these rating agencies are often based on subjective factors such as expert opinion, which is prone to be shaped by political influence and corruption.[14] The principle of transparency requires an independent and neutral credit-rating mechanism, ideally hosted by the UN or another multilateral space.

The principle of **sustainability** recognizes the primary goal of debt restructuring should be to restore the public debt to sustainable levels. While this principle is perhaps less explicitly articulated in human rights law, a robust understanding of debt sustainability is crucial for the realization of human rights. Indeed, the General Assembly resolution on the Basic Principles on Sovereign Debt Restructuring Processes explicitly endorses "minimizing economic and social costs ... and respecting human rights".[15] This is key because rising debt payments have been linked with public spending cuts and retrogressions in the

12 Guzman/Stiglitz (2016), p. 6.

13 International Monetary Fund/World Bank (2019), p. 15.

14 Khanna (2024).

15 UN General Assembly. (2015), para. 8.

achievement of economic and social rights in low-income countries. Unsustainable debt payments thereby have a direct impact on citizens' enjoyment of human rights such as health, education and access to food and clean water. As noted by international sovereign debt experts Juan Pablo Bohoslavsky and Matthias Goldman, "Sovereign debt sustainability is today widely recognized in international legal practice … the private interests of creditors need to be balanced against public interests".[16]

The UN sustainability principle also acknowledges that stakeholders in a restructuring process encompasses informal creditors, such as pensioners and workers. Current debt renegotiations often fail to take these stakeholders into account. As UN Independent Expert on foreign debt and human rights Attiya Waris described after her visit to Argentina to assess its debt situation, "Argentina must maximize its resources to uphold human rights and prevent regression".[17]

Another key principle identified in the UN General Assembly resolution is the duty to negotiate in good faith when debt becomes unsustainable. The UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing expand on this principle, specifying lenders' duty "… to behave in good faith and with cooperative spirit to reach a consensual rearrangement (…). Creditors should seek a speedy and orderly resolution to the problem."[18] Notably, this principle is clearly violated by vulture funds, which seek preferential treatment to other creditors through holdout and litigation methods.

Creditors who lend at an interest rate that includes compensation for risk cannot, in good faith, bargain to receive treatment as if the lending were risk-free. It is also important to mention the existence of odious or illegitimate debt, which may have been negotiated under repressive regimes or under exploitative terms.[19] The UNCTAD Principles underline this, emphasizing that "a creditor that acquires a debt instrument of a sovereign in financial distress with the intent of forcing a preferential settlement of the claim outside of a consensual workout process is acting abusively".[20] These types of debts produce little to no public benefit and should be subject to cancellation.

Rights-aligned statutory mechanisms

Of course, the UN Principles on Debt Restructuring will fail to have an impact if they continue to be violated or applied selectively. Thus, codification of these principles in hard law represents a preferable long-term solution. Given the difficulty inherent in any multilateral international endeavour, domestic legislation in individual countries has been identified as a possible first step towards debt restructuring reform. One benefit of this approach is that it is clear which countries should be targeted. The vast majority of sovereign bonds are regulated under either New York or English law. If those jurisdictions were to adopt a domestic legal framework for debt restructuring based on the soft law principles articulated above, this could fill the debt restructuring legal void without having to resort to passing an international treaty.

Unfortunately, these jurisdictions have historically failed to abide by the principles in past debt restructuring adjudications. Perhaps the most cited example is the treatment of the so-called "vulture funds", which emerged in Argentina's initial debt default in 2005. These are hedge funds that specialize in purchasing distressed debt on secondary markets during crises. After purchasing the debt at an extremely low value, the vulture funds then pursue payment in full (as well as additional compensation for risks they did not take) through prolonged and expensive litigation

16 Bohoslavsky/Goldmann (2016).
17 UN Office of the High Commissioner on Human Rights (2022).
18 UNCTAD (2012), p. 7.
19 Corkery et al. (2023).
20 UNCTAD (2012), p. 8.

in either New York or London.[21] These funds tend to have recovery rates of 3 to 20 times their investment,[22] while robbing other creditors of equitable treatment in negotiating processes and citizens of public resources that governments would otherwise provide.

One could certainly envision a better system for the resolution of debt crises through restructuring. Rather than the current mess of decentralized procedures, which feature an array of powerful creditors negotiating with low-income countries entangled in debt distress, there should instead be a simplified, comprehensive framework designed in accordance with the principles discussed above. Already in 2014, UN General Assembly Resolution 68/304 sought the establishment of a "multilateral legal framework for sovereign debt restructuring processes".[23] Support for a statutory-based debt resolution mechanism can even be traced back to 2002, when the debt crisis in Argentina motivated the IMF to create a proposal (although this proposal was quickly shelved due to opposition from IMF board member states).[24]

The establishment of an independent mechanism for debt restructuring, embedded within the UN, has been a longstanding goal for debt justice advocates. This could provide equal access to comprehensive information and independent technical support to the country team in charge of the renegotiation process. It could also codify the human rights-based principles discussed above, ensuring mandatory participation of all creditors in debt restructuring to prevent vulture fund litigation.

A multilateral statutory framework for debt restructuring remains the most effective and fair solution to the debt restructuring problem. A document published by the UN's former independent expert on foreign debt clearly outlines several human rights benchmarks that should be included in the new regime.[25] These include explicit references to the compatibility of debt restructuring with human rights obligations; the inclusion of human rights impact assessments and improving debt sustainability assessments; and the assurance that minimum levels of enjoyment of economic, social and cultural rights can be satisfied amidst debt restructuring.

So far, this vision has been easier to imagine than it is to realize. A number of efforts have been made to strengthen debt restructuring procedures, including the G20 Debt Service Suspension Initiative, the G20 Common Framework for Debt Treatment and the Global Sovereign Debt Roundtable. However, fear that participation would lead countries to have reduced credit ratings has kept many States from engaging, and power imbalances between creditors and debtors persist.

This persistent inequity highlights the importance of mobilizing cross-cutting stakeholders to join future demands for debt restructuring. The case of Pakistan is one of many recent examples illustrating how the problems are interconnected. In 2023, Pakistan spent 46 percent of its government revenue on servicing foreign debt, leaving it unable to combat its climate disaster.[26] At the same time, the country relied on unpaid care and domestic work to fill the labour gap, which worsens economic insecurity and social mobility for women and girls. Clearly, these movements are intersecting, and addressing them will require coordination and collaboration.

Fiscal justice

It is also important to examine the broader link between global debt restructuring reform and fiscal justice. Fiscal justice requires government investment in resources to tackle poverty, inequality and

21 For more information about the famous case of Republic of Argentina v. NML Capital, see https://harvardlawreview.org/print/vol-128/republic-of-argentina-v-nml-capital-ltd/

22 African Development Bank Group (2023).

23 UN General Assembly (2014).

24 Krueger (2002).

25 Bohoslavsky (2015).

26 Corkery et al. (2023).

other social problems. Over US$ 480 billion is lost each year due to abusive international tax practices.[27] This is a similar figure to those cited in calls from UN Secretary General António Guterres in order to meet the Sustainable Development Goals (SDGs) financing gap.[28] Governments also have the obligation under the International Covenant on Economic, Social and Cultural Rights to dedicate maximum available resources to realizing human rights. Currently, many countries in the Global South are forced to take on extreme amounts of debt to fund even basic social services. Thus, a vital part of combating over-indebtedness in the Global South comes down to expanding countries' fiscal space through progressive taxation and the elimination of tax abuse.

Another connection to fiscal justice is that any multilateral debt restructuring mechanism should also ensure that countries are not prevented from fulfilling their basic public spending duties under human rights law. As the Committee on the International Covenant on Social, Economic and Cultural Rights has underlined, States have the core obligation to ensure the satisfaction of, at the very least, minimum essential levels of economic, social and cultural rights.[29] States will find it extremely difficult, if not impossible, to fulfill these minimum essential levels if debt servicing enjoys the same or even greater priority in national budgeting than education or health expenditures. Retrogressive measures should be avoided and would need to be fully justified by reference to the totality of the rights provided for in the Covenant. Even then, retrogressive measures should be temporary, necessary and proportionate as well as being non-discriminatory.

Conclusion

There are several complementary recommendations towards a rights-aligned debt restructuring reform. First, soft law human rights standards and principles must be respected and used as a guide when interpreting and applying the law in sovereign debt disputes. This means, for example, not imposing any economic policy conditions on the debtor during the debt restructuring process, because of the principle of legitimacy. Additionally, independent statutory measures should be informed by these soft law principles, and should ensure mandatory participation of all creditors with an unbiased adjudicator. Finally, progressive taxation and other just fiscal policy must be part of the solution towards preventing countries from becoming embroiled in endless debt restructurings.

Reforming international tax law is fundamentally linked with debt restructuring reform. Of course, there are also a myriad of other issues that link to the debt crisis that must be taken into account, such as the right to development, the impact of debt on women's rights, the intersection of debt and climate finance and the legacies of colonialism that are still present in the international financial system. Improving our world's broken debt restructuring system is possible, but it requires rethinking the global policies that make up the current "non-system", as well as respecting fundamental human rights.

27 Tax Justice Network (2023).

28 https://sdg.iisd.org/news/un-calls-for-usd-500-billion-per-year-for-sustainable-development/

29 UN Committee on Economic, Social and Cultural Rights (1990).

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