Since states are not protected by bankruptcy or insolvency laws in national or international law, when a country’s sovereign debt becomes unsustainable and it can no longer repay its public debts it cannot simply declare bankruptcy as a private entity would do. Before reaching that moment of debt distress, the country’s government has very few options to avoid default: keep borrowing — making the problem even bigger, — raising taxes and mobilising other domestic resources to have more revenue to keep paying, or cutting public spending to free up resources to pay back its creditors. This last option comes at the expense of impacts on human rights, particularly women’s rights. All these alternatives generally end up delaying default, but not avoiding it. The country could also try a pre-emptive debt restructuring (to avoid default), but most countries avoid that option out of fear of rating downgrades by credit rating agencies and loss of market access.

Once default happens, the government needs to start a restructuring process, meaning renegotiating the contract terms of its debt with its creditors. According to the International Monetary Fund (IMF), between 1950 and 2010 there have been more than 600 cases of debt restructurings in 95 countries. These numbers show that it is often the case that a country that recurred to debt restructuring is likely to do it again, with repeat defaulters representing up to 61 per cent, exposing the inefficiency of the current system. On average, African debtor countries had to negotiate with the Paris Club seven times, with no debt sustainability achieved after just one negotiation.
What is sovereign debt restructuring?

Debt restructurings tend to be opaque processes with no commonly set rules nor universally-accepted consensus on how they should work or unfold. A combination of political and strategic interests, normative considerations and even religious dimensions influences what, in theory, should be a legal process driven by economic and financial rationale,

WHAT IS IT?
Debt restructuring can be defined as “an exchange of outstanding sovereign debt instruments, such as loans or bonds, for new debt instruments or cash through a legal process.” It can therefore mean any change in the terms of the debt – from minor changes to interest rates or when the debt is due to be paid – to major changes such as large scale cancellation of debt.

WHAT DEBT IS RESTRUCTURED?
Domestic or external sovereign debt. In this briefing we focus on the latter.

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WHO PARTICIPATES?
Primarily the debtor government and its creditor(s). The creditors can be:

- Bilateral: this is other countries that lent official loans, divided into:
  - Paris Club creditors: An informal group of 22 mostly western countries that, since 1956, coordinate bilateral debt restructuring. Since its inception, the Paris Club has taken part in 478 debt restructurings, reaching agreements with 102 countries.
  - Non-Paris Club creditors: Other countries, like China, India or Saudi Arabia, that particularly in the last decade have increased their official lending to global south countries. These creditors are not officially coordinated through any group, formal or informal.

WHO DOES NOT PARTICIPATE?
Multilateral creditors are normally excluded from debt restructuring. They argue that debt relief would jeopardise the credit-worthiness of the institution and they would rather continue financing countries in debt distress, usually via additional loans, than cancel the debt. Nonetheless, in 2005 the IMF and the World Bank (WB) participated in the Multilateral Debt Relief Initiative (MDRI), proving it is possible for multilateral lenders to cancel debt without impacting their credit-worthiness.

THE ROLE OF IMF AND WB
Even if not involved in the restructuring of a country’s debts, these two institutions still play very central roles producing the Debt Sustainability Analysis (DSA); financing the country even if it is in default (“lending into arrears”); or playing an informal mediation and influencing role in the negotiations. They are also observers to the Paris Club negotiations and can participate in the Common Framework Creditor Committees.

Debt rescheduling, where there is a change in the terms and conditions of repayment, such as a lengthening the repayment period, offering a grace period or lowering interest rates and fees

Debt reduction – also known as debt haircut or debt cancellation – where there is a cut in the face (nominal) value of the existing debt stocks.

WHEN?
The majority of restructurings happen after a country defaults, meaning that it cannot service its debt payment on due time. There’s also the possibility of pre-emptive restructurings, which happen prior to a default. The two things are not mutually binding, meaning that there can be a default without restructuring and vice versa.

HOW?
Sovereign debt restructuring actions generally fall into two categories (or a combination of them):

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Box 1: Debt repudiation, an alternative to a creditor-led debt restructuring?

Global south countries could address unsustainable and illegitimate debts by repudiating them. Repudiation is when the borrower states their intention to not negotiate a debt restructuring and not ever pay the debt and is a way of defaulting. In this case, the debtor does not recognise the responsibility of continuing to pay. For instance, the debt can be defined as “odious or illegitimate” if the government inherited debts from a previous non-democratic or corrupt borrower administration. In practical terms, this equates to a default without a negotiation with creditors, and implies a shut-down of access to new financing and accumulation of arrears with its creditors. In some cases, such as Cuba or Argentina, after a period of several years in default, the countries state their willingness to re-establish relations with their creditors and embark in a delayed restructuring negotiation.

Box 2: The Common Framework

In November 2020, the G20 and Paris Club agreed to establish the Common Framework for Debt Treatments (CF) aspiring to deliver on timely and comprehensive debt treatment for countries with unsustainable debt levels. The initiative is limited to a list of 73 countries and so far only four have requested treatment under the CF: Chad, Ethiopia, Ghana, Zambia. The main novelty of the CF in relation to other debt restructurings is that it establishes a bilateral creditor committee including Paris Club and other G20 creditors - notably China, India and Saudi Arabia. The treatment under the CF aims for changes in debt service over the course of the mandatory IMF program, a debt reduction in net present value terms, and an extension of the duration of the treated claims. A debt write-off or cancellation will only be provided in exceptional “most difficult” cases. Multilateral debts, which are the majority in many lower-income countries, are excluded from the CF treatment. The success of a debt restructuring under CF still relies on the will of the creditors, particularly on whether private creditors to decide to voluntarily engage in the creditor committees and deliver on comparability of treatment.

More than two years after Zambia, Chad and Ethiopia requested treatment, only Chad has finalised the process, ending with a debt rescheduling and no debt cancellation at all. In late-2022, Ghana applied to the CF after exploring possibilities for negotiating the restructuring outside the Framework for a long time. The uncertainties and lack of clarity regarding the implementation of the CF remain high. Both the IMF and the WB have called for a clearer timeline for the process, as well as greater clarity on implementing the comparability of treatment clauses. They have also vouched for a debt payment standstill for the duration of the debt restructuring negotiations. So far, the G20 has not reached an agreement on any of these.

In summary, we refer to sovereign debt restructuring as a process involving both a debtor government and its creditor(s) that changes the current terms for payment of outstanding sovereign debt instruments. The process is formally aimed at enabling the debtor government to address liquidity or solvency difficulties resulting from its current payment obligations and fiscal situation, and achieving debt sustainability in the medium term.

Today, a universal system that regulates the sovereign debt restructuring framework does not exist, to the extent that we can refer to the current situation as “the Non Regime.” There are no common norms that regulate the level of debt cancellation or rescheduling for a country depending on specific criteria, nor a timeline for debt restructuring. A government cannot negotiate its total debt stock in one procedure and in one place, but has to submit to a series of fragmented negotiations with different non-coordinated creditors through ad hoc operations, which ultimately leaves room for significant risks, such as vulture funds. The outcomes of such negotiations are heavily dependent on the skills of the law firm representing the debtor country and the willingness of a government not to pay if an acceptable agreement is not reached. Additionally, there is no guarantee that an agreement will be reached.
How does it work? Debt restructuring in the case of the fictitious country of Debtlandia

Debtlandia is a low-income country that has been devastated by the pandemic, heavily impacted by climate change and is facing payment difficulties on its sovereign debts. Debtlandia tries to avoid default at any cost, out of fear of rating downgrades and losing market access. Borrowing costs continue to increase and refinancing its debts with a new bond issuance is impossible. When a debt payment to bondholders arrives, and reserves are not sufficient, the country has no option but to hold the payments and enter default.

As of 2020, Debtlandia is eligible, and has no other option but, to apply for the G20 Common Framework (CF) to ask for a debt treatment. The first step to begin negotiating with its creditors is to ask the IMF for a programme, which the country has been trying to avoid given the harsh austerity conditions it will likely entail, along with the internal social and political tensions that can unfold as a result. However, without an IMF programme, even outside the CF, it is unlikely that the creditors will accept any debt restructuring. The IMF, together with the WB, will also provide an assessment of the country’s fiscal situation and indebtedness in their DSA. The DSA includes a detailed exam of Debtlandia’s outstanding debt and fiscal situation. It is not normally made public until the IMF approves a loan and a programme. The DSA is the basis for determining not only the size of the IMF loan within the new programme, but is also used to indicate the amount by which debt should be reduced to reach sustainable levels.

For the IMF to give the green light to a new loan and programme, its Board has to make a decision based on “assurances” that the creditors will participate in a debt restructuring process in good faith. Debtlandia knows that it can take months to get the assurances that the IMF needs, or for the IMF to accept the assurances that the country gets from its creditors. In the meantime, Debtlandia is still in default and accumulating arrears (unpaid interest and resulting fees). Once the IMF Board accepts the assurances and agrees on a loan and programme, the DSA will likely become public.

Box 3: Zambia’s Increasing Pressure to Restructure its debt two decades after HIPC – by Muchimba Siamachoka, Jesuit Centre for Theological Reflection (JCTR)

Zambia’s debt profile has deteriorated in recent years as a result of pre-pandemic issues, leaving creditors at odds over who should bear the loss on loans. Zambia became the first sovereign African nation to default on debt during the Covid-19 era, when it failed to make the US$42.5 million interest payments on its Eurobond in November 2020.

The establishment of credit committees by G20 Common Framework and Paris Club members was envisioned as a shift toward resolving the nation’s debt crisis. This, however, has proven to be a complex, unpredictable and lengthy process, despite the country joining an IMF programme in September 2022. The continued protraction of Zambia’s debt treatment process has already begun to have adverse implications on the performance of the country’s IMF Extended Credit Facility programme. For one thing, the continuous weakening of the Zambian Kwacha against the US dollar is causing citizens (whether businesses or the general public) to fail to absorb Zambia’s currency fluctuation. This has manifested in a higher cost of living (as Zambia is largely an import-based country), an unpredictable business environment, and low investments.

Zambia, like many other nations in debt distress and seeking a debt resolution/treatment, is in desperate need of an international mechanism to timely and comprehensively solve its debt problems, especially when confronted with multiple crises (slow post Covid-19 recovery, debt distress, climate change, global food crisis among others). It is morally imperative that nations stand in solidarity, even as a debt-reduction mechanism that works for everyone is established.

The IMF programme works as a guarantee for Debtlandia’s creditors, and it triggers the restructuring negotiations. Two committees are created, one with bilateral and another with private creditors. The back and forth of negotiations with one and the other starts. Debtlandia will probably agree on debt restructuring conditions with its bilateral creditors on the basis of the DSA, but it will maintain talks with the privates to see how much they are willing to accept. Once a deal is agreed with the bilaterals, the country needs to seek a similar deal with its private creditors, known as “comparability of treatment”. If it doesn’t, in theory, the bilateral creditors could step back and retire from the deal. In the history of the Paris Club, this has never happened.
The diverse creditor landscape is a complex knot that Debtlandia has to untangle. It has changed significantly in the past decades and neither group fully trusts the others. In an attempt to deal with this compound universe, some principles and instruments have been created, including the comparability of treatment principle. However it is not a written rule, but more of a gentlemen’s agreement. Another innovation to deal with this complexity is the inclusion of contractual Collective Action Clauses (CACs) in bond contracts. These define how to initiate and conduct restructuring negotiations and allow a qualified majority of creditors to modify the conditions of a bond series, as well as binding all holders of these bonds to the decision. This means that if the country reaches an agreement with a certain percentage of creditors as indicated in the CACs, the remaining creditors are obliged to comply with that agreement.

In the meantime, and throughout the whole process, any form of communication about Debtlandia’s economic situation and any indiscretions about the debt restructuring negotiations need to be handled strategically, as “markets do not like uncertainties.” Depending on how it handles the process, Debtlandia fears a loss of market access (even though it has no access to financial markets while in default) and of the reputational costs for future market access.

The potential for miscommunication is high. Debtlandia has to face several ambiguities throughout the process. For instance, the negotiations with the different creditors do not follow a precise timeline and can be extremely intricate, long, time- and resource-consuming. The legal context is ambiguous, too: several jurisdictions might be involved, each with different rules and perspectives. “It may not be clear which will prevail (and possibly none of them would prevail), and how the implicit bargaining among different countries’ judiciaries will be resolved.” Private creditors might get nervous – or just fight for the biggest return possible, not willing to take any cut – and either threaten to or actually take Debtlandia to the New York or London courts over the unpaid debts, the two jurisdictions under which most international government debts are owed.

Box 4: Ecuador: unsatisfying debt restructuring and social unrest – by Pablo Iturralde, Centro de Derechos Económicos y Sociales (CDES)

The Ecuadorian government announced in August 2020 that it had reached an agreement with private creditors for the restructuring of 41 per cent of its foreign debt. Although the restructuring implies fiscal relief for the coming years and avoids the risk of default, it does not represent a sustainable solution to Ecuador’s debt crisis. Thus, repayments were simply deferred for the future, so that between 2024 and 2027 Ecuador will have to pay approximately US$38 billion in public debt, which will mean, on average, the disbursement of US$5 billion per year, representing annually more than 20 per cent of the current General State Budget (PGE). In addition, the lack of better renegotiation mechanisms forced the government to request a new programme with the IMF, to assure private bondholders guarantees allow negotiations with them to begin. The austerity conditionalities in the IMF programme unleashed social protests. The renegotiation also benefited debt holders by revaluing bond prices. In fact, due to the pandemic, the face value of Ecuadorian bonds had fallen to 35 per cent of their value. Despite this, the negotiation of these bonds recognised 59 per cent (at present value) and 91 per cent (at face value). As a result, the Ecuadorian government transferred a large part of the cost of the Covid-19 crisis to the Ecuadorian population (at taxpayers’ expense) rather than sharing the burden with bondholders. Finally, the renegotiation included the capitalisation of interest in the form of a bond called “Bono PDI 2030” (Bond Past Due Interest), with the potential payment of “interest on interest” in case of default. This implies the capitalisation of interest (“anatocism”, the collection of compound interests over interests) which in Ecuador - as in many other countries - is prohibited by the Constitution.
After months or years of negotiations (the nine restructuring cases between 2014 and 2020 took an average of 1.2 years, with many cases going over two years of negotiations), Debtlandia will likely achieve an agreement with its bilateral and private creditors, that will most probably be “too little, too late”. Its debts to multilateral development banks (MDBs) and the IMF will remain untouched. As in most cases, Debtlandia will probably have to go through further rounds of debt treatment in the coming years, until creditors realise there is need for a substantial debt reduction for the country to achieve debt sustainability. Historically, debt default episodes have taken an average of seven years to be resolved, involving multiple restructurings. The IMF itself agrees that debt restructurings have often been too little and too late, thus failing to re-establish debt sustainability and market access in a durable way.

Box 5: Suriname, holding its breath and oil for 3 years... and counting

One striking case of what to expect from a debt restructuring process is Suriname. This Caribbean country began a process to restructure its debts with official bilateral and private creditors in November 2020, when it became the second country after Zambia to default on its sovereign debt in the aftermath of the Covid-19 pandemic. Twenty months later, in July 2022, the country finally reached an agreement to reschedule debt payments with its bilateral creditors at the Paris Club. India agreed on a small debt restructuring in January 2023. However, China has yet to reach a deal, and Suriname’s private creditors, mostly bondholders represented through investment funds, have also refused to close a deal (thus breaking comparability of treatment). They argue that the country could have bigger revenues in the future to repay its debts if its offshore oil reserves were exploited. The implementation of the country’s IMF programme, – which includes conditions to remove fuel and electricity subsidies – together with the rising prices due to global inflation and aggravated by the lack of resolution to the debt problems, have led to an increase of social unrest, including massive demonstrations in February 2023. Meanwhile, Suriname still works on its debt restructuring.

Is an alternative to the maze possible?

The debt restructuring process is chaotic, costly, long, and difficult to understand, particularly for ordinary citizens that suffer the consequences. Additionally, success is determined by the calibre of lawyers a country can afford to hire, as well as the willingness of a government to refuse to pay if creditors do not agree to an acceptable deal. Powerful creditor countries maintain the current lack of a system because it enhances their power, and that of their private companies, in debt negotiations. Furthermore, debtors today have to navigate new instruments, creditors, innovations and interests, which greatly complicate the restructuring process. As the World Bank President David Malpass described it back in 2020, it is “the modern equivalent of debtor’s prison.”

In opposition to this chaos, the offspring of an almost 80-year-old agreement, we propose a systemic reform of existing debt architecture. It is time to update the debt resolution frameworks to adapt to the new world we live in and, most importantly, to the needs of global south countries and their people. We need a permanent rules-based multilateral debt resolution framework that provides fair, timely and comprehensive debt treatment from all lenders and for all countries according to their needs. We need a mechanism that does not rely on creditors’ will, nor is defined solely by creditors. We propose a debt workout mechanism hosted under the auspices of the United Nations, since the UN is currently the only forum in which all countries have equal say and is neither a creditor nor a borrowing institution. This Debt Workout Mechanism should respond to 10 essential principles.
10 ESSENTIAL PRINCIPLES FOR A DEBT WORKOUT MECHANISM

1. It should be a body independent from creditors and debtors to assure impartiality.

2. The borrower has the right to choose to initiate the debt restructuring process in pre-default phase and an automatic standstill will apply to all external debt payments.

3. The initiation of the process should trigger a stay on litigation by uncooperative creditors.

4. The entirety of a country’s debt stock should be dealt with in a single process, reducing fragmentation and time.

5. Inclusive participation of all stakeholders, including civil society.

6. Independent assessment of debt sustainability and validation of individual claims to assess the legality and legitimacy of debts through public debt audit.

7. Focus on debt sustainability that puts the needs of the population before debt service, and that includes climate vulnerabilities and human rights, gender equality assessments.

8. Respect for international human rights law and the realisation of international development commitments, such as the Sustainable Development Goals (SDGs).

9. Transparency and accountability, as standard procedures for sovereign debt restructuring negotiations must be established, and the negotiations and their outcomes must be made public.

10. Enforceability, meaning that all parties must respect the decision of the independent body.

Ibidem.


The IMF defines debt distress as when “a country is unable to fulfil its financial obligations and debt restructuring is required”. When the state misses a payment on some or all of those falling due, it goes into default.


Ibidem.


Perera, ‘We Can Work It out: 10 Civil Society Principles for Sovereign Debt Resolution’.


CACs are ‘clauses included in sovereign bonds which bind all bondholders to debt restructuring terms agreed by a super majority of creditors. They are designed to prevent holdouts, such as vulture funds, to either block or request better terms from a country in a debt restructuring process’. https://www.eurodad.org/dam_debt_suriname


Perera, ‘We Can Work It out: 10 Civil Society Principles for Sovereign Debt Resolution’.