IMF in Theory: Sovereign Debts, Judicialisation and Multilateralism

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TABLE OF CONTENTS

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SUMMARY

It is argued that the successive regimes for restructuring sovereign debts, since the early 20th century have been shaped by the articulation of three institutional functions: information gathering and economic expertise, third-party mediation, and policy enforcement, also called conditionality. This reflects the standard problems of collective action being raised by any default, whether private or sovereign: investors have to be coordinated, informed and represented, the government of the debtor country should be able to commit itself to a new policy course, and a legitimate decision-making rule should address problem of "hold-out", minority investors. The negotiation rules adopted during the 1980s', which were centred on the IMF, are considered here as a reference case against which previous and current evolutions are assessed.

This analytical framework allows to revisit the international debate which unfold in 2001-2003 and which fitted the IMF proposal for a statutory *Sovereign Debt Restructuring Mechanism* (SDRM) against a market-based, contractual approach based on so-called *Collective Action Clauses* (CAC) – an option which was eventually adopted in April 2003. Whereas most participants to this controversy highlighted the many differences between these propositions, one important common point is being underlined: in both cases, third-party mediation was to be outsourced by the IMF and transfered to an independent body, built on a explicitly judicial model.

In the case of SDRM, a supra-national court would have had the capacity to oppose its decisions to those of the national courts in which jurisdictions the initial debt contracts had been signed – mainly in New York and in London. With CACs, on the other hand, the sovereignty of these courts is being reinforced: they have become a key actor in a restructuring process, which multilateral dimension has been proportionately diminished. It is defended that outsourcing arbitration reflects the demand by the private financial sector for a procedure of negotiation which would be much more protected than in the past against the interests of the sovereigns as against the "realistic", highly discretionary enforcement of conditionality by the Fund.

The consequence however is that the historic link between third-party mediation and the two other functions – expertise and conditionality – is being broken up. This suggests that the very constitution of the IMF is to be thoroughly redefined. In the absence of any new rule which would re-articulate the three functions it is defended that the overall result is a substantial weakening of the Fund as of the multilateral principles of collective action vis-à-vis payment crisis. The rules of interaction, as the mechanism of commitment and retaliation between actors are now much more fragile than they used to be. This probably shed some light on the many problems encountered by the Fund in its attempts to reform itself, since ten years.

ABSTRACT

It is argued that the successive regimes for restructuring sovereign debts, since the early 20th century have been shaped by the articulation of three institutional functions: information gathering and economic expertise, then third-party mediation, lastly policy enforcement, also called conditionality. Whereas these functions where integrated within the Fund during the 1980s' debt crisis, mediation has now been outsourced, under the pressure of the demand by the private sector for a thorough judicialisation of the restructuring process. That is, its inscription within rather rigid procedural rules which would provide much more protection against the interests and the intervention of the sovereigns, especially G7 governments. Two responses to this demand have been formulated: the creation of a supra-national "bankruptcy court", as envisaged in the SDRM proposal put forward by the IMF in 2001; and the reliance upon national courts, specifically those in which jurisdiction the initial debt contracts had been signed. This latter option corresponds to the contract-based approach to sovereign defaults based on Collective Action Clauses, which was eventually adopted in spring 2003. It is defended that outsourcing third-party mediation makes the IMF considerably much weaker, as it remains with only two functions and no consistent rules of interaction with its traditional partners – private investors and the government of debtor countries.

JEL Classification: F33, F34, K33

Key Words: Sovereign Debts, Judicialisation, Multilateralism, IMF, Conditionality

LE FMI EN THÉORIE : LES DETTES SOUVERAINES, LA JUDICIALISATION ET LE MULTILATÉRALISME

RÉSUMÉ

On défend que l'histoire des régimes successifs de renégociation des dettes souveraines, depuis le début du XX° siècle, a été déterminée par l'articulation de trois fonctions institutionnelles : l'expertise économique et le traitement de l'information, puis la médiation par un tiers-arbitre, enfin la surveillance de la politique économique, c'est-à-dire la conditionalité. Ceci reflète les problèmes d'action collective que soulève toute situation de défaut, tant privé que souverain. Les investisseurs doivent être coordonnés, informés et représentés, enfin le gouvernement du pays en crise doit pouvoir s'engager sur une nouvelle politique économique, une règle de décision doit pouvoir sanctionner les négociations et la recontractualisation de la dette. On considère que les règles de renégotiation des années 1980, centrées sur le FMI, représentent de ce point de vue le modèle le plus abouti de renégociation.

Ce cadre d'analyse permet alors de revenir sur le débat des années 2001-2003 relatif au nouveau régime de renégotiation des dettes souveraine, appelé par la globalisation financière. La plupart des contributions à ce débat ont souligné les oppositions entre les deux principales propositions en présence : d'une part le *Sovereign Debt Restructuring Mechanism* (SDRM), à caractère statutaire, que défendait le FMI ; de l'autre les *Clauses d'Action Collective* (CAC) à caractère contractuel et privé, auquel s'est rallié le secteur financier privé, suivi par les gouvernements du G7. Ici, on souligne surtout que les deux propositions revenaient à sortir du FMI l'une des trois fonctions principales : la médiation par un tiers-arbitre qui en particulier assure l'équité entre les sacrifices respectifs du pays endetté et des investisseurs privés.

De ce point de vue, tant le SDRM que les CAC répondaient à une demande de « judicialisation » exprimée en particulier par le secteur privé. La première option aurait conduit à la création d'un tribunal supra-national, capable en particulier d'imposer ses décisions aux tribunaux nationaux dans la juridiction desquels avaient été signés les contrats de dette initiaux – principalement à New York et à Londres. Avec les CAC, en revanche, la souveraineté de ces cours de justice est renforcée : elles sont devenues un acteur central des renégotiations, dont la dimension multilatérale est a contrario considérablement affaiblie. On avance que la raison principale de cette « externalisation de la médiation » renvoie à la volonté des investisseurs de placer beaucoup plus fortement la procédure de renégotiation à l'abri des intérêts et des interventions des souverains, ainsi que par l'exercice « réaliste » et discrétionnaire de la conditionalité, par le FMI.

Le problème est que cette évolution rompt le lien historique entre le tiers-arbitre et les fonctions d'expertise et de conditionalité, qui sont conservées par le FMI. En l'absence de toute règle nouvelle de *ré*-articulation des trois fonctions, on défend que cette évolution

implique un affaiblissement des principes d'une gestion multilatérale des crises financières : aux règles d'interaction rigoureuses entre le Fonds, les pays endettés et les investisseurs ont succédé des liens beaucoup plus lâches, marquées par la faiblesse des principes d'action collective, notamment les mécanismes de *commitment* et de rétorsion mutuelle. Ceci éclaire bon nombre des problèmes d'ajustement auxquels est confronté le FMI depuis une dizaine d'années.

RÉSUMÉ COURT

On défend que l'histoire des régimes successifs de renégociation des dettes souveraines, depuis le début du XX° siècle, a été déterminée par l'articulation de trois fonctions institutionnelles : l'expertise économique et le traitement de l'information, puis la médiation par un tiers-arbitre, enfin la surveillance de la politique économique, c'est-à-dire la conditionalité. Réunies dans le FMI pendant les années 1980, elles ont été depuis séparées en raison de la demande, par le secteur financier privé, d'une « judicialisation » accrue des restructurations : c'est-à-dire leur inscription dans des règles procédurales plus rigides, mises à l'abri des interférences des Etats souverains. Deux réponses à cette demande ont été formulées: la proposition d'un tribunal supra-national, défendue dans le projet dit SDRM du FMI ; puis la méthode dite des Clauses d'Action Collective, adoptée en 2003, qui présente un caractère nettement contractuel et privé, et qui renvoie la résolution des différends aux tribunaux nationaux des pays d'émission des contrats de dette. On défend que cette externalisation d'une des trois fonctions historiques du FMI affaibli considérablement cette institution, comme plus généralement la capacité à opposer aux crises financière internationales des règles contingentes d'action collective, susceptibles de peser fortement sur le comportement des différents acteurs.

Classification *JEL* : F33, F34, K33

Mots-clefs : Dette souveraine, judicialisation, multilatéralisme, FMI, conditionalité

IMF IN THEORY: SOVEREIGN DEBTS, JUDICIALISATION AND MULTILATERALISM[1]

Jérôme Sgard[2]

1. INTRODUCTION

How the International Monetary Fund (IMF) operates and what its objectives are has been historically a much fragmented field of research where, among others, students of international organisations have rarely met economists. A great number of sub-fields have thus developed very much on their own: agency theory, exchange rate regimes, conditionality, crisis management, sovereign debt issues, etc.

This article is an attempt to put together some of these elements within an analytical framework which accounts for the historical evolution of the Fund as for the most recent attempts at reforming it. It argues that its structure and rules of action have been shaped by its evolving role as a manager of sovereign debt defaults, an experience which was foreshadowed by its predecessors since the early 20th century. This requires that three functions be articulated: economic expertise and information, third-party mediation, and policy enforcement. How this is done is decisive for the working of the sovereign debt market but also for the evolution of financial multilateralism.

The underlying theme is that any default, whether private or sovereign, immediately raises acute problems of collective action which may stall the restructuring process and destabilise markets. How are investors to be identified and informed? Who should represent them around the table? How can the debtor commit itself to a new policy course? How should investors vote on alternative options? Unless a dispute settlement mechanism rapidly provides an answer to these problems, investors may run on the available assets or litigate in a much disorderly way. This indeed describes a typical Prisoner's dilemma situation: a common good is at stake, but the incentives for cooperation may be insufficient to reach a first-best solution. In principle, the answer is to design a Pareto-improving rule which would support the re-coordination of agents and help them negotiate on debt restructuring and economic adjustment. If successful, this would deliver higher economic efficiency and a more equitable distribution of the capital losses implicit in the default. The rather comprehensive framework adopted during the 1980s' international debt crisis comes out in

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this respect as a classical experiment and is used here as a reference case against which previous and current evolutions are assessed.

Yet, the principle of an institutionalised approach to sovereign defaults has remained subjected to repeatedly criticism. Some, for instance, have recalled that the first era of financial globalisation, in the 19th century, saw a lot of sovereign defaults which were settled without the support of a multilateral agent[3]. Others argue, from a more theoretical point of view, that any pre-agreed framework for sovereign debt renegotiation is doomed to be counter-productive[4]. Since the State debtor is not subjected to the credible threat of foreclosure on collaterals, or liquidation, private lenders can only count on a single "realistic" variable in order to protect their rights: namely the perceived long term interest of the sovereign in protecting its reputation of good borrower, as a guarantee for future access to capital[5]. But the trade-off between short-term opportunism and long-term interest depends upon the possibly unstable rate at which (often elected) authorities discount these future benefits, that is the length of their time horizon. Hence, easing the way back into the market after a default, with a pre-agreed rule, would only increase the risk of moral hazard: defaults would become more probable and the market would eventually decline.

The stability of international capital markets would then hinge exclusively upon hard market discipline and not third-party mediation on sovereign debt contracts should be envisaged on an *ex ante* basis[6]. A less radical conclusion states that some contingent rules may indeed help, though they should be negotiated by the parties and included *ex ante* in the contract whereas an *ex post* intervention by an authoritative, multilateral dispute resolver would be distabilising; at best, a non-compulsory "Code of Conduct", or a set of "best practices" may guide actors as they enter negotiations.

After a long period during which the policy impact of these arguments had been limited, the obsolescence of the 1980s' framework has given them renewed influence in recent years. This was most visible during the debate which fitted the IMF proposal for a statutory "Sovereign Debt Restructuring Mechanism" (SDRM) against a market-based, contractual approach based on so-called Collective Action Clauses (CAC) – an option which was eventually adopted in April 2003. Almost all contributions to this controversy discussed the obvious opposition between these two strategies, which actually fell along well-known theoretical (and ideological) lines: a top-down approach versus a market-based one, a constructivist against and one relying upon precedent, or, again, one which emphasises international rules against the competition among national legal and judicial institutions.

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[3] See Aggarwal (1996).

[4] See Vaubel (1983) for a critique of the 1980s'model.

[5] Eaton and Gersowitz (1981); Cohen and Sachs (1982).

[6] See for instance Bulow and Rogoff (1989). This literature *de facto* converges with comparable arguments which states that, as a rule, conditionality does not work. See for Collier (1997); or the Meltzer Report (International Financial Institution Advisory Committee, 2000).

Drawing on the three-functions approach to multilateralism, this article underlines however that both SDRM and CACs were to "outsource" third-party mediation towards a specific institution, explicitly build on a judicial model – on the one hand, a new supra-national "Forum", also dubbed "a bankruptcy court for sovereigns", on the other one the national courts in which jurisdiction the debt had originally been issued[7]. The main force beyond this judicialisation of third-party mediation is the increasing call by the private sector for more settled rules of debt renegotiation, which would provide moral legal certainty and more guarantees as regard independence from public interference. And this demand, it is argued, appeared not to be compatible with the Fund's otherwise poorly-regulated, highly discretionary interactions with borrowing countries or with its own principals – say the G7 countries. The core issue is thus the link between dispute-settlement and execution, or conditionality. Whereas in the 1980s' private banks accepted a loose trade-off between (relatively) effective enforcement and the risk of a close encounter with the sovereigns' interests, this formula seems not to be working anymore. Private/ contractual interests are now to be insulated from public/ policy ones so that even an external rule of interaction seems hard to design and implement. And this, in turn, is to affect heavily how the Fund operates, what should be expected from it and how the debt market will perform.

Within a standard neo-institutionalist framework, this article is as well an attempt to better understand how three models of social interaction are articulated, in a context marked by globalised capital markets: contractual or market transactions, principal/ agent relations, and the realistic interaction between sovereigns. In so doing it draws upon two main lines of applied research: the economics of sovereign debt restructuring, and the emerging field of international judicialisation. As regard this latter domain[8], the experience with sovereign debt contrasts strongly with the two models generally discussed. One is international private arbitration, which typically addresses contractual disputes between two private parties or, more recently, conflicts between a sovereign and a single direct investor - as at the World Bank's arbitration centre (ICSID)[9]. The alternate case is judicialisation within an existing international organisation, which generally addresses conflicts between sovereigns; the Dispute Settlement Body at the WTO immediately comes to mind, but many regional trade agreements provide other examples[10]. The case of a sovereign default however, raises different problems and thus comes out as a category of its own: the debtor

[7] In the rest of this paper, we use equivalently the terms mediation and arbitration as informal, or loosely institutionalised dispute-settlement procedures, although in the case of private agents arbitration is binding. See Shapiro (1981). Stone Sweet (1999) defines in very general terms « the 'judicialisation of dispute resolution' [as] the process through which a tryadic dispute resolution mechanism appears, stabilizes, and develops authority over the normative structure governing exchange in a given community ».

[8] See Tate and Vallinder (1995); Shapiro and Stone Sweet (2002) and Alter (2002) for a survey of the litterature.

[9] See Gaillard (1998) on the International Center for Settlement of Investment Dispute; Dezelay and Garth (1996) on private arbitration.

[10] McCall Smith (2000) on the case of trade-agreements. The judicial construction of Europe is arguably a third case, although farther apart from sovereign debt issues.

is to negotiate with a large number of private creditors, generally endowed with much heterogeneous contractual rights, which are de facto broken and will be thoroughly rewritten. This is specifically the stuff of a bankruptcy procedure: it should help solving the collective action problems surrounding renegotiation and, as a specifically judicial authority, and provided a qualified majority has been reached, it should give full legal validity to the eventual accord so that will also apply to minority investors.

Another difference with the two previous models of judicialisation relates to the underlying legal reference being used: rather than an emerging international contract law (arbitrage), the WTO law, an international treaty, or a compact of international treaties (in the case of direct investments), here the reference has a wholly different quality: it is the financial law of the various countries were the initial debt contracts have been signed and the debt issued. The implication is that giving an international organisation the authority to adjudicate sovereign debt settlements requires that a conflict of jurisdiction with national judiciaries be first settled – as the SDRM was to do. And indeed for a multilateral actor to interfere in the old, well-settled, liberal relationship between private contracting agents and national jurisdictions is certainly a major challenge. The creditors, to start with, would have to accept that the ultimate protection of their contractual rights would be shifted to a supra-national body, which would not be part of a trusted, coherent, hierarchical legal order. Indeed the suggestion is that whereas *ex ante* regulation of contracting activities by multilateral organisations is standard practice, their *ex post* intervention in private contractual dispute settlements seems much more contentious.

Section 2 sums up how, over the course of the 20th century, standard problems of sovereign debt renegotiation were addressed and how expertise, mediation and policy enforcement were progressively aggregated within a single institution. The following section analyses in more details how, during the 1980s' debt crisis, a rule-based process of contract renegotiation was articulated with a highly discretionary, "realistic" interaction between the Fund and the debtor country. Section 4 sums up how the Fund initially responded to the changes in the structure of international capital markets, after 1990; the notion of an international lender of last resort as a symptom of this early experiment. The sovereign debt restructuring mechanism (SDRM) proposal is then analysed and compared to the alternate CAC approach. This helps highlighting the underlying issues now at stakes, as regard the future of multilateralism (part 6). Part 7 concludes.

2. SOVEREIGN DEBT RENEGOTIATION IN HISTORICAL PERSPECTIVE: MULTILATERALISM AND INTERNATIONAL CAPITAL MARKETS

During the first era of financial globalisation, before 1914, no formal contingent rule or multilateral agent mediated between the defaulting sovereign and the (bond) investors. Bilateral negotiations exclusively aimed at reinstating the contractual rights of creditors which in principle could not rely upon the active support of their own government. Governments only intervened when the debtor was acting in obvious bad faith or refused to negotiate. In the absence of multilateral financial institutions, information gathering and economic monitoring was taken in charge by private Bondholders' Associations and by the largest international banks (Rotshild, Baring, Crédit Lyonnais, etc.)[11].

The early decades of the 20th century then witnessed a first series of attempts at establishing a public framework for debt renegotiations. Apparently, the issue could not be left entirely in the hands of the parties any longer. During the very first years of the century, the US thus invented third-party mediation in the person of the well-known *Money Doctors*. These were economic experts, generally a Professor in a major East Coast university, fully-armed with its modern, scientific, neutral knowledge. His role – not so different from that of present-day IMF – was first to produce a comprehensive account of the country' economic and financial position, as of its capacity to resume debt service; he would then recommend a stabilisation policy and give his seal of approval on the government's commitments. And in turn this would open access to a financial agreement, with possibly a new bond issue, launched by US banks in New York. Official reserves would almost certainly be invested in New York and, as well, a trade agreement with the United States would most probably be forthcoming[12]. This was indeed the time of Rooseveltian imperialism.

Remarkably, since then, and with very few exceptions, private investors *never* attempted to "re-absorb" this figure, originally incorporated by the *Money Doctors*, which was altogether an independent expert and a typical third-party mediator. Of course he would not always prove immune to corruption, he also happened to be plain wrong, and conditionality immediately became the object of incessant cat-and-mouse games. Specifically, *Doctors* were ill-equipped to address problems of enforcement and moral hazard which rapidly came to the fore[13]. However, at least until the SDRM proposal was rejected, the historical trend was always towards the reinforcement and further institutionalisation of this actor, i.a. *via* a constant effort to strengthen over time and codify the critical interaction between the judge-expert, the country and the investors. That is, drawing on Stone-Sweet (1999), a "diadic" conflict resolution framework was substituted with a "triadic" one, which is interpreted as a first, qualitative step towards institutionalised governance structure.

In 1922, the intervention of the League of Nations in Austria, as later in Hungary and Romania, was a further brake-through: the third party mediator was not any longer a private person, working exclusively for American banks and investors; it was now a multilateral body which intervened in the name of its member-States in order to help one of them. A multilateral stabilisation programme – the first in history – was negotiated with the Austrian government and then closely monitored by a High Representative in Vienna: economic information became more readily available and extra guarantees were added as regard the supervision of economic policy. In the meantime the League became the channel through

[11] Borchard and Wynne (1951); Lipson (1985); Mauro and Yafeh (2003); Clay (2001) and Flandreau (2003).

[12] On the US experience, see Flandreau (2003), then Eichengreen (1989); Rosenberg (1999) and Visser (2002).

[13] Kemmerer (1927) and Rosenberg (1999).

which some of its members offered their guarantee on a bond issue by the Austrian government. It was not yet a multilateral loan, but it was neither pure private lending nor a blatantly clientelistic bail-out[14]. And, in accordance with the principles of multilateralism, the sovereignty of the debtor was not affected. This was clearly stated at the time by Jean Monnet, who worked at the economic and financial section of the League: "Not only Austria did not loose anything in terms of independence as it relied upon foreign aid; it actually reinforced its independence, thanks to international guarantees and internal reforms"[15].

Yet, shifting the two initial regulatory functions –expertise and mediation – within an arena governed by the joint interests of the sovereigns was not wholly un-problematic. In principle these two public goods are produced by specific institutions, governed by self-standing rules and procedures: those respectively of an ideal-typical court and a scientific academy which, as such, should not be affected by sovereigns interests, even cooperative and benevolent ones[16]. How, in the future, these principles would be articulated within the same multilateral institution would become a defining feature of successive regimes of sovereign debt restructuring[17].

After 1944, the development of the IMF, as a universal, specialised financial institution, built on pre-war experiences and their many failures. The "first IMF" which emerged in the following years did not however deal much with sovereign debt, since the primary market, as regard developing countries, did not re-emerge before the early 1970's. That was nevertheless the period when the key concept of IMF bilateral *conditionality*, as well as a large body of experience and precedents was progressively built. The very notion that the IMF could indeed lend against policy commitments (adjustment measures) was only agreed upon in 1948 and became operational in 1952, when the framework of the *stand by* agreement was invented. In 1956 the disbursement of IMF loans in successive *tranches* was introduced, followed in 1958 by explicit *performance targets*. But it was only in 1968

[14] Pauly (1996); Eichengreen and Lindert (1989).

[15] See Monnet (1976), page 129-130.

[16] Here, as with the IMF, the open disinterestedness and neutrality of scientific expertise indeed contribute to the overall legitimacy of the « burden sharing » agreement; science is not merely a know-how or a social technology.

[17] The main components of a multilateral approach are indeed present in the 1920's. This experiment was first founded on a discourse of disinterested, neutral and de-politicised action, which would remain typical to all multilateral organisations (see Barnett and Finnemore (1999)). Second, it would not impair the *sovereignty* of the defaulting country, which political institutions was not to be affected. Third, following on Ruggie (1992), Keohane (1986) was a the notion of an "*indivisibility*", or a common good, which reflected the perception that national economic policies were mutually dependant so that some coordination was warranted. Lastly, emerging rules included an element of "*diffuse reciprocity*", or symmetry, that is a notion of equity or fairness as regard the conditions of adjustment to macro-imbalances. Ruggie adds that three or more sovereigns should participate and that their behaviour should be defined in general terms rather than in an ad hoc way.

that formal conditionality guidelines were adopted and another ten years before they were again reformed, with a strong emphasis put on the sequencing of interactions[18].

This built-up and codification of experience proved remarkably fruitful: when the (bank) debt crisis of the 1980s' started, with the Mexican default of August 1982, conditionality was immediately reinvested as the key element in the new renegotiation framework. The "second IMF" could thus immediately emerge as the central player in the debt restructuring process, at the exact place where the *Money Doctors* and the League of Nations had been standing in the past[19]. That is, it acted altogether as an independent, neutral economic policy expert, as a third party arbiter *and* as a provider of enforcement guarantees. Beyond, the main innovations *vis-à-vis* the experience of the 1920s were the monopoly of the Fund on the issue, the sheer number of countries were it intervened, the amount of credits it allocated and, not least, the ever more intense and complex relations it entered into with national governments.

3 CLASSICAL MULTILATERALISM AND CONDITIONALITY

A further feature of the triangular negotiation framework adopted in 1982 is its being entirely modelled on classic, post-World War II multilateralism. To start with, the representatives of banks (the so-called London Clubs) were *de facto* coopted within an arena which had been designed by the sovereigns and which operation was delegated to their own well-controlled, Westphalian creature – the IMF[20]. At no point did any institution or actor of national level intervene in the process: before agreeing on a stand-by agreement, or when confronted with problems of implementation, the Fund would never call for the support of domestic civil or constitutional courts, parliaments, electors or instances of arbitration. Symmetrically, there was no supra-national actor endowed with the capacity to impose its decision upon the collective of nations-States – as the SDRM framework would have allowed.

The core of the 1980s framework was a remarkable two-step decision-making procedure, which was followed virtually after all defaults, between 1982 and the end of the decade. First, the Fund's agreement upon a macroeconomic programme was a pre-condition for the conclusion of any financial accord with the private banks and, hence, for a return to the

18 Dell (1981); Gold (1979); James (1998) and Martin (2003).

19 In the preceding years, the World Bank and the UNCTAD had been investing much more intensively on issues of international debt.

20 The intense power struggle between the banks and the policy makers on a strategy to address the Mexican default is vividly analysed by Kraft 1984. See also Lipson (1985) on the enforcement of the collective action rules on potentially diverging actors.

primary capital markets[21]. As a gatekeeper, the IMF thus exercised a considerable leverage, which certainly reinforced the exercise of conditionality. But in turn this large power was balanced by the second step requirement that banks agree upon a debt restructuring agreement *before* the IMF loan could be actually disbursed. In other words, if the banks believed that the Fund was too soft on the country, because of a "preferred pupil" status or the pressures of a major member-State, they could reject the whole plan. Technically, this rule was summed up in the prohibition for the Fund to "lend into arrears": that is, lending to a country which had not cleared the arrears accumulated since the default, via a financial agreement[22].

The overall result was to lock together the expertise and the arbitration functions. While the former's act was concentrated in the seal-of-approval decision, the judicial dimension was formalised by the two-step decision-making rule as such[23]. Of course this was only an embryonic form of judicialisation, with limited procedural formalisation and guarantees of judicial independence. Yet the notion of a mediation, by a benevolent, disinterested third party was at the core of the process and provided legitimacy: it *de facto* allowed to settle the default, as the debtor and the banks recontracted debt and entered fresh mutual commitments. In this sense, the Fund already emerged in the 1980s' as an embryonic bankruptcy court.

Despite the duration of the 1980s' debt crisis – almost seven years – this collective action framework resisted opt-out strategies. If indeed some investors (or the debtor) could have easily opted out, or if they had simply been expected to do so, the two criteria for a successful restructuring agreement would have been threatened. First, the economic *efficiency* of the programme would have been weakened (e.g. by an insufficient debt reduction) so that the chance that the economy would stabilise on a sustainable growth path would have been adversely affected. Then *equity* between the debtor and the different classes of creditors, as among the latter, would have been damaged[24]. While the importance of the first element is self-evident, the second one – the "burden sharing" element – is the most fragile, because of its redistributive dimension.

Specifically, it is exposed to acute problems of inter-temporal consistency, *after* the agreement has been sealed. If indeed the sovereign were again to follow bad policies and to default, the financial concessions by the investors would have been of no effect; i.e. the

[21] Most countries also had bilateral official debt with national governments, which were coordinated within the Paris-Club, and multilateral debt which was excluded from any formal renegotiation.

[22] Boughton (2001); Cline (1995) and Dooley (1996) on overviews of the 1980s' debt crisis. In a large literature, see also Cohen (1985); Lipson (1986); Smith and Cuddington (1985) and Sachs (1984).

[23] This procedure was thus explicitly designed to include the interests of banks, so that the eventual outcome would reflect the joint interest of all parties; the formers' influence is not a hidden by-product of market structure, but was explicitly aimed at by collective action. See Gould (2003).

[24] It was only in 1987-88 that a consensus was formed on a diagnostic of insolvency, which calls for debt reductions, instead of illiquidity, which requires only rescheduling.

equity criteria in the initial agreement would have been violated *ex post*. And of course repeated failures in this regard would have threatened the overall strategy for debt restructuring (the "common good" justification for multilateral action). This is where conditionality, as a sequential interaction, as opposed to its actual policy content, takes shape.

What is Conditionality ?

The common strand as regard the concept of IMF conditionality is to present it as a complement to an otherwise fragile contractual relationship between lenders and a sovereign borrower. Conditionality is thus defined as a substitute for the many techniques whereby, at the domestic level, investors' rights are protected against opportunistic debtors (collateral, monitoring clauses, bankruptcy, foreclosures, etc.)[25]. Symmetrically, it may also be an instrument to help the sovereign committing itself on a given policy course. And in turn, the Fund would be a specisalised intermediary which would help sovereign contracting in order to fullfill its mandate as a "facilitator of financing" or a "catalytic" lender, which would ease the return of confidence and capital[26]. But other have as well applied the same approach to conditionality to lending by development banks (World Bank, IADB, etc.) and even by private commercial banks[27].

Although it is almost trivial to define the Fund's role as easing the return of capital, the "contractual paradigm" as regard the operation of conditionality is most confusing. Drawing on this argument, one may eventually infer that, when borrowing, sovereigns would in fact contract out part of their sovereignty, in a sort of augmented concept of intermediation. But this is not consistent with actual and historical practices. In the classical experience of the 1980s', IMF lending certainly represented a measure of support lent by the sovereigns to one of them, so as to ease the process of adjustment. But the efficacy of the Fund's conditionality – its capacity to bear on the sovereign's action – did not derive so much from this "contractual" transaction, or even from peers' pressure. The key element was the broader framework for debt restructuring, based on the two-steps decision rule, which would eventually facilitate the return of the country in the capital markets. Lending was part of this framework: specifically it was a device for the Fund to reinforce the credibility of its seal-of-approval and arbitration functions. Credits added to expertise and mediation, and hence eased the way towards a restructuring agreement[28]. In other words, in the 1980s' model, IMF lending reinforced conditionality, rather than the reverse as the "intermediation" thesis would have it.

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[25] "In lieu of collateral, Fund lending requires agreement with the borrower on economic policy measures that will improve its balance of payments and help it repay" (Krueger, 2001).

[26] Dhonte (1997); Gould (2003); Martin (2003) and IMF (2004a).

[27] See Williamson (1983) for good examples.

[28] « Fund lending implied a vote of confidence, backed by money » (IMF, 2004a).

This explains why considerable rule-making activity has been (and is) invested by the Fund in framing the sequential interaction with countries under programme: prior-actions are often requested before an agreement is signed, then the disbursement of successive tranches require review, mid-course and post-extinction evaluation of programmes are mandatory, waivers on performance criteria may be negotiated, article IV reviews come on top of this, plus specific reports on standards and codes, or financial stability. However, this apparently erratic build-up of information exchanges and negotiations does not reflect merely a bureaucratic accumulation of formal steps, with no actual coherence. It shapes a framework within which the actors interact, where successive moves take place and where, hopefully, credibility will accumulate. And in so doing, these apparently confused rules testify that conditionality works on the assumption that successive commitments will be opened to cheating, renegotiation, arm-twisting and so forth. In other words – and this is the key point – conditionality is entirely build on the full recognition that the member-State which negotiates with the Fund is a sovereign and is expected to behave accordingly, i.e. in a "realistic", opportunistic way. This is the main reason why IMF conditionality is built on a model of interaction wholly different from that of a private bank engaged in credit intermediation. Fund lending is definitely not a market transaction, but a realistic, Westphalian one, which structure is shaped by the Fund's multilateral constitution.

Tellingly, Joseph Gold (1979) who was a major figure in the formation of the Fund's legal doctrine, made very clear that conditionality has no contractual character. He underlined that policy commitments are too imprecise for this and, more to the point, that the Fund's discretion is not to be constrained if "targets" or "criteria" are not met[29]. Indeed, since the 1950s', the *Letters of Intent*, which summarise the sovereign's commitments, are exclusively signed by the country' authorities; provided the Executive Board agrees with it, the Fund would then *separately* announce that financial resources are made available. No single document, signed by the two parties, would ever sum up the respective rights and obligations[30]. Following on the same logic, the policy targets and criteria are to be considered only as indicators within the broader process of economic policy monitoring, which is the core of the strategic interaction between the Fund and the sovereign: that is, the actual basis on which a *stand by* agreement will be suspended or continued, a new Letter be negotiated, targets adjusted, etc.

Substantial discretion and room for judgement are thus defining characters of the Fund, which also reflect the incomplete character of any transaction with a sovereign State. The capacity of the Fund to adopt realistic, non-contractual strategies of constructive ambiguity, or to hide its information and intentions, are *de facto* instruments for the IMF to receive commitments: these, in turn, should not to be understood as contractually binding, but they would be credible enough, over time, for it to disburse successive credit tranches and for the private sector to sign on a debt restructuring agreement.

[29] Gold (1979) underlines that suspending access to the Fund's resources, by the borrowing country, is a discretionary decision by the institution.

[30] "Fund arrangements are not international agreements and therefore language having a contractual connotation will be avoided in arrangements and in program documents", Articles of Agreement, Article V, Section 3(b). (Guidelines on Conditionality).

Why a Multilateral Institution?

The main counterpart to the large discretion embedded in conditionality enforcement is the equally large, perhaps even larger discretion which the principals (G7 Executive Directors) have always preserved, collectively and individually, *vis-à-vis* the Fund[31]. The IMF is thus altogether an exceptionally powerful institution and one which integrity is always challenged and questioned by its own principals, precisely because of the large resources and operational discretion they have endowed it with. Hence the asymmetry : on the one hand the Fund follows tough realistic rules of interaction with borrowing member-States, while on the other one it is governed by a weak agency contract which can be easily trespassed by the principals. This may be interpreted as the needed counterpart to the structural weaknesses of the investors' position *vis-à-vis* the sovereign contractor. But as well, this suggested alignment of the Fund on the creditors' interests underlines the political dimension in its action: this is where most critics as regards its overall legitimacy probably derive from[32].

A straightforward reason for this unique principal/ agent relationship is the strong *executive* or reactive dimension of the Fund's interventions as a crisis manager. Its core functions indeed address *ex post* problems, such as a default or an open financial crisis: that is, situations where substantial discretion and delegation are probably inevitable. This makes a considerable difference with most other international economic organisations, which are either primary lenders (as development banks) or in charge of *ex ante* regulations: they are arenas where sovereigns negotiate for instance on norms and codes (eg trade in intellectual property rights) or they produce pure, non-excluable public goods (meteorology). In these cases, the short-term performance of the institution is considerably less a problem for its principals than in the case of the IMF, however the long-term costs incurred[33].

This may explain why G7 countries are often incited to brake formal rules of interaction, if they think for instance that the Fund is threatening their clientelistic interests. A more systemic experience is when the principals think, or are afraid that the Fund is failing to stem a large crisis. Such has been the case with most emerging economy crisis, since the

[31] On the principal/ agent theory applied to international institutions, see *inter allia* Keohane and Martin (1999); Nielson and Tierney (2003) and Pollack (1997).

[32] Specifically, the hypothesis would be that the interaction between the Fund and the borrowing countries is effective only because it unfolds in the shadow of the principals' discretion. A counterfactual experiment would test whether a more standard delegation contract, which would limit interference by the principals, would leave the Fund with the same leverage.

[33] This indeed applies to the Fund's own *ex ante* activities, such as surveillance and, more generally, the provision of information, expertise, agenda setting reports, etc. They have never attracted a comparable degree of opposition and dissent as *ex post* intervention and conditionality.

mid-1990s (Mexico, Asia, Russia, etc)[34]. As the international negative externalities at stakes became extremely large, and the Fund mobilised ever increasing financial resources, the "volatility" in the principal/ agent relationship increased tremendously: in most cases, though to a variable degree, the principals, specifically the US Treasury, de facto micro-managed the agent, if not the crisis itself [35]. The Korean liquidity crisis of 1997 comes out in this respect as a paradigmatic example: after a Fund programme had collapsed within a few days, the (American) principal designed and implemented from scratch an alternate strategy. It was based on a purely *ad-hoc*, provisory rule of collective action, which remembered comparable late 19th century experiences[36], and which mobilised the Fund as a mere instrument.

Hence, the defining paradox in the Fund's constitution: although the "Coasean" frontier of the institution is remarkably weak and easily contested, the rational for preserving it as a going concern and to endow it with large discretion and resources has never been seriously contested. If ever, after the 1997-1998 crisis, the G7 government had concluded that there was not rational anymore for preserving the Fund, its outside critics (and sometimes its own performance) would have provided enough argument at least to reduce its functions and resources. One reason for this resilience certainly derives from the standard neo-institutionalist emphasis on information and expertise, compounded by economies of scale. Whereas some principals may have the resources to monitor a given country and formulate policy proposals, they certainly cannot do the same for all countries under programme.

Another reason for preserving the Fund's agency is the above-mentioned, realistic, high-intensity, sequential pattern of interactions with borrowing countries which supports conditionality. First, its experience is de facto capitalised by the institution and could probably not be assumed by any other agent – least of all the G7 countries[37]. Legitimacy is indeed a serious issue at this point: as Jean Monnet suggested, international policy enforcement should not be perceived as infringing upon the sovereignty (or independence) of the debtor country; and that would probably be the case if it were seen systematically as the naked act of a sovereign, or a small group among them.

But the main reason for ceding agency is probably the principals' own understanding that their unstable, shifting set of interests would not provide conditionality enforcement with

[34] Retrospective reviews, journalistic accounts and memoirs have provided extensive information on how the US government acted and reacted during the successive crisis episodes after 1994. See, respectively, De Long and Eichengreen (2002); Haggard (2000), as well as Odling-Smee (2004) as an insider's account of the Fund's action in Russia during 1990s' where G7 interventions were pervasive; then Blustein, 2001 (on Asia and Russia), Graham et alii, 1995 (on Mexico), Kirk, 2001 and Lee, 1998 (on South Korea); lastly Rubin (2003) and Talbot (2003).

[35] Obviously the fact that, in several cases, these resources were lended by the G10 countries, under the General Agreements to Borrow, provided a basis for closer scrutiny. It is questionable, however, whether things would have been much different if the IMF had had enough available capital on its own.

[36] Borchard and Wynne (1951) and Flandreau (1997).

[37] Martin (2003).

the required time-consistency. One could not bargain efficiently on the Argentine or Turkish debt while fighting in Kabul, or discussing a constitution in Brussels. Outside large systemic crisis, substantial delegation would be a way to insure that the agent has a sufficiently long time-horizon in order to interact constructively with borrowing countries[38]. This is consistent with the account that, on a day by day basis, the input of Executive Directors on the average programme is limited, due both to the sequencing of interaction with the Staff and to asymmetries of information[39]. In other words, delegation can be withdrawn easily but the IMF is *also* exposed to the standard risks of insufficient monitoring and agency slack[40].

4. THE IMPACT OF GLOBALISATION

With hindsight, what made the success of the 1980s' debt regime was the agreement by all parties on a set of rules which articulated *within the same institution* the three canonical functions – expertise, third-party mediation and conditionality enforcement. Critically, mediation was insulated from the overwhelming, often unruly discretion which otherwise characterises the Fund operating mode, whether it deals with borrowing countries or with its principals. Why, then, did this method become inefficient during the 1990's? What were the reasons for launching such a radical proposal as the one put forward by the IMF in 2001, only to have it discarded after eighteen months of often acid debates?

The root-cause of the evolutions observed since the early 1990s' are well-known: tectonic changes in international financial markets have made crisis management considerably more complex. Pre-default, the size and liquidity of international capital markets have allowed many developing and emerging countries to substitute multilateral by private funding. Hence a loss of leverage by the Fund. Moreover, since the Mexican crisis, and contrary to the out-of-market strategies of the 1980s', crisis management has been focused on avoiding at any costs any interruption of foreign payments. For a while, the most popular related concept was that of an *international lender of last resort*[41]: just as its namesake at the

[38] The identification of conditionality enforcement as the core multilateral function is consistent with experiences where expertise and third-party arbitration were externalised: the role of commercial banks and Bondholders' Committee in the XIX° century is an example as regard the former case, SDRM and CAC as regard the latter one (see below). In the last resort, execution relied in the pre-1914 era upon measures of direct control over tax administrations, possibly supported by armed forces – an instrument which is not available anymore.

[39] Martin (2003).

[40] The report on the Argentine crisis published by the Fund's Independent Evaluation Office describes a textbook case of an agent exploiting asymmetries of information in order to extend its discretion and enter dangerous policy gambles. See IEO (2004).

[41] See Aglietta and Moutot (1993); Fischer (1999); Calomiris (1998) and Giannini (1999). The main institutional outcome of this episode was the creation by the Fund, in 1999, of the Contingent Credit Line which was however abandoned in 2003 (IMF, 2003a).

national level, this emerging regulator was to intervene on the spot, with a massive mobilisation of financial resources and would aim primarily at stabilising the international markets.

The corollary is that the interaction with the governments and with the private investors has become much more difficult: any form of collective action, negotiation, formalised exchanges of information not to speak of commitment, have become considerably more difficult. As is well-known this has been often considered a major source of moral hazard, as for instance when massive multilateral support was offered to Mexico without the private sector being involved in the resolution of the crisis. Free bail-outs would then become the source of more risky investments, and more crisis. After the experiences in Asia and Russia however, last resort intervention lost much popularity and was substituted to some extent by the notion of the Fund acting as a "signaling" agent, which intervention would "catalise" market confidence[42]. However, both the lender of last resort and the catalitic approaches suggest a much comparable "arms'length", non-transactional and non-committal pattern of interaction between actors, i.e. less institutionalised rules of collective action (if any). This indeed represents a weaker form of multilateralism, which one may or may not consider as an adverse evolution.

Since the early 1990s, collective action problems have become as well much harder to resolve in a post-default context. Among the reason for this evolution, the shift of developing countries from bank credits to disintermediated (bond) finance is obviously the key culprit. Not only are there now several thousands, often hundreds of thousand of investors which may be caught in each default, rather than a few hundreds banks as was the rule before. But their institutional quality is now considerably diversified: rather than being clearly dominated by the largest international banks, which use to have close interaction with central banks, capital markets are now peopled as well by investment funds of different varieties, insurance companies, multinational enterprises or even personal investors acting *via* the Internet. These market operators respond to very different investment objectives, time horizons, legal and contractual constraints, so that at time of crisis they may react in wholly divergent ways and may then refuse to enter an often time-consuming procedure of renegotiation.

These problems have been further compounded by a series of cases where minority investors successfully sued a sovereign issuer in US courts, after its US-issued debt had been restructured. Their aim was not to destroy the overall stabilisation plan but to obtain, for their own good, a much better treatment than the investors who entered the accord. It was thus a purely opportunistic action which, however, directly threatened the equity and efficiency criteria, and hence the incentive for any investor to enter any such negotiation.

[42] One main pratical difference between the two notions is that the latter is de facto articulated to an open, normative discussion of the limits to the Fund's financial engagement. In the last resort perspective, this would have been considered as a self-deating consideration (Fischer, 1999).

The very principle of collective action was directly weakened by such "hold-out" strategies[43].

This is the context in which the notion of a " bankruptcy court for sovereign" emerged[44]. On the one hand, the perceived risks of litigation called for an institution with the legal power to halt petitioning national courts. On the other hand, once it was recognised that crisis-stricken countries could not have open-ended access to last resort (or catalytic) public funding, it should be assumed as well that they may default. All standard problems of collective action then again come to the fore: how should the information be collected on how the economy is performing and who the actual investors are? Who should represent them at the roundtable? Should classes of creditors be created? How should the government commit itself? What should be the voting rules and the majority threshold? etc.

A "Bankruptcy Court for Sovereign"

The SDRM proposal, first formulated in November 2001, was an original, groundbreaking attempt to solve these problems[45]. A good part of the publicity it gained came from its being openly inspired from the *Chapter 11* of the US bankruptcy code[46]. This private sector procedure allows managers of distressed enterprises to suspend debt service and litigations by creditors, so as to negotiate a restructuring plan under the protection, and the supervision, of courts. The management may thus suspend debt service for a non-negligeable period of time (several years in the worst cases); it can also have access to fresh money (the so-called debtor-in-possession clause) and it remains a key player in the restructuring process: the management is not automatically ousted, shareholders do not loose their ownership titles and the firm is not dissolved.

This makes the *Chapter 11* an appealing reference when considering sovereign defaults: coordination problems have become an increasing source of concern; easier access to new financial resources may certainly help economic stabilisation; and, obviously, it is not in the power of investors to oust the government and – say – their stakeholders. Hence the key element in the SDRM proposal: it would have created within the Fund an independent, quasi-judicial body which would have first administered debt renegotiation and then legally sanctioned the restructuring agreements – the Sovereign Debt Dispute Resolution Forum.

[43] Fisch and Gentile (2004) and Krueger (2001).

[44] A bankruptcy approach to sovereign default has been discussed episodically since the late 1980s'. See Rogoff and Zettelmeyer (2002) for an overview, then Cohen (1989) for an early contribution; the seminal paper by Sachs (1995), and Eichengreen and Portes (1995). The theme was also put forward in a post-Mexico address by the then Managing Director of the Fund (Camdessus, 1995); some work along these lines had been done at the time at the Fund Legal Department.

[45] Krueger (2001) and IMF (2001).

[46] On the US Chapter 11, see Baird (2001). On a comparison with the SDRM proposal, Bolton (2002) and Roubini (2002).

Provided a qualified majority (75% of holders) had accepted such agreement, minority investors would not have been able to hold-out: in particular they would have lost the capacity to sue the sovereign, for instance in US court[47].

Two (expected) critics were levelled against the Fund's proposal[48]. For many in the financial private sector, as stated, the very notion of a public contingent rule to address sovereign defaults should be rejected, due to moral hazard problems. Others questioned specifically the legal authority given to a powerful supra-national actor to trespass contractual rights. In this respect, the SDRM framework was indeed quite revolutionary. Whatever the guarantees it would have offered, the Forum would have directly interfered into the domestic legal order of the countries where the initial debt contracts had been signed and the bond issued – first of all, the US and Great Britain. Other things equal, the effect would have been comparable to that of the International Penal Court which authority is not limited by the legal guarantees that each sovereign offers to its own nationals[49].

5 UNIVERSALISATION AND JUDICIALISATION

Oddly, in the initial SDRM blueprint, the Fund wholly under-estimated the extent to which this logic of judicialisation, which underlines the "bankruptcy approach" to sovereign defaults, required a profound redefinition of its own operating rules. This early mis-perception and its ensuing correction are indeed reflected in the succession of technical notes published by the Fund, between November 2001 and April 2003. They shed light on how the Fund's thinking actually evolved over time, *as if* it discovered only progressively the internal consistency of its initial proposal as of the problems of institutional design which it raised.

The scope of the proposal, to start with, was initially centred on internationally-traded bonds which are indeed the core segment of the sovereign debt markets, where collective action problems are especially acute. Later drafts then considered extending the very principle of collective negotiation to all types of debts, whatever their legal quality and origin: bilateral "Paris Club" debt, bank credit, multilateral debt, local public debt and even

[47] Compared to the 1980s' regime, this would have also reflected a shift to a fully-fledged compulsory conflict settlement mechanism.

[48] See for instance Shleifer (2003) and Schwartz (2003) for opinions stemming from the academic world. For a defense of a no-contingent clause approach by the private sector, see Emerging Market Traders Association 1999. The main private sector manifesto against the SDRM proposal is Emerging Markets Creditors Association *et alii* (2002). See also Moody's (2000).

[49] Unlinking international crisis management from the domestic regulatory order was much simpler in the 1980s: only bank supervision was concerned and it was much less developed than today. In the case of the US, the whole problem was solved with one sentence by Paul Volcker, then Governor of the Federal Reserve: « In such cases, where new loans facilitate the adjustment process and enable a country to strengthen its economy and service its international debt in an orderly manner, new credits should not be subject to supervisory criticism » (quoted in Kraft (1984), page 49).

the part of it which was owned by commercial banks[50]. The principle is indeed non-contentious: once economic expertise considers a debt reduction a prerequisite for stabilisation, then, for the sake of efficiency and equity, all investors in the defaulted debt should be part of it, even if a hierarchy of assets is preserved[51]. And if the market had been global, so should be the procedure as well[52]. This however was opposed by strong interests, which contributed to the eventual rejection of the SDRM: traditional defenders of Paris Club practices, as regard the restructuring of bilateral public debts, were not overly enthusiastic; and in a more vocal manner, the private financial sector apparently did not want at all to interact directly with holders of domestic public debt, which are subjected to wholly different normative rules[53].

A comparable evolution is observed as regard the procedure as such. In the first proposal, it was mentioned that the interests and rights of the parties were to be at centre of the process, though the Fund was to be as well an active participant, due to its traditional expertise function: "The Fund's involvement would be essential (…). We are the most effective channel through which the international community can reach a judgement on the sustainability of a country's debt and of its economic policies"[54]. Logically, the Fund was then to have a voice in the final agreement: "To ensure that the terms of the restructuring provide for a sustainable debt profile, some form of Fund endorsement of the terms of the restructuring would probably be necessary. Otherwise, there is a risk that the terms of the restructuring are such that an undue burden is placed on either the member's adjustment or future financing from the Fund"[55].

In other words, the Fund stated that there was a need within the deliberation process for an outside, neutral public actor which would be the ultimate guarantor of economic viability and overall redistributive equity. Its mandate, and the joint interests of the sovereigns, would not be contradictory to those of the parties, but rather complementary. The Fund would indeed force into the procedure a superior form of public good which private actors would not be able to take care of: just as in the 1980s, crisis management was to be directly articulated to the contractual settlement, though this is certainly alien to the concept of private bankruptcy[56]. As could be expected, in later drafts this conjunction of public and

[50] IMF (2002 f and g).

[51] "Having initially focused on coordination problems and the threat of litigation, I have been struck – after many discussion with the private creditor community – by the importance of (…) inter-creditor equity" (Krueger, 2002).

[52] Bebchuk and Guzman (1998).

[53] IMF (2002e).

[54] Krueger (2001).

[55] IMF (2001).

[56] Jackson (1986).

private interests was increasingly put in question, as the full consequences of the bankruptcy paradigm became clearer. Not only was it repeated again and again that "the essential decision-making power would be vested in the debtor and a super-majority of its creditors – not the Fund"[57]. But actual rules and procedures were progressively aligned on this principle.

This is reflected in the twin issues of how the mechanism would have been "activated" and whether this decision should have been linked to an automatic legal stay on investors' litigation. The very first proposal clearly stated that the Fund (i.e. its Executive Board) would have to agree on activation and that a stay would then be automatic – just as when a US firm puts itself under the protection of the *Chapter 11*. Already by February 2002 however, the stay was not to be automatic anymore and the Fund's discretion was being reduced: three months after activation, once creditors had been organised, they would collectively assume the decision to extend it or not[58]. In April, it was only mentioned that the Fund "could have the power to approve" a stay, although the institution was still part of the initial activation decision[59]. Finally, by November, activation was entirely left to the debtor country and the decision on the stay was fully transferred to the creditors[60]. Significantly how this would be reconciled with the possible need to stem a liquidity crisis and stabilise the economy was not mentioned: the Fund would have only kept a *de facto* influence, "through the exercise of its existing financial power"[61].

The trend towards judicialisation was finally reflected in the institutional framework within which the procedure would have unfold. Initially the renegotiation process was to take place within the Fund's existing structure, in a manner not so different from the 1980s' – that is with little institutional guarantees as regard judicial independence and insulation from interference by sovereigns. Apparently the old pretence of multilateralism being disinterested, neutral and apolitical was considered to enough in this respect. Then the overall process was shifted under the umbrella of the "Sovereign Debt Dispute Resolution Forum": i.e. a body created within the Fund, but endowed with a de facto independent, judicial constitution[62]. It was first to certify the super-majority decisions of investors, so that they would actually bind domestic courts. Then it would have adjudicated disputes as regard the operation of the procedure; in other words, just as a full-blown judiciary, it would have had a capacity to interpret its own legal rules. Later an appellate body was

57 IMF (2002a).

58 IMF (2002a). An underlying theme in this discussion is whether capital controls or a large moratorium may be enacted either by the country, tough with the Fund's blessing, or jointly by the debtor and the creditors' committee (see for instance IMF, 2000).

59 Krueger (2002).

60 IMF (2002f).

61 IMF (2002f).

62 IMF (2002e).

even added, which would have further formalised the Forum capacity to develop a (non-binding) case-based jurisprudence[63]. Finally a complex procedure was proposed which would have guaranteed the independence of the three "bankruptcy judges" which, in each default case, would have been in charge of the negotiation[64].

What had started as a cooperative and rather loose policy framework where private, sovereign and multilateral actors would have sorted out *all* the problems caused by a default, ended up as an almost paradigmatic model for a civil court. And whereas contractual renegotiation was initially to be closely articulated to crisis management – as they were in the 1980s' – the end-result codified how these two concerns should be carefully separated one from the other. As all practical responsibilities as regard the unfolding of negotiations were left squarely in the hands of the parties, any *de facto* link to actual policy making was to be excluded *by construction*. If ever SDRM was to be made acceptable, the restructuring process was to be established wholly out of reach from any policy maker.

At this point, the fact that the Forum would have been created within the IMF was presented only as a casual consequence of the transaction costs associated with the creation of a brand new institution. Moreover, if successful, the SDRM may have only worked as a threat to discipline actors: "the existence of a predictable framework should in itself help catalyze agreement without the need for formal activation. This is what happens in well-designed domestic bankruptcy regimes. Most restructurings take place 'in the shadow of the law' rather than in court"[65].

6 ANY FUTURE FOR A MULTILATERAL APPROACH TO FINANCIAL CRISIS?

The eventual rejection of the Fund's statutory approach led to the adoption of its main alternative: in the foreseeable future, the process for settling sovereign defaults will be much closer to private sector practices; it will as well remain within the realm of contractual conflict resolution; and, not least, it will be governed by national, i.e. local legal orders and judiciaries. The core concept is that of *Collective Action Clauses* (CAC). That is, contingent rules written into the original sovereign debt contracts, when issued, which define on an *ex ante* basis how a possible default would be dealt with by the holders of the

63 IMF (2000g).

64 The overall framework then closely resembled the Dispute Settlement Body of the WTO.

65 Krueger (2002).

given bond, and under which jurisdiction[66]. Significantly, whereas the SDRM would have created a supra-national judiciary, CACs rely exclusively on national ones, i.e. the courts in which jurisdictions the initial debt was contracted. Conversely, neither the SDRM nor the CACs formally require the presence of a multilateral body: if the Fund did not exist, both formula would not have been much different from what they have been, at least formally.

Within the framework of each bond issue, CACs thus address the same basic collective action problems as the SDRM – coordination between investors, information, representation, and qualified majority decision-making. Hence, they are more constructivist than the "no-contingent rules" approach, but they also leave un-addressed a series of problems which the SDRM was to settle. The most widely discussed is coordination or aggregation of holders of different bond contracts[67]. Under CACs, and contrary to SDRM, investors remain "encapsulated" in the closed structure of their original debt contracts, which remains guaranteed by the respective national judiciary. How should holders of different bonds be co-ordinated? How can they transfer the right to renegotiate the contract to a joint representative? What should be done with the bonds which do not include CAC?

These problems, of course, are not ignored by the proponents of CACs. They explicitly assume that they would be solved thanks to ad hoc innovation, experience building and market-based transactions – i.e. the usual methods of conflict resolution in the international private sector. Some have also argued at that point that the risk of crippling litigation would not be that large after all[68]. With the possible help of a voluntary Code of Conduct[69], and provided jurisprudence evolves positively, CACs may eventually reach the same objective as SDRM[70], though which much reduced risks.

Then, however, are questions which clearly fall outside the scope of any contractual dispute settlement, whatever the prowess of financiers and lawyers. As in the final version of SDRM, the core issue is again the articulation between recontracting and enforcement guarantees or, symmetrically, between economic stabilisation and the return of the country

66 On CACs, see Dixon and Wall (2000); Eichengreen and Portes (1995); Galvis and Saad (2004) and IMF (1999a, 2002b and c, 2003a). CACs have traditionally been included in London bonds, contrary to New York ones. This is why the discussion centred on New York law and legal practices. More generally, CACs reflect a logic where national jurisdictions and legal frameworks compete one against the other. The point is that competition has already delivered its result, under the former of a *de facto* duopoly, this being due to the tight vertical integration between private institutions and agents, on the one hand, and legal institutions on the other.

67 IMF (2003e); Galvis and Saad (2004) and Gugiatti and Richards (2004).

68 Roubini (2002). This opinion is partially vindicated in IMF (2004).

69 Banque de France (2003) and Institute of International Finance (2004). The good faith criterion put forwards by the Fund as a condition for lending into arrears are de facto equivalent to a code of good conduct (IMF, 2002d).

70 Eichengreen (2002).

in the capital markets. Today, no formal rule bind together the two sides of the dilemma, as the two-steps model of the 1980s did. On the one hand, as stated, even the statutory SDRM model did not make the renegotiation process conditional upon the Fund's seal of approval; even the activation of the dispute-settlement mechanism was not a decision to be shared with the Fund[71]. Conversely, there is no question that the Fund may return to a policy of no-lending into arrears or some equivalent rule: in a default-and-arrears situation, its only criteria for discontinuing disbursements is that the debtor would not negotiate in "good faith" with the investors, i.e. a notion which practicality is yet to be established. In other words, neither the contractual nor the policy side are conditioned one by the other[72].

As already stated, this apparently irresistible estrangement certainly derives from the expected resistance by the private sector against any public interference in contractual matters, as from issues of judicial sovereignty[73]. But a further hypothesis, which bears directly on the existing structure of the Fund, is that a judicialised approach to debt restructuring would just not be compatible with the high discretion/ low institutionalisation pattern of interaction between the IMF and member-States – borrowing ones and principals. That is: third-party arbitration and conditionality enforcement could not coexist anymore within the same institution. As private contracting further extended at the international level, the demand for neutrality, transparency and certainty in dispute resolution would have overshadowed considerations for the guarantees of execution earlier provided by the Fund - thanks i.a. to the leverage it gained from participating to the negotiation. Apparently, judicial discretion could not have coexisted anymore with the discretion of interacting, realistic sovereigns.

What is indeed at stake is the definition *and* further codification of how, in a globalising world, private interests and public rules should interact in dispute settlement. At the national level, in principle, the executive arm provides the judicial with credible enforcement guarantees, without infringing upon its independence – generally some sort of Supreme court takes care of this. At the international level, however, there is no independent constitution of the respective powers. Even the definition of an ad hoc external rule of interaction between a judicial body and conditionality is apparently not on the horizon. As stated, this comes as a sharp brake with the historical experiences: since the 1920s', financial multilateralism was founded on the opposite approach, where all functions were integrated within the same loosely institutionalised organisation – expertise, mediation, execution and even legislation, as exercised by the principals. The absence of a fully constitutionalised world-order would thus be the reason why today international

71 IMF (2002f).

72 Remarkably, in the final version of SDRM (IMF, 2002f), the term "conditionality" is mentioned only once in 75 pages.

73 There are indeed reasons to believe that the threat that G7 governments would adopt SDRM was a major factor beyond the private sector eventual acceptance, in September 2002, that CACs should be generalised.

private investors are not as global as generally assumed. They still hang forcefully to the guarantees offered by unmitigated judicial sovereignty[74].

7 CONCLUSION: ANY PLACE LEFT FOR THE FUND?

This article has analysed in historical perspective how the patterns of sovereign debt renegotiations have been closely articulated to the evolution of multilateralism in the financial sphere. Since at least the 1920s', and especially under the classical regime of the 1980s, renegotiations regimes were established under a multilateral umbrella which locked together three key functions: economic expertise and information, third-party arbitration and guarantees of execution. This indeed allowed to reconcile the efficiency and equity criteria which are preconditions for the resolution of any insolvency crisis.

This model however lost its relevance in a world of financial globalisation where the logic of private contracting weighs heavily on all institutions and rules. This was highlighted by the recent debate on how sovereign defaults should now be settled. First a loosely institutionalised approach, which still remembered the 1980s' multilateral regime, was rapidly abandoned (the first SDRM blueprint). Third-party mediation now has to be entrusted to an institution expressly built on a judicial model. A response was the proposal for a post-Westphalian, supra-national court, which was again shelved, probably because of its own constitutional inconsistencies (the final version of the SDRM). Finally the whole regulatory and dispute settlement process was reinstated where private contracts and property rights have always belonged – the national legal and judicial orders.

The main consequence is that, for the first time since the 1920s', third-party mediation is not incorporated with expertise and conditionality, in the same Coasean body. At least as long as the collective action problems surrounding CACs are not solved, this is world where the settlement of sovereign defaults has drifted back from an institutionalised, "tryadic" structure to a dual one, which capacity to support broader form of public governance is open to question (Stone Sweet 1999). The main reason for this, it has been argued, is that the *ex post* interaction between a multilateral institution and private agents has emerged as a most contentious issue, especially when contracts are to be rewritten and wealth reallocated. Indeed, as a rule, international contractual disputes between private agents, especially when large financial are at stake, are dealt within the most, de-politicised and de-territorialised framework – private arbitrage.

Practically, the main consequence of this divorce as regard the practice of multilateral intervention, is that a lot of discretion has been introduced in the interaction between the Fund, the member-states and the private sector. Each party has much more room to go its own way, as both the criteria and the instruments of mutual retaliation are much weaker. First commitments made by borrowing countries are much less credible – which does not

[74] This confirms Shapiro's remark that « there is no inclination to create larger-than-traditional jurisdictions to match the increasing geographic reach of contracting » (Shapiro, 1998).

mean that their policies are necessarily foolish. Then, the involvement of the private sector in the resolution of crisis has become a most challenging endeavour. And finally the Fund is much less able to resist undue pressures – either those of private interests and G7 governments, or those deriving from the Fund's own ideological preferences, errors of judgement or policy gambles[75]. The IMF thus appears as less encumbered by checks and balances, and altogether much weaker, because it has much less capacity to support collective action.

The overall response by the institution has been a broad attempt to design alternate strategies, which main character is a stronger element of market intervention, with less negotiation and limited expectations as regard pre-agreed rules of collective action. This trend is illustrated by fashionable concepts such as "policy ownership", "catalytic interventions" or the Fund acting as a "signaling" agent. These may well be substitutes for, respectively, conditionality, burden-sharing and seal-of-approval function; or, again, for guarantees of execution, arbitration and expertise. What indeed puts these new concepts together is that they only call for the most limited form of mediation.

A remaining, open question is why private actors, which have been the main force beyond judicialisation, do not seem to worry about enforcement guarantees. Are they myopic, or do they still believe in conditionality? Or in bail outs? Or do they deliberately or confusingly push towards a regime which would remember the first, 19th century era of financial globalisation: a period when indeed sovereign debt was private matter and multilateral action was either non-existent or *ad-hoc*?

[75] Striking examples of these risks are provided in the report on the Fund policy in Argentina between 1991 and 2001, published by its own Independant Evaluation Office (2004).

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