The World Economy in Crisis
The Return of Keynesianism?

30 – 31 October 2009

13th Conference of
the Research Network Macroeconomics and
Macroeconomic Policies (RNM)

How to Prevent and Solve a Classic Sovereign Debt Crisis: Beyond the debate CAC vs. SRDM.

Claire Barraud*, University of Grenoble, France.

Abstract: The International Lender of Last Resort (ILLR), in the IMF's body, and the Sovereign Debt Restructuring Mechanism (SDRM) of Anne Krueger have been given up, despite the seniority of the former and the successful design of the latter. Instead, the Collective Action Clauses (CACs) have been chosen as the only way to settle a sovereign debt crisis, in spite of their weakness to only govern restructurings. The purpose of a sovereign debt crisis settlement is not to reach a restructuring agreement only respecting creditors' rights, but to find an outcome to the crisis satisfying creditors' rights and the rehabilitation of the sovereign debtor. Globally, a classic sovereign debt crisis has multiple ins and outs and merits so a global and hybrid mechanism designed step by step, according to existing proposals. Instead of an ILLR, an International Lender of First Resort (ILFR) could distinguish among possible natures and causes of the crisis to bring settlement around the right process. Then only, in case of solvency crisis, CACs could be privileged. But lastly, if CACs fail to reach a reasonable agreement, an arbitration forum, as the one of the SDRM, would be in charge of forcing a decision satisfying all involved parties.

---

*Graduate Student.
Claire.Barraud@upmf-grenoble.fr.

1. Introduction.

Sovereign defaults do exist since sovereign have right to borrow. Regardless, all attempts to settle restructuring and crisis outcomes have failed. Adam Smith already asserted that "when it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open and avowed bankruptcy is always the measure which is both least dishonourable to the debtors, and least hurtful to the creditor" (*in* Rogoff and Zettelmeyer, 2002). However, creditors have never been agreed with a formal sovereign debt restructuring idea, because regarding crisis costs as a fair sanction for the debtor. On the other hand, an established mechanism necessarily calls for some national policies amendments, which are still considered as too complicated to endorse and to implement. Lastly, a formal mechanism would balance the interests of creditors and debtor, and so inevitably "tilt this balance too far from the perspective of one or other side" (Heillener, 2006). And, at first, this balance would tilt en favour of the debtor.

The central issues of a classic sovereign debt crisis have always been the difficulty to distinguish between liquidity and solvency crises and the one hand, and between capacity and willingness for State to pay off its creditors on the other. Chang and Velasco (1999) define illiquidity "as a situation in which a country's consolidated financial system has potential short-term obligations that exceed the amount of foreign currency available on short notice". Illiquidity is accordingly a temporary problem needing official bailouts and/or private fresh money to continue servicing debt obligations. Sovereign insolvency refers to debt unsustainability, defined as the incapacity, for a country, to meet the current and long-term obligations of both private and public sectors, without running into arrears, recourse to debt-rescheduling, or debt relief. The solvency issue is more problematic, especially because it is not temporary and corresponds to a situation in which bailouts and interim financing are pointless. In these circumstances, it is essential to be able to rapidly distinguish between these two types of crisis. Unfortunately, it is nonetheless complicated because both have common causes. In practice, some sovereigns are insolvent and other only illiquid. The problem is thus to distinguish among them, those that cannot pay off their debt just for now and those that are definitely no longer able to repay. A Lender of last resort at the international level has so been stressed because it was considered as the only entity capable to distinguish between the two types of crisis, given its experience of the matter. The IMF has tried to play this role but did not respond to the Bagehot's precepts. Specifically, the problem was that it took place whatever the crisis causes and amounts at stake, and often without success. In consequences, numerous concerns have been expressed against such an international lender of last resort (ILLR) and the IMF has finally given up this function.

The other issue concerns the capacity to differentiate between incapacity for a sovereign to repay and its willingness to do it. In a state of uncertainty, some authors have proposed to remain in a status quo framework, by letting each default be solved by an improvised settlement. Such a disorderly settlement is served with heavy sanctions for the sovereign because of long and costly crisis and negotiations. Sanctions are supposed to limit strategic defaults and make others so costly that the sovereign is supposed to do everything to avoid it in the future. Main sanctions are the crisis sinking, the negotiations stalemate and, at the end, a deterioration of the sovereign reputation, reflected in its markets access reduction. Specifically, fast crisis sinking is due to creditors panic, which is translated into three types of behaviours likely to occur in a short view (Roubini and Setser, 2004). First, a rush to the exits by debt owners reflects a loss of confidence in sovereign's ability to pay and lead to the classic prisoner dilemma. Indeed, each creditor seeks to sell its bond, anticipating that others are going to do the same. The problem is that the State can't repay everybody so that only few will be served. Accordingly, if it is rational for each bondholder to attempt to withdraw, it is

not the case at the general level, since only firsts arrived will be paid. Furthermore, such a rush exacerbates debtor's difficulties and undermines the value of bondholders' assets so that the only way to contain these problems is either to quickly restructure the debt, or to implement a payments standstill by the State. Such a payments suspension would thus be implemented unilaterally and could lead to sanctions, especially in terms of market access restriction. Second, a rush to the courthouse consists in asking the court to attach the debtor's assets. This rush creates, by itself, a collective action problem since the first creditor, getting the asset from the court, leaves the debtor with fewer assets to offer to its remaining bondholders, so that the latter can initiate litigation against the sovereign. Third, the free riding is certainly the main problem worrying economic literature about the collective action problem. Once the debt restructuring is closed by cooperation of some bondholders, others can take advantage of this success by opting out a restructuring, using nonetheless the court and obtaining full repayment, whereas cooperating bondholders just received a fraction of their original claim. Thus, hold-out creditors strongly harm the collective action because they reduce the incentive of other bondholders to cooperate, while they were initially likely to agree to a restructuring.

On the other hand, making the restructuring easier could induce rushes to defaults by sovereigns in that the probability of strategic defaults could increase under the effect of an established mechanism limiting its costs (Roubini and Setser, 2003). That's why some authors don't consider status quo as a mistake. Indeed, according to the "supporters of the status quo regime" (Roubini, 2002, p.8) the collective action problem would have been exaggerated by literature because sovereign would have different ways to limit it. Specifically, the rush to the exits can be stopped by a unilateral debt suspension. Even if in theory this suspension can lead to a rush to the courthouse, in practice this problem would be not severe in the case of a sovereign debtor, because "creditors have trouble finding assets worth rushing to claim" (Roubini, 2002, p.8). Concerning the holdout problem, it can be solved by different manners. The holdout problem appears if the sovereign can't defend itself (especially with unilateral exchange offers for all contract terms, or exit consents for non financial terms) and if creditors can take advantage of it. Yet, holdout creditor doesn't automatically receive a full refund, and has interest to accept exchange offer if the new value of claim is higher than the market value of the old claim. Moreover, litigation is costly and all creditors can't afford it.

Nonetheless, if some sovereigns have indeed managed their debt restructuring, the risks of a disorderly workout remains high. Moreover, an orderly restructuring would benefit both debtor and creditors. On the debtor side, a pre-established mechanism would prevent an economic and social collapse, while on the creditors side, it would preserve their assets value. The status quo main problem is that crisis causes are not tackled. Sovereign debt crisis can come from bad fundamentals of debtor as well as an external shock, a contagion effect or an error of judgment by markets. In all cases, there are two parties involved in the debt contract, and in many cases, the responsibility of the default comes from both parties. Accordingly, a restructuring must not use the same tools whatever the nature and causes of the crisis. Furthermore, some highlighted advantages of status quo regime are either hypothetical or risky in practice. Indeed, one holdout or rogue creditor, and only one, is often enough to strongly affects the rehabilitation of the sovereign, and unilateral exchange offer of exit consent under pressure can either be bad received and nonetheless followed by sanctions, or inadequate so that the sovereign only have a survival delay before the next default.

The financial liberalization has overwhelmingly increased the number of anonymous creditors without securing emerging financial systems to make them capable to manage this new model of growth. And the sovereign debt market is very speculative so that markets can "play" with human lives behind sovereign bonds values. Seeing restructuring as a necessity to repay creditors without conflict is a mistake. The purpose of a restructuring has admittedly to

be to repay creditors and keep their confidence intact, but also to secure the economic situation of debtor and its population, at least on the medium view.

The international community has understood this fact, and the IMF has made some proposals. The Sovereign debt restructuring mechanism (SDRM) of Krueger, designed in 2001, so wanted to settle a sovereign debt crisis step by step and in a global view. All potential effects of a sovereign debt crisis had found an answer so that the mechanism was both flexible and successful completed. Financial markets and some official sector representatives have nevertheless refused it, given the difficulty of implementation in practice and, especially, the interference of a third party, represented by the IMF, in contracts primacy. Accordingly, the SDRM has been given up by the IMF and there is nothing left of its main trumps.

A second-rate alternative has been proposed by John Taylor, consisting in including some provisions in debt contracts in order to pre-define some conditions of contact modifications. In case of default, creditors were so able to proceed to a restructuring on their own, only thanks to theses collective action clauses (CACs). But such a decentralized approach forgets some concerns and doesn't answer to others with efficiency. Specifically, they don't deal with the causes and the nature of the crisis, they only envisage, and partially, how to protect debtor from a violent crisis whereas all is planed to protect creditors interests, at least within the same issue, and nothing is said about the economic and social stabilization of the debtor after the crisis.

Nonetheless, CACs have been chosen as the only way to solve a classic sovereign debt crisis even though they show their weakness to only settle, by themselves, a restructuring. Sovereign debt crises are not very frequent but, by definition and by extension to the population at stake, they are violent and serious. A classic sovereign debt crisis is here taken as a violent and serious crisis, with multiple effects that could imply a global mechanism. A global mechanism does already exist, given the different proposals already designed and the existing institutions. Actually, the global mechanism would only be a hybrid mechanism including an International lender of first resort (ILFR), instead of the now defunct ILLR, the CACs and, as ultimate resort, a restructuring process governed by a third party in charge of balancing the different interests and points of view at stake. Thus, the ILFR, constituted *a priori* by the IMF, would be able to distinguish between the illiquidity and the insolvency in order to adjust the right mechanism to implement, would know the debtor's route so that it could inform creditors concerning its good faith. If it is a question about insolvency, then CACs would be at first privileged, knowing that, in case of strong crisis, a standstill would have been applied by the debtor under the IMF consent, even without a creditors' agreement. Lastly, in event of CACs insufficiency to reach a fair agreement, then an arbitration forum, similar to the one proposed in the last version of the SDRM, would be convened to come to a satisfying decision.

Given the different ways proposed, to the question of knowing whether CACs are self-sufficient to resolve a global sovereign debt crisis, the answer is no.

To explain this point of view, the second section presents the two institutional mechanisms at first designed to solve a sovereign debt crisis and the limits explaining why they have been given up. The third section presents the CACs features, their inefficiencies, and concludes with the necessity of a global mechanism, as quoted above. In this respect, it takes up the main advantages of the ILLR according to Thornton, Bagehot and Fisher, and of the SDRM to insert them in this hybrid mechanism.

2. The relinquishment of any institutional and global mechanism capable to settle a sovereign debt crisis.

Indeed, among the most successfully completed mechanisms having been designed, there are the institutionalization of an International Lender of Last Resort (ILLR), which is studied since the Nineteenth century, and an institutional mechanism to implement a sovereign bankruptcy. Both have been rejected whereas they corresponded to the most intellectually appealing ideas.

2.1 The failure of the institutionalization of an ILLR under the name of the IMF after many years of practice.

Ashton already declares, in the eighteenth century, that the Bank of England is a lender of last resort, while none theory does exist at this time (Kindleberger, 2000, p. 162). But Henry Thornton (1802) and Walter Bagehot (1873) remain the firsts to develop a theory about the lender of last resort (LLR), its role, its functions and its ways of intervention. These characteristics are still discussed within the issue of an International Lender of Last resort (ILLR).

Henry Thornton and the first global theory on the Lender of last resort.

According to Thornton, there are two categories of intervention on the money market (*in* Diatkine, 2003). On the one hand, an institution, like a Central Bank, is necessary to keep watch over the stability of the money value. On the other, the liquidity crises potentiality calls a lender of last resort (LLR). In this view, the Central Bank is not necessarily the lender of last resort, but a Central Bank as LLR seems to be "natural". Thornton links the monetary theory and the bank theory, so that he develops an analysis taking into account the banking risks, the information asymmetries, as well as the panic phenomenon or the systemic risk. For Thornton, the credit is a condition for exchange, and the durability of credit system relies on confidence. The Central Bank must secure this confidence by first protecting the money value. The liquidity and solvability risks have to be monitored by banks themselves. According to Adam Smith (1776), banks must discount only the real effects (issued in exchange of a real sale of merchandise, by opposition to a mere paper effects), lend most often at short term, in order to verify the borrower's capacity to repay (in other words, the risk of default), and build up again their reserves frequently in order to avoid the risk of liquidity. But for Thornton, it is not sufficient, because of the information asymmetry problem that takes place specifically in the credit market. In fact, except if the bank has the property of the good or the possibility to take it as a warranty in the contract, it can not be sure that the borrower makes a good use of the loan in order to ensure his repayment capacity. The same is true concerning the real effects, because they don't protect from the risk of liquidity, since the liquidity is defined by the author as the possibility to rapidly convert effect in money, without strong variation of price. All market participants are both creditor and borrower. So the aim of stability, which is the aim of a Central Bank, is to preserve this network by keeping intact the confidence into this payments system. This aim is higher than the one consisting in remaining stable the stock of money according to the output.

But in spite of these advises, bankruptcies can happen, especially because of the depositors' panics that form the famous liquidity races and then, the contagion phenomenon. "If one bank fails, a general run upon the neighbouring one is apt to take place" (Thornton, 1802, p. 179-1980, in Diatkine, 2003, p. 13). The contagion can lead to the systemic risk. And

here takes place the LLR because of the need for an external regulator. This ultimate lender must be different from the Government and require participants respect. The real difficulty, as already noted by the author, is to distinguish between a liquidity crisis and a solvability crisis. Because Thornton refuses a Central Bank bails out insolvent institutions suffering, according to him, the right consequences of its risky acts. Nevertheless, he's not either in favour of the open market operations and seems to trust in the Central Bank's informational advantage in differentiating the insolvent banks from the others, in order to limit moral hazard risks. Another way is to not lend automatically, but to act in a discretional way. In this case, banks taking risky positions are not able to know if they will be saved in the event of crisis. This uncertainty can, *ex ante*, dissuade them from taking too high and/or too many risks. The practice is today called the constructive ambiguity. But, concerning insolvent banks "too big to fail", in that they are likely to jeopardize all the system, if Thornton is not in favour of an intervention, he doesn't recommend anything.

And the LLR, whether it is national or international, always bumps into the moral hazard problem and the dilemma between the transparency and the constructive ambiguity.

Walter Bagehot and the action modalities of a Lender of last resort.

Bagehot, as well as Thornton, tries to find a "compromise between the respect of market laws and the willingness to sanctions management errors on the one hand, and the necessity to preserve the financial system integrity on the other"[1]. Aglietta and Denise (1999) summarize rules of action for a LLR, within Bagehot's views.

First, the LLR have to lend without restriction to the institutions in failure in order to keep intact the confidence about its capacity to provide all the money the system needs.

Second, the LLR has interest to impose a penalty rate on its loans. First because such a penalizing rate could stop a massive capital outflows, and second because it should encourage the institutions in difficulty to look for all available resources, before using the LLR ones.

Third, the ultimate lender must lend only to the solvent actors (whatever they are banking institutions or not) capable to give proof of a collateral valorised at the market price prior the crisis. First, because the LLR does not have to keep in life the condemned institutions with taxpayers' money. Second, because the confidence, and then the intervention efficiency are heightened if participants believe the LLR only lends to solvent institutions. In these circumstances, market receives the signal that this institution is solvent and still has access to credit. Third, because the market discipline would be jeopardized if a financial institution could resort to the LLR while it's insolvent and while it's responsible for what happens to it.

Fourth, it might be clear about its way and reasons of interventions, to limit the risk of panics.

Actually, Thornton and Bagehot disagree about only two characteristics. If Thornton tends to refuse the open market operations, Bagehot seems to prefer it. And if Thornton recommends the firsts fruits of a constructive ambiguity, Bagehot seems to prefer transparency. IMF problem as an ILLR is that it cannot use constructive ambiguity since interventions are defined in its mandate, and transparency leads to moral hazard concern.

[1] Aglietta M. and Denise C., 1999, pp. 29.

On the starts of the debate about the IMF as ILLR: Calomiris' Project vs. Fisher's project.

Most of authors working on the Lender in last resort refer to the Thornton and Bagehot's precepts. And the literature about the International lender in last resort also emphasizes the same difficulties of intervention as the ones described by Thornton and Bagehot.

Calomiris (1998b) stresses for some rules defined *ex ante* to strengthen the market discipline and, in event of crisis, to force private sector involvement. But according to Calomiris, "the IMF (can not) serve as an effective lender of last resort to the banking systems of developing economies"[1] because "The uses of IMF assistance and the U.S. Treasury Department's Exchange Stabilization Fund to bail out insolvent emerging market banks and international bank lenders are not only improper (in the sense that these sources of funds were not designed to be used in this way); such assistance and the doctrine that underlies it are a threat to the stability of the world financial system" (Calomiris, 1998a, p. 1)[2].. Calomiris relies on the Bagehot's rules to assert that IMF doesn't act as a LLR. First, because IMF applies preferential rate (below the market prices) instead of a penalty rate ("the IMF should lend funds on a senior basis at a bona fide penalty rate", Calomiris 1998b, p. 276). Second, because it doesn't ask for a certain collateral value at the market rate prior the crisis, but applies conditionality, that is not equivalent. But, in the context of sovereign debtor, whether or not the State has guaranteed private debt, it is impossible to apply such rate, given the social consequences on a population already weaken. It is also impossible to let die an insolvent State (by liquidation for example), like an incompetent bank or company, or replace Government. Third, because as a partisan of transparency, Calomiris regrets that "IMF secrecy (be) contrary to its proper role as a source of independent, objective, and informed opinion about the economic performance and financial risks of member countries. In pursuit of its appropriate mission, any policies or conditions for assistance advocated by the IMF should be revealed publicly"[3]. In short, rules for financial markets have to be defined *ex ante* and, in case of crisis, "the local central bank (unlike the IMF) has the information and legal authority to enforce the necessary conditions on the behavior of banks receiving such lending"[4].

Fisher is one of the most popular authors who inclined to the IFM as ILLR. He distinguishes two roles in the ILLR functions in time of crisis, a role of "lender", and a role of "manager" ("Lenders of last resort have generally undertaken two roles: crisis lender and crisis manager", Fisher, 1999, p. 87). On the one hand, the crisis lender provides liquidities to solve crisis, and especially panic likely to drive to contagion. On the other, "the crisis manager takes responsibility for dealing with a crisis or potential crisis, whether or not the institution itself lends for that purpose" (p. 88). The manager function consists in managing the collective action problem, which supposes a role of leader. That role could be played by the IMF, because "the IMF has increasingly been playing the role of crisis manager for the last two decades (…) in negotiating with member countries in a crisis and helping to arrange financing packages." (p. 95-96). The lender function is not necessarily that of a Central bank. And, in many cases concerning emerging economies, the Central Bank is not able to provide the necessary amount of liquidities. In consequences, the issue is not to know whether the crisis lender can create *ex nihilo* the money, like it is in the Central bank issue; but whether it can actually provide these liquidities. The how issue doesn't matter. The IMF can't admittedly provide all this liquidity by itself, but it can raise it from a group of capable institutions.

[1] Calomiris C. W., 1998a, pp. 13.
[2] Calomiris C. W., 1998a, pp. 1. On the same topic, see Meltzer, 1999 and Schwartz, 1998.
[3] Calomiris C. W., 1998a, pp. 15.
[4] Calomiris C. W., 1998a, pp. 13

"Despite this significant shrinkage relative to the original conception, the Fund as lender of last resort is still able to assemble a sizeable financial package in response to a crisis. In case of systemic problems, the Fund can augment the use of its own resources by borrowing" (p. 96). *De facto*, if the IMF can't have at its disposal an unlimited amount of money, like recommended by Bagehot, it can instead provide for "big amounts". "At the extreme, it is only a question of legalising and legitimating theoretically an established practice" (Sgard, 2002, p. 237).

The CCL: the official failure of the attempt of becoming an ILLR by the IMF.

That is exactly what the IMF will do, following the Fisher precepts, notably with its Contingent Credit Lines (CCL), in 1999. The aim was to force the private sector financing, with the support of the IMF, given the proof that qualified country had followed good economic policies and merited so to be helped. The economy should, indeed, be qualified for the CCL before the crisis. Briefly, debtor had to have followed economic policies so that it had not to use IMF resources, unless it would be victim of a contagion phenomenon, and had to have been the object of a "positive assessment" by the IMF. The country had to prove its "constructive relations with private creditors" (IMF, 2003c)[1]. However, criteria were too difficult to respect, and even Brazil, in November 1998, couldn't be qualified. In its last review of the CCL, the Executive Board wondered what could happen if a country was said publicly ineligible. It was likely to create a crisis by itself. Furthermore, not only laying out required the Executive Board approval, but the sum paid out was then gradual, while the economy was likely to need it in one time. Lastly, the CCL was designed for countries in a situation of preliminary crisis, while economies in need were those already facing a crisis. Finally, the CCL has never been used, and has been given up by the Executive Board in March 2003[2].

The CCL was a real political attempt in terms of institutionalization of an ILLR. For the first time, concerning the method, rules have been designed *ex ante*, making the IMF both a manager crisis before and during the crash, and a crisis lender, by persuading other parties to come together with it, even if it had would be done only through qualification criterions.

The flat refusals of the IMF as ILLR.

However, on the one hand, the majority of market participants didn't want the IMF as ILLR, particularly because an ILLR a la Kindleberger required a hegemonic role and then, a painful sovereignty transfer from both debtors and creditors. On the other, academic literature has vigorously criticized IMF bailouts because of conflicts of interests, moral hazard and different failures. These three features are well known now.

The conflict of interests concerns particularly the role of the United States within the IMF. A hegemonic ILLR, or merely a leader, especially if it acts according to a constructive ambiguity, means that its actions are discretional. Then, the choices of intervention can depend on the sensibility degree of this hegemonic power to the shock affecting the country in difficulty. Now, many have said that the belated intervention in Indonesia by United States could be explained by the fact that American interest was there less important than in Korea (Aglietta and Denise, 1999, p. 12). Korea received an arrangement equalizing twenty times the amount of its quota subscription. The same seemed to be true in Argentina in 2001. This is a problem for all countries that are not in close relations with United States, because the IMF

[1] The page is not actualised anymore. http://www.imf.org/external/np/exr/facts/ccl.htm

[2] More details about this removal are available in the IMF review of Contingent Credit Lines (2003c), http://www.imf.org/external/np/sec/pn/2003/pn03146.htm.

is the United States. An ILLR must intervene everywhere a liquidity crisis takes place and threats the financial stability.

The moral hazard occurs when market participants, anticipating a bailout in case of troubles, are prompted to carelessness, and so to take higher risks. “First, (an injection of capital) gives the bank managers and shareholders incentives to take additional risks (…). Second, the possibility that the official sector will provide risk-capital to a failed financial institution may reduce the incentives for uninsured creditors to monitor the behaviour and performance of the institutions to which they have lent” (Freixas and al., 2002, p. 39). That’s true, both in the case of sovereign bonds and in the case of debts’ banks that will be socialized by the State after a collapse. That has indeed been the case with the IMF interventions in the pass, “ex ante and ex post, in Mexico and in Asia. Banks and other lenders did not experience the large losses borne by ordinary citizens and by the owners of equity and real assets (…) Moral-hazard lending to Russia, encouraged by the bailout of foreign lenders to Mexico, permitted Russia to finance large unbalanced budgets by borrowing externally. The result is a much larger financial problem for international lenders and for the economies of other countries. The IMF continued lending despite the Russian government’s failure to meet the loan conditions” (Meltzer, 1999, p. 8).

Finally, too many of these interventions have ended in failure. “In all too many IMF-supported reform programs, there is no successful breakthrough to stabilization and renewed growth for many years. (…) The main problem is that the IMF does not adequately appreciate the linkages between reform and timely financial assistance” (Sachs, 1995, p. 13).

Lastly, during almost twenty years, the conditionality has made worse the economic and social conditions of too many people in poor countries. Of course a penalty rate on a sovereign seems to be impossible to apply. But the conditionality was maybe worse. The conditionality problem catches up with the one of interests’ conflict. Within the conditionality, many could smell a political ambition that exceeds the simple compensation of a loan, and that exceed the ILLR’s powers. The IMF organization is political, especially because of the hegemonic role of the United States, and the inexistent role of the developing countries, that are nevertheless the firsts to suffer from its decisions. One example is enough to explain this fact. The financial liberalization could have been made gradually, by strengthening first the financial institutions to make them able to face a choc. The same is true for the commercial opening. But the IMF didn’t mind, it only wanted the liberalization to be implemented. And when the first signs of distress have appeared, it just has had to critic the countries policies, the bad or the absence of implementation of their advices. Without thinking, throughout more than ten years, of a potential impossibility to implement such reforms. Or, worse, about the possibility of the impertinence, or dangerousness, of its advices. According to Stiglitz (2002, p. 164), the IMF itself has, for example, caused some crisis, like the Asian one in 1997, by some heavy declarations. And yet, if the stand-by arrangement allowed to Mexico exceeded seven times its quota subscription, it was only to allow it to pay off its creditors. It has been the same when the intervention in Russia in 1998 has exceeded more than three times the country’s quota (Aglietta and Moatti, 2000, p. 180).

Few people have forgotten these heavy failures. And let-alone have forgiven.
So, when the IMF has attempted to become an ILLR, just after its licking in Asia, some authors have recommended to merely remove it, at least as a lender (Schwartz, 1998). Others asserted that a good coordination between some regional Central banks could largely stand in for the IFM both for manager en lender crisis functions (Rogoff, 1999, Kremer and Pfister, 2002). Central banks networks would play the role of several regional ILLR, even if in emerging economies, such coordination is not ensured, because of the weakness of most of it.

Nonetheless, none of the two solutions addressed to solvency crisis concerns the crisis liquidity problem. It remains thus unsolved while it seems that, *a priori*, only an ILLR is

capable to either stop crisis by bailing out if it has analyzed it as a liquidity crisis, or to come private and official sectors together and involve them in crisis resolution. In this respect, it seems also that only the IMF, because of its experience, can do that. But if it's not recognized as competent to be an ILLR, it can nonetheless be recognized as a consistent Lender of first resort (LFR, see below).

IMF's project to become a quasi-ILLR has finally been given up. Nevertheless, the Fund has continued working on a solution for a new financial architecture, and more particularly, for sovereign debt crises problem. In 2001, Anne O. Krueger, the IMF's First Deputy Managing Director, so proposed a Sovereign debt restructuring mechanism (SDRM) in order to make the restructuring process more predictable and more ordered. It was overall a question of private sector involvement (PSI) to solve both moral hazard and collective action problems. However, one more time, after several modifications, stakeholders have refused the SDRM, considering it as too ambitious and dangerous for contracts primacy.

1.2 The abandon of an unabridged sovereign debt restructuring mechanism: the unwillingness to ambitiousness.

Thirty years of ideas about a real bankruptcy mechanism for sovereigns.

Actually, the call of the necessity for an ordered bankruptcy procedure doesn't date from 2001 and the Krueger proposition, nor from 1996 with the Rey report. Ohlin (1976) is one of the first authors to call for it, assuming that "development finance needs something like the institution of 'honourable bankruptcy'" (p. 220, in Rogoff and Zettelmeyer, 2002, p. 4). If Ohlin doesn't go further, Oechsli (1981) does it, in 1981, by invoking the American Chapter 11 of the Bankruptcy Reform Act and emphasizing on the necessity of "a creditor committee, an independent examiner and a monitoring party" (Rogoff and Zettelmeyer, 2002, p. 7) in charge of enforcing each party to respect its obligations. But if Oechsli doesn't consider a "court-like entity" as essential, Suratgar (1984) and Williamson (1985) think that a "quasi-judicial mechanism" is important, at least to the famous distinction between illiquidity and insolvency in order to know if a debt relief is necessary or not. In 1989, Cohen proposes the creation of an independent "International Debt Restructuring Agency" (IDRA) to structure orderly the negotiations between debtors and creditors. According to him, a third party is essential for monitoring. But according to Williamson (1992), the IDRA could also be in charge of eventual "unforeseen contingencies", letting in normal cases, the debtor and its creditors bargaining in the shadow of the law. But it is Sachs' paper in 1995[1] that will be the most influential article on this issue. If the IMF can't be the ILLR whom needs the financial stability, it can nevertheless contribute to solve the problem by becoming a competent authority for crucial questions, especially to sanction payment standstills. He proposes a real form of private sector involvement. "Like a bankruptcy court, the IMF could supervise the extension of "administrative priority" for new private-market borrowing for a liquidity-strapped member government" (Sachs, 1995, p. 11).

It is Anne O. Krueger who will materialize most of these ideas in a Sovereign Debt Restructuring Mechanism in 2001.

[1] Sachs J., 1995, Do We Need an International Lender of Last Resort ?,

The Krueger' SDRM: the more successfully completed settlement.

The Krueger's project, in 2001, wants especially reduce the IMF interventions to answer to the critics directed above. Krueger admits that it is impossible for the IMF to play the role of ILLR, providing for all necessary liquidities for all crises. "This is neither possible nor desirable, especially if the country's debt burden is clearly unsustainable looking forward" (Krueger, 2001, p. 1). The first SDRM addresses unsustainable debts and "severe liquidity problems" (p. 2), establishing that status quo harms both debtor, because crisis goes and on until the end of long, painful and uncertain close of bargaining, and creditors, because their assets value is decreasing during theses too long negotiations within a panic and so capital exit context.

The second Krueger's project, in 2002, takes up the first and corrects it because of several critics addressed to the first. According to Krueger (2002), "The absence of a predictable, orderly, and rapid process for restructuring the debts of sovereigns that are implementing appropriate policies has a number of costs. It can lead a sovereign with unsustainable debts to delay seeking a restructuring, draining its reserves and leaving the debtor and the majority of its creditors worse off" (p. 7). This sovereign debt restructuring mechanism is based upon the Chapter 11 of the American law about firms' bankruptcy, but is adapted to the sovereign case. It is especially foreseen for debt unsustainability too. To build and implement such a mechanism, several considerations have to be taken in account.

First, the procedure opening has to be initiated by the debtor, and not by its creditors or the IMF. Sovereign debtor has so to be conscious of its debt stock compared to its means to pay off it (GDP and/or exports). That implies that it must not wait too long for asking the opening. Accordingly, all the proceeding depends on it and its willingness to face the situation. But ideally, the debtor should have tried to convene its creditors in order to negotiate prior the default.

Second, from the start of the proceeding opening until the agreement, four principles have to be applied.

At first, the ***conclusion of the restructuring, at the creditors' majority***, is needed to solve the free-rider problem. Indeed, the majority vote of a representative creditors' committee, that has to unite 75 percent of bondholders, binds all creditors so that nobody can claim a full repayment if majority accepts a restructuring. A modification of the financial terms of a bond normally must require the unanimity of bondholders so that a restructuration is impossible if only one person asserts its veto. So, of course, with 75 percent, the restructuring option becomes more workable. But, these provisions only bond creditors within the same issue, not others. So the SDRM allows an aggregation of claims within the aggregation of bondholders' classes. Multilateral debts are not included because of the position of the IMF and the World Bank as priority creditors. Concerning the domestic debt, which poses problems too in emerging markets, its restructuration is concluded case-by-case, according to its role in the indebtedness unsustainability. Because, it is crucial that the banking system can continue to play its role of intermediary with foreign capital on the one hand, and within the domestic financial system on the other. The inclusion of domestic debt in restructuring mechanism would depend on the crisis severity and the capacity of the national bankruptcy law to take charge of it. It could be important to include domestic debt in restructuring process (IMF, 2002a). First, because the debt unsustainability can also stem from the domestic debt to a great degree. Moreover, because of the opening of the capital account, a debt denominated in local currency can also be risky, although less than a debt denominated in a foreign currency, since residents and non-resident can convert and transfer the proceeds of repayment. Second, because it would be difficult to encourage foreign creditors to restructure their claims, while residents would be paid in full.

On the side of bilateral debts, the IMF has considered that the Paris Club was competent.
Initially, the IMF was supposed to endorse the majority agreement so that it could be implemented. Throughout the proceeding, the IMF had to verify the good-faith of both debtor, in its policies driving, and creditors, in their consistent claims. But, a number of critics have been expressed regarding this endorsement because of the violation of creditor's rights and contracts integrity. So, in the second version, the SRDM wants to be reassuring and so doesn't rely on the IMF to make the agreement effective. Only the approval of the requisite majority of concerned creditors would constitute the determining factor of its effectiveness.

Second, a ***stay on creditor enforcement*** could initially be decreed by the IMF on the demand of the debtor. It was supposed to last from the start of the declaration of default by the debtor until the restructuring conclusion. The aim is here to insure a climate of negotiation sheltered from panic and crisis contexts. On the side of the debtor, the stay allows to decrease the severity of crisis, especially because of likelihood of rushes to the courthouse. On the side of bondholders, this suspension is able to calm the panic about the free-riders problem, which increases incentives of everybody to become themselves free-riders. The necessity of an extension of the stay would be evaluated and accepted by the IMF. In terms of consequences, it can imply a payments standstill and an exchange controls by the debtor according to the severity of the crisis, the capital flight and the institutional capacity of the debtor to well implement such controls. These two features could prevent self-fulfilling liquidity runs and its consecutive massive capital outflows and assets value collapses, which aggravate the crisis for both debtor and creditors. On the side of bondholders, this suspension could stop the panic that leads to liquidity runs and its consecutive prisoner's dilemma[1] and assets value collapse.

But, one more time, financial community didn't agree with such IMF prerogatives strengthening. The second SRDM so proposed to implement such a stay according to a majority vote of bondholders. Nevertheless, the time implied to take such a decision by vote and by class was estimated too long. Krueger so proposed a number of solutions. Either the sovereign debtor could apply a payment standstill unilaterally for a limited 90-day period and, then only, an extension could be decided by a vote of bondholders. Maybe bondholders could ask the IMF opinion to decide. Or the IMF could actually approve the stay during 90 days and then let the decision of extension to the vote of bondholders. Or again, the stay could depend on the vote of bondholders from the start but, in order to accelerate the voting process, it would be established a special "standing organization" (Krueger, 2002, p. 26). In all cases, any extension of the stay would have depended on the bondholders' approval. Finally, in 2003, the question of stay of litigations was not solved yet. Concerning the exchange control, a bondholders vote could approve it. "However, in the context of exchange controls that gives rise to the default of a multitude of debtors (each with their own group of creditors), such an approach would not be feasible. In these circumstances, the legal authority to approve a temporary stay, if that were deemed an eventual feature of a new statutory mechanism, would need to reside with the IMF" (Krueger, 2002, p. 38). Or, at least, as proposed in the last version, by a "Sovereign Debt Dispute Resolution Forum".
Finally, to sum up, the IMF has been criticized for being judge and jury throughout the process, and so partial, because of the presence, among its members, of both creditors and debtors states. What can mean moreover a number of conflicts of interests.

Third, ***the protection of creditors' interests*** would be insured by the debtor good faith. In fact, the debtor has not to pay nonpriority creditors and has to "conduct policies in a fashion that preserves asset values" (Kruger 2002, p. 16). It is in this latter purpose that the debtor might to implement an IMF-supported program, working closely with it in order to

---

[1] The prisoner's dilemma theory affirms that, in some circumstances, the self-interest pursuit doesn't lead to common interest because only the minority first arrived will be served (Olson, 1968, p. 2, in .Hardin, 1992, p. 251).

prove that, if the debtor receives IMF support, it is because it merits it. In these circumstances, bondholders can remain relieved and confident. About this issue naturally, none critic of the financial community has been expressed.

Fourth, ***the priority financing*** is essential to provide for fresh private money. The fresh liquidity has to allow debtor to generate necessary resources to meet the debt-service obligations and to continue its economic activities. The priority imposed by the SDRM means that new financings are "senior to all preexisting private indebtedness" (Krueger, 2002, p. 17) so that they are not supposed to be restructured in their turn.

In the first SRDM, some concerns have been addressed about the priority financing. In response, Krueger has proposed, in 2002, that exclusion of fresh money from restructuring be decided by a majority vote of bondholders.

The renunciation in spite of multiple reviews and improvement attempts.

The SRDM, in its two versions, would place the IMF as a third party monitoring the proceeding by the combination of both debtor and creditors interests. In the first translation, the mechanism granted the IFM a power of judge from the start to the end. In the second version, the IMF has just to ensure that the mechanism is pertinently used by both parties. As said Krueger in 2002, after some concerns expressed by financial community, "it is possible to design a framework where the key decisions are made by the majority of creditors rather than the IMF" (p. 38). However, in some circumstances, it can supervise some pieces of information, and decisions, especially like the implementation of an exchange control and like the pertinence of the bondholders' claims. Even though it was not a question of challenging the creditors' rights or interfering into the contracts integrity, any role of the IMF would has been rejected. The independence of the third-party organ would have been established through the IMF status amendments. The judges would have been selected "by a qualified and independent panel" (Kruger, 2002, p. 35) and their prerogatives would have been very limited.

But, in the last review in 2003, about the November 2002 version, none problem was solved and, for each characteristic of the SDRM, the Directors of the Executive Board always addressed different views. The positive point is that a lot of propositions, so a lot of potential solutions, was described and the financial community just had to choose.
The major changing in the text of 2002 is the "Sovereign Debt Dispute Resolution Forum" (SDDRF, IMF, 2002a, p. 6). It would have been an "independent", "transparent" and "accountable" body acting only within the framework of the SDRM (IMF, 2002a, p. 57), and nowhere else. The last 2002 version proposed two types of SDDRF. Either a kind of permanent setting judges, like in the United Nations' International Court of Justice (ICJ), or an ad hoc panels of judges or arbitrators only convened to solve disputes, but having been selected in advance. Concerning the selection, the 2003 review suggested the possibility , for Managing Director to "appoint members of the selection panel on the advice of outside professional associations and insolvency and debt restructuring experts and public or private international organizations that have developed an expertise in insolvency and debt restructuring matters, and the selection panel would be entrusted with the identification of potential candidates to the SDDRF, to be approved by the Board of Governors" (IMF 2003b, p. 7). If most Directors generally supported the establishment of an independent SDDRF, through an amendment of the Articles of Agreement, a few were agreed with the prerogative to terminate the operation of the mechanism with the SDDRF certification like it was proposed in the last version (IMF, 2002b, p. 56). Instead, "the need to limit the SDDRF's powers to the administration of claims and the resolution of disputes" has been emphasized.

The role of an independent body remained pertinent, but its powers had to be very strictly contained.

Moreover, the IMF has started to talk about the possibility of sanctions for false information given by the debtor, as demanded by the market opinion, even if the Fund would not have had any role to play in this regard. Accordingly, its power would have remained in its lending into arrears in order to prove implicitly the good-faith of the debtor.

In spite of all these modifications and compromises, the SDRM has been given up. An amendment of the IMF articles was unfeasible, especially because of the position of the American Congress against any strengthening of IMF powers, or role to play officially in these types of financial crises, put in light with the report of the Meltzer Commission (Cohen and Portes, 2003, p. 29). The last reports of the IMF (2003b and 2004b) concerning the sovereign debt crises resolution do no longer tackle the Krueger's SDRM framework.

If, admittedly, the SDRM was complicated to implement, specifically because of the need of IMF's functions amendment, it remains the only mechanism that has attempted to settle a sovereign debt crisis and its consequences, and not only the single restructuring issue. It was not just a question of successful restructuring but also a question of *ex post* stabilization. It keeps merit to have tried to combine both debtor and creditors interests, and not only primacy of contracts. By defining a debt sustainable threshold, sanctioning payment standstill, when it was needed, and supervising bargaining, the SDRM dealt with the crisis causes and nature issues, which play a crucial role in start, sequence of events and outcomes of crisis.

From 2002, regarding to the number of critics addressed to Anne Krueger, John Taylor, under Secretary of Treasury for International Affairs, proposed a less jurisdictional mechanism. According to him, the introduction of collective action clauses (CACs) in bonds issued by sovereign should allow to solve the sovereign debt restructuring, assuming that a contractual decentralized solution would be easier to implement than a centralized jurisdictional framework. But it is very uncertain that CACs could create their own collective action logic.

3. The choice of CACs only, despite the need for a global mechanism.

All by themselves, Collective action clauses (CACs) can't neither prevent nor manage a sovereign debt crisis because too many externalities are not taken in account. Actually, all the sovereign debt variables, that have to be considered, involve a hybrid mechanism between another type of official lender, CACs and, ultimately, a real restructuring mechanism à la Krueger. None of the three is thus self-sufficient.

3.1 The CACs insufficiency and the mistake of the market opinion.

The main provisions of CACs: only the collective action problem would be, a priori, solved.

In February 2002, John B. Taylor (2002a) makes a testimony, tackling two key parts of the reform agenda prepared by the Bush Administration, through some speeches by President Bush and Secretary O'Neill, for the World Bank and the IMF. The second part deals with the sovereign debt restructuring process and the IMF governance. According to Taylor, the crisis prevention requires a better appreciation by the IMF of the sovereign trends that appear unsustainable, a better confidence into the capacity of sovereigns to take the good

decisions prior the collapse and a higher transparency both of the IMF and countries information. As well as Kruger, Taylor thinks that the uncertainty that encircles a debt openly unsustainable leads to panic, pressures for IMF bailouts and a disorderly workout for the debt restructuring. But according to him, a "decentralized contract-based approach » (Taylor, 2002a, p. 5) is enough to make the restructuring process predictable and ordered, and so restore rapidly the market confidence. This market-based solution consists in encouraging sovereign and creditors to include some clauses in their debt contracts that foresee, in advance, the modalities of payment terms modifications. "Collective action clauses (CACs) are provisions in debt contracts specifying that the terms of the contract regarding principal, interest, and maturity can change if there is consent of a predetermined supermajority of bondholders" (Weinschelbaum and Wynne, 2003, p. 2). To develop them inside some important markets, Taylor (2002b) proposes three fundamental clauses that should be included in sovereign borrowing bonds.

The most important, the ***majority action clause***, makes the decision of this supermajority binding on the minority. The majority action clause prevents for the free-rider problem. If a majority of bondholders, again 75 percent, takes a decision, the minority must follow. The same is true for the end of the restructuring process. Any repayments officialised with the trustee must be to the benefit of the group and, therefore, are shared on a pro rata basis among all bondholders. The main consequence is that "if a bondholder wishing to pursue litigation has managed to acquire a sufficient percentage of bonds to enable him to require the trustee to initiate litigation, the requirement that the trustee distribute any amounts received through litigation to all bondholders on a pro rata basis will reduce such bondholder's incentive to do so" (IMF, 2002b, p. 14). The majority action clauses do already exist for sovereign bonds issued under the United Kingdom (U.K.) law, which governed, in 2002, 24 percent of all international borrowings, against "59% (…) under US jurisdiction, 10% under German jurisdiction and 6% under Japanese law, (the three) with no collective action provisions" (Weinschelbaum and Wynne, 2003, p. 6). In 2003, admittedly, Mexico began issuing global bonds with CACs under the New York law, soon followed by other emerging countries, like Uruguay, Brazil, Costa Rica, Colombia, Hungary, Panama, Peru, South Africa, Turkey and Venezuela (Galvis and Saad, 2004).

The second provision is a clause "describing the process through which debtors and creditors come together in the event of a restructuring" (Taylor, 2002b, p. 3). It is said a ***collective representation clause***. This clause would foresee the constitution of a creditors' representative in charge of negotiating with the debtor and of initiating litigation. Accordingly, the representative has to have powers of superior quality to those attributed to some classic administrative responsibilities, such as accountability or the information pooling.

The last important clause, ***the initiation clause***, would specify the way of opening the restructuring for the debtor. It is above all a question of time, specifically the time necessary to creditors to come together with the relevant information about the debtor situation, to elect a representative and decide how to negotiate with the sovereign. The relevant information should, for the IMF, be given by a third part, like a financial institution (IMF, 2002b, p. 16). Taylor proposes 60 days as a "cooling off" period. He specifies that a "temporary suspension or deferral of payments might be necessary", with the "appropriate penalties" (p. 3). During this period, it would be impossible for creditors to initiate any litigation against the sovereign nor to declare the full amount of the bond due and payable ("acceleration")" (IMF, 2002b, p.11). However, a lot of market participants assert that a "cooling period" always applied is "arbitrary and unnecessary" since some risks like the rush to the Courthouse have been overestimated and the majority enforcement provisions can, by itself, address these risks.

The scope of covered debt.

Concerning the domestic debt, market participants have estimated that a sovereign generally have "the legal tools to provide for an orderly restructuring of domestic debt". So, *a priori*, States should not have to include CACs into their domestic bonds. Market participants just want to be sure that transparency be proper concerning terms of the domestic restructuring before taking their own decision. Moreover, unless the debt contractual terms specify, explicitly or not, that a foreign court is competent for restructuring, the Sovereign can let play its "domestic sovereign immunity law, which generally protect its assets from attachment in local courts" (IMF, 2002b, p. 20).

Bilateral and multilateral credits are not concerned by CACs.

Concerning syndicated banks debts, if their loans generally include sharing provisions, they don't contain majority provisions, permitting to a qualified majority to bind the entire minority syndicated. Even if syndicates are well formed, above all because they are in relation with de debtor, this does not perfectly protect the restructuring from some dissidents and vulture funds. According to the Fund (2002b), efforts made by others should not exempt syndicated banks, even well organized, to do the same.

The role of the IMF.

Taylor is not especially reluctant to let play a certain role to the IMF, he just doesn't want to see their powers strengthened. The IMF role would so be to encourage the generalization of CACs in debt contracts by, for example, forcing countries with an IMF program to adopt them, "or making it a condition of exceptional access to its funds that countries utilize these clauses in their debt contracts" (Taylor, 2002a, p. 5). The IMF can also assess the debt sustainability and decide on a new IMF program. Accordingly, CACs are aimed at the unsustainable debt, as the SDRM was.

The main role for the IMF is to encourage the generalization of CACs in debt contracts. Because of the first mover cost, which implies a higher spread for the first issuer to include CACs, sovereigns can fear to send a signal of weakness. Moreover, if the sovereign thinks the compensation of this cost will be long, because of the market inertia towards this type of innovation, the reluctance is stronger. Besides, this cost can lie to CACs themselves, and not specifically to the first mover, so that all sovereign borrowers issuing bonds with CACs would be penalized by a higher borrowing cost. Nonetheless, some authors have in some extent answered to this concern (see below). In spite of these encouraging preliminary results, the IMF had to, at the beginning of talks about CACs, promote their general using in different manners.

The Fund surveillance could track the use of CACs by emerging markets, or at least the documentation used by them in their debt issuance. Moreover, the surveillance could encourage sovereign that didn't use CACs to exchange their bonds against bonds including such provisions and provide for them a technical assistance to support their use. Thanks to the "CAC-tracking", the IMF could make "the use of clauses known to the public" (IMF, 2002c, p. 17).

Then, the financial carrot-tactic could make dependant the access to IMF resources, or facilities, to the adoption of CACs, either in the next issue, or right now with an exchange offer. The switch would allow to counteract critics about the fact that CACs only work concerning new bonds, and doesn't apply for existing bonds. More specifically, concerning the inclusion of CACs in debt issued during the implementation of IFM-program, the Fund found itself that it would not be without risks. Especially because of the explicit signal of distress sent par borrower in such a context and, therefore, because of the risk of a

"stigmatization" of CACs use, if the latter are not already a market standard. A perception of these risks by the sovereign borrowers can sharply reduce their demands for Fund arrangements and then harm them insofar as they would have to face and manage a crisis on their own. Instead, the Fund could require a swap of all outstanding debt into debt with CACs, unless the willingness of bondholders to accept it be weak. The best solutions remains to make the CACs a condition for IMF lending into arrears, for increasing access limits under existing facilities or providing additional access.

The IMF has even proposed to amend its Articles in order to force its member to use CACs into their new bonds, or for their entire existing stock. Nonetheless, it would have been very difficult to exclude a reluctant member.

The IMF so had a lot of incentive tools to promote the CACs using, especially because it knew apprehensions of many borrowers and critics of many involved parties.

The main critics addressed to the CACs and their answers…

One of the main objections to the CACs was their ***absence under the New York*** (NY) ***law,*** while almost 60 percents of sovereign borrowings are made under this jurisdiction. But, in some extent, Gugiatti and Richards (2004) have demonstrated the contrary. They have studied five emerging sovereign issuers on the Euromarket (Bulgaria, Egypt, Kazakhstan, Lebanon and Qatar) under the NY law, but whose bonds contained CACs. The results are surprising. Although the authors have not been able to verify the contractual terms of all bonds, they have estimated that, out of the $13,1 billion issuance from these countries, $11,9 billions actually contained CACs, that is over 90 percent. Moreover, the provisions were "in line with those traditionally used in bonds governed by English law" (p. 7), including majority action provisions at 75 percent of bondholders for changing financial terms and 25 percent for changing non-financial terms. Only Egyptian bonds required 85 percent of bondholder's voices to amend payment terms, and a two-thirds vote for non payment terms. The main explanation lies in the fact that the sovereign called for investment banks and their legal advisors to issue their loan assets. All these investment banks were a London office of a New York firm. Accordingly, legal advisors might have "felt it would be potentially beneficial to the issuer and majority holders" (p. 10).

The second main concern that has been related is the ***absence of a claims aggregation.*** CACs' provisions only operate within the same issue. "Accordingly, they have no effect on bondholders of other issuances; nor do they apply to types of indebtedness such as bank debt and trade credit" (IMF, 2002b, p. 18). The problem is that sovereign debtor has the possibility to issue a multitude of debt instruments, which imply a multitude of anonymous different bondholders, with different interests. If CACs tackle only bonds containing them for a particular type of creditors, so CACs cannot solve the entire sovereign debt crisis. IMF (2002b) has proposed to develop clauses providing votes of all classes of creditors who held instruments with the same provision. But market reaction has been negative, assessing such a "super" collective clause that aggregates claims across instruments would drastically undermine their rights. They have put forward the argument according to which if some creditors are in closed relations with the debtor, so the latter would be able to influence the vote direction. Actually, Uruguay is the only sovereign that has tried to aggregate all claims and has raised the majority to 85 percent of voices. In order to avoid critics concerning its potential manipulation of votes, Uruguay has included a provision that prohibited it from issuing additional bonds of a new or existing series "with the intention of placing such debt securities with holders expected to support any modification proposed by Uruguay (or that Uruguay [planed] to propose" (Galvis and Saad, 2004, p. 8).

Another problem concerns the potential ***raise of borrowing cost*** for the sovereign that issues a debt with CACs. As said above, some works have showed that borrowing costs for "bad payers" are higher under the London jurisdiction (which contains CACs) than under the NY law (without CACs). Symmetrically, borrowing costs under the London jurisdiction for good reputational payers are lower than those under the NY law (Eichengreen and Mody, 2004). According to other works (Becker, Richards and Thaicharoen, 2002 and Guggiati and Richards, 2003), in the secondary market this time, none real variation of costs has been recorded, even for low-rated borrower. These results have been found under the assumption that either low-rated countries didn't carry any moral hazard concern (an anticipation by market participants of strategic default by the sovereign thanks to the CACs protection), or that markets did not see the CACs inclusion as a danger.

Nonetheless, there are other problems, especially concerning default causes, which have not been considered. Furthermore, some answers given to some concerns remain insufficient.

… Are finally not the more consistent.

Concerning ***the problem of different jurisdictions***, between 1991 and 2003, the Euromarket has raised \$45, 2 billions under the NY law, against \$121, 5 billions for the Global market under the same jurisdiction (Becker, Richards and Thaicharoen, 2002). And none study of this type has been made in the Global market to compare results to those of the Euromarket. And, at our knowledge, none study has nor been made concerning the Latin American emerging countries, even for the Mexican issuance in 2003. These markets are nonetheless the more renowned for their number of defaults in the pass, even if European emerging economies are currently the most concerned by a potential default.

Moreover, Weinschelbaum and Wynne (2003) invalidate Becker, Richards and Thaicharoen (2002) results because they "suffer from some sort of Lucas critique"[1]. The reason is that studied yields and results are estimated under the current regime, without renegotiation because of "compositional effect and the presence of the IMF". But these criterions would be different within a regime of CACs and/or SDRM. The authors base their analyse on two assumptions. The first explains that the probability of default is affected by the "compositional effect" of entire international borrowing, and not especially by the fact that some bonds are issued with CACs. According to them, three qualifications have to be considered; the composition of debt with and without collective action provisions, the number of legal jurisdictions under which the debt was issued and, to a lesser extent, the diversity of the debt maturity structure. The second assumption emphasises the importance of IMF interventions. Indeed, its presence also explains "the negligible yield differential in bonds" in that risk premium is likely to be reduced when markets anticipate an IMF intervention. Yet, at the time of studies about costs of CACs, the IMF was present and markets knew that. In their conclusion, Weinschelbaum and Wynne assert that the compositional effect correspond to "a large fraction of sovereign debt [which] is placed in jurisdictions not using friendly restructuring provisions, while the rest is divided among many jurisdictions. The fact that incentives are aligned within a jurisdiction does not imply that lenders would forgive in excess of what lenders in other jurisdictions would. When the compositional effects are present, CACs become an irrelevant dimension in debt contracts since under financial distress

[1] Initially, the Lucas critic concerns the fact that agents modify their behaviour in function of economic policies implemented, contrary to some hypothesis assumed in many models at the time. Lucas rejects the simple treatment of passed statistics to predict future behaviours of economic agents, and recommend to take into account their response to policy modifications.

no debt would be condoned. It is for this reason that yields in bonds with and without CACs are the same" (p.33).

Concerning ***the aggregation problem***, Taylor (2002c) wanted finally to be reassuring, saying that, despite of the absence of claims aggregation, CACs remained efficient to manage a sovereign debt restructuring. The problem of the debt crisis itself has so never been resolved, but remains important. A sovereign default can lead to an aggravation of the liquidity crisis and to an exchange rate collapse. If the domestic financial sector holds a part of the sovereign debt, then the sovereign drop, operated by rating agencies, also jeopardizes all domestic issuers. It is true that traditionally, domestic debt is distinguished from the external debt because of the existence, *a priori*, of competent national jurisdiction for domestic debt restructuring. But it also true that the both are linked since international lenders pertinently expect for an equal treatment with the one reserved to domestic bondholders. It is a question of equity. Moreover, ways used by sovereign to restructure its domestic are often cursory (a drastic relief, or even a repudiation), so that the credibility of both budgetary and monetary policies is reduced after that. Sovereign then suffers from the loss of confidence of its own populate, which if harmful in case of troubles. Here, the SDRM had the advantage to address this problem, by constituting specific creditors classes and a comparability of treatment between domestic and international bondholders, when it was needed. At the opposite, CACs, purely contractual, are not able to apply their own collective action approach (Sgard, 2004). The SDRM answered to a problematic question by taking into account all the involved parts in the debt, and included them in the collective action. Indeed, this is the condition to address the sovereign debt crises problem that has to open onto economic stabilization, and not only a little part of the restructuring. In the same spirit, if the number of bondholders is high, like it is in most of cases, the aggregation problem is proportionally exacerbated. Specifically, if each creditor holds a very small fraction of the debt, so that the probability to be refund, by influencing the government's incentive, is relatively independent of his individual actions, then he will have little incentive to cooperate (Weinschelbaum and Wynne, 2003). That is the same problem as the one concerning conflict among too many competent jurisdictions. Accordingly, the free rider problem is no longer solved, but only reduced among bondholders governed by the same contract.

A last concern relates to ***the origins of crisis and default***. It is essential to distinguish, as recommended by Williamson (1992), between endogenous and exogenous causes. The reason is that not only most of defaults come from an external choc, which is reflected in emerging markets spreads, but the sovereign debt market is strongly speculative. Accordingly, the emerging sovereign spreads volatility is often disproportioned compared to the evolution of the economic fundamentals. Covering up for sovereign default risk, even small, and for market risks because of the strong volatility of prices, drives yields higher. Moreover, since the emerging sovereign debt market is relatively narrow and behaviours are "herding", price reversals are fast and violent (Levasseur and Rifflart, 2003). Given the passed instability of these countries, after the financial liberalization in the 1990', markets tend to be paranoid. The current financial crisis is a good illustration. If the crisis emanates from the United States in 2007, the observed stronger increase of spreads has regardless concerned, at first, the Latin American emerging countries. And yet, these economies had previously accumulated exchange reserves, so that they did not represent any risks at this time. Specifically, 70 percent of developed countries' financial stress is transmitted towards emerging economies throughout the Emerging Markets Bond Index (EMBI, Allegret, 2009). So, only taking into account the market opinion, which is, by definition, responsible for many financial crisis and defaults, volatile, paranoid and non representative of the willingness to make the global

financial system safer, is a mistake. It is interesting to remind that IMF role in first and second versions of the SDRM has been critiqued precisely because being judge and jury. And yet, assuming that creditors are responsible for many sovereign crises and, paradoxically intrusting them with the power to lead negotiations, merely make them judge and jury in their turn. But surprisingly, nobody seems to be intrigued by this irony now.

The restructuring cannot proceed within the same framework (in other words, within the CACs framework) as it is about a State mistake or about a market judgment error. CACs give power, at least within negotiations, to creditors, whatever the reasons of crisis. The debtor interests, while the sovereign is not completely responsible for its default, are not considered. *Ex ante*, it just would have to lead credible policies, only in the purpose to raise resources necessary to repay, and *ex post*, it just would have to wait for an agreement among bondholders. What does matter if the higher credibility remains insufficient to reassure these paranoid markets. And, what does matter if the sovereign falls again into default a couple of years later because restructuring was not efficient. Most often, the restructuring agreement is not efficient because, precisely, the debtor interests, inherent to its capacity to continue its economic and, above all, social activities, are not taken into account during negotiations.

An efficient restructuring proceeding needs to distinguish between all responsibilities. If the bigger part of responsibility comes from the debtor, then CACs can be applied because the power has to incline towards creditors. But in case of exogenous causes, or market judgment error, then the power has to incline in favour of the sovereign debtor. Here, CACs are no longer a fair solution, and a switching towards a more formal restructuring mechanism, setting a neutral third party à la Krueger, becomes obvious.

Thus, CACs are not efficient concerning too many situations likely to occur. They only constitute a marginal modification of the restructuring process, which was easier to implement than a real mechanism, even more flexible than the Krueger' SDRM, and more likely to get into. However, their limits are numerous and obvious, so that they necessarily need to be completed and merged into a more global mechanism.

3.1 Beyond the simple restructuring, the necessity of a global and hybrid mechanism to settle sovereign debt crises.

The resolution of a debt crisis needs a global smooth method. It is pertinent to doubt that only one solution, as each evocated above, can by itself, deal with all consequences of a classic sovereign crisis. It possible to preserve the integrity of debt contracts, but it is impossible to respect it as before, from the start to the end. That's why a global mechanism is here proposed. Such a mechanism would have to respect the creditor rights until some extent, when all has been tried but in vain. It would be so a progressive ordered and predictable mechanism dealing with both liquidity and solvency crisis.

An International Lender of First Resort to prevent crisis and direct solutions.

It seems that the IMF has maybe not given up its desire to become a lender of last resort. Recently, Dominique Strauss-Kahn, the IMF director, has attempted to extend the Fund activities to budgetary support in favour of country in difficulties, and more generally to include in its functions all macroeconomic and financial policies that have an effect on the international stability (IMF, 2009). But Germany disagrees, considering such a proposition oversteps the Fund's mandate. Indeed, this proposition looks like an ILLR prerogative. Nonetheless, if the IMF still cannot be an ILLR, it can instead become an international lender

of first resort (ILFR), which would play two functions similar as those described by Fisher; a crisis preventive and a first aid of a crisis.

Kremer and Pfister (2002) consider a reform of the IMF is important regarding to its roles of supervision and financial intervention. They recommend a strengthening of the former by an incentive to improve the bank supervision. Specifically, despite some high costs of implementation (particularly those concerning the statistic processing, and the arbitration in favour of medium and long-term debts instead of short-term debts), banks have to be transparent and inspected in order to make them respect the Guidotti rule. The Guidotti rule wants reserves to be higher than debt outstanding for the next year. This rule application allows to do without international markets during one year. The IMF could follow the ratio evolution so that it could know when debt becomes equal, then higher than reserves, convene the sovereign and decide, with it, how to proceed in order to reduce the ratio. In case of failure, financial intervention has to be limited. The financial supply has to mobilize other resources than those of the IMF, such as additional funds like General arrangements to borrow (GAB) or New arrangements to borrow (NAB). The use of concerted bilateral lines of credits has to be come after the private sector involvement.

But, considering the fundamental role of spreads, reflecting the market confidence, the Guidotti rule is maybe not the best indicator to track the financial situation of a sovereign. Cohen and Portes (2004) consider that it would be not appropriate to treat every crisis with the same tools. They so propose a dichotomy between confidence crises and crises of fundamentals. The former is defined as crisis emanating from "an unforeseeable and unjustified loss of market confidence" while the second type is aimed at "a country where the macroeconomic indicators have long been unsatisfactory and which therefore is borrowing at abnormally high interest rates" (Cohen and Portes, 2004, p. 4). This distinction allows to know when an ILLR can pertinently intervene. In the first case, face to a confidence crisis, an ILLR would be justified in order to restore confidence by supplying liquidities. In the second case, when debt no longer bears a relation to the fundamentals, a bankruptcy procedure or a debt release can be applied. The difficulty comes from the distinction, because "the former often rapidly turn into the latter: if interest rates rise, debt can rapidly be subject to a snowball effect, which then becomes self-fulfilling with regard to the fundamentals themselves" (p. 6). The idea is to prevent this snowball effect, in confidence crisis cases and, more precisely, when sovereign is decided to restore confidence but has not time because of sudden raising spreads that lead to unsustainable levels of debt. The authors observe that, for the more indebted countries, the weight of interest rate, spreads and exchange crisis represent 40 percent of the outstanding debt increase. Cohen and Portes thus propose to establish an alarm signal when spreads, reflecting the aforementioned confidence, become too high. Such a mechanism supposes the assistance of an ILFR. Specifically, IMF members would contact the IMF when they are committed to a 300 (Cohen and Portes 2003) or 400-basis-point spread (Cohen and Portes, 2004). Then the IMF would work with the country to analyse the causes of the problem and propose solutions to solve it. An IMF programme would also be implemented, with the agreement of the country, opening access to IMF money if needed. This preliminary access to IMF resources would characterize the IMF as an ILFR. Moreover, the programme is easier to implement prior a crisis than after, because debt is not unsustainable yet. Of course, IMF support would remain conditional, by application of appropriate policies. Also, even if IMF charges a spread below the current market rate, it would remain substantial, in function of IMF judgement concerning a just limit that the country can afford. It would be a flexible case-by-case mechanism, since in some extent, the

country and/or the IMF need to know, *ex ante,* if it is a question of crisis of fundamentals or confidence crisis.

It would be possible to fear that information contained in spreads become less important if spreads are now considered as a policy tool. But actions to reduce imbalances would be voluntary, and not automatic. Markets are not supposed to fail to detect a potential insolvency of the borrower, as well as they are not supposed to reduce their price only because they know the borrower will take actions to correct imbalances. Another apprehension would concern the amount to be provided by the IMF. But, funds would be provided prior the crisis, therefore before reaching an unsustainable level of debt, so that the amount at stake would not be so important.

This idea has the great merit "to allow a country to take very early corrective actions, with the support of IMF loans" (Cohen and Portes, 2004, p. 18). In some extent, it would replace the defunct Contingent Credit Line Facility, with easier conditions of access and more predictable success.

Nonetheless, if success is not assured and the country has to face a crisis, some measures have to be taken. *Ex post*, Cohen and Portes first suggest the use of payment standstill during three months in order to freeze external commitments, to be able to impose a control over the capital transactions and to suspend the debt service. Moreover, this suspension would permit to open negotiations with creditors out of the panic and crisis atmosphere. But despite of this, the authors recommend the presence of a neutral third party, like the IMF, which could analyse crisis causes and propose a sustainable level of debt to reach, whether it is a question of restructuring for a liquidity crisis, or a relief for an unsustainable debt. Because, naturally, creditors rarely accept, by themselves, to renounce to a part of their loans. In the same way, in case of failure of these preventive tools within a liquidity crisis framework, the IMF could convene lenders and encourage them to contribute for fresh money supply.

Furthermore, one could argue that IMF, as a lender of first resort, would provide resources needed to permit the sovereign to continue its activities and avoid default. But in case where it is not enough, the IMF could bring creditors together to involve them in the crisis resolution. On their side, CACs could be able to take over and ensure a rapid agreement between creditors in cases of solvency crises. But CACs don't deal with payments standstill, while it is often useful.

The fundamental place of payments standstill and, a fortiori, of capital control.

In case where *ex ante* measures are not sufficient to avoid a crisis and a default, it is essential the sovereign can restructure its debt sheltered from panic pressure and attacks. Here again, CACs show their weakness. First, because sovereign default can lead to an aggravation of the liquidity crisis and of exchange rate fall, which also jeopardize the domestic financial sector. And none treatment comparability between domestic and external bondholders can be implemented with such an *ad hoc* mechanism. Second, because standstill and control over capital exit are not explicitly planed by CACs, while it is essential in most cases to correctly negotiate without assets and domestic activities collapse. Deliberately built to solve a private and decentralized problem, CACs are not competent to recognize extreme initiatives like a payment standstill or, worst, a control over the capital exit (Sgard, 2004).

And yet, a standstill and a control over capital transactions can be essential when crisis is strong. Haldane and Kruger (2001) have shown the moratorium advantages, which can be also applied to control over capital flight, if both are not considered as a way for debtor of infringing its obligations.

First, a standstill can solve, by itself, the collective action problem by encouraging a quick concerted action by reducing uncertainty and so panic about crisis ways-out.
Second, it motivates a rapid and voluntary agreement since it appears as a threat for creditors and as a message of non intervention by official sector for the debtor (Roubini and Setser, 2004). Considered like that, moratorium avoids too long restructuring negotiations. So does even more a control over capital flight. Third, moratorium can make the payments suspension more rigorous because it permits for debtor to take and implement appropriate measures to face the situation sheltered from crisis. Whether it is a liquidity crisis or a solvency crisis, the standstill can save the debtor situation by letting it time to find out solutions. Here, the best idea seems to be the one of Krueger, that is to let the debtor initiate it, knowing that it could implement it only during a predefined period with, ideally, the IMF consent. Consequently, the IMF consent rejects the argument of a possible abused use of moratoriums by debtor. Then only, creditors would be entitled to their say, by approving an extension. The reason is that the time necessary to decide if lenders agree with the standstill idea, even with a special meeting, would be too long in crisis context, where the lesser hour is numbered. Of course, one could argue that the debtor has to prove it plays in good faith. In this respect, the IMF can consent to lend into arrears, as a proof of IMF support, and with conditions. With conditions, the IMF can force debtor to negotiate with creditors in good faith, to ensure the comparability of treatment and establish a strict deadline, after which the procedure has to be closed. Such a transparency and IMF support could as well be applied to the potential necessity measure of controlling capital flight.

Concerning its setting up, as said Schwarcz (2000), a unilateral declaration can be harmful for both sovereign and its creditors. If a sovereign, by itself, declares a moratorium, it can later operate preferential payments to a limited number of bondholders, whereas an elaborated stay prevents from this “favouritism”. On the other hand, with a unilateral declaration, even recommended, the sovereign can fear a bondholders’ sanction, specifically concerning reputation and market access. Regardless, Schwarcz is not either partisan of a legalization of standstill, as proposed by Miller and Zhang (1999) in order to prevent “creditors races and to allow for debt restructuring” (Miller and Zhang, 1999, p. 13). According to Schwarcz, such legalization is based on the assumption that the debtor will succeed to cancel its interest payments. But it is not actually the case, since interest owed can continue increasing during the stay period. And it must not be the case, at the risk of manipulating this tool at strategic purposes by the sovereign. Accordingly, an ordered moratorium refutes the argument concerning a potential harm of contracts primacy. Furthermore, an institutionalization would be too difficult to implement. Indeed, it would require amendment of all laws of all domestic entities throughout the world, which is almost impossible, given the wish for every State to remain sovereign.

Instead, Schwarcz advocates in favour of a set of directives that would build a legal framework of standstill application. The first criterion would be the transparency of communication and information given by debtor to creditors. The second condition would be, for sovereign, to present a fair offer to its bondholders, that is an offer that does not strongly damage bonds value. And if a debt relief is required, it has to respect the sustainable threshold predefined (for example, by the IMF). Third, all creditors have to be equitably treated by debtor, whether they are national, international, or holding different bonds. Fourth, fresh money needs to have priority over others, and trade credits have not to be included in restructuring, so that economic activities are preserved. Fifth, the end of moratorium has to be pre-established and respected by the debtor, at risk to officially fail in its obligations, unless a creditors’ failure in reaching a reasonable agreement. These criterions interestingly remind those of the SDRM.

One could fear a rush to the exits by bondholders anticipating a standstill. Here intervenes the control over capital flight, which could prevent such rush, especially from short-term creditors. For medium or long-term creditors, the situation is different. "A credible, well managed standstill ought to enhance value for longer-term investors, by mitigating the costs of coordination failure. So the incentive for longer-term investors to rush for the exits will be reduced" (Haldane and Kruger, 2001, p. 20).

Others have argued a capital control (even needed) would be too costly and administratively impassable. It depends on the way of implementation. Such a control is not always required since the standstill represents a simple and temporary suspension of payments. Nonetheless, if a control is required, then it would also be temporary, so that its costs would not be prohibitive. Moreover, it would be implemented with the IMF support, and always in a transparency framework in order to reassure lenders.

The contagion effect has also been taken down. But, if the contagion of crisis occurs, certainly a contagion of standstill will follow. It is logic. Nonetheless, an ordered framework for moratorium is very different from a chaotic standstill, and would precisely contribute to reduce the contagion impact.

The stronger argument against moratorium remains the one according to which it would induce an increase of borrowing costs for borrowers, which are already high. There are several answers to give. First, it is preferable to have fewer entries but more stable capital, than a great attraction but of volatile capital. Throughout the 1990', a lot of emerging markets have received more (instable and speculative) loans than they needed, so that a reduction of capital entry is not necessarily synonym of a standard of living reduction, and even maybe is it synonym of an improvement of life quality. It is justified to remind that the sovereign debt market is extremely volatile because speculative. Second, with a decline of capital volume entrance because of moratoriums, it is possible that the maturity of debt change in favour of medium and long-term due date. "This improved composition of capital would reduce countries' susceptibility to future crises, by reducing the probability of capital flow reversals" (Haldane and Kruger, 2001, p. 20). Third, countries that have the fewer called for external capital are those that have recorded the higher growth rates for twenty years. Indeed, on the one hand, capital inflow is likely to lead the monetary policy to raise interest rates, and on the other, it can induce an appraisal of the exchange rate, which is harmful for exportable sector. Accordingly, a too strong entry of capital can create a risk of dynamic instability on the macroeconomic circle, without guarantee of growth acceleration (Artus and Cartapanis, 2008). Lastly but not least, there are some chances that a moratorium does not make borrowing costs increase since the risk evaluation by markets takes into account the probability of default, the amounts that can be recovered in that event, and the compensation for risk (the risk premium). So, first, if it is possible to believe that a standstill introduction can raise the probability of (strategic) defaults, it is as well possible to think that anticipations concerning a moratorium reduce this probability, because bondholders have more incentives to follow fundamentals et organize themselves *ex ante*. On the other, an ordered implementation of standstill increases the recovered amounts in the event of default, since the debtor is committed to lead policies that do not affect the bond value, because it is committed to treat equally all creditors and to make a reasonable offer. These three conditions considerably reduce the uncertainty for creditors, so that the borrowing costs have not to be defined higher.

Moratorium, and *a fortiori*, capital control, are essential to correctly deal with a sovereign debt crisis. In order to return to economic and social stabilization, and not only in order to just restructuring a debt, under the creditors sacred rights, which will fall in default

couple years later, again. "Debt standstills perform the dual function of reducing the deadweight output losses of financial crises and lowering the likelihood of crisis. The cost, however, could be lower expected output, depending on the strength of the crisis mitigation effect. But even here, standstills can be welfare enhancing if policy-makers consider the social effects of financial crises" (Martin and Penalver, 2003, p. 17). Accordingly, the payments standstill needs to be organized in advance in case where it would be then required.

The moderator: a dispensable trusted third party which has, regardless, to be planed.

The idea of a global mechanism is to forecast, in a smooth way, the potential difficulties likely to occur and to know how proceed in that events. Within a solvency crisis, CACs can be useful, but a formal mechanism is required if CACs fail.

Cohen and Portes (2004) propose creditors organize themselves within CACs framework during the stay period. That is possible, but only with bonds containing CACs. It is true that it needed to wait for generalization of CACs adoption in debt contracts before making a detailed analyse of their efficiency. It is as well true that, regardless, more is the number of bondholders, and more is the difficulty to find an agreement, even within the same class of claims (Weinschelbaum and Wynne, 2003). Consequently, not only the free rider problem is no longer solved but, worst, nor the panic phenomenon.

Even in an ideal world, where CACs would be universally included in debt contracts, the risk of failure of finding an agreement between bondholders is not eliminated, and the causes of crisis are not taken into account. The only way to compensate for them, it is to ensure a threat hangs over bondholders and all the process if none relevant agreement is found.

Concerning the coordination problem among bondholders or between bondholders and the debtor, the first threat is the standstill and, at the extreme, a control over capital exit. But if bondholders fail to fall agree despite this, because they are too many, or if an agreement with the sovereign seems to be impossible, a moderator has to be planed. "In the same spirit, if the debt has been issued in different legal jurisdictions, the absence of an international bankruptcy court creates conflict among jurisdictions of creditors. At the end, this free riding problem introduces a very costly renegotiation process (even under CACs)" (Weinschelbaum and Wynne, 2003, p. 3). Thus, the moderator first role would be to analyse the different claims among bondholders, and the sovereign offer consistency. The IMF, as a lender of first resort, would have already gave all necessary information about the economy fundamentals, crisis circumstances, and some opinions about the debtor and creditors behaviour. Its second role would be to arbitrate among creditors interests on the one hand, and between creditors and debtor interests in the other. The purpose would so be to find a compromise and reach an agreement. In this respect, the "Sovereign Debt Dispute Resolution Forum" (SDDRF, IMF, 2002, p. 6) would never have been given up. Its functions were essential, at least in last resort, to force parties to find an agreement by themselves. In the same way, the SDDRF intervention, even without judicial powers such as ratification of the agreement to make it effective, would have hanged over other claims without CACs disputes. In a more formal way, it could be established a type of SDDRF for bonds without CACs. It would have at least two advantages. First, it could encourage the CACs adoption for next issues, or exchange current bonds in favour of bonds with CACs, in order to avoid the SDDRF intrusion in the event of default. Second, it could constitute a solution for the aggregation problem so that bondholders governed by CACs would negotiate under provisions governance and others would be governed by a flexible procedure à la Krueger. Thus, the formal proceeding would

not constitute the only proceeding, but would occur in last resort, as an ultimate solution, or an ultimate threat.

Also, the default causes are important. The IMF, *ex ante*, has analyzed the debtor behaviour so that it knows if it is acting in good faith. If not, it is clear that such a mechanism constitutes, by itself, a moral hazard risk in that costs of the absence of negotiation are eliminated whereas they correspond to a just sanction for debtor acting in bad faith. On the other hand, nothing forbids sanctions for debtor by a SDDRF. Now, if the default occurs because of exogenous factors, in spite of pertinent expenditures of the money borrowed, CACs and a type of SDRM, just as described above, facilitate the renegotiation and "dominate [the debt contracts] without such clauses. In this case [when IMF is no longer supposed to bail out], collective action provisions, together with an international bankruptcy court, are recommendable because reducing the cost of renegotiation is not only optimal from the ex-post but also from the ex-ante perspective" (Weinschelbaum and Wynne, 2003, p. 4). Otherwise, the default and the restructuration would be very costly. The same is true for Ghosal and Miller (2003), who evaluate collective action clauses against a SDRM with an international bankruptcy court. They incline towards the latter, given that, for them, this court would be in charge of verifiability, commitment and enforceability power. Eaton (2002) also asserts that an international bankruptcy court can distinguish why things went bad (verifiability), whereas bondholders, by themselves, cannot.

At the end, market-based solution would remain privileged, either after the ILFR diagnostic or during a standstill needed. But fortunately, they would no longer represent the only way on which the crisis resolution has to count.

4. Conclusions.

The main problems, or causes, of a classis sovereign debt crisis, concerning the collective action among bondholders, are the rush to the exits (also defined as" creditor grab race", or as "multiple equilibrium" by Sachs, 1995, "because if each depositor suspects that the other depositors want to withdraw their funds in the near future, the individual depositor will expect that the bank will soon be faced with a liquidity crisis, and perhaps a forced and costly liquidation", leading then to the classic prisoner dilemma), the rush to the Courthouse and the free riding risk within an improvised framework of restructuring (Roubini and Setser, 2004). On the debtor side, the main problems are the short term debt and risks taken by domestic banks, likely to be socialized after a collapse, as well as its own debt, evolving in function of domestic policies, agencies rating appreciations, market speculation, policies led by developed countries and external chocks. Now, the main consequences of sovereign debt crisis are the financial, economic and social collapses for the debtor and the assets depreciation for creditors. The achieved restructuring purpose is not to permit the largest refund for creditors, but has to allow arbitration between this target and the economic and social stabilization for the sovereign debtor.

An obvious liquidity crisis calls for an International Lender of Last Resort à la Fisher. A doubt about the nature of crisis calls for an International Lender of First Resort, as defined by Cohen and Portes (2004), which would analyse causes to the purpose of choosing the right mechanism. If bondholders are few and most of bonds contain CACs, then CACs framework can be useful. If crisis and panic are severe, then a standstill and, at the extreme, a capital control, are needed to calmly negotiate. If bondholders are too many, governed by too different jurisdictions, cannot reach an agreement, disagree with the debtor offer, or if crisis comes from an external shock and/or a market judgment error, then CACs are no longer sufficient. In such cases, they need to be either completed, or completely replaced by a formal

mechanism calling for a neutral third party in charge of evaluating claims, debtor offer and arbitrating between different interests in game.

In the same way, although it has not been tackled in this paper, only a third party, with more powers than a mere "Sovereign Debt Dispute Resolution Forum", could resolve the illegitimate and odious debts issues, which are obvious and strongly problematic in several emerging and low-developing countries. The Ecuador case, which has repudiated a large part of its commercial debt in 2008, because finally judged illegal, is emblematic of this situation, because this part of debt had have been restructured a couple of years before. At this time interestingly, many authors considered this improvised restructuring as a success…

REFERENCES :

Aglietta M. and et De Boissieu C., 1999, “Le prêteur international en dernier ressort”, in *Architecture financière internationale*, Conseil d’analyse économique, *La Documentation française*, Paris.

Aglietta M. and Denise C., 1999, “Les dilemmes du prêteur en dernier ressort international”, *Revue française d'économie*, Année 1999, Volume 14, No. 4, pp. 35–85.

Aglietta M. and Moatti S., 2000, *Le FMI. De l’ordre monétaire aux désordres financiers*, Economica.

Allegret J.P., 2009, “La crise économique mondiale : impact sur les pays émergents”, conference given at the University of Grenoble, in the frame of *Les jeudis de l’Economie*, October 15, 2009.

Artus P. and Cartapanis A., 2008, “Globalisation financière et croissance dans les économies émergentes. La sous estimation des contraintes macroéconomiques induites”, *Revue économique* 2008/6, Volume 59, pp. 1145-1158.

Becker T., Richards A. and Thaicharoen Y., 2002, Bond Restructuring and Moral Hazard: Are Collective Action Clauses Costly?”, *IMF Working Paper* No. 01/92.

Calomiris C. W., 1998a, “The IMF’s Imprudent Role as Lender of Last Resort”, Cato Journal, vol. 17, No. 2, februrary.

Calomiris C. W., 1998b, “Blueprints for a New Global Financial Architecture”, in *International financial markets : the challenge of globalization*, edited by Leonardo Auernheimer, *Bush School Series in the Economics of Public Policy, University Of Chicago Press.*

Chang R. and Velasco A., “Liquidity Crises in Emerging Markets: Theory and Policy”, *NBER Macroeconomics Annual*, Vol. 14, (1999), pp. 11-58.

Cohen D. and Portes R., 2003, “*Crise de la dette: prévention et résolution*”, report of the Conseil d’Analyse Economique (CAE), Paris, *La Documentation française,* 168 p.

Cohen D. and Portes R., 2004, “Towards a Lender of *First* Resort”, Centre for Economic Policy Research, *Discussion Paper No. 4615*.

Diatkine S., 2003, “Théorie bancaire, théorie monétaire et prêteur ultime chez Thornton”, *Cahiers d’économie politique*, 2003/2, No.45, pp. 41-60.

Eaton J., 2002, “Standstills and an International Bankruptcy Court,” *Mimeo* 2002.

Eichengreen B. and Mody A., 2004, "Do Collective Action Clauses Raise Borrowing Costs?", Economic Journal, Vol. 114, No. 495, pp. 247-264, April 2004.

Fisher S, 1999, "On the Need for an International Lender of Last Resort", *Journal of Economic Perspectives*, Volume 13, No. 4, 1999, pp. 85-104.

Freixas X. and al., 2002, "Lender of Last Resort : A Review of the Literature", in *Financial crises, Contagion, and the Lender of Last Resort. A Reader*, *Oxford University Press*, pp. 27-57.

Galvis S. J. and Saad A. L., 2004, "Collective Action Clauses: Recent Progress and Challenges Ahead", *Georgetown Journal of International Law*, Volume 35:4, 2004.

Ghosal S. and Miller M., 2003, "Co-ordination Failure, Moral Hazard and Sovereign Bankruptcy Procedures," *The Economic Journal* 113, April 2003.

Gugiatti M. and Richards A., 2003, "Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets," *Research discussion paper* 2003-02.

Gugiatti M. and Richards A., 2004, "The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers", Reserve Bank of Australia, (July 11, 2003). Available at SSRN: http://ssrn.com/abstract=443840 or DOI: 10.2139/ssrn.443840.

Haldane A. and Kruger M., 2001, "The Resolution of International Financial Crises: Private Finance and Public Funds", Bank of Canada, *Working Paper 2001-20*.

Hardin R., 1992, "Collective Action as an Agreeable *n*-Prisoner's Dilemma", in *The Moral Dimensions of Public Policy Choice. Beyond the Market Paradigm*, John Martin Gillroy and Maurice Wade, Editors, *University of Pittsburgh Press*.

Helleiner E., 2006, "The long and winding road towards a sovereign debt restructuring mechanism", *Mimeo*. University of Waterloo.

IMF, Legal and Policy Development and Review Departments, 2002a, "The Design of the Sovereign Debt Restructuring Mechanism-Further Considerations", http://www.imf.org/external/np/pdr/sdrm/2002/112702.htm

IMF, 2002b, "The Design and Effectiveness of Collective Action Clauses", Prepared by the Legal Department, June 6, 2002, http://www.imf.org/external/np/psi/2002/eng/060602.htm.

IMF, 2002c, "Collective Action Clauses in Sovereign Bond Contracts-Encouraging Greater Use", Prepared by the Policy Development and Review, International Capital Markets and Legal Departments, June 6, 2002. http://www.imf.org/external/np/psi/2002/eng/060602a.htm

IMF, 2003a, "IMF Board Discusses Possible Features of A Sovereign Debt Restructuring Mechanism", *Public Information Notice (PIN)* No. 03/06, January 7, 2003.

IMF, Policy Development and Review Department, 2003b, "Crisis Resolution in the Context of Sovereign Debt Restructuring: A Summary of Considerations", https://www.imf.org/external/np/pdr/sdrm/2003/012803.htm

IMF, 2003c, "IMF Concludes Discussion on the Review of Contingent Credit Lines", *Public Information Notice* (PIN) n° 03/146.

IMF's Factsheet, 2004a, "The IMF's Contingent Credit Lines (CCL)", http://www.imf.org/external/np/exr/facts/ccl.htm

IMF, Research Department, 2004b, "Sovereign Debt Structure for Crisis Prevention**",** www.imf.org/external/np/res/docs/2004/070204.pdf.

IMF, 2009, "Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund", October 4, 2009, IMFC *Press Briefing.*

Kindleberger C. P., 2000, *Manias, Panics, and Crashes. A history of Financial Crises*, Fourth Edition, *John Wiley & Sons, Inc.*

Kremer G. and Pfister C., 2002, "Y a-t-il place pour un prêteur international en dernier ressort ?", *Bulletin de la Banque de France*, No. 78, June 2002.

Krueger A. O., 2001, "A New Approach to Sovereign Debt Restructuring", at the *Indian Council for Research on International Economic Relations*, Delhi, India, December 20, 2001

Krueger A. O., 2002, "A New Approach To Sovereign Debt Restructuring", International Monetary Fund, Washington, D.C., April 2002.

Levasseur S. and Rifflart C., 2003, "Crises de dette souveraine: Vers une nouvelle résolution?", Chronique de la mondialisation, *revue de l'OFCE* No. 86 2003/3.

Martin B. and Penalver A., 2003, "The effect of payments standstills on yields and the maturity structure of international debt", *Bank of England Working Paper* No. 184.

Meltzer A, 1998, "What's wrong with the IMF ? What would be better?", *The Independent Review*, volume IV, n.2, Fall 1999, pp. 201–215.

Miller M. and Zhang L., 1999, "Sovereign Liquidity Crisis: The Strategic Case for a Payments Standstill", *CSGR Working Paper* No. 35/99.

Rogoff K., 1999, "International Institutions for Reducing Global Financial Instability", *The Journal of Economic Perspectives*, Vol. 13, No. 4. (Autumn, 1999), pp. 21-42.

Rogoff K. and Zettelmeyer J., 2002, "Early Ideas on Sovereign Bankruptcy Reorganization: A Survey", *IMF Working Paper*, WP/02/57.

Roubini N., 2002, “Do we need a new international bankruptcy regime? Comments on Bulow, Sachs and White”, Discussion of papers by Jeremy Bulow, Jeffrey Sachs and Michelle White for the *Brookings Panel on Economic Activity* “Symposium: A Bankruptcy Court for Sovereign Debt”, April 5, 2002, Washington D.C.

Roubini N. and Setser B., 2003, “Improving the Sovereign Debt Restructuring Process: Problems in Restructuring, Proposed Solutions, and a Roadmap for Reform”, Paper prepared for the conference on “Improving the Sovereign Debt Restructuring Process” co-hosted by the Institute for International Economics and Institut Français des Relations Internationales, Paris, March 9, 2003.

Roubini N. and Setser B., 2004, *Bailouts of Bail-ins? Responding to Financial Crises in Emerging Economies*, *Institute For International Economics*, Washington, DC.

Sachs J., 1995, “Do We Need an International Lender of Last Resort”, Frank D. Graham Lecture, *Princeton University*, April 20, 1995.

Schwartz A., 1998, “Time to Terminate the ESF and the IMF”, *Cato Foreign Policy Briefing*, 48.

Schwarcz S. L., 1999, “Sovereign Debt Restructuring: a Bankruptcy Reorganization Approach”, Duke Law School Public Law and Legal Theory, *Working Paper* No. 1.

Sgard J., 2002, *L’économie de la panique. Faire face aux crises financières*, *La découverte*, Paris.

Sgard J., 2004, “Faillite souveraine, négociation privée et nouvelle architecture financière internationale”, in *L’économie mondiale 2004*, *CEPII*, Repères, *La Découverte*.

Stiglitz J. E., 2002, *La Grande Désillusion* (*Globalization and its discontents*), Fayard.

Taylor J. B., 2002a, “Grants and Sovereign Debt Restructuring: Two Key Elements of a Reform Agenda for the International Financial Institutions”, Testimony of John B. Taylor, Under Secretary of the Treasury for International Affairs before the Joint Economic Committee, February 14, 2002, PO-1016 (http://www.treas.gov/press/releases/po1016.htm).

Taylor J.B., 2002b, “Sovereign Debt Restructuring: A U.S. Perspective”, Remarks at the Conference ""Sovereign Debt Workouts: Hopes And Hazards?"", *Institute for International Economics*, Washington, D.C., April 2, 2002

Weinschelbaum F. and Wynne J., 2003, “Renegotiation, Collective Action Clauses and Sovereign Debt Markets”, Society for Economic Dynamics, *Meeting Papers* n°7.