1 SOVEREIGN DEBT IN CONTEXT

1 Introduction

The purpose of this book is to unveil the foundational legal paradigm that informs and shapes the character of the current sovereign debt regime using the philosophy of socio-economic rights. Sovereign debt and socio-economic rights have, over the years, become critical themes in the international development discourse.[1] Their interaction is complex for a number of reasons. In the first instance, sovereign debt is a double-edged sword: On the one hand, depending on certain variables, it can improve the well-being of citizens. On the other hand, it can 'impair a government's ability to deliver essential services to its citizens'.[2] It furthermore is a complex issue due to the multiplicity of interests and the multi-level governance spaces within which the regime operates. Complexity also arises from the competing theoretical paradigms undergirding the law of sovereign debt that has created a 'strained marriage' between public debt and private contracts.[3] The current legal vacuum on sovereign debt restructuring (SDR) is a reflection of the continuing influence of the dominant liberal paradigm over other competing paradigms. The liberal paradigm has advanced and sustained a fictional public-private divide that prioritises debtors' contractual obligations over their other treaty obligations.[4] This, it will be argued, is nourished by a formalistic,

1 United Nations Inter-agency Task Force on Financing for Development Financing for sustainable development report (2019) 117-126, https://developmentfinance.un.org/sites/developmentfinance.un.org/files/FSDR2019.pdf (accessed 29 September 2019). See also World Conference on Human Rights Vienna Declaration and Programme of Action (1993) paras 1 & 9-12 (calling 'upon the international community to make all efforts to help alleviate the external debt burden of developing countries, in order to supplement the efforts of the governments of such countries to attain the full realisation of the economic, social and cultural rights of their people').

2 SG Cecchetti and others 'The real effects of debt' (2011) 3-17, https://www.bis.org/publ/othp16.pdf (accessed 29 September 2017).

3 A Gelpern 'The strained marriage of public debts and private contracts' (2018) *Current History* 28.

4 An example of this 'creditor priority norm' is Spain's 2011 constitutional amendment that provides that '[l]oans to meet payment on the interest and capital of the state's public debt shall always be deemed to be included in budget expenditure and their

privity-based, two-sided creditor-debtor matrix that is incompatible with the multiplicity of interests visible in the contracting, restructuring and enforcement of sovereign debts.

The rights of citizens or rights holders are at the centre of both socio-economic rights and sovereign debt. States have obligations to deliver essential services to their citizens, despite the fact that there are competing demands on their limited resources. Virtually all prominent theories of the nature and evolution of modern states, from Hobbes's to Habermas's, indicate that states' obligations are inextricably linked to the interests of their citizens. In the words of Rasmussen, 'a country is simply an investment vehicle for its citizens … [and the] needs of a state's citizens [are] actually part of the reasons why sovereign borrowing is justified in the first place'.[5] This creates a fiduciary relationship between government and its citizens.[6] Therefore, there is constant pressure to fulfil the citizens' socio-economic rights while simultaneously performing other governmental commitments. This emphasises the need to prioritise the fulfilment of certain governmental obligations, especially during times of economic crises.

In these circumstances, borrowing becomes a viable option. Borrowing stimulates the economy by providing liquidity; it enables a state to invoke its future assets at a given time and helps to level consumption across generations because 'a transfer from future to current generations can raise society's intertemporal welfare'.[7] The assumption is that, with improved technology and more capital, the future generation will be richer than the present generation.[8] Thus, a state may borrow during an economic downturn against the potential prosperity of the future.[9] This invariably raises issues of inter-generational equity in the sovereign debt scheme. In

payment shall have *absolute priority*'. See Constitution of the Kingdom of Spain 2011 sec 135.3. Following its recent debt crisis, Greece also adopted legislation that mandates 'servicing of the public debt at a *priority*, in order to maintain and strengthen fiscal stability'. See Greece Law 2362/1995 (as amended 10 April 2012) art 1A.

5 RK Rasmussen 'Integrating a theory of the state into sovereign debt restructuring' (2004) Vanderbilt University Law and Economics Working Paper 18-19, http://ssrn.com/abstract=558266 (accessed 20 May 2017).

6 JR Oyola & M Sudreau 'Fiduciary relations' in C Esposito and others (eds) *Sovereign financing and international law: UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (2013) 213-235.

7 Cecchetti and others (n 2) 3.

8 As above.

9 Rassmussen (n 5) 19.

addition, borrowing is not simply an option. It has, in fact, become an existential necessity for many countries.[10]

Economists have shown the correlation between debt and economic growth.[11] Without borrowing, a country's economy is likely to stagnate; but excessive debt often slows economic growth.[12] It leads to panic and the usual adoption of contractionary policies by governments.[13] According to Cecchetti and others, 'higher nominal debt raises real volatility, increases financial fragility and reduces average growth'.[14] Finding the 'tipping point', however, is a difficult endeavour partly because of the complex interactions of multiple economic variables.[15] Nevertheless, a well-managed, purpose-driven sovereign debt system strengthens economies, builds infrastructure and improves the well-being and socio-economic conditions of citizens. The structure, terms and conditions of such debts are crucial factors for consideration.

It is important to note that excessive indebtedness is not a recent phenomenon. Over the past couple of centuries, several countries have experienced vicious circles of sovereign debt crises (SDCs) as a result of excessive, unsustainable debts. These often derail the fulfilment of socio-economic rights commitments of such indebted states. In 2010 an International Law Association (ILA) Study Group found that almost all sovereign debtors have defaulted over the past century and that sovereign debt defaults (SDDs) tend to occur at the rate of one to three in every year.[16] In another study covering 66 countries it was found that between 1350 and 2006 'virtually all countries have defaulted at least once and

10 R Campbell & M Wheatcroft 'The debt of nations: A policy insight' (2018), https://www.icaew.com/-/media/corporate/files/about-icaew/what-we-do/policy/public-finances/debt-of-nations.ashx?la=en (accessed 28 September 2019).

11 Cecchetti and others (n 2) 3-5.

12 CM Rainhart & KS Rogoff 'Growth in a time of debt' (2010) 100 *American Economic Review Papers and Proceedings* 573-578; IMF 'Public debt and growth' (2016), https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Public-Debt-and-Growth-24080 (accessed 20 August 2018).

13 Cecchetti and others (n 2) 3-4.

14 As above.

15 M Caner and others 'Finding the tipping point: When sovereign debt turns bad' (2010) 63-74, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1612407 (accessed 20 August 2017).

16 Sovereign Insolvency Study Group of the International Law Association (ILA) Hague conference report (2010) 980. However, Reinhart & Rogoff have shown that, as of 2008, Mauritius had never defaulted on its debts because of high growth rates. See CM Reinhart & KS Rogoff 'This time is different: A panoramic view of eight centuries of financial crises' (2008) 15, http://www.nber.org/papers/w13882 (accessed 12 January 2018).

many several times on [their] external debt'.[17] Some of today's wealthy states were, at some point, serial defaulters. For instance, between 1500 and 1800 Spain defaulted six times while France defaulted eight times and, in the latter case, default episodes were often accompanied by executions of private creditors (that is, a crude form of debt restructuring called 'bloodletting') in order to restore equilibrium to the economy.[18] England defaulted in 1340, 1472 and 1594.[19] In addition, between 1800 and 2006 many countries were in default and 'each lull has invariably been followed by a new wave of default'.[20] Between 1820 to 1840 and 1930 to 1950, respectively, half of all countries in the world were in debt default.[21] Several prominent debt resolution methods were employed by creditor nations up to the early part of the twentieth century, most of them crude in nature. These include the loss of territories.[22] Forced receivership and gun-boat diplomacy were the other prominent debt resolution methods employed by creditor nations.

Following the post-war institutionalisation of international finance, the circles of default reduced. However, this brought further complexities as the number of international creditors increased. The emergence of the International Monetary Fund (IMF), the World Bank (WB) and other multilateral development banks (MDBs) has fundamentally changed the sovereign debt landscape. It has also impacted on the realisation of socio-economic rights of debtors' citizens.

Another significant fact is that, following decades of relative inactivity, bondholders re-entered the debt market and became significant players in the market, especially following US Treasury's intervention through the issuance of the Brady Bonds in the late 1980s. Sovereign wealth funds (SWFs), banks and so-called 'vulture funds'[23] all became active in the debt

17 Reinhart & Rogoff (n 16) 20.

18 Reinhart & Rogoff (n 16) 21.

19 Reinhart & Rogoff (n 16) 20-21.

20 Reinhart & Rogoff (n 16) 3-5.

21 Reinhart & Rogoff (n 16) 4.

22 Reinhart & Rogoff (n 16) 12.

23 'Vulture funds' are hedge funds or private equity investors that buy securities in distressed investments such as high yield bonds in or near default or equities that are in or near bankruptcy. They file law suits to recover the original amount. Studies have shown that vulture funds generally win their law suits. Judgments in 25 of these cases yielded about $1 billion. Since 2004 the number of these cases has doubled, averaging eight cases annually as of 2016. See African Legal Support Facility 'Vulture funds in the sovereign debt context' (2016), https://www.afdb.org/en/topics-and-sectors/initiatives-partnerships/african-legal-support-facility/vulture-funds-in-the-sovereign-debt-context/ (accessed 28 June 2018).

markets, creating a complex debt composition that invariably increased the debt management challenges of many sovereign debtors. Informal groupings of creditors began exerting direct influence on sovereign debt regimes, especially in the sphere of the restructuring processes. The Paris Club, the London Club, the Group of Seven developed countries (G7) and the Group of Twenty most advanced economies (G20) are classic examples of players shaping this 'norm-creation' process. In collaboration with international financial institutions (IFIs), G7 and G20 (comprising influential creditor nations) issued different soft law instruments reflecting the dominant liberal (private law) paradigm. However, as official and non-official creditors began to cooperate for their common interests, inter-creditor tensions became inevitable. Some official creditors, for example the IMF, increasingly enjoyed preferred creditor status.

Without a fair statutory restructuring and bankruptcy framework in place, it was not surprising that pre-war default episodes resurfaced. With the fluctuation of commodity prices and rising interest rates, the 1980s and 1990s saw another cluster of defaults especially in Africa, Asia and Latin America.[24] Between 1950 and 2010, approximately 600 cases of SDR were reported.[25] The Russian debt crisis and the infamous Argentine debt crisis of the early 2000s were the result of another cluster of defaults. Some of Argentina's private creditors opened a 'Pandora's box' in sovereign debt adjudication (SDA) by invoking investment arbitration in their efforts to enforce debt claims against Argentina.[26] Unfortunately, although SDA through the investor-state dispute settlement (ISDS) mechanism expands creditors' space for the recovery of debt claims, it also narrows the debtors' options. Nevertheless, Argentina advanced, among others, a host of socio-economic rights-related defences and counterclaims. This re-ignited the controversy regarding the legitimacy of ISDS. It also underscores the relevance of socio-economic rights in sovereign debt disputes.

Following concerted campaigns for 'debt justice' around the world, creditor nations and multilateral development institutions launched two ambitious debt relief programmes in the form of the multilateral debt relief (MDR) and the heavily-indebted poor countries (HIPC) initiatives. The issue of debt relief also found expression in different United Nations (UN) declarations and resolutions, including the defunct Millennium

24 Reinhart & Rogoff (n 16) 24-25.

25 In fact, combined with past default episodes, some Latin American states spent 40% of their years in existence in a state of debt default as of 2008 while several African countries spent half their years of existence in the same situation. See Reinhart & Rogoff (n 16) 28-29.

26 M Waibel 'Opening Pandora's box: Sovereign bonds in international arbitration' (2007) *American Journal of International Law* 711-759.

Development Goals (MDGs) and their successors, the Sustainable Development Goals (SDGs). In addition, human rights-friendly standards have emerged over the years as a result of the works of the UN in this area.[27] Some of these standards recognise debtors' socio-economic rights obligations and the philosophies underlying these rights.

Despite these developments, especially the positive effects of the MDR and the HIPC initiatives on the finances of sovereign debtors, the debt problem persists. Indeed, following the 2008 global financial crisis (GFC), more waves of default were recorded. The Euro debt crises (2008-2015) exposed the vulnerabilities of developed economies arising from the devastating effects of contagion in a highly-integrated currency union. Greece, Ireland, Italy, Portugal and Spain were particularly affected and, consequently, their citizens' socio-economic rights were 'deprioritised'.[28] As in the case of the Argentine debt crisis, the Greek debt crisis also enriched the sovereign debt jurisprudence as thousands of creditors sought to expand the boundaries of SDA through invocation of the investment arbitration regime. The dominant private law paradigm incentivised this and other forms of international and transnational debt litigations. Interestingly, socio-economic rights found another entry point into the sovereign debt regime through some of these litigations.

Against the above background, this book interrogates the dominant private law paradigm to locate socio-economic rights in the critical phases of the sovereign debt regime especially in debt restructuring and adjudication. In the latter case, the focus will be on specific decisions of international courts and tribunals, not national courts. The book is not about domestic public debts because these are usually governed by the sovereign's internal laws that often have a clear legal hierarchy precluding or, at least, minimising the possibility of adjudicatory inconsistencies and norm-conflicts. In the same vein, the enforcement of socio-economic rights in domestic courts and institutions is outside the scope of this book. The focus here is on the relationship between socio-economic rights as contained in the International Covenant on Economic, Social and Cultural Rights (ICESCR) and the sovereign debt regime. Although national constitutional mechanisms play a critical role in the enforcement of socio-economic rights, the book narrows down the discussion to ICESCR. This is because of the varying significance attached to these

27 See, eg, UN General Assembly (UNGA) Basic Principles on Sovereign Debt Restructuring Processes (adopted 10 September 2015); United Nations Conference on Trade and Development (UNCTAD) Principles on Responsible Sovereign Lending and Borrowing (amended 10 January 2012); UN Human Rights Council (UNHRC) Guiding Principles on Foreign Debt and Human Rights (adopted 5 July 2012).

28 See n 4.

rights across jurisdictions as well as the potential inconsistencies between legal traditions in terms of the status and enforcement of socio-economic rights in various jurisdictions. Indeed, the enforcement of socio-economic rights in specific jurisdictions has been well covered in the literature.[29]

In addition, the broad principles under examination here have their roots in treaties, customary international law, general principles of law, UN declarations and resolutions and other soft law instruments. International tribunals are guided by these sources. On the contrary, national judicial decisions have peculiar legal traditions, offering diverse approaches to the application of these legal sources within their respective jurisdictions. Therefore, the cases selected for the purpose of review in this book have their roots in international law. Indeed, the dominance of a few creditor states (specifically the United States of America (USA) and the United Kingdom (UK)) as preferred jurisdictions for the enforcement of sovereign debts means that most of the domestic cases will come from these jurisdictions. Unfortunately, the USA is yet to ratify ICESCR which, as the book will show in chapter 3, is the main source of socio-economic rights in international human rights law (IHRL).

The case selection was made using the following criteria: the actual sovereign debt crisis that usually provides the factual and contextual background for instituting the substantive claim; the actual submission of debt recovery claims by creditors before supranational tribunals; the existence of elements of socio-economic rights-related defences or counterclaims by the debtor respondent; the respondent being a sovereign debtor; and the factual basis for legal analysis reflecting one or more features of modern sovereign debts as will be identified in the next chapter. In essence, parties' character, the nature of the substantive claims and defences are the principal determinants. The specificities of the tribunals and the jurisprudential traditions are immaterial. This is because, as noted earlier, there is no international debt claims tribunal; the current regime is fragmented and jurisprudentially incoherent in character. Consequently, creditors have been expanding their debt recovery options beyond the traditional domestic seat identified in the contract documents, to modern investment and human rights tribunals. In other words, there are no institutional constraints limiting creditors' international causes of action.

29 See generally M Langford (ed) *Social and economic rights jurisprudence: Emerging trends in international and comparative law* (2008); A Eide and others (eds) *Economic, social and cultural rights* (1995); CR Sunstein 'Social and economic rights? Lessons from South Africa' (2001) 2-17; A Nolan & M Langford 'The justiciability of social and economic rights: An updated appraisal' (2007) 3-36.

Finally, by focusing on international SDAs, the book excludes the institutional and reporting mechanisms under ICESCR. These are important, but they are not adjudicatory institutions whose attitudes can be easily discerned. It also excludes cultural rights as provided under ICESCR. It also is not concerned with specific socio-economic rights. The book deals only with the underlying philosophies of these rights as they feature in sovereign debt governance. In other words, the focus is on the aspects of the minimum core obligations and socio-economic rights' basic unifying themes of life, human dignity, equality and the underlying philosophy of inclusion and social justice. Hence, the specific constituents of these rights will not be discussed in this book.

2 Socio-economic rights in sovereign debt governance

Ordinarily, the notion of 'sovereign debt governance' suggests the existence of a well-structured, balanced and credible framework designed to fairly respond to or address the diverse and often conflicting concerns, tendencies and interests of primary stakeholders. Contrary to this supposition, however, the current regime for sovereign lending and borrowing is deeply flawed and fragmented, institutionally uncoordinated and skewed in favour of certain interests and, consequently, non-responsive to the interests of some of its primary stakeholders. Indeed, there is near universal consensus that the regime suffers three major problems: a lack of institutional structure that can guarantee legal certainty and adjudicatory coherence in the management of debt crisis; unfair practices that frequently reveal, first, a serious bad faith on the part of stakeholders and, second, an apparent lack of transparency and due process especially in creditor claims (for instance, vulture funds litigations) and in the negotiation and restructuring of debts; and the efficiency deficit in SDR, otherwise called the 'too little too late' problem, which largely arises because of widespread uncertainties, undefined debt resolution mechanisms and the fears of contagion and moral hazard.[30] According to United Nations Conference on Trade and Development (UNCTAD), 'the lack of clear, universally-applicable rules and principles creates uncertainty and seriously disrupts creditor coordination in sovereign debt restructuring processes'.[31]

Therefore, it is not surprising that parties would seek to use (and shape) this fragmented regime to their respective advantage. Without an international institution for debt resolution, multiple adjudicating bodies (national and supranational institutions) have been turned into sovereign

30 UNCTAD *Sovereign debt workout: Going forward, roadmap and guide* (2015) 3-4.

31 As above.

debt crisis management bodies. These include domestic courts, regional courts, international tribunals, G7, G20, IMF, the Financial Stability Board (FSB), the Paris Club, the London Club and, to a lesser extent, some UN-based institutions such as UNCTAD, the United Nations General Assembly (UNGA) and the United Nations Human Rights Council (UNHRC).

In light of the above, situating socio-economic rights within this regime would be problematic. Nevertheless, the multiplicity of interests characteristic of sovereign debt plus the growing movement towards sustainable debt for development as contained in numerous multilateral instruments (for instance, SDGs) provide an important window for cross-regime interactions.[32] Indeed, it is now widely recognised that a sustainable debt management framework is critical for indebted countries to minimise 'costs for economic and social rights and development'.[33]

The recurring waves of sovereign debt crises, as indicated above, have brought to the fore the tension between indebted countries' contractual obligations to their creditors and their socio-economic rights obligations to their citizens. This, in the context of a debt crisis, invariably raises fundamental policy issues among which is the status of the socio-economic rights of debtor's citizens. The historical evolution of this tension is striking. Since the adoption of the Universal Declaration of Human Rights (Universal Declaration) in 1948, socio-economic rights have become universal values embedded in, and protected by, various international legal instruments, including ICESCR. These instruments defined and directly imposed legal obligations on states to take steps towards the realisation of these rights. They, however, recognise the centrality of resource availability for this purpose.

Interestingly, it was around the same period that the structural foundations of modern international financial and investment regimes were laid. In the aftermath of World War II, the traditional creditor nations have managed to influence the structure of the international financial system in a manner that prioritises building, reinforcing and strengthening the contractual mechanisms for creditor protection. The IMF and World Bank, the foremost multilateral creditors controlled largely by the US and the EU, play a central role in multilateral debt relief initiatives. They have been at the forefront of the reform of the contractual framework for debt restructuring. The Paris Club also work with IMF in bilateral debt restructuring. Despite its unsettled character, the investment treaty regime

32 See ch 4 for an extensive discussion on this.

33 UNCTAD (n 30) 6.

has been controversially invoked by certain classes of creditors to enjoy additional layers of protection. The private law paradigm supports these bases of creditor protection, thereby empowering creditors while, at the same time, disempowering debtors.

Indeed, in response to the Eurozone debt crisis, the contractual governance framework had been reformed and strengthened to, supposedly, address the emerging 'holdout' and sovereign debt profiteering cultures.[34] This was engineered by US Treasury Department.[35] However, it only addressed the symptoms, not the problem. No attempt was made to address the philosophical foundation rationalising the utility of private governance framework in a complex regime. As noted earlier, sovereign debt is not an ordinary private debt. Therefore, reforming this fragmented, creditor-driven regime in the shadow of private debt contracts has only deepened the doctrinal misalignment visible in modern sovereign debt governance. Thus, despite the so-called 'reforms', sovereign debt-related problems still persist: sovereign debt profiteering, rising debt profiles, looming debt crises, debt unsustainability and distress. For instance, in 2018 global debt stocks stood at $244 trillion out of which approximately $66 trillion were debts owed by sovereigns.[36] A decade earlier the latter figure stood at $37 trillion.[37] Between 2013 and 2018, developing countries' debt grew from 36 per cent of their gross domestic product (GDP) to 51 per cent.[38]

This surging debt profile of countries poses significant risks to global financial stability, potentially constraining the fiscal capacity and policy space of indebted countries.[39] Indeed, sovereign bond issuances by

34 IMF *Strengthening the contractual framework to address collective action problems in sovereign debt restructuring* (2016); UN Department of Economic and Social Affairs (UNDESA) 'Technical study group report on sovereign debt restructuring: Further improvements in the market-based approach' (2017) 4-18, https://www.un.org/esa/ffd/wp-content/uploads/2017/09/EGM_sovereign-debt_Technical-study-group-report-30Aug2017.pdf (accessed 13 February 2018).

35 See S Brooks 'The politics of regulatory design in the sovereign debt restructuring regime' (2019) 25 *Global Governance* 411-413.

36 C Oguh & A Tanzi 'Global debt of $244 trillion nears record despite faster growth' *Bloomberg* 15 January 2019, https://www.bloomberg.com/news/articles/2019-01-15/global-debt-of-244-trillion-nears-record-despite-faster-growth (accessed 3 March 2019).

37 As above.

38 UN Inter-Agency Task Force on Financing for Development (n 1) 118.

39 UN DESA 'World economic situation and prospects: Monthly briefing No 124' (2019), https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/wesp_mb124.pdf (accessed 17 September 2019).

African countries have been projected to increase in the coming years.[40] For instance, they increased from an annual average of $10 billion in the early 2000s to around $80 billion between 2016 and 2020.[41] The COVID-19 pandemic compounded the situation.[42] The external debt of African countries was estimated at $1,1 trillion in 2022 and is projected to rise.[43] In 2022, 60 per cent of countries eligible for the WB-IMF Debt Service Suspension Initiative (DSSI) were either in debt distress or at high risk of distress as total external debt reached US $9 trillion in 2021.[44]

Therefore, repeated or serial debt defaults have become the norm in international finance. In the words of Reinhart and Rogoff, there is no such thing as 'This time is different'.[45] Unfortunately, this recurring trend had repeatedly derailed efforts towards the full and progressive realisation of socio-economic rights across the world. The recent reform efforts only reinforced 'the strained marriage between public debt and private contracts'.[46] As indicated above, the absence of formal bankruptcy procedures is a manifestation of this misalignment. Of course, economic variables, such as fluctuating commodity prices, global capital flows, rising interest rates and domestic political economy, are critical contributing factors.[47] Internal factors, including governance and constitutional arrangements of countries, also play a role in the frequency of defaults.[48] However, all these factors may not be unconnected to the private law paradigm.

40 UN DESA (n 39) 2-4. As of 2018, eight African countries were in debt distress while 16 were on the verge of distress. See Overseas Development Institute (ODI) *Africa debt rising conference* (2018) 2; S Mustapha & A Prizzon 'Africa's debt rising: How to avoid a new crisis' (2018), https://www.odi.org/sites/odi.org.uk/files/resource-documents/12491.pdf (accessed 11 June 2019).

41 A Adesina 'Evolution of debt landscape over the past 10 years in Africa' keynote speech by the president, African Development Bank Group delivered at the Paris Club on 20 June 2023, www.afdb.org/en/new-events/speeches/evolution-debt-landscape-over-past-10-years-africa-keynote-speech-dr-akinwumi-adesina-president-africa-development-bank-group-delivered-at-paris-club (accessed 20 October 2023).

42 See in general chapters in DD Bradlow & ML Masamba (eds) *COVID-19 and sovereign debt: The case of SADC* (2022).

43 Adesina (n 41).

44 World Bank *International debt report 2022* (2022) xiii.

45 Reinhart & Rogoff (n 16) 2.

46 Gelpern (n 3) 22.

47 Reinhart & Rogoff (n 16) 6, 30 & 39; M Eberhardt '(At least) four theories for sovereign default' (2018), https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=CSAE2018&paper_id=1125 (accessed 20 April 2019).

48 E Kohlscheen 'Why are there serial defaulters? Evidence from constitutions' (2007) 50 *Journal of Law and Economics* 713-730.

This paradigm has built a creditor-biased framework that has persistently rejected propositions for a statutory framework, forcing indebted countries into a dilemma of simultaneously satisfying conflicting obligations at a given time. The dominant paradigm has consistently ignored interests, including those of debtors' citizens, outside the bilateral creditor-debtor matrix built in the shadow of private debt relationship. Consequent upon this narrow relational construct, this paradigm leaves a legal vacuum and a governance deficit in the restructuring of sovereign debts, creating deep uncertainties and encouraging unrestrained creditor opportunism and forum shopping in the enforcement of debt claims by creditors. The UN Commission of Experts on the Reform of the International Monetary and Financial System observes that 'the existing system of protracted, creditor-biased resolution of sovereign debt crises is not in the global public interest and far from the interests of the poor'.[49]

It was partly because of this legal paradigm that creditors' socio-economic rights responsibilities received little attention in the sovereign debt literature despite developments elsewhere, especially in the area of business and human rights (BHR). Indeed, while debtors' socio-economic rights responsibilities have been well established, creditors' responsibilities have continued to generate controversies. Not surprisingly, many creditors have consistently and fiercely opposed the idea of making clear provisions setting out the socio-economic rights responsibilities of creditors in a concrete legal form. The efforts of the UNHRC have only yielded a soft law instrument, namely, the UN Guiding Principles on Foreign Debt and Human Rights (GPFDHR).

In addition, the recurrence of debt crises raises fundamental concerns about the current creditor-determined debt sustainability framework, the politics of 'debt diplomacy',[50] coordination and other collective action problems visible in contemporary SDR. It also rekindles concerns regarding the important but missing elements of transparency, legitimacy

49 UNGA 'Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System' (2009) 122, https://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf (accessed 10 February 2019). Some scholars do not think it is realistic to overhaul this 'messy hodgepodge' and propose incremental reform to the current system that is 'here to stay'. See M Sole 'Sovereign debt architecture is messy and here to stay, deal with it' *Financial Times* 16 August 2022.

50 Bilateral creditors, particularly USA and China, have been competing over loans to African countries. See 'US warns African nations against Chinese debt, offers "sustainable alternative"' *Africa News* 17 July 2018, https://www.africanews.com/2018/07/17/us-warns-african-nations-against-chinese-debt-offers-sustainable-alternative// (accessed 11 June 2019). See also *Law Debenture Trust Corp plc v Ukraine* 2017 EWHC 655 (a case involving Russia and Ukraine).

and fairness in the sovereign debt regime. The absence of these critical governance elements incentivised irresponsible lending and borrowing behaviours. Indeed, cases abound in which private speculators profited from a debt crisis while the debtor struggled to satisfy other competing, even more compelling, domestic and international obligations.[51] The presumed beneficiaries of such debts, that is, the debtor's citizens, may have little or no voice in the negotiation, contracting, restructuring and repayment of such debts.[52] Inter-creditor relations have similarly suffered as official creditors enjoy a 'preferred creditor status', a position that 'is definitely at severest odds with statutory duties, good governance, and the rule of law'.[53] History has shown that this status does not allow fair treatment of all creditors as it undermines equality of representation and equitable distribution during restructuring especially in the context of multiple debt issues involving private creditors.[54] It could also incentivise hold-out behaviour by private creditors, thereby undermining intercreditor equity. According to Raffer, official creditors are supposed to grant reliefs before any impending liquidity crisis hit an indebted member country. Had the IFIs been adopting this rather than the 'preferred creditor' approach, they could have 'defused quite a few crises, and saved the poor much misery, and other creditors a lot of money'.[55]

51 See, eg, *FG Hemisphere v Democratic Republic of Congo* 2011 637 F 3d 373 (claimant got over $200 Million judgment); *Donegal International v Zambia* (2007) *Lloyd Report* 397 (claimant got a $15 million judgment); *Kesington International v Congo Republic* (2008) *Weekly Law Report* 1144 (claimant got $118 million judgment).

52 The recent case of Mozambique is instructive here. Without the necessary parliamentary approval, the government of Mozambique guaranteed an external loan of $760 million in favour of its state-owned company in 2014. The amount of this 'secret debt' never made it to Mozambique, yet $90 million was paid as banks' fees and the lenders sold the debt on the secondary market. Upon default in 2016, the value of the debt fell. Thereafter, the government reached a one-sided debt restructuring agreement with four firms holding 60% of the bonds. This agreement literally allows the bondholders to get about 270% profits despite the illegitimacy or, more appropriately, illegality of the debt. See T Jones 'Outrageous Mozambique debt deal could make 270% for speculators' (2018), https://jubileedebt.org.uk/blog/outrageous-mozambique-debt-deal-could-make-270-profit-for-speculators (accessed 25 August 2019). Secret debts are not peculiar to Mozambique. Indeed, around the same period, certain sovereign debt obligations were also not reflected in the government debt management systems of the Republic of Congo, Ecuador, Zambia and Togo. See IMF & World Bank 'G 20 note: Improving public debt recording, monitoring and reporting in low and lower middle-income countries' (2018), https://www.imf.org/external/np/g20/pdf/2018/072718.pdf (accessed 5 July 2019).

53 K Raffer 'Rethinking sovereign debt: Pleading for human rights, the rule of law, and economic sense' (2016) 6 *Accounting, Economics and Law* 249.

54 OJ Mandeng 'Intercreditor distribution in sovereign debt restructuring' IMF Working Paper 4/183 September 2004, www.imf.org/external/pubs/ft/wp/2004/wp04183.pdf (accessed 13 September 2023).

55 Raffer (n 53) 254.

Finally, as the world grappled with the common challenges associated with debt crises, UN's organs and agencies have become deeply polarised regarding the way forward. Expectedly, most creditor states and private creditors have rejected several UN-led reform initiatives. They prefer a soft law approach that, in a sense, reinforces the private law paradigm.[56] The results include uncoordinated issuance of soft law instruments. Beside the regulatory confusion arising from the issuance of these instruments, this approach tends to amplify and strengthen the contractual governance framework. Interestingly, some elements of socio-economic rights have been incorporated into some of these soft laws, eg GPFDHR. Thus, as creditors expand their debt recovery claims to the investment treaty regime, some arbitral tribunals have been confronted with some socio-economic rights related defences and counter claims.[57] Not surprisingly, the interpretations of these tribunals are far from coherent, raising more questions than answers.

3 Deconstructing the liberal legal paradigm

The philosophical underpinning of the sovereign debt regime and its relationship with socio-economic rights have not received the deserved attention in the legal literature. This book attempts to fill this gap. The arguments advanced here are mainly rooted in and supported by legal theories. In the international legal arena, norms are sometimes imprecise as multiple actors struggle to shape the system to reflect their interests. In this regard, law is better seen in context because its making, application and enforcement are value-laden with juxtaposition between positivism and natural law approaches.

Locating socio-economic rights within the sovereign debt regime would require a critical interrogation and deconstruction of the liberal (private law) paradigm that has largely controlled this regime for decades. Thus, it is imperative to identify the ontological and epistemological assumptions influencing the choice of such paradigm to be able to deconstruct it.

A 'paradigm' is a set of beliefs, image of society, world views and fundamental philosophical assumptions about knowledge and the nature of the world. It consists of 'ways of knowing', a 'taken-for-granted mind

56 US and EU prefer IMF-led SDR reforms that basically maintain the primacy of US and UK laws and courts in the sovereign debt regime. A US Treasury official was quoted as stating that the US had 'no appetite for pursuing an international agreement that could result in a supranational authority to supplant core US sovereign decision making or judicial authority'. See Brooks (n 35) 409.

57 See the cases reviewed in ch 5, especially *Ubaser v Republic of Argentina* (2012) IIC 969.

set' and a 'shared frame of reference' among researchers in a field.[58] It is a background orientation explicitly and implicitly employed to philosophise, theorise, and formulate ideas or build an epistemological theory.[59]

The typologies of paradigms vary from the positivists (who tend to have a realist's ontology of determining how things are/work) to the constructivists (who postulate that reality is mentally constructed based on one's orientations, knowledge and experience).[60] There are also functionalist, interpretive, emancipatory and post-modern paradigms.[61]

A legal paradigm dictates priorities between legal principles. In the context of adjudication, for instance, imprecision or indeterminacy of legal norms could be minimised by paradigmatic understandings.[62] It is the 'court's implicit image of society … [providing] the background for an interpretation of a system of basic rights'.[63] Habermas identifies three principal paradigms of law: (i) liberal formalists' paradigm (that is, formal law); (ii) social-welfare paradigm (that is, materialised law); and (iii) proceduralist paradigm (that is, 'reflexive law').[64]

Liberal legal paradigm goes hand in hand with rational choice theories in economics and can be traced back to the Enlightenment period.[65] It creates a divide between the private-economic sphere and the public/common-good/state sphere so that the former is, first, left to the 'natural', spontaneous order produced by uncontrolled market forces.[66] Second, it

58 T Hutchinson 'The doctrinal method: Incorporating interdisciplinary method in reforming the law' (2015) 3 *Erasmus Law Review*, https://www.elevenjournals.com/tijdschrift/ELR/2015/3/ELR-D-15-003_006/fullscreen (accessed 26 August 2019).

59 N Onuf 'Of paradigms and preferences' (2012) 56 *International Studies Quarterly* 626-628.

60 PF Carspecken 'Paradigmatics of the "paradigm dialogue"' (1999) 79 *Counterpoints* 7-10.

61 Z Zhu 'After paradigm: Why mixing-methodology theorising fails and how to make it work again' (2011) 62 *Journal of the Operational Research Society* 786.

62 R Alexey 'Jurgen Habermas's theory of legal discourse' (1995) 17 *Cardozo Law Revi*ew 1032; G Motzkin 'Habermas's ideal paradigm of law' (1995) 17 *Cardozo Law Review* 1431.

63 J Habermas 'Paradigms of law' (1995) 17 *Cardozo Law Review* 771.

64 Habermas (n 63) 772-776.

65 H Farrell & M Finnemore 'Ontology, methodology, and causation in the American School of International Political Economy' (2009) 16 *Review of International Political Economy* 60.

66 Hayek is one of the fiercest liberal paradigmatists. He considers the market spontaneous, self-generating, endogenous order (cosmos) which could be distorted by any 'interference' (regulation). Interferences 'disrupt the overall order'. See FA Hayek *Law, legislation and liberty* (1982) 36-37, 128-129.

emphasises the protection of individual liberty in order to ensure equality of opportunities and social justice. Only rights can trump these liberties, hence interference with their enjoyment on grounds of collective good is prohibited unless it is necessary, proportionate and suitable.[67] This 'image of society' is exemplified by the norms of private law relating to property and contracts all of which are structured on the basis of formal or legal equality in status and opportunities or 'legal ability'.[68] Here lies the theoretical underpinning of the legal paradigm that informs the contractarian perspective on sovereign debt governance.

There are two broad fundamental assumptions underlying the liberal paradigm, namely, economic assumptions of market equilibrium, consumer sovereignty, party autonomy, sanctity, privity and freedom of contract; and sociological assumptions of formal equality of status, distribution and exercise of social powers as defined in the various norms of private law.[69] These assumptions have deeply penetrated the sovereign debt regime. The liberal paradigm is in this book referred to as the 'dominant private law paradigm'.

However, this paradigm has been accused of encouraging 'a closed, highly formal, vaguely machine-like' approach to legal theorising that reinforces hierarchies and inequality within societies.[70] Therefore, the second paradigm emerged using the same normative premises to change this 'image of society'. It emphasises substantive equality, direct government planning and the introduction of new 'basic rights grounding claims to a more just distribution of socially-produced wealth and a more effective protection from socially-produced dangers'.[71] This legal paradigm, it should be noted, reflects the changing economic and social conditions of Western societies that became evident in the nineteenth century. In particular, Marxism was instrumental to the popularisation of this paradigm. It, thus, is a left-leaning legal paradigm most notably employed by scholars of the critical legal studies tradition.[72] Unlike the liberal paradigm, the state has expansive powers under the social-welfare paradigm to provide services.[73] It '*pays for* the agency of the state at the

67 Alexey (n 62) 1030-1031.

68 Habermas (n 63) 773.

69 As above.

70 JP McCormick 'Three ways of thinking "critically" about the law' (1999) 93 *American Political Science Review* 413-414.

71 Habermas (n 63) 773.

72 McCormick (n 70) 413-414.

73 Habermas (n 63) 775.

expense of the autonomous status of individual actors'.[74] The major inadequacy of the social welfare paradigm is its 'susceptibility to legal arbitrariness and vulnerability to naked might', which is likely to impair the enjoyment of those social rights that it seeks to advance and protect.[75]

To circumvent the shortcomings of the above two paradigms, Habermas advanced what he calls the 'proceduralist understanding of law'.[76] According to this, a legal order is measured not only by the protection that it affords to private market players but also by the level of social guarantees granted to citizens.[77] Both, therefore, are equally important. Thus, under this paradigm, 'legal persons are autonomous only insofar as they can understand themselves at the same time as *authors* of the law to which they are subject as addressees'.[78] The private and the public spheres have a mutual, interdependent relationship and, therefore, are the 'centrepiece of the new image'.[79]

This seems to be a plausible, citizen-centric paradigm. The narrow conceptions of justice under the two competing paradigms (that is, liberal and social welfare) have thus been broadened by this unique marriage of paradigms to produce a 'multi-paradigm'. Accordingly, 'the formal' and 'the informal' mutually interact and reinforce each other, and the zero-sum game between 'the private' and 'the public' is replaced by 'complementary forms of communication found in the private and public spheres of the life world … and in political institutions'.[80] Although critical of the social welfare paradigm, Habermas seeks to pursue the social-welfare project at a 'higher level' because the 'intention is to tame the capitalist economic system'.[81] Habermas aptly observes:[82]

> [A] legal order *is* legitimate to the extent that it equally secures the co-original private and political autonomy of its citizens; at the same time, however, it *owes* its legitimacy to the forms of communication in which civic autonomy alone can express and prove itself. This is the key to a proceduralist understanding of law. [This image] … thematiz[es] the connection between forms of

74 As above.
75 McCormick (n 70) 416.
76 Habermas (n 63) 776-780.
77 As above.
78 As above.
79 Habermas (n 63) 777.
80 As above.
81 Habermas (n 63) 777-778.
82 As above (emphasis in original).

> communication that *simultaneously* guarantee private and public autonomy *in the very conditions from which they emerge*.

Therefore, the above three paradigms explain the ontological and epistemological assumptions informing, shaping and influencing the making and application of substantive legal principles, doctrines and traditions especially as they relate to the overarching ideal of justice. In particular, however, the proceduralist paradigm recognises the complexities brought by economic globalisation and, consequently, embraces the multi-layered forms of governance at the national, regional and international levels. Indeed, unlike the formal law and materialised law of the liberal and social-welfare paradigms respectively, it favours a 'reflexive' or 'global' law as advanced by prominent transnational legal theorists such as Teubner and Zambunsen.[83] 'Reflexive law' embraces normative evolutions and sees law as 'a system for the coordination of action within and between semi-autonomous social sub-systems'.[84]

Therefore, in light of the above insights, it might be implausible to adopt either of the two competing paradigms here. This is because the contractual governance framework is a child of the liberal paradigm and the social-welfare paradigm emerged in its shadow. Indeed, interrogating the dominant private law paradigm through the same 'societal image' or one directly opposed to it will only produce a predictable outcome. The appropriate approach to interrogate this paradigm is to adopt a multi-paradigmatic approach.

83 See, eg, G Teubner 'The King's many bodies: The self-deconstruction of law's hierarchy' (1997) 31 *Law and Society Review* 763-788; G Teubner 'Global Bukowina: Legal pluralism in the world society' (1996), https://ssrn.com/abstract=896478 (accessed 14 April 2019); P Zumbansen 'Law after the welfare state: Formalism, functionalism and the ironic turn of reflexive law' (2008) 56 *American Journal of Comparative Law* 769-808. Zumbansen describes transnational legal theory as a 'methodology'. He notes thus: '[F]rom a methodological perspective, the tensions between national and global, between public and private, and between law and non-law can be understood as constitutive elements of an emerging understanding of the law of world society. These tensions are constitutive and inherent to world society law, because they illustrate the unavoidable ambivalence … of competing and colliding ordering paradigms, alongside of which law seeks to express and assert itself … Transnational "law" can thus be reconceived as transnational legal pluralism in that it methodologically responds to the fragmented, disembedded evolutionary dynamics of norm-creation in the context of world society.' See P Zumbansen 'Transnational private regulatory governance: Ambiguities of public authority and private power' (2013) 76 *Law and Contemporary Problems* 132-133.

84 G Teubner 'Substantive and reflexive elements in modern law' (1983) (17) *Law and Society Review* 239 242.

Habermas's proceduralist paradigm fits this description. First, it provides a suitable theoretical premise that brings non-state actors (NSAs) into the legal accountability realm as seen in the adoption of the new governance model in the business and human rights (BHR) regime.[85] Second, Habermas's proceduralism recognises legal discourse as part of a 'general practical discourse' that aligns with the 'law in context', 'law in society' and 'law as a process' method adopted in this book. Third, the paradigm's legal form is that of 'global law', which embraces the formal and the informal, the hard and the soft, the international and the transnational normative instruments. It accommodates the multi-level governance imperative brought about by economic globalisation. Indeed, transnational legal theories evolved within this 'new image'.

Based on this approach, the book attempts to combine social justice-based theoretical premises with the popular rational choice and game theories to situate the citizens within the sovereign debt regime. Rational choice theory captures the 'ends-means calculation' by competing agents.[86] Game theory operates in a situation of perfect competition between rational agents which, in the context of SDR negotiation, for instance, implies that either the debtor or the creditor would lose.[87] In this circumstance, it is assumed that both agents bear some concrete socio-economic rights responsibilities, hence, prioritising competing obligations (that is, to debtor's citizens and to international creditors) becomes necessary.

Finally, theories of social justice are usually sceptical of both liberalism and particularism. They advance analytic, rationally-defensible arguments, first, against liberalism's unfettered, spontaneous order of 'market-justice' and, second, in favour of broad-based inclusion of all people.[88] Importantly, they usually are rights-based theories.

Therefore, one cannot but recognise the criticality of legal theory in advancing arguments to locate socio-economic rights in sovereign debt governance and to deconstruct the dominant narrative in this area. At

85 JG Ruggie 'Global governance and "new governance theory": Lessons from business and human rights' (2014) 20 *Global Governance* 5-17.

86 JP Bohoslavsky & A Escriba-Folch 'Rational choice and financial complicity with human rights abuses: Policy and legal implications' in JP Bohoslavsky & JL Cernic (eds) *Making sovereign financing and human rights work* (2014) 15-32; EV Towfigh 'Rational choice and its limits' (2016) 17 *German Law Journal* 763-778.

87 R Don 'Game theory' (2018), https://plato.stanford.edu/entries/game-theory/ (accessed 11 October 2018).

88 D Miller 'Recent theories of social justice' (1991) 21 *British Journal of Political Science* 371-391.

the foundational level, an 'image of society' that recognises and addresses the problematics of sovereign debt in international law is desirable. The relevance of legal paradigms that ignore the issues highlighted above is surely in question.

4 Structure

This book consists of six chapters. Chapter 2 conceptualises sovereign debt in international law with a focus on the sources of sovereign debtor's liability as seen from the private law paradigm: contracts, treaties, CIL, principles of law, and soft laws. It exposes the shortcomings of the traditional conception and argues for a development-driven reconceptualisation of sovereign debt that directly links indebted states to their citizens. Having unpacked the concept of sovereign debt, the chapter examines the nature of SDR and SDD and conceptualises 'sovereign debt governance' from a citizen-focused, multi-stakeholder perspective.

Chapter 3 argues for creditors' socio-economic rights responsibilities in relation to state obligations under ICESCR. It invokes the values of life and human dignity as the normative foundation for socio-economic rights and identifies the rights holders and the specific responsibilities of the duty bearers, including states, IFIs and other private creditors.

Chapter 4 attempts to locate socio-economic rights within the existing SDR regime and uses history to show that at the time when extra-legal measures (that is, the execution of creditors, forced receivership, gun-boat diplomacy and war indemnity) were the usual debt recovery norms, socio-economic rights, *stricto sensu*, were non-existent. This changed after World War II as these rights became concretised and embedded in the consciousness of the global community. Since then, a new set of multilateral and private lenders have emerged in the shadow of the dominant private law paradigm. The chapter critiques the existing SDR processes and examines the position of socio-economic rights under new legal instruments such as the UNGA's Basic Principles on Sovereign Debt Restructuring Processes (BPSDRP), the UNHRC's Guiding Principles on Foreign Debt and Human Rights (GPFDHR), UNCTAD's Principles for Responsible Sovereign Lending and Borrowing (PRSLB) and Sovereign Debt Workout Guide (SDWG). It makes a strong case for the prioritisation of these rights in SDR.

Chapter 5 attempts to locate socio-economic rights in sovereign debt adjudication. It delineates the contours of SDA in the international and transnational contexts using creditors' actions as the key determining factor and then reviews selected cases sourced from three distinct systems

of adjudication: state-state espousal claims, ISDS, and human rights-based creditor claims. Using cases from these three forms of SDA, the chapter examines the emerging trends and adjudicators' attitudes towards socio-economic rights in the sovereign debt regime.

Chapter 6 concludes by arguing that recurring debt crises over the past couple of decades are linked to the fundamental philosophical underpinning of the private law paradigm, which literally incentivises sovereign debt profiteering and simultaneously undermines the realisation of socio-economic rights. The chapter concludes that the current system is in need of a radical re-invention and that 'global law' (particularly its transformative character in norm creation, application and enforcement) needs to be expounded and more openly embraced to drive the re-invention of the sovereign debt regime in a manner that recognises the values of socio-economic rights.