ETHICS AND DEBT PROJECT

The Ethics and Debt Project aims to bring together theorists and policy practitioners in a constructive discussion about how to address the problem of severe sovereign indebtedness in a way that is effective and consistent with principles of justice. We have enclosed two background notes, which we hope would be helpful in introducing, respectively, some theoretical disagreements about justice to policy practitioners and the details of the practice of sovereign borrowing to moral and political theorists.

"The Players in the Game of Sovereign Debt," by Barry Herman, describes the current arrangements that guide the interactions of actors involved in sovereign debt. "Ethical Issues Relevant to Debt," by Christian Barry, discusses some of the principled disagreements that may underlie present disputes regarding the appropriate arrangements for sovereign debt resolution.

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THE PLAYERS IN THE GAME OF SOVEREIGN DEBT

Background note for the Ethics and Debt Project*

In policy discussions about government debt, especially of developing countries and particularly in cases when there is a crisis to overcome after a government defaults on its debt, commentators often talk about legal obligations, political necessity, and economic consequences. Implicitly or explicitly, commentators refer to what the "proper", "fair," or "just" actions would be. Typically, what is claimed as fair from the perspective of one group of interests (for example, the holders of defaulted government bonds) is regarded as unfair by another group (for example, the people whose taxes would be raised to pay the bondholders), and vice versa. Ultimately, a compromise is almost always reached between a sovereign debtor in crisis and its creditors. But does that compromise represent a fair sharing of the burden among the different players?

This paper discusses from a policy perspective the major players in sovereign debt, what interests they seek to fulfill, how they interact, and some of the challenges that they face.

THE SOVEREIGN DEBTOR

Sovereign indebtedness begins when the national or central government of a country chooses to borrow. The typical borrowings are uncollateralized obligations of the government in domestic or foreign currency, backed only by its "full faith and credit." This debt is recognized as an obligation of the government as a whole, and its management is considered the responsibility of the executive and legislative branches (in a democracy) or officials (in a dictatorship) of the government. The judiciary is responsible for assessing purportedly criminal actions relating to sovereign debt and settling disputes between the government, its creditors, and financial intermediaries in matters pertaining to government debt issued under domestic law. The courts of the borrowing country are not typically considered (by its creditors) as the relevant forum for settling disputes involving the government's debt issued under the laws of other countries, such as bonds issued in New York or London. The borrowing government may be bound by its constitution and accepted practice to abide by the decisions of its own courts, but there are no treaties by which governments are required to cede authority to any foreign court in matters of sovereign debt.[1] Only moral suasion, political pressure, or economic threats can make the government honor the decisions of foreign courts.

Types of government borrowing

Governments typically borrow for three main purposes: short-term transaction smoothing, medium-term expenditure smoothing, and investment in specific, usually longer-term

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* Prepared by Barry Herman. This paper has benefited from comments by Christian Barry, Lydia Tomitova, and Alys Willman-Navarro, only some of which have been addressed here. Comments and corrections on this work in progress would be most appreciated (contact: herman@un.org). Views expressed are those of the author and not necessarily of any institution with which he might be associated.

[1] In the United States and United Kingdom, where most international borrowing is arranged, sovereign governments are considered immune from lawsuits except when they engage in "commercial activity." Government borrowing is considered such an activity (and explicit waivers of sovereign immunity are standard clauses in loan or bond contracts). However, this only means that a private creditor can sue a sovereign debtor in court in New York or London. Winning a settlement is rare, and collecting on it is far rarer still.

projects, such as improvements in infrastructure. The first type of borrowing includes loans, usually for up to ninety days, typically from domestic commercial banks, to smooth deficits during revenue-expenditure cycles in government operations that arise because government expenditure and revenue flows are usually not synchronized. Comparable loans in foreign currency are taken to smooth international transactions over time, which helps to limit short-term volatility in the exchange rate. The average level of short-term government debt related to such borrowings usually grows more or less at the rate of growth of overall domestic economic activity, while the foreign currency component of such debt grows roughly in proportion to the growth of foreign trade and payments. This type of borrowing does not lead to sovereign debt crises.

Governments often also borrow during economic recessions in response to temporary declines in tax revenues and recession-related increases in expenditures. The alternative to the borrowing is to cut expenditure or raise taxes, aggravating the recession. All too often in recent years, developing countries with very limited borrowing capacity have had to follow the so-called pro-cyclical policies. The quid pro quo when instead undertaking "counter-cyclical" borrowing is that the government should repay the cycle-related debt during the next boom period, which entails running a budget surplus. This is to say that although the original maturity ("tenor") of the loans undertaken during the downturn could be anything up to, say, ten years, the government should either repay them during the recovery period or not roll over other loans as they mature. As a result, over the full economic cycle the net borrowing would be nil. Problems arise when the net borrowing over the full cycle is excessively large. This can happen when there is a sequence of adverse economic shocks, so recovery is repeatedly postponed or weak, or when a permanent adverse change is mistaken for a temporary recession. It could also be the result of policy failures of the borrowing government, such as not restraining expenditure during the boom when demands for expenditure are high.

Governments also borrow for specific policy purposes, for example, to purchase military hardware, or for specific long-term investments, such as constructing or improving highways or ports. While the "useful life" of some military hardware may be up to a decade, some infrastructure (with proper maintenance) will last a generation or more. Because such investments benefit residents over time, it is generally considered fair that the future beneficiaries of these investments bear some of their costs. Thus, instead of asking the current taxpayers to bear the full cost, governments borrow and share the cost with the future taxpayers through interest and principal repayments. Indeed, as infrastructure investments can raise economic growth, they can thereby also enhance the capacity of the borrowing government to service the debt out of higher tax revenues it collects on the higher incomes. There is nevertheless an important caveat in that very heavy borrowing for capital investment can place an excessive debt burden on the populace in the future. Government borrowings discussed thus far should all appear in its fiscal budget (and sometimes in the balance sheet of the central bank under external borrowing). Government debt may also rise in less transparent ways. For example, for policy reasons the government may guarantee the borrowing of another entity (state enterprise, public-private partnership, even private company). As the government is usually deemed a lower credit risk than any other domestic entity, a government guarantee lowers the interest cost or extends the maturity of the borrowing by the favored entity. In that sense, it is an attractive policy tool as it can assist the targeted recipient and yet it is not an actual budget outlay. In the event of default by the entity, however, the government becomes responsible for the repayment of the loan—that is, the guarantee creates a "contingent liability."

Governments may also incur debts without guaranteeing a specific loan, as when they have to borrow to make up a shortfall in promised payments, as to retired civil servants owing to underprovision or bad investment experience of their pension fund. In this case, the government guarantee is to the pensioners and exemplifies a class of contingent claims that can be labeled "unfunded obligations." Sometimes, governments even have to incur debts to make good on obligations on which there are at best only implicit guarantees. One example is borrowing to recapitalize the local commercial banks in a generalized banking crisis. In such cases, the government may buy a portion of the bad debt held by the banks using funds it borrows itself. The new financial resources transferred to the banks are meant to rebuild confidence in them, without which no market-based economy can function.[2]

In sum, most categories of government debt are intentionally incurred, although unfunded obligations and contingent liabilities can add to government debt in an unplanned way. It is usually difficult to forecast when or with what probability such contingencies would require new borrowing, but the probability is not zero. In that sense, official government debt statistics understate the fiscal condition of the government, albeit by an amount that is difficult to measure. More generally, economic shocks can turn what appeared to be responsible budgeting into a debt crisis, which moreover arrives at the moment when the government's usual creditors lose interest in extending further loans.

The art of sovereign debt management

To assist governments in their debt management, the international policy community has been trying to define what the "sustainable" level of government debt might be. There is as yet no consensus even what factors should be taken into account when defining "sustainability," let alone what debt-related indicators to monitor, and certainly we are far from agreement on any guidelines for maintaining it. Given the proliferation of debt crises over recent decades, however, the International Monetary Fund now prepares a standard report on sovereign debt as part of its annual consultations with governments on their macroeconomic policies. The report examines alternative economic scenarios and potential economic shocks and traces what happens in each case to standard debt indicators (for example, ratio of total debt to gross domestic product and foreign debt to exports of goods and services). Examination of the "debt dynamics" is meant to signal under what kinds of economic circumstances the country might become vulnerable to a debt crisis, although as noted above, actually having one requires that all usual creditors lose confidence and cease lending, which is impossible to foresee.

Regardless of how difficult it may be, the government is regarded as responsible in practice for managing its own debt. It may take a very cautious approach to borrowing, which lowers the probability of crisis. But this would be at the cost of foregoing the benefits from borrowing, which could be in moderating an economic downturn or in postponing essential infrastructure investment. The amount of risk to carry is thus properly a political decision, which means it should be taken by the appropriate political body of the government (executive and/or legislature). The international community of states could decide to share in the risk by providing automatic credit lines to governments that are

[2] It is widely held that taxpayers are justified in insisting on government regulation and supervision of privately owned banks in a market economy precisely because of this contingent claim on them owing to the essential public service that banks provide. This is an additional argument to the perhaps more standard one that deposit insurance should be coupled with official supervision to reduce the claims on the insurance fund from failed banks.

deemed to budget "responsibly" so that there would be some form of adverse risk insurance. Thus far, it has not chosen to do so. IMF lending (except for a modest "reserve tranche") usually comes after the fact and with a long list of policy conditions attached. The risk and responsibility is left fully with the government.

Why do governments service their debt?

At any moment in time, a government's debt is the cumulative result of the borrowing and repayment by it and all previous governments. When the government is considered legitimate and seems generally to represent the wishes of its people, the debt is viewed as the collective obligation of the people and should be serviced by current and future governments as contracted.[3] In fact, governments almost always do service their debts. When a new government is formed, it inherits and almost always accepts responsibility for all of the debts that were obligations of the previous regime. Governments do this for the same reason private sector borrowers do: the government wants continued access to credit from all its creditors and on favorable terms. Anything else threatens to make governing more difficult.

Yet there are limits. In the case of debts incurred for constructing infrastructure that continues to provide services (roads, school buildings, etc.), the change of regime should not matter. It was understood when the loans were incurred that they would have to be serviced over successive governments and the services from the investments are enjoyed by taxpayers under the new as much as the old regime. However, if the infrastructure investment had been grossly overpriced or is deemed dangerous to public health and safety, the investment agreement, including its financing, might be revisited (indeed, the government that signed the initial contracts may equally challenge the deal if it comes to suspect malfeasance). Governments are nevertheless cautious in challenging investors in such cases so as not to discourage investors in other projects. Specific cases of fraud or bribery are more easily pursued than general claims that all lending to a previous regime constituted "odious debt" that should not be serviced. Concerns to bring such ethical considerations to bear are typically swamped by desires to maintain as much space as possible in which to govern.

On the other hand, a government could reach the conclusion that its previous history of borrowing was so economically and socially harmful that it decides to eschew future borrowing. In this situation, the government may feel less impelled to service its already outstanding loans. Indeed, this issue has been discussed in relation to the crisis and 2001 default of Argentina. It is not clear in that case whether the events there represented a negotiating ploy to force a larger write-down of Argentina's defaulted bonds or a historically new direction in Argentine policy (and a fairly unique one among middle-income countries).

CREDITORS

It is necessary to discuss the different classes of creditors separately, as they have different motivations, expectations and behaviors in their acts of lending to a government, which might lead to different judgments about their obligations with respect to servicing that debt.

Commercial banks: bedrock of the financial system

Inside the banks

The loan officers of banks are expected to regularly assess and monitor the sustainability of their clients' borrowing. Banks also maintain risk managers to oversee that the overall

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[3] This point is elaborated in Christian Barry's note.

portfolio of loans extended by the bank is not excessively risky. This involves both questions of the mix of loans and the riskiness of individual clients. Moreover, as commercial banks are regulated institutions, the supervisory authorities are also obligated to monitor the riskiness of the portfolio of loans of the banks.

In fact, the players do not always follow their roles. First, banks can charge riskier clients a higher interest rate and thus lending to them is more lucrative, at least until a crisis erupts. Thus, management may discount warnings coming from the risk managers, especially when the banks operate as corporations whose shares trade on the stock market and whose management is remunerated according to short-term profit performance figures.

The responsibilities of loan officers and risk managers in banks are the same when lending to the government or private clients. However, the banks are likely to lend longer to a government whose debt indicators are worsening than to a private firm. One reason is the presumption, which is warranted by history, that the government is a less risky client than private entities. Second, banks exist in a political world and their governments can first pressure and then force the banks to continue to lend beyond what they would do voluntarily and can press "forbearance" on the part of regulators.[4]

Different factors press the banks to continue to lend to governments after risk flags go up. In the case of domestic banks that lend to their government in local currency, the concern is typically less that of default than erosion of the value of loans owing to inflationary money creation. But here all the assets denominated in nominal currency of all the banks will be at risk. Each individual bank will suffer whether it lends more to the government or not, as long as the banks as a whole continue to lend. Absent a joint decision of the banks to confront the government (an unlikely event), the lending will continue. In addition, domestic banks can also accommodate political pressure—as long as it is put on all of them together—to lend to their government in foreign currency (which means borrowing abroad on their own account for lending to the government). They can tolerate the risk of such lending because of the "moral hazard" problem: the banks know that should there be a general domestic banking crisis owing to a government default on its foreign currency obligations, they will have to be bailed out as a group using local currency resources since their operation is essential to the economy, as noted above.

A similar scenario played out at the international level in the 1980s after the large "money center" banks based in the developed countries had lent such large sums to developing countries that they put the entire international monetary system at risk. Then, when the bubble burst, rather than accept the bankruptcy of their client governments, the big banks joined together and continued lending for several years while regulators looked the other way.

On the other hand, during normal times, bankers typically press for "responsible" policies as seen from their perspective—that is, low-inflation policies that continue to provide relatively low-risk opportunities to lend to the government and varied opportunities to lend to the private sector, which is usually more profitable. They may exert pressure on governments individually or through local business associations. In addition, after the 1980s debt crisis the major international banks have increasingly acted together globally, as through the Institute of International Finance, based in Washington, D.C. But they do more than talk as they have also ceased to take on such large loan exposures to individual developing countries as they did before that crisis struck.

[4] This is the case for banks that are government owned, which still exist in many developing countries.

Large-scale international bank lending and its crises

Private international lending only emerged as a major form of international financial transfer to developing countries in the 1970s. It primarily took the form of international bank loans in foreign currency to governments. Banks had traditionally lent to governments to finance capital-equipment imports, such as airplanes or locomotives. However, these export credits often were (and still are) guaranteed by an official agency of the exporting country, and are thus of low risk to the banks. However, beginning in the 1970s, the banks also made large-scale, multi-bank loans to governments for general fiscal deficit financing, to replenish foreign exchange reserves, or for other purposes of such kind. It was this latter type of lending that created much of the foreign bank debt that ultimately had to be restructured by overindebted countries in the 1980s and early 1990s.

In this type of lending, the currency of the loan is the central issue in the prospect of default. As noted above, the government can usually service its domestic currency loans through additional money creation, albeit at the price of additional inflation. The government cannot create foreign money, nor can it mobilize it once it empties its reserves and loses access to new international credit. All it can do is notify the creditor banks that it cannot make its next payment and seek to restructure the obligations. In this regard, banks have to assess the "credit risk" in lending to a foreign government (risk of nonpayment), and they charge a risk premium above a risk-free interest rate as compensation for taking on the perceived risk of lending.

While 1980s-style multi-bank lending to developing country governments has largely departed the international scene today, it is useful to recall how the sovereign defaults to international commercial banks were resolved. The loan agreements themselves embody part of the story. That is, most of the large-scale bank lending was in syndications in which more than 500 banks would participate. The cross-default clause in the loan contract typically said that any default against one of the banks is a default against all of them. Funds that were recovered on a defaulted loan also had to be shared with all the other banks in proportion to their share of the debt. In short, the banks were pushed by their loan contracts to negotiate together with the government to resolve the situation. The lead managers of the loan syndicates usually led the negotiations, after forming ad-hoc Bank Advisory Committees or London Clubs, so named because many of their meetings in the 1980s took place there. This negotiating structure for the banks also turned out to be efficient for the sovereign debtor who only had to deal with a limited number of negotiators. However, it did not indicate what the debt workout should look like. In the early years of the 1980s crises, the governments and banks seemed to have a common interest in avoiding a formal state of debtor default. The emphasis then was put on "concerted" or "forced" additional lending by the banks acting collectively so the loans could continue to be serviced.[5] They were buying time while they hoped for recovery and the sovereign's return to repayment capacity. However, this ruse could not last—and inevitably, the question became how to share the losses from the actual insolvency.

There were essentially two sets of interests among the banks. Some of them had invested in the domestic banking sector of the debtor country and had long-term interests to protect. Their desire to recover on the defaulted debt had to be set against not wanting to jeopardize their other businesses in the country. Others had no long-term relationship with

[5] Left to their own devices, each bank would wait for the other banks to lend the funds to prevent a formal default; only by bringing the banks together and jointly agreeing to lend the country the funds to continue to service the loans could outright default be avoided, which became known as "concerted" or "forced" lending.

the debtor country and were only interested in recovering their funds. As the 1980s wore on, many of the latter banks lost patience, decided to cut their losses and sold their shares in the loan syndicates at deep discount to speculative investors in a new market in nonperforming debt. However, the investor who purchased his loan share at 30 cents on the original dollar of loan would make a very good profit if the final deal netted him 60 cents on the dollar. And so, eventually deals were struck among the remaining creditors and with the debtor.[6]

Today, London Clubs still form to deal with sovereigns that encounter difficulties with their bank debt, but there is little interest in arranging forced lending. In the 1990s crises, the banking community instead looked to the multilateral lenders, especially the IMF, to provide the resources to keep the loans "performing." By the end of the decade, however, governments of the major creditor countries reacted negatively to their experience with large-scale lending to stave off defaults of countries in crisis (although they did not lose a penny). Instead, they sought to limit the amount of official lending in such situations, preferring to see the banks accept losses more directly. In the parlance of international financial diplomacy, this has been called "involving the private (or creditor) sector in crisis prevention and crisis resolution." The terms of this bank-government relationship continue to evolve, but whenever a London Club is formed today it is generally understood to require dealing with an insolvent government and that the creditors will need to take a "haircut," i.e., accept less than full repayment of their loans.

Purchases of government bonds

Large-scale syndicated loans by internationally active banks are a much less common form of international lending today than they were in the 1980s because the international bond market has retaken its historical (nineteenth-century) role in arranging large-scale foreign lending. One reason for the increased popularity of bonds as a funding instrument is that it is easier for the banks as well as other creditors to buy (and sell) government bonds than it is to participate in loan syndications. Bonds are standardized financial "instruments" that are usually traded on markets, making them more liquid (that is, they could be traded faster) than participations in syndicated bank loans (which could also be sold, but in a "thinner," or with fewer participants, market).

Usually, the first markets in financial instruments to develop in a country are the markets in government "paper," beginning with short-term notes and eventually involving longer-term bonds. The government is the best known and least risky potential issuer in every domestic market. Internationally, the market for government bonds in "hard" currencies (those of the highly-industrialized countries) first emerged with developed country issuers in the Euromarket. Developing country governments thus only had to gain acceptance as issuers in an already matured market with standardized financial instruments. In addition, from the beginnings of the "Eurobond market" in the 1960s until late in the 1990s, governments rarely defaulted on their foreign bonds, making them seem lower risk credits than bank loans. More recently, international demand has begun to grow for government bonds issued on the financial markets of the larger developing countries, albeit first for dollar-linked domestic currency securities (bonds and other types of notes) and then local currency bonds themselves.

[6] In addition, IMF and international development banks lent additional funds to the governments to help them purchase so-called zero coupon U.S. Treasury bonds (which pay the total sum of their interest upon maturity of the bond) to use as guarantees of repayment to sweeten the final restructuring deals.

Main players in the international bond market

Several of the major internationally active commercial banks of the 1980s (or their post-merger successors) now make up some of the most important intermediaries in the emerging economy sovereign bond market. In this business, the commercial banks have taken up a bigger role in the core business of investment banks ("merchant banks" in the United Kingdom), which advise governments on how, where, and when to issue their bonds, help them to structure the bond offerings, take care of the initial marketing of the issue, and underwrite the issue as they effect their sale to first buyers (the contrast is with commercial banking per se, when the banks lend their own money).

International investors generally see government bonds as part of a portfolio of securities that they hold. The trick for the "portfolio manager" (whether individual or a firm) is to strike an appropriate balance among a variety of financial assets with different risk and return characteristics so as to give some expected average yield in exchange for an overall level of risk. The portfolio manager may buy and sell securities continually as she seeks to adjust to changing perceptions about the securities in the portfolio. In the developed countries, bond buyers usually see lending to their own government as a safe albeit generally low-yield investment. Own-government bonds are thus a standard part of most investment portfolios in developed countries, although in different proportions of the total invested, depending on the investor's ability and desire to be exposed to risk in exchange for taking the chance for greater yield. Foreign government bonds, in particular those of emerging economies, are still viewed as high-risk and pay a relatively high return.[7]

Whether in developed or developing countries, it is considered the responsibility of the buy-side institutional investor or purchasing household to choose its portfolio of investments wisely and not to subject the portfolio to greater risk than intended. There is a presumption that the institutional and individual investors are capable of doing this, i.e., that they have the capacity to assess the financial situation of the issuers of the securities they hold, including those of their own government and any other government whose bonds they buy.

Private and independent bond-rating agencies exist to help the buy-side make their assessments. It is considered to be the interest of the bond issuer that the market have credible information on their bonds—and indeed, the ratings industry lives off the fees paid by bond issuers for the assessments the agencies make of them. Moreover, government regulators of pension funds and other financial institutions heavily restrict the bonds that the institutions they oversee can hold, often requiring that only the bonds qualify that pass a particular hurdle rating ("investment" grade). Nevertheless, it is clear to all professionals in the market that the rating agencies are only making judgments of the probability of default on the bond. They issue no guarantee and unfortunately are often slow to react to changing circumstances that warrant a revised rating of the issues of a particular country or firm. As a result, most institutional investors make their own assessments of the riskiness of any individual bond, using the rating agency's grading as only one input into their assessment.

Whatever the extent and reliability of the information available, those providing it—market research firms, research departments of merchant banks, rating agencies — are not held financially accountable if the information proves false, as long as the information was provided in good faith. The same holds whether the information is used by institutional

[7] From the developing country government's perspective, the interest paid on foreign-issued bonds in hard currency may be a small fraction of that paid on domestic currency bonds, where the interest rate and inflation environments are very different.

investors or households to buy foreign or domestic currency bonds of their own government or of corporate issuers or of foreign governments.

While the presumption that the buyer/investor is responsible for being well informed may seem reasonable, things become much less clear if financial intermediaries have misrepresented the true risks of the government bonds being purchased by a household or by a buy-side intermediary, such as a mutual fund. What if the issuing government then defaults on those bonds? If the distortion was intentional, the sell-side intermediary is presumably guilty of fraud and should make the buyer whole. If the government issuing the bonds has withheld information relevant to the buy-side decision, the bond-issuing government should arguably be held responsible. In the latter case, perhaps the government officials would be found guilty of a crime, and the public in the debtor country would be responsible to make the creditor whole. When there is no fraud, the principle of caveat emptor ("buyers beware") generally prevails.

What happens in a bond default?

The bond itself is a contract between the issuing government and the holder of the bond by which the government promises to service the bond fully in accordance with its terms. The government that defaults on its bonds unilaterally breaks the contract and the contract stipulates what happens next. The default usually begins with the government advising the bondholders that it cannot make the next debt servicing payment falling due. Unlike bank loans, which are kept on the books at nominal value until a decision is made to declare them "impaired" there is no hiding from the loss in value of the bonds after the debtor's announcement. The bonds trade continually on international markets and the institutional investors "mark to market" each day.

After a grace period, the bond may be "accelerated" by the bondholders—that is, the government is obligated to repay the whole bond immediately and fully, which of course it cannot do. Unlike some of the provisions in bank loan contracts that drive the lenders together, individual bondholders have strong incentives to try to collect what is owed to them individually, which may start a "race to the courthouse" to try to attach assets of the debtor government in lieu of the defaulted bond. However, there is usually very little to attach (for example, all diplomatic property is off bounds). It is also never cheap to begin a legal proceeding against a defaulting government and the outcome is uncertain.

It has always been possible for a government that anticipates trouble to ask its bondholders to restructure the repayment obligations.[8] Most emerging economy bonds are issued under New York law, and until recently the standard contracts made a negotiated restructuring of repayments virtually impossible, as they required approval of all bondholders. There is a way around this—called "exit consents"—by which the government offers to swap the old bond on which it could not meet its obligations with a new bond and as part of the deal the bondholders agree to change the nonfinancial terms of the old bond in such a way as to make the old bond virtually worthless. This works because to change the nonfinancial terms usually required only a simple majority of bondholders. However, with the recent introduction of "collective action clauses" (CACs) into developing country bonds introduced (or "floated") in New York, there is now a practical mechanism (which existed all along in bonds floated in London) by which the government could directly approach its bondholders

[8] In fact, the simpler way to accomplish the same thing would be to borrow to cover the payments falling due and repay that loan later; thus asking to restructure a bond means the government's reputation has already sagged so much that it has lost access to the market for issuing new bonds.

to change the financial terms of the bond before (as well as after) it defaulted. The bond contract will say what specific majority is required to effect the change and how the bondholders are to be mobilized. If accepted, the government then commits to fully meet the new terms.

Over the next ten-fifteen years, as new bonds with CACs increasingly replace maturing old bonds without them, it should become easier to mobilize the holders of individual bond issues to renegotiate with the insolvent debtor government. This is, however, a rather minor reform. In particular, it involves no built-in mechanism for bringing the holders of all outstanding bond issues of the debtor together to restructure their obligations (called the "aggregation" problem). It is of course attractive to the debtor if the bondholders form themselves into a single bondholders' committee with which it can negotiate, and the large institutional investors that may hold several different issues of a country's bonds may also have an interest in forming a single creditors' group.[9]

Even if CACs lead to better mechanisms for bringing the bondholders together for negotiation with the sovereign, it is difficult to see the direction in which the negotiations themselves would move, in particular in light of the Argentine experience. That is, it took four contentious years and many (thus far) fruitless court cases to "cure" Argentina's defaulted bond debt. This could make a more cooperative approach to negotiations more attractive to the creditors and the debtor in the next case of default. On the other hand, Argentina's unprecedented debt reduction—albeit conditioned on not intending to return to the market for new financing any time soon—may encourage defaulting debtors to toughen their negotiating stance, making for a more protracted negotiation.[10]

In all such cases, bondholders risk more a partial than a complete loss in the event of sovereign default. The crucial question is how much loss the bondholders and other parties should bear under different sets of circumstances. Today there are no general principles to govern or guide how much loss should be asked of the bondholders, nor whether bondholders, the banks, and any other commercial medium-term lenders should receive the same or different "haircuts" in a debt workout for a sovereign in financial crisis. If it is not obvious that the haircut should be the same for all—that is, there are open questions of which subcategories of each type of creditor should be treated differently, and in what ways. Another question that has vexed government and private creditors is how the private creditor haircut should compare to that on restructured debt owed to other governments. Finally, would it be just if other parties who are neither the debtor country nor the creditors absorb some of the loss, especially if they could do so at a relatively low cost (for example, in treating the debts of the poorest countries, bilateral aid donors have contributed amounts unrelated to their own loans to the country).

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[9] One issue of contention between governments and private creditor representatives (as expressed in discussions of a prospective "code of good conduct" for sovereigns and their private creditors) is who should pay for the expenses of a creditor committee. The reader may imagine how the different sides of this dispute align themselves.

[10] Having defaulted at the end of 2001, in early 2005 Argentina made a take-it-or-leave-it swap offer of new bonds for old at 30 cents on the dollar and its Congress essentially declared any original bonds remaining after the swap void; Argentina had claimed its bondholders had all along refused to enter into serious negotiations despite trying to engage them. Yet, this is not unsurprising, since the government was asking them to absorb unprecedented losses, which many of them did as in the end 74 percent of the bondholders agreed to the swap.

Government creditors and the Paris Club

Government-to-government lending is a very different category of international finance from private lending to governments. For many governments of developing countries, especially the poorest ones, official lending is the main source of foreign credit, but even middle-income countries have some debt to other governments. Most of the loans to poor countries are highly subsidized. Many are offered as official development assistance (ODA), for military equipment purchases, or for emergency humanitarian assistance (although the latter is probably mostly grant assistance now). While there are exceptions, such loans are usually repayable in the currency of the lending government. Most of the lending is of a medium-term nature, and a large part is contingent, wherein the creditor government guarantees the loan of a private lender (usually a bank), promising that the guaranteeing government will cover the obligations should the borrowing government default.

A large part of the loans and guarantees are of a semi-commercial nature, primarily credits to promote the export products and services of the lending government's economy. However, the lending or guaranteeing export credit agency is not a private or for-profit entity. Governments create such agencies for policy purposes. Unlike a private corporation, the export credit agency does not need to report quarterly profits to the market, which investors can scan when deciding whether to buy, hold, or sell equity shares (the claims on which are secondary to creditors' claims for the repayment of loans). But the export credit agency is mandated to cover its costs (or not exceed its budgeted subsidy). Losses will displease its government overseers, thereby potentially threatening its resource stream, and hindering the professional prospects of its managers. Its mandate entails a moderate subsidy of exports, but nothing more. Thus, officers of these agencies can be expected to have a similar responsibility to be informed about the repayment capacity of the borrowing governments as private creditors. Also, like private creditors, they will make great efforts to recoup their loans when the borrower defaults.

When a borrowing government defaults on officially guaranteed export credits, the guarantor government pays what is owed to the private creditors, takes over the obligation directly, and seeks repayment from the defaulting government. The creditor government equally will seek repayment of any of its direct loans on which the debtor government defaults, including ODA. It does not seem to matter in practice if the defaulted repayment is on an ODA loan, collection of which might itself compromise the development capacity of the borrowing country. It seems that the pursuit of development assistance goals is overridden by the exercise of the lending government's "creditor rights" in its credit recovery negotiations with the debtor.[11]

A borrowing government usually defaults on the loans of all government creditors at once. Each creditor wants to recover all of the funds owed to it, but the very act of default signals that the debtor cannot satisfy all of them. Rather than compete against one another to recover what they can, the main government creditors formed the so-called Paris Club in the 1950s, and have since then jointly negotiated their overall debt relief package with the debtor government, guided by an assessment of the financial needs of the debtor as prepared by the IMF. In general, the Paris Club does not reduce the level of debt but instead postpones

[11] This is not to deny that ODA debt is in practice often treated differently, nor that several creditor governments long ago converted all their ODA loans into grants; it is rather that the practice is not universal and considerable bilateral ODA is still given as loans and repayment is insisted upon and renegotiated as part of debt restructurings after recipient governments default.

payments, capitalizes unpaid interest, and charges market interest rates on all the outstanding amounts.

In essence, the basic Paris Club agreement is thus a refinancing of the debt, buying time for the debtor economy to recover and resume the debt servicing. The Club typically addresses only part of the problem at any sitting about a given country, rescheduling debt payments over a one or two-year period, requiring a sequence of visits and agreements. This "short leash" approach is meant to add pressure on the government to that of the IMF to follow policies deemed corrective of the debt crisis. However, the Club has also made special "deep" relief arrangements for certain politically important cases (Poland and Egypt in the early 1990s and Iraq most recently), and it has adopted different policy frameworks for dealing with special situations. The most notable is for the heavily indebted poor countries (HIPCs), which can receive substantial reductions in the stock of their debt and the new Evian Approach, which opens the possibility of debt reduction in special cases for countries outside the HIPC process.

The result of a Paris Club negotiation, called an Agreed Minute, specifies only the general terms of the debt restructuring deal (such as how much debt will be postponed for how many years, what percent of covered obligations will be written off in special cases). The debtor government then has to negotiate implementing agreements with each of the Paris Club members, in which the interest rate on postponed repayments, penalty fees, and precise loans to be affected are determined. These negotiations can drag on for many months after the Paris Club decision and can impose a considerable administrative burden on the debtor government, since it may have to negotiate deals with as many as nineteen individual creditor governments.

The debtor is required by the terms of the Agreed Minute to seek comparable debt relief from all the governments and even the private creditors on which it defaulted. However, creditor governments that are not part of the Paris Club are not bound by the agreement, nor are private creditors, and the debtor government is usually not in a position to press its case. Indeed, even the Paris Club creditors have not succeeded in doing more than exhorting those other creditors to match the relief in the Agreed Minute. As a result, the debtor may receive less relief overall than envisaged in the Paris Club arrangement.

The debtor government is not in a strong position to press its own case in the Paris Club either. Many developing countries that come to the Paris Club, especially the poorer ones, have not had the capacity to estimate their own debt-relief needs. In any case, as noted above, the creditors are mainly guided by the assessment presented by IMF and it has been accused of regularly underestimating the level of needed relief. It is not clear if this reflects an inherent optimism based on the need to assume that the policy and output targets that accompany the IMF's recovery program for the country will be attained, or aan emphasis on how much relief the creditors say they are willing to grant. It is only clear that over time the Paris Club has acknowledged the need for deeper cuts in debts owed to its members by the poorest countries and that IMF has produced the economic memoranda needed to underpin those cuts at each step.

Multilateral institutions
The IMF was established to mitigate international financial instability. The World Bank and the regional development banks were established to transfer financial resources to selected governments in amounts and on terms that the governments could not get without such assistance. All of these institutions are themselves creditors of developing countries, but given their different nature it is useful to discuss them separately.

International Monetary Fund
The IMF is a credit union. Governments contribute their domestic currencies plus a certain amount of gold or hard currency, and in return are able to draw from the Fund's currency pool during times of need for balance-of-payments adjustment. Of course, the developed countries put very much more into the Fund than the poor countries, as there is no demand to draw the currencies of the latter and all members want to be able to draw the currencies of the former group. This fact provides the argument for "conditionality" in Fund lending: the owners of the drawn resources want assurances that their resources will be returned. It also shapes the governance structure of the Fund. Decision-making power, determined by the voting rules for the Executive Board, is in proportion to the usable resources contributed (although whether that should continue is being contested).

For countries entering a balance-of-payments crisis, IMF is the one international "lender of last resort." It lends when no one else will, albeit not immediately and always with conditions and thus typically after a crisis breaks open.[12] IMF can deploy quite substantial sums of money of its own and it can mobilize large sums from governments on an need basis, especially in any case that is seen to threaten global financial stability. Moreover, once the IMF and the government agree upon an economic adjustment program,(by approving a "stand by" or other lending arrangement) other multilateral creditors may step forward and proffer funds. An active IMF program is also a precondition for a Paris Club negotiation. Private creditors in cases of sovereign default have also looked to IMF for leadership on when to negotiate with the debtor government.[13] In short, IMF is regarded as the principal interlocutor of the whole "international community" with the debtor government on its adjustment policies.

All classes of international creditors of a government believe that while balance-of-payments crises—and external debt crises in particular—may occur for any of a variety of reasons, the workout requires policy adjustments by the government. While there may be cases in which this is not true (for example, a crisis caused by a temporary fall in commodity export prices that might correct itself when prices recover to a normal level), it is presumed always to be true. IMF thus demands policy changes as the quid pro quo for the use of its funds. It also closely monitors the government's policy agreement, releasing its loans only in periodic "tranches" after being satisfied at each point with the pace of implementation of the program.

The problem is that IMF adjustment programs are subject to strong criticisms by various international actors, if not by the creditors. The complaints go beyond the fact that IMF imposes stringent constraints on developing economies. The stronger complaint is that

[12] The phrase "lender of last resort" is used in a different sense here than in discussions of national central banks providing short-term loans for regaining liquidity to the commercial banks in a domestic banking crisis.
[13] IMF insists, nevertheless, that it does not and should not intervene in actual debtor/creditor negotiations on the terms of relief. Private creditors agree with the Fund on this, and one of the reasons that they so forcefully resisted the IMF initiative to create the Sovereign Debt Restructuring Mechanism in 2003 is that they feared that IMF would manipulate the debt negotiations from behind the scenes.

the IMF often gives poor advice, demands inappropriate policies in exchange for the funds it provides, and is congenitally overoptimistic about the country's recovery. Indeed, time after time, governments—especially the poorest ones—do not complete their Fund programs. The standard defense of IMF policy prescriptions is that the policies would succeed if the governments followed them more assiduously. The reply to that defense is that were governments to do so, they would fall owing to the political disruptions and economic stresses that implementing the programs embodies. Indeed, for over thirty years the IMF has only lent to developing and "transition economies" (Eastern Europe and successor countries of the former Soviet Union), although it was established for all its members to use. Developed countries have not subjected themselves to "conditionality" as it is now being practiced. If they were to do so, it could be argued, adjustment programs might look somewhat different.

In addition to concerns about the effectiveness of IMF policy advice, many of the poorest countries accumulated so much debt to the IMF while purportedly attempting to follow its advice that they arrived at a debt crisis vis-à-vis the IMF itself. This is especially troublesome because until recently the IMF never countenanced any relief of member obligations to itself. The "preferred creditor" status of the IMF is a conventional practice and not part of the Articles of Agreement. Nevertheless, other creditors, including the private sector, accept it precisely because the Fund serves as the international "lender of last resort." Thus, inability to service IMF debt is a sign of deep financial distress. It means that the country cannot service its IMF debt even after receiving all the relief that nonpreferred creditors would accord it.

In fact, the IMF provides some relief from its obligations under the international initiative for the HIPCs. It has been financed essentially by the organization itself (through the investment income on the net proceeds from off-market gold sales in 1999), taking advantage of the large stock of gold carried on its books at far below the world market price, most of which is even today untouched. The relief is not, however, enough. Indeed, the governments of the major creditor countries acknowledged this in 2005, although they have not reached consensus as of the time of writing on how to bring about the additional assistance.

World Bank and regional development banks

The multilateral development banks were created between the 1940s and 1960s, a period when most governments in the world could not borrow from foreign private sources. Instead, most of the governments globally or in a region joined the development banks by purchasing shares denominated in hard currency, with the biggest and richest countries purchasing the largest number of shares.[14] With this strong equity backing mainly from the shareholding of the developed countries, the banks would issue their own bonds in the world's largest capital markets at interest rates very close to those of the developed country government shareholders. The banks would in turn lend these funds for long-term investment projects to developing country members at only a small mark-up over the interest cost to the bank itself. The lending decisions were made by the executive boards, whose composition reflected the shareholdings of different governments in the bank, as must have seemed natural to the bankers and finance ministry personnel who created them.

[14] Governments actually had to purchase outright only a fraction of the value of their shares as "paid-in capital," the rest being "callable."

Today, more effective participation of the borrowing governments in decision-making is an accepted goal, although how to achieve it remains in dispute.

Since the poorest countries could not afford loans on the terms resulting from the resources raised from bond sales, the shareholders of the multilateral banks organized highly subsidized lending "windows," most notably the International Development Association (IDA) of the World Bank. These loans were initially funded by contributions from donor governments in proportions and amounts agreed at each triennial refunding exercise,[15] although they are also funded today from repayments of old loans. The loans have a longer tenor than standard World Bank loans (up to forty years instead of twenty) and a service charge of 0.75 percent in lieu of interest (plus a running commitment charge of 0.50 percent to pay before any funds are drawn). A major point of contention is the extent to which even these loans are too expensive for some countries so that only grant financing is warranted for them. Indeed, IDA is increasingly providing grants instead of loans to the poorest countries.

The difficulty that HIPCs have had in servicing their IMF debt applies equally to their servicing of debts owed to the multilateral development banks. Like the IMF, but for a different reason, these institutions are also regarded as "preferred creditors," and until the start of the HIPC Initiative they had not allowed any rescheduling or postponement of their own obligations. The argument against permitting such rescheduling or postponement is that such a practice would worry the buyers of World Bank and other development bank bonds, since they would view the revenue stream of the bank as potentially compromised by debtors not fully servicing their loans. The bond buyers would then demand a higher interest rate to buy new bonds, and all the borrowers from the development banks would suffer. It was thus arguably in the interest of all the borrowers that each borrower services every dollar of its debt.

The primary flaw in this argument is that the poorest countries borrowed only from the highly concessional windows, which were not funded from bond issues. It is hard to imagine that bondholders would not distinguish Mozambique from Mexico. The second flaw is that when it came time for someone to actually cover the obligations that the poorest countries could not pay to IDA and comparable windows of the regional banks, part of the funds came out of the profits of the banks from their lending to the other countries. This is to say that those somewhat better-off developing countries have paid part of the cost of debt relief for the poorest countries (the rest has come from voluntary donations from the richer countries). Thus, insisting on no outright forgiveness of HIPC multilateral bank debt has at least partly come at the expense of the non-HIPC developing countries.

One way or another, countries qualifying under the HIPC Initiative obtain relief from most of their creditors. IMF plays a central role in coordinating this process, as it does for non-HIPCs, although it shares this responsibility more closely with the World Bank in the case of the HIPCs. This is probably because the Bank takes the lead in mobilizing the donors to put up the resources for multilateral debt relief (and that the initiative was started by its president). But it is probably also because unlike debt relief for other countries, relief under the HIPC program requires that the government develop in consultation with its civil society a package of structural reforms and pro-poor policies that it incorporates into a Poverty Reduction Strategy Paper (PRSP).[16] Debt relief for HIPCs, in other words, is

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[15] IDA completed its fourteenth replenishment in 2005.

[16] In fact, governments have prepared many PRSPs with limited consultation and in some cases World Bank staff themselves prepared PRSP drafts on an interim basis. While some fault the Bank for not pushing hard

conditioned on the adoption of an agreed set of social policies, in addition to the standard economic policies demanded of other debtor governments.

DO THE PIECES COHERE AS A SYSTEM?

Although the present arrangements for HIPCs and other countries clearly concentrate power on the side of the creditors, it should be noted that they are actually less unbalanced than the case of private corporate bankruptcy proceedings, where creditors hold almost all of the power over the disposition of the bankrupt enterprise. Defaulting on obligations to creditors is considered a serious breach of property rights, which are considered an essential aspect of a well-functioning market economy. A question that is central to recent debates on sovereign debt is whether the treatment of sovereign governments in debt crisis should be modeled on that of municipalities facing bankruptcy. When municipalities and other sub-sovereign public entities in the United States go bankrupt, a separate part of the U.S. bankruptcy code (chapter 9) is applied. Some have suggested that model ought to be adopted to deal with sovereign insolvency too, since it seems more even-handed in its treatment of creditors and debtors. Sub-sovereign public entities within the United States are responsible to the states. At present, there is no comparable responsible authority at global level over sovereign governments, nor is there a comparable legal system or enforcement mechanism. Strictly speaking, then, chapter 9 is an inapplicable model, though the question remains of whether arrangements that share some of its features would improve on the present process for resolving sovereign debt crises.

The "international community," as represented by the IMF and World Bank, oversees the process of HIPC debt work outs. Their Executive Boards, which include developing countries—if only with a minority voice—as well as developed countries, can be said to coordinate the official creditors, who account for almost all of the debt, as such poor countries usually have only limited amounts of defaulted private debt. Yet, the relief accorded has been halting and inadequate. It is given in stages, like the tranches of IMF adjustment financing, albeit over a longer period of time. It is as if the relief was a reward for adhering to an adjustment program rather than acknowledgement that the country was insolvent and its obligations unpayable.

Not surprisingly, there are many strong criticisms of the HIPC process, not least that it has not been successful in bringing about sufficient debt relief to enable HIPCs to enter onto sustainable development paths. The HIPC initiative will be ten years old in 2006, and it may well be revised one last time before that anniversary to provide additional multilateral debt relief. However, some major creditor governments still resist deepening that relief adequately. Other governments are willing to arrange for deeper multilateral relief now, but would then soon again offer new loans to the borrowers and perhaps begin a new cycle of debt buildup and debt forgiveness. The alternative would be to provide more assistance in the form of grants, but the major creditor governments also do not seem willing to increase the level of grant assistance adequately to replace future unsustainable borrowing. In short, while the Fund and the Bank may be said to coordinate the HIPC process, they cannot be said to lead or control it.

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enough for civil society involvement (or for not taking challenging civil society views on board when expressed), the PRSP exercise seems a unique foreign intervention into borrowing country politics.

In the case of non-HIPCs in debt difficulty, even international coordination is elusive, let alone leadership. There is a mixture of private and official creditors (multilaterals do not offer relief in these cases) and no mechanism by which the necessary overall amount of relief can be assessed and apportioned. Each class of creditors seeks the best deal it can get when a restructuring is necessary: commercial banks through a London Club, bondholders through various bondholder committees, government creditors through the Paris Club, and others independently. There is no coherence mechanism to put the pieces together and see if they add up to what the country needs. There is also no interest among the major creditor governments, organizations of private creditors, or major international borrowing governments to consider what such a coherence mechanism might look like. It is not because any of these parties think the current situation is ideal. They rather fear that anything else would be worse.

ETHICAL ISSUES RELEVANT TO DEBT

Background note for the Ethics and Debt Project[*]

The practical significance of sovereign debt

The economic collapse in Argentina, financial crisis in Turkey, and unsustainable debt burdens of many developing countries highlight the practically urgent problem of excessive indebtedness. High debt levels can limit a sovereign government's capacity to provide social services necessary for the well-being of citizens, and divert resources and energy from the pursuit of long-term development strategies. In addition, after governments default, the mechanisms for managing the restructuring of sovereign debt usually act slowly, do not return the country to debt sustainability, and often leave the different classes of creditors as well as the people of the indebted country feeling as if they have been unfairly treated. This in turn can create disincentives for lending and investment that can be crucial to the prospects of wealthy and poor countries alike. An often overlooked but very important effect of financial crises and the debts that often engender them is that they can lead the crisis countries to increased dependence on international institutions and the policy conditionality for their continued support, limiting the capabilities of their citizens to exercise meaningful control over their policies and institutions.

There has been growing public recognition of these problems, and increasingly potent popular movements have pressured governments, financial institutions, and the financial community to seek better solutions to the debt crisis. Some of these resulting initiatives, including that for the Heavily Indebted Poor Countries (HIPCs), have focused on defining sustainable debt levels for poor countries and designing policies to maintain debt at these levels.[17] In some cases, some debt relief has resulted from these programs.

Other proposals, such as those for institutional arrangements that would mimic at the global level the legal bankruptcy regimes under national law (albeit without the same enforcement authority), have sought means of distinguishing between debts for which creditors deserve full repayment from those for which creditors either lack claims or have claims that are too weak to recover what they have lent.[18] Still others have instead recommended a contractual approach to sovereign debt crises, in which new clauses are introduced into bond contracts to enable debts to be restructured more easily and quickly.[19]

Debates on sovereign debt

The merits of the aforementioned programs and proposals for dealing with sovereign debt remain hotly disputed. While disagreements about policies and practices to deal with debt are sometimes purely empirical, with advocates of opposing positions differing only on the best

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[17] For the World Bank's description of the HIPC Initiative, see www.worldbank.org/hipc/about/hipcbr/hipcbr.htm.

[18] See Kunibert Raffer, "Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face," *World Development* 18, no. 2 (1990), pp. 301–13.

[19] For discussion, see Arturo Porzecanski "The Constructive Role of Private Creditors" [in the roundtable, "Dealing Justly with Debt"] *Ethics & International Affairs* 17, no. 2 (2003), pp. 1–33; and Group of Ten, "Report of the G-10 Working Group on Contractual Clauses"; available at www.bis.org/publ/gten08.pdf.

means to achieve shared aims, the intensity of the debate concerning debt, and the heated rhetoric with which they are often conducted, suggest that they may be rooted in deeper disagreements of value. It is not obvious, however, what disagreements of value are at stake in this debate. Most participants agree that the current situation is morally unacceptable and that "something must be done" to remedy it. But advocates have seldom articulated their underlying justifications for why this situation is unacceptable, and they have thus provided little basis for determining whether their chosen policies would constitute progress. And when the rhetoric in a debate surrounding an important practical dilemma is either heated or evasive (and often both), participants may accuse one another of bad faith or naiveté about the facts of the case. They are also likely to invoke principles that support their side of the argument without thinking through their argument's broader implications—or perhaps purposefully ignoring them. These tendencies make it more difficult to identify correctly the true nature of the disagreements—and hence the evidence and argumentation that could be relevant to resolving them.

The purpose of this brief background note is analytic—to help explain the type and nature of some of the disagreements of value that may underlie the debate on sovereign debt, and in particular on competing criteria of *justice* that may be invoked in assessing institutional arrangements for dealing with sovereign debt. It concludes with a few conjectures about which disagreements of value seem to play the most significant role in the controversies over sovereign debt.

The meaning and ethical status of debt

What is debt? It might be argued that A owes a debt to B when B has provided some benefit to A and has asserted a claim to repayment. This obviously won't do, however, since the mere fact that B claims that A owes them repayment for something does not show that A is indebted to B. Indeed, people make scurrilous claims all the time and it would be misleading to suggest that rebutting such claims amounts to "debt relief" or that by ceasing to assert them a creditor has thereby "reduced their claims" on a "debtor." It is more natural in such cases to claim that there were no debts to begin with, only invalid claims that have been rebutted. It may therefore be appropriate to define debt in terms of *ethically* valid claims. That is, A owes a debt to B only if B has a valid moral claim to repayment from A. This *moralized* understanding of debt has many things to recommend it. Indeed, speaking of "debt relief" and "voluntary" reduction of "claims" suggests, often misleadingly, that the creditors involved had morally valid claims to repayment and are therefore offering "assistance" to poor countries. What is at issue, it may be argued, is whether developing countries have such debts in the first place, not the conditions under which they should be "forgiven," since claiming that if they go unpaid it will be because they are forgiven essentially assumes the legitimacy of the creditor's claims.

While I am in sympathy with this account, and believe that the concerns that it emphasizes are very important, I fear that it may cause some confusion in evaluating the current debate on sovereign debt, which has been framed (for better or worse) in terms of the conditions under which (and terms on which) debts should be repaid. For this reason, I will understand debt in the following way:

A owes a debt to B if and only if:
(1) B has lent resources to A; and
(2) B has a claim to repayment from A that has at least prima facie *legal* validity.

I will assume, moreover, that it makes sense to distinguish between legally valid and ethically valid claims. That is, while determinations of legal validity may (as Ronald Dworkin and others have argued) depend in part on ethical considerations, and while the fact that one has a legally valid claim may not implausibly be seen as an important ethical consideration in determining whether one should be repaid, there are many contexts in which those who have legally valid claims to repayment lack ethically valid claims to repayment and in which those who lack legally valid obligations to repayment nevertheless have ethically valid obligations to repayment. Conflicts between legally valid and ethically valid claims and obligations will be most pronounced when legal systems are unjust or where they contain many "gaps," but it is unlikely that such conflicts can ever be completely removed.

We can distinguish between the ethical statuses of different types of debt. At the first level, a distinction can be drawn between (a) those debts which the debtor has an ethical obligation to pay and (b) those debts which the debtor has no ethical obligation to repay. Because obligations are a subset of reasons for action, they are always *pro tanto*—that is, they count for or against certain courses of action, but they may not always be decisive (for example, when there are countervailing reasons of greater significance). It may turn out that what an agent ought to do, all things considered, will involve a failure to honor some of her obligations. Among those debts that the debtor has an ethical obligation to repay (set (a)), we can therefore distinguish between (i) those debts which the agent ought to repay and (ii) those debts which the agent nevertheless ought not repay. Having an obligation to repay is neither sufficient to establish that one pay, nor is it necessary. Similarly, the fact that some debtor lacks an ethical obligation to repay a debt does not mean that they should not repay it. Among those debts that the debtor has no obligation to repay (set (b)), a distinction can thus also be drawn between (i) those debts which the debtor ought nevertheless to repay; (ii) those debts which the debtor may permissibly not pay; and (iii) those debts which the debtor ought not to repay.

We can also distinguish between debts in terms of the attitudes that *creditors* ought to take toward them. That is, among those debts that the debtor is obliged to repay (set (a)), a distinction can be drawn between (i) debts which the owner of the debt ought (in part or entirely) to "forgive"; (ii) debts for which the owner of the debt may permissibly demand repayment; and (iii) debts for which the owner of the debt ought to demand repayment. Among those debts that the debtor lacks an obligation to repay (set (b)), we can similarly distinguish between (i) debts for which the owner of the debt ought not to demand repayment; (ii) debts for which the owner of the debt may permissibly demand repayment; and (iii) debts for which the owner of the debt ought to demand repayment.[20]

Finally, one can distinguish between the ethical status of a debt, and the ethical status of particular claims regarding the *terms* on which the debtor is obliged to repay it. That is, a distinction can be made between the general obligation to repay a debt and a specific obligation to repay it on certain terms (according to a particular schedule). It may be tempting to think that this distinction is not important. After all, when a debt is incurred, a

[20] These last two possibilities may seem strange, but they are hardly impossible to imagine. We may think, for example, that country A has no obligation to repay a debt to country B because the debt was incurred by a murderous military dictatorship that used its resources to repress and impoverish the population. Suppose, however, that although this dictatorship is longer in power it has been replaced by a corrupt and wasteful regime that consistently misallocates public funds in harmful ways. A creditor country may arguably demand repayment from such a regime if it justifiably thinks that these resources would do more harm than good if left in the regime's hands, especially if they use these funds to lessen the suffering of the debtor countries residents or that of unjustly impoverished persons.

contract typically stipulates the schedule on which it is to be repaid. Insofar as there is an ethically valid claim to repayment of the debt at all, it might be argued, there ought therefore to be an ethically valid claim to repayment on the terms under which it was incurred. This seems intuitively implausible, however. Suppose that I freely borrow resources from A on terms that I repay him in monthly installments over the course of the following year. Due to an accident, however, I find myself unable to work for a period of six months, after which I will resume earning a salary at the same level. If during the period of incapacitation I stick with the payment schedule stipulated in the initial agreement, I will be unable to afford physical therapy and pay for other basic necessities, which will raise the risk that I will never be sufficiently rehabilitated to resume work. It seems plausible to claim that the mere fact of my injury does not shield me from A's claim to repayment. Indeed, if it remains much more difficult than anticipated to repay A even after I resume full-time work, it may nevertheless plausibly be maintained that I am obliged to repay the full amount. However, it may not be plausible to claim that I am obliged to repay according to the original schedule.[21] These considerations are relevant for evaluating issues that frequently arise in the debt context. When some agent is unable to keep up with payments, they are typically expected at least to continue to pay the interest owed on the principal. This means that, insofar as they are unable to pay according to schedule, the entire amount of the debt will grow. The claim of the lender to "full" repayment thus becomes ambiguous, since it can refer to the principal (plus the interest attached to each monthly payment as stipulated in the original agreement) or it can refer to the principal, interest on monthly payments stipulated in the original agreement, and any additional interest payments that arise because the debtor does not meet their monthly obligations. If we believe that there are compelling reasons to diverge from the stipulated payment schedule even while honoring the obligation to repay the principal, then we may hold that creditors lack claims to the additional interest that might otherwise be thought to be owed to them if the debtor is unable to meet their monthly payments.

The reasons for modifying the terms on which claims can be repaid may seem much more decisive when, unlike my simple example, the lender's behavior adversely affects the debtor such that it is much more difficult for them to meet their payment obligations. Suppose some very rich and powerful country G1 provides loans to a weak and poor country G77 at time T_1.[22] At time T_2, G1 decides to raise interest rates in response to fears about inflation in its domestic economy. Given its position in the world (that is, the size of G1's market represents a significant share of the world market, G1's currency is a "hard" currency in international financial transactions, and so on), this domestic decision affects the cost of borrowing in the world as a whole. Because poor countries like G77 typically "roll over" their debt, taking out fresh loans to meet prior debt obligations, increases to the cost of borrowing make it extremely hard for them to service their debts, including their debts to G1. Consequently, G77 can no longer meet its monthly payments to G1 at time T_3 and is unable to pay down either the principal, or even pay the interest on the principal. Its debt to

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[21] It is also important to note that even if we do hold that I am obliged to repay on the same schedule, and that the creditor may permissibly demand repayment in full, we may not feel that he may permissibly demand repayment on the original schedule. If the cost to him of allowing greater flexibility in repayment terms is slight, we may think that he acts very wrongly if he nevertheless insists on sticking with the original schedule.

[22] This example draws on Sanjay Reddy's discussion of the role of U.S. monetary policies in the debt crisis in "Developing Just Monetary Arrangements," *Ethics & International Affairs* 17, no. 1 (2003), pp. 81–94. See also Harold James, *International Monetary Cooperation Since Bretton Woods*, (Washington, D.C: International Monetary Fund,1986), and Kunibert Raffer and Hans Singer, *The Economic North-South Divide* (Northampton: Edward Elgar, 2001).

G1 thus grows. In some cases in which the decisions of one agent greatly undermines the capabilities of agents to whom they are indebted to repay, we may wish to argue that this invalidates their ethical claim even to the principal. In others, we may grant the validity to the claim to repayment of the principle, but hold that the lending agent's behavior invalidated the original terms on which they could demand repayment. In still others, such as when we judge the lender to have affected the debtor's position through "fair competition," we will find the causal relevance of the lender to the debtor's position at a later time irrelevant.[23]

This note has so far been mainly formal. It has identified the ethical statuses that debts may have, but has provided relatively little guidance about how to determine which status particular debts have. I have provided categories without indicating which considerations ought to be decisive for determining *which debts fall into which category*. A *criterion* for evaluating the ethical status of debt must provide such an account.

Empirical and theoretical differences regarding the ethical status of debts

We can distinguish between *purely empirical* and *theoretical* sources of disagreements about the ethical status of debts. Disagreements are purely empirical when advocates of opposing positions agree on the considerations that are relevant for determining the ethical status of debt, but nevertheless disagree about how these considerations apply to a particular case because they disagree on relevant facts. That is, we can have purely empirical disagreements about the justice of Collective Action Clauses for resolving debt problems because of divergent predictions of how this arrangement will serve our shared objectives of reducing poverty and ensuring that creditors' property rights are protected.

Disagreements are theoretical when disputants hold different views about the aims that ought to be pursued, the procedural fairness of various arrangements that might be implemented to promote these aims, or about how responsibilities for achieving these aims can be fairly allocated. That is, we may agree completely in our predictions of the likely effects of CACs, yet still disagree about their justice because we attach different degrees of importance to the objectives of reducing poverty and protecting creditors' property rights, or some other considerations that are deemed ethically relevant.

Morality, justice, and debt

Within the domain of ethics a rough but nevertheless useful distinction can be made between *morality*, which is concerned with principles for the ethical assessment of the character and conduct of individual and collective agents, and *justice*, which concerns the ethical assessment of social rules.

Philosophers have sometimes tried to capture the distinction between the morality and justice that I have in mind through the crude metaphor of games. *Morality* asks what individual players *within* the context of a game should and should not do, including their compliance or noncompliance with the rules of the game themselves. Questions of *justice*, on the other hand, concern whether we are playing the right *kind* of game in the first place, or whether the rules themselves ought to be revised.[24] The distinction between justice and

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[23] Clearly, our assessment of all of these cases will depend on our ethical assessment of the process through which the lender has affected the position of the debtor. The importance of this point is emphasized further below.

[24] See esp. John Rawls, "Two Concepts of Rules," in *Collected Papers* (Cambridge: Harvard University Press, 1999), pp. 20–47. This understanding of justice is not without its critics. See, for example, G. .A. Cohen, *If You Are an Egalitarian, How Come You're So Rich?* (Cambridge: Harvard University Press, 2000), esp. ch. 9 and 10.

morality crosscuts the distinction between empirical and theoretical disagreements, since we can have empirical and theoretical disagreements about each.

In speaking of questions related to the "ethics" of debt, we can thus distinguish between (1) those questions that relate to the assessment of various actors involved, such as whether lenders should be more discriminating about which states to provide resources to, and whether borrowers ought to have made sounder borrowing decisions, been more honest in their dealings with creditors (and their own people), and acted more fairly in their decisions regarding budgetary expenditures; and (2) those questions that relate to the assessment of rules that govern economic exchanges, such as whether the rules governing global economic interaction ought to permit deeply flawed governments to borrow assets in their country's names, thereby binding present and future citizens to repay them.

Questions of justice that are raised by sovereign debt will be emphasized in what follows. This is not because questions of the morality of different "players in the debt game" are irrelevant. Indeed, the conduct of such agents clearly *is* relevant, since many of the problems related to debt mentioned above could be at least partly alleviated were collective agents such as states and banks to act less recklessly and with more regard to the harms their conduct imposes on others in their lending and borrowing decisions. Indeed, developing a clearer sense of the considerations relevant to assessing the justice of rules governing debt will also at least go partway toward understanding the morality of the actors involved in sovereign debt, since justice assessments help us to evaluate the individual and collective agents who institute, benefit from, uphold, or seek to reform these rules. However decent a lender may be—avoiding, for example, loans to notably corrupt regimes—our overall moral assessment of their behavior may not be positive should they actively lobby their governments in support of rules governing debt workouts that seem on balance to be unjust. Furthermore, our ethical assessment of the rules governing economic interaction will significantly influence our *descriptions* of the interactions among different agents that are relevant for the assessment of their conduct. Assessing the conduct of G1 and G77 in the case sketched above, for example, will depend at least in part on whether unilaterally raising interest rates to a significant degree is a legitimate expression of national self-determination or instead involves the illegitimate exclusion of those who are significantly affected by political decisions from exercising some degree of influence over them. If the former, then the possibility of G1's undertaking such a policy will be considered as part of the background circumstances that G77 must take into account in deciding whether and on what terms to borrow. If the latter, then G1's claim to amounts lent to G77 may reasonably be viewed as weakened due to the fact that they have subsequently imposed undue harms on G77.

Debt and conceptions of global justice

The word "justice" has a somewhat broader meaning than indicated in the preceding section, usually associated with evenhanded treatment of persons and groups. Recent discussions of justice, however, have tended to focus on assessments of the rules and institutions that govern the interactions of participants within a social system, which John Rawls has famously called the "basic structure of society." The fundamental role of a conception of justice is "to specify the fair terms of social cooperation."[25] In domestic settings, the prevailing institutional arrangements that determine the terms of social cooperation include the tax system, bequeathable rights to private property, and the structure of political

[25] John Rawls, *Justice as Fairness* (Cambridge: Harvard University Press, 2001), p. 7.

decision-making. Most fundamentally, the issue of sovereign debt raises questions of "global" rather than "domestic" justice, since it relates to global rules and arrangements, including markets in capital and labor, international trade and monetary arrangements, and constitutive features of the modern state such as its sovereign rights to tax, to bind citizens through agreements, to control the use of natural resources within its territorial domain, and to represent its interests in international bargaining and rule setting.[26] Questions of domestic justice are nevertheless relevant to this issue, since we may wish to treat differently the debts of states that we deem to have "legitimate" or "reasonably just" governments and institutional arrangements from those that lack them.

The aim of any *criterion* of global justice is to provide plausible absolute and comparative judgments about feasible global institutional arrangements, whether actually existing or merely proposed.

A criterion of justice typically involves two main elements. The first element is criteria of *distributive justice*, which assess the distribution of benefits and burdens within a social system. The second element is criteria of *procedural justice*, which assess the ways in which the basic parameters of the social system are themselves fixed. Theoretical disagreements about the justice of institutions for dealing with sovereign debt may relate to either of these components. With respect to distributive justice, for example, participants in these debates may disagree about *whom* we ought to look at in assessing the benefits and burdens of social cooperation.[27] There may also be disagreement about *what* should count as the benefits and burdens that are relevant for these assessments. We might refer to these variables as the *goods* of global justice. [28] Different conceptions of global justice might, for instance, evaluate countries and persons as faring better or worse according, variously, to their economic performance, literacy rates, life expectancies, enjoyment of civil and political liberties, freedom from coercion, or to some weighted combination of some or all of these kinds of goods. *Distributive* requirements may also be at issue, such as whether one ought to use sum-ranking, maximin, or some indicator of inequality as an aggregation function for combining the relevant goods enjoyed by the subjects of justice for the purpose of evaluating global institutional arrangements, as may be *minimal* requirements, whether, for example, it should be required that all subjects enjoy security and access to basic liberties and necessities.

An account of distributive justice may also take note not only of the *shares* of goods enjoyed by the subjects of justice, but also the *ways* in which these shares of goods have came about. One might hold, for example, that, all things being equal, justice requires that

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[26] Different terms, such as the "global basic structure," the "international regime," the "global institutional *scheme*," or the "social and international order" have been used to refer to these global institutional arrangements. For a helpful synthetic overview of some recent literature on this topic, see Charles Beitz, "International Liberalism and Distributive Justice: A Survey of Recent Thought," *World Politics* 51, no. 2 (1999), pp. 269–96.

[27] We might refer to these entities as the *subjects* of global justice. Some may take states as their fundamental subjects, focusing on their absolute and relative conditions, such as whether there are steep inequalities in wealth or political influence between them, or whether they lack the resources and capacities to secure just domestic institutions, while others focus directly on the distribution of benefits and burdens among persons.

[28] Resources, freedoms, opportunities, and happiness have recently been defended as the goods whose distribution is relevant for the ethical assessment of social arrangements. Leading discussions include John Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1971); John Rawls, "Social Unity and Primary Goods," in Amartya Sen and Bernard Williams, eds., *Utilitarianism and Beyond* (Cambridge: Cambridge University Press, 1982), pp. 159–86; Amartya Sen, *Commodities and Capabilities* (Amsterdam: North-Holland, 1985); and the essays in Amartya Sen and Martha Nussbaum, eds., *The Quality of Life* (New York: Oxford University Press, 1993).

inequalities in wealth among countries be minimized, but hold that all things are not equal when some countries have lesser shares of wealth because of decisions or actions for which they can reasonably be held responsible. Such considerations are familiar in discussions of domestic justice—where the distribution of wealth among different persons within a society is often deemed more or less just depending on the extents to which these differences can be attributed to the prudence or negligence that these persons have exercised in their economic decision-making or to differences in their social circumstances and/or brute luck. Views of distributive justice that give weight to such considerations may differ about the moral relevance of different ways through which such outcomes may have come about. So-called luck egalitarian views of justice, for example, allow people's shares of goods to vary insofar as they do so in response to their responsible actions or attitudes, but disallow differences in shares due to *all* other factors. Others, such as John Rawls, have argued that justice permits people's opportunities to vary insofar as they do so in response to their responsible attitudes and actions or to inequalities in their *natural* endowments but disallows inequalities of opportunities that are traceable to inequalities in their social starting positions.[29] All views of justice that grant significance to the ways in which outcomes come about require that we be able to make a "cut" between those features of an agent's present circumstances for which they can be reasonably held accountable and those they cannot. In practice, making any such "cut" is extremely difficult. It arguably becomes even more difficult when it is "national" or "statal" responsibility rather than individual responsibility that is at issue. Any criteria of justice that rely on distinctions that are difficult to apply of course raise difficult questions about how such criteria should be applied in real world contexts.[30]

Taken as a whole, an account of global distributive justice may be summed up by a more or less complicated demand about how global institutional arrangements should be designed, such as "develop those global institutional arrangements that tend over time to maximize the resources available to persons falling in the bottom global income quintile," "equalize the opportunities for economic growth among countries," "eliminate all inequalities of national wealth and opportunity that cannot be attributed to that nations responsible attitudes and actions," and so on.

Whether or not institutional arrangements governing debt are distributively just cannot therefore be judged in isolation from the broader framework of rules governing economic and political interaction. That is, whether some particular initiative for sovereign debt workouts is just will depend in part on rules governing many other aspects of the global economy. A system of rules for working out sovereign debt crises that tends to favor debtors over private creditors may be superior or inferior to one that favors private creditors over debtors depending on the character of other rules governing their interactions through trade and investment, and so on.[31]

Considerations of *procedural* justice relate to the conditions under which institutional arrangements can be fairly and legitimately determined. That is, it may be important to treat

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[29] Rawls adds the further requirement that even inequalities due to differences in endowments can permissibly lead to inequalities in shares of social goods only if allowing such inequalities works to the advantage of the least advantaged. For a helpful discussion of these issues, see Samuel Scheffler, "What Is Egalitarianism," *Philosophy & Public Affairs* 31, no. 1 (2003), pp. 5–39.

[30] For an interesting discussion of these issues, see Alexander Cappellen, "Responsibility and International Distributive Justice," in Andreas Follesdal and Thomas Pogge, eds., *Real World Justice* (Berlin: Springer, 2005), pp. 209–22.

[31] This may raise difficult questions regarding the appropriate sequences of reforms to the rules governing global economic interaction.

the subjects of justice (whether individuals, groups, or countries) not only as patients who have needs to receive certain benefits but as agents who have rights to shape the social arrangements that affect them. If this is so, then the performance of global institutional arrangements must be evaluated with a view to the legitimacy of the procedures by which they are run and not only with regard to their efficacy in generating desirable distributions of goods. A criterion of procedural justice may require, for instance, that the standing rules of global institutional arrangements be publicly known and subject to revision, monitoring, and reinterpretation through collective decision-making procedures. With respect to sovereign debt, for example, disagreements may relate to divergent assessments of the conditions under which countries and the interests of groups within them have had a fair opportunity to influence the institutional arrangements that govern these debts (as well as their ongoing operations). Different understandings of procedural justice may also figure in differences among participants in this debate regarding the conditions under which a collective agent such as the government of a state can legitimately bind the state's present and future citizens (and successor governments) to repay loans borrowed in their name. Some may argue that the rights of nondemocratic regimes to bind their citizens to repay debts, for example, should be weakened or perhaps even eliminated in some cases.[32]

The procedural justice of a system of rules governing debt, too, cannot plausibly be judged in isolation from the justice of other rules governing global economic interaction.[33] Insofar as some countries fail to have a fair opportunity to influence other important decisions—perhaps including the kinds of globally consequential monetary policy decisions mentioned above—it may arguably give them a correspondingly stronger claim to exercise influence on the features of any system of rules governing debts, or perhaps a more important role in monitoring them than they otherwise could have.

In addition to the two criteria of justice mentioned above, justice must also specify what might be called *deontic principles* of justice that serve to specify different agents' obligations to uphold, and comply with just arrangements when they are in place, to work toward bringing about just arrangements where they are lacking, and to remedy the hardships brought about when unjust arrangements are in place.

A system of debt rules can be deemed distributively just or unjust because of the outcomes it generates, and procedurally just or unjust because it advantages one party at the expense of another in the debt resolution process. And there may be disagreement not only about what justice requires with respect to rules governing debt resolution, but what it requires of particular agents who are in a position to take action with respect to these rules.

Key theoretical disagreements

The preceding discussion identified some of the general disagreements about justice that *may* underlie controversies regarding sovereign debt. I conclude here with some conjectures about some of the issues that actually underlie such debates.

Defining the limits of external sovereignty

It is often finance ministers who make the borrowing decisions on behalf of the government and thus of the people as a whole. The debts that they incur are recognized and treated as an

[32] See, e.g., Michael Kramer and Seema Jayachandran, "Odious Debt," typescript, Harvard University 2002; and Thomas Pogge, "Achieving Democracy," *Ethics & International Affairs* 15, no. 1 (2001), pp. 3–23.

[33] The importance of this point is emphasized in Ann Pettifor, "Resolving International Debt Crises Fairly," [in the roundtable, "Dealing Justly with Debt"] *Ethics & International Affairs* 17, no. 2 (2003), pp. 2–9.

obligation of the government as a whole, which in turn raises revenues to service its debt at least in part from taxes imposed on citizens. The present and future citizens (and other subjects taxable by the borrowing government) are therefore held liable to repay it. Such ministers (and the government more generally) thus enjoy not only *internal sovereignty*—special power and authority within their state, but also *external sovereignty*—the power to alter the claims of others on their citizens, and thus the privileges of their citizens with respect to them.[34] Like internal sovereignty, external sovereignty admits of degrees. And just as the international order places limits (however tentative and imperfectly and inconsistently enforced) on the internal sovereignty of governments, so too it can place limits on the external sovereignty of governments. An adequate criterion for assessing the ethical status of debt must clarify the extents to which governments should enjoy external sovereignty with respect to borrowing.

The present practice is to grant governments nearly absolute external sovereignty with respect to borrowing. This practice is highly questionable—by what right should oppressive elites be entitled to run up debts in the names of those whom they impoverish (or worse)? At the same time, granting a significant degree of external sovereignty with respect to borrowing clearly serves an important purpose—governments can raise resources for important projects (understood broadly to include investment in infrastructure, education and health, improving working conditions, and so on) that benefit those living within a state only because they enjoy such sovereignty. The question, then, is how to permit enough external sovereignty to enable governments to borrow for justified projects while at the same time limiting their capacity to abuse such privileges. Similarly, the external sovereignty of governments with respect to *lending* is also nearly absolute.[35] Here again, the existence of relatively robust lending privileges seems to benefit both the lending governments and the recipients of loans. Yet here an unlimited lending privilege can also harm both the lending and the borrowing state. It can harm the borrowing state if the resources are used to unjustly enrich a small elite or for repressive purposes. And it can harm the lending state because it may unduly burden its own taxpayers with footing the bill for loans that are never repaid.[36] Of course, it may be argued that the present system is, all things considered, more just that any feasibly attainable system. This might be because the aims of distributive justice are best served (in the long run at least) by a system of nearly unlimited external borrowing and lending sovereignty; because one cannot legitimately determine and implement a better system; or because a revised system of external sovereignty that was distributively and procedurally just could only be brought about were we to unreasonably demand that many agents undertake heroic efforts and make great sacrifices to bring it into being or sustain it. But this certainly isn't *obviously* true. A justified *criterion* for evaluating the ethical status of debt must provide such a plausible account of the proper scope of external sovereignty with respect to borrowing and lending under present circumstances. A practically oriented discussion of such an account must address not only what particular form of external sovereignty with respect to borrowing and lending is justifiable, but how we might

[34] The terminology of powers, claims, and privileges is drawn from W. N. Hohfeld, *Fundamental Legal Conceptions* (New Haven: Yale University Press, 1919).
[35] Some interesting proposals are introduced in the Kremer and Jayachandran, "Odious Debt"; and Pogge, "Achieving Democracy."
[36] Reckless lending can, of course, also harm their "moral" interests, since it may implicate them in harms abroad.

legitimately go about revising existing institutional arrangements to bring them more into line with it.

Collective responsibility

Suppose that some system of external sovereignty with respect to borrowing and lending is in place, and that we have reason to believe that it is the best available system. Suppose further that some country becomes heavily indebted, and can service its debt obligations (as contractually defined) only by severely cutting back on expenditures on education, health, and security, and that these cutbacks will predictably lead to acute deprivations among its people. We are thus faced with the question of whether the residents of this country ought to bear the cost of its government's earlier decision to borrow—or whether this cost ought to be pushed on to others, whether they be the creditors or perhaps other agents.[37] Some would hold that our answer to this question ought to depend not only on how badly off the country is in absolute and relative terms and how costly it would be to offset the costs that it faces, but also upon how the country became heavily indebted. David Miller, for example, has recently argued, "If people have poor or otherwise inadequate lives because of decisions or actions for which they are responsible, then outsiders have no obligation of justice to intervene." He adds that while "it might still be a worthy humanitarian objective to provide aid to those who are responsible for their own impoverishment, but it is not a matter of justice, and it is arguably wrong to compel people to pursue it."[38] If the country has acted imprudently or recklessly, it might therefore be argued, then it is unfair that the resulting costs be pushed onto others, even if the country can only pay the costs with great difficulty and at great sacrifice. The intuition behind such a view is strong.[39] Any view that wishes to distinguish in this way between costs that do and costs that do not "belong" to those on whom they initially fall must, however, meet four challenges:

First, they must indicate how the distinction ought to be drawn between those outcomes (or particular features of outcomes), which are attributable to the agent, and those that are not. What grounds can be given for holding an agent responsible for harm that befalls them? Tort law, for example, attributes outcomes to an agent when it can be shown that (1) she causally contributed to the outcome; (2) the outcome was her fault; and (3) the faultiness of her conduct was causally relevant to the outcome. Fault operates normally with some notion of a "standard of care" and draws essentially on the idea of what a "reasonable person" ought to do given what was foreseeable in the contexts in which they acted. This is

[37] One could imagine a general compensation scheme into which all countries pay in proportion to the size of their economy that provides resources to heavily indebted countries to meet their debt obligations without sacrificing the provision of goods and services to their people.

[38] David Miller, "Justice and Global Inequality," in Andrew Hurrell and Ngaire Woods, eds., *Inequality, Globalization and World Politics* (Oxford: Oxford University Press, 1999), pp. 187–210.

[39] It plays a major role in Rawls's discussion of distributive justice in his *The Law of Peoples.* He writes: "Two liberal or decent countries are at the same level of wealth . . . and have the same size population. The first decides to industrialize and to increase its rate of (real) saving, while the second does not. Being content with things as they are, and preferring a more pastoral and leisurely society, the second reaffirms its social values. Some decades later the first country is twice as wealthy as the second. Assuming, as we do, that both societies are liberal or decent, and their peoples free and responsible, and able to make their own decisions, should the industrializing country be taxed to give funds to the second? According to the duty of assistance there would be no tax, and that seems right; whereas with a global egalitarian principle without target, there would always be a flow of taxes as long as the wealth of one people was less than that of the other. This seems unacceptable." John Rawls, *The Law of Peoples* (Cambridge: Harvard University Press, 2001), pp. 117–18.

not the only way to draw such a distinction. Liberal egalitarian theories of distributive justice typically draw the distinction in terms of whether those outcomes result from factors under the control of an agent or inequalities that are outside of their control.

Second, they must indicate whether the relevant distinction can be drawn not only with respect to the outcomes of individual behavior, but to the behavior of collective agents such as states. If such responsibility is modeled on the tort standards above, for example, a plausible conception of the "standard of care" that draws essentially on the idea of what a "reasonable state" entails must be developed. Or alternatively some distinction between those outcomes that are under the control of the state and those that are not must be made out.[40]

Third, since it is not possible to hold a country responsible for some outcomes without holding the individuals living in that country responsible for them, it must indicate the conditions under which we are justified in holding not only present but also future individuals in a country responsible for the policies made by their government.[41]

Fourth, they must clarify how the distinctions mentioned above can be made in a reasonably precise way in practice. What kinds of standards should be employed in determining whether some debt crisis is fully or partially the responsibility (in the relevant sense) of the indebted country? Must the indebted country "prove" that they are *not* responsible before some adjudicative tribunal, or should we instead presume that their costs should be shifted to others unless it can be shown with great confidence that they *are* responsible for these outcomes? What kinds of institutional arrangements might be developed that could fairly apply such distinctions?[42]

These four questions ought to be a focal point of the conference. Here, as above, the questions must also address the question of how we might legitimately develop institutions that would make such determinations of collective responsibility (if they are desirable).

Participation in decision-making

It has become a commonplace that poorer and weaker states have become increasingly vulnerable to external intervention even in matters of domestic governance, directly— since financial crises and state failures lead them to accept economic conditionality and external intervention—and indirectly—since weak governments face strong incentives to cater to the interests of more powerful states and their constituents. Insofar as the legitimacy of institutions and policies depends (at least in part) on the political role that those who are affected by them are allowed to play in shaping them, these developments can be quite problematic. Disagreement over the appropriate terms on which different agents should be able to exercise influence with respect to political decisions seems often to underlie

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[40] See Cappelen, "Responsibility and International Distributive Justice."

[41] Some of the complexities that arise with respect to intergenerational justice are addressed in Axel Gosseries, "What Do We Owe the Next Generation(s)?" *Loyola of Los Angeles Law Review* 35 (2001), 293–354.

[42] Kunibert Raffer proposes the establishment of (ideally) a permanent international court of arbitration or (more likely) ad hoc panels that would hear complaints about the effects of IFI conduct lodged by governments as well as by international and nongovernmental organizations. "Risks arising from events beyond the parties' control would remain with the client. Risks arising from negligence of IFIs would remain with the risk imposer." See Kunibert Raffer, "International Financial Institutions and Financial Accountability," *Ethics & International Affairs* 18, no. 2, pp. 61–78. Kremer and Jayachandran have proposed an independent institution that would be charged with assessing whether regimes are legitimate and whether any sovereign debt incurred by such regimes should be declared "odious," and thus not the obligation of successor governments. See Kremer and Jayachandran, "Odious Debt."

disagreements of the arrangements required to resolve sovereign debt crises fairly. These disagreements are of two main types. The first concerns the more general issue of who ought to be included (and in what way) in determining policies and institutions (whether national or international) that substantially affect the economic position of different countries. Some participants in debt controversies hold that procedural justice requires that the standing rules of global institutional arrangements be publicly known and subject to revision, monitoring, and reinterpretation through collective decision-making procedures, while others resist this, citing instead the importance of granting states the prerogative to pursue their own goals, most importantly the promotion of the well-being of their citizens. The importance of this kind of controversy is quite evident from the example of G1 and G77 sketched above. If procedural justice demands that the legitimacy of political decisions made by states depends in part on the political role that those who are affected by them are allowed to play in influencing them, then G1's policy of unilaterally raising interest rates to a substantial degree without consultation or collective decision involving others whose livelihoods will be significantly affected by such a decision may be quite problematic, which may in turn influence our assessment of the status of G77's debts to G1.[43] The second disagreement relates more specifically to the issue of participation in determining a "solution" to a debt crisis. The IMF's Sovereign Debt Restructuring Mechanism , for example, has been criticized on the grounds that because the mechanism would be overseen by the Fund's own executive board (which is in turn dominated by the official creditors of the powerful G-7), it would "ensure that Fund staff and the executive board would play a preemptive role in shaping the outcome of the debt crisis resolution negotiations by setting the country's level of debt sustainability, on the basis of which will be determined the necessary debt reduction."[44] Similar complaints have been lodged against CACs.

[43] This example is one of many that might be given to illustrate the influence of decisions made by one powerful collective agent on the prospects of other agents.
[44] Pettifor, "Resolving International Debt Crises Fairly," p. 5.