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Norms and Troubled Sovereign International Debt

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ABSTRACT

Troubled sovereign international debt is a global governance challenge, requiring solutions balancing the interests of the global economy, creditors, and debtor nations and their citizens. Unspoken ethical and/or logical assumptions exert subtle influences on sovereign debt debates and negotiations. The paper explores the origins of the major contemporary norm, identified as Sanctity of Contract, and then locates three emerging mental models, each of which implicitly challenges the dominant norm, allowing for alternative priorities, decision rules, and ideal allocations of losses to resolve debt crises. The authors designate these reformist rationales Shared Risk, Comparable Treatment, and Human Solidarity, and provide brief examples of actual policy reform suggestions that illustrate the thinking found in each set of challenger ideas.

Key Words: global financial architecture, debt restructuring, ideas and policy making, development finance, global governance

Key Concepts: international governance regimes, ideas, and troubled sovereign international debt

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INTRODUCTION

This paper does not recommend or examine specific public policy choices. Instead, it concerns itself with the assumptions, often implicit and unexamined, that inform and shape discourse about an important international public policy arena: the treatment of sovereign borrowers that default on their international debts. What do opinion leaders in national governments, law firms, academia, media, activist organizations and elsewhere think about defaults or threatened defaults by sovereign debtors in poor and middle-income economies? What are the major ideas about truth, justice, proper procedures and economic efficiency that underlie debates about desirable responses to struggling sovereign debtors from the Global South? The paper examines the role of norms and mental models in shaping the discourse and interpreting the outcomes associated with situations of troubled sovereign international debt. We identify Sanctity of Contract as the most influential norm to have guided sovereign debt negotiations over the past fifty years. More recently, however, three alternative mental models—arising from various academic disciplines or epistemic communities[3]—have challenged the dominant norm's underlying assumptions, offering new perspectives on its validity and applicability.

Our first section introduces key concepts: international governance regimes, the role of ideas in public policy, and the international issue arena of troubled sovereign international debt. The subsequent sections delve into the ideas driving the postwar global sovereign debt governance regime, examining how the Sanctity of Contract norm gained prominence and how three alternative mental models contest its assumptions. Prospective reforms that align with existing mental models may have an advantage in shifting established norms and garnering broad policy coalitions. Brief conclusions summarize the arguments.

INTERNATIONAL GOVERNANCE REGIMES AND THE ROLE OF IDEAS

An *international governance regime* is a loosely bounded set of widely understood (if not always universally endorsed) norms, rules and procedures, sometimes but not always associated with a formal international organization or organizations, that (attempt to) regulate or govern cross border interactions within a policy issue arena. In this sense, international governance can be conceptualized as an umbrella term for "a variety of specialized problem-solving arrangements" (Cowhey and Aronson 2017: 95). The operation of international regimes is of course sensitive to the relative power capabilities of their interested actors: ceteris paribus, dominant states operating via pressure exerted on other states are more able to impose their preferences on an international regime's rules and laws than are weaker players. However, international governance regimes are not simply about the relative overall power capabilities. Even if we assume, for the sake of simplicity, that states are the only significant actors and that the preferences of the powerful will prevail, where do these preferences come from (see Finnemore 1996: 1-33)? They derive from ideas and norms about what type of international issue arena governance, and to what ends, is good, correct, and proper.[4] This paper argues that ideas — in addition to interests and power — motivate policy preferences and outcomes in sovereign debt restructurings.

There is no world government with enforcement powers over sovereign states or their citizens. So, why do participants in an international governance regime comply with its rules and procedures? We may distinguish between a formal *law,* which is written, and a social *norm,* which is a belief about

[3] A group of technically qualified experts, often geographically distant from one another, who share a similar world view (Haas 2021). More loosely, any group of people with a similar subject matter socialization and world view.

[4] Our work builds on a broad body of research that acknowledges the influence of factors beyond power—such as ideas, norms, mental models and international governance regimes—in shaping policy (See Krasner 1982; Goldstein and Keohane 1993; Naj and Kohli 2023).

appropriate behavior in certain types of situations, shared among a group of people. Referring to the familiar case of rule-enforcement within a domestic political system, Posner and Rasmusen (1999: 369) write:

> Laws are promulgated by public institutions, such as legislatures, regulatory agencies and courts, after well-defined deliberative procedures, and are enforced by the police power of the state, which ultimately means by threat of violence. Norms are not necessarily promulgated at all. If they are, it is not by the state. Often a norm will result from (and crystallize) the gradual emergence of a consensus. Norms are enforced by internalized values, by refusals to interact with the offender, by disapproval of his actions, and sometimes by private violence.

Rule-enforcement works somewhat differently in international relations. In the international space, public international law (as exemplified by treaties) is both weak and a blunt instrument: often the only enforcement mechanism for countries ignoring their treaty commitments is to expel them from an international organization, requiring a nearly-impossible-to-achieve consensus. Most of the time the offender experiences few consequences. Nonetheless, voluntary cooperation occurs in many international policy arenas, despite the absence of sanctions backed by the credible threat of force. Instead, national policymakers recognize that multilateral cooperation over time can provide valuable collective goods, enhancing member states' security or prosperity. Adherence to the norms of international regimes enables countries to establish reputations as either reliable or unreliable partners for international cooperation. That is, shared social norms about ethical and/or rational behavior, leading to converging expectations, become particularly important in international governance regimes. Norms can support or undermine international law.

We further distinguish between a norm and a mental model. In this paper's discussion, an international *norm* is a shared belief about what behavior, goals or procedures are ethically appropriate and/or logically valid that is strongly associated with an existing international governance regime. The term *mental model* refers to important ideas held in common among a group of people constituting an epistemic community, but which have not yet become strongly associated with an international governance regime. That is, norms represent the status quo, while would-be reformers promote novel values and causal propositions that they would like to see incorporated as additional norms within the loose set of institutions, procedures and expectations that constitutes a de facto international governance regime. Over time, mental models can undermine established norms and constitute new norms by demonstrating the viability and desirability of other plausible conceptualizations of desirable behavior, slowly eroding the legitimacy of existing norms. Both norms and mental models can influence or legitimate policy preferences.

Finally, both established norms and reformist mental models may be based on either principled or causal logics, or both (Goldstein and Keohane 1993: 9-10). *Principled beliefs* appeal to our understanding of what behavioral choices are right, proper and moral. People, including national policymakers, often justify their behavioral choices by claiming that they embody ethical or moral principles shared within a social group. Ethical principles are notable in that they leave room for altruism, or endorsement of a course of action that occasions greater material costs than direct benefits for oneself. This type of belief or guide to action rests on arguments about the moral virtue of acting to promote the collective self-interest of the family, tribe or cultural group, city, country or even all of humanity. The logic and the impulse to obey ethical principles are normative. An alternative type of reasoning that may motivate or justify behavior rests on logical arguments linking cause and effect. These *causal arguments* focus on illuminating true, factual relationships. In many public policy discussions, reform advocates look to economic models to inform and legitimate policy choices. For example, within the rational choice paradigm dominant in contemporary economics and much of political science in the Global North, humans are assumed to be self-interested actors whose rational behavioral preference always will be the action that they judge will yield the best outcome for themselves. Within the rational choice model of reality, disputes only can be settled voluntarily by an appeal to both parties' self-interest. In practice, the line dividing principled from causal logic isn't always sharp. As our extended case study of the global sovereign debt regime makes clear, some policy-relevant ideas begin as one type, then gradually also assume elements of the other type.

Troubled Sovereign Debt: As Policy Problem and International Governance Regime

The *international policy problem* considered in this paper is as follows. A low- or middle-income country is unable to make a scheduled payment of interest and/or principal to its foreign creditors. This is international public debt, which in practice refers to debt that is either denominated in a foreign currency or incurred in a foreign jurisdiction or both. A legal process ensues, beginning with a determination of how severe the repayment difficulties are, leaving aside for now questions of who makes this judgment and on what basis. A country might be illiquid, meaning that the sovereign borrower possesses assets sufficient to repay the debt, but they are temporarily unavailable. An example would be if the country's major export market was hit by a crisis, delaying hard currency payment for goods already ordered and shipped. If the problem is illiquidity, then the borrower may alter its repayment schedule or access additional short-term bridge financing. If, however, a determination is made that the problem is more severe and ongoing, then the country is insolvent. In this case, debt restructuring (implying a reduction of the original debt) and/or economic restructuring (tough new domestic policy conditions that are binding on the sovereign debtor and expected to generate a domestic budget surplus) may be required to restore debt sustainability. Both creditors and debtors will assess the debt crisis, seeking to protect their own interests. Creditors seek to minimize debt cancellation and recover their capital in a timely manner, while debtors seek to reduce their debt burden as much and as rapidly as possible, while retaining their reputations as reliable borrowers. An international debt workout process is a negotiation, typically between a sovereign debtor and one or more private (or official) creditors. A loss mostly borne by the private creditor occurs if the debtor simply repudiates past debt, wholly or in part. A loss mostly borne by the sovereign debtor occurs when the borrower government contracts new loans, whose primary purpose is to repay prior debt.

Anecdotes and historical databases illustrate a long history of sovereign default (Reinhart and Rogoff 2009; Roos 2019) and tend to paint private creditors as the primary losers. A Bank of Canada-Bank of England database records a default rate greater than 25 percent of all international sovereign bond issues every year from 1830-50, with subsequent peaks in 1930 and 1980, in each case involving international financial contagion (Beers and De Leon-Malagnit 2019: 14). Even more striking, in a 200-year sample of 321 sovereign default restructurings with foreign private creditors, the mean creditor loss is 45 percent, while geopolitical crises led to the largest "haircuts" for creditors (von Luckner et al. 2023: 1). As Lindert and Morton (1989: 40) dryly observed during the 1980s Latin American debt crisis, "Those [creditors] caught in the current lingering debt crisis cannot blame their innocence on an absence of historical literature." One reason for high direct creditor losses from outright defaults was the lack of even the rudiments of a coordinated international governance regime prior to the 1980s, in contrast, for example, to informal yet consequential gentleman's agreements among core country central banks to support the gold standard from about 1870 to World War I (Eichengreen 2019). Although unpaid creditors were the direct losers from defaults, unreliable sovereign debtors suffered reputational costs, deterring future lenders.

The bones of the current *international governance regime for troubled sovereign debt* date from the mid-20th century. In the closing months of World War II, the major Western powers among the soon-to-be-victorious Allies organized conferences to negotiate new multilateral institutions to help manage key international policy sectors that had led to bitter conflicts among states, contributing to a horrific war fought on three continents. The initial goal of one such new institution, the International Monetary Fund (IMF), was crisis-prevention by making loans to countries suffering from illiquidity. Gradually, the IMF also assumed the task of assisting in the management of previously decentralized sovereign defaults. Specifically, the Latin American debt crisis that began with Mexico's default in 1982 resulted in considerable innovation and the construction, over the course of a decade, of the current global sovereign debt regime, organized by the US government and the IMF (for contrasting histories, see Ocampo 2017; Eichengreen 2019).

Although operating somewhat informally, today's international sovereign debt regime has historically novel features. First, the IMF acts, along with (and arguably at the behest of) the home governments of the major private creditors, as the de facto coordinator of most official and private creditors, with the increasingly important exception of China as a creditor in the 21st century. Thus, the IMF enables and legitimates joint action among the various creditors of a single sovereign debtor.

Second, the IMF has taken the leading role in arranging, and funding, "bailouts" for troubled debtors via new loans. In practice, most of the new loans have gone to repay private creditors, while the debtor country ends with higher debt and austerity conditions imposed from outside to ensure that a sufficient net surplus is generated to send abroad. The IMF and other international multilateral financial institutions have also assisted private creditors in other methods of ridding themselves of non-performing assets, as via the process of securitizing and selling loan assets. With minor changes, this system remains in place today.

Third, although the IMF plays an important role, there are many other independent actors. These include individual countries with varying power capabilities; large private financial institutions; exclusive clubs of countries, such as the Group of 7 (G7) or Group of 20 (G20); multipurpose and universal membership organizations of countries such as the United Nations; a wide variety of joint public-private financial organizations issuing recommendations such as the Basel Banking Committees of the Bank for International Settlements (BIS); and various transnational interest and lobbying associations, from the Washington, D.C. based Institute for International Finance, a forum for senior figures from the world's major multinational banks and financial institutions to discuss and coordinate their regulatory preferences, to faith-based debt relief organizations.

Notwithstanding the significant postwar and post-Latin American debt crisis reforms, as well as other less consequential modifications, some scholars argue that the contemporary international sovereign debt governance regime has been biased in its actual operations. The justifications for the mid-20th century creation of the IMF, as well as the inauguration of the Brady Bonds and other reforms that emerged from the Latin American debt crisis of the 1980s, have been that these policy innovations provided much-needed stability as compared to the chaos reigning in international financial markets during the 1930s. They have, it is confidently asserted, protected the national financial systems of the core capitalist economies, to the collective global benefit of continued global economic growth. Nonetheless, many expert observers also have concluded that the post-1980 reforms in practice redistributed bargaining power towards private creditors and improved their relative outcomes during defaults. Thus, Huizinga and Sachs (1987) write that "Ironically, during 1982-86 the [Latin American] debt crisis did not have a serious adverse effect on the reported current earnings of the banks, even though it called into question their very solvency." Comparing outcomes for Latin American sovereign debtors in the 1930s with those of the 1980s, Felix (1990), Stallings (1990) and Ocampo (2014) each concluded that debtors fared notably better during the Great Depression, when there was little collective international financial governance, than in the 1980s and after. Similarly, Kharas and Linn (2008) observe that, despite heavy losses for Asian economies during the Asian financial crisis, foreign banks "escaped with minimal losses."

Loss allocation during a debt crisis, moreover, is a zero-sum game, and these benefits to creditors came at a cost to debtors. In fact, other observers have profoundly criticized the economic, political or human costs of the post-1980s de facto global governance regime for resolving troubled sovereign debt (Brown 2009; Espósito, Li, and Bohoslavsky 2013; Guzman, Ocampo, and Stiglitz 2016; Kapur 1998; Zucker-Marques, Gallagher, and Volz 2024). Some scholars identify a continuing shift of political power and influence away from sovereign borrowers and toward global private financial capitalists. Guzman, Colodenco, and Weidenbrug (2024b) argue that "[T]he asymmetry in coordination between private creditors and emerging market debtors has equity and efficiency implications. Private creditors are often better coordinated and able to extract power rents" (see also Alami et al. 2023; Armijo and Sood 2023.)

This paper endorses the basic claim that the postwar international debt governance reforms have had many positive outcomes: few wish a repeat of the chaotic politics or economics of the 1930s. At the same time, it seems fair to conclude that the current situation tips the balance quite far toward satisfying the preferences of private creditors and their home governments—at the expense of generating tougher outcomes for sovereign debtors in the Global South. In thinking about possible reforms, one can examine specific technical suggestions to alter legal contracts in this or that fash-ion, or to expand or contract the remit of a multilateral institution thusly. Our approach, instead, is to seek out the underlying and often unexamined beliefs about how the world *should* work or *does* work, with the aim of refocusing at least some of the policy reform debates at this level.

The paper's next two major sections summarize the status quo, which we designate the reigning norm, and three emerging mental models (MMs) that challenge its assumptions. Two tables, located in the section on the three alternative approaches, compare all four norms and MMs and their key policy reform suggestions.

THE REIGNING NORM: SANCTITY OF CONTRACT

Sanctity of Contract is our label for the dominant norm underlying and embodied in the international debt governance regime. The norm arises from both a centuries-long moral-ethical discourse and more recent causal economic assumptions within the postwar rational choice tradition. The norm assumes that all parties to a debt contract have entered their relationship voluntarily, with one party agreeing to supply financing, and the other agreeing to repay the initial capital with interest. Should a debtor withhold payment, the debtor is presumed to be at fault regardless of circumstances. This norm holds financial contracts sacrosanct and views default as a "broken promise or a breach of con-tract" (Ams et al. 2020: 276). The breaching party is held accountable for both principled and eco-nomic reasons, while the need to punish defaulting debtors is considered morally justified, econom-ically rational, and essential for system-maintenance. Moreover, contemporary legal interpretations of the Sanctity of Contract norm result in a *contractual approach* to reform, positing that procedures and terms of any required debt-rescheduling ought to be laid out in the original debt contract, and thus rejecting the right of any judicial or executive bodies to alter the terms of a debt contract after it has been agreed. Even well-intentioned deviations from the laid-out terms of the contract constitute ethical failures.

As a Moral Imperative

In Shakespeare's immortal words, circa 1600, "Neither a borrower nor a lender be; For loan oft loses both itself and friend, and borrowing dulls the edge of husbandry" (Polonius, *Hamlet,* Act 1, Scene 3). Then and now, credit and financial contracts make many people deeply uncomfortable. Pre-indus-trial sympathies often lay with debtors, preyed upon by rapacious moneylenders, as in Shakespeare's *Merchant of Venice*. Over time, the gradual extension within Western Europe of political voice from landed aristocrats to new groups with wealth resulting from trade greatly improved the reputation and social standing of urban merchants and creditors, while individual debtors came to be viewed as irresponsible, lazy or even sinful. These ideas underpinned the creation of English debtors' prisons, appearing as early as the 14th century. A defaulting debtor would languish behind bars until either the debt, plus accrued expenses charged by the prison for food and shelter, was repaid or the creditor released the debtor (Duffy 1985). These public policies, congenial to newly influential groups such as merchants and bankers, gradually also assumed a moral or principled dimension. Subsequently, the late 18th and early 19th century campaigns to end debtors' prison also were waged in part on moral grounds, including by efforts to distinguish between intentional irresponsibility and hard luck—"malfeasance versus misfortune" (Peebles 2013: 6-10)—with the assumption that the latter was less deserving of punishment. Agitators also claimed that prison life itself encouraged laziness, and that ending the practice therefore would encourage hard work and thrift (Finn 2003).

While debtors' prisons are no more, a powerful societal norm equating defaulting debtors with irresponsibility lingers. The Sanctity of Contract norm exalts saving over borrowing: frivolous persons borrow against their futures to consume today, while responsible individuals withhold consumption today to fund tomorrow's purchases or emergencies. Both staples of children's literature such as Aesop's fable of the ant and the grasshopper, and academic research such as the Stanford marshmallow experiment in the 1960-70s, which linked later life-success in children to their ability to delay gratification, have reinforced this norm (Calarco 2018).

Contemporary creditors and their governments readily extended the moralizing analysis to defaulting debtors from poor countries. In his enduring work on sovereign default, Winkler (1933: 17) began from the premise that, "An obligation ought to remain, in all conscience, an obligation …regardless of the entities of debtor and creditor. [T]he lender expects fulfilment of a contract." The tendency to lay blame primarily on debtors, whether individuals, businesses or countries, remains the popular wisdom. For example, writing about the Latin American debt crisis, financial journalist Tim Congdon (1984) quoted Jeremy Bentham's *In Defence of Usury*, published in 1787, "'Those who have the resolution to sacrifice the present to the future, are natural objects of envy to those who have sacrificed the future to the present. The children who have eaten their cake are the natural enemies of the children who have theirs.' … Latin American presidents know that their citizens have eaten too much cake."

Similarly, during the Greek financial collapse in 2009, both German Chancellor Merkel and French President Sarkozy labelled Greece a "debt sinner" (Carney 2011). The Peterson Institute for International Economics observed that, although "many economists feared that forcing tough austerity on Greece would strangle its economy … Germans and others in Europe felt that Greece had to suffer the consequences of its alleged misbehavior" (PIIE 2020: 5). Joseph Stiglitz (2015), a critic of this approach, likened the rescue packages from Europe and the IMF to 19th century debtors' prisons. When the crisis spread to neighboring countries, political leaders were quick to distance themselves from Greece, emphasizing that they would repay their debts (Bojeson 2012).

As an Economic Imperative

Among the experts involved in contemporary sovereign debt workouts, a different, yet equally potent, set of assumptions drawn from the rational choice paradigm of human behavior also supports the Sanctity of Contract norm. It is worth carefully unpacking this reasoning, which understands itself as objective, rational and logical, and thus as an antidote to unscientific, value-driven approaches to the topic.

In the latter third of the 20th century, a rigidly formalized version of *rational choice* logic spread throughout the social sciences, becoming close to hegemonic in the discipline of economics and subsequently colonizing American political science. Summarizing broadly, the core assumption is that social actors are self-interested, rational utility-maximizers. Therefore, to ensure the joint welfare of a group, individuals must be deterred from acting selfishly. The specific application of rational choice logic to debt negotiations builds on the presence of *moral hazard*, a term originating in discussions of insurance in the late 19th century (Baker 1996, as cited by Rowell and Connolly 2012: 1053). Moral hazard "refers to the idea that the very provision of insurance raises the likelihood of the event being insured against taking place" (Lane and Philipps 2002, n.p.). The prospect of a safety net reduces the incentives for prudent behavior and encourages excessive risk-taking: if a country can anticipate debt relief and assistance from multilateral public actors such as the IMF on default, then why should it strain to make its scheduled repayments? The conclusion reflects the assumptions: if a defaulting debtor is met with sympathy, then other borrowers will renege on their contracts, and the entire system of financial intermediation—which serves a valued social function—will collapse. Therefore, creditors/adjudicators/regulators must be cruel to be kind.

The moral hazard argument for treating sovereign debt contracts as sacrosanct is further buttressed by a (re)interpretation of economic and financial history with this rational choice lens (for example, Calomiris and Haber 2014). Within the moral hazard construct, it is assumed that sovereigns default not due to an inability to pay, but rather for political or opportunistic reasons: "[A] state may be short of liquid assets but is never insolvent" (Gianviti 1998). Former Citicorp CEO Walter Wriston opined, "Countries don't go out of business... The infrastructure doesn't go away, the productivity of the people doesn't go away, the natural resources don't go away. And so, their assets always exceed their liabilities, which is the technical reason for bankruptcy."[5] Unless the creditor has really good information about the true net worth of the debtor, as well as the ability to exact some penalty for cheating (the equivalent of repossession of a car, house, or factory), it is rational to assume the debtor cheats. Consequently, the basic model of debt workouts assumes the debtor can pay the debt but simply refuses to do so (as in Eaton and Gersovitz 1981: 289-90).

A related assumption is that private creditors are weak, and sovereign debtors powerful, a framing implying that reforms to the so-called global financial architecture should lean toward improving outcomes for private creditors, not debtor countries. This thinking is reinforced by histories of sovereign debt that emphasize the losses experienced by investors. The very language of "sovereign," rather than "public" or "central government," debt holds echoes of authoritarian absolutism. Of course, this framing makes no distinction between the central governments of powerful countries, such as the advanced industrial democracies, and those of emerging market and developing countries (EMDCs). Overall, the moral hazard logic also implies that voluntary private capital flows will dry up in the absence of stronger regulatory and legal penalties for defaulting sovereign debtors.[6]

Policy Reforms Promoting Sanctity of Contract

At least three categories of post-1980 de jure or de facto policy shifts in the decentralized global governance regime for troubled sovereign debt build on Sanctity of Contract logics. In rough chronological order, these are reforms with the goals of enhancing creditor bargaining power, weakening debtor incentives to cheat, and partially voiding sovereign immunity..

Enhancing creditor bargaining power. During the 1980s Latin American debt crisis, the US government and the IMF actively encouraged private creditor cooperation via the so-called "London Clubs," an informal and ad hoc transnational network allowing representatives of the various multinational bank creditors of a single country to locate and meet with one another to coordinate their strategies,

[5] https://www.imf.org/external/np/exr/center/mm/eng/mm_dt_01.htm. Accessed July 29 2024.

[6] While many political economy models have assumed that getting a poor reputation with investors would act as a market-based sanction on unnecessary sovereign defaults, considerable contemporary evidence suggests that private bond investors are not greatly deterred (Cardoso and Dornbusch 1989; Jorgensen and Sachs 1989; Eichengreen 1989).

inter alia forestalling potential debtors' efforts to play one lender off against another. The London Clubs took their cues on interest rates and other parameters from the Paris Club, a grouping of official creditors established in 1956 and formally institutionalized in 1976. However, similar efforts of debtor countries to share tactics and strategies met with fury from the US government and business press, which branded a planned 1983 conference of Latin American sovereign debtors in Cartegena a debtors' "cartel" or oligopoly. Creditors, multilateral organizations and their backers meanwhile quietly offered better deals to Brazil and Mexico if they refrained from participation (Stallings 1990: 95-97).

Weakening debtor incentives to cheat. In the early 21st century, the IMF proposed to supplement the sovereign risk assessments provided by the three major credit rating agencies—Moody's, Fitch, and Standard and Poor's—by providing better intelligence to creditors on debtors' finances ("reducing informational asymmetries"). Formally inaugurated in 2005, these debt sustainability analyses (DSAs) offered freely available and standardized report cards on the amount and composition of debt that each low- and middle-income country could likely handle, under various assumptions (IMF 2023). Ostensibly designed to assist countries in programming their own borrowing, the DSAs also inevitably became an input employed in debt renegotiations. Some observers have been happy, perceiving that the DSAs mitigate debtor moral hazard by making it harder for debtors to claim inability to pay. Others, more concerned with the implications for sovereign debtors, conclude that the metrics included in the DSAs display a bias toward creditor concerns and thus tend to overestimate the true sustainability of debt burdens, impeding reasonable settlements (Laskaridis 2020).

Other shifts in the conditions of financing reflect private creditor innovations that their designers justify by reference to moral hazard arguments For example, the 1990s saw the appearance of a special class of private hedge investors, popularly dubbed "vulture funds," whose business model involved purchasing deeply discounted troubled debt for the sole purpose of profiting through litigation. While the many detractors of "vulture funds" label them blackmailers, their Wall Street fans understand them as "freedom fighters," whose activities improve the functioning of capitalist markets (Abelson and Porzecanski 2014; Kolhatkar 2018). The claim is that these aggressive investors prevent frivolous defaults, as "the prospect of lawsuits will have a helpful deterrent effect," preventing irresponsible debtors from cheating (Fernández and Fernádez 2007: 43).

Perhaps the best-known such fund is Elliott Capital Management (ECM) which purchased, for about 11 cents on the dollar, a scant 7 percent of the sovereign debt on which Argentina defaulted during its turbulent debt, banking and political crises of 2001. Although owners of the remaining 93 percent of Argentine bonds accepted debt reduction and rescheduling, ECM sued Argentina repeatedly, demanding 100 percent payment of the bonds' face value and pursuing litigation for 11 years, damaging not only Argentina but also the large majority of bondholders who had accepted the previous reschedulings and wanted to move on (Merle 2016). Financial journalist Tim Worstall asserted (2014, 2016) that the vulture funds were entitled to the full value of the bonds, reiterating the idea that Argentina would cheat whenever it could. Intriguingly, these funds do also sometimes find local and non-governmental organization (NGO) allies in debtor countries. For example, in approving vulture fund litigation against Congo, anticorruption campaigners argued that "such lawsuits may be the only way of holding the country accountable for how it spends" (Polgreen 2007).

Preemptively voiding sovereign immunity. Sovereign immunity refers to the doctrine exempting states from facing legal proceedings in a foreign country, drawing its justifications from the mutual non-intervention traditions of international public law, dating to the 1648 Treaty of Westphalia. Following World War II, foreign direct investors, largely from the former imperialist powers, purchased mines, farms and factories in newly independent countries. Experiencing conflicts with host governments over taxation, local procurement and employment, or expropriation of assets, private investors petitioned their home governments for remedies. Investors' home governments, assisted by World Bank legal experts, encouraged EMDC governments to sign bilateral or multilateral investment treaties (collectively international investment agreements, or IIAs). These IIAs contained new protections for private foreign investors, notably investor-state dispute settlement (ISDS) clauses, whose crucial feature was an ex ante blanket agreement by foreign direct investment (FDI)-host states that foreign firms could sue them for international dispute arbitration, even if legal remedies under host country law had not been exhausted or even attempted (CCSD 2022; Van Harten 2020: 14-33). This implied a partial voiding of sovereign immunity, frequently resulting in significant negative impacts on third parties, mainly domestic citizens of the host state. It was justified by the moral hazard perspective underpinning the Sanctity of Contract norm, that is, its defenders claimed that its effect was merely to reduce borrower incentives to cheat. Moreover, supporters asserted that increased foreign direct investment would compensate for the host state's loss of national sovereignty. As of end 2023, 1,332 cases had been brought by investors (UNCTAD 2024), mostly by large multinational firms and against EMDC countries (Samples 2019).

THREE EMERGING MENTAL MODELS: DERIVED FROM ECONOMICS, JURISPRUDENCE AND GLOBAL ADVOCACY

Numerous critics have proposed specific reforms to the current Sanctity-of-Contract-based global sovereign default regime. Most such reforms have the explicit intent of improving debt workout outcomes for EMDC borrowers and their populations. Most reforms also (consciously or not) reflect the influence of one or more of three mental models, here assigned labels of our invention, with conceptual roots in economics, jurisprudence and global advocacy. We term them mental models, rather than norms, because they represent values and logics that are familiar in the sovereign debt world, and even widely accepted within certain epistemic communities engaged in reform activities, yet they have not attained the broad "common sense" status of the Sanctity of Contract norm. Singly and collectively, each of these sets of ideas query some of the assumptions embedded in the contemporary international debt governance regime.

Table 1 compares all four sets of ideas. Sanctity of Contract, the reigning norm, is buttressed by both principled convictions, widely held in society and even by this paper's authors, and a model of human behavior based on rational choice causal economic logic, largely limited to the epistemic community of professional economists and bankers. None of the three challenger mental models seeks to displace the dominant norm entirely, yet each proposes that important perspectives have been omitted from or marginalized in contemporary sovereign debt policy debates.

The Shared Risk mental model deploys the same causal economic arguments as those used in the dominant contract-enforcement discourse, while arguing that a more balanced application of the logic will better protect international finance. The other two mental models draw mainly on principled, moral, or ethical arguments. Comparable Treatment has roots in philosophy and jurisprudence and appeals to prevalent ideas about fairness and justice. The final mental model, Human Solidarity, asserts that humanitarian imperatives such as protection of basic human rights, economic welfare and the long-term developmental capacity of the state ought to override contractual public debt obligations. Each subsection first explores the underlying principled or economic efficiency-based logic embodied in the mental model, and then closes with brief references to actual reform proposals that appear to embody these logics.

Table 2, placed at the close of this major section, recapitulates the specific debt reform projects mentioned.

Table 1: Comparing Norms and Mental Models for Sovereign International Debt Restructuring

NORM/MENTAL MODEL	MAJOR SUPPORTING ARGUMENT(S)	
	PRINCIPLED, ETHICAL	CAUSAL ECONOMIC
SANCTITY OF CONTRACT "Financial contracts must be honored."	Default is a moral failure	Debtors will cheat ("moral hazard") Private creditors need protection from sovereign debtors to protect the financial system
SHARED RISK "Shared risk implies shared responsibility for losses."		*Both* debtors and creditors will cheat ("moral hazard") unless public policies shift incentives
COMPARABLE TREATMENT "Similar actors and situations deserve equivalent legal treatment."	Equal justice under the law	
HUMAN SOLIDARITY "Debt workouts must respect the moral absolute of prioritizing human lives and livelihoods over profits."	Ordinary citizens should not bear the brunt of bailout conditions imposed by the IMF and other third parties	

Source: Authors' compilation.

Shared Risk, a Challenge to the Dominant Norm's Characterization of Private Investors

The *Shared Risk* mental model asserts that all financial contracts, and certainly those for long-term sovereign lending from banks or via negotiable bonds, involve risk for both parties, each of whom is making a risk-reward calculation. This is a mental model employing rational choice causal economic logic, which is familiar in the elite epistemic community of financial economists, especially those employed in universities or the research departments of international financial institutions.

The debtor has bet that the funds loaned can be used for productive investment supporting future economic growth or other outcomes in the public interest, and thus will be worth their cost. The creditor(s) has assessed the risk of non-payment by the sovereign borrower, and further conducts risk assessments of its loan portfolios. Creditors then charge a risk premium (rate above the risk-free borrowing rate), which reflects their consent to assume this financial risk. At the systemic level, exposure to risk ensures that both parties behave prudently. Those who conduct their due diligence and make wise investment decisions succeed, whereas those who imperfectly calculate risks face losses: the risk of sovereign default is simply the cost of doing business. After all, creditors continue to lend, and not infrequently to serial defaulters (Reinhart and Rogoff 2009).

The logic mirrors that of the dominant Sanctity of Contract norm. Recall that Sanctity of Contract employs rational choice assumptions to argue that vulnerable global private creditors need strong legal and regulatory protections from self-interested sovereign debtors, who will cheat if they can. That model posits that countries suffer no consequences for default, unless they wish to borrow again in the immediate future. However, the Sanctity of Contract reasoning contains a significant logical fallacy, especially in the simplified versions that typically enter the political and policy debates, which is the frequent assumption that only debtors face moral hazard. In fact, private creditors confront a closely equivalent temptation: creditor-side moral hazard. Creditors' profits derive from making loans and investments, and they will charge higher interest or fees to borrowers perceived as riskier. If, however, private financial actors can anticipate recouping their investments even when things go awry, then creditors' incentives to engage in risky behavior increase. Instead, the post-1980 reforms have on balance increased creditor-side moral hazard.

First, the contemporary practice of offering multilateral bailout packages to "rescue" defaulting sovereign debtors while making private creditors whole has led to pervasive creditor-side moral hazard. One poignant example comes from the IMF's involvement in Russia's 1998 economic crisis, where "members of the IMF's European II department privately nicknamed the proposed Russia package the FIEF, or 'Foreign Investor Exit Facility'" (Blustein 2003: 252). If private banks or institutional investors can credibly claim that their services are essential to the core economies of the Global North, especially the United States, still the linchpin of global finance, or that major banks and institutional investors are "too big to fail," generating "systemic risk," then private creditors reasonably can anticipate that their own national governments and major multilateral financial institutions such as the IMF will provide additional protection against creditor losses from bad loans.[7] Once private creditors begin to anticipate these interventions, private creditors gain incentives to make risky loans without due diligence.[8]

Second, the shift in bargaining power allowed creditors to pass off a greater portion of losses onto debtors, often by delaying meaningful debt reduction during protracted negotiations. Both Von Luckner et al. (2023) and Ams et al. (2019) find that sovereign debt restructurings are increasingly made up of multiple rounds of "interim restructurings" with low "haircuts" for creditors before finally restoring solvency to the debtor nation by reducing its debt to a manageable level. Overly optimistic debt sustainability analyses that assumed illiquidity instead of insolvency often justified insufficient haircuts. Ams and coauthors (2019) find that 86 percent of restructurings from 1980-2012 required multiple rounds.

Once one recognizes that both private international creditors and sovereign debtors face similar moral hazard incentives to obfuscate, then the logical underpinning of the rational choice arguments favoring only reforms to the global financial architecture that will reduce sovereign debtors' incentives to cheat, without touching the similar incentives for their creditors, falls apart. For some scholars, creditor-side moral hazard is one of the key reasons for "odious debt," whereby certain creditors face incentives to collude with corrupt governments to provide imprudent loans (Kremer and Jayachandran 2003). The core policy implication of Shared Risk is that both contracting parties should accept losses in cases of sovereign default.

The related policy reform goal is to **embed risk sharing in debt contracts**. Shared Risk focuses on the failure to recognize moral hazard risks on both sides of the debt contract, and proposes solutions that repair creditor and systemic incentives, whether through ex ante contract modifications or new national laws that forbid or discourage investors to seek profits at the expense of countries in which they invest. For example, issuing GDP-linked bonds or commodity-linked bonds (which can provide relief by tying debt servicing to the price of a key export) or simply capping debt service payments as a share of exports or linked to balance of payments pressure (that is, reinstating the "bisque clause"

[7] The problem of creditor-side moral hazard has, in some eyes, become so pervasive that it is referred to as "bailout culture," viewed as an endemic problem within the United States (Levine 2025).

[8] Some economics research recognizes creditor-side moral hazard, although efforts to measure its empirical significance yield mixed results. Lane and Philipps (2000) test for moral hazard in quite limited ways—whether news of new IMF rescue packages or increased IMF resources results in observable short-term market impacts, such as lower spreads in emerging market lending—and find no evidence that it matters. Meanwhile, Haldane and Scheibe (2004) find "concrete evidence" for moral hazard.

employed in postwar Britain) are ways to embed risk sharing mechanisms into debt contracts (Griffith-Jones and Sharma 2006; Benford, Ostry, and Shiller 2018; Atta-Mensah 2004). Multilateral financial institutions might need to act as "market makers" for such instruments, as private capital has demonstrated "little enthusiasm" for such instruments (Guzman 2020: 708), which allocate risk more evenly between debtor and creditors. Related options also include natural disaster clauses, which forces climate-related risk-sharing. Notably, these possible reform options remain ex-ante and contract-based, and thus, are potentially more congenial to those steeped in the Sanctity of Contract framing.

Comparable Treatment, an Appeal to Abstract Justice

Comparable Treatment, a second mental model challenging the contemporary sovereign international debt workout regime, claims that many debt settlements simply are unfair. That is, the underlying argument is principled and based on ethics. At the same time, this mental model articulates a sophisticated logic. Unsurprisingly, the contemporary actors with whom we associate this mental model are primarily technical experts, holding advanced degrees from fields such as law or economics, who have concrete experience with sovereign debt negotiations. This mental model, like the others that challenge the dominant Sanctity of Contrast norm, begins from the perception that the loose international debt regime is biased in favor of wealthy private creditors and against the interests of poor and emerging economies and their citizens.

The core (although sometimes implicit) statement is that at present all sovereign debtors are not treated equally. The underlying ideas emphasize abstract justice, blind to the social connections and personal characteristics of plaintiffs and defendants, each of whom should be dealt with fairly. The Comparable Treatment mental model also associates the rule of law with the idea that similar persons, including juridical persons, must be treated similarly. This core principle has deep roots in the development of Western legal and political systems, reaching back even to late medieval or early modern Europe, at which time societies were by no means democracies. Nonetheless, successive categories of persons, initially feudal lords vis-à-vis absolute monarchs, and later merchants and skilled craftspersons through their guilds, gradually won legal rights, prominently including secure property rights, for their groups. The idea that laws and government ought to be "fair," in the sense of treating similar categories of individuals or corporate persons similarly, pervades Western liberal philosophy, ethics and jurisprudence—which ultimately undergird both today's international public law (governing, for example, diplomacy and the rights of sovereign entities) and, equally, contemporary international private or commercial law, on which sovereign debt contracts in practice are based.

In the context of debt negotiations, this mental model implies including a principled judgment about what is fair or just when designing rules for allocating losses in debt workouts. Of course, existing debt contracts already embody this mental model. For example, the idea that actors in equivalent situations ought to receive similar treatment already is ubiquitous in the "pari passu" clauses in sovereign debt contracts, which call for equivalent treatment for similar tranche creditors. These considerations derive from long-standing concerns about sovereign debtors' incentives to give preferential treatment to strategically important creditors (such as domestic creditors with political influence) or creditors' temptations to free ride by holding out during reschedulings in hopes that other creditors might accept losses first. The idea is that all creditors with a certain bundle of contractually specified rights ought to be treated equally, and moreover, that losses should be shared equitably across different classes of creditors. Indeed, solving the free rider problem was part of the impetus to form creditor organizations such as the Paris and London Clubs. Various multilateral initiatives including the G20's "Common Framework" explicitly enforce Comparable Treatment among creditors.[9] Comparable Treatment appeals to both societal and legal norms favoring impartial justice, and there have been calls to apply the logic more "fairly" across international private and official creditors by addressing concerns over free riding, such as in the UK's recent parliamentary discussions about requiring private investor haircuts before public sector bailouts[10] (see also Laskaradis 2021: 16-17) and calls for the IMF to forgo its "preferred creditor" status and absorb its fair share of losses (Fitch Ratings 2023; Schadler 2014).

What is novel is the argument that these principled, ethical justifications also can be construed more broadly to apply not only to creditors, but also to sovereign debtors, providing a basis to assert that similar debtors (however "similarity" might be defined) ought to receive comparable treatment *across debtors, financial contracts and/or diverse financial crises.* Thus, an ambitiously reformist vision of Comparable Treatment might oppose preferential treatment to sovereign debtors who are strategically important to creditors' home country governments, and instead advocate for countries to receive equivalent consideration during "similar" crises in different time periods. For example, calls for reform that implicitly rely on the expectation of Comparable Treatment are grounded in the perception that IMF rules have not been applied equally to all member nations, leading to much angst among EMDCs (Kharas and Linn 2008). Reflecting this mental model, Japan complained about Brazil's special treatment in 1999, which apparently was due to Brazil's strategic relationship with the United States, but which contrasted with the IMF's harsh treatment of Asian nations a year earlier (Blustein 2003: 348). Ocampo (2017: 170) bluntly states that "existing mechanisms [for sovereign international debt workouts] do not guarantee equitable treatment, either of different debtors or of different creditors" and argues that reform is urgently needed on grounds of both equity and efficiency (p. 171, and referencing Stiglitz 2010). Extending the Comparable Treatment idea from a narrow application only to all creditors included in a single debt contract (as at present) opens the way for appeals to precedent in debt adjudication and arbitration processes.

Thus, the Comparable Treatment mental model expands on a widely endorsed practice as it applies to creditors, positing that debtors also should be able to call on a similar fairness-within-the-category principle. Although many experts, participants and activists in and adjacent to the existing, yet decentralized and loose, international sovereign debt regime, share these reform goals, there exists little consensus on how to move in this direction. Nonetheless, each of the reforms listed here seems to us to derive from this underlying motivation.

Let sovereign debtors organize. A key barrier to Comparable Treatment is the perception, widespread into the early 21st century, that it is ethical for all creditors of a given country to organize and coordinate a strategy, but illegitimate and against the "laws" of market economics for sovereign debtors to coordinate, which instead is branded "cartelization" or creation of an anti-market monopoly. Several works have explored how debtor coordination could in fact, mitigate the power imbalances between negotiating parties and improve outcomes for those debtor countries (Fernandez and Glazer 1989; Guzman et al. 2024; Bohoslavsky and Cantamutto 2024) To facilitate debtor coordination, a UN-affiliated body might act as a clearing house for sovereign debtors to share information on how to minimize delays and ensure speedy restructurings—expanding on activities that the UN Conference on Trade and Development (UNCTAD) and UN Department of Economic and Social Affairs (UNDESA) already conduct informally.

Discourage "holdout" investors. Holdouts arguably impede the productive functioning of sovereign debt markets, as their core business plan is to disrupt restructurings, preventing the troubled debtor

[9] See https://www.mef.gov.it/en/G20-Italy/common-framework.html. Accessed July 29 2024.

[10] In 2023 the British Parliament discussed renewing a lapsed 2010 law that forbid the granting of official debt relief unless private creditors also accepted losses (UK Parliament 2023, Sections #17-29 and #58-64).

and other creditors from exiting the situation until they pay a "ransom" to the holdout(s). Collective action clauses (CACs) can be inserted in new sovereign bond offerings. They grant a supermajority of investors the ability to bind all bondholders to restructuring agreements and are favored by many market actors as a relatively non-intrusive tool for combating vulture funds (Buchheit et al. 2019: 19) Other options include restoring "champerty" laws, which prevent actors from acquiring assets for the sole intent of litigating. Once common, they have largely been removed from modern legal systems but were in 2024 being considered in the New York Senate as bill S5623 (Jubilee USA 2024).

Create a multilateral sovereign debt adjudication body. A dedicated sovereign debt restructuring mechanism (SDRM) or institution, with the explicit mandate of mediating or adjudicating conflicts over sovereign debt workouts, holds the potential to be viewed as fair, transparent, predictable and legitimate across private investors, creditor and borrower governments, and other stakeholders. It could permit a more transparent, open process and might allow lawyers for sovereign debtors a centralized venue to study precedents set in previous debt workout negotiations. The proposed SDRM either could be attached to the IMF, as that institution would prefer, or constitute a new standalone multilateral (Bantekas and Lumina 2018; Krueger 2002; Ocampo 2016). In principle, such a centralized arbitration mechanism could be a place to begin incorporating post-contract exceptions, or third-party-sourced compensations, agreed by some multilateral process. For example, the Alliance of Small Island States (AOSIS) or other extremely climate-vulnerable polities, might perceive the SDRM as an actor that could endorse using grants from a climate fund to repay outstanding debts for states subject to slow-moving climate disasters.

Although an SDRM provides significant reform potential, it also implies a redistribution of international political power and a grant of discretionary authority to a new multilateral body, and consequently has received powerful pushback from those preferring the current contractual arrangements. In the current political context, such an expansion of global financial governance, even via the more cautious version in which the new body would affiliate with the IMF, looks unlikely.

Human Solidarity, in Pursuit of an Ethical Sovereign Debt Framework

The set of ideas we term *Human Solidarity* asserts that sovereign debt negotiations should be subject to certain moral absolutes. This mental model is supported by a firm belief that human rights are "universal," "inalienable" and "indivisible," and therefore asserts that all parties to a debt contract must also respect, protect and fulfill these rights. It has been most influential among civil society debt-relief advocacy groups, such as Jubilee, affiliated with the Catholic Church, as well as many similar groups based in regions of the Global South. The mental model also is popular in academia, especially in the humanities and social sciences. Although its essence is a principled, ethical argument, Human Solidarity thinking also motivates empirical work demonstrating the private-creditor-bias of the loose contemporary debt workout regime as it actually operates.

This mental model anchors the discussion of sovereign debt reform to its impact on human rights, explicitly highlighting the detrimental developmental impacts in emerging economies in recent debt workouts. Although states are actors in financial markets, they also hold unique obligations, such as providing public goods and services, which are central to the achievement of human rights. Debt workout regimes must recognize that the government's ability to carry out these core obligations (its "state capacity") can be limited by an excessive debt-servicing burden. When significant levels of resources are diverted away from key areas such as infrastructure, education and healthcare and instead directed towards external creditors, ordinary citizens suffer. Processes and institutions that result in disastrous reductions in income for a country's poorest citizens, permanent and profound environmental damage, or which systematically retard the debtor country's economic growth over long time periods, are ethically unacceptable and must be rejected. Wealthy international private lenders and investors must consider the human consequences of their lending and their calls for contractual repayment. Neither they, nor their home governments, nor the multilateral financial institutions can divorce themselves from the consequences of their repayment demands as felt in developing countries.

Crucially, Bohoslavsky et al. (2023) conclusively find that "social variables, intrinsically linked to economic and social human rights" are not considered by private corporate creditors during the debt work out process. This is further supported by several case studies documenting clear detrimental impacts to human rights following restructurings (Vargas, Ramos-Escamilla, and Garcia 2016; Lumina 2013; Bantekas and Lumina 2018). This mental model advocates including such considerations directly within the debt workout process, prioritizing solutions that explicitly consider the costs to human rights (for example, by requiring Human Rights Impact Assessments) and quickly and reliably restore the debtor country's economic stability and growth to minimize deleterious effects to its citizens (United Nations Human Rights Council 2018). A Human Solidarity perspective seeks to establish the existence of fundamental humanitarian imperatives that cannot be superseded by creditors' demands for restitution, recognizing that burdensome repayment schedules can undermine state capacity and the ability for a state to uphold its responsibilities for safeguarding human rights and investing in the long-term well-being of its citizenry. However, as Goldmann (2014) argues, "respect for human rights does not amount to denying the validity of contractual commitments (*pacta sunt servanda*), or to abolishing conditionalities and structural adjustment. It would only make debt workouts fairer and prevent cases of excessive hardship." The reform options that follow from this moral-ethical perspective generally imply a greater role for international institutions and a multilateral consensus, which can be designed to complement the current governance regime, rather than contradict it. Potential solutions that align with this mental model include:

Provide humanitarian debt relief. Human rights organizations have pointed out that debt crises and subsequent restructuring packages have negative long-term impacts on economic growth and disproportionate impacts on vulnerable groups. Economic restructuring includes regressive taxes and austerity measures, both of which divert resources from welfare programs and decrease human right standards (Vargas Delgado, Ramos-Escamilla, and Garcia 2016).[11] Several multilateral initiatives to provide forgiveness on official loans exist, including the Heavily Indebted Poor Countries (HIPC) Initiative and Debt Service Suspension initiative (DSSI). However, such measures generally apply only to debt to official bilateral or multilateral creditors, and have not yet been extended to privately held debt. New options to ease the debt burden on middle-income emerging market countries, the main borrowers in private capital markets, are under discussion. Nonetheless, vocal critics from the Global South maintain a principled position that anything less than full debt forgiveness (at least of official debt) and positive net capital inflows to EMDCs is illusory as a solution (for example, Chandrashekar and Ghosh 2024). Their interpretation of Human Solidarity is that reforms of the loose global sovereign debt governance regime ought to be judged solely by EMDC outcomes, not by the seductions of economic models.

Leading actors promoting sovereign debt relief on the implicit basis of Human Solidarity include institutions and actors formally engaged in global governance, including the international financial institutions, alongside a wide range of non-state advocacy groups, academic experts and national officials. These actors conceptualize their core missions as serving the public good, although of course specifics diverge. The most basic expression of this mental model is periodic calls for blanket reduction, suspension or cancellation of troubled sovereign debts. Thus, in the 1970s international financial institutions (IFIs) encouraged middle-income developing countries, especially in Latin

[11] https://www.hrw.org/news/2023/09/18/time-align-financial-institutions-human-rights. Accessed July 29 2024.
https://www.ohchr.org/sites/default/files/Documents/HRBodies/HRCouncil/RegularSession/Session23/A_HRC_23_48_Add.2_ENG.PDF. Accessed July 29 2024.

America, to contract private bank loans to fund economic and social growth, an option whose costs became apparent in the 1980s. Low-income countries that borrowed from bilateral and multilateral official creditors also found themselves in "debt-traps," eventually inspiring the 1996 IFI-backed HIPC for partial debt cancellation. The faith-based organization, Jubilee 2000, was launched in the UK in the early 1990s to advocate for debt relief for poor countries, reinventing itself as "Jubilee" in the 21st century. The website of the Jubilee US Network declares, "We believe right relationships among people and nations are sacred," and takes credit for campaigns resulting in "more than $130 billion in debt relief for the world's poorest."[12] In 2012, the UN Human Rights Council proclaimed excessive debt repayments an abrogation of basic human rights.[13] More recently, the COVID-19 pandemic highlighted the important link between healthcare spending and debt. According to UN Deputy Secretary-General Amina Mohammed, 59 countries spent more on debt servicing than on healthcare in 2020.[14] The inability to allocate resources to combat the COVID-19 pandemic forced fiscally constrained governments around the world to rely on concessional financing and the G20's DSSI to finance their pandemic responses. The G20 requested that private as well as public international creditors suspend debt service, but only one private creditor opted to do so, a set of choices that contributed to the 2020 pandemic death toll in poor countries, which was quadruple that in wealthy ones (Oxfam International 2022). This brief list, which could be expanded a hundred-fold, illustrates the varied multilateral and transnational actors perceiving troubled sovereign debt through the lens of Human Solidarity.

Add climate. A Human-Solidarity-based discourse also justifies the inclusion of climate-related considerations into debt contracts and troubled debt workouts. This category includes ex ante natural disaster clauses and ex post debt-for-nature swaps, in which troubled foreign debt is swapped for a borrower government's promise to meet climate targets. It also includes the suggestions to include estimates of anticipated climate-related adaptation and mitigation spending in the IMF's DSAs as a matter of course (Maldonado and Gallagher 2022; Volz et al. 2021) and to implement debt-for-climate swaps. IMF Managing Director Kristalina Georgieva has frequently campaigned to link sovereign debt relief to debtors' efforts to fight climate change (Harvey 2023).

And once again: **Create a multilateral sovereign debt adjudication body.** Like Comparable Treatment, Human Solidarity strongly pushes in the direction of creating a new international agency, an ambitious solution that currently seems politically unlikely. In principle, an SDRM could go beyond merely looking to precedents to try to achieve similar results for equivalent situations, and instead could expand its remit by explicitly permitting, for example, participation by third-party stakeholders, such as the local citizenry in a debtor country, or legal briefs presented on behalf of protecting the global commons or other innovative collective actors. Ocampo (2016) presents a useful history of some of the specific proposals for a SDRM.

This long section has identified three mental models that appear to motivate different groups of would-be reformers of the still somewhat loose and decentralized, yet powerfully influential, contemporary sovereign international debt regime. The behavior and policy preferences of relevant actors operating in sovereign debt markets are implicitly guided by norms and mental models, and yet the underlying normative assumptions influencing policy discussions and recommendations receive relatively little attention. Returning focus to these bedrock beliefs and assumptions, we have mapped the values and logical underpinnings of proposed reforms in contemporary debates. The discussion omitted unilateral solutions on the part of sovereign debtors, such as self-insurance via

[12] https://www.jubileeusa.org/. Accessed June 24, 2023.

[13] https://www.ohchr.org/en/special-procedures/ie-foreign-debt/about-human-rights-and-foreign-debt. Accessed July 29 2024 and https://www.ohchr.org/sites/default/files/Documents/HRBodies/HRCouncil/RegularSession/Session23/A_HRC_23_48_Add.2_ENG.PDF. Accessed July 29 2024.

[14] https://press.un.org/en/2022/dsgsm1718.doc.htm. Accessed July 29 2024.

foreign exchange buildups as a defense against financial contagion that might spark external debt crises. Table 1 at the beginning of this section identified what we judge to be the essential claims of each norm or reformist mental model. Table 2 below summarizes some specific reform goals and particular reform policies that we interpret as being founded in these four sets of ideas. One value of mapping ideas to policy-reform lies in the possibility of building coalitions to support reforms. Mental models can undermine deeply entrenched norms, creating opportunities for new norms to be established.

Table 2: Norms, Mental Models and Related Policy Reforms

NORM/MENTAL MODEL	REFORM GOALS	SPECIFIC REFORMS, ADOPTED OR SUGGESTED
SANCTITY OF CONTRACT	Enhance creditor negotiating power	Paris and London Clubs
	Weaken debtor incentives to cheat	IMF Debt Sustainability Assessments (DSAs); Regulators should allow vulture funds
	Preemptively void sovereign immunity	Investor-State Dispute Settlement (ISDS) clauses in international investment treaties
SHARED RISK	Embed risk-sharing between sovereign debtors and profit-seeking foreign creditors in contracts	GDP or export-linked sovereign bonds; Bisque and natural disaster clauses.
COMPARABLE TREATMENT	Encourage debtor organizing and information sharing	Empower the UN Conference on Trade and Development or similar bodies to organize and inform debtors
	Discourage holdout or vulture investors	Collective Action Clauses (CACs); Champerty laws
	Impartial institution to adjudicate fairly among creditors and sovereign debtors.	Create a new institution, a global Sovereign Debt Restructuring Mechanism (SDRM)
HUMAN SOLIDARITY	Humanitarian debt relief	IMF's Highly Indebted Poor Countries (HIPC) program for debt relief; G20's Debt Service Suspension Initiative (DSSI) during the height of COVID-19
	Add climate to debt workouts	Include climate adaptation and mitigation spending in IMF's DSAs
	Create a new institution, a global Sovereign Debt Restructuring Mechanism (SDRM)	Adds to basic SDRM a mission to protect debtor state capacity and global welfare (e.g. climate)

Source: Authors' compilation.

CONCLUSIONS

In this paper, we sought to unpack the major principled and causal economic ideas undergirding diverse preferences around proposed legal and institutional reforms to procedures, regulations and laws governing troubled sovereign international debt. The core argument is that ideas matter and can affect actors' policy preferences.

Sanctity of Contract represents the dominant ethos in sovereign debt markets, with a robust and direct influence that supports the current de facto and de jure global financial architecture. The perspective here summarized as the Sanctity of Contract norm derives from a powerful combination of principled arguments about who is to blame for defaults and causal economic reasoning about debtor nations' incentives during restructuring negotiations. Sanctity of Contract logic has been employed to justify numerous pro-private-creditor reforms since the 1980s.

In response, this paper named and elaborated three emerging mental models that singly and jointly provide compelling rationales for further desirable reforms of the current global debt workout regime in order to also incorporate debtor country concerns, thus leveling the playing field. *Shared Risk*, in common with the dominant norm, founds its arguments in the logic of rational choice economics but argues that private creditors as well as sovereign debtors suffer from "moral hazard." *Comparable Treatment* is in essence a juridical mental model, endorsing the ethical and practical goal of equal, or at least equivalent, treatment of all actors in a given category under unbiased laws and rules. Finally, *Human Solidarity* posits that sovereign international debt workouts should be subject to certain moral absolutes, in common with other institutions regulating human society, including national laws and global governance regimes.

An enhanced understanding of how these norms and mental models operate can help reform advocates to clarify their own preferences and form effective coalitions capable of implementing positive change. The paper also highlighted several comparatively modest reforms with significant potential to improve outcomes, perhaps achieving some of the anticipated beneficial effects of a more ambitious solution such as creation of a new multilateral institution like a SDRM.

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