Event Transcript

Sovereign Debt in the Euro Area: A Re-assessment

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Adam S. Posen: Good afternoon everyone, welcome, welcome back to most of you to Peterson Institute for International Economics. I was torn between finishing chewing and starting on time. I'll try to do both. We're having a special afternoon session and I think it's a credit to both the interest to the the subject of our distinguished speakers that we got such a great turn out without offering anybody lunch. So I commend you all.

We're here today to talk about sovereign debt restructuring, which is honestly a very critical issue, the sort of sexy part as it were of recent months, as of course Greece and issues in Europe, but as the people of this audience are well aware, there is also a very important court decision recently having to do with Argentina, which is setting precedent. Then we had some news today about, I think it wasSpain was issuing its first bonds with tax in them. A whole nest of issues requiring a great deal of sophistication, judgment, market and political realism to do the right thing on and for that reason I'm very grateful that we have the panel we have here today.

It's also a point of personal pride that, I'll explain in a moment that we have these particular three people. Who's going to be leading off is Jeromin Zettelmeyer in the academic community, in the fund now at the European Bank for Reconstruction and Development where he's Deputy Chief Economist and Director of Research. Jeromin has been an intellectual force on these issues for some time. He co-authored a wonderful book, Looking at the Sovereign Crises from the Mid '90's through 2006 and at some point we may trouble him to reflect back on what was right and wrong about that book, but that's for another occasion.

Not that anything was wrong with that book, but what you might update as a result of the last few years, I guess is the way to put it.

I am very proud to say that Jeromin is joining the Institute as of today as a part-time Senior Fellow, a nonresident Senior Fellow, in part thanks to his initiative and the good graces of Erik Berglöf, the Chief Economist of the EBRD. But this is the start of what we all expect will be a very long and fruitful association with Jeromin and so this is all of you getting to see his debut on the Institute's stage, which we're very proud of. So welcome Jeromin.

Sitting next to him, but speaking third is Professor Anna Gelpern of the American University School of Law. I know she has a few fans, if not a whole-on clack following her here today and you're all welcome. Welcome to the institute which generally does sponsor pretty interesting discussions and we'll hope to have more of them.

As many of you, I hope, know, Anna served with distinction in the Treasury of the Clinton Administration, has been a frontline lawyer in a leading commercial law firm and for the last several years has been teaching at American with distinguish visiting appointments at places including now Georgetown; and she is at the absolute forefront of bringing together law and economics, something which Jeromin does as well. In fact it's hard to think of two people who are as well versed on both sides of that as these two and we're looking forward to Anna's remarks and in particular she's going to be able to bring us more up to date on some of the implications of the recent court decision.

Finally, on the panel, but speaking second, is Bill Cline. Bill Cline should need no introduction, but after Barney Frank the other day made fun of me about saying, "Without further ado", I will give a bit of introduction. Bill is, depending how you count it, employee number one, employee number two, or employee number three, but no more than three of the Institute along with John Williamson and Fred Bergsten and he's arguably in sheer volume and depth the most productive person we've ever had at the Institute. One of the things I inherited from Fred Bergsten is to be able to count on Bill to come out with a rigorously done original methodology, entirely topical study with freakish regularity.

Bill is in the midst of a project where he has come up with a new method for thinking about public debt sustainability issues with a probabilistic perspective. Some of you have seen his early publications from the Institute on that. They're on the website and he's going to be sharing some of his insights from that work on today, looking at Greece and some of the other European countries.

Anyway, it's a very exciting program. We will end promptly at 4:00. The idea is to have our three speakers speak for somewhere between 45 minutes and the first hour combined and then open it up for questions and comments and just for the record, the first question and comment goes to our friend Mikis Hadjimichael and I apologize for mangling the pronunciation of the second name. He is here as a representative of the Institute for International Finance, where he is Director of Emerging Markets policy and we have a number of recent publications by the IIF on these issues available out in the lobby as well. So without further ado.

Jeromin Zettelmeyer: Thank you so much. I'm hugely honored and flattered and also a bit nervous to be up here seeing so many former IMF colleagues and colleagues from the Institute and others that really know a lot more about the topics of today than I do. I do this as an amateur. I worry normally about transition economies and development issues and so forth.

So I'm going to make two points in my remarks. I will make a point about Greece and the reason for starting with Greece I think is that Greece was and to some extent still remains the potential main threat to the integrity of the Eurozone; and so I think it's useful to start by asking where we stand on Greece following the late November restructuring of payment terms for the official sector, the OSI, if you wish, and the buyback and the extension of the program. And to sort of save all my remarks on Greece, I'm going to be sort of mutual to positive to optimistic. And then I will just give you one thought on the remainder of the high debt countries in the Eurozone and then maybe the flavor's going to be mutual and possibly a little pessimistic.

So let me start with my point on Greece. So the question is, if you look at the press, particularly the buyback got in December, it's generally fairly negative press and so I think one has to ask the question beyond the short-term relief of having had the disbursement, enabling the recapitalization of banks and continuing, keeping the game on the road for a while was this OSI and buyback useful or was it just another case of delaying the inevitable. Clearly the OSI was not as big as many including here in Washington would have hoped and so my answer to that question is really both. It is a case of delaying the inevitable, so this is one case, but in my view, presumably not the last case of official debt restructuring in Greece. But nonetheless was useful, even very useful I think in at least two ways.

First, so I've done a little bit of number crunching to find out whether there is a basis for the argument that the buyback was purely a boondoggle that helps the creditors and the answer is, the creditors did in fact obviously make money on this that was inherent in the market based approach. You can see that merely from the fact that prices picked up in the order of 25% since the buyback was announced, even though of course that also would reflect the effect of the program extension, the OSI, which are separate. But nonetheless, there was some actual debt reduction in a real sense, in a present value sense. So when you combine both operations; the buyback and the official sector involvement, you get something—and this is really preliminary, really rough—in the order of 20% of GDP. So this is a lot less than the PSI was, but it is something and of course, you know, one has to point out and from an official perspective, this is the second time that at least, possibly the third one depending on how you count, that Greece's payment terms were eased.

Now the second sense in which this was useful and this one is actually far more important is as a precedent. So in my view this demonstrates what you might call a soft OSI, a soft official sector involvement approach that can be repeated further down the road if necessary. So it is really about focusing on sustainability in a flow sense. What can the country pay at any given time and then keep postponing the problem and at the current level of debt, at the interest, at the very low interest rates, that these OSIs will gradually go to, you will then I think end up at something that you could call sustainable debt. Of course it's politically still very unpleasant, it still involves a regular repeat of this game and it does mean that Greece will be dependent on official financing for a long time unless then they sustain at some point to go for a bigger cut and that choice is out there.

The results, however, of this with or without a bigger cut in the official debt is that in my view that the probability of a second PSI has become far less likely after what we have seen; both because of what it reveals about how the official sector will handle this and ironically and so this is the sense in which the buyback is a problem because the buyback has selected effectively those creditors out of the creditor pool that would have gone for an orderly restructuring. What you're left with is presumably a group that is far more likely to put up a fight if they were a second attempt at the debts exchange. So the combination of having the private sector debt quite low and the composition of that group I think makes the second PSI far less likely.

Okay, now I just came back from talking to some people outside the building who sort of accused me of being very mechanistic and sort of obsessed just with the debt problem and missing the big context and the big context is growth and then so what about growth in

Greece? So I think that even here that maybe a little bit of a reason for optimism.

So the usual argument of why you need a much more maybe radical operation to deal with … to invite a recovery of growth and what has happened in November – December is the debt overhang argument, and roughly the debt overhang argument works to the expectations of future taxation. So the argument is that investors are much likely to come to Greece including and particularly in the private sector because they expect that the difficulties, the continuing difficulties in the private finances will in the future be clawed back from them in some form or the other typically through higher taxes, lower subsidies, something of that sort.

Now here I think that Greece is indeed a bit different where we are at this point and the argument is that whatever you may think of what will happen with respect to official sector debt restructuring in the future, it is my view extremely unlikely that it would result in more austerity in an attempt to do a higher primary surplus, right? So roughly the model, the debt overhang story is that when it comes to renegotiate the debt next time, there will be some attempt to redistribute the burden of taking the heat, if you like, between the official sector and even higher taxes and I think we are in Greece clearly past that point. So I think that it is probably fair to see the 4.3% primary surplus as a sort of an upper bound of what realistically will be achieved in Greece. And once the next step of renegotiation if anything, there will be a further easing on the austerity and so in that sense, none of this is going to give you a huge stimulus. But combined with, on the back of the huge compression, the very large output gap that exists now, I think there is some sense that Greece may turn around this year or next year.

There are of course big risks. Their risk #1 I think is, I'm not really connected with the German political scene, but my superficial impression is that Greece really was very close to losing the patience of the official sector and the reason why it did not is because France and Germany felt they needed to give the new government a chance. If the new government does not deliver on this chance, it may be different next time. And then of course, needless to say, there's the continuing risk of a social explosion because even this so-called optimistic scenario I have described to you is one that involves low growth and high unemployment for a long period.

Okay, after this optimistic picture, let me just quickly say something about the other Eurozone countries. So I haven't done any real serious analysis of these and a part of it is that one has to work to one's comparative advantage; and we have Bill here on the podium who has done very serious analysis of debt sustainability and so rather than trying to compete with Bill in his area, I'm just going give you sort of a very simple framework to think … well, I'm going to put into your head an idea of what do you think about the likelihood to get out of the debt problem in the remainder of the European Mediterranean countries. And that's the logic of this beautiful chapter in the last World Economic Outlook that operates historically. It looks at a group of attempts to reduce debt from levels about 100% and it basically asks a very simple question of did they succeed within a reasonable period, a decade or so in lowering debt below a 100% and putting debt on a downward sloping path. So it's a somewhat loose criterion of success.

And so they spend a lot of time, it's a case study basically, there some econometrics but it's basically a case study of a handful of cases; the UK between 1918 and 1933, Japan in the late '90s, the U.S. just after the Second World War and then Canada, Belgium and Italy between the mid '80s and the 2000s and so this includes both successful cases and failed attempts. So the failed attempts are the UK and Japan, the U.S. is a successful attempt and the others struggled initially and eventually became successful. So there were two phases there; one very sort of protracted attempt of doing it with austerity alone which did not work and eventually things came together.

But the basic takeaway from that chapter is that physical adjustment is necessary but not sufficient and what you also need, the extra ingredient that you need is accommodative monetary policy. And from here it's very easy and in fact, people like Martin Wolf have done that to construct real impossibility theorem for the Eurozone because clearly the ECB's mandate is such that it arguably prevents it from running a monetary policy that might be sufficiently accommodative to a company, the fiscal contractions in the high debt countries and keep the show on the road. And then on top of that you have the self-fulfilling expectations that increase sovereign risk, worry about the breakup, this all gets reflected in high interest rates in the periphery conditioning on a particular ECB monetary policy and offsets, more than offsets the little bit of stimulus that the ECB does impart. So this is just financial fragmentation argument.

And so, clearly if we're going to get around that problem, we will need to find some sort of substitute for easier monetary policy in the Eurozone. So one option, so the one way of interpreting the OMT is as providing that sort of substitute. And so it has worked well I think in lowering rates, but there's a limit to which it can work because it's calibrated, quite deliberately calibrated by the ECB to take away only the, if you like, the self-fulfilling portion of the risk, right? It's not to generate negative real interest rates in those peripheral countries, which is by and large what the successful experiences had for some time.

And so the question is that this is enough and so here I actually tried to do a little bit of a quantitative exercise. I ran some simulation space from real projections and sort of current interest rate, the lower interest rates and looked at whether the debt would be sustainable in this very crude sense of the WEO chapter whether that comes down within a period of about 10 years or not. And so when you do that, the answer you get is that it works for Italy even under pretty pessimistic zero growth, real growth assumptions and that's largely because they already have a primary surface, right, so they've already done the adjustment; but it's far less clear for the others that particularly like in the case of Spain still have the adjustment in front of them. And so there's real sense that for these countries we might need something else on top, another substitute for easy money and we don't want that substitute to be a Eurozone exit.

So what might that be? And so the next best thing I can think of is the old idea of the German redemption pact that was launched by the German Council of Economic Experts about a year-and-a-half ago and so the idea of that is essentially that on top of this, which is arguably like a stock support of the OMT, you put in a flow subsidy. So on the new debt issuance, you put in a guarantee and that is a relatively efficient way because you're only guaranteeing the new debt, but you're doing it for a long time of ensuring that the debt dynamics are on a good path. This would have to be conditional obviously on adjustment otherwise it is completely unthinkable in the European context. As such, it could be conditional on the same things that the OMT is conditional on namely a program. But the thing about this that is not … because it's not just about breaking a panic, but it's about improving the debt dynamics over a sustained period, you require a much further reaching commitment, a longer horizon, and that is difficult. And then the other substitute if that doesn't work is just debt restructuring and some attempt of orderly debt restructuring.

So what are the risks here? Well, the obvious risks is that the underlying program commitments that are necessary both for the OMT and for something like the debt redemption pact might not be there because of continued political resistance to them. Now that I think I take a little less seriously because I think that if rates went back up, if the debt dynamics deteriorated, probably that would be enough to get, say, a country like Spain over that hurdle where they would finally ask for a program.

But then the other risk is that assuming that the program commitment works and we do actually do something like the debt redemption pact, what you would get is a very long deflationary drag, right? So it would be adjustment, but it might … it will be a successful adjustment but it would be a very long adjustment. So it might be that the best scenario in that case is successful adjustment, but at the expense of a lost decade as far as growth is concerned.

Thank you.

William Cline: Thank you, Adam. It's a pleasure to have this opportunity to take stock at the present debt problem with Jeromin and Anna. Most of my comments will focus on the European debt crisis but I'll also offer a few thoughts on the recent court decision on Argentina.

The central question in sovereign debt strategy is always whether the crisis is one of liquidity or solvency. The most meaningful way to address this question is to conduct projections of the economy and the debt to determine whether the debt is sustainable without some form of forgiveness.

A key feature of the European debt problem has been the paradigm shift from financial market perception that industrial countries never default which they hadn't done for the 1930s to the realization that indeed they can and they did. Greece did.

In this regard, it has been very encouraging that we have seen these declines and these spreads—for Ireland from its peak in July, 2011; for Portugal since its peak in January, 2012. Now of course potentially the greater threats come from the much larger economies of Italy and Spain whereas spreads above the 10-year German bund reached 500 to 600 basis points in late 2011 and mid 2012 but have now fallen to 300 to 350 basis points after Mario Draghi pledged to do "whatever it takes" to maintain the euro and introduce the outright market transactions, financial bazooka.

The European debt simulation model that I've been developing is an accounting framework incorporating probabilities of alternative scenarios. Its principal metric is the ratio of gross debt to GDP, the focus of the markets even though it could be argued that net debt or net interest maybe at least if not more relevant.

An equation one GDP is simply last year's GDP expanded by real growth and GDP deflator; equation two, the fiscal deficit equals net interest payments minus the primary surplus; and equation three net interest equals the sum of different components of the debt times their respective interest rates minus financial assets times interest rate earned on them; equation four sets the primary surplus at the expected ratio to GDP, here pie.

The net borrowing requirement equals the fiscal deficit plus debt discovery which includes contingent debt saved from the provinces as well as bank recapitalization minus receipts from privatization, here Z.

Equation six, the gross borrowing requirement equals the net borrowing requirement plus amortization plus purchases of new financial assets. Equation seven indicates an amortization equals all of short-term debt category one, the maturities coming due on the old debt, category two, and maturities that come due on new debt borrowed after 2012, category three. Then equation eight says that the new borrowing of medium- and long-term debt is essentially a residual, it's a gross borrowing requirement minus the assumed rollover of short-term debt.

Finally, you get the equation stating the three debt stocks, their behavior over time which is the amortizations being subtracted off of old debt. New debt is rising via the borrowing minus the amortization on that new debt and this gives you the components of the debt to GDP ratio.

The probabilistic approach considers three cases for each of five variables. Is it unfavorable, a baseline, and a favorable case? So, you get three to the fifth power or 243 possible outcomes. For each variable, I set the probability that it will be at its baseline at 0.4. In the absence of further information, the probability of the unfavorable case or of the favorable case is then 0.3 each. But then I take account of the correlation between the states.

Will the unfavorable case of a particular variable be positively or negatively correlated with the unfavorable case of another variable and how closely? The probability that the variable in question will then be at its unfavorable or favorable state will then be 0.3 plus the influence of its correlations with the other variables in that particular scenario.

I come up with this notional matrix of correlations of states. I suggested the primary surplus is positively but moderately correlated with growth. Higher growth does mean more revenue but it also means that there's less need to shoot for a high primary surplus fiscal target and in the context of reestablishing debt credibility.

The interest rate, favorable state, is fully and positively correlated with the growth favorable state because the markets are going to look at the growth in judging the credit risk. Under more normal circumstances, this correlation will be the opposite because under conditions of that rapid growth, the monetary authority will be tending to crank up the interest rate so the direction would be the opposite.

The favorable state for bank recapitalization is positively correlated with a favorable state for growth. Privatization is negatively correlated with the primary surplus because the two are substitutes as sources of income. The favorable state for the interest rate is positively correlated with the favorable state for bank recapitalization because there's less stress on banks.

The assumptions I make about interest rates in this exercise are as seen for the German bund returning to somewhat more normal levels and as shown for the spreads above the German bund for the other countries. Portugal's has the highest spread, 650 basis points, but by 2018, all of the countries are down to spreads of 200 basis points. In the adverse case, I add 150 basis points to all these spreads and in the favorable case, I subtract 50 basis points from all of these spreads.

The baseline growth rates are as assumed in the most recent IMF WEO. Growth plateaus at 1.7% for Spain and Portugal, 1.4% for Italy, 2.9% for Ireland. Unfavorable growth is about a half percent lower for Spain, Italy and Portugal; 1% lower for Ireland. And the favorable cases are based on the seventh decile of the various eight-year averages over the past 20 or 30 years and this comes up with a remarkable 7% as the possible upside for Ireland, 3% for Spain and Portugal, one and two-thirds percent for Italy.

I think we should not dismiss these strong snapback growth rates. After all, in a non-financial crisis recession, the rule of thumb used to be that the deeper the recession, the faster the spring back. The baseline of primary surpluses plateau at about 3% of GDP for Ireland and Portugal, 1.7 for Spain, 5% for Italy which has demonstrated the capacity for a high primary surplus. The favorable or unfavorable spread is intentionally set with a wider downside risk for the case of Italy because it is so high.

The extent of bank recapitalization and debt discovery is of course high for Spain, 9% of GDP in 2012, 6% of GDP for Portugal but zero in the base case thereafter. Privatization brings in about 0.6% of GDP per year over a two- to four-year horizon for Portugal, Ireland and Italy.

What are the results? For Ireland, the range of the projected debt ratio is as low as 75% of GDP by 2020 at the favorable and 25th percentile of the range. Even in the adverse 75th percentile, the ratio by 2020 is 108% which is down from a peak of 120%. The probability-weighted average is considerably lower than the baseline because of this very high favorable variant for the growth rate.

In Portugal, the 2020 debt ratio is down to 109%, down from 123% in both the baseline and the probability-weighted outcomes. And there's almost no improvement in the 75th percentile adverse case but a ratio as low as 100% in the 25th percentile, favorable case.

Italy shows a favorable trend. The debt ratio is 100% by 2020. The probability-weighted path is 111% with the … showing the downside risk on the primary surplus. Even in the 75th percentile adverse case, there's an improvement from 125% to 118% by 2020.

Spain conversely shows a rising debt ratio but it is starting from a lower level.

What you then get is a picture that looks like this in the baselines. You get a convergence of all of these economies to something like a 90% to 110% debt ratio range. My conclusion then is that the four economies should be broadly considered to be solvent and capable of sustaining their debt and that even in the 75th percentile adverse cases, three of the four show improvement from the peak debt ratios and the fourth, Spain, is still well below the 120% benchmark that has become a key threshold for solvency in the European debt crisis.

Now Greece is an exception and it has required bankruptcy treatment. At first, it looked like there was a chance that Greece could sustain its debt but the growth projections were successively downscaled. GDP was supposed to be 18% higher by 2015 than in 2009; now, it's projected to be 9% lower.

It's important that the fiscal adjustment has been quite substantial. The real primary spending has fallen by 24% and that's quite an astonishing adjustment, but even so, the primary surplus has not met the original targets and as a result, the successive estimates of the debt ratios got higher and higher.

The private sector haircut of 60% of GDP was not sufficient to radically change or to sufficiently change this. As we now know, there's been substantial further improvement from the official sector relief in December. But I think the central question of Greece is if, as my numbers show, even if they are at 120% by 2020, a country that has defaulted and is not going to be as readily available or not to be as easily in the position to access the private markets at a given debt ratio as other countries that have consistently honored the debt.

So once you start thinking about what is the debt ratio at which a country that has had the default could re-access the market. It doesn't seem to me it's going to be 120%. That suggests that there's got to be more official debt relief down the road. There's 90% of the debt is held by the official.

I'm running out of time so let me simply say on the second topic which is the decision of Judge Griesa on Argentina, my view is that this is not the precedent that many seem to worry so much about. If you read that decision, you will see a litany of anguish that spans over a decade that in some sense goes a bit of a way to push the system back from the rogue debtor problem which became dominant with Argentina but I will perhaps have a chance to address that issue in the question period. Thank you.

Anna Gelpern: First of all, I am deeply grateful to Adam and to the institute, to Adam for his incredibly overly generous introduction and your hospitality. And it is absolutely humbling to be here at this table with Bill and Jeromin so I'm grateful, humbled and as Jeromin said earlier, correctly insecure.

Now, another reason for humility is that I am a lawyer so I have absolutely nothing to say on subjects like debt sustainability but for any law students in the room, there will be a pop quiz on the model that Dr. Cline just put up. You have two days to study though, radio.

Now, although our primary topic is Europe, I am glad that Bill mentioned Argentina which used to be the focus of sovereign debt happenings and is migrating back into the spotlight where Europe has held court since 2010.

We are—and I don't think it's much of an exaggeration—living through something of a revolution in the legal regime for sovereign debt management that may rival what happened in this world in the '80s and '90s when much of the law was made; and that is not only or even primarily on account of the second circuit decision that we just heard about, which may or may not stick. But really in two places in Europe and in New York/

Argentina, we are seeing dramatic changes ranging from the path-breaking restructuring by Greece—which you've heard about a bit and I'm sure we'll talk about more—and then also a slew of contract and treaty reforms, at least designed to promote creditor collective action, affecting a class of government debt that is much, much bigger and more important in the global financial system than anything we had tinkered with before.

As for Argentina which is in its 12th year of default and litigation, we have had a ruling by the court of appeals for the second circuit endorsing a remedy that attempts to influence Argentina by targeting various intermediaries and market infrastructure, and that is really the bigger significance of the decision. So I will start with Europe and talk a bit about Argentina and then try to bring the two together all very briefly.

Now first, as for the Greek exchange—and here I commend the paper by Jeromin and colleagues called the Greek exchange autopsy or some other colorful title like that but definitely had something to do with dead people—Greece restructured a record volume of domestic law debt. Now, this is not the first time we've had a domestic law debt restructuring but most likely the first time when domestic law debt was the predominant concern, arguable exception of Russia but the scale is absolutely incomparable. This is the biggest and most comprehensive restructuring of this sort. And if you were to accept BIS classifications and I have no reason not to, this is the first time we have had a restructuring of developed country domestic debt which is a near $40 trillion category as compared to developing country foreign debt which has been the focus of all the theory and conversation and is about $500 billion to $600 billion, right? That's TR and B, right, trillion billion? So we're playing in a completely different puddle, if you will, and one has to keep asking whether the models developed for one category should really hold for the other.

Now ironically, one notable legal feature of the Greek exchange was of course the move from domestic law to English law debt. The other was the use of domestic legislation to amend the terms of the debt retroactively across the board to enable creditor majorities to buying the minority, legislation that is misleadingly sometimes called or often or always called the retroactive collective action clauses. We can return to that in the Q&A.

Now speaking of collective action clauses, Europe of course is also at the forefront of contract reform and Adam referred to this in his introduction. Even before the Greek exchange beginning in 2010, in fact one of the earliest initiatives in response to the Greek crisis was a move by eurozone officials to harmonize domestic bond documentation, an initiative that is now enshrined in ESM treaty and includes a commitment to issue starting this year debt with standardized and identical collective action clauses, binding dissenting minority bondholders with the vote of the majority. Now, Netherlands I think was the first to go a few days ago. Now, we have Spain and we can expect other countries to go forward.

From my perspective, this is significant not so much because of the introduction of collective action clauses. I'm on record as being fairly skeptical that as it stands, this reform will make a material difference in these countries' capacity to restructure one way or another. They're not bad but they're not transformative in and of themselves.

What is important I think about this initiative is the harmonization of contracts in a giant, taking back to trillions, right, and notoriously heterogeneous category of debt. Most government debt issued in this world is issued under domestic law, under documentation that is anything but standardized and very little read or understood and very often hard to find. So the fact that Europe is moving to standardize this and publish it and sort of having these public discussions about this is important to my mind.

Another important element is the fact that this is treaty-driven reform in the context of a debate about a restructuring mechanism and loss distribution that is very self-consciously political. So if this is a beginning of contract harmonization and greater transparency in a $40 trillion world of domestic law debt, this is a big deal. If this is a sign of greater acceptance of treaty-based debt restructuring reform albeit in Europe which likes its treaties but still this is a big deal, okay?

Editorials suggesting I think correctly in my view that Europe is positioned to lead on statutory bankruptcy, yeah, they're right but the extent to which the rest of the world would be willing to follow I think is a very big question mark. But all in all by sovereign debt standards, the Europe story is actually relatively optimistic and I think it's mostly a reflection of the sorry standards of sovereign debt.

Argentina is a whole other story in every way. In a ruling last February, a federal district court in New York said that Argentina violated a clause in its debt contracts which ostensibly promised equal treatment to the holders of its old defaulted debt and its new exchange debt. And importantly, it also said that the remedy should include enjoining Argentina, prohibiting Argentina from paying its exchange bonds unless it also pays proportionately to the defaulted bondholders, right, to the holdouts.

Now, creditors have claimed, the holdout creditors have claimed, and the district court, Judge Griesa, agreed that entities in active concert or participation with Argentina which includes the Indenture Trustee Bank of New York Mellon, DTCC, Euroclear which is in Belgium, and the exchange bondholders could be in contempt of court if they accept or process payments to the exchange bondholders.

This is important because until this time, sovereign debt has been essentially unenforceable, right? It's pretty easy to get a judgment; it is virtually impossible to get paid. Now, what this does is it creates a business model where most people go into a restructuring because their options otherwise are dismal, but the few remaining if they have the resources and the commitment to stick it out for 10 years could collect an outsize award. If this ruling stands and it survived one round of appellate review in late October and is back for another hearing in late February, sovereign debt becomes enforceable to a point but not by sanctioning the debtor itself which is still practically unreachable but rather by the shear breadth of the collateral damage it could inflict in the financial system, financial infrastructure, as well as what it does for the doctrine of sovereign immunity.

Now, this is not a sky is falling argument, I just want to be clear. This is purely a "I don't know to what extent anybody will or wants to blow up the world." But mechanically, the remedy is you cannot reach Argentina; therefore, you go for everybody else and hope that they make the debtor come to their senses. Okay?

Going forward, the choice then will no longer be whether to take a deep discount or to take a chance and hold out, right, but whether to take the discount plus be a defendant in litigation versus holding out. This does not mean holding out becomes more attractive. I absolutely buy the argument of the investors who say, "Look, the last thing we want to do is stay there for 10 years and hope that somebody is as outrageous as Argentina and a judge as exasperated as Judge Griesa," right?

But at the same time, what happens is participating becomes unattractive, right, and who will sign up to be an indentured trustee if that means a high likelihood of being a defendant in a litigation? And while Argentina is arguably unique by sovereign defaulter standards—and those are some pretty amazing standards—there's absolutely nothing in the opinion that says, "It's Argentina only. These are the five things and everybody else can go free." The court had the option to limit its holding to something uniquely bad that Argentina did, this domestic legislation it passed. It didn't do it. It went much broader.

Now, no wonder then because of the nature of this remedy that you've had briefs from dozens and dozens of market participants on both sides from American Bankers Association amazingly siding with Argentina, New York Clearing House, same thing, retail bondholders siding with the holdouts and the U.S. government, in an interesting procedural move, also intervening both at the district court and … sorry, in the first round of appellate review and then again now.

Now, arguments made to the effect that Argentina's clause is unusual and the growing prevalence of collective action clauses should make the problem go away which we've seen in the financial times among other places are missing the point. The pari-passu, the equal treatment payment formulation that Argentina has, is increasingly common; and just for two absolutely random examples, Cyprus has an identical provision in its English law bonds and Italy has one that's quite a bit more vulnerable than what Argentina had. Again, it doesn't mean that they're about to be sued; I'm just saying.

Collective action clauses, what they do—and again, they're wonderful; so is vitamin C—what they do is they reduce the number of holdouts left but they do not affect the weapon that the holdouts remaining hold in their hands, okay? You can make a bond issue drop out of a restructuring even with aggregation across different bond issues. Now for one example from Jeromin's paper, less than half of Greece's foreign law bonds that contain collective action clauses actually went into the restructuring. I think they tried a vote in 36 and succeeded in 17, right, so you had about €6 billion in holdouts with collective action clauses.

Transition will take time. Some bonds without collective action clauses are decades out, but again, that argument I don't find particularly interesting. And perhaps the sleeper argument is there are instruments other than bonds that do not have collective action clauses and cannot readily be brought in that may be able to avail themselves of this remedy.

Now, the big question of course and this is where we've seen a lot of editorializing and I suspect we'll see more, would statutory bankruptcy help and is Europe the start. To be sure, if a regime like the IMF sovereign restructuring mechanism were there and Argentina moved to restructure all of its debt under its procedures, the likelihood of holdouts would be dramatically lower if close to nil. Whether that is worth the trouble and whether SDRM is the right regime, I think, is something we can productively discuss in the Q&A and for weeks and months and years ahead.

So, thank you.

Adam Posen: Thank you Anna. I'm just saying it's a phrase we don't hear here very much. It's good to have a lawyer. I do want to get to to Mikis and others who want to ask questions or make comments, but let me just quickly circle back, if Jeromin or Bill wants to say something about the Argentina comparison. Yeah? Bill and then Jeromin.

Bill Cline: Yeah, I guess I don't understand, Anna, your view that the CACS don't solve a problem. If I buy a bond that has a Cack, I'd have no standing to complain and hold-out if it meets the threshold and they say that this is now restructured. So unless you can convince me, I think that the CACS do solve the problem.

Brazil is borrowing with CACS, Mexico is borrowing with CACS. I think what it might suggest is that you want to set the CAC threshold at 70% instead of 93% because in the instance of getting the threshold, the hold-out might be more of an issue. But I wonder if you could clarify why you don't think that the Cack basically addresses this.

Anna Gelpern: So, precisely for the reason you mentioned, right? And Greece is a perfect example. And query how low do you want the thresholds to go, and would the optimal threshold depend on whether the Pari-Passu remedy is available? At the moment, partly because of all the liability management, there are a lot of orphan bonds, right? So, small issues trading at a deep discount where it takes a relatively small investment to make the bond drop out.

And I was on a panel a few days ago where a lawyer representing some of the hold-outs in Greece said actually that CACS in that case made it easier to hold-out because it gave them the road map for which issues, how much to buy. So process works for both sides. If it's a predictable process it's a predictable process for hold-outs as well.

I do not think there's anything wrong at all with hold-outs. I think that it is the prerogative of voting creditors to keep their issue out of their restructuring. What I'm concerned about with the remedy is that this remedy targets everybody who goes in. And therefore destabilizes, to my mind, leaves the outcome of the exchange uncertain.

Adam Posen: Okay. Jeromin?

Jeromin Zettelmeyer: So yeah, my main question is again to Anna is I haven't quite understood whether you think the sky is falling or not. Because on the one hand you seem to say the sky is not falling, on the other hand you say this has been drafted in a way that is completely general. So in my simple sort of economist mindset, I am a potential hold-out. I observe this judgment.

So there are four interpretations. First, from the very innocuous in the sense of the dot-debt restructuring regime to the absolutely catastrophic. The innocuous interpretation is, "Look, we always knew that hold-outs would win with some probability, this is just one realization. I don't need to revise my probability as a hold-out that I might win, so my incentives don't change at all," okay? So this is absolutely no precedent whatsoever setting interpretation.

The next interpretation is, "Look, the probability of winning as a hold-out just went up, but it's still a lot below one." That's kind of what you seem to be suggesting with this thing that is slant, unattractive to hold-out.

Third interpretation is the probability of winning went up, and maybe on top of that or alternatively, there is a certain class of debtor for which the probability of winning as a hold-out is now equal to one. So for those nasty debtors they shouldn't even try to hold-out debt-restructuring because it will never succeed.

And then the fourth case is this is such a strong precedent because it's so broadly drafted that after this moment every judge, at least within the New York law perimeter and possibly even outside, is going to just cut that tenure process short. And after two weeks decide that because Greece's arguments are so general, the hold-outs always win.

If it's the last thing, this is indeed the end of sovereign debt restructuring as we know it and we need to pull out the big guns. As I understand it as either with ESDM or some gigantic Cack with aggregation across all debt classes. So where in each of these four categories are we?

Anna Gelpern: I must say I really like the idea of a gigantic—okay. So I'm aware I'll never tell you yes or no, right? So however, I have a really good reason not to tell you yes or no because this case is on appeal. And what happened was the judge issues his remedy; it gets appealed to the Second Circuit.

On October 26th, the Second Circuit says, "We think you got the interpretation of the clause right, but we want you to think about two more things. We want you to think about what exactly does proportional payment mean? Does it mean 1 dollar to 1 dollar? Or 100% owed, meaning an interest payment, to 100% owed, meaning full principal, accelerated, defaulted penalties etcetera, etcetera, right? And number two we'd like you to think about the breadth of the injunction. Does it reach bank intermediaries? Does it reach clearing systems, does it reach exchange bond holders?"

Now, on the Wednesday before Thanksgiving, Judge Rosay did something that did not endear him to anybody—well maybe not—to the plaintiffs, yes. And he issues this ruling that basically says, "The answer is obvious, proportional means they get 100% of what they are owed." Meaning you know a hundred million to 1.3 billion. "And it applies to everybody, including "clearing systems"." Ignoring completely, as far as I could tell, letter from the New Yorker Fed and various other submissions.

The Second Circuit then did something very unusual. It stayed the application of the judges' order and said, "You know what, we're ready to hear from everybody and their cousin. If you have something to say about this, we let you come in as an intervener, as an amicas, as a non-party appellant." And so what we have had is just on January 4th, we had 17 briefs filed from all manner of interested parties.

So that's why I actually don't know how this is going to come out. My prediction is that it will be very hard for the court to go back on the ruling all together, but they could pear it back to the point where it's not much of a change to the status-quo.

Adam Posen: Okay. So now we've seen the benefits of interdisciplinary discussion. And I'm going to open it up to the floor. Mikis Hadjimichael from the IIF has right to first question. We usually have a travelling mic, I don't think we have one, or do we? Yeah? Okay, Mikis could you make yourself known? And then catch my eye if you want to be next in the queue.

Mikis Hadjimichael: Hello, thank you very much Adam. It is indeed my pleasure and honor to have the first round of questioning. The issues covered are so broad it's tempting to jump into all of them. But first let me explain my biases in the interest of full disclosure.

I used to be with the IMF for 28 years, including a reviewer for many European countries. I'm Greek, Greek from Cyprus. I am with the IIF, covering debts, sovereign debt issues. I participated in the negotiations of the PSI as a member of the steering committee of creditors. And I was a member of the joint private sector committee that review the experience with the debt restructuring in Europe.

So I may have obvious biases, but we are also covering many issues related to Pari-Passu in Argentina. So I will make three comments and one question if you allow me.

Adam Posen: If you're going to make three comments, they all better be brief though.

Mikis Hadjimichael: All right. Is the debt buy-back for Greece a success or not? The short answer is it wasn't necessary; it was a waste of scarce resources. Why? The only benefit is because Greece was blackmailed to do that in order to get condition of their review, and in that way it was a success.

But if you're going to do a debt-restructuring, for God's sake don't pre-announce it because you only raise the price and you minimize the benefit. And if you're going to do it, use at least new money rather than diverting existing funding that was meant to repay the banks to minimize the crowding out.

So in the end Greece is losing and it's not getting any benefits in terms of debt restructuring or sustainability because the fixation with the debt ratio of 120% of GDP for 2020 is meaningless. This perception ignores the fact that the debt of Greece is highly concessional in the context of the arguments we use for developing countries.

When you pay 2% interest rate and it doesn't mature until after 10 years, and then for the next 30 or 40 years, it's really a waste of money. You don't get any benefits. What is far more important for the sustainability that is not captured really by models built is the fact that you cannot have any true debt sustainability unless a country really restores market access.

No matter what the debt ratio is, if you don't have market access the country is destined to rely on official financing. Official financing either should be forgiven, or it would not be unwound unless private sector chips in. For the private sector to come in, you need growth. That's a missing analysis and a missing element in the strategy in Europe.

Now, the second broad comment is the OMT. Certainly the Marriot Rickey Put has been effective so far on the expectation something will happen. We are hoping that something will happen on the policy front otherwise it will be found wanting and we will have a market backlash.

The OMT actually depends on two conditions that are not easily fulfilled. First, the country has to ask for a program, and secondly the country must already be having access to the market. But when it's needed, it's for country's that need to have market access, like Greece, like Portugal, in Ireland. Not when they have achieved the objective. So in that sense it's a bit narrow minded.

Now, the argument about the concern about growth in Greece, it misses the fact that because of constraints of political nature, Greece has been forced to implement a degree of fiscal adjustment that is unprecedented. Already the cumulative improvement in the primary balance is 17 percentage points of GDP. It has never happened anywhere else before. The declining GDP is 20% so far and is going to 25, exceeding the decline in the U.S. during the Great Depression. This is not a sustainable strategy, the strategy has to change. It does not mean that the debt has to be forgiven. It can be looked at in different ways, but the emphasis on growth is missing. And Greece is having a far steeper fiscal adjustment than Ireland, and Ireland is declared a success. Now the question.

Adam Posen: Yeah, please, the question.

Mikis Hadjimichael: The question, sorry for the long-winded thing, but you see they are all related. I would appreciate if Jeromin and others could comment on how do we can get out of this mess. What should be the strategy for Europe to have a sustainable resolution of sovereign debt crisis? Is it more growth? Is it more financing? Is it more direct lending by the ESM for bank recapitalization? Because most of these countries have high debt because of their need to recapitalize their banks. Thank you.

Adam Posen: Just before—I've got three names on my list. Yeah, I've seen you, I've nodded at you. I've got three names on my list for after this. I'll ask Jeromin and maybe others to comment quickly.

I'll just say, it is conceivable to listen to everything you just said Micas and say that the answer is forgiveness. I mean there's nothing in what you said that says the answer wouldn't be to simply just write it all off. I'm not saying that is the best thing, I'm just saying that that is one possible path. But let me turn over to the expert.

Jeromin Zettelmeyer: Okay, so I think there are two ways in which Europe can get out of the mess. And they are both not great, unpleasant. So one is restructure. The other one is bite the bullet and go for a protracted period of adjustment. I think that there are then more stupid ways of doing that adjustment that are completely self-defeating and smarter ways of doing the adjustment. The smarter ways do require very flexible interpretation of the ECB's mandate, which I think is happening. And they probably require more efforts on the side of the creditor countries.

Now, it's really not for me to say what they should do, it's a matter of political and social preferences. So my own preference is to go for the restructuring. But I can see that if you structure—I mean let's not forget this is a wealthy area of the world, right? If they want to remain at a high level—we're not talking about the last decade in Latin America with huge amounts of poverty. We're talking about essentially a high living standard not continuing to grow over a long period.

Downside is, of course, the huge social implications. So if Europe can find a way of mitigating the social implications of a projected low-growth period, it might well choose to go without essentially the slow pain rather than the fast and quick pain.

Final small point. What I think is really important is that if we think of strategies for adjustment, we should not structure them in a way that takes the restructuring option off the table irreversibly.

So this is what I like about the essentially subsidy mechanisms from the north to the south that can act on the flow rather than the stock, right? You gradually accumulate debt from the south or you gradually guarantee debt from the south. But all the while there's still a substantial stock of non-guaranteed debt, and if this whole thing goes off track you still have the restructuring option.

What I find uncomfortable about the OMT, is that it's a stock operation. It's wonderful so far because it has not been executed. It just works through expectations. The minute they actually buy the entire Italian debt, we will have lost the restructuring option. So this is just a side remark, thanks.

Adam Posen: Bill, can you be very brief because we do want to get some other questions in.

Bill Cline: Right. If you think the growth rates that I projected, and that the IMF growth rates are hopelessly over optimistic, then you might want to reconsidering restructuring. If you don't, then it seems to me that steady as you go is much better for the welfare of these economies over the longer term. There's a price to be paid if you default. You can make that price a little bit lower if you just stretch out.

You look at the spreads that Chili paid versus even just Mexico, let alone even Argentina, for a decade. Chili never enforced the haricot on anybody. So it's, I think, very seductive but basically misleading and misguided to push restructuring. I don't think there's restructuring without tears.

Also on buy-backs let me simply say that in 1989, Argentina could have repurchased its debt at 17 cents on the dollar. And listened to economists who said, "Oh you don't want to do that, they will push the price up." Well they eventually paid 65 cents on the dollar in the Brady plan. So I think that this was a good deal on the buy-back.

Adam Posen: The gentleman at the back row on the edge there. That's you, yes. Why don't you come to the mic, and then there was a lady about three rows in front of him to the left, yeah, if you could be next in line at the mic. Thank you.

John: Hi, John Dishart with the FT. A question first for Anna. What legal problem do you see with Brosay imposing those terms on the clearing and settlement systems given that all of them, Bank of New York, all the agency banks, New York Fed, all of the people that were covered by the injunction, none of them were sovereign entities, meaning they are covered by New York law. Even the New York Fed is not a sovereign entity, it does not enjoy sovereign unity. And Argentina have even recognized that in the past by doing all of its clearing for a very long time through the BIS which is a sovereign entity which avoided that.

So I don't quite understand the distinction you're making between the clearing and settlement systems and Argentina itself. I mean what's the difference? It's putting the agency bank in the position of a sovereign. And even the Argentines implicitly recognized that when they paid an extra couple of hundred basis points to do all the clearing and through the BIS.

And a question for Mr. Zettelmeyer. In your modeling of the effect of the buy-back, it seems as though no account was taken of the decapitalization of the Greek banking system through the forced—it was a forced exchange offer for them, decapitalize the banking system. A month later they have to turn around and put the same cash back in, having destroyed, in effect, the lending capacity of the Greek banking system and the capacity of that system for growth.

All of the projections for growth that Dr. Klein and other people have put up are based on the availability of credit. It seems like that's a term that's missing in any of the modeling that was done.

Adam Posen: I didn't do my usual movie theatre. Please turn off your cell phones. Please turn off your cell phones. Anna you go first.

Anna Gelpern: Thank you for the question. So the argument for sovereign immunity purely goes to what amounts to commandeering of Argentina's treasury resources, right? There is absolutely no—that has absolutely nothing to do with the fact that a US court has no jurisdiction over what a sovereign government does at home, right? So there is no question that a US court cannot order a seizure of an amount of money or so much as a paperclip in Argentina or at BCRA.

And what the court has done and what these appeals court have said was that nobody is seizing any property. We are just telling them that they cannot make this expenditure without also making this other expenditure. And the question is whether that is consistent with foreign sovereign immunity under either FSIA or customary law, where the presumption is sovereign stuff is immune unless we specifically say it isn't, okay?

And there are some very good arguments. There's some legislative history on injunctions that makes this a somewhat fuzzy area. But that's what the US brief goes to. And frankly if the Supreme Court were to take this, which I think is a low probability, it's issues like that, not New York contract interpretation, that would drive it.

Now, as for the intermediaries, there are two completely distinct arguments. One has to do with a really pointy headed point of payments law, which is that intermediary banks, banks that just shuttle payments in the middle of the chain, are not subject to attachment or injunction.

Because of the way in which this payment chain is structured, there are serious questions about whether Bank of New York Mellon is in fact an intermediary bank. And the way the payment goes is it's just a credit on the BCRA books, the Central Bank of Argentina, to Bank of New York. And then the money belongs to the bond holders. So the question is it's all outside of the US, it's all in Argentina, and can you arrest that transfer? There are compelling arguments both ways.

More importantly there's case law and policies that suggest that financial system infrastructure, be it indentured trustees, clearing houses, someone like the DTC, cannot and should not serve as enforcement mechanisms. And of course Belgium passed a law shielding Euroclear from precisely such action. And Euroclear, which ironically is named in the judges' order even though it's in Belgium, let alone a clearing system and immune under its own law, said, "Hey we can't do it, we won't do it, this is wrong." So there's some interesting arguments there, thanks.

Adam Posen: Jeromin?

Jeromin Zettelmeyer: I mean just to say that basically I take your point. So when one thinks about the net benefits of the buy-back, one has to subtract the fact that some of this may result in high debt recapitalization needs, so the banks, which in turn increases the debt. So I have—the highly preliminary number I have on the present value effect of the buy-back, not taking into account that effect is 8.5% of GDP. So you'll have to subtract something from that. How big that something is I don't know. I think the effect will still be positive, but thanks for the point. I'll look at that.

Adam Posen: He's already in the spirit of taking constructive criticism well. This is very good. Jo Murray?

Jo Murray: Yeah, Joan Murray [inaudible 00:21:20] New Rules for Global Finance. I have to preface it briefly that I used to work for Jubilee USA and debt cancellation.

So I would like to take Anna's point of the sky is not falling or even if it does falling there's a phoenix phenomenon. That is this not finally the time for a comprehensive sovereign debt restructuring mechanism, not located in the IMF, where sovereigns can deal with this problem comprehensively and we don't waste decades of development or decades of lawyerly and economist's time. Can't we be comprehensive and creative finally?

Adam Posen: Okay, big think.

Anna Gelpern: All right. There are three distinct arguments for sovereign bankruptcy. One of them is debt overhang and collective action problems, sort of the efficiency argument, right? And arguably we have had, not withstanding some high profile cases, arguably debt restructuring for the sake of efficiency has proceeded willy-nilly in a way that's not so terrible. And if this case is really contained on appeal, then I think the impetus for a more comprehensive system goes away.

The argument I've made recently that I've belatedly come to is that the real reason for bankruptcy is to address the short fall of legitimacy in the system, which I think Jo Murray was referring to. The fact that this well oiled system is not terribly transparent and not intelligible by its mass of constituents and the people who actually take the distribution effects. The fact that it never does give debtors a fresh start because immunity is a very imperfect analog to discharge. And the fact that the system continues to be fragmented.

And I think that all those arguments stay on the table no matter what happens in this case. But I certainly think that public support for a comprehensive system and policy support could go up dramatically if the broad interpretation and the broad remedy is upheld.

Adam Posen: Bill, you've heard this argument many times. Do you want to say something?

Bill Cline: Well I don't think it's any secret that I think the SDRM is not a particularly great idea. It's inherently gets you into the politics; who in the IMF decides what's fair? I'm just very skeptical. I continue to think that if somebody is going to base a decision on holding out, they have to look at the precedent that is established.

If Creasa holds, is not overturned, the precedent is this. If a country stiff arms its creditors for a decade, totally cuts itself off, then somebody is going to say they ought to get ratable payments, which means that they pay 5% of their total amount they owe, the people who restructured, they have to pay 5% of the total amount that they owe to the guy that didn't restructure it.

As Jereman was sort of suggesting, there's enough cascades of low probability hurdles in that that I do not see this as radically overturning the work-out system that has developed. And I particularly think that with the CACS—you can say okay you don't have aggregations, so somebody can buy something up. Isn't not terrible. Well that also by definition means it's not going to be huge amounts of the debt. So I have a somewhat different view about the ground swell of push for a steer-in.

Adam Posen: I think it's great that we had that discussion. I think, whether a fan or not, I'm not sure there's anybody would see a ground swell at the moment for the SDRM, but I'm glad to have all points of view on this. The lady right there, there's a microphone and then we'll go back. This whole side of the room has been very quiet, so okay that person there, okay, is next. Sorry.

Nancy Jacklin: Hi, Nancy Jacklin. I'm at FICE. Just one quick follow up on the SDRM issue Is that if the problem with this case, or the risk this case presents, is that it makes hold-outs more likely and willing to hold-out, because now they have a path to recovery that didn't previously exist, SDRM does not solve that problem because at least with the IMF approach to SDRM, you still had to have a majority, some majority of the creditors, agree to a deal with the debtor, and then that became binding. It was, as you said, a gigantic Cack.

And the problem with this case is whether you're going to be able to get that majority together if creditors feel the path through the courts is going to be a better way to recover. So the only real solution to the Greece approach is to keep local law as the binding law where the country can basically re-write the debt anyway they want. So I don't see that the SDRM that people are talking about is a solution to this problem.

Adam Posen: Okay thank you. We generally prefer questions to comments, but thank you. Jereman, you had said you disagreed with that point?

Jeromin Zettelmeyer: Yeah. So thank you. I think we were both in the fund when this debate took place. Roughly speaking, I do not think—I mean there is a distinction between being—the reason why this is so devastating is like, and I explained, because hold-outs are being given a new tool that does not consist in direct enforcement vis-à-vis the country, like going to Argentina and grabbing assets. But rather, in being able to interfere with the normal creditor relations with that country.

So I do not think that this will incentivize a situation where everyone has an incentive to be a hold-out unless there is a mainstream creditor there also right? So what would happen is simply—let's take the worst possible interpretation, that as long as creditors are uncoordinated, they would not have any incentive to negotiate right? But everyone would hate that because it would mean the crisis would continue to fester and no one would get paid, right? No one would get paid, because it's not about, "You may now go and collect an asset in Argentina," it's, "You may interfere with creditor relations." But there are no normal creditor relations anyway right? The country is bankrupt, no money is flowing.

So I do think that in this Cresay scenario, there continues to be a very strong incentive for creditors to get together, to coordinate and to make a deal. Then the problem is that they will be worried about the hold-out that will destroy it.

And here is where the SDRM would have come in. So you would have had this process of registering claims, of pointing a representative to negotiate with the debtor country. And once that negotiation is successful it would then have been binding for all hold-outs. So I do think that the version of the ERCM that we did discuss would address this problem.

Adam Posen: Thank you. That was very clear and forthright. I'd like to ask the last two questions to be grouped together so we can try to come in on time. There was a gentleman in the right and center and if you can come to the front. And Ted Truman after him please. If Ted wants to yield his time to somebody else he can, but I assume he doesn't.

Eduardo Borensztein: Hi, Eduardo Borensztein from IDP. I guess this is mainly for Anna. What would happen if the standard debt contract did not include a Pari Passu clause, and I'm not proposing that. I just to know.

Anna Gelpern: If your contract does not—oh, right sorry.

Adam Posen: Yeah, exactly, thank you, thank you Ted.

Ted Truman: So I was going to defer to Nicolas Veron about his colleague, but I won't. Ted Truman from the institute here. So my question is, and it was hinted at I think by maybe Bill or Jeromin answered an earlier question.

So is it one answer—it's a two part question. Is it one issue that if this holds up and in some sense it might kill of issuing debt under US law, right? But not British law presumably, but ultimately isn't it basically saying there isn't going to be any debt issued under anything other than national law? Which some people might think is a good idea.

Then I ask the second question. You may call that fragmentation, but maybe it's constructive fragmentation. Other question is under the European, or the EU or the current collective action clauses, so can Spain change its terms still? Are they standardized? So when you have standardized European stuff, right? Is that now European law and therefore we're in the foreign law world? Or is it Spanish law which means that the Spanish

Parliament can change it? So which category does the European structure stand under your Excellency esquire. And the other lawyer—economist practicing law without a license?

Adam Posen: Okay. I'd suggest that we do this in semi-reverse order. So Anna can deal directly with the legal hypotheticals. Jeromin can deal a bit with how Europe's going to work out, and Bill can have the last word on whether any of this is a good idea or not.

Anna Gelpern: Okay. So on Eduardo's question, if you have no Pari-Passu clause, you have no Pari Passu remedy. So that's that.

Adam Posen: Translate that; two more sentences for the non-lawyers.

Anna Gelpern: So if you have no clause that says, "Your debt will be equal to other people's debt," you cannot then go and invoke that clause to get paid proportionally with the other people, right? So the clause that gives you the right is called the Pari-Passu equal step clause. If you don't have the clause, you don't have the remedy. It's a contractual remedy. Okay.

So I am especially delighted to see Ted Truman and Nancy Jacklin, sort of Treasury and IMF officials, in the same place as Kristina Kirshner, that domestic law is sort of the only place to go. I thought I would try.

But English law firms are, I think, secretly delighted at this because this could never happen in the UK. I think that it's an interesting question if a really important court in the United States says this clause means this. I think it's terribly—well it's not terribly—it's harder for a court elsewhere to say no it means something completely different.

As far as EuroCACS, I'm not an EU lawyer, so I think Jereman is more of a lawyer here than I am. However that wouldn't prevent me from talking about this. The treaty commitment is to adopt these clauses in your contracts. Is it not to use these clauses, it is not to forebear from using other restructuring mechanisms. Now, I know that a lot of folks in Europe say that it really means something a lot more than it says, and I'm willing to trust them because I'm practicing without a license here, but I don't see it.

Finally, if the opinion in New York said, "If you're a country that stiffed its creditors for ten years, you're cooked," I don't think anybody would have a problem with that opinion. The opinion is full of emotion, but its ruling says, "There are any number of reasons why you could be cooked, and we're not really sure, all we know is that Argentina is cooked," right? So and when the Creditors Council was asked, "Well when do you know that a debtor is a wrong debtor?" he said, "You'd know it when you see it." So let's all go buy some rogue debt.

Adam Posen: Uh, okay. Jeromin?

Jeromin Zettelmeyer: So I'm not an EU lawyer. I know even less than Anna. But I think if I can just speculate the flavor I think of the standardization is, well just that. Standardization of—analogous to the standardization of the domestic policy and student. So my interpretation is that you know, everyone is still just issuing under domestic law, just the contracts look the same. But parliaments can still go out there and change the whole thing if they wish. That's my understanding.

Adam Posen: And so final word to Bill on is any of this a good idea?

Bill Cline: Yeah I just keep coming back to the fact that I think if you tally up the amount of debt and put it in a set of countries that are really under stress etcetera, that this is going to be an issue for, it diminishes it quickly. Because it's basically stuff that doesn't have CACS in it. The new standard is CACS. Certainly not any of the European stuff because that's got domestic law.

And I continue to think, because the system works on a precedential process, any lawyer worth his salt is going to stand up and say, "Well the precedent here is ten years of stiffing the creditors." So I think it's somewhat blown out of proportion, but it will probably be set aside because it will probably be reversed and that's maybe where it comes out.

Adam Posen: On that optimistic note. Thank you all for coming out. Thank you to Mikis and everybody with their points of view who are willing to engage in exchange on such a technical issue. But I think we covered a lot of ground. And thank you for joining us for Jeromin's maiden voyage as a public member of the I-Institute's team. We'll look forward to seeing you again soon.