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## **SOVEREIGN INSOLVENCY EXPERIENCES IN LATIN AMERICA**

*The Perfect Storm: Debt and National Trauma*

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## **THE PERFECT STORM: DEBT AND NATIONAL TRAUMA**

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“Perhaps I am doomed to retrace my steps under the illusion that I am exploring, doomed to try and learn what I should simply recognize, learning a mere fraction of what I have forgotten.”

Andre Bretón, Artist, of the Surrealist movement that followed World War I

Catastrophic sovereign debt crisis often provokes deep national trauma which, depending on the context and geopolitical order of the time, may radically affect the course of nations. These are the extreme cases, the perfect storms, not the sovereign debt restructurings that happen with little national fanfare and are backed by a relative political consensus within the citizenry of the debtor country. Latin American Brady debt restructurings, for example, took place after a decade of lost economic opportunities and stagnation when nations were looking for a way out of default. Brady restructurings were also backed by the full diplomatic support of the United States and other nations. Certain other debt restructurings are done in the context of liquidity constraints requiring only modest reprofiling to extend maturities and lower current debt service. Other restructurings happen after the nation's people have already accepted that life as they knew it has changed and that debt restructurings and the correlative economic and policy reforms demanded by lenders are inevitable, perhaps even necessary.

But then there are perfect storms. That is, when crisis hits head-on, and at the same time adamant creditors, driven by diverse and legitimate needs, raise their voices in a chorus that turns to severe and deafening criticism. Diplomacy fails and turns into a war of words, even if not, as used to happen in past centuries, war and invasion itself. In perfect storms, the heightened rhetoric of debt crisis, the economic shock suffered by the debtor nation and the political

instability resulting from the combination of all these factors may provoke a descent into a seemingly bottomless maelstrom that may alter a nation's politics and cultural identity as well as the geo-political order of the time.

Two useful historical examples of sovereign debt crisis that altered the course of nations are Germany after World War I and Argentina's default in 2001. These examples illustrate the pivotal role of national trauma and the long-lasting impact on debtor nations and their citizenry when they are over-run and humiliated in an effort to force them to pay. The complex and volatile ways which a nation's citizenry is affected by catastrophic debt crisis must be taken into account much more than it is at present. I believe that, in the same way we have guidelines of sovereign restructuring applicable to debtors, we should consider guidelines of engagement by creditors. Because the sovereign debt restructuring process involves issues of national identity and self-determination, a debtor nation at its most vulnerable moment, faces the threat of symbolic, if not real destruction and invasion. Bitter and inflammatory campaigns that misconstrue the conditions affecting debtor nations — and a vacuum of diplomatic intervention and of voices representing the sovereign's perspective — worsen the storm for all parties.

#### A. The Predictable Battle

Creditors caught in a sovereign debt crisis often decry the outlandish indulgence or ill management that they claim brought on the crisis. This is even when it is well known that lending, often reckless lending, fed the crisis and cannot be disowned as part of the problem. Moreover, in many cases, policies advanced by other nations, the official sector and multilateral organizations contributed to the problems and created self-serving benefits to lenders as well as to borrowers. When lending risk was well-understood and yet credit was continuously extended,

when policies were advanced in favor of certain ideological economic positions or benefits in trade or in business to other interests and nations, the debtor nation's problems are part of a complex matrix of actions and effects. And yet the discourse on those troubles often turns unidimensionally to blame the nation in trouble as if it were akin to a glutton who gorged on debt and now suffers the punishment for his sin. If there are stereotypes about the nation and its people, those are frequently marshaled forth mercilessly to serve the cause of the nation's "sin". Island nations are deemed lazy, those with distinguished intellectuals are deemed arrogant, others procrastinators, others something else.

Creditors are diverse in nature, often numerous, and vocal in their discontent. They include creditor countries with their own political constituencies to mind, official sector entities with policies to uphold and members to appease, private funds with styles of investment and investors to answer to and bondholders with varying needs and styles of negotiation. They all raise their voices and naturally press for assurances that they will be paid. The International Monetary Fund and other such entities act to demand policy programs that, in their view, assure sustainability. They hold forth economic models as if they were infallible, with little intellectual dissection in the world at large. In the court of world-wide public opinion, the creditors, with their multiplicity of voices, all seek to pressure and negotiate through positions amplified in the financial press and other media. And against this multiplicity of interests and voices, debtor nations often have little chance of raising their voices and proclaiming their needs and claims on the world stage.

The nation's needs are inevitably complicated and the gap between the din coming from outside the nation and the self-perception of its citizenry often diverse. Debtor nations may only successfully restructure if they can avoid political upheaval and balance domestic concerns for

their financial systems and the needs of their people. The creditor chorus, heard in the debtor country, and the policies the countries adapt as a quid pro quo for continued lending may have a destabilizing political significance. Great polarization, derision, and humiliation of the debtor country in broad terms, may add to the dislocation of the country's citizenry, already reeling from crises and chafing at reforms that call for greater sacrifice. When extreme conditions and polarization of perceptions worsen, the nation's people are likely, sooner or later, to react to their own social trauma by embracing political movements that address their needs, their poverty, their hunger, their uncertainty and try to resuscitate their old sense of stability.

Is it any wonder that a nation's citizenry facing hungry children, mass numbers of unemployed, unprotected old, failing financial institutions, lack of access to savings, diminished prospects and the rest of the maladies that attend social collapse, may rebel against any national government that appears to place foreign interests over their own, particularly when they feel defiled by outsiders? Is it surprising that much of this citizenry resents prescriptions and denouncements from other shores when the nation's children may lack food, when their people can no longer trust that each day will follow the next in the woven tapestry of life they have come to expect, when all has fallen apart? Traumatized nations, as traumatized individuals, faced with lost illusions, in pain, face the fear that they will lose themselves, be overtaken and dissolved, even if figuratively – face the equivalent of death for a nation. And so it is not surprising that electorates under these conditions may rise up and demand political policies to take care of the country's people, not creditors, and to restore their lost sense of national pride and sense of fairness.

The tragic irony is that at the same time that societies in crisis may rebel against external directives and abandon political parties that seek to have them accept further austerity in order to

have access to continued lending, creditors may become more emboldened than ever to heighten their rhetoric, lobby to exclude and isolate the nation and demand even greater commitment to economic plans that are untenable within the political environment of the debtor nation. The justification always seems to be that the debtor nations risks falling again into “profligacy” or must be taught it a lesson. As the chasms in perception broaden, the gunboat diplomacy of old takes hold, if only symbolically. Hostilities, if not military then political in nature, are aroused. The debtor nation fears invasion, if only metaphorically, while the creditors seek further to pressure the nation into what they feel is fair to them.

This phenomenon is obvious. And yet history repeats itself because in the context of catastrophic debt default, participants appear unable to temper the provocative descent into destructive rhetoric against debtor nations that may be otherwise avoided in favor of diplomacy in other contexts. Shouldn't this change? The Brady restructurings for example, seemed most successful in part because they involved the dedicated diplomacy and interest of many developed nations.

## B. Two Examples

After losing the First World War, Germany was charged with paying burdensome reparations pursuant to the Treaty of Versailles. When Germany defaulted on reparations in the midst of a worsening global economy, crisis ensued. In January 1923, Franco-Belgian forces occupied the Ruhr, the German center of coal, iron and steel production. The threat of being overtaken, of having resources taken away, of the reality of being invaded, caused huge social trauma within Germany. Many have speculated that the social trauma that betook German society shaped the German national character from there forward. Movements arose that

promised to resuscitate German supremacy. Therein lies the tragic basis of the horrific events that would befall the world as part of the Second War World. But also, therein, lay a German zeal for self-determination noted to this day. These are only theories, but they provide important insights.

In a very different case, many decades later, Argentina's catastrophic debt default, found an electorate choosing ways to self-determination after traumatic default. The criticism of Argentina coming from outside the country's shores — criticism that never admitted any subtlety or progress — was unrelenting practically from the time of the default. For more than a decade hence, after implementing policies centered on self-determination, even after successfully restructuring approximately 92 per cent of its international debt in the form of bonds, Argentina has been vilified continuously and in the worst and most unempathetic terms by many commentators. Inflammatory commentary compares the country to the most heinous and rapacious of nations. Few voices outside the country, beyond a few allies, rise to defend it. My law firm Cleary Gottlieb represents Argentina as well as other sovereigns. Therefore, I cannot comment on this beyond asking whether this is all that we can or should aspire to?

The debt of nations is a deeply volatile thing. It needs careful handling, diplomatic intervention, and here I use "diplomacy" not in the formal sense, but in the general sense of skill in the handling of affairs without arousing deep hostilities. This may be sorely lacking in the midst of crisis. Empathy seems to fail. Resoundingly. Diplomatic engagement with Latin America has flagged from the times of the Brady restructuring. Everyone knows that fanning prejudice risks folly. But the same awareness of peril beyond financial risk, and the danger of financial catastrophe has not informed many sovereign debt crisis.

In sum, when debt crisis is part of an economic collapse that shatters the populace's sense of day-to-day normalcy, the negotiation between debtors and creditors must take account of the political context. A nation's people do not sit at the negotiation table, but they elect those who do and their traumas have lengthy sequelae.

There have been rules of engagement codified for debtor nation. But what of creditors? In a court, a judge curtails excess, enforces rules of order. Should there be rules of order in consultations and in the processes that attend sovereign debt restructuring?

There are perfect storms. We must deal with them. Before that, we must understand the volatile factors at work, we must understand the national trauma that the debtor country undergoes. To make things work, to contain the storm, as a first step, we must, if at all possible at this stage, lower the volume of discourse. How we can do this and whether guidelines would be practicable are questions in their own right. But they deserve to be raised if only to have us think of the prominence and emphasis we give to the various interlocutors, voices and actors in the global sovereign debt restructuring stage.

By ignoring the national trauma associated with catastrophic debt defaults, the world often falls into rhetoric that compares these nations to "deadbeat" individuals. "Why don't they just pay?" is a common refrain. But a nation is not an individual. Among other things, individuals can be protected by bankruptcy laws. Nations cannot be.

With the oversimplified rhetoric comes oversimplified solutions. Civilized society depends on payments of debt. Civilized society also depends on taking into consideration the needs of people and sometimes forgiving debt. If we do not, the people who are the object of

derision and figurative or real invasion will take care of having their voices heard. And their reactions will not always be temperate.

We can start a better process by discarding models that ignore the social needs of a traumatized society. And we can pick interlocutors that respect, not just seek to exploit, the delicate balances of nations.