Economic and Financial Committee (ECOFIN)

Topic 1: Economic sovereignty and debt restructuring balance

Research report by: Sihyeon Bae, Lucrezia Chionsini, Matilda Dod and Carlotta Zunino

Contents

1. Definition of key terms

PIGS: The acronym PIGS (later PIIGS) appeared in the 1980s to designate Portugal, Italy, Greece, and Spain (later Ireland), countries whose debt levels were above the European average and whose budgetary decisions to address this issue were considered dubious by the Union's bodies. This acronym is clearly pejorative, even mocking. Echoing the word "pigs," it highlights the poor economic management of these countries while implicitly stressing that other EU members were forced to provide financial aid under solidarity mechanisms, particularly during the 2008 crisis.

Austerity: A set of economic policies a government imposes to control public sector debt. Governments usually implement austerity measures when this debt is so large that the risk of being unable to make repayments becomes a real possibility.

Bailout: When a government provides money and/or resources to a failing company to help prevent the consequences of its potential downfall, which may include bankruptcy.

Sovereign Debt Restructuring: There is no universally accepted definition, but it can be described as an exchange of debt instruments, such as loans or bonds, for new debt instruments or cash through a legal process. "Sovereign" refers to debt issued or guaranteed by the government of a sovereign state.

Default: When a sovereign state is unable or unwilling to fulfill its financial commitments. When a nation defaults, it means it has not made the necessary loan or bond payments. This has serious economic consequences for the nation, making it expensive or impossible to borrow money in the future.

2. Introduction

Public debt can be vital for development. Governments use it to finance their expenditures, protect and invest in their people, and pave the way to a better future. However, it can also become a heavy burden when public debt grows too much or too quickly. This is what is happening today across the developing world.

The financial system, as it currently operates, isn't adaptable to all countries worldwide because it can be unfair, as the interest rates that must be paid vary by nation. In particular, in the least developed countries, the amount of debt is often lower because their loan applications are frequently rejected (since they are unable to repay the debt), but the interest rates are higher.

3. Background information

Economic sovereignty refers to a state's power over its own economic policies, which can extend to public debt management. When a government attempts to restructure its debt, it is typically engaged in negotiations to reduce unsustainable levels of debt. Among the terms of these negotiations, the balance of power plays a role in determining the outcomes, as the relative bargaining strength between creditor and debtor influences how the burden of adjustment is distributed. If creditors have other options that promise impressive returns, they may be less willing to offer the concessions needed, potentially jeopardizing the restructuring process.

From the government's perspective, technically, they can raise money through taxes or various economic policies. However, the measures used often leave people severely impacted socio-economically.

Domestic versus external debt restructuring also differs in the dynamics at play. While it benefits governments to take advantage of local laws, minimizing reputational risks associated with international markets, the challenges are unique, particularly considering the impact of restructuring on domestic financial institutions holding large government securities. Inadequate management of the restructuring process for domestic debt may lead to capital losses for banks and pension funds, impairing their ability to lend and support future growth. Therefore, striking a balance between the need to retain economic sovereignty and ensure financial stability during the restructuring of debt is essential for sustaining economic recovery.

4. Major countries involved

Greece

High public debt and unsustainable fiscal management brought Greece to the brink of an economic crisis. After the 2008 global financial crisis, the country struggled to pay its debts and lost the support of international markets. By raising interest rates, it made it even more difficult for Greece to obtain loans from other members, deepening its economic problems. Greece received its first international bailout in 2010, when it borrowed 110 billion euros from the European Union and the International Monetary Fund (IMF), on the condition of harsh austerity measures, including spending cuts and tax increases. These measures did not solve the crisis, and in 2012, a second 130 billion euro aid package was necessary. In 2015, Greece was again on the edge of default and received a third bailout package worth 86 billion euros. However, this package only imposed further austerity measures that sent unemployment above 25% and pushed more people into poverty. Even though the economic situation showed some signs of recovery, the social situation remained critical. The impact, including high unemployment and increasing inequality, continued for years and left a deep imprint on Greek society.

Spain

The 2008 financial crisis in Spain was partly caused by the global crisis, but it also had specific internal causes. In the years before the crisis, the country saw rapid growth in the housing market, driven by low interest rates and high borrowing by households and banks. Low interest rates made it easier for people and banks to take on debt, which led to increased demand for property and rising prices. When the housing market collapsed, property prices dropped sharply, and many banks faced large losses, leading to a severe economic crisis. Unemployment increased dramatically, and access to credit became more difficult. In 2012, Spain had to request a European bailout for its banking sector, receiving a loan of 100 billion euros. Despite this, the government had to introduce austerity measures, which worsened the social and economic situation, causing a sharp rise in unemployment and cuts to public spending. The recovery started slowly in 2014, helped by an increase in exports and internal reforms, but the social impacts, such as high unemployment and growing inequality, lasted for a long time.

Portugal

The Portuguese financial crisis of 2010-2014 was one of the most difficult phases of a long period of economic burden that had affected the country since 2001. Starting in 2008, the global crisis aggravated the situation and made it impossible for Portugal to obtain new financing on international markets, even increasing public debt. In 2011, the Portuguese government sought an international bailout program to avoid default. The European Union, the International Monetary Fund (IMF), and the European Central Bank (ECB) provided a bailout of 78 billion euros, on the condition that the country implement austerity measures, including public spending cuts, tax hikes, and structural reforms. This period of austerity had a devastating impact on the population and the economy; unemployment increased, and disposable income fell. However, the program did enable Portugal to achieve the fiscal targets imposed by the euro area under the pressure of the euro crisis. The official exit from the bailout program came in May 2014, marking the start of a slow economic recovery.

Italy

Italy faced the 2008 financial crisis with high public debt and a recession that further worsened its economic situation. Italy was not formally seeking a full bailout but was facing skepticism from financial markets about its ability to manage its debt. In 2011, as the markets and the European Union exerted pressure, Silvio Berlusconi's government fell, and Mario Monti took his place. To reduce the deficit and satisfy the international community, Monti adopted austerity policies, including raising taxes, cutting public spending, and introducing structural reforms. However, these policies strained the economy, leading to increasing unemployment, particularly among youth, and reduced income for many families. Nonetheless, Italy avoided complete economic ruin, aided by the European Central Bank, which introduced various monetary measures to help struggling countries. After December 2013, the economic recovery was slow, and it was not until 2014 that the economy started to show some growth. However, unemployment remained high, and social inequalities deepened. Although the country experienced weaker economic growth for some time, it still managed to avoid the kind of devastating crisis faced by other large eurozone nations.

Venezuela

Venezuela has faced a severe economic crisis due to high levels of debt and ineffective economic management. The crisis led to inflation, shortages of goods, and a sharp decline in the value of the currency. To manage its debt, the country attempted to restructure it without formally declaring default, negotiating with international creditors for payment delays and reductions. However, Venezuela refused intervention by the International Monetary Fund (IMF), fearing it would undermine its economic sovereignty. The government implemented policies such as price and exchange rate controls to contain inflation, but these measures had negative effects, worsening the economic contraction and increasing poverty. The conflict between maintaining economic independence and addressing the crisis led to prolonged economic and social instability.

Argentina

Argentina has faced severe debt crises, with two key moments: the default in 2001 and another significant one during the pandemic. In 2001, due to excessive indebtedness and an economic crisis, Argentina declared the largest default in history, restructuring its debt with significant social sacrifices. Then, in 2020, during the pandemic, the country once again tried to restructure its debt, reaching an agreement with its lenders for a reduction in the debt and a payment delay, also due to inflation and economic difficulties. The debt restructuring raised concerns about Argentina's economic independence, as the government was forced to implement austerity measures, including cuts to public services and tax hikes, to satisfy the demands of its lenders. These measures had significant social impacts, leading to higher unemployment and reduced social benefits, while also restricting the government's ability to pursue its own economic policies for growth.

5. UN involvement

The *Declaration on Principles of International Law concerning Friendly Relations and Co-operation Among States*, in accordance with UN General Assembly Resolution 2625 (XXV) of 24 October 1970, includes the right of every state to choose and develop freely its political, social, economic, and cultural systems. Thus, the right to choose an economic system is an integral element of the sovereign equality of states.
The right to choose an economic system is a vital component of "economic sovereignty"; it is, however, not an independent category in international law—it is one of the aspects of sovereignty. Economic relations, along with political and other relations among states, are governed by the same principles. These include the sovereign equality of states, non-intervention, and the self-determination of peoples.

One of the fundamental documents on international economic relations, the *Charter of Economic Rights and Duties of States*, adopted by the UN General Assembly Resolution 3281 (XXIX) on 12 December 1974, states:

Every state has the sovereign and inalienable right to choose its economic system, as well as its political, social, and cultural systems, in accordance with the will of its people, without outside interference, coercion, or threat in any form whatsoever.

There have been several debates on debt restructuring. However, the absence of clear rules and an established sovereign debt restructuring framework makes solving the issue very complex and often results in lengthy debt renegotiations, after which debtor countries have not always succeeded in bringing themselves to debt sustainability, thus initiating a default state.

6. Useful links

- Our Common Agenda - Policy Brief 6: Reforms to the International ...
- SUSTAINABLE DEVELOPMENT REPORT2023

7. Bibliography

- http://ppuam.amu.edu.pl/uploads/PPUAM%20vol.%2012/09_Tyranowski.pdf
- http://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf
- https://www.un.org/en/desa/sovereign-debt-restructuring
- https://en.wikipedia.org/wiki/2007%E2%80%932008_financial_crisis
- https://www.investopedia.com/terms/p/piigs.asp
- https://www.financialpipeline.com/how-hyperinflation-took-hold-in-argentina-and-venezuela/
- ://unctad.org/publication/whttpsorld-of-debt
- https://www.elibrary.imf.org/view/book/9781498382656/ch019.xml
- https://icrier.org/pdf/OP02SovDebt.pdf
- https://academic.oup.com/jiel/article/20/1/115/3059560
- https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf
- https://www.brookings.edu/articles/restructuring-domestic-sovereign-debt-fiscal-savings-and-financial-stability