



## Sovereign Debt: Crises and Restructuring



Anne Krueger

In the past several years, the world has watched in surprise and dismay at the difficulties in the euro area. Although Iceland (not a member of the Eurozone) had experienced problems earlier, attention began to focus on the euro area's problems when Ireland encountered major difficulties. But it was the eruption of the Greek situation and recognition of its severity that led to most consternation. By early 2011, Portugal was joining Greece and Ireland as euro-area countries confronting major economic difficulties. They requested and received external support from Eurozone countries, the ECB, and the International Monetary Fund (IMF). Spain and Italy were soon seen as potential crisis candidates, and that worry has persisted. Meanwhile, Cyprus has requested support from the IMF in an amount greater relative to its size than that accorded in the largest IMF support packages prior to the problems of the Eurozone.

Many characteristics of the difficulties faced by the GIPSIs (Greece, Italy, Portugal, Spain, and Ireland) had confronted other countries in earlier years. One need think back no further than the "Asian crises" of 1997-98, or the Turkish, Argentine, and Uruguayan crises around the turn of the 21st century, to rec-

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ognize some major similarities. And those crises followed on many more in earlier decades, including especially the "debt crisis" of the 1980s, which involved many emerging markets, especially in Latin America.

But other features of the situation were quite different, and they accounted for much of the initial surprise and focus on the euro area. First and foremost, the afflicted euro area countries were not regarded as emerging markets. Earlier, it had been thought that financial crises were something to which emerging markets, but not advanced industrial countries, were prone. The IMF had not provided support, nor entered into a program with any industrial country since the 1970s. It was thought that they had become immune from crises. While low-income countries have also encountered difficulties, it was (largely correctly) thought that those problems were different, involving as they did almost entirely only official credits.

Secondly, until shortly before recognition of Greece's difficulties, markets and analysts had regarded the countries of the euro area as if they were virtually one for financial purposes. Spreads on Greek government bonds were little more than those on Germany's, despite recognition of the much stronger economic and financial position

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of Germany. Implicitly, it was thought either that the stronger economies of Europe would stand behind the weaker ones or that even the weaker ones would always take the necessary actions to maintain their standing within the euro area by adjusting their domestic economic policies.

Thirdly, until the GIPSIs encountered difficulties, there had been a relatively standard formula – about which I will say more later – with which the international community, largely under the aegis of the IMF, addressed the problems raised by crises in emerging markets. There were three, and sometimes four, parts. For the country in difficulty, that formula entailed, first, an adjustment of the domestic policies that were deemed to have contributed to the crisis AND second, an adjustment of the exchange rate. The third part then consisted of financial support for the country from the international community (usually under the leadership of the IMF) as the country undertook policy reforms. On some occasions, a fourth part had focused on a partial or total restructuring of the country's debt, sovereign and sometimes total.

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But membership in the euro area effectively precluded exchange rate adjustment and a loss of control over monetary policy. Hence, a large component of the adjustment package that had been used in earlier crisis situations was not comparably available to the GIPSIs. Controversy over virtually all aspects of the euro area difficulties has been unabated since its onset. Issues have included the degree of austerity imposed on the GIPSIs, what euro wide ECB monetary policies should have been and should be, whether sovereign debt of euro area governments could be and/or should be restructured, how banking issues (including capital flight) should be handled, and many more.

To a degree, these controversies arise because the world is in uncharted territory and we simply do not have enough understanding of, and data concerning, the issues to reach definitive conclusions. But a considerable amount of the controversy appears to arise because of failure of public understanding,

at least as it is reflected in the popular AND financial presses, of the issues. It is some of these issues that I will address here. There are, it seems to me, two serious failures of understanding which cloud the discussions of sovereign debt and policy options for the euro area, the ECB, the IMF, and the GIPSIs.

The first is the failure to comprehend the necessity for macroeconomic adjustment as a crucial part of any policy package designed to enable a country to return to a stable macroeconomic and growth path and restore creditworthiness. The second is the insufficient recognition of the implications of debt unsustainability for future growth and financial stability for the country or countries in question.

The two issues are interrelated. It is necessary to understand the macroeconomic issues first. Thereafter I turn attention to issues of debt sustainability or unsustainability. I will conclude with some considerations regarding the adequacy and optimality of the international economic architecture for minimizing the losses associated with measures to address financial crises and their consequences.

Before starting, I should note that there are many sorts of sovereign obligations. Sovereigns may borrow from foreign (or domestic) banks; they may issue bonds to foreigners or domestic residents in foreign currency; and they may issue bonds in domestic currency, usually to domestic residents (although if the currency is convertible this distinction does not matter). For my purposes, I shall simply speak of debt, except where a distinction is needed among different kinds of instruments.

## **The Need for Macroeconomic Adjustment**

A country can be at risk of a financial crisis for any number of reasons. There may have been a sustained period of overly expansionary monetary and fiscal policy. That would have been reflected in current account and/or fiscal deficits and resulting accumulating sovereign debt obligations. There may

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have been a significant change in the country's external environment, such as a sharp drop in the price of a major export (oil?), to which insufficient adjustment in public and private investment and savings was made, with a consequent buildup of inflationary pressures (with an inadequate exchange rate adjustment so that the real exchange rate is overvalued), current account deficits, and rising costs of borrowing from abroad. Private banks may have been far too lax in extending credit with a buildup of nonperforming loans threatening the banking system. Economic dislocation may have resulted from armed conflict, or from natural disaster.

The factors leading to financial difficulties can be any one of these (or others) but they have in common that macroeconomic adjustment is needed, and that the status quo ante can persist only with accumulating private and public debt and rising inflation rates. For the sake of exposition, let me assume that a country is experiencing one of these macroeconomic pressures which, if not corrected, could lead to crisis (which I shall define later). Let me further assume that, for political reasons, policy makers are failing to take measures to correct the situation. In that circumstance, sustained expansionary pressures will be anticipated, and people in the country and in the rest of the world will want to shift out of assets in that country and to hold foreign assets whose expected return is higher. Meanwhile, it is usually the case that the nominal exchange rate does not adjust sufficiently to maintain the real exchange rate, so that the current account deficit will rise. And, despite current account deficits and fiscal deficits, the country's borrowing requirements are rising, perhaps after a period when foreign exchange reserves are run down. These financing needs can generally be met, if at all, only at higher and higher spreads. Moreover, existing obligations must be rolled over, which can happen only at higher cost.

As time passes, the debt/GDP ratio (and debt/export) ratio rises, debt servicing costs increase because of the larger volume of out-

standing obligations and because of rising interest rates on outstanding and new debt. At some point if earlier policy adjustments have not been made, creditors become unwilling to roll over obligations as they become due, and the authorities must either default or take corrective measures.

It will not, generally, be the case that the country can persist in its expansionary policies until such time as it can no longer do so; once economic agents recognize the high likelihood of future overly expansionary measures, their actions will bring on the crisis as they sell domestic assets (capital flight), and get out of domestic currency and into foreign currency (thereby reducing banks' equity). While this will not happen all at once, increasing capital outflows (which may lead the authorities to permit some increase in interest rates), a reduced outlook for exports and efforts to bring imports forward, and foreign sales of domestic assets (or even reduced reluctance to acquire and hold additional domestic debt) will bring on an unsustainable situation even when the underlying fundamentals may be such that prompt action could still reverse the situation.

To provide a concrete illustration, Japan's sovereign debt is over 220 percent of GDP, the fiscal deficit is over 6 percent of GDP, and the economy has been subject to deflationary pressure. Yet, to date this has not brought any significant increase in pressures on the Japanese authorities. Interest rates are close to zero, yet the debt is almost entirely domestically held. The reason is that, to date, observers and analysts seem to believe that the Japanese government will change course before things get totally out of hand. Of course, should the outlook for government behavior change drastically, the situation could change markedly, but at least until now, expectations that sovereign debt obligations will continue to be honored have prevailed.

By contrast, some countries that have undergone expansionary macroeconomic policies and inflation for sustained periods without

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policy alterations, have been confronted with sharply rising interest rates when they attempt to roll over or sell new debt, as the likelihood that those policies will be corrected appears to diminish.

The time during which spreads are rising and the situation is deteriorating depends on a number of factors, including the severity of the correction apparently needed in the country and of course the likelihood that such a correction will be undertaken. That, in turn, implies that the initial situation in one crisis-threatened country may be very different from that in another. An example of this was the contrast between Brazil and Argentina in the 1970s, 80s, and early 90s. Brazil historically had not defaulted on its debts nor imposed capital controls to contain capital outflows, while Argentina had. In consequence, in roughly similar circumstances, significant capital flight in Argentina was a major issue for the authorities, while there was little capital flight in Brazil.

Likewise, countries can take corrective action in time, which may avert crises if the action is perceived to be sufficient and sustainable. Latvia, for example, was confronted with an unsustainable situation in 2007-8; the country, however, opted for an “internal devaluation”, under which civil servants’ wages were sharply decreased, government spending was drastically reduced, and other measures were taken. The Lats, however, had tied their currency to the euro, and were determined to maintain the exchange rate; these policies worked to prevent a crisis which otherwise would have occurred.

But regardless of the precise situation at the time when spreads are rising and capital outflows are beginning to mount, the lesson is clear: policies that address the underlying reasons for the macroeconomic imbalance are imperative if viability is to be restored. If the authorities delay action sufficiently, economic activity diminishes, and ultimately political pressures force action.

The point of all this is that, as long as holders of a country’s obligations are not confident

that these obligations can and will be honored, difficulties intensify. And confidence will not improve unless measures are taken to correct the underlying macroeconomic imbalances that are resulting in the deteriorating situation. Hence, macroeconomic adjustments are a necessary component of restoring a sustainable path of economic activity.

One of the chief complaints regarding the measures undertaken in some of the Eurozone countries has been that there is “too much” austerity. While judgment is clearly called for in determining the policies and time path needed, there must be sufficient austerity (i.e. a reduction in government expenditures and/or increase in revenues and tightening of monetary policy) to provide promise that the imbalances will be brought under control.

It should also be noted that, in the absence of any external support, needed austerity would usually be significantly greater and more immediate. For example, in Greece’s case, the estimated prospective budget deficit at the time reforms began was in excess of 15 percent of GDP, while interest service on the debt was less than 5 percent of GDP. By the time reforms were undertaken, Greece was unable to access international capital markets. Without foreign resources, it is evident that EVEN IF Greece had defaulted on all existing obligations, either government expenditures would have had to be cut by around 10 percent of GDP (tax revenues cannot be raised instantaneously), or the inflation rate would have risen sharply. Either way, the resulting “austerity” would have been far greater than that called for under the program supported by the troika of the IMF, the ECB, and the EU.

When a country reaches a crisis situation, foreign financing enables a less painful adjustment; when there is a depreciation of the currency, it takes time for exports and imports to respond, and foreign financing can buy that time. Likewise, increased revenues and/or reduced government expenditures take time, as do asset sales (as in

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privatizations).

In most crisis situations, therefore, countries' leaders have turned to the IMF for financial support for an "IMF program" that spells out the policy corrections that will be undertaken to address the underlying imbalances and the financing that will be provided. Without the policy changes, the prospects would be for increasing imbalances; without the financial support, the resulting deflationary impact of policy adjustments would be considerably greater.

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One other aspect of adjustment should be noted. That has to do with exchange rate adjustment. Few countries (except the very large ones) adopt an entirely freely floating exchange rate regime. In many countries with macroeconomic imbalances, currencies are either "managed floats" or fixed relative to another currency (such as Latvia was to the euro). In periods of imbalance, the policy temptation is often to intervene in the foreign exchange market to suppress part or all of pressures to depreciate the currency in order to avoid some of the inflationary pressures in the domestic economy.

In countries where the exchange rate has not been allowed to adjust to a realistic level in real terms, an exchange rate adjustment is a needed and desirable part of the adjustment package in order to restore incentives for exporting and correct imbalances in the current account. Such an adjustment can offset a significant part of the pressure for austerity that would otherwise result from fiscal and monetary tightening. An exchange rate change may not be a part of the policy package because the authorities choose to maintain the nominal rate or because, as in the euro area, exchange rate change is not an option. When that is the case, the needed monetary and fiscal correction for a given imbalance will necessarily be larger.

### **The Role of Debt**

Debt can play a role in the buildup to crisis, and in crisis resolution, in several ways. Sometimes, borrowing has been undertaken

mostly in the private sector (in response to very easy monetary policy), but proves uneconomic and the banks end up with balance sheets that must be shored up by government support (which, in turn is financed by issuance of government debt). Sometimes sovereigns must buy up bad debt held by the banks and finance it by borrowing.

There are many metrics by which the viability and sustainability of debt can be judged, and all play a role. They include whether debt is public or private, whether it is denominated in domestic or foreign currency, whether it is held by domestic residents or foreigners, and the average maturity and structure of the debt.

To simplify discussion here, I shall assume that we are considering sovereign debt, that the debt is denominated in foreign currency, and that spreads are rising sharply in the secondary bond market while new issues (for rollover and to finance current deficits) can be floated only at prohibitive rates as the crisis unfolds.

A key concept, and one that is often ignored or misunderstood in public discussions, is that of debt sustainability. By debt sustainability is meant whether the sovereign will be able and willing to service debt obligations in the future if and when economic activity should return to normal. To understand the issue, it is useful to start by recognizing that, if the sovereign's interest obligations were more than 100 percent of GDP and the sovereign had no assets, debt would clearly be unsustainable. Even 100 per cent tax rates would fail to result in sufficient revenue even to service existing debt (quite aside from the question as to whether any revenue could be collected with such confiscatory rates). And, of course, no one would lend to the sovereign in these circumstances.

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To be sure, it is extremely improbable that a country could reach such a situation (except perhaps at the end of a war or natural disaster). Well before that point was reached, potential creditors would recognize the increasing likelihood of debt-servicing dif-

difficulties and if no changes were made in underlying policies, creditors would first require higher spreads and then refuse entirely to hold or roll over the sovereign's debt.

To think in terms of sustainability, it is useful to define a sovereign's "primary surplus" as the difference between all sources of revenue (which we shall call taxes) and non-interest expenditures. Of course, the sovereign can change the prospective primary surplus by cutting expenditures and perhaps raising tax rates or reforming aspects of taxation. But there are limits to the amount by which this can be done.

But once the prospective primary surplus is known, it defines the amount going forward that the sovereign will have available for debt servicing obligations. If, for example, a country's primary surplus next year will be minus 4 percent of GDP, the country would have to borrow to cover the primary deficit AND interest obligations on existing debt.

To get at the notion of sustainability, suppose the country has interest obligations of 9 percent of GDP, and must borrow 4 percent because of its primary deficit. It must then borrow 13 percent of GDP. If its growth rate is 6 percent, its debt to GDP ratio will grow by 7 percentage points.

Obviously, the debt/GDP ratio cannot rise indefinitely. If the country's future prospects will not permit a reduction in the primary deficit and there is no reduction in the interest rate on the debt (as there surely would not be in these circumstances), the debt/GDP ratio will rise indefinitely and debt is clearly unsustainable.

I have picked extreme numbers, of course. In Greece's case, the average interest rate on outstanding debt was around 5 percent, debt/GDP is now well over 100 percent (after restructuring over a year ago), and growth is not expected to be above 2 percent in the near future. Hence, if the primary deficit did not change over time to a primary surplus and/or the rate of growth did not accelerate significantly, the debt would have

to be restructured (so that payments of interest were lower).

In fact, in the Greek case, all of these are part of the policy package agreed by the Greeks with the troika. Debt was restructured; government tax and expenditure policies are to be altered and the primary deficit has already been considerably reduced; the interest rate is lower; and measures are to be taken to permit a faster rate of growth (by changing a large number of microeconomic policies that have diminished the potential growth rate of the economy).

More generally, a country whose debt trajectory does not appear sustainable will not be able to roll over or service its outstanding obligations, as private creditors would refuse to roll over debt or buy new obligations. The appearance of sustainability is crucially important, and there is a widely varying range in which countries' macroeconomic policies would, if continued, result in unsustainability, and yet where potential creditors believe that policy corrections will be made. As already mentioned, the country's past record of honoring its obligations is important. But if the debt/GDP ratio continues rising and insufficient policy action is taken to reassure creditors that debt servicing obligations will be met, creditors will demand ever higher spreads and accept increasingly short maturities on any sovereign obligations they purchase.

For my purposes, though, the main point I wish to stress is that policies undertaken to restore a country's creditworthiness in international markets will be doomed to failure if it is judged that inadequate corrective policies (including prospects of reaching sustainable debt levels) will be undertaken (or that corrective policies undertaken are likely to be reversed because of political backlash or for other reasons). When that is the case, return to a sustainable macroeconomic and growth trajectory requires addressing the issue of debt overhang, in addition to the macroeconomic and exchange rate policies, and financial support from the international community, discussed earlier. This can be

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done in three ways: by a partial write down of the face value of debt obligations; by a re-phasing of the timing of obligations which, in effect reduces their net present value; or by a reduction in the interest rate attaching to obligations. Evidently, a combination of the three could also be used. Until that is done, a sovereign cannot hope to access the private international capital market for roll-overs or financing of new obligations.

### The International Economic Architecture and Sovereign Debt

At present, the official international community does not formally interfere in restructuring of sovereign debt to private creditors, leaving that to be agreed between the debtor and creditors. The official community does, however, enter into the equation through the International Monetary Fund. The IMF does not lend unless there is a strong prospect that the country's altered monetary, fiscal, exchange rate, and other policies will enable the country to regain access to the private international financial market within a reasonable period of time, normally three years or so. The anticipated evolution of the economy must assure a return to debt sustainability. And, as already seen, without some funding when policies are adjusted, the feasibility of a country meeting its short-term obligations is severely impaired.

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But without policy reforms, the outlook for growth, the current account trajectory, and fiscal imbalances is negative. In that event, the IMF cannot devise a program which gives promise of a return to sustainability: the factor leading to the crisis would, if not corrected, simply lead to further imbalances. Hence, pressure can arise on debtors and creditors alike to reach an agreement on restructuring, in one or a combination of the ways described above. The creditors can find it in their interest as otherwise default might render their holdings valueless. Without restructuring and policy reform, the situation may deteriorate further, and the write down of existing obligations could be even greater. When the domestic economic situation becomes sufficiently dire, policy

makers finally recognize the infeasibility of maintaining debt service and decide to enter into negotiations.

Some restructurings have been delayed for long periods, during which countries' economies languished with output growing slowly, if at all, and debt burdens rising. Delay has come about for a variety of reasons. Political leaders may be overly optimistic that good fortune (an increase in the price of one or more export commodities, accelerated growth or the like) may improve the outlook sufficiently. They may (and often do) refuse to recognize the reality of the existing situation. Denial in the face of impending crisis is frequent. And difficulties and uncertainties surrounding the likely structure and course of restructuring negotiations may deter initiating proceedings. There are also other potential issues, such as the likelihood of holdout creditors, and how that will affect restructuring prospects.

For some or all of these reasons, restructuring may be delayed long past the point where outside observers have concluded it is inevitable. Recently, that was the case with Greek restructuring early in 2011. In many other cases, refusal to recognize the need for restructuring has delayed action for some time.

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This is significant because, once restructuring becomes a virtual inevitability, economic activity is dampened, and recession generally sets in or intensifies during the period before a realistic policy package including restructuring, monetary and fiscal adjustments, exchange rate changes, and external financing is agreed.

For Greece, output was falling for more than a year before the underlying issues began to be addressed. In Argentina in 2001, it can be argued that restructuring was virtually inevitable well before the beginning of the year, but almost two years were wasted, with the economy in steep recession, before adequate adjustment measures were taken. In the 1980s, a number of countries, especially in Latin America, experienced a "lost

decade" from 1982 or 1983 until the implementation of the Brady Plan under which debt was restructured.

Recommendations have been made to address the issue. When a private institution within a country is facing prospective insolvency, bankruptcy legislation governs the ways in which to proceed. These can be used to prevent creditors from running for the exits, and, when desirable, preserving the institution as a going concern (if the value of the enterprise as a going concern is greater than the sum of the value of the parts). Internationally, there has been no corresponding set of procedures.

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To be sure, sovereigns are sovereign so the assets cannot be sold off. In that regard, sovereign indebtedness differs from domestic indebtedness, but it bears similarities in that creditors can try to get rid of their holdings, and create the international equivalent of a bank run.

This has been recognized for some time. It has further been seen that the international financial architecture has not had a mechanism for reducing the economic losses associated with sovereign indebtedness when there is unsustainable debt. If a country experiences short-term difficulties (due, perhaps to crop failure or a cyclical drop in its export prices), an IMF package can be devised without any debt restructuring, or at most some rephrasing of outstanding debt. And, in these cases, creditors are normally willing to roll over debt.

But when debt unsustainability is at issue, the situation changes. The problem must be addressed before the crisis can begin to be resolved. In the 1990s, the G-10 recognized that the losses were unnecessarily large, and in 1996 recommended that collective action clauses (CACs) be placed in sovereign bond contracts issued in foreign currency. CACs in bond contracts commit the creditor to consent to a restructuring if a critical threshold of holders of the issue vote to accept the sovereign's restructuring offer.

*CACs may well address part of the problems, especially the holdout problem.*

When the G-10 proposed CACs to address the restructuring problem, the international community did not act. But in the early 2000s, in the wake of the Asian crises, Russia, and Turkey, the issue arose again. At that time the IMF put forward a proposal for a sovereign debt restructuring mechanism (SDRM), which would be entered into by treaty, and under which sovereign debt difficulties might be resolved.

The proposal was debated for a year and a half, but at that time it failed to receive sufficient support to go forward. In its stead, CACs were endorsed and began being placed in bond contracts. CACs may well address part of the problems that have arisen when sovereign debt is truly unsustainable, as they mitigate the holdout problem, by requiring all holders of each individual bond issue to agree to a restructuring if more than 75 percent (usually) of the holders vote to do so. They may even require all bond holders across issues to accept the sovereign's offer if a higher threshold of all bond holders vote for acceptance (usually 85 percent).

The U.S. administration's argument against the SDRM was that "the private market can resolve the issue". One could, of course, make the same claim about insolvent firms: the market would somehow resolve the issue even without an insolvency law. But almost everyone would agree that an appropriate insolvency regime reduces the economic costs of firms' failures to creditors and debtors alike. A strong case can be made that an international insolvency regime, along the lines proposed in the SDRM discussion, could reduce costs of crises in the context of unsustainability, and hence increase world welfare.

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To date, CACs have hardly been tested. Older issues do not have CAC clauses within them (although they have been required for bonds issued under UK law for some time). And, there are potential difficulties if holders of one or more issues were to vote against the restructuring. (This might happen, for example, if a vulture fund were to buy up

more than 25 the percent of a particular issue in the secondary market). There are also other concerns about CACs: what would happen to a sovereign's debt to banks? How long would the voting mechanisms take and would that delay restructurings? It is too early to tell how real these concerns are.

There is also the matter of treatment of holdout creditors. Yesterday, the New York court under whose jurisdiction many bonds have been issued held a hearing on an appeal by Argentina against a ruling under which sovereign creditors who have restructured their debt may not service new debt unless they service holdout debt in the same proportion (which would mean payment of principal and accrued interest in many cases). If that ruling holds, the incentive for holding out would be greatly increased.

When the SDRM was proposed, it was intended to address the holdout problem, as well as to facilitate timely debt restructuring and hence reduce the economic costs of delay. It received support from many countries, but it would have required more than 85 per cent of the share in the IMF in order for it to take effect. After the SDRM proposal had been discussed (and altered in several ways to reduce some concerns about it), the United States made it known that it would vote against it if it came before the Executive Board. Since the U.S. held more than 15 per cent of the shares in the Fund, the proposal was withdrawn by Fund management.

*A European SDRM might set an example for the global community to follow.*

The euro area crises, and the high level of indebtedness of the peripheral countries, have once again led to concerns about unsustainable sovereign debt. Bruegel, the EU think-tank, proposed a European sovereign debt restructuring mechanism early on in the crisis and a resolution mechanism is in process of development. While a European mechanism and experience might set an example for the global community to follow, experience with it will be some time in the future. In the meantime, the treatment of creditors

outside the eurozone would continue to be an issue.

In the meantime, it can be argued that the international financial architecture still needs a strengthened mechanism for addressing issues of unsustainable sovereign debt. The complacency that existed about the immunity of industrial countries from sovereign debt crises has certainly been shaken, if not destroyed, by the Eurozone experience. But while the crisis has once again focused attention on the issue, there seems to be little global movement to date to lead to a consensus on strengthening the architecture. Of course, one can hope that CACs and adoption of reasonably prudent macroeconomic policies will do the job, and that no further action will be needed. But if past experience is any guide, future crises entailing sovereign debt will happen, with greater losses in welfare than are necessary.

## Conclusion

When countries encounter financial crises, it is because they have failed earlier to adjust policies to correct the underlying imbalances. In those instances, resolution of the crisis normally entails both adjustment of macroeconomic policies and financial support in the short term while the policy measures take hold. For countries where sovereign indebtedness has increased to the point of unsustainability, restructuring the sovereign's obligations to enable a return to voluntary debt servicing is also an essential part of the package. While judgment must be used in assessing how much adjustment must be undertaken how rapidly, it should not be forgotten that in the absence of financial support from the international financial community, the reduction in economic activity that would be required would be considerably greater. From the vantage point of the global economy, macroeconomic policy adjustment, financial support, and debt restructuring should be seen as part and parcel of the remedy.