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MICHAEL LIVERMORE: Hi. This is Mike Livermore, and with me today is Mitu Gulati and Lee Buchheit, both world class experts on sovereign debt. Lee spent several decades at the law firm Cleary Gottlieb, where he was a major figure in the legal wrangling in the wake of many different foreign debt crises. *The Guardian* newspaper once referred to Lee as, quote, "a fairy godmother to finance ministers in distress."

Mitu is a colleague here at UVA Law. We're very lucky to have him. He writes on a wide range of topics, including sovereign debt restructuring. He also co-hosts the podcast *Clauses and Controversies,* which is a lot of fun, and listeners should definitely check that out if they're interested in the conversation that we have today.

But just to get us started, I thought we might begin with how you got your start-- how you guys both got your start in sovereign debt practice. So Lee, what drew you to that area as something that you wanted to devote your career to?

LEE BUCHHEIT: Well-- thanks Mike, I appreciate the invitation to be on with you folks. It was, as so much else in life, pure serendipity. I had been posted to my firm's London office in the late '70s and early 80s, and this was the end of the syndicated loan boom. So the great boom that followed the oil shocks in the mid 1970s.

And I got back to Washington just-- Washington was my home office just a couple of months before Mexico declared a moratorium on payment of its external debt. And I got a phone call from a colleague in New York. And he said, son, you've been doing these syndicated loans, you must know how to restructure them. And I said, oh, sure, sure.

Little did we know that the circumstances afflicting Mexico afflicted 24, 27 other countries, and all of them would be driven into a full-scale debt restructuring within the matter of a couple of years. But working then on Mexico, which was very much the flagship restructure in the 1980s, many of the countries that followed Mexico called my firm, and we had the privilege of helping them.

But I realized, almost from the moment it started, that this was for me because the legal elements in it at that time was very, very small. No one had done this since the 1930s. And so the legal component was probably 25% politics, both domestic and international were 50%, and the remaining 25 was pure theater. And my weak spot has always been the law, so I figured this was perfect for me. And I just decided to make it my life's work, and have done it for 40 years.

MICHAEL LIVERMORE: Yeah, that's fascinating. It is interesting how those early serendipitous experiences end up just shaping our life paths.

LEE BUCHHEIT: Yeah.

MICHAEL LIVERMORE: How about you Mitu? How did you get interested in this general area of law as an object of scholarly inquiry?

MITU GULATI: Oh, I think by mistake. I was a junior associate, like I think you were, a long time ago at this firm, Cleary Gottlieb, where Lee was one of the superstars. And I didn't know anything about sovereign debt. It turns out this is actually stuff that my father used to work on, but I didn't even know what he did. But I wanted to do foreign travel. The whole point of going to one of these fancy Wall Street firms, I thought, was I want to travel business class someday.

And I had heard Lee Buchheit, he's the ticket to go business class to exotic locations. So I tried. There was a long line. I mean, he was the star, so everybody wanted to work with him. But the barrier to entry other people did not realize as quickly-- maybe because I have a devious mind-- was flowers and chocolates to his assistant. And then you could jump the queue. And then Lee got stuck. I think she told him, there's only one person who wants to work with you. And that was me.

MICHAEL LIVERMORE: Very smart. Very smart. How long did you guys work together at the firm?

MITU GULATI: Oh, not that long. I think our research collaboration-- we became friends, and Lee quickly realized that I was sort of an incompetent lawyer. And he's the one who sent me away. If I remember correctly, a judge called Lee and said, I need a law clerk. One of my law clerks has gotten pregnant. Or there was something that got it started. And Lee told me, he said, you're not very good at this job. Maybe you should try something else.

LEE BUCHHEIT: I never said that. I never said that.

MITU GULATI: Yeah, I think it was. He encouraged me to try other avenues in life.

MICHAEL LIVERMORE: Think about this academic thing, maybe that'll work out for you.

MITU GULATI: Yes. Yes. But then, a couple of years later, he had this client, Ecuador, and had an idea for a transaction that we had talked about. But it seemed legally dubious at the start, so he said, maybe this is something that you and your students can think about. And we started thinking about it. And as we thought about it in class, we ended up thinking, this could actually work. And so Lee and I wrote an article about that transaction. He implemented it. And we've written at least one article every year since then, and that was probably 25 years ago.

MICHAEL LIVERMORE: Yeah. Yeah. That's really wonderful. Maybe just for an audience that's unfamiliar with the world of sovereign debt, we could just start with some basics to kind of situate ourselves. So one question that I think naturally arises-- we're in the US, and we know that the US government borrows a lot of money, and that there's a substantial amount of debt. But just as a basic question, why does the US Treasury borrow money? There's other ways of getting money. We can tax. We can-- the US is actually in a position to print money. So what's the what's the advantage of debt versus these other ways of putting little green pieces of paper into the Federal Treasury?

LEE BUCHHEIT: Well, the answer is politics. Part of it is politics. The only honorable way, as a politician sees it, that you can get money is borrowing it. The alternatives are politically unpalatable. They are taxing, which no one seems to want to do, or cut expenditures, which no one seems to want to do. So if you're a government and you spend more than you take in, that's called a budget deficit. The only way to cover the budget deficit is to tax more, spend less-- both of those are politically unpalatable-- or you can borrow.

And borrowing has-- borrowing is in one sense an intergenerational sin. Some poor devil some time in the future is going to have to restrict their standard of living in order to service that obligation. But from a politician's standpoint, the principal virtue of that poor devil is he or she hasn't been born yet, and they certainly can't vote.

Now you ask the other question, which is why not just print this stuff? After all, we do have the printing press. And there is a theory, very popular in certain corners now, called Modern Monetary Theory, which is just that. Let's just print all we need. The answer the answer to that is that fiat currencies-- that is, currencies like the US dollar that are backed by nothing other than an assumption on the part of everyone who holds them that they will be able to use them to buy a pound of butter, or to pay your taxes, or whatever it is. The value that the currency will have is to some degree linked to its scarcity.

And if you simply printed endless amounts of money, you'd find yourself looking more like Weimar than you want to. And so it is, principally, inflation, that is the worry with simply opening up the printing presses. Plus the fact no one believes that if the US Congress thought that it could spend all the money it wanted just by hitting a button on a printing press-- my heavens, Bernie Sanders would think that he had died and gone to nirvana.

MICHAEL LIVERMORE: So it's a constraint on spending basically, that's--

LEE BUCHHEIT: Yeah.

MICHAEL LIVERMORE: And I assume that the position in the United States is different from other countries. I mean, I think the new monetary folks and others would argue that the US is in a special position. One could presumably argue about that. But presumably, just printing money isn't even in the cards for a place like Mexico, or Bolivia, or other jurisdictions. So what are the special factors that would make that option especially-- and the taxation option, obviously, can be very difficult when you have a substantially reduced tax base. So what are the factors that affect these kinds of decisions for developing countries especially?

LEE BUCHHEIT: The United States, along with a couple of other countries, like Japan, has the inestimable benefit of being able to borrow in its own currency. So at one level-- putting inflation aside, at one level, no creditor of the United States of America need worry that the US will not have the money to pay them back.

MICHAEL LIVERMORE: Right. Because it's dollar-- just to reiterate, because it's a dollar denominated thing, so the US government can get its hands on dollars as much as it wants.

LEE BUCHHEIT: Exactly. No Mexican finance minister can say that. And therefore, when you lend to a Mexico, you're taking a risk that when the time comes to repay, the country will not be able to raise, either by exporting goods and earning dollars, or borrowing dollars, the money to repay you.

We also have the enormous benefit of being the world's only reserve currency. And what that means is that you've got almost a captive audience of central banks and others out there who need to buy your obligations. So we enjoy huge advantages. And Mike, we take full advantage of it.

MICHAEL LIVERMORE: Right. Yeah, I think people don't realize-- many folks in the US don't realize how advantageous the United States government is in these markets. And then, we all are beneficiaries of that situation. It's really incredible. So who owns this? So I can buy Treasury bills, and presumably that's how some foreign debt is held, but I doubt that's the lion's share. So who's on the other side of the transaction? We know that there are the borrowers, the States-- and who's on the other side? Who's buying this debt?

LEE BUCHHEIT: Well, today the principal buyer is the Federal Reserve and the US Social Security Administration. What has happened since the financial crisis of 2008 is that in order to stimulate the economy, the world's large central banks-- like the Fed, and the European Central Bank, and the Bank of England-- have been pursuing a policy called quantitative easing.

What it means in practical terms is that they buy the debt of their own government. That creates demand, that reduces the interest rate that the government would have to pay on that debt. And that reduction in the interest rate ripples through to all borrowers, public and private, and encourages people to borrow money, build new factories, and so forth.

So right now, an enormous buyer of US debt is the United States. You might think that is incestuous, but it's the reality. Other central banks buy a lot of it. The Chinese hold more than a trillion dollars of it. And then you've got investors, sovereign wealth funds, et cetera, that need to invest their money in something that they regard as a safe store of value. So.

MICHAEL LIVERMORE: Now, this is US-- this is US debt, which is considered safe for various reasons. And what about the kinds of debt that you've often found yourself working on in places like Mexico? Who are the typical parties that own that kind of debt, of countries that are not as well fiscally positioned as the United States?

LEE BUCHHEIT: Well, for an emerging market country, there are likely to be three categories of creditors. They'll be the multilateral institutions-- the Bretton Woods institutions that were set up at the end of the Second World War. The IMF, International Monetary Fund. The World Bank. The regional development banks, Asian Development Bank, African Development Bank, et cetera. Then you have what we call bilateral creditors. These are government to government loans.

And then commercial creditors. They can be a wide variety. They can range from commercial banks to institutional investors. The Aetna insurance company, the Fidelity mutual fund, sovereign wealth funds, the Singapore sovereign wealth fund. To so-called hedge funds, private investment vehicles that buy sovereign debt. And within that category, you have a subgroup that specialize in what they euphemistically call distressed sovereign assets.

MICHAEL LIVERMORE: So you've worked in a lot of instances where sovereigns have gotten themselves into trouble one way or the other-- where, essentially, they can't pay their debt back. So how does this happen? Is it just-- like, I know if I ever find myself where I can't pay my debt back, that might be because I made bad decisions, it could be because of an external shock that was unexpected. What are the kinds of situations that result in sovereigns unable to meet their commitments?

LEE BUCHHEIT: I would say there are three types. The most forgiving are circumstances where the country is hit by an external shock. So the hurricane, the tidal wave in Indonesia, the earthquake. Or a pandemic that causes severe disruption to the world's economy and makes it impossible for the country to export its commodities. There's no culpability with those things. And so they're frankly easier to deal with.

In most cases, the cause of the country's problems will be chronic fiscal mismanagement. A country that, for the reasons we just described, the local politicians find it easier to borrow than to trim the public sector payroll, or limit pensions, or tax. And so the debt relentlessly accumulates.

And at some point, you see, these countries are completely dependent upon the willingness of new investors to lend them the hard currency needed to repay what they already owe. And if those investors get skittish, they will, in the first instance, increase the interest rate that they want to charge for those loans. But in the final instance, will cease lending altogether.

This is Greece in the spring of 2010. 300 billion euros all in the form of bonds, and no one wanted to buy Greek debt anymore. So what do you do? But a final cause is sometimes just a buildup of debt stocks at a time when it is easy to do it. This afflicts commodity exporters in particular.

So oil goes to $100 a barrel, and you're an oil exporter. Well, a lot of people will lend you money. And it isn't too hard for a finance minister to persuade himself or herself that if everyone wants to lend me money, I'll take it. And then oil goes back to $40 a barrel. And then you've got an unsustainably large debt stock.

MICHAEL LIVERMORE: Right. Got it. So you have these different causes, and presumably they can be mixed up with each other as well, so that you could have some mismanagement, and then an external shock, or some unpredictability in commodity prices, and things come to a head. And it becomes clear that the country is in trouble.

And presumably, they call Lee Buchheit or someone in a similar position, and they say, what do we do? Like, we're literally don't have enough money coming in. If we try to raise taxes more, we're worried that it's going to depress the economy and tamp down on growth. What are our options? And so what are some of the answers that are-- just in broad strokes, what are some of the answers to that question?

LEE BUCHHEIT: Well, history says that countries facing those situations tend to delay announcing the need for a debt restructuring as long as they can. History says that politicians demonstrate a pathological procrastination. Why? Because debt restructurings are disagreeable always. And if you can put it off to the next administration, that looks awfully good.

If you can't, normally-- not invariably, but normally, the country would go to the International Monetary Fund and say, we need assistance in the form of a stabilization program. The fund will send a team of economists down. And the first thing the team of economists will do is say, well, you've got these weaknesses in your economic policies, and we want you to fix them as a condition to the program. And that can often be politically uncomfortable because the weaknesses are the very things that the politicians did not want to do on their own, like raise taxes or collect taxes.

And then the country-- and the IMF will usually say, if your debt is unsustainable-- not usually. It will always say, if your debt is unsustainable, as they reckon sustainability, they will tell you that you need to do some form of debt restructuring. So you need to go to some or all of your creditors and ask for some form of debt relief. And that then launches you into a discussion with your bilateral creditors, your government creditors, and your commercial creditors.

MICHAEL LIVERMORE: And so these conversations get started, and presumably, what the issuer here, the country says is, look, we can't pay back our debt on the current terms. What can you do for us? And it just-- presumably, everyone's in a position where, if it's broadly recognized that this is the case, that a restriction is going to be necessary, the lenders want to get as much out of their existing debt as they can and the borrowers want to pay as little as possible. So how do they possibly come to an agreement in these circumstances?

LEE BUCHHEIT: Usually with great difficulty. The IMF will conduct something called a debt sustainability analysis. That's a forward-looking projection which really says, based on certain assumptions about the economy of the country, how much can the country reasonably afford to pay in external debt service?

And by reasonably I mean-- every country, I guess, is theoretically capable of servicing its external debts if it took extraordinary measures. I remember one creditor telling me, we simply don't understand why you don't sell Patagonia to the Chileans. I remember another one saying, you know, you could get a wonderful price for the Acropolis. These are measures that are obviously politically impossible.

MICHAEL LIVERMORE: Just off the table. Yeah.

LEE BUCHHEIT: Yeah. And then, yes, you can ratchet down austerity on the economy, but it is, in the first instance, an enormous political problem. And it is in the final instance, a moral problem. Do you let your citizens go without food, education, and medicine in order to pay hedge funds in Greenwich, Connecticut? That's how it's viewed.

So the IMF makes that basic judgment, how much you can afford to pay. And then, typically, the country will cling to that and say to its creditors, look, this is the quantum of debt relief we need. And the discussion then becomes, who provides it? The commercial creditors will want the bilateral creditors to do it. The bilateral creditors will want the commercial creditors. The bondholders will want the bank loans. The banks will want the bondholders. Et cetera, et cetera. And so that is the negotiation process that the country is launched on.

MICHAEL LIVERMORE: And it's really interesting in the kind of examples that you're giving of how obviously and deeply normative the question of how much can a country pay is. And I think that can get lost in some of these debates. It's not just a kind of a technical question about what the capacity is, there's just these kind of moral limits. And of course, obviously, if you do too much austerity and you stop feeding your population, that's going to be good for long-term economic growth. So there's some of those issues in there.

But as we're thinking about the normative implications of these broadly sovereign debt issues, you've worked with a lot of countries in these situations, and I recall at various points over the last several decades general broader public conversations about debt, especially for the least developed countries, and the role that debt has in potentially impeding economic growth and development.

Do you have views on that? Is the current structure of global debt a serious impediment to development? Are there things that we should be thinking about very broadly to change the system, or are we in an equilibrium that is maybe not desirable on every dimension, but a reasonable accommodation of different interests?

LEE BUCHHEIT: Well, I think the first thing, Mike, to realize is not all debt is bad, not all debt is good. Borrowing money to build a bridge, build the road, build a factory that encourages economic growth, that is benign. The problem usually arises when the country is borrowing the money simply to cover chronic budget deficits. The politicians just don't want to tax because tax and you don't get re-elected.

For a while, the borrowing cushions disagreeable consequences for the citizenry. They're not aware of it, usually, because no politician stands up and says, friends, I'm not going to raise your taxes this year because JP Morgan is prepared to lend us the money. But for a while, they're the beneficiaries. But that quickly runs out at the time that the country can no longer borrow to refinance, repay what it's already incurred.

Then cometh the IMF, and the IMF will say you've got to raise taxes, cut the subsidies on cooking oil, reduce your public sector workforce, cut public sector pensions. And all of a sudden, the average citizen on the street says, oh my gosh, this debt crisis is having direct and immediate consequences. And by the way, this is a common thing. They don't remember because they never appreciated that the incurring of the debt saved them from some of these disagreeable things.

They will also say a lot of the debt was simply squandered. It went to corruption, it went to build a statue of the dictator or whatever. So we never saw any benefit, but we're the poor devils that have to pay for it now that the IMF is here. And we have to reform our economy to make us presentable once again in the market, so that we can return to this idea of borrowing money to repay what you already owe.

MICHAEL LIVERMORE: Yeah. So it's no-- it's no fun all around. Mitu, was wondering if you had thoughts on this. I know it's a big question, but just the general relationship between high debt loads and development, is it a red herring or is it a really serious issue?

MITU GULATI: Oh, I think this is a giant Ponzi scheme that we are in right now, especially given the much higher levels of borrowing that we have seen across the globe during the COVID crisis. And I would have thought that we would have given some consideration to the fact that debt levels are increasing, growth rates in many parts of the world are decreasing. In some parts of the world, where the economies are completely dependent on tourism, they're down to near zero, and that this will come crashing down.

But we aren't. We're pretending that the easy money being generated by the Federal Reserve and the European Central Bank and the low interest rates that the developed world has faced, that's just going to keep going on, and on, and on. I don't know.

I think that Lee, who thinks he might have been able to retire, is not going to be able to stop working anytime soon because-- I mean, these countries are already crashing. And the debt restructurings, they're not on the horizon, they're coming tomorrow. Day after tomorrow. So I just think this is-- unfortunately we've had a little bit of respite, but disaster is right here. It's not on the horizon.

LEE BUCHHEIT: Mike, let me give you the most poignant example of this in my career. I was called in to help a country some years ago, not by the government authorities. I was asked to come down by the United Nations Development Program, the UNDP. And you might say, why? Answer, it turned out the country was spending 60%-- six zero percent of all the revenue the government collected in servicing its external debt.

What that meant was that every other use of government resources-- health, education, military, police-- the government was unable to provide them. And the UNDP, which had a very large office there, was, frankly, picking up the slack. So the UNDP said, help them restructure their debt so that more of the revenue can be deployed by the government in these normal governmental functions, and take the burden off of us. And there are a lot of countries that are paying 40, 50, even as much as 60% of government revenues in debt service.

MICHAEL LIVERMORE: Yeah. That's really staggering. I do want to turn to this really interesting deal that the two of you are working on that has some very interesting possible environmental angles to it. But before that, I just have to ask, in light of what Mitu was just saying is-- and that sounds like if countries start to go into a cascading global crisis where they can't pay back their debt-- and presumably that has ramifications for the financial sector more generally.

Is that the kind of thing that could initiate a very serious financial-- a global financial crisis? Or is it the kind of thing that's sufficiently cordoned off? Or the amount of money we're talking about isn't so massive that it might cause very real suffering and problems for the affected countries, but it wouldn't broadly propagate through the whole financial system.

MITU GULATI: This is the really-- I mean, this is the really big question. There's a conflict in the international financial community that maybe Lee will talk about it-- about whether or not we're on the brink of just another Great Depression type-era, or that we have figured out how to solve it by just pumping money into the system.

MICHAEL LIVERMORE: It doesn't seem like you can do that forever.

MITU GULATI: Yeah. Two years ago, people were very worried. The IMF, and the World Bank, and the other international financial institutions put in place a couple of mechanisms-- neither one of which has worked. The only thing that has worked is the easy money that sort of inadvertently worked. So, you know, it's-- the solutions haven't worked, and the easy money is now going to stop because I think the Fed and the ECB are worried about inflation.

MICHAEL LIVERMORE: Sure.

LEE BUCHHEIT: Yeah. What we fear is a contagious debt crisis. That is a circumstance in which multiple countries would be unable to refinance their maturing debt at more or less the same time. Classic example was the 1980s, when you had more than two dozen countries. We saw it a little bit in 1997 with the East Asian crisis, when you had Thailand, and South Korea, and Indonesia. But that's, I think, what worries people.

For so long as the debt crises are in individual countries or a handful of countries, I think the system can absorb it. But if the circumstance were to spread, it would have a profound effect on the world economy, as the Latin American debt crisis of the 1980s did. It nearly brought down the banking systems in the developed world.

MICHAEL LIVERMORE: And so is this kind of on the order of magnitude of the 2008 truly massive financial crisis and Great Recession, or is it worse than that? Is it maybe not that severe, or we just don't know?

LEE BUCHHEIT: We don't know, but the difference is that this would have severe political ramifications because you would have countries slipping in-- in many cases, back into poverty. And it can be geopolitically very disruptive.

MITU GULATI: I mean, we have to remember that many of the countries that are in trouble in the sense that they have huge debt loads, and potentially won't be able to keep borrowing to repay the interest on those huge debt loads, are still not out of the pandemic. In the West, it's so tempting for us to think that-- especially in our little bubbles at universities, to think that this is all over, we're back to normal, when much of the world is not out of it.

They don't have high quality vaccines. And now they go into severe debt crisis. And the debt loads are just so much bigger than they've ever been before. I am a pessimist. Maybe you become a pessimist because you work on debt restructuring, so back of your mind, you pray for more debt restructurings. But this is not one I'm praying for.

MICHAEL LIVERMORE: Yeah. So this is all troubling. Kind of terrifying. And to maybe move us from one terrifying, troubling crisis to another one, you guys are working on-- kind of how this came to my attention was a deal that combines some of the issues that we've been talking around about debt refinancing with climate change. And thinking broadly about how to get the necessary resources that are needed globally to mitigate, adapt to climate change, and generally to address environmental problems around the world.

So you both worked together on a transaction to restructure debt in Belize that had an interesting environmental component to it. So maybe we could just talk a little bit in terms of-- it might be something of a bright spot, thinking a little bit about how that restructuring worked, and is it the kind of thing that could be expanded to other contexts. So what was the broad outline of how that restructuring worked?

MITU GULATI: I should clarify that Lee and I wrote an article about, sort of-- it depends on what Lee says. Maybe the precursor to thinking about this. But Lee worked on the actual Belize deal and I did not. And then I wrote about it. So all credit and especially all blame goes to Lee. But I do think it is very exciting in the sense of if we do have a series of debt restructurings maybe, just maybe, we can use that template to get some assistance for the environment as well. But Lee, I'll help you explain how you mucked things up.

LEE BUCHHEIT: OK. Well, Belize. Belize, a country in Central America, facing the Caribbean. Badly affected by the pandemic crisis. 40% to 50% of Belize's GDP is directly or indirectly tied to tourism, and of course, the tourists stopped coming. So it was a devastating blow. The country had only one bond in the international markets that had been placed back in 2007. It had always been troublesome. The country is regularly hit by hurricanes, and droughts, and things that make it difficult for it to service its external debt. And we had restructured that bond three times in the last 13 years.

Along came the Nature Conservancy, a non-governmental organization. And they said, look, we have a program in which we, the Nature Conservancy, will borrow money from the bond market and on-lend it to you, Belize, to allow Belize to make an offer to repurchase that troublesome bond at a deep discount.

In return, Belize, which already had a pretty aggressive environmental conservation program, agreed that it would accelerate that program and have it monitored by the Nature Conservancy. Those sorts of funds allowed Belize to make an offer to its bondholders to repurchase the bonds. There was a long negotiation, as you can imagine. In the end, the price was just above $0.50 on the dollar.

But at the end, the [INAUDIBLE] asked for what the discount was, five points or so. And Belize said, we can't afford to pay more than this, but we'll tell you what we'll do. We will take a portion of the savings that this transaction produces for Belize and we will prefund something called an endowment account that is managed by the Nature Conservancy.

And the annual earnings on that endowment account will be used in perpetuity to fund environmental conservation projects in Belize, particularly in the marine area. Belize has the second largest barrier reef in the world, and it is a place of enormous environmental diversity and sensitivity. And so protecting it is good for Belize, but it is good for the planet.

And this was an effort to appeal to the public statements by many institutional bondholders that they are sensitive to what they call environmental, social, governance issues, and that they're looking for opportunities to demonstrate their support for that. Well, this was a tangible way in which they could do it. And so it was a technique used to bridge the final step in the negotiation. But it will result in a significant amount of money being used in perpetuity for environmental conservation.

MITU GULATI: So one thing that is, to me, very cool about it, but also raises the question of whether it can be reproduced elsewhere, is the amount. Lee didn't explicitly say this, but it's in many of the press accounts, such as Tommy Stubbington's piece in the *Financial Times* where investors said to him that they basically gave Belize another $0.05 on the dollar. Now, to someone who doesn't work in this area this might not seem a lot. Belize needs a lot of relief, what's $0.05 on the dollar?

But if you were following the literature on ESG and the "greeniums," it's tiny. So to the extent any greenium, meaning the extra price benefit you get for being green and environmentally kosher, it is tiny. It's like a few basis points. $0.05 on the dollar is hundreds of times more than what normally we think people are willing to give for environmental protection. So either this was just a fluke or Lee can do this magic again. But there is this disjunction between the reality of what investors are willing to give and the reality of what they were willing to give in Belize.

MICHAEL LIVERMORE: Yeah, that's really interesting. Let me just see if I-- just to reiterate the structure here, just to see if I actually understand what's going on. So Belize has creditors in the form of a bond. The Nature Conservancy goes into markets and borrows money that it will presumably have to repay. Well, maybe that's just step one. Nature Conservancy will have to repay the money that it borrows. Is that correct?

LEE BUCHHEIT: Yeah. Yes.

MICHAEL LIVERMORE: OK, so Nature Conservancy borrows the money. Nature Conservancy lends the money to Belize, which, then it goes out to the bondholders and says, look, we can't pay back all of our debt, but we're willing to buy back these bonds at a discount. And this is what Mitu was talking about, what's the question of how much of a discount.

And there's two factors that are going to affect how much of a discount. One is just Belize's financial situation, as what we were talking about before, like how much can Belize actually afford to pay. And then there's this question of maybe Belize can get a little bit extra in terms of its deal because it is going to kind of have this arrangement with the Nature Conservancy.

And the environmental effects here are two-fold, it sounds like. So one is in the terms of the debt agreement between the Nature Conservancy-- or the original agreement between the Nature Conservancy and Belize, where Nature Conservancy lends money to Belize for this transaction. There's some agreement to engage in environmental conservation. And then in addition, there's this the creation of this endowment that is being funded by the discount that Belize is getting on the debt repurchase. Is that-- in broad outlines, did I repeat back to you what you said correctly, or have I missed something?

LEE BUCHHEIT: Yeah. Only minor tuning on the last bit of it. The quid pro quo for the Nature Conservancy lending this money to Belize was Belize accelerating its Environmental Protection Program and allowing the Nature Conservancy to monitor it and all the rest of it. So those were promises that Belize made to the Nature Conservancy.

MICHAEL LIVERMORE: Mm-hmm. Got it. And the endowment was a second thing that happened.

LEE BUCHHEIT: Was a promise that Belize made to its bondholders that said, we'll take a portion-- not all, but a portion. But a portion that represented 1.3% of 2020 GDP. We'll take a portion of the savings, and we will prefund this account that the Nature Conservancy is going to manage. And it will be used in perpetuity for environmental conservation. So that was a promise to the bondholders.

And in return for that-- or the request was that, treat this-- if you want to put it in these terms-- as a kind of sweetener, in effect. We're down to the last negotiation for how much the discount is. We think we can afford to pay only this much. You would like more, we appreciate that. But if you accede to our proposal, we'll put this into the deal, allowing you all to tell your shareholders, your investors, your regulators, and the general public that you are acquitting your environmental, social, governance promises and objectives.

MICHAEL LIVERMORE: Great. Yeah, it sounds like, on its face, to be a really wonderful thing, right? So that Belize gets the much needed debt relief that it's after, the bondholders get paid back, at a discount. They take a-- as they say in the business, they take a haircut.

But part of that haircut comes with the ability to look spiffy, so to speak, and go out to the world and say that they're fulfilling their environmental commitments. And that's good from a PR perspective. And the Nature Conservancy obviously is kind of engaged in this transaction to protect the environment, and the environment gets-- there's a broad environmental benefit.

So it sounds-- I mean, of course, I'm a skeptical law professor, so I wonder if it sounds too good to be true. So maybe that's just one quick question. Is it too good to be true? Is there something hiding here that, if not-- the reasons to be skeptical, that actually this story is as win-win-win as it first appears.

LEE BUCHHEIT: Well, the missing thing that we haven't talked about is the loan that the Nature Conservancy is extending to Belize represents more than just Belize risk. There's a US government agency, the Development Finance Corporation, which is issuing what they style a political risk insurance policy, which says that if ever Belize fails to pay, this US government agency will indemnify the Nature Conservancy, and ultimately, the bondholders who are buying the instrument that is the origin of all of these funds.

They will ensure that if ever they have to get an arbitral award against Belize, that they'll indemnify the bondholders for that. So that was an important-- a crucial element in this. Belize, even with retiring its bonds at a 50% discount, still would not, on its own, have had the credit standing to sell a bond directly or indirectly at a tolerable interest rate.

MICHAEL LIVERMORE: And this kind of backstop insurance, essentially, by the US government, was that made possible because of the environmental characteristics of this deal? Or is that the kind of thing that shows up in the background of these restructurings more generally?

LEE BUCHHEIT: No, it doesn't. It's very rare. I think the US government is doing this, in part, in support of its own professed environmental climate-related program. The things that you heard the president speak about in Glasgow this week.

MICHAEL LIVERMORE: Sure. That's really interesting. And it's funny how-- and again, this is the world of policy-making. There's the stuff that happens on the surface that we all see, that is big and splashy, and then there's the very behind the scenes underwriting or insuring a transaction that is very obscure to the general public, but can really have important policy consequences.

LEE BUCHHEIT: Yes, indeed.

MITU GULATI: Well, I was thinking that's, in some ways, such a key part of our prospects for doing these kinds of transactions in the future. Lee probably can't talk about countries that are on the brink of defaulting tomorrow, but you have countries like Sri Lanka, that I love dearly, and that have lots of coral reefs, but a huge debt stock. And if you had the international organizations and countries like the US and also the European Union, if they're willing to say, look, we have something at stake here, if they engage in environmental protection, then there is a global good that we get a benefit out of.

They could really enable these debt restructurings to happen in a beneficial way in which we've never seen it happen before. I mean, the way in which these debt restructurings have always happened in the past is what Lee described at the beginning, which is the IMF makes this sustainability determination, and then the country has to do a lot of austerity and beat themselves on the chest and over the head about how terrible they've been, and then they have to behave well.

Now we're thinking about it as a global problem. It's not the fault of individual countries or individual dictators, it's just-- look, we had COVID crisis, that was a global problem. We have environmental crisis. And we need to fix these with official international help. But I don't know. Maybe I'm too optimistic in the middle of being very pessimistic.

MICHAEL LIVERMORE: Well, it's a good-- you need something to leaven the pessimism to get out of bed in the morning. So, I mean, if we think broadly about this, is there-- I mean, I care about the environment. Obviously I teach in this area and I write a lot about environmental issues. But I do wonder if there's anything special about the environment here.

Is it possible that lenders could facilitate-- or the US government, for that matter, facilitate transaction where similar types of endowments-- that actually sounds like a particularly interesting feature of this deal-- were set up for things like infrastructure development, or health care, or backstopping the government pensions. Or various components of a country's fiscal management or spending that, broadly speaking, people recognize are good ways for countries to be spending their money in areas where they under-invest in. Is there a theoretical difference between those kinds of programs and the environment? Or is it just that the political stars align better on the environmental expenditures?

LEE BUCHHEIT: I think the latter. You could certainly use the technique to finance a variety of projects that, one way or another, would be motivated by societal good. The environment, and particularly the climate issue, is a planetary problem. It will require a planetary solution. And therefore-- remember what we're talking about, particularly with commercial investors. You're asking them to forego receipt of money that they're legally entitled to. There's no doubt about that.

And they will tell you, look, we have a fiduciary duty to the people who invest in our fund-- our shareholders, our investors-- some of whom are the fire department pension fund. How do we justify to them leaving money on the table? Sure, it may do some good in your country, but if we give the money back to our investors, they'll do some good in their country.

So how do we-- the fact that climate and environment is so much in the forefront right now of being a planetary problem allows, I think, these financial intermediaries to justify to their own investors that this is something that's not-- we're not just benefiting the Republic of [INAUDIBLE], the borrower, we're benefiting all of us.

And that shared sacrifice, I think, is easier for them to justify to their own constituents. And that's why I think, at the moment-- and the political winds may shift. I think to try to redirect these resources toward environmental conservation is easier.

MICHAEL LIVERMORE: Yeah. Mitu too mentioned the "greenium," which I take to be a combination of green premium, and I think what I take to be the greenium in this instance was $0.05 on the dollar, or 5%, which does, to me, sound like an awful lot. To be honest, I've always been somewhat skeptical of the ESG conversation. I think there's a lot of optimism about private companies engaging in these broadly socially beneficial programs.

And I guess the root of some of my skepticism is just that that's just not what these companies are set up to do. They're set up to make money for their shareholders, and that's where their-- they have legal obligations. And most of the folks I know who work in the sector have felt ethical obligations to maximize shareholder value. So it's always been-- it's been a little unclear to me how much of this is just PR and how much of this is real.

So $0.05 on the dollar sounds like it sounds like a lot. Does that seem like the kind of thing that we could expect in future transactions? Or, again, is it a consequence of a particular political moment? Or maybe the-- I don't know who the bondholders were in this instance, if it was held broadly by lots of different parties or if it was concentrated in a few actors, that might make it a little easier to arrive in a negotiation.

MITU GULATI: Mike, can I-- Lee, before you answer, let me add to Mike's question, because I'm a little puzzled and intrigued by what you got in relief. So one point, I think it's what is important to realize here is that it's not just that they got $0.05 more, at least according to some of the press accounts, but they got something like 35% more of the votes.

So, Belize needed the votes of the creditors. It needed 75% of the votes of the creditors to engineer this exchange. They only had about 50% who had agreed. And then there was this slew of articles in the financial press, who usually never report about little Belize getting into yet another default, but they had all these articles that praise the deal and talked about how cool it was. And would have these beautiful pictures of scuba diving in the coral reefs.

And then they got another 35% of the votes in a matter of days. And I'm used to these sovereign debt restructurings taking years, years to get an agreement. And they got this in days. So Lee, this is both amazing and also reason to think, OK, how many countries are going to have such pretty coral reefs?

And all the hedge fund people I know, they like to go on vacation, scuba diving. So they sort of imagine themselves scuba diving by the pretty coral reef and saying, I saved this coral reef. But if you were talking about Lebanon's debt restructuring, I don't think hedge fund guys are going to Lebanon for vacation.

LEE BUCHHEIT: Guys, let me rain a little bit on this parade. I don't think it's possible in the Belize transaction to quantify exactly how much this was worth. And I don't think you can say it was worth $0.05. Inevitably in a negotiation you come down to the final bit. There'll be a difference between the bid and the asked.

In this case, because we were talking about a discount level. One side says, I can afford to pay $0.51 and no more. And the other side says, we have to have $0.60. Some on the other side say $0.65. And so it's a question of bridging the inevitable gap.

And the way this technique can be used most effectively is for the sovereign borrower, when they reach that point in the negotiation, to say, we can put a sweetener on the table that is not quantifiable. It isn't money, but it is glory. It is a vindication of your vaunted social environment principles, and therefore it is worth something to you. But I can't tell you precisely how much. And so that's the use of the technique.

If the other side then says, OK, we'll accept these terms and won't fight anymore, that's the benefit. But how much-- absent that, how much the negotiation would have gone on for and what the final result would be, no one will ever know.

But there is-- one other thing. Mitu and I put an op-ed into the *Financial Times* in the spring with a technique, a different technique that is arguably applicable to a much, much, much broader range of sovereign debt workouts, and that was one which said that-- typically, a debtor country will have to issue a new debt instrument in the restructuring. The new debt instrument will reflect the debt relief that it has negotiated, either a principal haircut, a lower coupon, or a delay in maturity. So the country will now be obliged to pay in foreign currency the interest on the new debt instrument.

And what we argued was that you could give the debtor country the option to discharge a portion of that foreign currency denominated stream of payments, discharge it in local currency, if the local currency is invested in a project that the creditors have approved. The logic of it is this-- every creditor going into a sovereign debt workout knows that it has to give debt relief.

The whole raison d'etre of a debt restructuring from the creditors' standpoint is that you want to improve the debtor countries debt dynamics so that it can return to voluntary market operations and pay you back the residual amount of your claim. That's why you do it. And therefore, from the creditor's standpoint, the only issues are, how do you do it, and how much debt relief are you getting?

Well, a country has an external debt problem because it lacks the foreign currency needed to repay its external debt. You can improve the country's debt dynamics by saying you can discharge a portion of that foreign currency denominated liability by paying local currency. That improves their debt dynamics. So it achieves the creditor's objective, which they know they're going to have to accede to one way or the other.

But the creditor said, invest it in an approved project-- it could be environmental, it could be something else-- in the debtor country. Good for the debtor because it is saving precious foreign currency. And also, unlike a payment on an international bond, normally the payment goes out of the country. It's gone. It's a deadweight loss. In this instance, you're taking some of that payment and discharging it by investing local currency in your own country. So that's a technique, I think, that has far, far broader application. Belize was unusual because it was a cash buyback. And you very rarely see those.

MICHAEL LIVERMORE: And the Nature Conservancy was involved. So you have this third party that was kind of--

LEE BUCHHEIT: Exactly. Exactly.

MICHAEL LIVERMORE: And whereas what you're describing could be worked out between just the debtors and the creditors. So I can imagine a criticism of this kind of deal-- even though, obviously it has a lot of advantages in terms of achieving debt relief and seeing expenditures on socially desirable projects. But one concern I could imagine folks raising is that there's kind of a neocolonial dynamic here, where you have hedge fund folks who like to scuba dive forcing Belize to spend more money on coral reef protection than it otherwise would, or creditors in general dictating how these sovereigns are going to spend their money.

And of course, there's a north-south dynamic here, and a dynamic between developed and developing countries. And I'm curious if either of you have thoughts about that dynamic. Is that an overblown critique, or is there something to it?

MITU GULATI: I think this is one of the reasons why the environmental part of ESG is much more likely to work, because there one can see it as a global public good that we are all going to benefit from together. To the extent the money is going into making sure these countries have better democratic institutions, or treat women better, or have better judiciary, that all looks awfully like interference with their domestic structures, regardless of how odious we may think their domestic structures are.

We didn't-- I mean, Belize is an exceptional case, but I don't think that we've heard any complaints that the coral reefs are going to be preserved. I mean, there's something about the way in which people across the spectrum were enthusiastic about what happened that I think is about the environment. And I don't know-- you're the environmental expert so I don't actually know. How do you articulate why that worked? I'd be curious as to what you think.

MICHAEL LIVERMORE: I will answer that question in a second. Lee, you got cut off right when you were about to start answering the question, so I wanted to kick it back to you. We've got a little bit from Mitu, and then--

LEE BUCHHEIT: There's a simple answer to your question, Mike. The way you phrased it was-- and I'm going to paraphrase it. How do these foreign creditors get off telling the debtor government how it should spend its money? And the fallacy in that sentence is it isn't the debtor country's money, it is the creditor's money.

The debtor country has solemnly promised to repay these creditors a certain amount of money over a certain period of time. That is the creditor's legal entitlement. If the creditor says, we will accept less money from you if you devote the balance to this purpose, it is the creditors saying that you may use their money. And surely that's within their entitlements to do.

MICHAEL LIVERMORE: Yeah, that's interesting. That's-- right. That makes sense. I think that-- Mitu's point was, broadly, that maybe the environment is special on some of the optics here. Even, Lee, under the theory that you're offering, that really, what we're talking about is the creditor's money, then maybe there's something paternalistic even of saying, we're willing to spend our money to benefit you, Belize. Whereas it is more in keeping with that theory, I think, to say, we want to spend our money in a way that creates some joint value. And I think that's probably a dynamic in the environment that maybe is a little different.

Still, reforming the-- creating a fund for additional infrastructure investment could be jointly beneficial if it puts a country in a better position to pay its debt going forward. But maybe there's something more immediate about the environment. It's also very possible that it's just a symbolic matter. That there's kind of a feel-good side of the environmental investment that a fund for infrastructure wouldn't have.

LEE BUCHHEIT: Yeah. Again, I think it goes back to the effort that's being made now to convince every citizen of this planet that we are jointly invested in the health of the planet. And that for some of us to exploit the environment is injurious to all the rest of us. And therefore-- look, I grew up in Pittsburgh, Pennsylvania a very long time ago. And I remember the local industrialists who took the position that if God did not want me to pollute the Monongahela River, why did he put it in front of my factory?

MICHAEL LIVERMORE: Yeah, there's surprisingly still people who think along these lines.

[LAUGHTER]

But hopefully that view is somewhat more in the minority than it was in the past. It's interesting, some of the cultural divides on environmental issues. And one of the things I think is also fascinating in this area is, it would have been-- this is a broader thing, but I think that back then, where would the banks have been on a question like that, right?

The financial industry would have probably been more on the side of in the industrialist by the river, and these days finance is a pretty green-- culturally, a pretty green group of people who are concerned about the environment, and that-- just as from a personal level, I think many people are. So I think that's an interesting development that we've seen in the past recent decades.

LEE BUCHHEIT: Yes, indeed. To set it in context, the phenomenon you've just described is one in which a lender able to lend, let's say to a polluting steel mill, and earn a higher interest rate on that loan refrains from doing so for these motivations. The phenomenon we've been discussing for the last hour is one in which a lender entitled to receive a higher interest rate voluntarily forebears from asking for all of it if the difference is invested in an approved project in the debtor country.

It's the same thing from the investor's standpoint. In one case, he's forbearing from collecting money he's already owed. In another case, he is forbearing from lending money that he knows he could lend and earn a higher return than he does to a green project.

MICHAEL LIVERMORE: Yeah. And we got to-- I mean, again, even with some skepticism on this ESG movement, my own view on this, for what it's worth, is that it's ultimately it's a sign of, hopefully, shifting politics, and will likely be part of a broad social response to environmental problems. Well, I think that I've taken enough of your guys' time.

I think we could continue talking for hours about these really fascinating issues. So I think I will just end with a big thank you for the conversation today. I learned a lot. And it's all really fascinating stuff. And also thank you for working on these really interesting issues and staying engaged on all these questions.

LEE BUCHHEIT: Thanks, Mike. I enjoyed it very much.

MITU GULATI: Thank you, Mike. That was a treat.