Special Issue
Democracy and Financial Order—Legal Perspectives

A Discourse Theoretical Approach to Sovereign Debt Restructuring: Towards a Democratic Financial Order

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Abstract

This Article studies the role of law for aligning democracy with a market-based financial order. Jürgen Habermas's discourse theoretical understanding of the role of law in the welfare state establishes a structure for exploring this issue. According to this approach, law needs to be enforceable, law-making and law-application need to be institutionally separated, and public law needs to be distinguishable from private law. The contemporary practice of sovereign debt restructuring reveals some empirical and normative challenges to this understanding of the law. Based on these findings, this Article proposes several conceptual and institutional improvements that might lead to a more stable relationship between democracy and financial order. In particular, we argue that sovereign debt restructuring should tap the legitimating potential of existing transnational discourses that are characterized by cross-border cleavages in public discourse.

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A. Democracy and Financial Order as a Challenge for Legal Theory

The financial crisis, which began in 2008, triggered an extensive debate—both public and academic—about the impact of a globalized financial order on democracy. Is it possible to match the power of the former by democratic institutions?[1] In many respects, this debate rehashes and further develops earlier controversies about the relationship between democracy and capitalism. One position in the controversy fears that the economic powers unleashed by capitalism will endanger equality and democratic sovereignty, whereas a counter-position suspects that democratic decision-making will unduly restrict liberty and hinder individuals from unfolding their economic potential.[2]

The debate has been ongoing for centuries. Scholars adapted the basic positions described above to the particular challenges of their time. Alexis de Tocqueville observed a highly egalitarian, pre-industrial society in the United States, which he believed would endanger political freedom, prompting him to send a warning message about the authoritarian potential of the quest for equality to his native France.[3] In contrast, Karl Marx and Friedrich Engels believed that the capitalist mode of production relied on, and reproduced, economic inequalities.[4] They concluded that only revolutionary change would bring about a democratic economic order in a post-capitalist society.[5] The development of the modern welfare state since the late 19th century has juxtaposed writers like Karl Polanyi, who cautioned that a market-based society would require a strong nation-state to curb market forces,[6] and Friedrich August von Hayek, who claimed that a free-market economy was a precondition of democracy.[7]

Contemporary contributions to this debate are abundant, but traditional left-right distinctions provide little orientation. Some theorists perceive democracy as being

[1] *See generally* DANI RODRIK, THE GLOBALIZATION PARADOX: DEMOCRACY AND THE FUTURE OF THE WORLD ECONOMY (2011); EMILIOS AVGOULEAS, GOVERNANCE OF GLOBAL FINANCIAL MARKETS: THE LAW, THE ECONOMICS, THE POLITICS 110 (2012); Jakob von Weizsäcker et al., *Mobil, Gerecht, Einig*, 43 DIE ZEIT (2013), http://www.zeit.de/2013/43/glienicker-gruppe-europaeische-union.

[2] *See* Oisin Suttle, *Debt, Sovereign Default, and Two Liberal Theories of Justice*, in this issue, for varieties within the liberal tradition.

[3] *See* ALEXIS DE TOCQUEVILLE, 2 DEMOCRACY IN AMERICA Ch. 1–2 (1838).

[4] *See* Karl Marx & Friedrich Engels, *Manifest der Kommunistischen Partei*, *in* 4 MARX ENGELS WERKE 459, 474 (1974).

[5] *See id.*

[6] *See* KARL POLANYI, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME (1944).

[7] *See* FRIEDRICH AUGUST VON HAYEK, THE CONSTITUTION OF LIBERTY (1960). For more on this debate, *see* Carl Christian von Weizsäcker, *Die normative Ko-Evolution von Marktwirtschaft und Demokratie*, MPIFG DISCUSSION PAPER (2014).

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irreversibly dismantled by financial markets,[8] while others believe that either a return of the nation-state or the democratization of international institutions are the only options for democracy.[9] Still others imply that technocratic policy-making guided by benchmarks will achieve outputs that overcome problems of democratic input.[10] Finally, some authors recommend measures to increase economic equality in the developed world,[11] while others make recommendations to emancipate the developing world from its economic dependence.[12]

Yet, what is underrepresented in the recent debate about the complicated relationship between democracy and the financial order is any reflection on the role of law. Despite some remarkable contributions,[13] scholarship theorizing about the role of law in this relationship remains in an infant stage.[14] This is especially surprising because both democracy and a market-based financial order heavily rely on the law—in practice as well as in theory. Democratic decision-making manifests itself in law-making, while financial orders require a legal infrastructure for the regulation of financial markets as well as for aspects that are government controlled such as public spending, taxes, and money.[15] It is thus fair to suppose that the perceived relationship between democracy and the financial order hinges on a person's particular concept of law. Just as there are "varieties of capitalism"[16] and different theoretical approaches to democratic governance, the role attributed to law—and the understanding of its capacity and limits—varies with the

[8] *See*, *e.g.*, Saskia Sassen, *Global Finance and Its Institutional Spaces*, *in* THE OXFORD HANDBOOK OF THE SOCIOLOGY OF FINANCE (Karin Knorr Cetina & Alex Preda eds., 2012); WOLFGANG STREECK, GEKAUFTE ZEIT: DIE VERTAGTE KRISE DES DEMOKRATISCHEN KAPITALISMUS (2013).

[9] *See* Boutros Boutros Ghali, *Die Welt braucht ein Parlament*, 24 DIE ZEIT (2009), http://www.zeit.de/online/2009/24/uno-reform; RODRIK, *supra* note 1.

[10] *See* Carmen M. Reinhart & Kenneth S. Rogoff, *Growth in a Time of Debt* (Nat'l Bureau of Econ. Res., Working Paper No. 15639, 2010).

[11] *See* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 471 *et seq.* (2014).

[12] *See* M. Shamsul Haque, *Globalization, New Political Economy, and Governance: A Third World Viewpoint*, 24 ADMIN. THEORY & PRAXIS 103–24 (2002).

[13] *See generally* Paul Kirchhof, *Erwerbsstreben und Maß des Rechts*, *in* 8 HANDBUCH DES STAATSRECHTS § 169 (Paul Kirchhof & Josef Isensee eds., 2010); Frank Schorkopf, *Finanzkrisen als Herausforderung der internationalen, europäischen und nationalen Rechtsetzung*, 71 VERÖFFENTLICHUNGEN DER VEREINIGUNG DER DEUTSCHEN STAATSRECHTSLEHRER 183–225 (2012); Katharina Pistor, *A Legal Theory of Finance*, 41 J. COMP. ECON. 315, 315–30 (2013).

[14] *See* Rosa Maria Lastra, *Do We Need a World Financial Organization?*, 17 J. INT'L ECON. L. 787, 787–805 (2014).

[15] *See*, *e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 22 (1962).

[16] *See generally* PETER A. HALL & DAVID SOSKICE, VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE (2001).

particular legal theory adopted. Often, however, the underlying concept of law seems to be implicit rather than explicit.

This is aggravated by the fact that developments in the globalized financial order during the last decades have called into question legal theories that were mostly developed with a view to the nation-state. These theories face several obstacles when addressing the aforementioned problems associated with aligning democracy and financial order. On the one hand, the current financial order lacks some of the structures and institutional requirements presupposed by concepts of law developed for democratic states. On the other hand, legal theory falls short of providing a satisfactory conceptual framework for capturing the inherent problems of financial order. Structural-institutional deficits and conceptual shortcomings mutually reinforce each other. This impairs the search for a viable solution to the democracy-capitalism conundrum for a globalized financial order.

This Article seeks to remedy this problem by recasting the interaction of democracy and the financial order in the light of a legal theory perspective. As there is no universally accepted legal theory, we approach this research question from one particular understanding of the law: Jürgen Habermas's discourse theory of law and democracy.[17] Discourse theory lends itself to this analysis because it has arguably provided one of the most widely referred-to and enlightening reconstructions of the role of law for the politics and economy of Western post-war welfare states. Part B of the Article elaborates upon how Habermasian discourse theory views the relationship between democracy and the financial order. It develops the underlying concept of law, both in the original setting of the post-war welfare state and in today's globalized environment. Part C applies this theoretical approach to the contemporary legal framework for sovereign debt restructuring. Notably, three essential elements and preconditions of the discourse theoretical understanding of the law are absent in this context: First, soft law is much more effective than discourse theory assumes; second, there is no clear functional separation between law-making and law-applying institutions; and third, the distinction between public and private interests and law is not straightforward. In line with the normative and reconstructive character of discourse theory, part D makes tentative proposals which comprise both modifications to the discourse theoretical understanding of law and democracy, and to the structural-institutional framework for sovereign debt restructuring. The first of the problems revealed requires a conceptual switch from law to authority. The second commands the establishment of democratically controlled adjudication for sovereign debt restructuring. The third calls for a genuinely new concept of the public. While discourse theory normally assumes that the public is characterized by a common lifeworld, this Article contends that, as shown by the current state of sovereign debt restructuring, a concept of the public adequate for global financial regulation should rely on transnational cleavages as fundamental dividing lines in society that run across, not

[17] *See* JÜRGEN HABERMAS, FAKTIZITÄT UND GELTUNG (1992).

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along, national borders. While this proposal would not reach the level of democracy that allegedly characterizes domestic welfare states, it would be a second-best and realistic solution for the legal regulation of a more democratic global financial order.

B. The Role of Law for a Democratic Financial Order in Discourse Theory

The following summarizes Habermas's idea of the relationship between democracy and financial order, originally developed in his reconstruction of the modern welfare state. Habermas conceptualizes the law as a system of rules subject to central enforcement, with separate institutions responsible for making and applying the law, and a distinction between private and public spheres, each governed by its proper law. In his more recent writings on globalization and Europeanization, Habermas generally stuck to the concept of law developed in the context of the welfare state.

I. Democracy and Financial Order in the Nation State

To date, Habermas's most in-depth analysis of democracy and the economy is a short monograph from 1973 entitled "Legitimation Problems in Late Capitalism" (LC).[18] It represents an important work in a larger debate on the crisis of the modern welfare state during the 1970s. In this debate, the term "late capitalism" characterizes a view that perceived the crisis of the welfare state as the result of inherent contradictions in capitalism. The opposite view feared that union power and clientele-ist practices would render the democratic welfare state ungovernable.[19]

Arguing in support of the former approach, Habermas distinguished different stages of economic development of modern society. The relevant criterion for this distinction, as well as the main focus of much of Habermas's work, is the question of social integration—of what keeps society together and determines people's collective identity. Habermas held that capitalism's inner contradictions put social integration at risk at each of several ideal-typical stages of development of the modern state. Accordingly, liberal capitalism, characterized by largely unregulated market economies, tends to create cyclical economic crises which threaten social integration through unemployment and ensuing class struggles.[20] In late capitalism, the modern welfare state intervenes in the market in order to avoid or mitigate cyclical economic crises. It creates investment opportunities and

[18] JÜRGEN HABERMAS, LEGITIMATIONSPROBLEME IM SPÄTKAPITALISMUS (1973). For an English summary, *see* Jürgen Habermas, *What Does a Crisis Mean Today?: Legitimation Problems in Late Capitalism*, 40 SOC. RES. 643 (1973). In the following, references to this footnote always refer to the German-language monograph.

[19] Armin Schäfer, *Krisentheorien der Demokratie: Unregierbarkeit, Spätkapitalismus und Postdemokratie*, MPIFG DISCUSSION PAPER (2008). *See, e.g.*, ERNEST MANDEL, DER SPÄTKAPITALISMUS: VERSUCH EINER MARXISTISCHEN ERKLÄRUNG (1972); CLAUS OFFE, STRUKTURPROBLEME DES KAPITALISTISCHEN STAATS: AUFSÄTZE ZUR POLITISCHEN SOZIOLOGIE (1972).

[20] HABERMAS, *supra* note 18, 42–43.

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provides infrastructure to increasingly monopolistic companies. While this reduces cyclical economic downturns, it increases public debt and inflation. One could therefore say that, according to this view, multiple, permanent financial crises are the late capitalist equivalent of cyclical economic crises characterizing liberal capitalism.[21] They reduce the capacity of states to provide welfare services (generating a rationality crisis), which in turn disappoints citizens and reduces their loyalty (leading to a legitimacy crisis), both contributing to social disintegration. Instead of class struggle, late capitalism encounters crises of the political system. In the end, Habermas observed that late capitalist societies face a choice between breaking the domination of elites and monopolies or switching to more authoritarian forms of government.[22] This late capitalist perspective sharply opposed the "ungovernability" view, which advocated the retreat of government intervention—with considerable success.[23]

From today's perspective, Habermas's LC is outdated in a number of respects. The "great moderation" profoundly shattered LC's assumption that inflation was a permanent feature of welfare states.[24] LC's progress narrative assumed that religion would gradually fade away as a means of social integration during modernity, but the rise of religious extremism, a genuinely modern phenomenon, demonstrates the fallacy of that prophecy.[25] Nevertheless, in other respects, LC forecasts accurate assessments of the situation in Western welfare states towards the end of the 20th century. Among them is the idea that communicative rationality may have a decisive function for social integration.[26]

Habermas developed this idea more fully in later works,[27] in respect of political discourse notably in "Between Facts and Norms" (BFN).[28] In this work, almost twenty years after LC and in the midst of the "great moderation," Habermas displayed a much more harmonious view of politics and, in particular, of the relationship between democracy and capitalism. According to this later approach, society in democratic welfare states was held together by communicative action. Habermas considered representative democratic institutions like

[21] Cf. Schäfer, *supra* note 19, at 13.

[22] *See* HABERMAS, *supra* note 18, at 66–73 & 128–30.

[23] *See* Schäfer, *supra* note 19, at 17.

[24] *See generally* Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Meeting of the Eastern Economic Association: The Great Moderation (Feb. 20, 2004).

[25] *See* Volker Rittberger & Andreas Hasenclever, *Does Religion Make a Difference? Theoretical Approaches to the Impact of Faith on Political Conflict*, 29 MILLENNIUM: J. INT'L STUD. 641, 641–74 (2000).

[26] *See* HABERMAS, *supra* note 18, at 140.

[27] JÜRGEN HABERMAS, THEORIE DES KOMMUNIKATIVEN HANDELNS, VOL. 1 (1981) 369ff.

[28] HABERMAS, *supra* note 17.

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parliaments, which he mostly ignored in LC, as the keystones of social integration. He recognized them as the places where pragmatic discourse about diverging self-interests converged with socially integrative discourse about ethics and morals. Thus, in democratic institutions, debates in the wider public sphere coalesced into rationally acceptable political decisions, thereby generating loyalty among the people. The administration rendered these decisions effective, while courts ensured respect for fundamental rights. A competitive market economy produced welfare benefits which supported the whole order. Both systems, the administration and the market, required a legal framework. On the one hand, law enabled each system to function effectively by defining enforceable rights, status, and competencies. On the other hand, law tied these systems to the "common good" and to the socially integrative effects of communicative action.[29]

Habermas's idea of society advanced in BFN is not entirely harmonious, however. In fact, Habermas is very much aware of the risk that powerful economic interests might disturb the fragile balance between public and private interests. In this respect, law might become a vehicle for vested interests that threaten social integration. The presumption that law is legitimate might disguise illegitimate power.[30]

II. The Underlying Concept of Law

BFN's account of the late twentieth century welfare state assigned a key role to law. Three important assumptions, central to understanding the relationship between democracy and economic—and financial—order, characterize Habermas's concept of law in BFN: (1) Law consists of centrally enforceable rules; (2) law-making and law-application require different modes of reasoning and procedures; and (3) one needs to distinguish public law from private law.

1. Law as Enforceable and Legitimate Rules

A first, important element of Habermas's concept of law invokes Immanuel Kant's doctrine of right.[31] Accordingly, law has a dual character; it consists of rules that are supposed to be both legitimate and effective. Habermas suggests that the legitimacy of law derives from communicative reason expressed in the practice of political discourse. But it is precisely law's origin in political discourse, and hence its contingency, which entails the possibility that people might reasonably disagree with legal rules. This applies *a fortiori* to rules regulating market activity. Some market participants might have strong incentives to violate legal rules that stand in the way of the pursuit of their self-interest. Hence, legal

[29] *See id*. at 58–59.

[30] *See id*. at 59.

[31] *See* IMMANUEL KANT, INTRODUCTION TO THE SCIENCE OF RIGHT: GENERAL DEFINITIONS, AND DIVISIONS § D (1790).

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rules require some form of enforcement. Ideally, by being both legitimate and effective, legal rules unite freedom and constraint, allowing their addressees to choose whether to obey the law for intrinsic reasons because they believe it to be legitimate, or for extrinsic reasons because a violation entails negative consequences.[32]

While Habermas discussed the issue of legitimacy extensively, he dedicated relatively little thought to the modalities of law enforcement. His understanding of these modalities seems to follow what one might call a "constraint theory."[33] Accordingly, law enforcement requires centralized or coordinated government institutions with the ability to deploy the full range of police powers and other means that directly compel the addressee of a legal rule. Constraint theories have been highly popular in legal and political theory since early modernity. They may have originated in a modern anthropology that resonated especially well with Protestantism.[34] While medieval scholastics had presumed human nature to be amenable to both good and evil purposes and ends,[35] modernity and the Protestant Reformation firmly established the idea of the *natura corrupta*—the sinful character of human nature since the fall.[36] This was a core theme in Martin Luther's theory of justification.[37] Thomas Hobbes' political theory reflected this anthropology when it argued that society requires a Leviathan to keep in check the rational egoists who compose it.[38] After Hobbes, constraint theories of law made their way into legal and political theory and the underlying anthropology became increasingly secularized. Constraint theory reappeared in early capitalist writings in the form of the idea of the *homo economicus*.[39] If

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[32] *See id.* at 46–47.

[33] MATTHIAS GOLDMANN, INTERNATIONALE ÖFFENTLICHE GEWALT 339–44 (2015).

[34] Note, however, that important work reflecting this anthropology predates the Reformation. *See* NICCOLÒ MACHIAVELLI, IL PRINCIPE (1513).

[35] *Cf.* THOMAS AQUINAS, 2 SUMMA THEOLOGICA, q. 109, art. II., 829 (1265–73)).

[36] *See e.g.* CONFESSIO AUGUSTANA Art. 2 (C.P. Krauth trans., 1874) (1530), http://www.ccel.org/ccel/schaff/creeds3.iii.ii.html.

> Also they teach that, after Adam's fall, all men begotten after the common course of nature are born with sin; that is, without the fear of God, without trust in him, and with fleshly appetite; and that this disease, or original fault, is truly sin, condemning and bringing eternal death now also upon all that are not born again by baptism and the Holy Spirit.

[37] *See* MARTIN LUTHER, VOM UNFREIEN WILLEN 1924 (1525) (describing man's need for divine redemption after the fall due to his sinful nature). Luther's understanding of state and society is consistent with his theology of justification. *See* ERNST-WOLFGANG BÖCKENFÖRDE, GESCHICHTE DER RECHTS- UND STAATSPHILOSOPHIE 418 (2d ed. 2006); Armin E. Buchrucker, *Luthers Anthropologie nach der großen Genesisvorlesung von 1535/45*, 14 NEUE ZEITSCHRIFT FÜR SYSTEMATISCHE THEOLOGIE 250, 257 (1972).

[38] *See* THOMAS HOBBES, DE CIVE § 1 (1647).

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self-interest is considered as such a dominant driver of human behavior, it seems obvious that it can only be controlled by directly constraining enforcement mechanisms. The focus on constraint has thus influenced the idea of law of eminent writers in the post-enlightenment era, most prominently that of John Austin,[40] but also that of Marx and Engels.[41] In Habermas's work, constraint theory leads to a conceptual distinction between intrinsic and extrinsic modes of motivation, between legitimacy and enforcement, between discourse and constraint—the latter being limited to classical means of law enforcement.

2. Relationship between Law-Making and Law-Application

The presumption that, besides being effective, law is also legitimate is quite a demanding one. It applies not only to legislation, the legitimacy of which taps communicative reason brought about by legislative procedures that relate law to the wider public sphere. It also implies that the application of the law to individual cases is legitimate, not merely the expression of arbitrary power, of vested interests and economic preponderance. In other words, some kind of reason needs to connect law-making and law-application, legislation and adjudication.

This is not a trivial issue. Towards the late 19th century, the ideas underlying post-enlightenment *Begriffsjurisprudenz*—the view that legal reasoning and legal decisions are objective—increasingly came under stress. The legal realist movement argued that legal reasoning is contingent due to the indeterminacy of language. Power, rather than justice, prevailed in the application of the law.[42] This position was corroborated by the linguistic turn, which argued that the meaning of linguistic propositions like legal rules was determined by their usage in a specific context, not by any intrinsic semantic content.[43] This raised the question whether one could understand the application of the law as guided by reason and not just by power or the random mood of judges, and whether it was possible to consider legal decisions as "right" by any standard.

Habermas provides an affirmative answer to these questions, based on the idea that law-application follows a specific kind of discursive rationality that is different from the rationality of law-making.[44] Unlike Dworkin, Habermas did not assume that the rationality

[39] *See* ADAM SMITH, THE WEALTH OF NATIONS Ch. 2 (1776).

[40] JOHN AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED (1832 (2001)), 21.

[41] MARX and ENGELS, *supra* note 5, 459, 477.

[42] *See* OLIVER WENDELL HOLMES, THE COMMON LAW (1881).

[43] *See e.g.*, RICHARD RORTY, THE LINGUISTIC TURN (1967).

[44] *See* HABERMAS, *supra* note 17, 272–91.

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of law-application depends on the capacity of the judge to find the right answer.[45] Rather, he replaced a subjective standard of rightness with one that is intersubjective. Rightness then becomes a question of intersubjective acceptability. Law-applying discourses follow specific rules which make their results intersubjectively acceptable. Among them are the rules of procedure which determine the issue at stake, allowing some arguments to be presented and excluding others. Legal arguments as such are not determined by rules of procedure, but by the positive law as a reference point. It is the task of the law-applier to rationally reconstruct the law with respect to a specific case.[46] The standard of rightness of legal decisions, the regulative idea of the only right decision, thus becomes a question of procedure and acceptable arguments.

Nevertheless, part of this story is that the judiciary needs to be embedded in a framework of democratic legitimacy.[47] After all, intersubjective rightness is not the same as objective rightness. It involves an element of contingency, which is only acceptable as long as there is a representative parliament that can intervene and change the law in reaction to judicial decision-making. Also, judges need to be democratically selected, whether by election or indirectly by appointment.

3. The Public-Private Distinction

A further distinction that is crucial to Habermas's understanding of the law is that between public and private law. This distinction, which finds its common law equivalent in specific rules for commercial activities,[48] reflects the emergence of separate public and private spheres in early modern societies as an important requirement of liberal capitalism.[49] Post-enlightenment doctrines of private law hypostatized the idea of the subjective, or private, right as an apolitical institution with a solid foundation in natural law or reason.[50]

[45] *Cf.* RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 14 (1977).

[46] *Cf.* Matthias Goldmann, *Dogmatik als rationale Rekonstruktion: Versuch einer Metatheorie am Beispiel völkerrechtlicher Prinzipien*, 53 DER STAAT 373, 373–99 (2014).

[47] *See* ARMIN VON BOGDANDY & INGO VENZKE, IN WHOSE NAME? A PUBLIC LAW THEORY OF INTERNATIONAL ADJUDICATION [XX] (2015); Christoph Möllers, *Die drei Gewalten: Legitimation der Gewaltengliederung*, *in* VERFASSUNGSSTAAT, EUROPÄISCHER INTEGRATION UND INTERNATIONALISIERUNG 100–06 (2008).

[48] *See* JÜRGEN HABERMAS, STRUKTURWANDEL DER ÖFFENTLICHKEIT 90 (1962).

[49] *See id.* at 23–32 & 158–69 (discussing the entanglement of the public and private spheres since the late 19th century).

[50] *See* JÜRGEN HABERMAS, 2 THEORIE DES KOMMUNIKATIVEN HANDELNS 525–27 (1981); HABERMAS, *supra* note 18, at 112–35. This reveals the Kantian element in Savigny. *Cf.* JOACHIM RÜCKERT, IDEALISMUS, JURISPRUDENZ UND POLITIK BEI FRIEDRICH CARL VON SAVIGNY 184–86 (1984); Chris Thomale, *Rechtsfähigkeit und juristische Person als Abstraktionsleistungen: Savignys Werk und Kants Beitrag*, *in* PERSON UND RECHTSPERSON: ZUR PHILOSOPHIE DER PERSONALITÄT IN DEN INTERPERSONALEN VERHÄLTNISSEN DES RECHTS 173–85 (Rolf Gröschner, Stephan Kirste & Oliver W. Lembcke eds., 2015).

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Nevertheless, the development of the welfare state during late capitalism led to an increasing entanglement of the public and private spheres, characterized by both governmental interventions in the market that restrict liberty, and by the transfer of public services to private actors. This made the liberal capitalist separation of the private and public spheres, and of private and public law, untenable.[51] At the same time, its theoretical justification crumbled away. With the demise of natural law and the law of reason, only positive law remained as a foundation for both private and public law. The establishment of the welfare state laid bare the political contingency of the positive law,[52] leading legal theorists to draw different conclusions.[53] On the one hand, Kelsen revealed the ideological character of the distinction between public and private law by pointing out that all law was ultimately state-made.[54] Not surprisingly, his theory shows little concern for individual rights. On the other hand, the ordoliberal school of thought saw subjective rights as functional tools for establishing a capitalist economy. Some of them considered democratic decisions constraining individual rights as risks to the economic order.[55] Both approaches considered public law, respectively private law, as a functional necessity devoid of moral content.[56] They did not offer insights into how one might imagine the relationship between freedom and democracy as a productive one. Capitalism and democracy seem to defeat each other.

In his earlier work, Habermas followed a similarly pessimistic view in which law served two different purposes in late capitalism. On the one hand, law played the role of a medium between the economy and the welfare state, serving as a functional tool. On the other hand, some legal rules, like constitutional or criminal laws, had the character of an institution within the society as a whole, depending on shared background convictions embedded in the lifeworld.[57] In BFN, in line with his more optimistic view on the relationship between capitalism and democracy, Habermas gave up this position and shifted to what he called the procedural paradigm of the law.[58] Accordingly, freedom and democracy, hence subjective—or private—rights, and objective—or positive—law, mutually precondition each other. Habermas reached this result by observing the

[51] *See* HABERMAS, *supra* note 48, at 158–69, 194.

[52] *See id.* at 196–98.

[53] This coincides with the difference between liberal and republican approaches to democracy. *Cf.* HABERMAS, *supra* note 17, at 351.

[54] *See* HANS KELSEN, PURE THEORY OF LAW 281–84 (Max Knight trans., 2d ed. 1967).

[55] *See* HAYEK, *supra* note 7; *see also* Thomas Biebricher, *The Concept of Law in Neoliberalism*, in this issue.

[56] This does not apply to the deontological tradition in liberalism. *See* Suttle, *supra* note 2.

[57] *See* HABERMAS, *supra* note 50, at 536.

[58] *See* HABERMAS, *supra* note 17, at 502 n. 47.

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communicative practices and procedures of contemporary democracies and by carefully analyzing theories of social contract. The mutual self-interest of citizens to have their private rights guaranteed by an objective legal framework does not provide a sufficient reason for entering into a social contract because one cannot understand private rights as having an intrinsic objective content. Under these conditions, citizens run the risk that the positive law will only recognize the subjective, or private, rights of the stronger, more powerful segments of society. Hence, citizens would only accept a social contract and the legal order it establishes if it guarantees and limits private rights in legitimate ways. This immediately leads to the idea of the equiprimordiality of private and public law, of individual freedom and democracy. By transcending their self-interest in the imaginative moment of a social contract, citizens are able to establish an objective order of positive law which recognizes subjective rights and, simultaneously, provides for procedures that allow limiting their exercise.[59] Private and public law have equivalent relevance; neither has precedence over the other. In this way, Habermas, following Kant, distinguishes the common good from individual self-interest. The former transcends the latter. A qualitative difference exists between the public and the private interest, hence between public and private law.[60]

This distinction does not amount to some form of systemic fragmentation that would compromise the interaction between politics and the economy.[61] Nevertheless, it entails different types of legitimacy. Public law, including the legal framework for the exercise of private freedom and the acquisition of subjective rights—i.e. market regulation—is geared towards the public interest and requires democratic legitimacy. It needs to be adopted by institutions enabling practical discourse. This creates objectivity in the more modest form of inter-subjective rationality.[62] Private law—i.e. subjective rights acquired through transactions framed by positive law—is geared towards supposedly mutual private self-interest and finds its justification in private autonomy.[63] Accordingly, markets, especially financial markets, are characterized by the interaction between public and private actors. What Pistor considers the "essential hybridity" of the law of finance is in fact a reflection of the equiprimordiality of democracy and freedom.[64]

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[59] *See id.* at 117.

[60] HABERMAS, *supra* note 17, 118–23.

[61] For more about the position of systems theory, see Lars Viellechner, *The Limits of Law (and Democracy) in the Euro Crisis: An Approach from Systems Theory*, in this issue.

[62] *See* HABERMAS, *supra* note 17, at 166–291.

[63] *Cf.* Matthias Goldmann, *A Matter of Perspective: Global Governance and the Distinction Between Public and Private Authority (and Not Law)*, 5 GLOB. CONST. 48, 48–84 (2016).

[64] Pistor, *supra* note 13.

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III. Democracy and Financial Order in a Global Context

The preceding analysis reflects Habermas's thinking in a nation-state context. But globalization entails some serious challenges for Habermas's earlier assumptions about the relationship between democracy and financial order. These challenges have become the subject of some of Habermas's more recent writings. In a series of shorter essays, he discusses transformations of the public sphere, challenges for regulatory and enforcement capacities in a multi-level system, as well as the imminent threat of the legitimacy deficit of global decision-making. Nevertheless, his concept of law has remained relatively stable.

In his essay on the constitutionalization of public international law, Habermas finds that legal regulation as a means of social integration is struggling to unfold in the post-national setting.[65] It lacks not only the essential procedural prerequisites of discursive law-making, but also an underlying common lifeworld and corresponding global public that would provide a basis for social integration. Given this context, international organizations should limit their scope of activities to issues which enjoy a high degree of acceptance and legitimacy because they are supported by an underlying moral consensus, namely the prohibition of the use of force and protection from grave human rights violations.[66] By contrast, international organizations should refrain from redistributive activities. At this stage, Habermas left the question open regarding how to regain democratic control of an increasingly globalized economic and financial order whose regulatory needs are currently addressed at best by technocratic responses.

In "The Lure of Technocracy: A Plea for European Solidarity," Habermas takes a very critical stance towards the expansion of technocracy at the expense of democratic authority.[67] This development has been particularly severe in the context of the Eurozone crisis. It has revealed the preference of states for pragmatic, short-term solutions to regain control of the crisis over fundamental, long-term changes to the EU's institutional setting that would enhance democracy. As a consequence, the European idea has remained an elite project with very limited options for citizen involvement. This further endangers social integration in and beyond the nation-state because it uncouples the decision-making processes from representative institutions and removes them to exclusive circles.[68] Combined with the lack of an inclusive European public and an active civil society, these developments result in financial regulation which does not meet the needs or the expectations of the people:

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[65] Jürgen Habermas, *Hat die Konstitutionalisierung des Völkerrechts noch eine Chance?*, *in* DER GESPALTENE WESTEN: KLEINE POLITISCHE SCHRIFTEN X 113–93 (2004).

[66] *See id.*, at 172–73.

[67] *See* Jürgen Habermas, *Im Sog der Technokratie: Ein Plädoyer für europäische Solidarität*, *in* IM SOG DER TECHNOKRATIE: KLEINE POLITISCHE SCHRIFTEN XII 82–111 (2013).

[68] *See id.* at 82–92.

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"A democratically uprooted technocracy neither possesses the power nor the motive to respect the demands of their constituencies for social justice, social safety, public welfare and public goods against the systemic preferences of a competitive and growth-oriented economy."[69]

Nevertheless, Habermas refuses to accept the "nostalgic option" brought forward, amongst others, by Wolfgang Streeck,[70] i.e. the roll-back to the nation-state.[71] Habermas argues that a policy of economic and financial isolationism is neither prudent, as it would be impossible to isolate a nation and undo globalization, nor necessary, as Streeck underestimates the regulatory capabilities of democracies.[72] Most importantly, in contrast to Streeck, Habermas believes that a democratic public can constitute itself beyond the nation-state, enabling coordinative rule-making by sovereign states to be transformed into common policy-making. There is no reason to think that political, social, and cultural identities are tied to the nation-state or that their evolution beyond national borders leads to a tyranny of the majority or a loss of diversity. The combination of European and national citizenship as representations of the EU's dualistic legitimacy structure is a prime example of how to successfully integrate domestic and global identities into a decision-making process.[73] Solidarity, understood as a mutual interest in the integrity of a common political way of life,[74] derives from a social context that is legally constructed. Hence, in Habermas's view, one possible solution to reunite capitalism and democracy beyond the nation state consists of encouraging solidarity through legal structures and institutions. For the Eurozone crisis, such an approach would require countering technocratic tendencies with more democratic structures and institutions.[75] This would include developing a political union that complements, rather than replaces, the member states and is in line with the duality of European citizenship—represented by the European Parliament—and

[69] *Id.* at 92 (author translation).

[70] *See* STREECK, *supra* note 8.

[71] Jürgen Habermas, *Demokratie oder Kapitalismus? Vom Elend der nationalstaatlichen Fragmentierung einer kapitalistisch integrierten Weltgesellschaft, in* IM SOG DER TECHNOKRATIE, KLEINE POLITISCHE SCHRIFTEN XII (*id.*, 2013) 138-157.

[72] *See id.* at 142–45 & 149–52.

[73] *See id*. at 152–54; Jürgen Habermas, *Die Krise der Europäischen Union im Lichte einer Konstitutionalisierung des Völkerrechts: Ein Essay zur Verfassung Europas*, *in* ZUR VERFASSUNG EUROPAS: EIN ESSAY 39–69 (2011). For the dualistic legitimacy of the Union, *see* Armin von Bogdandy, *Das Leitbild der Dualistischen Legitimation für die Europäische Verfassungsentwicklung*, 3 KRITISCHE VIERTELJAHRESSCHRIFT FÜR GESETZGEBUNG UND RECHTSPRECHUNG 284, 284–97 (2000).

[74] *See* Habermas, *supra* note 67, at 104.

[75] *See id.* at 155–56.

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national citizenship—represented by the Council—and the active promotion of a European public.[76]

Ultimately, Habermas believes that the idea of the welfare state developed more than a decade earlier with respect to the nation-state is in principle a possible model for reconciling democracy and capitalism on levels beyond the nation state. He does not join with authors who fear the demise of the Keynesian welfare state.[77] Habermas finds that legitimacy is the main problem for a global financial order, just as it was in the late capitalist welfare state—albeit under different auspices: Instead of financial incapacity, deliberate policy choices are preventing the global order from generating the loyalty of the people.[78] Habermas's answer is that the public needs to constitute itself beyond the state, establishing adequate structures for the representation of citizens and nation-states on the international level and effective mechanisms for the regulation of global economic activities. The hope is that representative legal institutions charged with regulating the economy will lead to the emergence of a global public and provide a basis for solidarity. This vision for a global democratic economic and financial order assigns an important role to the law. The concept of law remains unchanged in respect of all three characteristics elaborated above.[79] One may ask whether this is how law actually functions in the context of a global financial order.

C. The Role of Law in Sovereign Debt Restructuring Practice

This section explores the extent to which the discourse theoretical concept of law that was initially developed in the context of the modern welfare state provides a reconstruction of sovereign debt restructurings that is both empirically and normatively satisfactory. To do so, it will apply the concept of law underlying Habermas's ideas about democracy and financial order to the contemporary practice of sovereign debt restructuring.

We test the concept of law for its empirical and normative robustness because the global financial order entails both empirical and conceptual challenges and because it follows from Habermas's particular methodological approach, known as rational reconstruction.[80]

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[76] *See* Habermas, *supra* note 67, at 93–96; Jürgen Habermas, *Zur Prinzipienkonkurrenz von Bürgergleichheit und Staatengleichheit im supranationalen Gemeinwesen: Eine Notiz aus Anlass der Frage nach der Legitimität der Ungleichen Repräsentation der Bürger im Europäischen Parlament*, 53 DER STAAT 167, 167–92 (2014).

[77] *See* BOB JESSOP, THE FUTURE OF THE CAPITALIST STATE (2002); STREECK, *supra* note 8.

[78] *See* Schäfer, *supra* note 19, at 39.

[79] *See supra* Part B.II.

[80] Goldmann, *supra* note 46; Jürgen Habermas, *Rekonstruktive vs. verstehende Sozialwissenschaften*, *in* 1 PHILOSOPHISCHE TEXTE 338 (2009); Markus Patberg, *Supranational Constitutional Politics and the Method of Rational Reconstruction*, 40 PHIL. & SOC. CRITICISM 501, 501–21 (2014).

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Rational reconstruction oscillates between the empirical and the normative; it aims to carve out the normative presuppositions underlying contemporary practice. This is also the measure of correctness we apply when testing the theory. The theory might be unsatisfactory, requiring conceptual adjustments to the extent that it does not adequately capture an important element of contemporary practice that is expected under the general normative presuppositions of that practice. By contrast, the structural and institutional framework constituting contemporary practice might need to be adjusted to the extent that it contradicts the general normative presuppositions of that practice. Indeed, in case the application of a theory resulting from rational reconstruction to a particular practice shows a gap between practice and theory, solutions will often include elements of both.

Sovereign debt restructuring is an ideal case study; it represents a particularly difficult case of some of the typical problems pervading the contemporary global financial order.[81] To some extent, sovereign debt crises are the result of unregulated global financial markets which make credit easily available to states. These crises are also a product of regulatory failure on both domestic and international levels. Modern welfare states, whether in developing or developed economies, do not always have adequate mechanisms in place to curb the pileup of debt. Internationally, there is no comprehensive and predictable mechanism to resolve sovereign debt crises. Instead, the resolution of these crises lies in informal, fragmented negotiation processes. Most importantly, in sovereign debt crises, the rationalities of democracy and contemporary financial order clash with particular intensity. Sovereign debt restructuring entails some form of agreement between the debtor state and its creditors about structural adjustment measures and financial relief, each of which have an immense impact on domestic policy.

Before scrutinizing Habermas's concept of law in the context of sovereign debt restructuring, we should emphasize that we consider his analysis of globalization in many respects as correct and helpful for the analysis of sovereign debt restructuring. Sovereign debt restructuring raises questions of solidarity and distribution. As Habermas observes, there is practically no institution available that has the necessary democratic legitimacy for such questions.[82] Instead, sovereign debt restructurings involve technocratic actors and decision-making processes. This is especially true for the role of the International Monetary Fund (IMF) with its high degree of technical expertise and comparatively low level of democratic legitimacy, given that the relative shares of the IMF's capital a member possesses determine that member's number of votes. The Paris Club, the informal

[81] For an overview of contemporary sovereign debt restructuring practice, *see Sovereign Debt Workouts: Going Forward: Roadmap and Guide*, U.N. CONF. ON TRADE & DEV. (Apr. 18, 2015), http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=987; Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950–2010: Literature Survey, Data, and Stylized Facts* (Int'l Monetary Fund Working Paper No. WP/12/203, 2012) [hereinafter, *UNCTAD's Roadmap*].

[82] *Cf.* Habermas, *supra* note 67.

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committee of bilateral debtors, represents another highly technocratic institution lacking in democratic legitimacy.

Any proposal or solution based on Habermas's analysis will, to some extent, rely on the law to regulate the financial order. One should therefore examine whether the concept of law implicit in Habermas's writings about globalization may serve the rational reconstruction of the contemporary practice of sovereign debt restructuring. There are three gaps between Habermas's concept of law and contemporary practice which require conceptual or practical adjustments. These gaps concern the following: (1) the role of soft law and information in sovereign debt restructuring; (2) the law-making role of adjudication in relation to sovereign debt restructuring; (3) and the extremely complex mix of public and private actors, acts, and interests, which make the reconstitution of a global public more difficult than Habermas's writings recognize.

I. Hard and Soft Law in Sovereign Debt Restructuring

One important aspect of the contemporary practice of sovereign debt restructuring is the role of instruments that are not considered binding international or domestic law. These instruments—including soft law and information—seem to escape a discourse theoretical concept of law. Such instruments play important roles at different stages of a sovereign debt restructuring process.

For example, the IMF carries out Debt Sustainability Assessments (DSA) which frame sovereign debt restructurings in many ways.[83] They provide an estimate as to whether a state is in a financial situation that allows it, with high probability, to roll over or reduce its debt in the foreseeable future without a major correction in the balance of income and expenditure.[84] DSAs are regulated by the internal law of the IMF adopted by the IMF's management as part of its general competence.[85] A DSA consists of two steps. In the first step, the IMF examines whether the debt-to-GDP ratio of a country meets defined benchmarks which correspond with the relative development level of the country in question—the more developed the country, the higher the benchmark. The second step consists of further scrutiny for additional risk factors, which can be higher or lower depending on the outcomes of the first step.

[83] *See* MICHAEL RIEGNER, LEGAL FRAMEWORKS AND GENERAL PRINCIPLES FOR INDICATORS IN SOVEREIGN DEBT RESTRUCTURING 6 (2014).

[84] *See* INT'L MONETARY FUND, ASSESSING SUSTAINABILITY 5 (2002), https://www.imf.org/external/np/pdr/sus/2002/eng/052802.pdf; INT'L MONETARY FUND & INT'L DEV. ASS'N, DEBT SUSTAINABILITY IN LOW-INCOME COUNTRIES – PROPOSAL FOR AN OPERATIONAL FRAMEWORK AND POLICY IMPLICATIONS (2004), https://www.imf.org/external/np/pdr/sustain/2004/020304.pdf.

[85] *See* INT'L MONETARY FUND, STAFF GUIDANCE NOTE FOR PUBLIC DEBT SUSTAINABILITY ANALYSIS IN MARKET-ACCESS COUNTRIES (2013); INT'L MONETARY FUND, THE JOINT WORLD BANK–IMF DEBT SUSTAINABILITY FRAMEWORK FOR LOW-INCOME COUNTRIES FACTSHEET (2013).

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The IMF carries out DSAs for several purposes: As part of its regular bilateral surveillance activities under Article IV of the Articles of Agreement; in order to examine whether a country applying for a loan is eligible; and during the disbursement of a loan. While one might, in general, doubt the significance of the IMF's surveillance activities, their role in sovereign debt crises renders them highly influential. At the same time, DSAs cannot be reduced to purely technocratic, econometric exercises, as they involve some level of political judgment. First, the predictive power of debt-to-GDP ratios is highly controversial.[86] Second, DSAs involve projections about expected growth and other macroeconomic figures, which are difficult to predict. In particular, DSAs have, at times, underestimated the negative effects of restrictive fiscal policies for growth[87] and social development. Third, DSAs are only as good as the risks included in the assessment, thus they depend on the IMF's assessment of a situation.

Once the IMF has decided that a country is eligible for IMF support, it sets out its plans for policy reform. This involves another array of non-binding instruments, which include letters of intent and memoranda of understanding. Formally, these documents are non-binding instruments addressed to, or consented with, the IMF.[88] Nevertheless, they are highly effective. The concerned country needs to implement the reform program set out in these instruments in line with specific performance targets.[89] If it fails to do so, it faces sanctions, like the withholding of subsequent installments. This would seriously impede the entire restructuring process.

The IMF and country also agree to the terms of a restructuring in soft instruments. One example of such an instrument is the Agreed Minutes which conclude Paris Club negotiations regarding the restructuring of bilateral debt. Like the entire architecture of the Paris Club, these instruments are formally non-binding. The Agreed Minutes stipulate the details of the deal between the borrower and its lenders, including whether there will be debt relief and the conditions of any debt restructuring. The principle of comparability requires the debtor country to offer any other creditor comparable terms.[90] The members

[86] *Cf. supra* note 11 (discussing the controversy surrounding the Reinhardt paper and the 90% threshold it advocated).

[87] Olivier Blanchard & Daniel Leigh, *Growth Forecast Errors and Fiscal Multipliers* [XX] (Int'l Monetary Fund, Working Paper No. 1, 2013).

[88] INT'L MONETARY FUND, GUIDELINES ON CONDITIONALITY, para. 9 (Sept. 2002), http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.pdf.

[89] *Id.* at para. 11.

[90] Paris Club, *Que signifie la comparabilité de traitement?*, http://www.clubdeparis.org/en/communications/page/what-does-comparability-of-treatment-mean; *see* Daphne Josselin, *Regime Interplay in Public-Private Governance: Taking Stock of the Relationship Between the Paris Club*

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of the Paris Club have the economic power to enforce the terms of the Agreed Minutes. The same applies for the intermediate and outcome documents of bail-out negotiations in the Eurozone. The statement of the Eurozone concerning Greece from February 2015 is one example.[91]

As these examples demonstrated, soft legal instruments play a decisive role in every stage of the restructuring process. In line with what Chris Brummer has observed for financial market regulation, soft legal instruments owe their effectiveness to the power of institutions, reputation, and markets.[92] As a result, soft law and information may have effects akin to those of hard, binding law, even in the absence of central, official enforcement mechanisms. By contrast, some rules that formally belong to the realm of hard international law in the sense of Article 38 of the Statute of the International Court of Justice may be very ineffective in sovereign debt restructuring. In particular, this concerns economic and social rights. For example, structural adjustment programs often seem to be responsible for a decline in the level of human rights protection.[93] The citizens affected by such measures have few legal safeguards against such measures, because institutions like the IMF do not consider themselves to be bound by human rights. Only recently, domestic constitutional courts have taken effective steps to enforce constitutional guarantees against adjustment programs.[94]

II. Law-Making and Law-Application in Sovereign Debt Restructuring

In sovereign debt restructurings, domestic and international courts have played an especially important role because the issuance of sovereign debt became classified as *acta iure gestionis* to which no sovereign immunities apply.[95] Decisions of domestic and international courts sometimes have effects for many other cases, countries, and creditors. Such decision-making is not embedded, as it should be according to the discourse

and Private Creditors Between 1982 and 2005, 15 GLOBAL GOVERNANCE 521, 531 (2009); *see also* Das, *supra* note 89, at 16 (emphasizing the discretion the application of the comparability principle gives to the Paris Club).

[91] Statement 71/15 of Council of the European Union of Feb. 20, 2015, Eurogroup Statement on Greece (Eurogroup), http://www.consilium.europa.eu/en/press/press-releases/2015/02/150220-eurogroup-statement-greece/.

[92] Chris Brummer, *Why Soft Law Dominates International Finance—And Not Trade*, 13 J. INT'L ECON. L. 623, 637 (2010).

[93] M. RODWAN ABOUHARB & DAVID CINGRANELLI, HUMAN RIGHTS AND STRUCTURAL ADJUSTMENT (2008); Matthias Goldmann, *Human Rights and Sovereign Debt Workouts*, *in* MAKING SOVEREIGN FINANCING AND HUMAN RIGHTS WORK 79 (Juan Pablo Bohoslavsky & Jernej Letnar Cernic eds., 2014).

[94] *See* Cristina Fasone, *Constitutional Courts Facing the Euro Crisis. Italy, Portugal and Spain in a Comparative Perspective* (Eur. Univ. Inst., Working Paper No. 25, 2014).

[95] *See* Republic of Arg. v. Weltover, 504 U.S. 607 (1992).

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theoretical view of adjudication, in a legislative framework representing, by-and-large, those affected by the decisions. Currently, courts engage in a sort of *ersatz* rule-making because there is no comprehensive international legal framework for sovereign debt restructuring for them to rely on.[96]

The avalanche of cases against Argentina before US courts presents a formidable example of domestic judgments that have effects for third states and individuals not within the same jurisdiction. In these cases, New York courts famously interpreted the *pari passu* clause, a boilerplate provision in sovereign bond terms, in an unusual way. Many industry members had thought that this clause secured the formal rank of the bonds,[97] but the state courts held that the clause implied a right of bondholders to equal payment conditions, even if they chose not to participate in a debt restructuring and exchange their bonds for new bonds with a reduction in principal, maturity extensions, and lower yields—so-called uncooperative creditors. On top of this, the courts issued injunctions obliging banks processing Argentina's payments to its cooperative creditors to divert funds and make pro rata payments to non-cooperative creditors.[98] The adverse effects of this decision for Argentina are obvious, but the decision also affects creditors other than the plaintiffs, whether they are US citizens or not. This precedent might severely compromise future restructurings of sovereign debt. The decisions put a premium on free-riding and provide a huge incentive for bondholders not to participate in bond exchanges. They put uncooperative creditors in a position that is more favorable than that of cooperative creditors because the former get the entirety of their arrears paid if Argentina continues regular debt service to its cooperative creditors.[99] These are remarkable conclusions for a view based on creditor equality.[100]

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[96] *See* JULIAN SCHUMACHER, HENRIK ENDERLEIN & CHRISTOPH TREBESCH, SOVEREIGN DEFAULTS IN COURTS (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2189997.

[97] Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869 (2004).

[98] NML Capital, Ltd. v. Republic of Arg., No. 08 Civ. 6978, 2012 U.S. Dist. LEXIS 167272, at *7–8 (S.D.N.Y. Feb. 23, 2012, revised Nov. 21, 2012) (order granting an injunction):

> Whenever the Republic pays any amount due under . . . the [Exchange Bonds] . . . the Republic shall concurrently or in advance make a 'Ratable Payment' to Plaintiffs . . . . Such 'Ratable Payment' shall be an amount equal to the 'Payment Percentage' multiplied by the total amount currently due to [Plaintiffs]. Such 'Payment Percentage' shall be the fraction calculated by dividing the amount actually paid or which the Republic intends to pay under the terms of the Exchange Bonds by the total amount then due under the terms of such Exchange Bonds.

[99] *Id*.

[100] Marc C. Weidemaier & Anna Gelpern, *Injunctions in Sovereign Debt Litigation*, 31 YALE J. ON REG. 189 (2014).

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These cases are not isolated instances; there are already copycats.[101] The ruling has influenced sovereign bond restructuring without the possibility of legislative intervention by an institution representing, at least approximately, those affected by it. The EU has allowed courts to render decisions affecting the policies of other member states, not just private citizens, as would normally be the case in trans-border private law disputes. The European Court of Justice (ECJ) decided that German courts can serve Greece a statement of claim challenging its 2012 haircut.[102] If push comes to shove, German courts may have to decide whether the legislative measures enabling the 2012 haircut were in conformity with the Greek constitution—a decision which, in a German context, would be reserved to the German Federal Constitutional Court.[103] This prospect has motivated other courts to engage in seemingly desperate attempts to shoot down the case.[104]

Some claims involve the application of international law, leading to yet another form of adjudication without the possibility of effective legislative correction. International investment tribunals have considered sovereign bonds as investments within their jurisdiction *ratione materiae*.[105] This gives privately appointed panels of three judges the possibility to call into question decisions affecting not only the plaintiff, but the entire success of a sovereign debt restructuring process. Attempts to invoke necessity or good faith as a defense under customary international law have mostly failed, whether before international or domestic courts.[106] In 2015, an investment tribunal seemed to get cold feet when it declined jurisdiction, stating that "sovereign debt is an instrument of government monetary and economic policy and its impact at the local and international levels makes it an important tool for the handling of social and economic policies of a

[101] *See Export-Import Bank of China v. Grenada*, No. 13 Civ. 1450, 2013 U.S. Dist. LEXIS 117740 (S.D.N.Y. Aug. 19, 2013). *But cf.* Natalie Wong, *NML Capital, Ltd. v. Republic of Argentina and the Changing Roles of the Pari Passu and Collective Action Clauses in Sovereign Debt Agreements*, 53 COLUM. J. OF TRANSNAT'L L. 396 (2015) (pointing out the more cautious approach in cases against Granada).

[102] Case C-226/13, Fahnenbrock v. Hellenic Republic, (June 11, 2015), http://curia.europa.eu/juris/document/document.jsf?text=&docid=164953&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=301904.

[103] GRUNDGESETZ [GG] [BASIC LAW] Art. 100(1), translation at http://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0559.

[104] Cf. the judgment of Landgericht [LG] [regional court] Nov. 19, 2013, Konstanz Case No. II O 132/13 B, arguing that Greece enjoys sovereign immunity. However, this contradicts its finding that the debt instrument belongs to *acta iure gestionis*.

[105] *See Abaclat v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility (Aug. 14, 2011).

[106] *See* Bundesverfassungsgericht [BVERFGE] [Federal Constitutional Court] May 8, 2007, 60 Neue Juristische Wochenschrift [NJW] 2610; Bundesgerichshof [BGH] [Federal Court of Justice] Feb. 24, 2015, Neue Juristische Wochenschrift [NJW] 2328.

State. It cannot, thus, be equated to private indebtedness or corporate debt."[107] As laudable as the insight into the limits of legitimate judicial decision-making may be, it increases the confusion. It does not create a substantive defense applicable across the board, nor is there a legislature that could guide further courts faced with highly contradictory precedents. Progress in terms of predictability seems to depend on judicial activism, a rare and unpredictable resource.

But there are positive examples. The ECJ has shown judicial self-restraint when assessing the legality of the rescue measures of the European institutions, including the ECB.[108] Even when examining whether the consent of the Commission to the Memorandum of Understanding with Cyprus was compatible with the right to property of the depositors on whom it inflicted financial losses, the ECJ engaged only in a perfunctory review of the proportionality of the measure.[109] Although Habermas accurately points out the legitimacy deficit of the rescue measures,[110] unaccountable judicial law-making would make a bad situation worse. Granted, one may disagree with the stance taken by the ECJ in these cases. Yet, one can hardly claim these decisions were unlawful. Law is malleable—both at the center and at the periphery.[111] Malleability may depend on the institutional context in which a court operates; whether a court must review the decisions of institutions with more democratic legitimacy than the court may influence the court's interpretation.

Of course, there is also the reverse problem of executive decisions without judicial control. Most acts of international organizations, including those by the IMF and the Paris Club, are not subject to judicial review. There is no court that can determine whether the Greek bail-out did or did not meet the IMF's lending requirements as those requirements had been traditionally understood.[112] In cases like this one, one important characteristic of the financial order makes it even more important to have independent judicial review, ideally

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[107] Poštová banka, A.S. and Istrokapital SE v. Hellenic Republic, ICSID Case No. ARB/13/8, Award, para. 324 (Apr. 9, 2015).

[108] *See* Case C-370/12, Pringle v. Ireland, (Nov. 27, 2012), http://curia.europa.eu/juris/document/document.jsf?text=&docid=130381&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=306209; Case C-62/14, Gauweiler v. Deutscher Bundestag, (June 16, 2015), http://curia.europa.eu/juris/document/document.jsf?text=&docid=165057&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=306571.

[109] *See* Case C-8/15 P, Ledra Advertising Ltd v. European Commission, (Sept. 20, 2016), http://curia.europa.eu/juris/document/document.jsf?text=&docid=183548&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=884615.

[110] *See supra* Part B.III.

[111] *But see* Pistor, *supra* note 13.

[112] *Cf.* INT'L MONETARY FUND, THE FUND'S LENDING FRAMEWORK AND SOVEREIGN DEBT – PRELIMINARY CONSIDERATIONS (June 2014).

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embedded in a constitutional setting: It is entirely constituted by the law.[113] This comprises products, transactions, and money, its only commodity. Legal certainty is therefore of the essence if we expect markets to work smoothly. Legal uncertainty may not only generate transaction costs, but pull the plug entirely.

III. Public and Private Law in Sovereign Debt Restructuring

For Habermas, a democratically legitimate financial order depends on the legal structure of a public sphere.[114] Sovereign debt restructuring features a conglomerate of private and public actors, instruments, and rules. This makes it difficult to determine which public spheres should be deemed relevant and to what extent decisions can be legitimately made in the context of private transactions. This builds on Katharina Pistor's "essential hybridity" of the law of finance.[115] Essential hybridity highlights the fact that private financial transactions have an immediate impact upon the public interest because they increase or decrease the quantity of money in the market and, with it, the indebtedness of public or private actors.[116] This raises the question what should be the relevant public in the first place.

The confusion of the public and the private is most acute in sovereign debt disputes governed by domestic private law, as described in the preceding section. The fragmented nature of contractual relations between creditors and their debtors generates coordination problems.[117] To solve these problems, the IMF advocates a contractual approach.[118] Contractual collective clauses might increase certainty and reduce fragmentation in sovereign debt restructuring, but they avoid the issue of the relevant public. Indeed, contractual mechanisms alone, almost by definition, do not constitute a public, or provide for solutions that represent the public interest. Contracts certainly play a role in public law contexts, such as cooperative administrative arrangements,[119] but such arrangements are always embedded in a public law framework, which gears them towards the public interest. Without that underlying framework, private law serves the self-interest of

[113] *Cf.* Pistor, *supra* note 13.

[114] See B.III.

[115] *See* Pistor, *supra* note 13.

[116] *Id.*

[117] *Cf. UNCTAD's Roadmap*, *supra* note 81.

[118] INT'L MONETARY FUND, STRENGTHENING THE CONTRACTUAL FRAMEWORK TO ADDRESS COLLECTIVE ACTION PROBLEMS IN SOVEREIGN DEBT RESTRUCTURING (Oct. 2014).

[119] *See e.g.*, Stephan Schill, *Transnational Legal Approaches to Administrative Law: Conceptualizing Public Contracts in Globalization* 27 (Jean Monnet Working Paper, No. 05, 2013); GUILIO NAPOLITANO, PUBBLICO E PRIVATO NEL DIRITTO AMMINISTRATIVO (2003).

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strategic market actors, not the public interest. Although this might advance commutative and restorative justice, it is inapt to bring about distributive justice. This requires solidarity, for which an actual—or at least an identifiable—public is necessary.

This is easier said than done. In the context of a globalized financial system, democratic institutions and financial activities part ways, especially in respect to the complex arrangements charged with the restructuring of sovereign debt. They involve and affect various constituencies, ranging from taxpayers in debtor and creditor states, private creditors, and international organizations in the field, to third states and private actors that might be indirectly affected by the restructuring. The Greek referendum of July 2015 juxtaposed various constituencies on the domestic and supranational levels, each claiming to have at least an equal say in the decision-making process. Habermas's emphasis on two strands of legitimacy in the EU, one deriving from Union citizenship, the other from citizenship in the EU Member States,[120] faces severe limits in this context. As for the IMF, it certainly does not find itself represented in such a structure. The same goes for creditors from third states and creditors of other Eurozone members indirectly affected by the solution due to path dependencies. Even for the Eurozone, an international framework built around and constituting an international public seems necessary.

But to constitute such an international public is highly difficult. There is no institution, even with minor modifications, designed for that task. The IMF is highly unequal given that voting power is determined by financial capacity, not population or some other representative factor. This perpetuates the financial rationality, which a public must be able to call into question. The Paris Club may have transformed itself from an agency for the enforcement of bilateral debts into an organization sincerely concerned about debt sustainability,[121] but it has not transformed itself into an inclusive, representative institution. The General Assembly of the United Nations may come closest to an institution that could be transformed along the lines of Habermas's suggestion for the European Parliament,[122] but one cannot expect a body of that size to have the necessary resolve for efficient executive decision-making.

Habermas's suggestion that international organizations should simply refrain from decisions is not an option either. In case of an acute debt crisis, any restructuring would likely be better than no restructuring at all, even if it is of doubtful legitimacy. Discourse theory thus leads to a conundrum; it attempts to transfer the late capitalist welfare state

[120] *See infra* Part B.III.

[121] Armin von Bogdandy & Matthias Goldmann, *Sovereign Debt Restructurings as Exercises of Public Authority: Towards a Decentralized Sovereign Insolvency Law*, *in* RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE SEARCH FOR COMMON PRINCIPLES 39 (Carlos Esposito, Juan Pablo Bohoslavsky & Yuefen Li eds., 2012).

[122] Habermas, *supra* note 72, at 87.

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model to a global environment, but this environment seems unfit to meet the requirements of the late capitalist welfare state model for a series of practical and theoretical reasons. Discarding the late capitalist welfare state model in favor of a more liberal model does not seem to be an option either, as it would reduce the democratic character of the financial order.[123] The only realistic hope is that of a middle ground between a fully institutionalized, EU-style public institutional setting and the demise of the welfare state model. The structure of transnational discourse may point in that direction.

D. Lessons for Sovereign Debt Restructuring

As has been said above, rational reconstruction approaches issues from both an empirical and a normative angle.[124] Any solution to the problems of Habermas's concept of law identified above may therefore have an empirical and a normative component. In some respects, institutions and procedures might have to change. In other respects, our understanding of the law and of democracy might require adaptation.

We suggest three modifications, which have partly institutional-procedural and partly conceptual implications. They take up the challenges previously identified. All of these proposals are reconstructive in that they engage with current developments, proposing realistic modifications while refraining from any grand institutional redesign. We do not propose, for example, the establishment of a fully-fledged binding international mechanism for sovereign debt restructuring, which—as desirable as it might be—is unlikely to happen in the near future. Our proposals are of an incremental nature. They comprise a shift in focus from binding law towards a broader concept of authority, measures for embedding adjudication in quasi-legislative frameworks, and finally, proposals for the creation of a public on the international level that would neither require grand institutional design nor amount to a demise of the welfare state.

I. Towards International Public Authority

In Habermas's view, law is uniquely suited for combining legitimacy and effectiveness. The preceding analysis highlighted the role of soft law and non-legal instruments such as DSAs in effective sovereign debt restructuring. A discourse theoretical approach should not exclude these instruments from its consideration by only focusing on hard, binding international law. Rather, it should recognize that effective soft and non-legal instruments are an important and useful part of global regulatory efforts to the extent that they are legitimate.

[123] *Cf.* HABERMAS, *supra* note 17, at 182–87.

[124] *See* Patberg, *supra* note 80.

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This observation relies on the insight that the "constraint theory" misses much of what motivates human behavior. It draws too strict a line between intrinsic and extrinsic forms of motivation and overlooks that there might be intermediate forms. Foucault's analysis of the development of the modern welfare state shows how governments have used more subtle means—incentives, information, and indoctrination—to motivate people.[125] Modern studies in motivational psychology have provided insights into why such mechanisms are effective. Between purely intrinsic motivational forces—like, for example, entirely personal convictions—and purely external motivational forces—the threat of force, for example, there is a scale of intermediate types of motivation where external factors motivate people because they influence the way people think about their identity, strategies, and the world.[126] Although the motivations of states, companies, and international institutions arguably do not operate in exactly the same way as the individual motivations,[127] it seems that similar forces are at work in the realm of soft law and non-legal instruments.

This is the reason why the proposal focuses on international public authority instead of international law as the relevant concept for identifying effective governance instruments that require legitimacy.[128] For this purpose, one should understand "authority" as "the legal capacity to determine others and to reduce their freedom, i.e. to unilaterally shape their legal or factual situation."[129] A mechanism that can be rightly considered to shape a factual situation does not need to reach the level of physical sanctions. Rather, it is sufficient that the act gives rise to some form of power which the addressee can only avoid at some cost, be it reputational, discursive, ideational, financial, or other. If such authority is public—if it claims to represent the common interest of a certain group—it needs to be democratically legitimate.[130] Thus, identifying an act as one of public authority does not extend any kind of unconditioned blessing over it. Instead, it obliges the author to ensure that the act is democratically legitimate.

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[125] Michel Foucault, *Governmentality*, *in* THE FOUCAULT EFFECT (Graham Burchell, Colin Gordon & Peter Miller eds., 1991).

[126] GOLDMANN, *supra* note 37, at 344–58; *see* Goldmann, *supra* note 63.

[127] For a nuanced defense, *see* Anne van Aaken, *Behavioral International Law and Economics*, 55 HARV. INT'L L.J. 421, 435 (2014).

[128] Armin von Bogdandy, Philipp Dann & Matthias Goldmann, *Developing the Publicness of Public International Law: Towards a Legal Framework for Global Governance Activities*, 9 GERMAN L.J. 1375 (2008).

[129] *Id.* at 1381-82.

[130] The international character of public authority derives from its having a basis in international law. *See id* at 1383.

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The ramifications of the concept of authority as we define it here have been set out in full detail elsewhere.[131] Suffice it to say that it does not imply that any instrument of international institutions counts as public authority. Rather, it needs to pass a certain threshold. We define this threshold incrementally, applying a reconstructive approach, which discovers typical acts in the practice of international institutions that usually influence the legal or factual situation of their addressees. These acts deserve recognition as "standard instruments," and their legal framework needs to ensure their legitimacy and effectiveness.

As the preceding analysis reveals, sovereign debt restructuring features at least three typical acts that can serve as standard instruments: DSAs, Agreed Minutes or other non-binding instruments resulting from negotiations, and Memoranda of Understanding. Considering these instruments as acts of international public authority recognizes their function for the regulation of sovereign debt restructuring and obliges their authors to ensure their democratic legitimacy.

II. Towards Democratically Embedded Adjudication

The problem of un-embedded adjudication requires mostly institutional and procedural responses. Adjudication is indispensable for legitimate sovereign debt restructuring because the latter affects private, individual rights. Adjudication needs to be democratically legitimate and embedded in equally democratic law-making processes.

For many reasons, an international treaty framework would provide a satisfactory solution to the problem of un-embedded adjudication. Such a framework might set up an international insolvency court and stipulate reasonably predictable substantive and procedural rules for the entire restructuring process, including judicial review. Yet such a solution seems highly unlikely, at least in the near future. It is therefore necessary to look for alternatives to this type of framework. We propose a two-pronged strategy: The first prong relies on a certain measure of judicial activism, while the second prong consists of an incremental strategy aimed at establishing a quasi-legislative, soft legal framework.

At present, courts have the power to simply decide not to enforce sovereign debt instruments where enforcement would endanger either the financial situation of the country concerned or the effectiveness of international efforts to achieve debt sustainability. By choosing not to enforce these instruments, courts would avoid interfering with international negotiating frameworks that have a greater chance of involving all affected parties. Specifically, courts should stay such proceedings as long as the debtor country is cooperating in good faith with the creditors to achieve a consensual

[131] The ramifications of the concept of authority as we define it here have been set out in full detail elsewhere. For more on these ramifications, see von Bogdandy et al., *supra* note 128; GOLDMANN, *supra* note 33, 359.

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restructuring. In fact, it is possible to argue that the enforcement of sovereign debt instruments is legally barred in such a situation. As set out elsewhere, this might follow from good faith or sovereign debt sustainability as general principles of law.[132] Good faith, as a widely accepted general principle, governs contractual sovereign debt instruments. If the debtor state, as part of its good faith duties, initiates restructuring negotiations in good faith, rejecting this offer might amount to a violation of good faith. The German Federal Court of Justice recently disagreed with this position.[133] Yet it mixed the good faith defense with the necessity defense despite the fact that both defenses have quite different requirements and legal effects.[134] Additionally, one might also argue that sovereign debt sustainability has become a general principle of (international) law.[135] The history of sovereign debt restructuring since the end of the Second World War shows a development from a quasi-colonial setting focused on the enforcement of bilateral debt, to mechanisms aimed principally at social and economic development—even though these mechanisms might often fail in practice. This development has been epitomized by the Heavily Indebted Poor Countries Initiative.[136] Nevertheless, this prong of the proposed strategy is a risky one. Progressive judicial reasoning cannot always be relied on, especially in the case of important countervailing economic interests. Perhaps a more democratic supranational and international judiciary would be more inclined to take such steps,[137] but, for the time being, another safeguard seems more practical.

The second prong of the proposed strategy involves embedding judicial decision-making in a quasi-legislative framework. As part of this prong, soft legal instruments—which we have found to be less ineffective than is sometimes assumed—would corroborate and encourage judicial recognition of good faith and sustainability as general principles of law. The United Nations Conference on Trade and Development has taken this approach in recent years by means of its "Principles on Promoting Responsible Sovereign Lending and Borrowing" in 2012[138] and, more recently, its "Principles for a Sovereign Debt

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[132] Cf. von Bogdandy and Goldmann, *supra* note 121; UNCTAD, *Roadmap*, *supra* note 81.

[133] *See* Buchheit, *supra* note 106.

[134] Int'l Law Comm'n, Responsibility of States for Internationally Wrongful Acts, U.N. Doc. A/56/49, at Art. 25 (2001).

[135] Juan Pablo Bohoslavsky & Matthias Goldmann, *An Incremental Approach to Sovereign Debt Restructuring: Sovereign Debt Sustainability as a Principle of Public International Law*, 41 YALE J. INT'L L. 13 (2016).

[136] *See* LEONIE F. GUDER, THE ADMINISTRATION OF DEBT RELIEF BY THE INTERNATIONAL FINANCIAL INSTITUTIONS (2009).

[137] With respect to the ECJ, *see* ANTOINE VAUCHEZ, DÉMOCRATISER L'EUROPE 90 (2014).

[138] United Nations CONF. ON TRADE & DEV., PRINCIPLES ON PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING (2012), http://www.unctad.info/upload/Debt%20Portal/Principles%20drafts/SLB_Principles_English_Doha_22-04-2012.pdf.

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Restructuring."[139] The UN General Assembly adopted a revised version of the latter in September 2015 by an overwhelming majority.[140] Courts might receive further guidance by the principles of the Human Rights Council elaborating the human rights implications of sovereign debt restructuring.[141]

III. Towards a Cleavage-Sensitive Concept of the Public

The most profound institutional and conceptual problem regarding sovereign debt restructuring concerns the question of how to constitute an international public. As discussed earlier, Habermas's proposal to build a supranational public on the basis of national and supranational citizenship[142] comes under stress in the complex setting of sovereign debt restructuring.[143] We suggest that a middle course situated between Habermas's model and the demise of the democratic welfare state model and its replacement by technocratic regulation is a realistic option.

The structure of global discourse reveals how that option could look: (1) Cleavages in public discourse running across national borders and dividing people in different societies more or less along the same lines create discourses that have a potential for legitimizing the exercise of public authority in sovereign debt restructuring. (2) With regard to sovereign debt restructuring, current world public opinion is divided not only along national or regional borders, but also across national borders. In each state or region, people disagree about the right balance between free markets and governmental regulation, as well as about whether regulation should be on the domestic or international level. These two intersecting cleavages characterize a transnational discourse that has the potential to contribute to the legitimacy of sovereign debt restructuring. (3) This prompts two proposals how one could use that potential. One option is implementing institutional improvements that integrate the different sides of a specific cleavage into sovereign debt restructuring. Another option is to attach special significance to decisions taken in one particular constituency based on a discourse centered on a particular cleavage.

[139] See *UNCTAD's Roadmap*, *supra* note 81.

[140] *Cf.* U.N. G.A., *Basic Principles on Sovereign Debt Restructuring*, Draft Resolution, U.N. Doc. A/69/L.84 (July 29, 2015).

[141] *E.g.* Human Rights Council, *The Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of All Human Rights, Particularly Economic, Social and Cultural Rights*, U.N. Doc. A/HRC/RES/20/1018 (July 2012).

[142] *See infra* Part B.III.

[143] *See infra* Part C.III.

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1. Cleavages in Public Discourse

Democratic nation states gain legitimacy from their ability to bridge deep cleavages in society. Originally formulated by political scientists Seymour Martin Lipset and Stein Rokkan in 1967, the concept of cleavages stems from empirical research revealing the striking stability and efficiency of democracies in Western Europe.[144] According to Lipset and Rokkan, historically developed party systems are the main causes of widespread participation and acceptance of decision-making bodies. Lipset and Rokkan identified the cleavages of Labor versus Capital, State versus Church, and Center versus Periphery as the most crucial divisions structuring political discourse in Western Europe in the preceding decades and century. The decisive question is whether a society manages to institutionalize these discursive divisions in a way that ensures participation on either side of the cleavage in the exercise of public authority. If successful, this institutionalization may stabilize society and contribute successfully to social integration. For instance, during the struggle between Labor and Capital in the 19th century, owners and employers, on the one hand, and tenants, laborers, and workers, on the other, were ultimately able to aggregate their interests and form political parties. Hence, the conflict continued in political discourse, the newly founded political parties acted as advocacy coalitions, and the conflict between the two groups did not escalate.[145]

The underlying concept is simple: Political affiliations emerge in crucial, entrenched divisions in society. Cleavages are different from disagreements on other political questions in that they epitomize fundamental conflicts revolving around fundamental values such as the distribution of public goods. These fundamental conflicts determine the political affiliations of people on either side of the cleavage. Hence, cleavages structure discourse in two ways: They separate people on different sides of a cleavage, but allow alliances to form across political, geographic, religious, or ethnic lines among those on either side of the cleavage. If a political system succeeds in institutionalizing either side of a cleavage, the system will enjoy a high degree of stability and legitimacy. This is the story of the post-war party system in Western European states.[146]

Certainly, the post-war party system has lost a good part of its capacity to absorb societal conflict lines. Habermas has observed as early as in 1987 that societal conflicts

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[144] Seymour Martin Lipset & Stein Rokkan, *Cleavage Structures, Party Systems and Voter Alignments. An Introduction*, *in* PARTY SYSTEMS AND VOTER ALIGNMENTS: CROSS-NATIONAL PERSPECTIVES 1 (Seymour Martin Lipset & Stein Rokkan eds., 1967).

[145] *See generally* Alan S. Zuckerman, *Political Cleavage: A Conceptual and Theoretical Analysis*, 5 BRITISH J. POL. SCI. 231 (1975). *See* WILHELM HEITMEYER, WAS HÄLT DIE GESELLSCHAFT ZUSAMMEN? (1997) (regarding the development of capitalism and social integration); Michael Vester, *Kapitalistische Modernisierung und gesellschaftliche (Des-)Integration*, *in* WAS HÄLT DIE GESELLSCHAFT ZUSAMMEN? 149 (Wilhelm Heitmeyer ed., 1997).

[146] Lipset, *supra* note 144, at 2–5.

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> no longer flare up in domains of material reproduction; they are no longer channelled through parties and associations; and they can no longer be allayed through compensations. Rather, these new conflicts arise in domains of cultural reproduction, social integration and socialization; they are carried out in sub-institutional—or at least extra-parliamentary—forms of protest; and the underlying deficit reflects reification of communicatively structured domains of action that will not respond to the media of money or power.[147]

In hindsight, one might argue that Habermas's quote observed the first societal consequences of globalization that has transformed the structure of cleavages in society. Indeed, globalization might be one of those processes of profound change which Lipset and Rokkan considered essential for the emergence of cleavages.[148] The issue which determines the cleavage needs to be in the center of the public debate.[149] Globalization has led to major social transformations that increasingly politicize the public sphere on a worldwide scale.[150] This has been the object of recent empirical research by Michael Zürn and Pieter de Wilde.[151] The concept of cleavages therefore may have the potential to describe transformations of the public sphere in the wake of globalization.

For this reason, the concept of cleavages lends itself to a discourse theoretical approach. Both the cleavage concept and discourse theory consider the public sphere as the main resource of legitimacy. The idea of cleavages can be used to identify specific transnational discourses relevant to the financial order. Transnational discourses structured along specific cleavages are tantamount to public spheres in which participating groups or individuals align themselves on either side. If the global level—where the two sides of a cleavage meet—succeeds in channeling this disagreement into institutions and procedures

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[147] JÜRGEN HABERMAS, THEORY OF COMMUNICATIVE ACTION VOLUME TWO: LIFEWORLD AND SYSTEM: A CRITIQUE OF FUNCTIONALIST REASON 394 (1987).

[148] Lipset, *supra* note 144, at 14; Kevin Deegan-Krause, *Full and Partial Cleavages, in* THE HANDBOOK OF POLITICAL CHANGE IN EASTERN EUROPE 35 (Sten Berglund, Joakim Ekman, Kevin Deegan-Krause & Terje Knuten eds., 2013).

[149] *See* Pieter de Wilde, *No Polity for Old Politics? A Framework for Analyzing Politicization of European Integration*, 33 JOURNAL OF EUROPEAN INTEGRATION 559 (2011).

[150] *See* HANSPETER KRIESI ET AL., POLITICAL CONFLICT IN WESTERN EUROPE (2012); Peter A. Furia, *Global Citizenship, Anyone? Cosmopolitanism, Privilege and Public Opinion*, 19 GLOBAL SOC'Y 331 (2005). Also, see surveys available at www.WorldPublicOpinion.org.

[151] Pieter de Wilde and Michael Zürn, *Debating Globalization: Cosmopolitan and Communitarian Argumentation* (2012), http://paperroom.ipsa.org/papers/paper_12480.pdf.

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that allow for fair and transparent discourse, there may be a realistic chance for transnational social integration. Taking into account discourses characterized by cross-border cleavages may enhance the legitimacy of sovereign debt restructuring.

2. Two Transnational Cleavages: Market Versus Government and Domestic Versus International

In order to make use of cleavages for sovereign debt restructuring, one first needs to identify the relevant cleavages that characterize discourse in the field. Some claim that "[p]opular agitation around the international politics of public debt tends to express itself in terms of nations versus nations, rather than people versus financial markets."[152] Indeed, Russia's refusal to grant Ukraine a sovereign debt restructuring in 2015 is a case in point for a cleavage that runs along national borders. Similarly, in the history of sovereign debt in the twentieth century, the dominant cleavage was located between the Global North and the Global South, which may also be seen as a cleavage between the center and the periphery of international finance.[153]

There is evidence, however, that cleavages regarding sovereign debt issues do not necessarily run along national boarders any longer—at least in the European Union.[154] Research on social movements has shown that there are two transnational, intersecting cleavages, which shape the debate about sovereign debt restructuring. The first cleavage resembles—and goes beyond—the traditional labor versus capital cleavage. This cleavage is characterized by two different and competing attitudes concerning the organization of the economy: Market liberalism or neoliberalism versus governmental regulation or interventionism.[155] The former attitude refers to a less welfarist approach, which emphasizes the importance of free markets. Proponents of market liberalism prefer requiring debtor states to pay back their debt in order to let market discipline work and to prevent the moral hazard that might derive from overly accommodating debt restructurings.[156] The latter attitude, interventionism, strives for a stronger role of the

[152] ARMIN SCHÄFER AND WOLFGANG STREECK, POLITICS IN THE AGE OF AUSTERITY 21 (2013).

[153] Regarding the center-periphery dynamics in international economic law, *see* David Kennedy, *Law and Political Economy of the World*, 26 LEIDEN J. INT'L L. 7 (2013).

[154] *See* Floris de Witte & Mark Dawson, *From Balance to Conflict: A New Constitution for the EU*, 22 EUR. L. J. 211 (2016); *see also* STEFAN BARTOLINI, RESTRUCTURING EUROPE: CENTRE FORMATION, SYSTEM BUILDING, AND POLITICAL STRUCTURING BETWEEN THE NATION STATE AND THE EUROPEAN UNION 248–81 (2005).

[155] For the neoliberal view, *see* FRIEDRICH A. HAYEK, THE ROAD TO SERFDOM (1944). For the interventionist view, *see* JOHN MAYNARD KEYNES, THE END OF LAISSEZ-FAIRE (1926); KARL POLANYI, THE GREAT TRANSFORMATION: THE POLITICAL AND ECONOMIC ORIGINS OF OUR TIME (1944). The two views come in many different shades. *See* SOSKICE, *supra* note 16.

[156] The leaked plan of the German Ministry of Finance in November 2015 provides an example of this. *See* Carlos Bastasin, *Mr. Schäuble's Ultimate Weapon: The Restructuring of European Public Debt*, BROOKINGS (Dec. 15, 2015), http://www.brookings.edu/research/opinions/2015/12/15-schauble-public-debt-weapon-bastasin; Otmar Issing,

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state in market regulation and the provision of welfare services. It therefore advocates more generous sovereign debt restructurings, stressing that economic hardship in debtor states and a lack of solidarity undermines the legitimacy of political systems.[157]

There is ample empirical evidence for the existence of the cleavage along neoliberalist and interventionist lines and its relevance for depicting attitudes on sovereign debt restructuring. Donatella della Porta identified the emergence of a global cleavage in both the North and the South in current anti-austerity protest movements.[158] Economic globalization and the consequences of financial markets are in the center of this cleavage between the winners and the losers of globalization. The roots of the cleavage go back several decades; advancement of neoliberalism since the 1970s, the Latin American debt crisis, and the conditionality attached to structural adjustment programs by the IMF have all triggered recurrent protests. Emerging in the periphery, resistance against IMF and World Bank instruments has soon expanded globally. As a consequence, as della Porta rightly observes, the Global North has witnessed an immense wave of anti-globalization protests during the last fifteen years. These protests intensified in the wake of the financial crisis and the ensuing sovereign debt crisis. The Occupy Movement in the capitals of international finance and anti-austerity protests in Spain, Portugal, Italy, and Greece have shown a significant amount of collective identity, organizational capacity, and discursive action. Their claims include demands for a more democratic and just economic or financial system.[159] In the run-up to the Greek bailout referendum of July 2015, many countries witnessed anti-austerity protests and public expressions of solidarity with Greece.[160] The cleavage thus appears to be truly transnational in character. However, it should be borne in mind that this cleavage is not (yet) as deeply entrenched in society as traditional cleavages confined to the nation state, as it is not (yet) supported by powerful and persistent transnational institutions.

Some Remarks on Debt, Default, and Debt Relief (LSE Financial Markets Group Paper Series, 2015), http://www.lse.ac.uk/fmg/workingPapers/specialPapers/PDF/SP240.pdf.

[157] *See, e.g.*, Martin Guzman, José Antonio Ocampo & Joseph E. Stiglitz, *Creating a Framework for Sovereign Debt Restructuring that Works*, *in* TOO LITTLE, TOO LATE: THE QUEST TO RESOLVE SOVEREIGN DEBT CRISES 3 (Martin Guzman et al. eds., 2016); Yanis Varoufakis, *A New Approach to Eurozone Sovereign Debt*, PROJECT SYNDICATE (Aug. 17, 2015), https://www.project-syndicate.org/commentary/eurozone-sovereign-debt-solution-by-yanis-varoufakis-2015-08?barrier=true.

[158] DONATELLA DELLA PORTA, SOCIAL MOVEMENTS IN TIMES OF AUSTERITY: BRINGING CAPITALISM BACK INTO PROTEST ANALYSIS (2015).

[159] *Id*. at 89–97; CRISTINA FLESHER FOMINAYA & LAURENCE COX, UNDERSTANDING EUROPEAN MOVEMENTS: NEW SOCIAL MOVEMENTS, GLOBAL JUSTICE STRUGGLES, ANTI-AUSTERITY PROTEST (2013).

[160] E.g. solidarity protests surrounding the Greek referendum took place in several European capitals, including in Lisbon, Barcelona, Rome, Paris, Berlin and Brussels.

Michael Zürn and Pieter de Wilde have identified a second transnational cleavage that structures the debate about sovereign debt restructuring. They argue that a cleavage has emerged between cosmopolitan and communitarian attitudes, whereby the cosmopolitan attitude favors international solutions for global problems, while the communitarian attitude prefers domestic responses.[161] Zürn and de Wilde were able to demonstrate that this cleavage exists beyond the Western world. It relates to contentious issues such as trade, regional integration, migration, and human rights.[162] One can map this new cleavage in the increasing politicization of international institutions,[163] although it falls short of the high degree of institutionalization typical of traditional cleavages on the level of the nation state.

Both cleavages intersect. Cosmopolitan and communitarian views exist on either of the sides of the previously described cleavage between market liberalism and governmental interventionism. In fact, as the literature on the varieties of capitalism[164] and on welfare state models has shown, a variety of views exist regarding the role of the state in regulating markets and providing welfare.[165] This might have a conditional effect on the manifestation of the cleavage with respect to sovereign debt restructurings, as austerity policies will have different effects according to the prevailing model of economic and welfare regulation, affecting the population to varying degrees.[166] Likewise, whether solutions are sought on the national or international level is often a matter of degree rather than an exclusionary position. For example, among those favoring European

[161] de Wilde, *supra* note 149.

[162] *See* Pieter de Wilde, Wiebke Junk & Tabea Palmtag, Representing Globalization Conflict In International Organizations: Cleavage Formation Beyond the State presented at ECPR General Conference (Sept. 3, 2014), http://ecpr.eu/Filestore/PaperProposal/bab379c6-8b11-4980-9765-83c1bf34dd46.pdf; Pieter de Wilde, Ruud Koopmans & Michael Zürn, Conflicts or Cleavage? Contesting Globalization in Western Europe and Beyond presented at ECPR General Conference (Sept. 3, 2014), http://ecpr.eu/Filestore/PaperProposal/ce7978ec-3492-4c4f-ba81-459b6ad76667.pdf.

[163] *See generally* MICHAEL ZÜRN & MATTHIAS ECKER-EHRHARDT, DIE POLITISIERUNG DER WELTPOLITIK: UMKÄMPFTE INTERNATIONALE INSTITUTIONEN (2011); Pieter de Wilde & Michael Zürn, *Can the Politicization of European Integration be Reversed?*, 50 J. COMMON MKT STUD. 6 (2011); Michael Zürn, *The Politicization of World Politics and its Effects: Eight Propositions*, 6 EUR. POL. SCI. REV. 47 (2014).

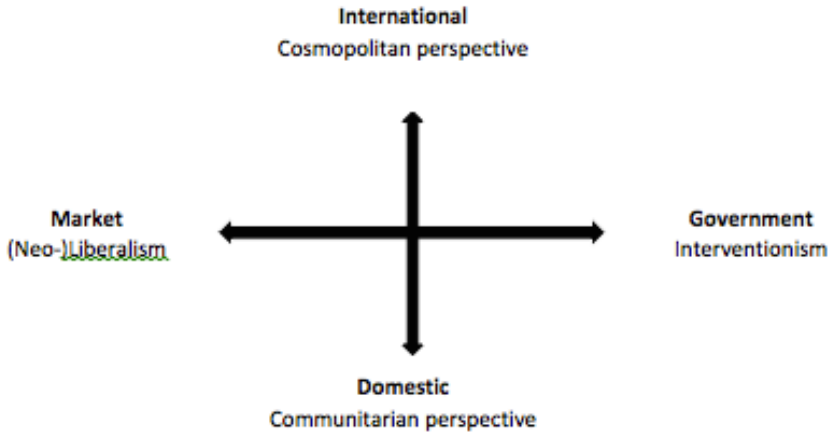
[164] HALL, *supra* note 16.

[165] According to Gøsta Esping-Andersen, the development of institutions predominantly preoccupied with the production and distribution of social well-being led to the rise of the welfare state, with variations of welfare state institutions and policies in capitalist democracies. Esping-Andersen distinguishes the liberal, conservative, and social democratic model of welfare state regulation. *See* GØSTA ESPING-ANDERSEN, THE THREE WORLDS OF WELFARE CAPITALISM [XX] (1990); MANFRED G. SCHMIDT ET AL., DER WOHLFAHRTSSTAAT. EINE EINFÜHRUNG IN DEN HISTORISCHEN UND INTERNATIONALEN VERGLEICH (Manfred G. Schmidt et al. eds., 2007).

[166] Paul Pierson, *Three Worlds of Welfare State Research*, 33 COMP. POL. STUD. 798 (2000).

solutions in the Eurozone debt crisis, some would favor the introduction of Eurobonds,[167] while others think that liability for sovereign debt should remain domestic.[168]

This leads to the following distribution:



This scheme represents the abstract form of the views emerging from the two mentioned cleavages. The concrete distribution of views might vary from case to case. With respect to the European sovereign debt crisis, Habermas distinguishes six different positions. These positions reflect and further differentiate the two above-mentioned cleavages. According to Habermas, defenders of national sovereignty include both "ordoliberal proponents of a lean nation-state" and "republican or right-wing populist proponents of a strong nation-state," while advocates of progressive European integration comprise "economic liberals of various types" and interventionists wishing to regulate the financial market.[169] Proponents of interventionist policies can be further distinguished according to the familiar left-right divisions on the political spectrum, which separates the "Eurodemocrats" from the technocrats.[170] Yet, this distribution is specifically tailored to the Eurozone in 2013 and therefore constitutes only one possibility of how the two transnational, intersecting cleavages in debt restructuring might manifest in practice.

[167] *See* Martin Schulz, Interview, *Daumenschrauben angezogen*, 36 DER SPIEGEL (2012) http://www.spiegel.de/spiegel/print/d-87997155.html.

[168] *See* Wolfgang Schäuble, Interview, *Keine Rettung um jeden Preis*, 33 DER SPIEGEL (2011), http://www.spiegel.de/spiegel/print/d-79973965.html.

[169] Habermas, *supra* note 73, at 83–84 (translated version).

[170] *Id*.

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3. Cleavage Sensitivity in Sovereign Debt Restructuring

The decisive question is how sovereign debt restructuring can take the two cleavages identified above into account and productively channel the legitimating potential of these transnational debates. Again, the reconstructive methodology is most appropriate for advancing incremental developments of existing practice in line with the principles expressed in that practice. The guiding idea behind our proposals is similar to that of the duality of member state and EU—or cosmopolitan—citizenship endorsed by Habermas. Based on this duality, sovereign debt restructuring should represent citizens in two ways: As citizens of a state and in accordance with their affiliation with the different sides of the two cleavages.

Integrating this dual concept of representation into sovereign debt restructuring is very difficult because affiliation with the different sides of the two mentioned cleavages is not formalized like EU citizenship.[171] In fact, these new transnational cleavages lack the institutional embeddedness of the traditional nation-state cleavages, which historically manifested within party structures. Transnational civil society and international social movements do not have the same organizational capacity as political parties. Although the groups initiating and sustaining these cleavages have less organizational capacity, taking into account the identified manifestations of these cleavages is crucial in sovereign debt restructuring to account for the legitimacy problems identified above. Furthermore, as discussed in the previous subsection, in the past two decades, the increasing transnational manifestations of the two cleavages are extremely relevant for sovereign debt restructurings. One option to reflect the cleavages in sovereign debt restructuring negotiations would be to allow the participation of representative civil society groups; another option would be to reconsider the significance of domestic democratic decision-making processes for international sovereign debt restructurings.

With regard to the first option, the idea to involve non-state actors in the institutional framework—and in the decision-making mechanism of an international organization—is not entirely new. The global cleavage between Labor and Capital has been integrated into the structure of the International Labour Organization for a long time, and representatives of workers and employers enjoy a high degree of participation in the organization.[172] The representatives participate in the main bodies along with domestic government representatives and enjoy voting powers. Similarly, certain international economic

[171] For an inspired proposal for institutional changes in the European Union, *see* de Witte & Daweson, *supra* note 154, at 214–17.

[172] For a proposal as to how the design of an international financial architecture could draw on the institutional setting of the ILO, *see* Katerina Tsotroudi, *International Labour Standards as a Model for the Future: The Case of Financial Regulation*, *in* LES NORMES INTERNATIONALES DU TRAVAIL: UN PATRIMOINE POUR L'AVENIR. MÉLANGES EN L'HONNEUR DE NICOLAS VALTICOS 615 (George Politakis ed., 2014).

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organizations such as the Organization for Cooperation and Development (OECD) and the Andean Community of Nations and the Southern Common Market (MERCOSUR) provide for the participation of both workers and business representatives.[173] In these organizations, representatives have mostly consultative functions.[174] The level of institutionalization of the various positions emerging from the two intersecting transnational cleavages is far lower. It is difficult to find groups or organizations that could legitimately claim to represent a position. It would therefore appear inappropriate to give direct decision-making power in sovereign debt restructuring negotiations to the representatives of the various positions reflecting these particular cleavages. This would not exclude institutional arrangements for participation that has a consultative function. Such participation should be extended to industry representatives, civil society organizations, unions, and other entities.

The second option, not exclusive to the first, concerns the status attributed to international restructuring operations to democratic decisions taken on the domestic level. The Greek and Icelandic referenda, which took place in the context of a transnational discourse characterized by the two cleavages, provide good examples. One cannot discard such decisions as mere expressions of national interest given that the underlying cleavages are transnational and exist in one way or another in many countries. This is evidenced by the solidarity movement in favor of the Greek government, as well as by an equally vocal countermovement. Yet, a referendum in Greece or Iceland cannot claim to express the will of other states, other states' citizens, or of their private and public creditors. Like Greece and Iceland, other creditors and other states have their legitimate self-interest, for which bargaining-style restructuring negotiations are appropriate. One should therefore attribute some significance, albeit not a dominating one, to domestic democratic decisions like the Greek or Icelandic referenda in debt restructuring negotiations by making them cleavage-sensitive. One way of doing so would be to attribute veto powers to such decisions. Should the debtor country veto the result of negotiations in a democratic procedure framed by a transnational discourse along the two cleavages, creditors would then not be allowed to walk away from the negotiating table—or to threaten the debtor with the prospect of leaving the monetary union. Instead, they would have to continue negotiations and find a different solution. The same applies to democratic decisions taken in creditor states, provided that discourse is framed along the two cleavages.

This does not give carte blanche to debtor or creditor states. Their citizens need to be aware that such veto powers only work as long as decisions are actually structured by the two transnational cleavages and do not revolve solely around domestic interests.

[173] *See* other organizations, for example, *Consejo Presidencial Andino*, *Consejo Consultivo Empresaral*, and *Consejo Consultivo Laboral*.

[174] In the case of MERCOSUR, workers' and employers' representatives can also vote on instruments and policies to be adopted by the organization in the area of social and labor affairs.

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Competent domestic and international courts could decide whether that is the case. They should also become more cleavage-sensitive and respect domestic democratic decisions.[175] One way of doing so would be to impose a stay on enforcement measures as long as there is a duty to negotiate due to a legitimate veto.

E. Towards a Democratic Financial Order

This text has taken a discourse theoretical perspective on the role of law in the relationship between democracy and financial order. We have argued that Habermas's idea of transposing the welfare state model into the global and European arenas implies a concept of law that is doubtful in several respects. This has led us to develop proposals that take into account soft law and information as forms of authority, embed adjudication in quasi-legislative structures, and make sovereign debt restructuring more sensitive to transnational cleavages between preferences for market liberalism or governmental regulation, on the one hand, and domestic or international solutions on the other.

The practical application of our proposal might require more investigation, as would the question of whether it could be useful for other segments of the financial order to ensure that they are squared with democracy. In any case, we hope this Article has shown that—at least in theory—there are viable alternatives that exist between the unlikely prospect of a fully democratic, welfarist world federation and a return to liberal capitalism and national solutions.

[175] For the ECJ, *see* Jan Komárek, *National Constitutional Courts in the European Constitutional Democracy*, 12 INT'L J. CONST. L. (2014).

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