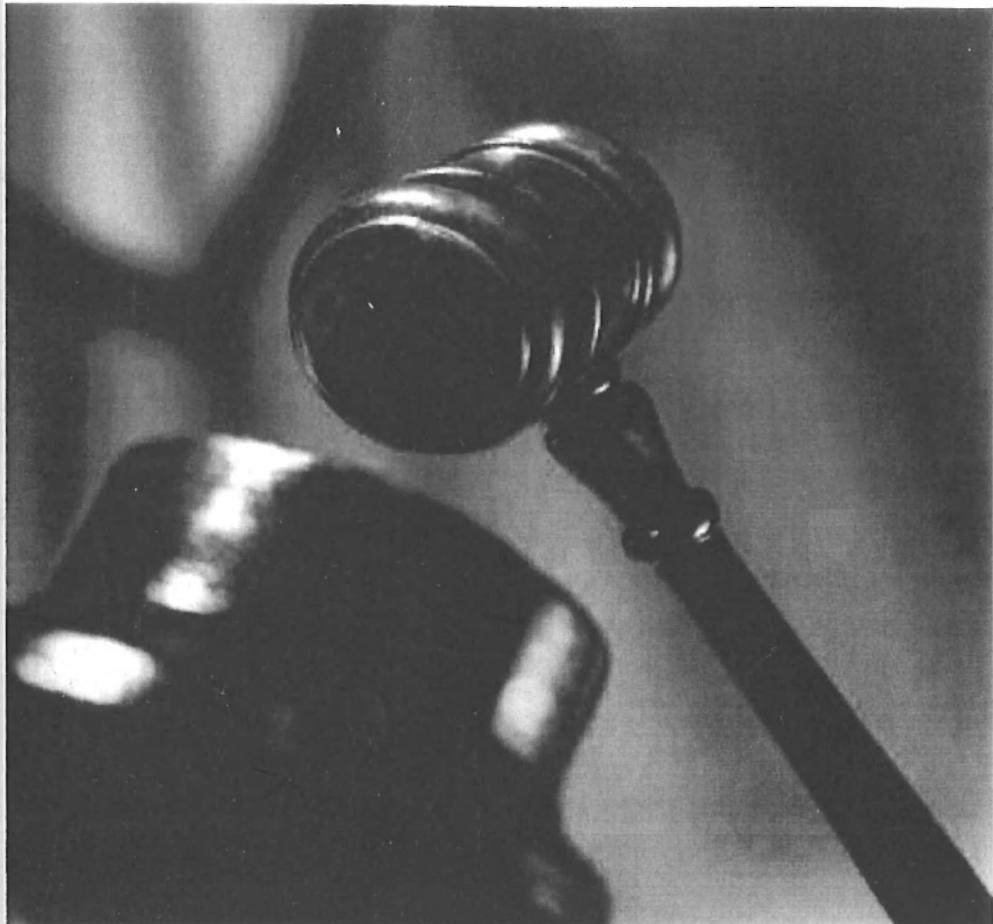


AFRICAN FORUM AND  
NETWORK ON DEBT AND  
DEVELOPMENT  
④ Implementing Fair debt  
arbitration

## Implementing Fair Debt Arbitration



## What Needs To Be Done?



African Forum and Network  
on Debt and Development

Implementing Fair Debt Arbitration: What Needs To Be Done?

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## About AFRODAD

### AFRODAD Vision

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

### AFRODAD Mission

To secure policies that will redress the African debt crisis based on a human rights value system.

AFRODAD Objectives include the following:

- 1 To enhance efficient and effective management and use of resources by African governments;
- 2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of the people in the world.
- 3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being a political, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of 1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board of seven people from the five regions of Africa, namely East, Central, West, Southern and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff compliment of Seven programme and five support staff.

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AFRODAD wishes to express its gratitude to Professor Raffer Kunibert of the University of Vienna in Austria for taking considerable time and effort to produce this piece of work. It was not easy to envisage what we at AFRODAD were looking for in the paper, but we believe he caught the vision and mission and was able, without much ado, to put this work together. We also wish to thank Mr. Opa Kapijimpanga for his input especially for working with the AFRODAD secretariat in developing the Terms of Reference for this work.

We remain greatly indebted to the Ford Foundation for supporting this ambitious work that AFRODAD embarked on since 2002. The purpose and vision remains that of ensuring that everyone, great and small in our global village comes to realize that there is need to find lasting solutions to the past, present and future debt questions of the least developed countries of the South in our uneven global village.

## Preface

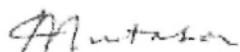
"Everywhere in the world new ideas are resisted not because they are bad or wrong , but just because it is human to be sceptical of new ideas that we neither understand nor are fully convinced of"- anonymous.

The Fair And Transparent Arbitration (FTA) mechanism unpacked in this publication is meant to explain in detail - why arbitration and not just debt cancellation. The publication looks at the rationale and support for debt arbitration and how this can be realized in today's global village. It is meant to provoke us to think beyond our usual mental boxes.

The two versions of the Heavily Indebted Poor Countries Initiative (HIPC) of 1996 and 1999 have failed to give a lasting solution to the third world debt question. The Multilateral Debt Relief Initiative (MDRI) of 2005 at the Gleneagles G8 Summit has just joined the number of creditor-initiated proposals (on the debt crisis of the developing world) with its own shortfalls, especially the fact that it is building on the wrong foundation of HIPC conditionalities and process. It seems in the process - the ecological/historical debt; the illegitimate debt and odious debt have been forgotten or simply swept under the carpet. Yet, countries such as the Democratic Republic of Congo (DRC), the Philippines, Argentina and Indonesia among others are still choking and paying for the debts of their former dictatorial regimes; wrong/bad policy advice of the International Financial Institutions; irresponsible borrowing of past regimes and reckless lending by creditors.

The question of what is to be done about future debts - those coming after debt relief from the beneficiaries of the 2005 Multilateral Debt Relief Initiative are not clear. AFRODAD believes that debt relief on its own is not the panacea – it is necessary to address the question of uneven power balance between the global South and North if debt is not to be used any more as an instrument of control or domination of the former by the latter. The apportioning of the present debt crisis between creditors and debtors remains vital for the building of good global partnership between the global South and North (see The Millennium Development Goals (MDGs) Goal No. 8). There is urgent need to end the domination and monopoly of creditor nations in deciding how to handle the global South debt within a fair and transparent arbitration process.

We at AFRODAD are strongly convinced that any piecemeal solutions that we have seen and heard of is just but part of a process to the lasting solution - a Fair and Transparent Arbitration (FTA) mechanism within the auspices of the United Nations. Debt relief or cancellation can work best alongside a Fair and Transparent Arbitration mechanism to avert the historical problem of countries falling back into indebtedness.



Charles MUTASA  
Executive Director

## List of Abbreviations

AFRODAD	African Forum and Network on Debt and Development
ACP	African, Caribbean and Pacific Group of States
AfDB	African Development Bank
AfDF	Africa Development Fund
AU	African Union
CONAIE	Confederation of Indigenous Nationalities of Ecuador
DAB	Debt Arbitration Body
DRC	Democratic Republic of Congo
EU	European Union
FTAP	Fair and Transparent Arbitration Process
HIPC	Heavily Indebted Poor Countries Initiative
FTA	Fair and Transparent Arbitration
FTA	Fair and Transparent Arbitration Process
G7/8	Group of Seven/Group of Eight
IADB	Inter American Development Bank
IBRD	International Bank of Reconstruction and Development
ICJ	International Court of Justice
IDA	International Development Agency
IFCAI	International Federation of Commercial Arbitration Institutions
IFIs	International Financial Institutions
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
MDGs	Millennium Development Goals
MDGs	Millennium Development Goals
MPs	Members of Parliament
NGOs	Non Governmental Organisations
OECD	Organisation of Economic Corporation Development
OED	Operations Evaluation Department
PCA	Permanent Court of Arbitration
RSA	Republic of South Africa
SDRM	Sovereign Debt Restructuring Mechanism
SSA	Sub-Saharan Africa
US	United States
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNICEF	United Nations Children's Education Fund
WTO	World Trade Organisation

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## 1.0 Introduction

The demand for a fair and transparent way of solving the sovereign debt problem afflicting "developing countries" has been on the table since 1987. While some demands once considered "impossible" by official creditors have found acceptance, the absolute domination of debt management by official creditors has remained virtually unchanged. Creditor and debtor attitudes have, nevertheless, shifted since the early 1980s, although much too slowly and not far enough. This lethargy has caused a lot of avoidable damage to debtor economies and the poor. Much still remains to be done. Strong lobbying of creditor governments is needed to make them eventually respect human rights, the Rule of Law, good governance and basic legal principles, such as tort laws or the demand to respect treaties ("pacta sunt servanda"), even when this works to the advantage of people who are not nationals of OECD countries.

This paper discusses setting the scenario to introduce an arbitration process on debts. Although it seems a deceptively small, formal step it would change creditor-debtor relations fundamentally for the better. Official creditors would stop being the judge, jury, expert, bailiff, plaintiff and often even the debtor's lawyer all in one. Both sides would be parties, as usual in any debt relations and as demanded by the Rule of Law.

Debt arbitration in this paper may mean two technically different forms of arbitration, both equally unacceptable to official creditors at the moment: a fair and transparent process of debt reduction aligning a country's total debts to its capacity to pay (international arbitration based on the main principles of the US Chapter 9 or FTAP) or arbitration restricted to specific types of debts, such as illegitimate or odious debts.

On how to mobilise and support debtors, the paper first briefly summarises changes in creditor attitudes, which – although slow and insufficient – prove that campaigning, lobbying and the force of arguments can make recalcitrant creditor governments change their views. Further effort is needed to prepare the stage for debt arbitration, then the potential role of the UN in solving the problem of a sovereign debt overhang, as well as the question of which types of debt should be brought before an arbitral tribunal in the absence of a demand for a full-fledged FTAP covering all debts. The paper concludes with the necessity of a mechanism to shield debtor economies from tortious creditor behaviour and advice. The legal double standard of denying the poor this basic legal protection, otherwise universally accepted and considered as a matter of course, must be addressed. The poorest countries, whose projects and programmes have been planned and closely monitored by their creditors and "donors", suffer especially strongly from the absence of decent legal and economic rules. Quite substantial parts of official, especially multilateral, debts would never have come into existence without this undue and unjustifiable discrimination suffered uniquely by Southern countries. The formation of arbitral tribunals itself need not be discussed, as it is described elsewhere in detail (cf., e.g., AFRODAD 2000; Raffer 1990, 1993a).

## 2.0 Slow Changes In Creditor Attitudes

Progress in creditor attitudes has been slow, mostly because of resistance by official creditors. For understandable reasons, debtor governments have usually been reluctant to demand that creditors implement what they preach, a behaviour that is about to change at present, as Nigeria or Argentina demonstrate. In spite of the recalcitrant attitude of official creditors, the following moves have occurred:

HIPC I broke the taboo of multilateral debt reductions although IFIs remain unduly preferred against economic, legal, and ethical reasoning.

HIPC II finally introduced the idea of debtor protection, which was considered utopian when first made, although still in a rudimentary form and very different. Highly insufficient, these anti-poverty programmes are a perceptible change from the position held more than a decade ago in discussions on a sovereign Chapter 9 or FTAP that debtor protection would be impossible, recognising that anti-poverty measures can and must be part of "debt management". Lobbying and pressure by civil society on the G7/8 was of paramount importance to bring about this still insufficient move in the right direction.

The IMF recognised the need for an orderly framework to determine which part of their debts insolvent debtors can actually pay, although not for low-income countries. This was quite a break away from the IMF's traditional debt management. So was Krueger's (2001, p.8) correct statement that this orderly framework would reduce restructuring costs (for similar statements (see Raffer 1989, 1990, 2002). Unfortunately, the SDRM itself is a highly self-serving mechanism that would enhance the status and power of the IMF, its proposal seems to indicate that the IMF finally recognised that present "debt management" is untenable, at least for one group of countries.

After denying the need and even the possibility of registering and assessing debts in the usual way in any domestic insolvency procedure, the IMF (2002, p.68) demanded specific checks regarding "for example, the authority of an official to borrow on behalf of the debtor", echoing what Raffer (1990, p.309) had demanded. (Raffer 1993a, p.68). Unfortunately, this new insight has not yet had any practical "on the ground" effects.

The idea that the debtor government's demand for an insolvency procedure should automatically preclude further lawsuits and legal enforcement by creditors during insolvency procedures (Raffer 1990) had initially been taken up by the IMF's SDRM. The Fund's position then changed and still remains unclear.

The IMF took up arbitration, although in a perverted and self-serving way, exempting IFIs and remaining evasive about Paris Club members that are also the Fund's main shareholders. All IMF documents on the SDRM, though, are clear that private creditors would be fully subject to arbitration - where private and public, including multilateral, creditors would be treated equally, and neither debtors nor private creditors would be subject to the IMF's arbitrary decisions.

Although arbitrarily picking countries and those multilateral institutions whose claims should be reduced, the G8 decision at Gleneagles during the summer of 2005 advances the idea of equal treatment of IFIs. It proves that debt reduction is possible in the case of multilateral funds, a fact that had been denied vigorously by IFIs themselves over the years. The arbitrary choice of countries and institutions (debts vis-à-vis IDA and the AfDF but not vis-a-vis their Inter-American equivalent) once again highlights creditor arbitrariness, though – and thus the urgent need for reform.

While all these changes are insufficient and happened too slowly - thus being even insufficient to stop the further build-up of unpayable debts - they are slow improvements, but nevertheless steps in the right direction that give hope and prove that public pressure, and public pressure alone, is able to change present debt management. It was lobbying by the Jubilee Movement and nearly 20 million signatures from all over the globe that brought about HIPC II with its lower thresholds and trace elements of debtor protection. As will be discussed in more detail below, only public lobbying and pressure can bring about a fair, humane and proper solution for sovereign debts. NGOs are, however, not alone. Parliamentarians, politicians, academics, and private creditors are ready to support such demands.

### **3.0 Mobilising And Supporting Debtors**

As already stated, it is necessary to convince decision makers that the civilised standards undisputed in the cases of all other debtors must finally be applied to the South. Many public creditors will need protracted lobbying, as they might hope to "sit out" initiatives first by waiting until NGOs focus on other issues. Unfortunately, there is no shortage of causes worth fighting for in North-South relations, which makes such a policy a plausible hope. There is also a need though, to encourage debtor governments to demand relief that is rightly theirs. As they are in a very difficult position they need support, not least by public opinion pressure on official creditors, ensuring that debtors demanding any form of fair legal procedures are not immediately subjected to repressive reactions by official creditors. The good news is that such repressive action has become much less likely nowadays than it was some 5 or 10 years ago.

Support for fair legal processes is unfortunately still extremely limited among creditor governments. The new Norwegian government's (2005) declaration explicitly expresses the intention to support arbitration on illegitimate debts: "Norway must adopt an even more offensive position in international work to reduce the debt burden of poor countries. The UN must establish criteria for what can be characterised as illegitimate debt, and such debt must be cancelled". The document firmly opposes undue conditionality regarding privatisation: "No requirements must be made for privatisation as a condition for the cancellation of debt." Finally, "The Government will support the work to set up an international debt settlement court that will hear matters concerning illegitimate debt". Norway has invited African governments, parliamentarians or NGOs and can also be approached to support specific actions in favour of such arbitration.

"Debt settlement" is defined as "payment" (Oxford English Dictionary and Collins Cobuild) or "adjustment or accord reached, as in financial matters" (Webster's), but also "deal effectively with, dispose or get rid of" (OED). The original does not use "settlement". It formulates "opprettelsen av en gjeldsdomstol for behandling av spørsmål om illegitim gjeld" which literally means establishing a court (of arbitration or otherwise) dealing with the question of illegitimate debts. This and the clear demand for cancelling illegitimate debts make the government's intentions absolutely clear.

Norway's commendable readiness to introduce the Rule of Law into North-South relations is not the first case of a creditor government speaking in favour of debt arbitration or even FTAP. In 1990 a working group of Swiss NGOs submitted the idea of international insolvency to the Swiss Bundesrat, supported by two papers written by Prof. K.W. Meessen (Augsburg/Geneva) and Kunibert. It was taken up and discussed in the Swiss Parliament. Switzerland tried discreetly to discuss this proposal internationally, but finally stopped these attempts as no other creditor government signalled any interest. The lack of reactions to the Swiss initiative might, to some extent, be an effect of the official euphoria about new capital flows to Latin America in the early 1990s that stopped any discussion on mechanisms for debt reduction.

The Helsinki Process on Globalisation and Democracy created at the initiative of the Finnish Government in co-operation with the Tanzanian Government in 2002 also promoted novel and empowering solutions to the dilemmas of global governance. The question of sovereign debts and the FTAP proposal based on Chapter 9 were discussed there (see <http://www.helsinkiprocess.fi>).

While examples of creditor governments remain scarce, there is more support from Northern parliamentarians. Parliamentary resolutions exist, requesting governments to support or propagate an international Chapter 9. Groups of parliamentarians have prepared bills to alleviate the debt problem. The Italian Parliament (2000) passed a law on debt relief in the summer of 2000, Article 7, which requests an examination of present debt management. Under the title International Regulations on Foreign Debt this article reads:

The Government will propose, to the relevant international institutions, the starting (initialize) of the necessary procedures to obtain a ruling from the International Court of Justice on the consistency between the international regulations governing developing countries' foreign debt and the general framework of legal principles and human and people's rights.

German parliamentarians have been engaged in bringing about sovereign insolvency. In April 1999 the Bundestag (Parliament), demanded that the Government study the issue of international insolvency. A question (Kleine Anfrage) by the CDU/CSU parliamentary faction in March 2000 requested information on what the Federal Government had done to fulfil this demand; whether it considered initiating such a mechanism and, if so, on what basis and what concrete steps had been taken.

During a Conference in Uruguay's Parliament the Montevideo Declaration calling for FTAP was formulated, and signed by Latin American Parliamentarians (available at <http://www.erlassjahr.de/content/montevideo/submit.php>). Later on parliamentarians from outside the continent followed suit.

Unfortunately, creditor governments have shown no inclination to implement the will of the elected representatives of their people.

Referring specifically to US municipalities, the Confederación de Nacionalidades Indígenas del Ecuador (Confederation of Indigenous Nationalities of Ecuador, CONAIE) that was part of the government for a short while, demanded international arbitration, which was also seconded by Jubileo 2000 Red Guayaquil, who were one of the organisers of a conference on Ecuadorian debts in early December 1999 where this solution had been presented. CONAIE demanded creditor governments to respect the Rule of Law.

The ACP-EU Joint Parliamentary Assembly demanded FTAP in 2000, believing "that consideration should be given to the creation of an International Debt Arbitration Panel to restructure or cancel debts where debt service has reached such a level as to prevent the country providing necessary basic social services ."

The High-Level Regional Consultative Meeting on Financing for Development, Asia and Pacific Region (Jakarta, 2 - 5 August 2000, Session 1) called for an international bankruptcy procedure for states, possibly as a result of lessons learnt from the Asian crisis.

"There is a need for an international bankruptcy procedure. It should also be ensured that private debt does not become government debt".

On Capitol Hill there is an understanding that something needs be done, as illustrated by the Jubilee Bill which aims at achieving 100 percent debt cancellation for 50 poor countries. Afro-American members of the Senate and Congress could be approached from Africa, either by their colleagues in African parliaments or by NGOs. The Debt Relief and Development in Africa Act (H.R.2232) sponsored by Rep. Maxine Waters in 1999 required a Human Development Fund organised in a similar way, which would get money freed by HIPC debt relief. This bill was referred to a Subcommittee and did not pass Congress, though. It mirrors the idea of a transparently managed fund financed by the debtor in domestic currency, proposed in a discussion with public servants of the G7 and representatives of the Bretton Woods Institutions by Ann Pettifor (1999) as a means to guarantee that the money is actually used for the poor and for expenditures necessary for a fresh start of the debtor economy.

NGOs have not carried most of the burden of campaigning for debt arbitration. People within the public sector also want reform of present "debt management". Parliamentarians have supported debt arbitration, especially in Germany and Latin America, as well as Italy and the USA. A coalition across the North-South divide must be built between governments in North and South willing to change the present discrimination of Southern debtors and their peoples; international organisations, parliamentarians, public servants, NGOs and the public at large; as well as private creditors interested in re-establishing the economic viability of debt distressed Southern debtors. However, even in the best of all likely cases, continuing strong public pressure will be necessary.

The reactions of the public should not be discounted. When Jubilee 2000 UK started its campaign, many doubted whether as complex an issue as international debts could be communicated to a public not really concerned about this issue. It was proved that people in creditor countries, once the sheer injustice of present structures is explained, object to present practices much more than their governments. There is a desire for fairness and an opposition to injustice that would support demands for debt arbitration and make recalcitrant governments change their preferences.

## **4.0 The Role of Southern Governments and Inter-governmental Bodies**

For understandable reasons the dependence of debtor governments on the goodwill (or arbitrariness) of their creditors may hinder many of them from speaking up as loudly as they might wish to, and actually should. However, the resolution of Nigeria's House of Representatives calling on the President to repudiate her debt - which in the end resulted in an unprecedented Paris Club agreement - or Argentina's unilateral cancellation of a substantial part of some debts show that debtor states, too, have meanwhile gained some manoeuvring space. This, unfortunately, was also brought about by the strong deterioration of living conditions in these debtor countries, which obviously made them feel that they had not been left any other choice but to defend their legitimate interests whatever the costs.

### **4.1 The Potential Role of the African Union**

The African Union has worked on debts and seconded ideas very much along the lines indicated above. At the AU's Experts' Preparatory Meeting in Dakar 2005, the President of the Republic of Senegal argued that any lasting solution to Africa's debt crisis must first and foremost be based on an audit - a "radioscopy" - to "make known the amount to be repaid" (AU 2005, p.4), recognising the principle that debt should be repaid. This is a clear call to tackle the problem of illegitimate debts and debts that would not exist in the case of debtors in the North where basic legal principles of debtor-creditor relations are respected.

Recognising the odious and immoral aspect of the debt, the experts agreed that debt cancellation should be the ultimate goal for Africa (*ibid.*, p.7), recommending it to African leaders to avoid being subjected to conditionalities related to debt cancellation (*ibid.*, p.9). All this suggests that the AU should play a key role. Not being itself a debtor government, the AU may also have more policy space than governments themselves, which should be used.

One of the initiatives that could be envisaged, by the AU for instance, would be a declaration by parliamentarians demanding debt arbitration or - ideally - FTAP. The Montevideo Declaration could be signed by African MPs or serve as a blueprint for a declaration taking Africa's situation more specifically into account. After Argentina's unilateral debt cancellation and the resolution of Nigeria's House of Representatives the demand for fairness, respect for human rights, and the Rule of Law could be formulated even more explicitly there.

The AU (2005, p.7) mentions recommendations on debt by "African Eminent Personalities". These include repudiation or comparison of annual debt service with annual expenditures on social policies. This, too, proves that many more people are ready to demand what is rightly theirs than some years ago, not least because of the deterioration of debtor economies. The reputation of eminent personalities would greatly advance the cause of fair treatment of African debtors, as well as Southern sovereign debtors in general. Important and decisive support could come from respected elder statespersons if such persons could be asked to speak clearly in favour of debt arbitration. Unlike serving ministers or presidents, they are no longer under the constraints of day-to-day politics, which is a huge advantage when it comes to describing present debtor discrimination truthfully and clearly as well as to demanding change. Such declarations by eminent personalities are often a powerful and valuable means of gaining public support.

As many African countries are members of the Commonwealth, this is a potential platform to discuss debt arbitration. The Commonwealth Secretariat could be approached to further the discussion on this issue. The question could also be brought up in the Commonwealth by a debtor government.

Last, but not least, private creditors must also be approached. At present they are discriminated by the unjustifiable preferential treatment granted to IFIs. When the Paris Club "forgives" (a word otherwise only used in the case of sins and sinners) Southern debts, they are expected to grant comparable treatment, although they did not have any say in determining the outcome - very similar to debtor countries themselves. While the private sector is less important in most African countries than in emerging markets, this common feature should be used as a starting point to make the advantages of proper legal procedures, especially FTAP better known with the private sector.

They should be informed that present de facto exemption of IFIs forces them to take larger losses. As quite a few multilateral debts are of a dubious nature, if normal legal standards were applied, they thus have to bail out IFIs.

Unlike in cases of Paris Club "treatment" they would have the status of being party in a FTAP. Insufficient debt relief also restricts import capacities, and thus export possibilities of Northern exporters, who are another group, which should logically have an interest in a proper and sustainable solution of the debt problem. It is strongly advised to try to win support from anyone whose interests are not served by present, unfair "debt management".

## 4.2 The Potential Role of the UN

Over decades the UN has advocated reforms of traditional debt management. In the 1980s, UNCTAD was among the first to propose emulating corporate insolvency for sovereigns to overcome the debt crisis. The Secretary General, in his Report "In Larger Freedom" provided valuable inputs to the discussion, both by suggesting a debt arbitration process to balance the interests of creditors and sovereign debtors in 2000, and by his proposal to redefine sustainability as the level of debts allowing debtor countries to achieve the MDGs and reach 2015 without increases in their debt ratios. The Financing for Development Process and the Multi-Stakeholder Meetings have moved the discussion forward. At the concluding session in Geneva "[T]he proposal to create a multi-stakeholder working group to explore additional mechanisms to improve debt workouts was widely supported and discussed at length. Participants agreed with the proposal that the working group examine such issues as a code of conduct for sovereign debtors and their creditors; operationalization of the doctrine of 'odious debt' and a provision of arbitration or mediation services to facilitate dispute settlement." (UN, FfD 2005, p.9).

By establishing the MDGs as targets accepted by all members, the UN's Millennium Declaration sets a basis for FTAP in two ways. Firstly, the MDGs' aim to reduce poverty and misery must be funded. Logically, this can only be done in heavily indebted countries if these expenditures enjoy priority over debt service rather than the other way round, as is still present practice. This would be in line with debtor protection granted to anyone but the South. Secondly, developing a global partnership for development with regard to dealing comprehensively with the debt problem, which is part of Goal 8, demands a substantial reform of present debtor-creditor relations which is along the lines indicated by the Chapter 9-based debt arbitration mechanism or FTAP or arbitration on, for instance, illegitimate debts. All UN member states explicitly stipulated their determination "to deal comprehensively and effectively with the debt problems of low- and middle-income developing countries, through various national and international measures designed to make their debt sustainable in the long term." They further bound themselves, declaring: "We will spare no effort to promote democracy and strengthen the rule of law, as well as respect for all internationally recognized human rights and fundamental freedoms, including the right to development."

This unanimous declaration is a perfect starting point for civil society and anyone interested in demanding change and proposing models to implement it, such as FTAP, which fulfils all criteria enshrined in the Declaration. Countries declaring that they will spare no effort to abolish present double standards should be clearly and openly taken to task if they fail to fulfil their promises.

Official creditors should be asked to comply with the very exigencies of political conditionality they demand debtors and aid recipients to fulfil. If the Rule of Law, human rights or good governance are indeed as important as the OECD-governments state, they must be in favour of applying these principles universally - including to the debt issue where creditor governments themselves have manifest interests. In plain English, they must spare no effort to overcome present double standards regarding the treatment of Northern and Southern debtors if they really mean what they declare. The fact that this is not the case must be clearly addressed and official creditors must be asked to abide by what they preach. They must be reminded of their commitments until these are fulfilled.

If and when debtor countries demand debt arbitration, the question on how to proceed arises, especially on which institution should be approached to launch and support such arbitration. As shown, the UN should have an important role to play when it comes to introducing fair legal relief for debtor countries - as also demanded by Norway for determining illegitimate debts.

As there is no entity with a mandate for sovereign debt arbitration yet, one would either have to create a new body or extend the mandate of an existing organisation. What must be clear, though, is that such an organisation must neither be a creditor nor controlled by creditors or debtors. This precludes IFIs, also in the form proposed by the IMF as an "independent" judicial organ of the IMF. Any arbitral body must be able to act in full independence as far as its decisions are concerned.

If one were to anchor debt arbitration within existing UN structures, changes of mandates would be necessary or at least indicated. The following possibilities might be considered:

- ι UNCITRAL, the UN Commission on International Trade Law
- ι The Office of Legal Affairs of the UN Secretariat
- ι Involving the General Assembly
- ι UNCTAD
- ι The UN's role in the case of ad hoc arbitration

Finally, options not involving the UN, but an international treaty will be discussed briefly.

#### **4.2.1 UNCITRAL**

UNCITRAL was established by the General Assembly in 1966 with the "general mandate to further the progressive harmonization and unification of the law of international trade." (UNCITRAL 2005). It is a subsidiary body of the General Assembly. Its mandate is based on "a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not." (UNCITRAL 1985, footnote to Art. 1.1) It is wide in order to "cover matters arising from all relationships of a commercial nature, financing; banking; insurance" (*ibid.*). As waivers of immunity prove, sovereign debts are based on debtor-creditor relations that are logically commercial in nature, little if at all different from others. A wide interpretation including sovereign debts of a commercial nature would thus not be illogical, although this does not seem to be the way UNCITRAL's mandate was understood when it was created and still is interpreted. Interpretation, however, may change over time.

The Commission established Working Groups, among them one on "International Arbitration and Conciliation" (Working Group II), and one on "Insolvency Law" (Working Group V). UNCITRAL adopted a Legislative Guide on Insolvency Law on 25 June 2004 in order to assist the establishment of an efficient and effective legal framework to address the financial difficulties of debtors. This guide, however, is intended as a reference for national authorities and legislative bodies preparing new laws or reviewing existing ones. Its advice aims at balancing the interests of the various parties directly concerned - stakeholders, so to speak - as well as public policy concerns.

UNCITRAL elaborated rules and norms for arbitration, the UNCITRAL Arbitration Rules adopted in 1976. The General Assembly recommended their use in the settlement of disputes arising in the context of international commercial relations. They are something like a blueprint that may be used either without modification or with modifications the parties might wish. Arbitral bodies have indeed drawn on them in preparing their own institutional arbitration rules. Nothing would prohibit the parties of a sovereign debt arbitration procedure to apply these rules.

(The lack of) debt arbitration regarding commercial transactions of sovereigns is an aspect of business law that has an impact on international trade; this would, without any doubt, stretch the present understanding of UNCITRAL's tasks. However, as the Optional Arbitration Clause for use in contracts in USA-USSR Trade of 1977 included UNCITRAL's Arbitration Rules, and Soviet firms engaged in foreign trade were public entities, one might argue that these rules were de facto already applied to governments and their property.

Because of the successful work done so far, UNCITRAL could be given the mandate to establish sovereign debt arbitration or FTAP. One might discuss whether this would extend its mandate, but it would no doubt do so de facto, extending it further than trade matters in the strict sense as understood at present.

The General Assembly seems to have a formal, but absolute, mandate since the explicit introduction of sovereign debt arbitration in whichever form would be contentious. Building on UNCITRAL's already existing knowledge and capacities could do this. As Working Groups perform the preparatory work on topics within the Commission's programme of work, this new sub-entity might be called by another name, e.g. UNCITRAL Debt Arbitration Body (DAB) to document this different task.

There could be a roster of arbitrators at UNCITRAL or at DAB if it comes into existence, from which creditors and debtors can choose their panels. But the DAB could also have the mandate to help establish panels whose members are freely nominated by the debtor and the creditor sides. Closer to ad hoc arbitration, these two ways of establishing panels might be more acceptable to the parties than predetermined panels.

It is likely they could be formed more quickly as well, than a standing panel where the choice of arbitrators would also affect countries not yet party to procedures. Case-by-case panels avoid such considerations going beyond the present case itself.

UNCITRAL's Model Law would perfectly allow arbitrators to proceed on the basis of the main principles of the US Chapter 9, such as protection of the governmental sphere (§904, Chapter 9, Title 11, USC) or the right of the population to be heard (by representation), and that decisions on procedural matters should be left to the panel as/when needed (cf. e.g. Raffer 2004a, p.12). Article 19 guarantees the parties' freedom to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings, subject to a few mandatory provisions on procedure. Long negotiations to agree on procedural rules would thus be unnecessary. In this way any tendencies towards unnecessary formalities could be kept out of the procedures, restricting them largely to contents. Formal subterfuges hindering quick solutions and increasing costs to the parties could thus be avoided.

#### **4.2.2 General Assembly**

As the General Assembly could not perform arbitral functions itself, one would rather think of it as providing the framework necessary for debt arbitration. Barry Herman once suggested a special body elected in a way comparable to UNCITRAL (where the General Assembly elects members), or electing individuals by the General Assembly and the Security Council. The debtor majority in the General Assembly might make creditor states sceptical and reluctant. One can rightly argue that this would only invert the present power/voting structure in debtors-creditors relations, where creditors dominate by their majority of votes within IFIs. Such problems can, however, be easily overcome by, for instance, Barry Herman's idea to hold a two stage election allowing only candidates with more than a certain percentage of votes to pass to stage two, which would give both the creditor and the debtor sides a veto.

Finally, in the General Assembly each member state might be free to name one person. These nominees would then represent the roster from which creditors and debtors could choose their panel members.

#### **4.2.3 Office of Legal Affairs of the UN Secretariat and UNCTAD**

As UNCITRAL is the International Trade Law Division of the UN Secretariat, this would not really be a fundamentally different option from investing UNCITRAL with this task. In this case, too, a new special subdivision would be very strongly advised.

As an advocate of insolvency protection for countries early on, UNCTAD could also be given the mandate to facilitate such arbitral proceedings. In all cases, solutions offering the directly affected parties more say (free nominations, rosters) are preferable to the alternative of forming an institutionalised panel before starting the first case.

#### **4.2.4 International Court of Justice**

The ICJ is the principal judicial organ of the United Nations. Only states may be parties before the ICJ (Art. 34.1, cf. also Art.35 of its Statute).

A special panel ("chamber" in the terminology of Art. 26) - or special panels to get rid of the present backlog of cases more quickly - at the International Court of Justice or the ICJ itself are other possibilities.

In that case its statutes would have to be amended to allow private creditors to be parties – otherwise these creditors would be excluded from defending their interests. Furthermore they would not be bound. Pursuant to Article 59: "The decision of the Court has no binding force except between the parties in that particular case. The ICJ may also give an advisory opinion as in the case where Italy's government was requested by law to propose that relevant international institutions seek. Such opinion would, however, only have moral but not legal force. The only bodies at present authorised to request advisory opinions of the Court are five organs of the UN and 16 specialised agencies of the UN family.

### **4.3 Ad hoc Panels**

For practical reasons it seems easy to work with ad hoc panels for each case, established by both the debtor and creditor.

These can be established immediately, and too much time has already been wasted because of creditor-caused delays. They could work without an international treaty if important public creditors – the G8, for instance - agreed, while negotiating and ratifying a treaty would take time. Against their determined opposition, no form of debt arbitration would be in anyway possible. The more formal approach of a new permanent body or a treaty would mean that all eventualities and effects of the text or mandate to be agreed on would have to be considered, which at best means that it would take quite some time. At worst such negotiations offer a huge array of possibilities to delay the first case. The time-consuming process of negotiating and ratifying an international treaty - even under the best possible conditions - is not necessary and should be avoided.

The UN would support and facilitate that process: sovereign debtors file the request for debt arbitration/insolvency proceedings based on the US Chapter 9 by depositing its demand for this procedure at the UN, either directly with the Secretary General, with a UN officer or one of the UN-institutions proposed above. The UN would thus provide administrative services of a secretarial, technical nature, a possibility also foreseen by UNCITRAL, acting as a facilitating body. The UN would make the demand for debt arbitration publicly known as a guarantee that all creditors get this information (the country should, if possible, already present a list of creditors). Creditors would then register at the UN their addresses and the names of people representing them during the procedures. Various administrative services (e.g. hearing rooms or secretarial services) may need to be procured for the arbitral tribunal to be able to carry out its functions. The UN might offer one or two persons as secretariat staff, as well as provide an office if needed. As foreseen by Article 7 of UNCITRAL's Arbitration Rules, the UN could act as the appointing authority if one side should fail to nominate its arbitrator(s) in time or if the nominees should fail to agree on the one further member to reach an odd number. This would mirror the IBRD's General Conditions pursuant to which the UN Secretary General might be called on to appoint the third person. Furthermore, UN bodies such as UNICEF might formally be given the official status of representing the affected population.

Ad hoc panels are suited for the present debt overhang because of their speed, practical flexibility and their self-dissolving quality. Once the backlog of cases has been dealt with, it is to be hoped that there will be no more need for such a body. The existence of an international Chapter 9 would both be a disincentive to loose lending and an incentive to finding solutions "in the shade of the law" as Krueger put it. Any standing body with the exclusive mandate to chair sovereign insolvency cases would thus hopefully soon be underemployed.

As the new Norwegian government declared, that they would support arbitration on illegitimate debts, they could be approached to fund the modest costs of the first panel - should costs be a problem – since present debt negotiations generally come with costs. Any additional costs would largely boil down to travel expenses of three to five arbitrators, if arbitrators could work pro bono and the UN could provide the limited administrative services needed for free.

## **5.0 International Treaty-Based Arbitration Outside the UN**

The Permanent Court of Arbitration (PCA) (2005) at The Hague, established in 1899 during the first Hague Peace Conference might also be a further possibility. It is not part of the UN. The 1899 Convention, which provided the legal basis for the PCA, was revised at the second Hague Peace Conference in 1907. At present the PCA has 104 members. Initially conceived as an instrument for the settlement of disputes between states, the PCA was authorized in the 1930s to use its facilities for conciliation and for the arbitration of international disputes between states and private parties, thus making it available for resolving certain commercial and investment disputes. The Permanent Court of Arbitration Optional Rules for Arbitrating Disputes between Two Parties of Which Only One Is a State (1993) and its Optional Rules for Arbitration between International Organizations and Private Parties (1996) already allow private entities to be parties. For over a decade, the PCA has been a member of the International Federation of Commercial Arbitration Institutions (IFCAI).

Paulus (2003) proposes a "model law" formulated by, e.g., UNCITRAL or UNCTAD, to be copied by countries in order to avoid different national laws dealing with sovereign insolvency, combined with a neutral entity. The latter could either be a UN organisation, such as the International Court of Justice, but also a body totally outside the UN such as the Permanent Court of Arbitration.

### **5.1. Arbitral Decisions - Over Which Debts**

If a decision was made on arbitration on certain types of debt rather than on the implementation of a full-fledged FTAP, there would have to be a choice on which debts demand arbitral awards.

It must be recalled that arbitration was fairly standard before World War II. Arbitration to solve disagreements with creditors was part of Germany's London Accord of 1953. Because the relief granted to Germany – not only by Northern creditors – was so generous that no disagreement occurred later on, arbitration remained a theoretical issue.

The IBRD created the International Centre for the Settlement of Disputes (ICSID) to provide arbitration, which proves that it is not, on principle, against arbitral proceedings. If disagreements between transnational firms and host countries can be solved that way there is no reason why disputes between the IBRD, borrowing countries or affected individuals cannot be solved too. Arbitration has become increasingly popular with OECD governments; as NAFTA, WTO dispute settlement, and the now officially aborted Multilateral Agreement on Investment prove. OECD governments only shun it when it comes to sovereign Southern debts - to protecting the human dignity of the poorest.

Private creditors have stipulated arbitration (Rocha 1999, pp.132ff), though not often and only restricted to fairly closely defined issues, such as Nigeria's oil-indexed payments in the agreement of 1991. Official creditors differ nowadays, both from their own past views and from the private sector. In the course of bilateral negotiations under the auspices of the Paris Club its members forced Brazil to change legal requirements in order to "exempt specifically ... Paris Club bilateral restructuring agreements" (*ibid.*, pp.91ff) from arbitration. The Republic had been legally obliged to settle disputes by arbitration instead of waiver of immunities. A quite disturbing point emerges: laws, even the constitution, do not matter when they are the laws or the constitution of a Southern country.

It is impossible to avoid asking why arbitration is considered good for Germany but bad for a "developing country", or why official creditors shy away from arbitration even more than the private sector. Logically, there is no reason for such legal double standards between North and South, if one believes the Rule of Law should be applied generally. The behaviour of Northern governments and IFIs so far do not suggest that they really believe so.

Debt arbitration as envisaged by AFRODAD would be an innovation in international law. On top of recalcitrant creditors, all obstacles usually facing innovations have to be taken into account. Therefore it is mandatory either to demand equal treatment of Southern debtors with regard to all debts (in other words: FTAP), or to start the first arbitration process on debts whose illegal and illegitimate character is absolutely clear, rather than with debts where this is less clear or where legal principles on which the case has to be built are not yet fully developed and/or acknowledged.

Unless full FTAP is demanded, i.e. if only certain debts are to be challenged, it is best to choose debts where undue discrimination of debtors and/or wrongdoing by creditors is undeniable. A positive award, even for only one type of debts accounting for a relatively small percentage of total debts, would be a huge step forward towards establishing sovereign Southern debtors as party rather than debt slaves. There is no valid argument against the demand that the very foundations of the Rule of Law and the basic principles on which any decent legal system rests must be applied irrespective of whether they favour someone in the South or the North – if one does not deny the equality of all people.

This suggests building the first case on very clear debts whose illegal nature is obvious or easy to demonstrate, if one decides to demand arbitration on selected claims or group of claims. Basically, this is the same argument that has to be used to demand FTAP. With this necessity in mind, the following types of debts are analysed below to evaluate their suitability:

- 1 Illegitimate Debt
- 1 Odious Debt
- 1 Perfectly Legal and Legitimate Debt

## 5.2. Illegitimate Debt

Although this expression has gained some popularity among NGOs, it is not (yet) an entrenched term. This presents an opportunity to coin this term, to determine what, precisely, is to be understood by illegitimate debts.

The OED defines "illegitimate" as "not authorized by law; improper" or "wrongly inferred". According to Webster's Dictionary it means "against the law, illegal", but also "illogical". Finally, Collins Cobuild describes illegitimate as "not allowed or approved by law or social customs". Briefly put, all three widely spread dictionaries subsume two kinds of debt under "illegitimate":

- a) Illegal debts - those debts whose existence violates the law; basic legal principles or that are legally null and void. It would comprise debts incurred in violation of national laws, of international law, such as in breach of legal obligations or statutes of IFIs, and general universally accepted legal principles, especially debts whose servicing violates human rights. What Jeffrey Winters (2004) called "criminal debts" are also illegal. These are debts from IFI disbursements to corrupt governments, such as Suharto's, knowing that large parts of these loans would be embezzled.
- b) Debts that might be legal by strictly formal standards, yet whose existence or servicing violates socially established norms. Often, servicing them can thus not be enforced or even expected - it would be somehow "illogical" to honour them, unless the debtor is a Southern sovereign. To give an illustration: in some European legal systems gambling debts are legal (if paid they extinct an obligation and repayment cannot be demanded later) but, nevertheless, not enforceable (payment cannot be enforced by the winner/creditor) due to moral considerations reflecting societal disapproval of the underlying reason for such debts.

The US has even pressured credit-card companies to reject gaming-related transactions (which technically would no longer be considered gambling debts in many jurisdictions because signing a credit card transaction would be considered an additional, different transaction) because the US considers internet gambling illegal (Time, 9 January 2006, p.29). By contrast, neither the US nor any other creditor government has ever exercised any comparable pressure when "governments in many ... countries were forced to assume the losses" of "private banks and corporations" (IBRD 1998a, p.xx). Creditor governments and IFIs have insisted that these illegal debts which governments had been forced to assume be "honoured". Elected legislators in the US were more concerned. A Bill was introduced by Reps. B.A. Morrsion and S. Levin demanding investigation and declaring such forced debts null and void (Raffer 1990, p.309). It did not become law.

Obviously, odious debts (discussed below) can be subsumed under "illegitimate", although one might discuss whether under a) or b). The evolution of the doctrine of odious debts in international law and its recent acknowledgement and corroboration in the case of Iraq would suggest subsuming it under illegal debts.

From the point of view of campaigning it seems logical first efforts will focus on illegal debts because there are no arguments against servicing such debts. There is no possible logical defence against applying commonly recognised legal principles and equal treatment on people, whatever their citizenship. It is absolutely impossible to defend debts violating laws, especially laws within creditor countries, including those jurisdictions that have usually been stipulated in waivers of immunity. Therefore, official creditors must be asked to discuss illegal debts. Silence is not golden in that case but deplorable.

It is more difficult when it comes to b), the violation of morals, ethics, and social customs. This fact does not mean that the legitimacy of these debts should not be questioned. Quite the contrary, campaigns by civil society have an impressive record of improving the way things are handled. Things once declared impossible and foolish, such as working no longer than 10 hours per day (or even less) as well as abolishing slavery have become reality.

### 5.3 Odious Debt

Although the odious debt doctrine has received unexpected support from the US government in the case of Iraqi debts, the concept is not clearly defined (for details cf. the *locus classicus* Adams 1991). What appeals most to NGOs is the rather wide interpretation in the Tinoco case, which - if generally accepted - would make this concept applicable to a substantial share of sovereign debts.

In 1922, Costa Rica refused to honour loans made by the Royal Bank of Canada to the former dictator Federico Tinoco. Chief Justice Taft, of the US Supreme Court, was the sole arbitrator. While holding that Tinoco's government was a legitimate de facto government capable of binding the state to international obligations he held that the Royal Bank of Canada simply "knew" that the funds in question were to be used for the personal expenses of the retiring ruler. This case thus stands for the principle that funds borrowed by the state must be for legitimate governmental use, and not for personal enrichment, otherwise there is no obligation to repay. This would void criminal debts to the extent that this money was embezzled, which may be substantial shares. Considering cases such as the Blumenthal Report this might reduce multilateral debts considerably.

The implication of this case on debts incurred by corrupt dictators is clear. This understanding of odiousness would also comprise criminal debts. However, it is not uncontested and more stringent conditions were demanded, e.g. by A.N. Sack. Basing a case on odiousness seems risky. Officially, Iraq's debts were not reduced because of odiousness. A CRS Report for Congress (Weiss 2005) available at an official US homepage (of the US Embassy in Italy) does not mention odiousness as the reason for US efforts to achieve debt relief for Iraq. It introduces odious debts in the following way: "Proponents of a doctrine of 'odious' debt assert that some of Iraq's debts could potentially be classified as non-legitimate under international law since they were undertaken during the Hussein regime and that international law should be able to expunge these debts."

The concept of 'odious' debt does not appear to be well established in international law." (Ibid, p.6) It is conspicuous that the pertaining footnotes (omitted here) quote demands to apply "Iraqi Terms" to other debtors, e.g. S. Raghavan "African Advocates to U.S.: Reduce Our Debt Like Iraq's", in The Miami Herald of 20 February 2004. The initial opinion regarding odious debts of the US government goes completely unmentioned. What follows is thus to be expected:

"While such a commission could increase the legitimacy of a final debt restructuring plan, some believe that Iraq is not likely to seek an 'odious' debt claim. Moreover, the U.S. government has made clear its intention to restructure its Iraqi debt through the Paris Club process, and parallel negotiations with non-Paris Club countries in the Middle East and Asia, and Iraq's private creditors."

(ibid. one quote omitted)

This source states, though: "Under traditional Paris Club guidelines, Iraq's petroleum and gas reserves would render it ineligible for debt relief." (ibid., p.4)

The Paris Club (2004) does not use the O-word, as can be seen in its press release. It speaks of "a comprehensive debt treatment of the public external debt owed to them providing a total amount of debt reduction of 80 % in three phases" and "ad hoc treatment". The very word "odious" does not even exist on the Paris Club homepage, unless its own search engine does not work properly. It disappeared.

One cannot help conclude that this happened after the US and other creditors saw the enthusiastic reactions of NGOs. Technically, official creditors can thus assure – although at the peril of being accused of hypocrisy – that Iraq's debt reduction has nothing to do with odiousness. Technically, this weakens NGO arguments that it was recognised by Paris Club creditors.

Since even South Africa had not used it after apartheid it might be very difficult to build a case on this concept. In passing it might be noted that approximately two-thirds of Iraq's debt was held by non-Paris Club countries – creditors expected to implement the Club's decision without properly participating in determining the amounts of reductions.

As not all illegitimate debt is odious, focusing on this type of debt would also reduce the quantity of debts addressed in most, if not all, cases. This does not mean, however, that campaigners should stop pointing out debts that can be defined as odious.

The concept of odious debts also illustrates creditor domination cum arbitrariness. The US propagated it twice: to free Cuba from Spanish colonial debts, and when Iraq was invaded. In both cases US interest is evident. Conspicuously, this concept was neither discussed nor applied to dictators such as Somoza, Mobutu or the fascist military juntas in Chile and Argentina – all enjoying strong US support. In all these cases substantial claims of US creditors existed - unlike in colonial Cuba and Iraq. The present discussion of odious debts and the rather thorny question of what constitutes such debts would largely have been avoided if the Rule of Law had not been waived in sovereign lending.

#### **5.4 Perfectly Legal and Legitimate Debts**

Obviously these should be paid. These debts are the prime example where the sanctity of contracts, so often quoted by creditors, applies. But even in this case, where there is not the slightest fault of bona fide creditors, there exists one notable and generally accepted exception. In the case of a debt overhang, all decent legal systems make a clear choice by exempting a minimum of resources to safeguard the debtor's dignity and survival. In the case of insolvency protection only the capacity to pay subject to debtor protection (e.g. financing the MDGs) would be necessary. In many sub Saharan African countries this would result in virtually or actually total cancellation and proof would be easy. It should be emphasised once again, that a FTAP would not exclude legal action based on grounds of illegality, odiousness etc.

Laws may terminate, modify, or permit a party to terminate or modify contracts, explicitly allowing unilateral changes of contractual rights, even with regard to perfectly legal and legitimate claims. Section 365(a), 11 USC empowers the trustee (subject to the court's approval) to "assume or reject any executory contract or unexpired lease of the debtor". Pursuant to §365(g) this "constitutes a breach of such contract", a perfectly legalised breach.

Injured entities are given a prepetition claim for any resulting damages, and are treated as prepetition creditors with respect to this claim. Considering the statistical distribution of unsecured creditor receipts the law itself practically annihilates perfectly legal claims. In the case of railroad reorganization (Subchapter IV of Chapter 11, Title 11 USC) §1165 protects public interest "in addition to the interests of the debtor, creditors, and equity security holders". Section 1170(a)(2) permits courts to abandon railway lines if this is "consistent with the public interest". There exists a public interest in the preservation of rail transportation that mandates finding a balance between various interests, which economically means that creditors may have to lose more than without such balancing. The plan can only be confirmed (§1173.a.4, 11 USC) if consistent with the public interest. There is a public interest in the functioning of the municipal debtor that safeguards a minimum of municipal activities within the US pursuant to Chapter 9. No creditor government has shown a remotely similar public interest in avoiding that debt service increases infant mortality within Southern debtor countries.

"Developing countries" and their inhabitants are the only type of debtors not protected in any comparable way. There is a powerful argument to end this global double standard. Clearly and persistently drawing attention to it is thus mandatory, and – given the difference in political power between official creditors and campaigners – the only way to act.

## **6.0 Policy Advice and Tort**

This is another facet of unequal and unfair treatment of Southern sovereign debtors. As a general legal principle, tortious or illegal behaviour makes consultants or creditors liable to compensate damages and may void contracts. While it can be argued that breaches of statutory duties make debts based on these violations automatically illegal, bad/wrong advice deserves more detailed analysis.

National liability and tort laws serve the purpose of compensating those suffering unlawful damages, such as those resulting from negligent or unduly risky conduct or from providing dangerous products/advice. They are based on the general legal principle that agents paid for their work - such as IFIs are - also have duties and liabilities, without which ultimately no legal or market system could function. There are very few examples where this principle has not been applied, always - as was officially assured - in order to serve the affected people better: communist, centrally-planned economies and IFIs, in both cases with sadly visible results. There is no reason why these basic and useful legal principles cannot apply equally to all on the globe. People in the South must be granted the same protection against the risk that those providing services might make money on their own negligence as people in OECD countries and, indeed, OECD countries themselves as legal entities are. Continuing present practice involving high cost to the poor must not be allowed.

### **6.1. IFIs in Arbitration**

"Donors" and IFIs monitor the use of their loans tightly. While the importance of their decisions may vary from country to country, it has always been particularly strong in the poorest countries. Lack of local expertise to participate appropriately in decision making as well as high dependence on official sources are the reasons. Such countries' debts, mostly owed to official sources, are largely creditor-determined, the result of creditors' decisions and monitoring. The going practice of forcing debtor countries to pay for all their creditors' failures is particularly unjustified in these cases.

This deplorable practice has a built-in institutional self-interest by IFIs in crises. IFIs are allowed to insist on full repayment with interest, even when (rather than if) their staff cause damages because of grave negligence, by disregarding their duty of care or minimum professional standards. Prolonged and aggravated crises increase their importance and income. While private creditors forced to reduce claims eventually feel the sting of the market mechanism, IFIs can increase their exposure, knowing that they will be protected. At present, new loans necessary to repair damages done by prior loans increase IFI-income. As first adjustment measures by the Fund were implemented in sub Saharan Africa in the mid-1970s, Africa is a prime illustration of how unsuccessful programmes increase IFI involvement and importance. This perverted economic incentive system is absolutely irreconcilable with the market mechanism.

The role of IFIs is, unfortunately, particularly pronounced in the poorest countries that are least able to afford paying for IFI errors, because these countries have very limited or no market access. Market terms might be too expensive and they often lack the resources to finance staff able to check IFI policy advice critically. This situation is reflected in a relatively large share of multilateral debts and strongest IFI interference into these economies. As the debate about whether countries "own" what is described as "their" policies when considered convenient proves, even IFIs doubt whether their clients actually implement these policies by their own free will. If IFIs were only lenders, advisers or consultants, any decent legal system would impose a duty of care and the observation of professional standards on them. Tortious behaviour makes normal consultants liable to compensate damages and may void contracts. In the case of IFIs, public creditors have perverted this very essential legal and economic principle. When discussing "ownership", IFIs logically admit that policies might be forced onto countries in distress, which would increase IFI liability above that of mere lenders or consultants. It should be emphasised that the right to damage compensation in tort law does not depend on human rights violations. Tortious behaviour and damage caused by it are technically sufficient, although human rights violations would invest compensation demands with further moral and ethical weight. Human rights abuses financed by IFIs may be found, according to literature, especially in resettlement programmes (cf. Raffer & Singer 1996, p.208).

Legally, though, such violations and IFI involvement will not always be easy to prove. Protracted discussions are better avoided. If IFIs should actually have supported a repressive regime in the way characterised by the odious (or criminal) debts concept, this latter concept might be a more promising option.

Restricting claims for damage compensation to human rights violations would in all probability strongly restrict the amount of debt affected, as it would very often be difficult to prove. Using the legal concepts of tort and due diligence would widen the amount of debts potentially affected. There is a quick and easy way to implement damage compensation, both for specific cases (such as willingly inflicting damage on borrowing member countries, as did unfortunately happen according to the IMF's own official documents) or if a country has a debt overhang. Suffice to say that in the latter case, the equal treatment of all (including multilateral) creditors, would immediately install financial accountability without imposing undue burden of proof on the victims.

The demand for proper legal arrangement in the case of tortiously inflicted damage can be corroborated by looking at the statutes of Multilateral Development Banks (MDBs). Their founders did not want to abolish compensation for tort, which is especially clear in the case of the IBRD founded in 1944. The IBRD's initial purpose was to be an International Bank for Reconstruction, i.e. for Europe. Its historical origin lies in the proposed European Reconstruction Fund - the answer to the Nazi plans of a "New Order" with a European Economic Community very similar to present EU structures. In the 1942 relevant memorandum this had developed into an investment fund for relief and reconstruction, without mentioning development. Because of the insistence of developing countries present at Bretton Woods "and Development" was eventually glued onto the initial name.

It is no comforting thought that this intention to finance reconstruction in Europe might explain the particularly clear emulation of normal, civilised, legal borrower-lender relations in the statutes of the IBRD. This might even lead minds more critical to ponder on whether these clauses would have remained unobserved if OECD countries had ever decided to invoke them.

### **6.1.1 Arbitration and the Bretton Woods Institutions**

At Bretton Woods the normal principles of tort law and creditor/consultant liability were obviously seen as a matter of course. Article VII.3 of the IBRD's Articles of Agreement explicitly allows actions against the Bank except by members or persons acting for or deriving claims from members. Property and assets are "immune from all forms of seizure, attachment or execution before the delivery of final judgment against the Bank." Actions may be brought against the Bank in courts of competent jurisdiction in the territories of members in which the Bank has offices, appointed agents for the purpose of accepting service or notice of process, or issued or guaranteed securities. The Bank's founders had no intention to exempt and protect it from legal and economic consequences of failures. There was no intention to remove accountability. Suing the Bank before national courts was, therefore, considered normal. Later on MDBs tried to get immunity from lawsuits, as the recent attempt of the IBRD in Bangladesh illustrates. Such attempts go directly against the intentions of the institution's founders. Technically one might argue, though, that a specialised panel, more familiar with development work, would be a better choice. As IDA is more relevant for SSA it should be mentioned that Article VIII, Section 3 copies the respective IBRD clauses.

The reason why members are not allowed to sue the IBRD is not that they were supposed to pay for the Bank's failures. They were given another alternative: arbitration, so that there is no need to use courts. Quite possibly, the same reason lies behind this arrangement as in the case of waivers of immunity stipulating courts in OECD jurisdictions for disagreements with private creditors. The Bank's founders might well have been concerned that national courts might not be sufficiently neutral. In the past, the IBRD's General Conditions (Section 10.04) foresaw arbitration as the means to settle disagreements with borrowers, be they members or not, for "Any controversy between the parties to the loan agreement", or "any claim by either party against the other" not settled by agreement. The present General Conditions for Loans (of 1 July 2005) repeat this in Section 8.04 (with minor changes):

Any controversy between the parties to the Loan Agreement or the parties to the Guarantee Agreement, and any claim by any such party against any other such party arising under the Loan Agreement or the Guarantee Agreement which has not been settled by agreement of the parties shall be submitted to arbitration by an arbitral tribunal as hereinafter provided ("Arbitral Tribunal").

Bank and loan parties appoint one person each. Both sides agree on a third arbitrator. The President of the International Court of Justice or the UN Secretary General appoint this third person if parties fail to agree. The Section contains the necessary procedural provisions. Procedures making the Bank financially accountable need not be invented. IDA's General Conditions for Credits and Grants (also dated 1 July 2005) repeat the IBRD's, nearly literally ("Financing Agreement" instead of "Loan Agreement" is one difference). Arbitration could be applied if governments or other borrowers claim damages suffered due to the Bank or IDA's negligence. This may lead critical minds to believe that pressure on debtors is the only explanation why these IFIs are not held financially accountable. Naturally the IFC should also be subject to arbitration.

The statutes of the Inter-American Development Bank mirror IDA's. Pursuant to Article XI.3 the possibility of real legal relief exists: "However, member countries shall have recourse to such special procedures to settle controversies between the Bank and its members as may be prescribed in this Agreement, in the by-laws and regulations of the Bank or in contracts entered into with the Bank." Technically this would allow contracts making the IDB financially accountable. If used to the full, that clause could confer at least the same status to borrowers as the IBRD's General Conditions. Historically, the IDB was established as one answer to the Cuban revolution, at a time when a massive interest in containing communism in Latin America existed.

Pursuant to the present Articles of Agreement of the African Development Bank of July 2002 (6th Edition) Article 52 ("Judicial Proceedings") explicitly restricts legal actions against the Bank to "cases arising out of the exercise of its borrowing powers when it may be sued only in a court of competent jurisdiction in the territory of a member in which the Bank has its principal office, or in the territory of a member or non-member State where it has appointed an agent for the purpose of accepting service or notice of process or has issued or guaranteed securities." This article then echoes the IBRD's, equally prohibiting "attachment or execution before [emph. KR] the delivery of final judgement against the Bank", and equally barring "members or persons acting for or deriving claims from members" from bringing actions against the Bank.

Article 62 ("Arbitration"), however, restricts arbitration to disputes with former members or members "upon the termination of the operations of the Bank", as does Article 61 of the statutes of the Asian Development Bank. As with the IBRD, "the President of the International Court of Justice, or such other authority as may have been prescribed by regulations adopted by the Board of Governors" has the power to appoint arbitrators. The UN Secretary General is not mentioned.

Seen from a purely technical point of view – the reality is deplorably different - an African borrowing country has the right to demand arbitration at the IBRD or IDA, but not at the AfDB. Technically, the statutes of 2002 treat borrowers worse. Although in practice the way borrowers are treated has nothing to do with whatever statutory obligations an IFI might have on paper, this is a difference worth being mentioned. Especially so, as the European Bank for Reconstruction and Development, which obviously has no African countries as clients, submits to arbitration and recognises the right of domestic courts to decide on the implementation of arbitral awards.

Asking questions regarding disputes between the Bank and borrowers should be done with Article 59 in mind, though, pursuant to which the "Board of Directors may waive, to such extent and upon such conditions as it may determine, the immunities and exemptions provided in articles 52, 54, 56, and 57 of this Agreement in cases where its action would in its opinion further the interests of the Bank."

The Board has the authority to allow a borrower country to sue or start arbitral proceedings as it would be authorised statutorily in the case of the IBRD, if – as one should hope - compensating as well as avoiding unlawful damage suffered by members is in the interest Bank. It is noteworthy and rare that not legal principles nor the Rule of Law, but exclusively the Bank's interest is the determining trigger. This recalls a bit WTO dispute resolution (Article 3.7 of the Understanding on Rules and Procedures Covering the Settlement of Disputes to be precise), where "fruitfulness" is explicitly established as the guiding principle of dispute settlement, more important than enforcing the Rule of Law with impartiality (Raffer & Singer 2001, p.214). If jurisprudence is considered the *ars boni et aequi* (the art of the good and equitable) this clause of the AfDB's statutes is an oddity prompting the question why the Rule of Law is irrelevant when it comes to African countries. It should also be noted that the IBRD's or IDA's statutes do not stipulate the IBRD's or IDA's interests as the determining necessity. Thus the present statutes of the AfDB's, the most recent of all IFIs, seem to indicate a further tendency towards eroding the rights of borrowing countries, which in this case are uniquely countries from the South. This tendency of reinforcing legal double standards must be reversed.

## **7.0 Conclusion**

The only viable way to proceed is drawing attention to existing legal double standards – which minds more critical than mine might even be inclined to call a global form of legal apartheid. This is a strong and justified moral, legal, ethical and economic argument. Both the demand for equal treatment by applying debtor protection in general to the South (in the form of an international Chapter 9 based debt arbitration or FTAP), or demands to re-establish the Rule of Law with regard to specific types of debts or damages tortiously inflicted can be easily communicated and will be understood by the public at large. It should also be easy to show that this present double standard is untenable and most severely at odds with what official creditors themselves state to be the principles on which international relations and national policies should rest. Not raising this issue allows official creditors to remain complacent about their "generosity". Doing so and exposing the illogic (to avoid the word hypocrisy at the peril of being called unduly diplomatic) of official creditors is the way to bring about reform.

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**African Forum and Network on Debt and Development**

31 Atkinson Drive, Hillside,  
PO Box CY1517, Causeway, Harare, Zimbabwe  
Telephone 263 4 778531, 778536 Telefax 263 4 747878  
E-Mail [afrodad@afrodad.co.zw](mailto:afrodad@afrodad.co.zw)  
Website: [www.afrodad.org](http://www.afrodad.org)

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