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Fair and Transparent Arbitration Processes

A new road to resolve
debt crises



Discussion Paper
by Thomas Fritz and Philipp Hersel
August 2002

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Fair and Transparent Arbitration Processes:

A new road to resolve debt crises.

A contribution to the reform of the international financial system.

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Preface

The Asian economic crisis of 1997/98 sparked discussion about necessary reform of the international financial system even in official institutions of the financial world. The question of debtor/ creditor relations was addressed, as well as durable solutions for the debt crises of developing countries. But discussions within official institutions led to only a few proposals with no further suggestions for fundamental improvements.

Alongside this official discourse was non-governmental work in both North and South. Non-governmental organisations, churches and social movements, some directly affected, focused on debt problems and submitted numerous proposals. Besides the realisation that debt crises can only be defused by substantial debt relief, the question was how debt relief and future debt relations could be rearranged in the interests of those who, thus far, have carried the main burden of indebtedness: the poor and impoverished people of the debtor countries.

Defeating the "creditors cartel" has emerged as key to the question of "How" in the context of debt relief and borrowing. This is because creditors alone determine the rules for debt relief, debt restructuring and new borrowing. Debtors currently have no say in the decision-making process concerning their debts.

Because of that BLUE 21 and MISEREOR, together with NGOs, social movements, intellectuals (and by now even some official authorities) in North and South, encourage the establishment of Fair and Transparent Arbitration Processes. With participation of the affected governments and especially civil society, this approach should resolve the current debt overload of developing countries, and prevent it in the future. This paper will hopefully stimulate discussion about these arbitration processes, to develop the concept further and encourage its application.

The discussion must involve those concerned in the debtor countries. That is why this paper is being published simultaneously in English, German and Spanish.

Discussion about alternatives to the status quo is also necessary in our own society. Thus the paper presents the idea of Fair and Transparent Arbitration Processes, gives information about the institutions which determine today's debt management, and promotes discussion of some key aspects of the process.

We hope that this paper will be a small step ahead on the path to greater justice globally and international solidarity, and look forward to continued critical and constructive discussion toward those ends.

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Summary

The existing institutions and mechanisms that manage international debts have not solved the debt crisis of developing countries in the 1980s, nor have they prevented or solved the debt and financial crises of the last decade, including those in Mexico, Southeast Asia, Brazil and Argentina. Current international debt management as designed by the Paris Club, International Financial Institutions (IFIs) including the IMF and World Bank, the London Club, the G7 and other fora has inherent systemic imbalances that favour the interests of creditors over those of debtors.

The reason for this is simple: creditors are the deciding actors in all these institutions and thus tend to disregard the severity of debt crises and underestimate the need to reduce their claims. So far this situation has meant too little debt relief too late, for too few countries. And policy conditions forced on debtors have not helped them to restore either their economic development or solvency.

This critique is not new. An intensive discussion about reform proposals started in the 1980s soon after the beginning of the debt crisis. Some proposals made then concluded that the debt situation could only be solved through a procedure for debt resolution that accepted the fact that a sovereign debtor can become insolvent. The establishment of an international bankruptcy mechanism was proposed to complement domestic bankruptcy laws. This paper offers a short historical account of such reform proposals since the 1980s and explains how the issue recently reappeared on the international agenda due to campaigning by NGOs and social movements as well as the ongoing reform discussions following the 1997/98 financial crisis in Southeast Asia.

Part I of this paper presents the specific framework of an international insolvency procedure that relies on Fair and Transparent Arbitration Processes (FTAPs) to solve debt crises. Unlike today's fragmented debt management approaches that deal with private, bilateral and multilateral debts in different fora and schedules, an FTAP should deal with all outstanding external debts in a comprehensive way. In

cases of payment difficulties a debtor state should be allowed to open an FTAP and thereby declare a temporary debt service moratorium until completion of the arbitration process.

Our proposal is for establishment of ad-hoc panels to tackle individual countries' debt problems. An FTAP-panel should be composed of one or two individuals from both the debtor side and the creditor community. They would then agree on a third or fifth person so that an uneven number could make decisions by simple majority. The sessions of the arbitration process should be open to the public and all stakeholders in the process: creditors, debtors and other parties affected by the debt situation. Representatives of the population of the debtor country, for example, would have the right to be heard by the panel. All claims against the concerned country must be brought forward by the creditors and then the FTAP-panel would decide on the legitimacy of the various parts of the debt stock and rule as to how much debt relief is necessary.

Many loans now owed to foreign creditors were never used – nor even intended – for the benefit of the debtor state's population. Instead these loans encouraged corruption and capital flight, financed military repression and respective arms exports from the North and served the interest of private creditors. There have been many "unholy alliances" between the ruling elites of North and South. To prevent future debt crises, the perverse incentives for lending and borrowing money must be overcome and creditors must shoulder their part of the responsibility. Therefore, the issue of legitimacy and political responsibility is of central concern not only for ethical and political reasons but also to prevent history from repeating itself.

Beyond asking for the legitimacy of claims, the debtor country's need for funds to meet the basic requirements of its population should provide the second guiding principle in defining the amount of debt relief necessary. Future debt service should in no case compromise the fulfillment of basic needs or human rights in the debtor country. The

International Covenant on Economic, Social and Cultural Rights and other bodies of international law provide a legal basis for a concept of "debtor protection" that puts human rights and basic needs before creditor claims.

Part II of this paper focuses on five aspects of possible FTAPs. These are:

1. *A deeper analysis of existing debt management mechanisms and institutions*

The shortcomings and weaknesses of today's debt management procedures are compiled, with special attention paid to the re-emergence of bondholders. Conclusions include the fact that any successful future debt management needs a creditor-independent entity with the power to sanction a unilateral debt standstill, which can ensure the participation of creditors and debtors on an equal basis and allows a rescheduling agreement that can encompass debt write-offs. The debt standstill should be accompanied by comprehensive capital controls to combat capital flight. Furthermore, to keep the debtor's economy viable the international community should provide lending into arrears financing. These new loans must not be coupled with IMF conditionalities. With the growing importance of bond financing for emerging economies, it might be advisable to create standing bondholder committees. An FTAP must ensure that governments are not forced to assume the debts of their private sectors, thus preventing the socialisation of private debt.

2. *Arbitration as a means to solve debt problems*

Arbitration is a long established but still up-to-date way to deal with conflicts, particularly those between states. Some hundred years ago the international community of states accepted that arbitration was a more appropriate means to solve debt-related international conflicts than use of unlimited power politics. Today arbitration is well accepted as a means of addressing international economic conflicts. However arbitration is only as good as the principles and rules that guide the arbitral award. Accordingly, the more clearly the rules of an FTAP panel are codified, the more an FTAP can help to promote progress towards the rule of law in international relations and thereby overcome today's creditor-controlled relations. Appeals for ad-hoc FTAPs are compatible with attempts to arrive at a more institutionalised framework in the long run, such as an International Insolvency Court.

3. *The legitimacy of claims*

The legitimacy of outstanding debt is a central issue for an FTAP. However it would be too heavy a burden for the proposed FTAP panel to decide on the legitimacy of a wide range of particular claims without clear and internationally agreed upon criteria, which currently do not exist. Furthermore, the scope of existing criteria is limited, like, for instance, the doctrine of "odious debts", the World Bank's environmental guidelines or the OECD "Convention on combating bribery of foreign public officials in international business transactions". These criteria do not cover a wide range of aspects concerning the legitimacy of individual debt contracts, as for example structural adjustment loans that were tied to bad and counterproductive macroeconomic advice by the IMF.

An important element of an FTAP is a public audit of the external debt, to determine and uncover illegitimate claims. Public debate on certain problematic loan packages could uncover loose lending and corruption and contribute to stricter public surveillance of large infrastructure projects. Such debate might also foster development of binding standards for loan contracts on national and international levels. In this respect, the activities of Export Credit Agencies deserve special attention.

4. *Putting basic needs before debt service*

The central principle must be that people's basic needs take preference over creditors' claims, and that debts must not be serviced if this compromises the fulfilment of basic needs of the population in the debtor countries.

The body of international law clearly protects social human rights such as "the right to social security", "the right to a standard of living adequate for the health and well-being of himself (sic) and of his family, including food, clothing, housing and medical care and necessary social services" or "the right to education". Based on these human rights, indisputable basic needs include:

- material needs: sufficient food and access to clean water, shelter, clothing, essential household equipment
- basic services: education (at least primary and secondary), basic health services, essential transportation facilities.

Social human rights explicitly state the responsibility and obligation of debtor governments to care for the rights of

their population first, before fulfilling any creditor claims. To meet these basic needs the state must facilitate peoples' opportunities to earn at least a minimum income and receive basic social services.

The paper offers various considerations and concepts to transform these priorities into relative and absolute indicators for public spending. These indicators, applied to a group of 81 developing countries, call for a reduction in debt service for between 48 and 68 country cases, with 18 up to 38 countries needing complete debt cancellation.

5. *Participation within an FTAP*

Broad-based public participation must be an indispensable element of a Fair and Transparent Arbitration Process. If debt relief efforts are to have a positive impact on the livelihoods of the poor, then the affected peoples' own perspectives on legitimacy, political responsibility and basic needs must be heard and taken into consideration. Participatory procedures offers various levels of involvement, ranging from information-sharing, consultation and joint decision-making up to initiation and control by stakeholders. Joint decision-making, control over the process, monitoring and evaluation of the outcomes are central concepts and must be implemented in all phases of the process, from its design to implementation and subsequent evaluation. All parts of civil society and urban and rural areas should be represented in the participatory process. Timely and appropriate provision of all necessary information is indispensable.

There has been a lot of experience with participatory approaches as a whole, however their extension into the field of macroeconomic policy is rather new. So far their impact on macroeconomic policy-making is very weak, and experiences with approaches of the IMF and the World Bank to allow participation are sobering. However, processes like the "participative" evolution of the "Poverty Reduction Strategy Papers" have led civil society in various debtor countries to develop their own criteria for meaningful participation. In many countries citizen experiences and criteria have strengthened civil society's capacities to intervene in the area of debt and macroeconomic policies in the future, which gives additional hope that Fair and Transparent arbitration processes can be an inclusive and democratic tool in addressing the debt crisis today.

Introduction

Since the visible "outbreak" of the international debt crisis in 1982 much has been said and claimed with regard to necessary debt reductions and debt relief for developing countries. Nonetheless, 20 years later many indebted countries still face an unresolved debt crisis. Their trade balance and state budgets do not provide the necessary resources to service the debts and promote development. Their social situation has deteriorated in the last two decades. And their production was not diversified with more sophisticated products; rather their vulnerability to external factors like declining terms of trade has deepened. In other words, the crisis still prevails.

A logical implication of the failure to settle the debt crisis is that mechanisms to deal with the debt crisis are still inadequate. Due to shortcomings on either the creditor side, the debtor side or both, the international debt management did not achieve its core objective: to provide sustainable solutions to debt crises to encourage growth, social development and international credibility in the debtor countries.

This is not to say that there have been no efforts on both sides, however limited. In the last ten years creditor initiatives like the Brady Plan, the various reduction schemes of the Paris Club since 1990, and the recent Heavily Indebted Poor Country Debt Initiative (HIPC Initiative) have provided some debt relief. Debtor countries, on the other hand, significantly altered their policies towards a more export-oriented strategy, with severe cuts in their public spending.

In both creditor and debtor countries the cost of these efforts were mainly paid by the vast majority of lower-income people. Medium and low-wage taxpayers in the North paid for most of the moderate loan write-offs of banks and public creditors. And the poor majority of the population in the debtor countries paid even more, through lower wages, rising food prices, lost employment and being excluded from social services that were formerly available. Cuts in services have particularly affected women, children

and the elderly. This paper expands from the hypothesis that the roots of the persistent failure to solve the debt crisis must be looked for in the mechanisms of debt management itself. Institutions such as the Paris and London Clubs, the International Financial Institutions (IFIs: the IMF and the World Bank), the G7, and other fora play a central role in addressing international debt problems. Obviously, these institutions have so far failed to solve the developing countries' debt problems in a comprehensive and sustainable way.

There are various reasons why institutions fail to deliver solutions. Firstly, the elements of a solution can clearly exceed the political scope and power of the institutions. Secondly, the institutions might not be sufficiently committed to finding solutions. Thirdly, the institutions include such diverging interests that a compromise solution cannot be found. All these reasons do, and do not, apply in some respect.

When considering the first reason, the central fact to be acknowledged with regard to institutions like the Paris Club, and even more the London Club, is that they are clubs of creditors. They can correctly state that their scope is somewhat limited with regard to the policies that must or should be adhered to by debtor governments. However, these institutions impose strong conditionalities on debtors, particularly in the case of the Paris Club. And the Paris Club seldom neglects to impose conditions, and expects debtor countries to pursue IMF conditionalities.

Another limitation of the creditor clubs is that their concern is only with debts. It is well understood that as long as debtor countries have persistent trade deficits against creditor countries, there is little chance that they will ever earn enough foreign exchange to pay off their debts. Institutions like the IMF, the World Bank, the G7, the OECD and the World Trade Organisation (WTO), that either consist only of creditors or are strongly influenced by them, deal with trade issues and have the political power to make a diffe-

rence. However, rather than providing a trading system that allows debtor countries to run trade surpluses, these institutions use the leverage of their conditionalities to open up debtors' markets for creditor countries' imports. This automatically weakens developing countries' capacities to limit and substitute for imports and drains their foreign exchange earnings even more.

Although the G7, the International Financial Institutions (IFIs) and the WTO do have the sufficient political scope and are concerned with the whole range of international economic policies, they obviously do not use their role in debt management to strengthen consistency between policies in different fields, such as debt and trade. The G7, the IFIs and the WTO force debtor countries to open up their markets. But at the same time the creditors obstruct the debtors' ability to sell their products in the North, particularly in the areas of agriculture and textiles.

This situation offers clear proof of the second root of persistent failure. Rather than pursuing a consistent strategy to address the debt problem, creditors' commitment to finding a sustainable solution is heavily compromised by their own interests in expanding their export markets and protecting domestic jobs in weak sectors from foreign competition.

Another clear sign of lack of commitment on the creditor side can be seen in the various attempts to limit amounts of debt relief by technical tricks. One example is the somewhat arbitrarily composed list of debtor countries with access to special debt reduction schemes. The list of "Heavily Indebted Poor Countries" (HIPCs), which can benefit from debt relief under the "HIPC Initiative", was altered over time with no explanation. Some countries, such as Nigeria or Indonesia, have very similar economic and debt problems to those on the list, but are not considered as HIPCs. When creditors are confronted by this situation, they openly respond by asking where the enormous additional resources for debt relief for Nigeria and Indonesia should come from.

That leads us to the third potential reason for failure, namely the insurmountable divergent interests within the governing institutions. Debtor-creditor relationships are inherently characterised by diverging interests. However, as will be argued later, the institutions of debt management are clearly dominated by creditors and their interests. Therefore the third reason does not apply in terms of the debtor-creditor conflict since the debtors do not have the bargaining power to prevent decisions of the debt

management institutions that hurt their interests in the first place. The fact that the debt management institutions generated outcomes shows, that the remaining divergences within the creditor community could have been tackled. Though, evidently at the expense of an equitable and sustainable solution of the debt problem as a whole.

Weaknesses of today's debt management

There is a clear bias in debt management today in favour of the creditors, as they control the institutions concerned with debt negotiations. Furthermore, debt management today is fragmented into different fora, each dealing with only part of the outstanding debt, either with regard to governmental creditors (Paris Club), commercial banks (London Club) or multilateral creditors (such as the IFIs and regional development banks). Obviously this situation leaves out some creditor groups, particularly bond holders. And it does not provide for an integrated approach where the outstanding debts of a particular country can be negotiated as a whole to secure a comprehensive solution to all aspects of a debt problem.

Another shortcoming of today's debt management can be seen in the lack of assessing political responsibility for a debt situation. Generally speaking, the underlying assumption of debt managers is that when a country runs into debt problems, the causes lie in the bad policies of the debtor government. The usual allegations include bad macroeconomic management, economically unviable projects, corruption or insufficient democratic governance and accountability. Beyond that, creditors sometimes refer to an unfavourable international economic environment (like declining terms of trade) or simply to natural disasters. All of these reasons are either caused by the debtor or considered as being beyond human control. Creditors hardly ever look at their own roles and responsibility for the situation. However, it was the creditors themselves who lent the money for the unviable projects, gave loans to governments already known for being corrupt, and even worse, helped such governments stay in power by supplying arms and other military equipment obviously intended to be used against their own populations. An unfavourable international economic environment for debtor countries, such as declining terms of trade, is often caused, or at least supported, by policies in the creditor countries like protectionism, export dumping etc.

Obviously, the existing system does not systematically ask for political responsibility on the creditor side, nor

does it pretend to do so. As only debtor governments are considered to have failed, only they are obliged to alter their policies. The most intriguing indication of this inequity is the 20 year period of "structural adjustment" in the South. "Structural adjustment" was never considered to be an adjustment of creditors and debtors alike to an inherent default in the international economic order, but only an obligation to debtors to adjust their policies to meet creditor claims.

Whenever it comes to debt reductions, there are systems of "burden sharing" to decide how the losses in claims have to be distributed amongst the creditors. In general, the IFIs enjoy a preferred creditor status which means that their claims have to be served first. Within the HIPC-Initiative the IFIs also get served first and only award relief after almost all debts of the Paris Club and the London Club have been cancelled. However, as commercial banks today play no role in HIPCs (only about 3 per cent of total debts, World Bank 2000), the vast majority of debt relief comes from creditor governments. The crucial shortcoming is that there is no assessment of which particular projects or programmes were deemed to fail from the beginning due to ill planning.

It is this disregard of political responsibility that allows debtor governments to blame creditor-institutions such as the Paris Club or the IMF for all the negative consequences of debt service and structural adjustment programmes. Debtor governments thereby can easily distract attention from their own political mistakes and disguise their abuse of loans in the past. As long as debt negotiations take place behind closed doors, there is little incentive to either party, whether debtor government or creditor, to alter the pattern of recycling debt: taking on new loans to pay off old ones. On the contrary, the secrecy of today's debt management prevents international lending and borrowing from being combined with a comprehensive development strategy in which both parties have a role to play.

The previous list of weaknesses in today's debt management is far from exhaustive. However these weaknesses can be declared responsible for at least part of the current unresolved debt crisis. Furthermore, they can be put forward from different angles. The question of responsibility can be addressed both as a political assessment, and in terms of inverse incentives and market failure. Whereas some will argue for debt relief for Indonesia by referring to the political responsibility of the creditors -- unrestricted lending to a highly corrupt and suppressive dictatorship

under Suharto -- others will claim that particularly the loose and short-term lending of private banks was inspired by the inverse incentives, namely that they would be bailed out by the IMF in case of a crisis. The experience of the Southeast Asian crisis since 1997 has thus far proven the banks to be right. They were bailed out with 40 billion US\$ in the form of a loan package by the IMF, just as in the case of Indonesia.

Although the creditor community is very reluctant to address the issue of political responsibility, many economists and politicians, also within the IMF and G7 governments, are at least willing to deal with the bailout respectively as the so-called "moral-hazard" problem. This debate takes place in various international fora under the headline of "New International Financial Architecture" and as "Private Sector Involvement" in particular.

However either of these perspectives, that of political responsibility or of preventing moral hazard involves a systemic critique of today's debt management or the regime for private capital flows. Both perspectives aim for a greater amount of debt relief to be shouldered by private creditors and hope that stronger rules for "bailing in" private creditors in bearing the costs of financial and debt crisis can have a substantial impact on the habits and terms of future private lending. This paper presents a new approach to international debt management and is thus part of the ongoing debate on reform of the international financial system. The proposal is to settle debt problems in a sustainable, equitable and comprehensive way through Fair and Transparent Arbitration Processes (FTAPs) (see part I of the paper).

The purpose of this paper and its structure

The objective of this paper is to offer an insight into the general concept that future debt problems can be handled by means of arbitration rather than creditor-dominated debt rescheduling institutions and "clubs". This idea is not new (see p. 16 for the history of the idea). It was put forward by several Jubilee 2000 campaigns and NGOs since the late 1990s and plays an increasingly important role in discussions within and beyond the NGO arena. Just recently the debate gained additional momentum following statements from the IMF first deputy managing director Anne Krueger (Krueger 2001, 2001a).

The paper should help us imagine how a "Fair and Transparent Arbitration Process" (FTAP) could work in

practice, and provides background information on some of the issues involved.

Beyond helping to spread the concept of arbitration in debt management in general, this discussion paper should also facilitate a strategic debate on FTAP. Which objectives and problems in debt relations should an FTAP address and what are the necessary instruments for doing so? Whose interests does an FTAP address, who has stakes in that process and what roles do debtors and creditors have to play? Rather than outlining a static proposal for a Fair and Transparent Arbitration Process (FTAP), this paper suggests a framework of components that such an FTAP should include.

Whenever a political proposal questions the basis of existing institutions, it raises questions of fundamental political objectives and judgements as well as many technical questions. This paper goes rather for the more fundamental questions, and hopes not to get lost in technicalities. However, some apparently technical questions do touch directly upon the political economy between the powers involved.

According to this objective, the paper has the following structure:

Section 1 of part I starts with presenting our proposal for an FTAP. The second section gives a brief review of the historical evolution of the idea of arbitration in debt management. Part II offers some background articles on main elements of the FTAP-proposal, namely the existing framework of debt management and its links to the ongoing debate on reforming the international financial architecture (section 1); an overview of arbitration in other fields of international economic governance (section 2); the issue of legitimacy of claims (section 3); the question of how to define basic needs (section 4); and the issue of participation of civil society in an FTAP (section 5). All of these background sections draw some conclusions about an FTAP which should help to identify the requirements so that an FTAP can work successfully.

Part I:

A framework for an overdue debt management reform.

The proposal for an FTAP and its genesis

The Proposal for Fair and Transparent Arbitration Processes (FTAPs)

The following section will outline the core framework for Fair and Transparent Arbitration Processes (FTAPs) to solve international debt problems. The proposal for FTAPs builds on various elements which have been previously defined (see particularly Raffer, 1990). It combines aspects of insolvency procedures for sovereign states with human rights and basic needs approaches and is advocated by various international Jubilee campaigns.

A Fair and Transparent Arbitration Process consists of the following main elements:

1. An impartial arbitration panel would resolve an actual insolvency of a sovereign debtor by awarding sufficient debt relief to solve the country's debt problem on a sustainable basis.
2. The country's need for financial resources to fulfil the basic needs of its population provides the guiding principle for the arbitration process.
3. It is a comprehensive process and therefore requires equal treatment of all debtors and creditors, public and private in a given case.
4. A broad participation of civil society and transparency at all stages of the process is crucial.
5. The arbitration process must include a decision as to which debts are legitimate and should therefore be dealt with in the process.
6. In case of violation of the arbitration award, the arbitration process can be recalled.¹

Any successful future debt regime must overcome the creditor bias in today's debt management and must provide a comprehensive approach to dealing with all outstanding debts of a country. To do so, any terms of debt renegotiations, restructurings and debt relief should be determined by an arbitration proceeding. An impartial arbitration panel ("FTAP panel") should conduct a proceeding, during which all claims, liabilities and stakes of all foreign creditors, domestic debtors and other affected parties must be put forward for consideration by the panel, which would make a final award decision. The panel should be made up of one or two individuals from both the debtor side and the creditor community, who would then agree on a third or fifth person so that an uneven number could decide by simple majority. Each FTAP panel would operate on an ad-hoc basis on the individual case of one debtor country.

In the case of an existing or perceived insolvency, any sovereign debtor could file a petition to start the FTAP process. This petition would start the FTAP regardless of the insolvency situation.² As soon as either side starts an FTAP, debtors and creditors have to nominate the respective individuals for the arbitration panel. Simultaneously, the start of an FTAP would automatically prompt a debt standstill on all external debt liabilities of the debtor country, which would also include all debts of private entities in the debtor country that are contracted in foreign currency.³ All debts that accrue after the moratorium goes into effect are not subject to the award of the FTAP and enjoy a preferred creditor status against all former liabilities, public or private.⁴

¹ These were the core principles that were agreed upon at a first international workshop of NGOs and Jubilee campaigns on FTAP in January 2000 in Wuppertal/Germany.

² This condition might sound too loose not to be abused by one of the parties. However, a debtor country will be careful not to start an FTAP without good grounds, as it increases its future borrowing costs. Creditors, on the other hand, will be reluctant to initiate an FTAP too early, as the automatic standstill prevents them, at least temporarily, from receiving debt service payments (see footnote 4).

³ This proposal does not imply any sanctioning of a debt standstill by the IMF. For further details see p. 25.

⁴ The timing of the standstill will reveal a general judgement of the situation. If potential lenders consider the debt situation to be so bad that the FTAP will probably provide debt relief, they may provide "fresh money" that they wouldn't have provided given their pessimism about the country's capacity to pay before the start of the FTAP. If this is the case, an FTAP will actually ease access to new credit. On the other hand, if the creditor community thinks that the country will not gain debt relief from the FTAP, ...

After the arbitration panel is established, it will announce a reasonable date up to which all creditors must fully announce their claims. All claims not announced by that date are invalid and will not be serviced in the future.

All creditors must provide evidence for their claims (e.g. credit or bond contracts).

As the ultimate purpose of the arbitration panel is to rule on the amount of debt relief that is appropriate, its ruling should be governed by two central concerns:

1. What claims should be considered legitimate, and therefore part of the existing debt burden to be dealt with in the FTAP?
2. How much of the existing debt burden must be cancelled to allow the debtor government to fulfil the basic needs of its population?

The answers to these questions are given in the form of a final and binding arbitration award decided by a simple majority of the arbitration panel.

The FTAP's assessment of the debt relief necessary to meet a country's basic needs and judgement of the legitimacy of individual debt contracts, such as loans for individual projects or structural adjustment programs, trade credits, bonds etc., would resemble a public court proceeding. The FTAP panel acts like the chair of a regular proceeding in which all the involved stakeholders -- creditors, debtors and other parties affected by the debt situation, for example the population of the debtor country -- can bring forward their arguments.

The proceeding would start with cases where the evidence brought forward by a creditor for its claims is disputed by the panel. The creditor then has the opportunity to present its point of view and prove the validity of the claim. Simultaneously, all other stakeholders have the opportunity to raise their voice if they consider a particular loan or bond not to be legitimate. For example, local communities could state that their human rights were compromised by a large dam project, and that creditors were well aware of these human rights violations. Such contributions should help the panel to assess the past use and misuse of foreign loans, for example for particular infrastructure projects, the

quality of the project's original design with respect to technical, economic and social objectives and consequences, questions of corruption, of developmental impact, of displacement problems etc.

There may be various reasons to doubt the legitimacy of outstanding debts⁵ and all stakeholders should be free to make their points. However, the panel would finally decide which arguments are most convincing and, accordingly, which debts are to be treated as legitimate claims.

The second issue at stake in the public proceeding is the question how far debt service compromises people's basic needs and human rights. As a state is a political and social institution of its population, it must serve its core domestic obligations before satisfying external creditors. The guiding principle for the FTAP decision is therefore that debt service can be paid only if sufficient financial resources exist to allow the debtor country to provide public services that are necessary to meet the basic needs of the population. Core domestic obligations of a state are the provision of basic social services such as free primary education, basic health care, access to water and sanitation, etc. This criteria is the analogy to debtor protection in national legislation (see chapter 4 in part II).

There will certainly be very divergent views on the consequences of debt service to the provision of such social services, as well as contradictory perceptions of what social needs should be served before external debts are serviced. Some might argue that no debt service should be paid before the health service is sufficiently developed to ensure a life expectancy similar to that in creditor countries. Creditors, on the other hand, will probably respond that debts must not be seen as the single reason for a higher mortality in debtor countries and that therefore debt service is not compromising life expectancy.

As all parties have the right to be heard, the panel should develop a comprehensive insight into the debt situation of the country concerned, and know how debt service affected and still affects different sectors of the debtor country's society. In its final award, the panel must take into account the main arguments and perspectives brought forward during the proceedings and must argue why it considers its award to be a just compromise among all the interests involved.

To ensure access and transparency for the proceedings before the FTAP-panel, the sessions of the panel must be announced nationwide, for instance through information

⁴ ... the borrowing costs for "fresh money" will increase as they consider the debtor to be unwilling, rather than unable, to pay. In this case they would expect the arbitration panel to rule against debt relief, which further undermines creditor expectations of getting their money back.

⁵ For a more detailed discussion of the legitimacy of claims, see Part II, section 3.

campaigns in the media and schools, and funds must be made available to ensure broad distribution of information to, and participation from, people in remote areas. The arbitration panel should pay special attention to voices of the poor and marginalised in the proceeding, as they will probably have less chance and ability to raise their points due to scarce resources. The media, domestic as well as international, should play a central role to guarantee the transparency of the FTAP, to ensure that it is a public event rather a new form of secret negotiations taking place between governments and private creditors behind closed doors.

The fairness and transparency of an FTAP is obviously strongly connected to the capacities and resources of civil society actors to raise their voices in the process. The legitimacy assessment and the amount of debt relief awarded by the panel, depend on civil society's resources and access to the proceedings, to information and to the media.

If the arbitration panel finds significant evidence in the public proceeding, for example through testimonies from members of civil society, that loans were abused by corrupt debtor governments or other elites for private purposes and channelled to foreign bank accounts, the arbitration panel should seek international support to repatriate these accounts and hand them over to the debtor government.⁶

The public proceedings should give the arbitration panel a sound understanding of how debt service has affected the social situation of the debtor country and what civil society considers as basic needs to be addressed by future government spending. Accordingly, the hearings should help to identify priorities for the debtor government's future social expenditure plans and force the government to announce clear commitments about the nature, quantity and priorities of its future social spending.

This announcement must be sufficiently clear and public to hold the government accountable to its own population and to monitor its future social policies. When the panel finally awards debt relief to allow for the fulfilment of basic needs, the award implies that the debtor government will in fact adhere to its commitments made before the panel.

Only after the public proceedings, will the arbitration panel rule on the legitimacy of claims and the amount of debt relief necessary. Depending on how much of the debt is

already diminished by ruling out illegitimate debts and the amount of abused funds repatriated, the panel can assess whether and how much the remaining debt stock must be reduced to allow the realisation of basic needs. Generally speaking, the losses should be shared equally among the creditors and all claims should be reduced proportionally. However, in some cases the creditor community might find it appropriate to award preferential treatment to particular creditors, as for example regional multilateral development banks such as the African Development Bank (AfDB), to prevent their financial crisis and bankruptcy.

As there will, of course, be negotiations going on between the representatives of debtors and creditors in the arbitration panel in the process of defining the award, the issue of trade concessions by the creditor side could also be part of FTAP awards⁷. The essential issue of trade can, however, not be solved by FTAPs. A sustainable solution for the debt-creating structural trade deficits of developing countries, such as those caused by protectionism and dumping in the North, cannot be found without substantial reforms in the international trading system, which are beyond the scope of this paper.

The final award is binding for all parties. If any of the parties believes that the award is violated by any other party, it can call upon the original arbitration panel to check for a violation. If the panel finds a violation of the award on the debtor side, for example if it did not provide the promised social spending, it can recall the FTAP. In this case the panel's former decision on the legitimacy of claims remains untouched, but the amount of debt relief can be reconsidered. If the panel finds a violation on the side of a creditor, such as a confiscation of some of the debtor country's foreign assets to recover its claims, the original FTAP award should serve as the legal basis for a proceeding before a national court. In this case the FTAP award should be treated as an award under the New York or ICSID Convention⁸.

⁶ There are clear incentives for creditors to support the panel in finding expropriated funds. As the repatriated funds enhance the overall financial situation of the debtor country, all creditors should be interested in locating corrupt flight capital.

⁷ For the linkages between debt management and trade see Hersel, 1999

⁸ For the binding force of the New York Convention on international arbitration awards see p. 29 respectively p.30 for the ICSID-Convention.

FTAP: A framework allowing for country-specific circumstances

What can be considered an advantage of an arbitration process, i.e. the flexibility of the procedure, on the one hand, can be also called a lack of codified rules on the other hand. Obviously, the FTAP-panel has a wide room for judgement as there are no binding rules e.g. for the assessment of illegitimate claims. Chapter 3 and 4 of part II deal with the issue how criteria for the legitimacy of claims and the necessary spending for basic needs could be derived. The greater the clarity of the criteria and principles for the legitimacy of claims and the debt-service capacities are transformed into a binding set of rules, the higher the possibility that FTAPs deliver fair and equitable solutions for different country cases. However, one main argument for an FTAP as compared to a standing international bankruptcy court for sovereigns is that an FTAP does not necessarily need a formal international legislation or treaty. The reason to go for a solution that does not require the signature of several dozen states is clear: an international treaty will take ages if it is possible to enact at all. This is not to say that a formally more binding base for an FTAP is undesirable.

As long as there are no internationally codified rules to be applied by an FTAP we must focus on strengthening the ability of civil society to intervene and increase the overall level of public participation in FTAP proceedings. But even here we come across conflicts. A truly participatory process takes time, whether it involves hearing civil society's contributions on the issue of the legitimacy of debt, or on how freed resources should be targeted towards basic needs. This has been learned by NGOs during the consultation processes for Poverty Reduction Strategy Papers (PRSPs).

Greater civil society participation would require extended FTAP proceedings, thus delaying debt relief. An in-depth assessment of all contracts and projects for which debts have accrued would be a lengthy investigation. However, if the legitimacy assessment is considered central to preventing future moral hazard in reckless lending and to assessing political responsibilities for the past, a long series of hearings might be appropriate even if they delayed the final FTAP. Obviously the quality of participation will be strongly influenced by the capacity of civil society to raise its voice and organise political intervention. It therefore should and must be left to civil society in the respective country to decide about the degree of participation and the time it takes to organise an appropriate participatory process.

The history of the FTAP proposal and today's debate in various fora

As was already pointed out, the FTAP proposal builds on various elements. The main element is made up of proposals to deal with indebted sovereign debtors in a way of state insolvency procedure. Adam Smith already put this idea forward: "When national debts have once accumulated to a certain degree, there is scarce, I believe, a single instance of their having been fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; ... When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor" (Smith, 1910, II: 412-413).

During the second half of the 20th century there were many voices arguing that the international post-war economic system lacked a bankruptcy procedure for sovereigns. In 1976 G. Ohlin referred particularly to developing countries: "Development finance needs something like the institution of 'honourable bankruptcy' (...). It is not recognised how important the institution of bankruptcy is to enable the credit system to work without too much risk aversion and to recover quickly from failures" (c.f. Malagardis, 1990: 181).

Soon after the "outbreak" of the debt crisis in 1982 the British banker D. Suratgar (1984) proposed a framework for sovereign insolvency. The idea was then picked up by several other economists, as for instance Nobel Prize winner Lawrence Klein, as well as by the United Nations Conference on Trade and Development (UNCTAD, 1986, annex to chapter VI).

"The lack of a well-articulated, impartial framework for resolving international debt problems creates a considerable danger, which has in part already materialised, that international debtors will suffer the worst of both possible worlds: they may experience (and many are experiencing) the financial and economic stigma of being judged *de facto* bankrupt, with all the consequences that this entails as regards creditworthiness and future access to financing. At the same time, they are largely without the benefits of receiving the financial relief and financial reorganisation that would accompany a *de jure* bankruptcy handled in a manner similar to chapter 11 of the United States Bankruptcy Code."

It was Vienna-based Professor Kunibert Raffer, who in the late 1980s highlighted the exemplary role of Chapter 9 of the US bankruptcy legislation as a model for insolvency cases of sovereign debtors. Chapter 9 is designed to solve insolvencies of domestic public debtors, i.e. US municipalities (Raffer, 1990). Chapter 9, as the argument goes, addresses questions of sovereignty sufficiently while safeguarding the positive aspects of an orderly insolvency. It was also in 1990 that the Swiss parliament and government, inspired by an initiative of Swiss NGOs, scrutinised the proposal and brought it up in various international fora. However, this Swiss initiative did not trigger much response internationally.

The debate on reforms in international management of debt got new attention following the Mexican crisis in 1994/95, particularly with regard to international bonds. In reviewing possible reforms, Eichengreen and Portes (1995: 38) also identified an "international bankruptcy court or tribunal" as one option, though they doubted the idea could gain enough political support to be implemented in the near future. "There are strong arguments, however, behind some of the functions that such an institution and procedure would fulfil" (ibid.: 42).

In 1998 UNCTAD (1998: 91) addressed the issue again in its Trade and Development Report. "One proposal is to create an international bankruptcy court in order to apply an international chapter 11 drawn up in the form of an international treaty ratified by all members of the United Nations. Under such an arrangement, the international court would be empowered not only to impose automatic stay and allow debtor-in-possession financing status, but also to restructure debt and to grant debt relief. Arbitrators would be nominated by both creditors and debtors, and to ensure impartiality no court in either a creditor or a debtor country should chair the proceedings."

Almost all authors considered the political chances for a standing international insolvency or bankruptcy court, established by an international treaty, to be a "non-starter" (Eichengreen/Portes, 1995: 47), or at least highly ambitious. They therefore all referred to a second best option, namely that of starting with a mediation or ad-hoc arbitration procedure rather than going for a standing court with powers codified in international law.

On the basis of these ideas, some Jubilee 2000 Campaigns put the issue on their agenda. They advocated that an international arbitration procedure also address the more systemic problems of the financial system, in order to pre-

vent a situation where countries would end up in another debt trap in 20 years, even if broad debt relief had been granted at the start of the new Millennium.

In the co-ordination between Jubilee 2000 campaigns, particularly in Europe, it was agreed that the proposal be put forward under the provisional name of "Fair and Transparent Arbitration Process". The proposal was strengthened as part of the declaration of Tegucigalpa by Latin American Jubileo 2000 campaigns in 1999.

In 2000, Kofi Annan, Secretary General of the United Nations, wrote in his Millennium Report (Annan, 2000: 38): "I would go a step further and propose that, in the future, we consider an entirely new approach to handling the debt problem. The main components of such an approach could include ... establishing a debt arbitration process to balance the interests of creditors and sovereign debtors and introduce greater discipline into their relations."

In October 2000, Jubilee movements from 10 countries sent a joint appeal to the Preparatory Committee for the High-level International and Intergovernmental Event on Financing for Development (FFD), requesting that FTAP be put on the agenda of this major event. In May 2001, a similar appeal was addressed to the G7 summit in Genova/Italy. By then the base of movements and NGOs supporting this appeal had significantly widened, to include more than 40 institutions from over 20 countries (FTAP Appeal, 2000, see p. 58).

Two other papers, by Opa Kapajimpanga of the African Forum and Network on Debt and Development (AFRODAD, 2000) and the Jubilee 2000 Coalition in Canada (Dillon, 2001), promoted the debate on FTAP within the NGO arena. AFRODAD calls for a more formal "International Arbitration Court on Foreign Debt" to deal with the legitimacy of debts and debt relief. Dillon's paper discusses various pros and cons of Kunibert Raffer's proposal.

In 2001, Jubilee Plus (2001) published a report on the current crisis in Argentina, which focuses particularly on the illegitimacy of a large part of Argentina's debts and stressing the capability of an FTAP to deal with the Argentine crisis.

The most recent contributions from the NGO-arena stressing the need for an FTAP have been a paper from AFRODAD (2002) and the report summary of the "Alternative Committee of the International Forum on Globalization" (Cavanagh et al., 2002). The AFRODAD paper offers some legal background on arbitration and highlights some sce-

narios on how a debt arbitration mechanism could be institutionalised. In spring 2002 the "Alternative Committee of the International Forum on Globalization" will publish a major report called "A Better World is Possible – Alternatives to Economic Globalization". The summary of this report, drafted by a group of 18 scientists and intellectuals from the North and the South (e.g. Walden Bello, John Cavanagh, Martin Khor, Vandana Shiva, Lori Wallach), was presented at the World Social Forum in Porto Alegre/Brazil in February 2002 and received great attention. In its section on "New Global Institutions" the report summary includes the demand to "Create an International Insolvency Court" (Cavanagh et al, 2002: 19) as one of the five most important steps.

In March 2002 NGOs, debt campaigns and movements from almost 20 countries met in Guayaquil/Ecuador to review the evolving international debate on an insolvency oriented debt arbitration mechanism, particularly with regard to the recent developments in the IMF (see next paragraph). The working document resulting from this conference can be found in annex 2 (p. 61).

With regard to the creditor arena, there are contradictory responses to the idea of sovereign insolvency and debt arbitration. In 1999, in a declaration concerning the G7 summit in Cologne, the German parliament called upon the government to study the advantages and chances of an international insolvency procedure for sovereign debtors to prevent future debt crises. The examination by the government is still under way and some papers critical as well as supportive of the FTAP-proposal have been produced. The discussion on FTAP gained much momentum after a speech in November 2001 by Anne Krueger, First Deputy Managing Director of the IMF, outlining "A New Approach to Sovereign Debt Restructuring". In her address she said:

"A formal mechanism for sovereign debt restructuring would allow a country to come to the Fund and request a temporary standstill on the repayment of its debts, during which time it would negotiate a rescheduling or restructuring with its creditors, given the Fund's consent to that line of attack. ... There is an analogy here with domestic insolvency regimes like the US bankruptcy court. ... It is also worth emphasising that while this proposal would create a mandatory process for restructuring, the outcome in any given case will remain where it should be – in the hands of the debtor and creditors. ... The new approach would also benefit the international community more widely, by contributing to a more stable international finan-

cial system. The presence of a formal mechanism that would encourage them to restructure would help convince private institutions that the official sector is not waiting on the sidelines to bail them out when things go wrong" (Krueger, 2001).

Although Krueger's "Sovereign Debt Restructuring Mechanism" (SDRM) differs significantly from an FTAP, it recognises some of the principles on which an FTAP is based:

1. all debt should be dealt with in a comprehensive framework;
2. sovereign international debt restructuring can have parallels to national insolvency procedures;
3. standstills are an important instrument of orderly debt solutions;
4. an orderly mechanism for debt resolution must have a preventive effect for future crisis, particularly by bailing in private creditors.

The SDRM-proposal was just recently discussed at the IMF/World Bank Spring Meetings 2002 and the IMF was encouraged to continue its work on examining the chances and requirements of the SDRM. However, today the IMF seems even less willing to accept any diminishing of his powerful position in debt management in the interest of an impartial and just solution.

For the community of debtor countries the G77 already made a remarkable statement in favour of FTAP at the 3rd Session of the FFD Preparatory Committee in May 2001. Addressing debt and systemic issues, the G77 called to "consider last resort mechanisms, including mediation type mechanisms and the consideration of provisions similar to USA bankruptcy code". However, it must also be recognised that some "emerging market" governments such as Mexico and Brazil are reluctant to the idea of an FTAP as they fear higher risk premiums on their bonds, resulting in higher borrowing costs.

As pointed out, in today's agenda of creditor institutions and the IFIs, the debate takes place under the topics "Orderly debt workouts" and "Private Sector Involvement". This debate is the subject of the first chapter of Part II.

Part II:

Special issues in debt management reform examined

II.1: Existing procedures governing international debt management

by Thomas Fritz

Current procedures for sovereign debt workouts have so far failed to prevent national debt crises. In the developing world debt crises remain a recurrent feature of everyday life, regularly destroying economic achievements and forcing millions of people into poverty. Therefore, it appears necessary to have a closer look at the established procedures of international debt management, their functioning and obvious shortcomings. Generally speaking, these procedures involve national governments and several governmental groupings, multilateral institutions and private sector representatives. They are of an informal nature and rely on general principles, which are applied case-by-case. Their outcomes strongly depend on the bargaining power of the parties involved.

1. The Paris Club

The Paris Club is an informal group of creditor governments, mainly from industrial countries, that convenes to reschedule the bilateral debts of a debtor country that experiences payment difficulties. The setting of governments involved in a particular rescheduling negotiation varies case by case, depending on the claims of creditors. There is a permanent secretariat based at the French Treasury and an agreed-upon set of guidelines and principles by which debtor countries shall be treated more or less consistently. The first Paris Club negotiation took place in 1956, when Argentina sought rescheduling of outstanding payments due on export credits. Negotiations and settlements have to be guided by four major principles (Eichengreen/Portes, 1995).

Imminent default:

For a debtor country to be eligible for a rescheduling, it must be agreed that the debtor is unable to meet its debt service. The IMF forecast of the balance-of-payments position of the debtor country serves as a source for this decision. This requirement aims at preventing debtors from seeking "strategic" default.

Conditionality:

An IMF-approved structural adjustment programme (SAP) must be in place before restructuring negotiations can begin. Applying strong economic reform programmes is supposed to minimise "moral hazard" on the debtor side. Although the macroeconomic orthodoxy of SAPs has long been criticised for producing adverse social, economic, and ecological effects, the official community began a more serious debate about SAPs for the first time in 1999⁹. Following the recommendations of that year's G7 summit in Cologne, official creditors added a further conditionality by obligating debtors to prepare so-called Poverty Reduction Strategy Papers (PRSPs).

Comparability of treatment:

Equal burden sharing among all creditors should be achieved, with the burden allocated according to exposure. The debtor country is enjoined not to grant preferential treatment to creditors who are not members of the Paris Club. Furthermore, the debtor country is expected to seek a measure of debt relief from private creditors as generous as the official relief granted by the Paris Club. Exceptions are the IMF, the World Bank and other multilateral agencies that enjoy preferred creditor status.

Consensus:

Each settlement has to be accepted by all Paris Club members taking part in negotiations. Nineteen permanent members of the Paris Club, all of them OECD members, take part in negotiations. Other creditor countries may be included, but only on a case-by-case basis. There are several examples of excluding important creditors in rescheduling, resulting in weak outcomes for the debtors (Kaiser, 2000). Paris Club meetings usually take one or two days, and at the end agreed-upon minutes are signed. The debtor must then

⁹ The Structural Adjustment Participatory Review International Network (SAPRIN) recently presented a cross-country examination of the impact of World Bank adjustment programmes (SAPRIN, 2001).

negotiate bilateral agreements with each creditor government that signed onto the minutes. Debts eligible for Paris Club rescheduling includes medium and long-term debt as well as arrears falling due during the so-called "consolidation period" – namely, the period of the mandatory IMF programme. A large part of the debt owed to the Paris Club consists of officially guaranteed export credits.

The rescheduling terms have evolved over time, with the degree of concessionality depending on the debtor country's income level. Up to now middle-income countries don't receive any reduction of their debt stock; their liabilities are merely rescheduled by extending the repayment period and/or modifying the interest rates. Following the 1988 G7 summit in Toronto, Paris Club members were allowed to grant low-income countries debt relief in so-called net present value¹⁰ of up to 33% (so-called Toronto terms). The extent of the relief-option increased over time, with the London terms of 1991 allowing maximum debt reductions of 50%, the Naples terms of 1994 allowing 67%, Lyon terms of 1996 (80%), and the Cologne terms of 1999 increasing the maximum reduction to 90%. Each of these steps had been commanded by preceding G7 summits, revealing the seven richest industrial countries as the decisive forces behind any new debt management framework. Nevertheless, until now all of the rescheduling terms failed, as they did not provide an exit strategy for the debtors (Eberlei, 1999).

Furthermore, only debt contracted before a specified cut-off date is considered eligible for debt restructurings, with the cut-off date being the date of the country's first Paris Club rescheduling. Since a lot of countries' first appearance at the Paris Club occurred in the 1980s, all debts accumulated thereafter are not eligible for rescheduling. For instance, a possible debt relief of 90% (according to Cologne terms) wouldn't cover the total debt stock of a low-income country, but only debt incurred until its first Paris Club rescheduling, thereby drastically reducing the scope of debt relief. A lot of countries have rescheduled their debts a number of times, thus proving the insufficiency of the Paris Club procedures. Since 1956 roughly 70 countries have negotiated more than 300 reschedulings (ibid.).

2. *The London Club*

The London Club provides a set of procedures for rescheduling debt owed to commercial banks. These procedures are more diffuse than the Paris Club process, because the community of bank creditors is larger and more heterogeneous. The first meeting of the London Club was held in 1976, when Zaire's debt was rescheduled. There is no fixed venue or standing secretariat. Instead, banks participating in rescheduling negotiations form an ad hoc steering committee, typically with 15 members. Steering committees are generally set up after a debtor suspended payments. The terms of an agreement between the steering committee and the borrower are presented to the entire community of bank creditors for approval. The agreement needs to be approved by banks holding up to 90-95% of total bank exposure. However, dissenting creditors are not compelled to accept the agreement. Instead, they can sue sovereign debtors for enforcement of the original loan contract, thereby holding up the whole restructuring process. Since the steering committee must get approval for each stage of defining the terms with all the banks it represents, the whole process can be lengthy and inefficient. For example, it took 14 years for Poland to reach a settlement with its bank creditors.

Like the Paris Club, commercial banks insist on applying IMF economic reform programmes before starting negotiations. They also require that debtor countries not extend more favourable treatment to dissident creditors than to London Club members. Comparable treatment is fostered by "sharing clauses" contained in loan covenants, which require any creditor who receives disproportionate payments from the debtor to share these proceeds with other creditors (Vitale, 1995).

3. *The re-emergence of bondholders*

In the follow-up to the 1994-95 Mexican crisis, as well as to the 1997-98 Asian crisis, the official community discovered the emergence of bondholders as a creditor group of growing importance. Their role has been examined in two reports. The first was the Group of Ten¹¹ report on "orderly resolutions of sovereign liquidity crises" ("Rey

¹⁰ The net present value of debt is the discounted value of the future debt service. It can either be higher or lower than the nominal debt, depending on whether the average interest of the debt is higher or lower than the market rate. A loan with a concessional interest rate has a lower net present value than one at the market rate. A claim of 100 Euro due in one payment of 100 Euro next year has a lower net present value than a claim of the same amount due tomorrow.

¹¹ The Group of Ten is an informal grouping comprising finance ministers and heads of central banks of G7 countries plus Belgium, the Netherlands and Switzerland. The G-10 serves as a forum for deliberation and co-ordination regarding the international system of currencies.

Report", Group of Ten, 1996). The second was the report of the ad-hoc Group of 22, comprising major industrial countries and a range of "systemically significant" emerging economies (Group of 22, 1998). Both reports paid special attention to internationally traded bonds and other securities, since these forms of debt had become increasingly important since the end of the 1980s. While portfolio investment flows to developing countries expanded rapidly throughout the 1990s, the increase in commercial bank lending remained moderate. Bank loans were a main source

of financing for developing countries in the 1970s, but after the outbreak of the debt crisis in 1982 private banks reduced their exposures drastically. In the 1990s portfolio investments accounted for 21% of net capital inflows to developing countries, while the share of bank loans amounted to 24%, far behind their pre-debt-crisis share of 50% (see charts).

These changes in capital flows have been accompanied by changes in the composition of the investor community. In addition to private banks, a variety of institutional investors, such as mutual funds, pension funds, insurers, and securities brokers, have become a notable source of funds, particularly for emerging market borrowers. This shift of sovereign borrowers from loans towards increased issuance of bonds means that creditors' claims become more dispersed, thus enhancing the bargaining power of debtor governments in the course of debt negotiations. On the other hand, in cases of imminent payment difficulties, bondholders are more likely to sell their holdings than commercial banks, because securities are easier to trade than loans.

Furthermore, while there exist certain procedures for rescheduling bilateral official credits (the Paris Club) as well as commercial bank credits (the London Club), comparable mechanisms are missing for bonds and securities issued by sovereign borrowers. The official community and several private banks are critical of the fact that these debt instruments are regularly not covered by debt restructuring arrangements. Consequently, they are demanding the "bailing-in" of bondholders in order to reach an equal burden sharing between all groups of creditors. It has to be stressed, however, that the World Bank and the IMF, because of their preferred creditor status, are also shielded from sovereign debt restructurings.

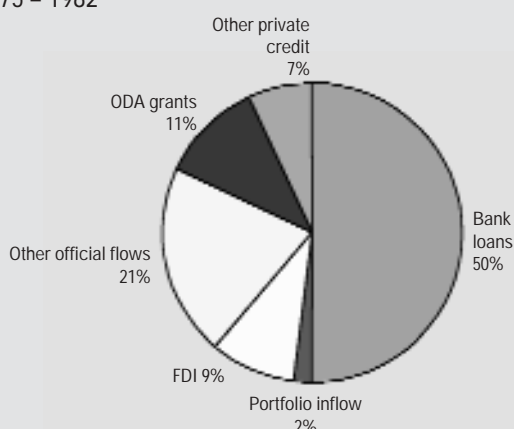
In order to encourage coordination among bondholders, the G-10, G-22 and also the G-7 proposed the incorporation of so-called "*collective action clauses*" in sovereign bond contracts. These clauses provide for

1. collective representation of bondholders (collective representation clauses),
2. qualified majority voting to alter the terms and conditions of the bond contract (majority voting clauses),
3. and the sharing of proceeds among creditors (sharing clauses) (Group of Ten, 1996).

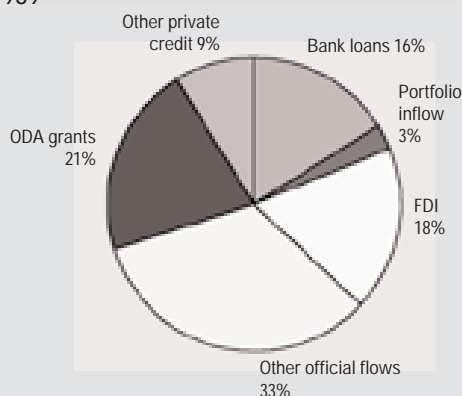
Similar clauses do already exist in a number of countries for domestic bond issues, but they are not generally applied to international bond offerings. Internationally, some

Developing countries: net capital inflows by type of flow, 1975-1998

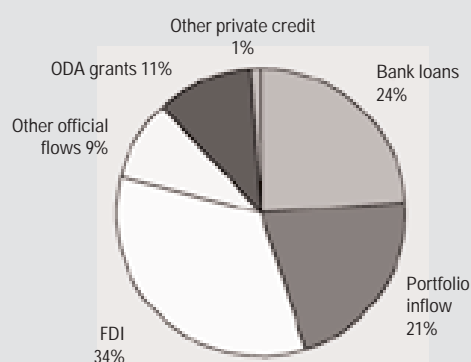
1975 – 1982



1983 – 1989



1990 – 1998



Source: Akyüz, Y./Cornford, A. (1999: 10)

of these clauses can be found in syndicated loan contracts¹² or in bond covenants, which are subject to English law. The share of emerging markets' sovereign bonds, which are subjected to English law, accounts for 20%. Nevertheless, the majority of emerging market bond issuers (currently 49%) opts for US law, under which it is not usual to integrate collective action clauses. The same applies to international bonds under German or Japanese law. Most market participants voiced objections against integrating such clauses into bond contracts. Particularly bond issuers, i.e. emerging markets governments, are afraid of the rise of risk premiums and thus higher borrowing costs. According to the Emerging Markets Traders Association, sharing clauses would threaten the legal right of creditors to enforce their claims, whereas majority-voting clauses might be acceptable, if they remain voluntary (IMF, 2000: 119). Several private banks, although themselves investing in emerging market bonds, seem to favour collective action clauses. For example, the federation of German commercial banks pointed out that shielding bondholders from debt restructurings would contravene the principle of equitable burden sharing (Deutsche Bundesbank, 1999).

The case for bondholder committees

Since there are no permanent fora for the wide range of bondholders and the lack of coordination between them is regarded as a major obstacle for orderly debt workouts, several authors have suggested the resuscitation of standing bondholder committees. These existed from the nineteenth century until the 1930s in the United Kingdom, the United States and other creditor countries. As with the London Club proceedings, debt holders would appoint representatives to negotiate with debtor governments. Representatives of mutual funds, pension funds, banks and individual investors would be members of the negotiating steering committee. Eichengreen and Portes (1995) went a step further by recommending a single international committee, dubbed the 'The Bondholder Council', which should also include representatives from governments and international institutions. They dismissed the idea of separate committees dealing with different classes of bondholders, as was frequently the case in the nineteenth century. The resolution of conflicts between different bondholder classes should rather be the main purpose of the Bondholder Council. In a later publication Eichengreen discusses the possibility of creating two

Bondholder Councils, one coordinating holders of government bonds issued under New York law, the other coordinating holders of bonds issued under English law (Eichengreen, 1999: 77). Nevertheless, the proposals for establishing bondholder committees did not receive much support in the official arena, because the private sector disliked the idea. As the IMF put it, market participants "have a concern that a standing committee may reduce the cost of default for the sovereign borrower, by making it more orderly, and hence increase the probability of default" (IMF, 2000: 121). Consequently, the IMF states that standing creditor committees are "generally not considered practical" (ibid.), and instead of this, promotes ad hoc coordination among bondholders. But that is, what is already happening today. In recent cases of bond restructurings coordination of different bondholder groups occurred on an ad hoc basis.

4. Debt management at work

Having described the established procedures and principles of international debt management, the next step entails a deeper insight into the course of debt restructurings. How do the described principles apply? How do different actors behave in debt crises and which shortcomings can be faced? By answering these questions, requirements for a reform of debt management procedures will be elaborated.

4.1 Incentives for the grab race

One important challenge for countries facing imminent debt crises is to prevent of international banks from cutting their credit lines. At first hints of difficulties, international banks have a strong incentive to "rush for the exits" before a debtor government declares a suspension of payments. International banks react by refusing new loans and not extending the maturities of existing credit lines, the so-called "rollovers". Furthermore, they try to liquidate collateral. Refusing rollovers alerts other creditors as well, thus triggering the well-known herd behaviour.

Investors in local currency denominated securities, for example, attempt to sell government bonds and change their proceeds into hard currency before the government announces a debt restructuring or imposes capital controls which could restrict the convertibility of the currency. The refusal to roll over short-term foreign loans has been a major factor deepening the recent East Asian financial crisis. The sudden lack of foreign currency made private sector enterprises unable to repay their foreign debts or finan-

¹² Syndicated loans are huge credit packages provided by consortia of banks.

ce imports and exports. Furthermore, this shortage drove down the exchange rate of the domestic currency and raised interest rates, making it even more difficult for private enterprises to service their debts. They were forced to liquidate assets or to close down. Frequently, the creditors' behaviour isn't justified by the economic "fundamentals" of distressed countries. Creditors' overreaction is often explained by the so-called collective action problem: *"Even though the creditors as a group are better off if they continue to roll over their maturing claims on a debtor, an individual lender or investor has an incentive to exit"* (Akyüz/Cornford, 1999: 17). This incentive is strengthened by the facilitation of seizing foreign assets of indebted governments and the possibility to take legal recourse in order to attach current and future capital inflows, for example new disbursements of the IMF.

Principally, the doctrine of sovereign immunity states that government assets are not subject to commercial law, so that they can't be seized for non-payment of debt. But the current practice in international commercial contracts differs distinctly: *"The legal doctrine of sovereign immunity would appear to exempt the property of foreign governments from the jurisdiction of domestic courts. ... Over the years, however, as a result of considerable evolution, the practical application of the doctrine has increasingly given creditors leverage to retaliate against defaulting sovereigns. In modern times, the ability of countries expressly to waive sovereign immunity in their commercial contracts has strengthened the rights of their creditors, thereby paving the way for an expansion of international lending. ... Most developing-country government debt contracts after 1976 have contained explicit waivers ... (which) have made it more difficult for sovereigns that repudiate their debt to engage in international trade, and their existence supports the assumption that creditors can impose direct sanctions on a reneging sovereign debtor"* (Obstfeld/Rogoff cited in: Miller/Zhang, 1999).

Thus, waiving debtor countries' immunity in debt contracts gave creditors further possibilities to retaliate against defaulting governments, besides the option to restrain the latter's access to capital markets. Waiving the immunity, as is common for emerging markets, allows the grabbing of debtor governments assets and gives strong incentives for other creditors to follow suit. In the absence of an insolvency procedure or at least creditor coordination, the grab race of creditors takes place at the earliest signs of an imminent default. Furthermore, by suing governments in order to attach future cash flows creditors can exercise strong influence on a debtor country's debt servicing capa-

city, the so-called "strangulation by litigation". When in 1998 the Russian government announced the write-down of domestic debt held by foreign residents, creditors threatened to seize Russian assets worldwide. A commercial banker said: *"If they don't sit down and negotiate, they are going to be sued all over the world. All their assets will be attached. Every time an Aeroflot aircraft lands, it's going to be seized"* (cited in: Miller/Zhang, 1999). Preventing sovereigns from experiencing these kinds of disruptive grab races serves as one important argument for the internationalisation of insolvency procedures, which, on the domestic level, allow firms to file for protection against their creditors, thus gaining a sanctioned standstill on debt payments.

4.2 *Interbank rollovers – or the socialisation of private debt*

Preventing creditors from the rush to the exits by convincing international banks to rollover their credit lines, among other things, is a difficult exercise usually entailing high costs for debtor governments. Furthermore, private banks don't appreciate mandatory rollovers, thus governments try to reach voluntary agreements. If the efforts of a debtor are successful and commercial banks do rollover their claims, the official community hails this as an example of an orderly debt workout as well as effective private sector involvement. But these workouts have their price, as shown by the cases of Korea and Indonesia during the recent East Asian crisis.

South Korea:

In December 1997 South Korea faced severe debt-servicing problems. Although there were only \$6 billion in reserves, interbank claims that had to be served within the next two months amounted to \$26 billion. Short-term interbank credit lines, the main source of external credit for local Korean banks, had been cut back, and the rollover ratios fell to near zero. An IMF programme failed to restore confidence. At the end of the year the central banks of the USA, Japan, Germany and the UK called meetings to convince their respective commercial banks to roll over their maturing interbank lines. The central banks voiced concerns over a possible risk to the world's financial system and promised additional official resources. The banks finally agreed, lengthened the maturities for a few months, and the rollover ratios rose up to 95%.

At the beginning of 1998, Korea and its London Club private creditors agreed on a longer-term solution for \$24 billion of interbank loans. These were restructured into one-, two-, or

three-year loans with surcharges of 225 to 275 basis points above the international reference interest rate LIBOR, thereby clearly exceeding pre-crisis interest rate levels. As additional "sweeteners", these loans were given an explicit guarantee by the Korean government, hence the former claim on a Korean bank turned into a claim on the sovereign. This kind of socialisation of private debts is a common feature of today's debt workouts. Commercial banks, which had rolled over credits, interpreted the government guarantee as a bailout of their claims, and made good profits after the recovery of the Korean economy. Not to forget, the sovereign guarantee gained credibility by the biggest rescue package the IMF had ever arranged, totalling \$57 billion (IMF, 2000; Huffschmid, 1999).

Indonesia:

After November 1997 the Indonesian economy faced a broad-based drying up of its foreign currency reserves due to bank runs and domestic capital flight, forcing Indonesian corporations to default on their foreign currency loans. At the end of January 1998 the Indonesian government sanctioned this de facto standstill by declaring a "pause" for private sector foreign exchange denominated debt service. Simultaneously, only the obligations of Indonesian banks received a state guarantee. The payments standstill aggravated relations with creditors and delayed the establishment of a London Club steering committee. Eventually, London Club creditors and the government reached agreement on a corporate debt-restructuring scheme, which again was backed with the sweetener of a preferential foreign-exchange guarantee of the sovereign. In the Indonesian case the IMF rescue package amounted to \$40 billion (IMF, 2000; Huffschmid, 1999).

Both cases illustrate that common practices of private sector involvement in debt workouts frequently entail the socialisation of private sector debt. With increased private sector borrowing throughout the 1990s, the share of non-guaranteed capital flows to emerging markets rose as well, exceeding public and publicly guaranteed flows since 1995. After the outbreak of the East Asian crisis this trend reversed sharply, and non-guaranteed borrowing

almost completely disappeared. This reversal is a result of the creditors' pressure on governments to guarantee the debts of their private sectors. Therefore, socialisation triggered the rise of public and publicly guaranteed debt after the East Asian crisis, as the figures for Thailand, Indonesia and South Korea show:

Additionally, the upgraded terms of the new loan contracts provided commercial banks with extra profits, particularly in the Korean case. Besides, considerations as to whether or not the privately contracted loans served reasonable economic or social purposes, so that the states guarantees could be justified, did not play any role. The question of legitimacy of claims, completely ignored in international debt restructurings, will be further examined in chapter II.3.

The increase of private sector foreign-currency borrowing reveals the necessity of effective *national bankruptcy laws* as well, which are frequently deemed insufficient or are missing in developing countries. Forcing governments to assume private sector loan losses by taking over state guarantees contradicts common bankruptcy principles. Furthermore, *private* borrowers also have to be shielded against the above mentioned grab race of dissident creditors. By plundering the debtors' assets they can trigger a premature liquidation of corporations, thereby preventing possible rehabilitations. Even the IMF underlines the necessity of effective national insolvency procedures:

"In a liquidation procedure, one of the reasons for a stay on the ability of creditors to enforce their legal remedies is to avoid a premature dismemberment of the enterprise, thereby providing an opportunity for the liquidator to maximize the value of the assets of the estate. It should be of no surprise, therefore, that the existence of a stay in the context of a rehabilitation procedure is critical. An enterprise cannot be rehabilitated if it is being dismembered through the attachment of its assets by creditors" (IMF, 1999: 40). The state's budget will also be saved, because "subjecting the enterprise to the application of the general insolvency law sends a clear signal regarding the limitations of public financial support". Furthermore, in the context of a financial crisis "an effective insolvency law can provide a useful means of ensuring that private creditors contribute to the resolution of the crisis. For example, a rehabilitation procedure provides a way to impose a court-approved restructuring agreement over the objections of dissenting creditors" (ibid. 8).

Country	Public debt as percentage of GDP	
	1997 (pre-crisis)	April 2000
THAILAND	15.7	51.9
INDONESIA	23.0	93.0
SOUTH KOREA	12.0	22.2 (end-1999)

Source: Chomtongdi, 2000

4.3 *Moral hazard and the case for a debt standstill*

Yet, the above-mentioned contribution of private creditors to crisis resolution is regularly being undermined by the so-called "moral hazard" problem, of which the Korean and Indonesian cases are intriguing examples. Banks and other private creditors rely on the assumption that their excessive lending can't be sanctioned by systemic default. They expect that sufficient international support of the official community, e.g. the IMF, multilateral development banks and G7-governments, will be made available to allow a country to meet all its contractual obligations. This expectation has often been met by rescue packages of the international community, which in the case of the crisis-hit East Asian countries amounted to roughly \$120 billion. The probability of awarding such rescue packages is particular high when the international community perceives a systemic risk through possible contagion effects. This is regularly the case when a country is regarded as "too big to fail", as for example Korea or Brazil. But official bailouts tend to encourage creditors to take unwarranted financial risks and stimulate speculative behaviour. Some debtor governments may also be encouraged to follow inappropriate borrowing practices, so that a de facto alliance of borrowers and lenders tries to extract funds from international organisations.

It is argued that if the international community didn't provide emergency finance, a creditor panic could affect the debtor country much more severely. On the other hand, if it does provide emergency finance, creditors' loose lending practices will be encouraged. This dilemma underlines the necessity of "orderly debt workouts" (UNCTAD, 2001: 132), which should encompass internationally agreed standstills on debt service payments followed by fair and transparent arbitration processes. Such an internationally sanctioned moratorium would relieve pressure on the public sector to provide large-scale bailout packages, thereby mitigating the moral hazard problem and discouraging risky lending behaviour. Furthermore, an internationally agreed-upon debt standstill would force private creditors to the negotiation table and weakens their possibilities to protract rescheduling negotiations in expectation of further sweeteners by the sovereign. Additionally, the standstill would have to be accompanied by comprehensive capital and foreign exchange controls, in order to combat capital flight which might be triggered by its announcement.

Additionally, such a moratorium would have to be combined with the provision of financial support by the interna-

tional community to keep the debtor's economy viable. The funds required for this so-called lending into arrears would be far less than the large IMF-led bailout packages. Principally, the IMF policy of – "in exceptional cases" – lending into arrears if a country suspended payments would allow for such emergency financing. Additional private lending, if necessary, could be encouraged by granting "seniority" to new claims, so that these would be served first. Nevertheless, the provision of financial support by the IMF would have to be decoupled from the usual conditionality of implementing structural adjustment programmes. Instead, a fair and transparent arbitration process, which secures basic economic as well as social needs of the distressed country, including the participation of the affected local population, would have to be started.

Similarly, the IMF is not the appropriate institution to sanction a moratorium, because of several conflicts of interest. Therefore, Wyplosz (1999: 180) asks: "*Which institution should be in charge of declaring a standstill? The IMF has an obvious information advantage, but it faces conflicts of interest. It can be a lender itself, its board is dominated by lender countries and there exist obvious links between its own programmes, debt servicing and negotiations with debtors. A new independent court might be needed for the task*". Under another IMF-free alternative, suggested by Akyüz and Cornford (1999: 39), "*the decision for standstill could be taken unilaterally by the debtor country and then submitted to an independent panel for approval within a specified period. Its ruling would need to have legal force in national courts for the debtor to enjoy insolvency protection*". Creating an independent entity, whether on an ad hoc basis or as a standing body, which has the power to sanction an internationally agreed debt standstill, seems to be an important pre-requisite for debt management reform.

4.4 *Bond restructurings: Examples of successful private sector involvement?*

As was mentioned above, the lack of coordination between bondholders is seen as a serious obstacle in facilitating orderly debt workouts. Nevertheless, the official community regards recent bond restructurings of Pakistan, Ukraine, Russia and Ecuador as examples of improved restructurings and successful bail-ins of bondholders. But these examples clearly show that ad hoc coordination on a voluntary basis is not sufficient to enable effective workouts, prevent the socialisation of private debt and provide for necessary debt relief. Furthermore, they reveal the strategic bargaining between different creditor classes,

which hampers restructuring negotiations and impairs the terms of the final outcome.

Pakistan:

Restructuring agreements with the Paris Club of bilateral official creditors contain a clause obligating debtors to seek rescheduling terms from other creditors, excluding the IFIs that are at least comparable to those of the Paris Club agreement. But until recently, sovereign bondholders had been exempted from the comparability of treatment principle, because the value of their claims was deemed too small to justify rescheduling. This judgement has changed with the emergence of bonds as preferred emerging market debt instrument. Finally the Paris Club extended its comparability of treatment principle to bondholders as well. The first example of this new policy was the January 1999 Paris Club agreement with Pakistan. The Pakistani government was expected to seek comparable terms not only from its London Club bank creditors, but from its sovereign bondholders as well. Therefore, following a June 1999 agreement with the London Club, Pakistan launched a coerced restructuring of its eurobonds in November. But the terms of the exchange were so comfortable that 99% of bondholders took part and the collective action clauses of the UK-style eurobonds did not have to be invoked. The agreement contained the swap of three dollar-denominated eurobonds for one six-year amortising eurobond with a 10% interest.

The effect of this sweetener on the debt service profile is sobering. According to market estimates, the Paris Club and London Club agreements together with the bond exchange were to bring debt service payments back to pre-crisis levels by 2001 and will even be higher for the remaining maturity of the exchanged bond. Thus, we face another example of "successful" private sector involvement without any substantial debt relief. Furthermore, since the extension of comparable treatment to bondholders raises the likelihood of countries defaulting on their bonds, rating agencies revaluated certain emerging market bonds, thereby raising the funding costs for the affected countries: *"Rather quickly market participants and sovereign rating agencies have judged countries with a large share of Paris Club debt relative to total external debt to be more likely to be subject to PSI pressures [PSI = private sector involvement, T.F.] from the official community"* (IMF, 2000: 144).

Ecuador:

In September 2000 Ecuador negotiated a restructuring agreement with the Paris Club. It was its seventh appearance before the Club in 17 years, but up to the present no

sustainable solution to Ecuador's external debt burden of more than \$13 billion has been reached. A year before, in September 1999, Ecuador became the first country to default on Brady bonds. These bonds were a product of the "Brady plan", called after a former US treasury secretary. According to this plan, commercial banks agreed in 1994 to reduce their credit claims on Ecuador in exchange for bonds, half of them secured by a guarantee of the US treasury. Although Ecuador managed to reach an astonishingly quick restructuring agreement with Brady bondholders in August and even the IMF stressed that a lengthening of maturities would not be sufficient to restore financial sustainability, the Paris Club declined to reduce Ecuador's debt. Instead, debt service obligations were merely rescheduled over an extended period of 18 years. In 2000 Ecuador's debt service accounted for 50% of the state budget, leaving only 9% for basic social services like education and health care (Erlassjahr 2000, 2000: 11f.).

The recent cases of bond restructurings show that in the end even the participation of all creditor classes, including bondholders, as well as the existence of collective action clauses, do not provide for sufficient solutions to sovereign indebtedness. On the contrary, sometimes the results are weaker when all creditor classes are involved by separate negotiations with the debtor country. Furthermore, the intention of the new policy of private sector involvement doesn't seem to be finding a viable solution to recurrent debt crises. Rather, it helps to conceal the general unwillingness of the official community to progress in a convincing manner. The official demand of private sector involvement allows pointing at others in an effort to divert attention from one's own insufficient offers. Thus creditor classes are still paralysing each other to the detriment of suffering debtors. Therefore, we envisage another important prerequisite of an effective debt workout: the integration of the totality of creditor claims into one single rescheduling procedure. Of course this would encompass the claims of the international financial institutions as well, since their claims particularly on lower income countries have risen constantly over the years.

5. Requirements for a Fair and Transparent Arbitration Process

Recalling the sobering experiences with seemingly endless Paris Club restructurings, it becomes clear that today's debt management needs comprehensive reform. One of the main features of such a reform is overcoming the apparent creditor dominance and lack of transparency of debt negotiations. Mainly G7 governments (on the offici-

al side) and private banks (on the commercial side) set up the rescheduling terms which then will be applied in an incoherent and arbitrary manner, in certain cases the terms being completely ignored or modified. The outcomes of rescheduling have so far proven totally insufficient for low-income countries and middle-income countries as well, the latter still not eligible for any debt stock reductions.

So, what are the particular requirements for overcoming the orthodoxy of today's debt management and enabling a fair and transparent arbitration process (FTAP)?

First of all, we need a *creditor-independent entity* that has the power to sanction a unilateral debt standstill, ensures the participation of creditors and debtors on an equal basis, and brokers a rescheduling agreement that can encompass debt write-offs as well. A *panel* comprising representatives of the creditors, the debtor government, and an independent arbitrator, could be charged with negotiating the details of the rescheduling scheme. Whether the independent entity should be established on an ad hoc basis or as a standing body remains to be discussed. Yet particular *guidelines* would be necessary to ensure that the outcomes of the negotiations, such as possible future debt service obligations, don't place too heavy a burden on the state's budget in order to *retain the capacity to finance basic needs* such as education, health care or social security nets (for a deeper discussion of "debt sustainability" and basic needs see chapter II.4). The civil society of debtor countries has to have a say in the process of determining the expenditures necessary for financing basic needs.

The independent entity sanctioning the debt standstill cannot be the IMF, because of several apparent conflicts of interest. It should, therefore, *be examined whether the UN or other international fora could provide such a service*.

The debt standstill should be accompanied by comprehensive *capital controls* in order to combat capital flight. Furthermore, the international community – and if deemed necessary private creditors – should provide *lending into arrears* financing, to keep the debtor's economy viable. These new loans have to be decoupled from IMF conditionality, i.e. structural adjustment programmes. Additional private lending could be encouraged by granting "seniority" to new claims, so that these would be served first. In order to prevent different creditor classes from paralysing each other, the *totality of creditor claims and creditor clas-*

ses has to be integrated into the rescheduling procedure of an FTAP. Of course this would encompass the claims of the international financial institutions (IFIs) as well. Insofar, the FTAP should enable comprehensive negotiations with bilateral, multilateral and private creditors (commercial banks and bondholders).

The coordination of different creditor classes could be facilitated by mandatory inclusion of *collective action clauses* in debt instruments, particularly loan packages and government bonds. These clauses could help bringing debt holders to the negotiation table of an FTAP. Because of the growing importance of bond financing for emerging economies it might be advisable to encourage the creation of standing *bondholder committees*. Promoting the mandatory inclusion of collective action clauses and the creation of bondholder committees would be a particular task for the governments of major financial centers.

In order to prevent the disruptive grab race of creditors in cases of imminent default, debtor governments should be protected from being sued by dissident creditors. Therefore, *waivers of immunity* contained in most developing country debt contracts *should be voided with the start of a fair and transparent arbitration procedure*. No creditor should be allowed to sue during FTAP proceedings.

An FTAP has to make sure that governments aren't forced to assume the debts of their private sectors, thus *preventing the socialisation of private debt*. Therefore, debtor governments should exert due restraint concerning official guarantees. Accordingly, pressures from the creditor side to provide guarantees or assume private losses have to be rejected. Additionally, *effective national bankruptcy laws* could relieve pressures to socialise private debts, as well as prevent private corporations from premature liquidation triggered by creditors grabbing their assets.

II.2: Arbitration as a pattern of governing debt relations

by Philipp Hersel

The next chapter will review international arbitration as a tool to resolve international economic conflicts and ask for its application to the field of debts. As outlined in the introduction, today's institutional setting of debt management suffers several shortcomings. Like any other procedure, arbitration is not a magic bullet. Here we will ask whether, and to what extent, arbitration can offer advantages compared to today's debt management.

1. What is Arbitration?

Arbitration is a type of peaceful dispute settlement whereby conflicting parties decide to bring their conflict before a tribunal, which will decide on the issue in question and make a final ruling ("arbitral award"). At the beginning of any arbitration, the conflicting parties must agree on a framework of rules that the arbitration proceeding should follow. This framework of arbitration rules includes the procedure on installing the arbitral tribunal, how many members it should have, the timeframe for submitting evidence and expertise, and how the arbitrators will be remunerated. Normally the parties involved use already existing sets of arbitration rules, as they are provided by the International Court of Arbitration (ICA) at the International Chamber of Commerce (ICC), by the Permanent Court for International Arbitration (PCA), by the International Centre for the Settlement of Investment Disputes (ICSID) or by the United Nations Centre for International Trade Law (UNCITRAL). In many cases contracts and treaties already refer to particular sets of arbitration rules to be applied if any conflict evolves in the future.

Besides choosing the procedural or arbitration rules, the parties to an arbitration proceeding can sometimes also choose the legal framework, e.g. which parts of international and national private or public law or treaties should serve as the basis for the decision of the arbitral tribunal. For example, if a French and a Russian corporation go for arbitration, both sides determine the relevant US law to be applied as the legal basis for arbitration. In case of a judicial proceeding, the parties would have to apply the legislation of the local court, i.e. French or Russian law.

In the governance of international trade, arbitration has been the most commonly used settlement mechanism for a long time when it comes to disagreements in the interpretation of treaties, difficulties in fulfilling contractual obligations, etc. Trade-related international arbitration

takes place in similar constellations as in international debt relations: disputes between private firms, between private and public bodies and among public entities (mainly sovereign states). According to the different constellations there are well-developed international regimes and institutions that promote, execute, and survey arbitration proceedings.

2. Arbitration between private entities ("commercial arbitration")

As there are millions of private firms but only some 200 states and territories involved in international trade, the bulk of arbitration procedures deal with conflicts between private firms or individuals of different national origin. For these actors, arbitration is one of the most commonly used methods of conflict resolution. Arbitration as an appropriate mechanism for dispute settlement is so widely accepted that commercial contracts often provide for arbitration in advance. "Arbitration as a means of dispute resolution between parties involved in international trade is an important and integral provision of many commercial agreements." (Oehmke, 1990: 1)

Arbitration on the international level has much appeal for commercial actors. "Arbitration awards enjoy much greater international recognition than judgements of national courts." (ICA, 2002). Furthermore, "arbitration is faster and less expensive than litigation in the courts. Although a complex international dispute may sometimes take a great deal of time and money to resolve, even by arbitration, the limited scope for challenge against arbitral awards, as compared with court judgements, offer a clear advantage. Above all, it helps to ensure that the parties will not subsequently be entangled in a prolonged and costly series of appeals." (Ibid.) However, although they are not court judgements, arbitration awards can be enforced by national courts. The "United Nations Convention on the Recognition and Enforcement of Foreign Arbitral awards" (the "New York Convention") of 1958 ensures that decisions awarded by international arbitration must be respected by national courts in the by now 122 contracting states of the convention.

As previously pointed out, arbitral awards are not subject to the regular chain of appeals and new decisions by a higher court, as we are used to from national jurisdiction. An appeal to an arbitration award is only allowed if one of the

parties doubts that the initially agreed arbitration rules have been appropriately applied.

As mentioned above, there are several frameworks of arbitration rules provided by private and public international institutions. The most important one for commercial arbitration is certainly the International Court of Arbitration (ICA) at the International Chamber of Commerce (ICC) in Paris. In fact, the ICA itself is neither a court nor standing tribunal for arbitral proceedings, but provides the framework of rules, offers a list for potential arbitrators and controls the conformity of proceedings with the rules of the ICA. The ICA gets either appealed to because it is already scheduled to be the dispute settlement institution in the commercial contract between conflicting parties, or because both parties agree to submit their dispute to the ICA independent of an arbitration clause. In the first case, a party wishing to have recourse to arbitration must submit its request for arbitration to the ICA Secretariat, which will then inform the other party or parties, thus starting proceedings. The arbitral award will, depending on the clause in the contract or the decisions of the parties or the ICA, be handed down by one or three arbitrators. Either the parties agree on whom they wish to be the arbitrator(s), or the Secretary General of the ICA will nominate the arbitration tribunal from lists of potential arbitrators from national arbitration societies.

If the parties do not want to resort to any supervising institution for their arbitral proceedings, they can also decide just to apply the ICA rules rather than bringing the case to the ICA itself. Another possible set of arbitration rules is the UNCITRAL Model Law on International Commercial Arbitration, as agreed upon by the UN in 1985. The high level of procedural as well as institutional development in international commercial arbitration is both the condition and result of the frequent use of arbitration as the regular type of dispute resolution between private parties in the area of international trade. Because of the sheer number of proceedings and cases and the level of institutionalisation, the vast majority of academic research on international arbitration focuses on commercial arbitration between private parties. This might be one of the reasons why official debt negotiators, if they deal with public creditors and debtors, are so unfamiliar with arbitration as a pattern to resolve economic conflicts on the international level.

3. *State-Private, State-State Arbitration*

However, beyond private commercial arbitration there is also an institutionalised framework of international arbitration for state-private and state-state conflicts. Actually, the early roots of such arbitration can be found in attempts for peaceful settlement of inter-state conflicts in ancient Greece between Athens and Sparta. "It started with a treaty in 445 BC in which, according to one version, the parties promised not to go to war against a party willing to submit the issue in dispute to arbitration" (Sohn, 1990: 10). Sohn considers this as to have been a blueprint for the Covenant of the League of Nations almost 2400 years later, in which it is agreed that members of the League would not go to war, "if a matter had been submitted to arbitration, until three months had elapsed after the arbitrators made the award, and then only against a Member of the League who refused to comply with the award." (Ibid.) Obviously, international arbitration emerged and grew in the face of sovereign states that were, at least partly, willing to subordinate their "sovereign" right to go to war to an independent tribunal of arbitrators.

At the very end of the 19th century arbitration between sovereign states took a major leap in international law. In 1899 the First International Peace Conference took place in The Hague. The Conference adopted the Convention for the Pacific Settlement of International Disputes, which was aimed at "extending the empire of law, and of strengthening the appreciation of international justice", and "obviating, as far as possible, recourse to force in the relations between States" by "institution of a tribunal of arbitration, accessible to all" (Peace Conference, 1899¹³).

One of the most important results of the conference was the creation of a Permanent Court of Arbitration (PCA) with an International Bureau in The Hague. The purpose of this court was and is to facilitate arbitration between states by helping with the composition and nomination of arbitration tribunals by the means of lists of potential arbitrators that are nominated by the contracting states of the Convention. At the Second International Peace Conference in The Hague in 1907, the role of the PCA was strengthe-

¹³ All major powers signed the convention either as participants of the conference (e.g. Austria, Belgium, China, Denmark, France, Germany, Greece, Hungary, India, Italy, Japan, Mexico, Netherlands, Russia, Spain, Sweden, Switzerland, United Kingdom, United States) or in the aftermath. Today the convention has been signed by almost 70 states. The last signatory was Eritrea in 1997.

ned. With regard to the issue of international debt, the conference adopted a special "Convention Respecting the Limitation of the Employment of Force for the Recovery of contract debts". In Article 1 it says: "The Contracting Powers agree not to have recourse to armed force for the recovery of contract debts claimed from the Government of one country by the Government of another country as being due to its nationals. This undertaking is, however, not applicable when the debtor State refuses or neglects to reply to an offer of arbitration, or, after accepting the offer, prevents any compromise from being agreed on, or, after the arbitration, fails to submit to the award" (Peace Conference, 1907)¹⁴.

This convention clearly proves that already almost 100 years ago sovereign states, debtors and creditors alike recognised the need to settle international debt problems through open negotiations involving neutral arbitration, rather than by applying power politics and force.

There is another international arbitration institution that is particularly concerned with financial conflict resolution between states and private parties: the International Centre for the Settlement of Investment Disputes (ICSID). ICSID was established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID-Convention), which came into force on October 14, 1966. Part of the World Bank Group, ICSID has an Administrative Council and Secretariat. The Administrative Council is chaired by the World Bank's President and consists of one representative of each State that has ratified the Convention. Unless a government makes a contrary designation, its Governor for the Bank is simultaneously the country's representative on ICSID's Administrative Council. In August 2001, the ICSID-Convention was signed by 149 countries of which 134 had ratified it by national legislation.

As international loans and particularly portfolio flows are transnational investments, ICSID is intuitively the institution most directly concerned with the issue of arbitration in debt management. However, up to today ICSID generally dealt with conflicts in foreign direct investment and hardly with portfolio investment, leaving alone loan contracts.

Recourse to ICSID conciliation and arbitration is entirely voluntary and must be agreed upon by the parties involved in the conflict. Once the parties agreed to go for an

ICSID arbitration proceeding, neither of the parties can unilaterally withdraw its consent. Moreover, all ICSID Contracting States, whether or not parties to the dispute, are required by the Convention to recognise and enforce ICSID arbitral awards.

Provisions on ICSID arbitration are commonly found in investment contracts between governments of member countries and investors from other member countries. Advance consents by governments to submit investment disputes to ICSID arbitration can also be found in about twenty investment laws and in over 900 bilateral investment treaties.

4. *Arbitration and the rule of law*

The use of the arbitration process as an alternative to unlimited power politics is clearly a step towards more equitable international relations. As arbitration clauses in treaties, or treaties on arbitration itself, are part of international law, the adherence to arbitration clauses is clear instances of the rule of law on the international level.

Of course, the highest institutional quality of the rule of law is an independent jurisdiction that is only bound by a democratic legislation. However, this ideal of the rule of law is even not the case in many countries on the national level, let alone in international jurisdiction and legislation. The last century witnessed several attempts at giving international courts greater decision-making powers to arrive at legal awards on the basis of international law.

The clearest step in this direction was the creation of the Permanent Court of International Justice (PCIJ) in The Hague in 1920. After the experience of World War I this court was designed to complement the PCA and expressed the desire of nation states to emphasise the application of international law rather than fall back on military force. As we all know, this project did not come to a happy end; the high aspirations of having a binding international juridical institution proved to have been far too ambitious. Arbitration remained the more favourable option as compared to the court, even after some kind of international jurisdiction was reinvented as the International Court of Justice after World War II and strengthened by the UN Charter.

Taking this past record of international judicial institutions into account, systemic solutions to international debt problems through international jurisdiction seem very far away. Arbitration in this field, on the other hand, can be considered as a first and major step, which states can take

¹⁴ Today the convention is signed by 71 states. The last signatory was Macedonia in 2001.

towards creation of a set of international rules that are binding for each state regardless of its economic or military power. Thus, if one is looking for the rule of law on the international level, arbitration and litigation are not opposite poles of possible regimes. Rather arbitration is an incremental step towards a higher level of the rule of law that might be crowned by international jurisdiction at some point in time.

The proposal of Fair and Transparent Arbitration Processes (FTAPs) draws on the principle that in almost all developed national legal systems even the most heavily indebted individuals enjoy a minimum of debtor protection. Indebted individuals are allowed to spend their income on shelter and nutrition and to maintain a minimum standard of living before they must service their debts. This right of debtor protection can be enforced before national courts. On the international level there is no similar form of debtor protection. Of course indebted individuals are different from indebted countries, but the point is that indebted countries must be capable of providing basic social services to its people as needed. The capacity of the state to sustain at least a minimum level of social security is often a question of life or death for the poor, and at the same time touches upon the legitimacy of the modern state itself. If there is still a very long way to go before international debtor protection by means of international jurisdiction becomes attainable, then arbitration might be the first step to take in this direction.

5. *Arbitration: As good as the rules applied*

The central element for arbitration and jurisdiction alike are the rationales, rules or laws that have to be applied in a respective proceeding. The most independent and responsible court cannot secure debtor protection if this protection is not incorporated in the body of law. The same applies to arbitration. Even if arbitration levels the playing field between conflicting states, an arbitral award can never be more equitable and just than are the rules and laws that underlie the proceedings. This leads us to today's most ambiguous area of international arbitration between states: the Dispute Settlement Mechanism (DSM) of the World Trade Organisation (WTO). The dispute settlement scheme of the WTO is based on arbitration and must be considered as one of the most influential arbitral institution in interstate conflicts. In case of a conflict, a country can ask the Dispute Settlement Body (DSB), which is composed of the representatives of all WTO member states, to set up a panel of three independent arbitrators to deal with the

issue. The arbitrators must not be nationals of one of the parties involved in the dispute. After the panel has come to a judgement, this is reported to the parties and the DSB. The involved parties have the opportunity to appeal to an Appellate Body, but appeals are limited to issues of law covered in the panel report and legal interpretations developed by the panel. If the reports of the panel and, if applicable, the Appellate Body are not rejected by the DSB by consensus, the rulings are binding. If the parties do not comply with the judgement, the DSB can allow trade sanctions against them. There are several reasons for the strength of the WTO dispute settlement mechanism. Firstly, with its predecessor, the General Agreement on Tariffs and Trade (GATT), the WTO builds on a long tradition of international treaties and negotiations in the area international trade. Therefore, the codification of agreements and rules in the area of trade is highly advanced compared to other fields and is only challenged by the International Law of the Sea.

A second reason for the strength of WTO arbitral awards are the potential sanctions that can be imposed by the WTO. Thus the DSM is not only an arbitration procedure, it also includes a political mandate to enforce the rulings by exercising substantial pressure. Thirdly, the policy environment is important, too. International regulation of trade in the WTO is basically a trade liberalisation project: the underlying objective of international rules is to prevent countries from having protectionist regulations, or to limit these as much as possible. Trade is an area where so far the most powerful states (the US, Canada, Japan, EU) have obviously benefited from liberalisation and have therefore pushed for an international framework that offers the chance to enforce free trade. The benefits obviously outweighed the reservations in countries that usually strongly oppose international codification and enforceability of rules (particularly the US) and created the momentum for a really powerful arbitration mechanism in the WTO.

This is the point where the question of "What rules?" comes in. On the one hand, the enforceability of liberal/neoliberal trade rules was promoted by the most powerful actors just because it removed protectionist rules, as in developing countries, and limited their scope of state intervention. On the other hand, the commitment of the industrialised countries to leave international trade to "the market forces" ends abruptly when it comes to liberalisation of their own markets for imports from the South, especially in the area of agriculture, textiles and semi-manufactured goods. However North-biased the WTO rules are, in some cases

the panels have ruled in favour of developing countries. From its foundation in 1995 until the end of 1999 there were 27 final rulings, which included six cases in which developing countries complained against industrial countries' practices. In four of the six cases the panels ruled in favour of developing countries (see WTO, 2001). Despite criticism of the neoliberal rules of the WTO, as concerns arbitration it entails at least one positive aspect: the subordination of even the most powerful countries under the DSM indicates the acceptance of the general principle that the same rule must be applied to all. Furthermore, as many cases dealt with by the DSM were conflicts between the major powers (the EU and the US), the arbitration system of the WTO secures a minimal degree of consistency of policies between the major players.

In the realm the international financial system there is no binding institution like the WTO. Although the IMF plays an important role, even minimal consistency and policy coordination is missing in many fields of international financial policies, for example as far as exchange and interest rates between the US, the EU and Japan are concerned, not to mention the fact that industrial countries hardly ever adopted financial policies consistent with the needs of developing countries. The institutional framework of debt management is no exception from that type of "benign neglect". Obviously, arbitration can only be as equitable and just as are the principles and laws that underlie an arbitral ruling. The underlying set of rules to be applied in an arbitration process can vary from a very general setting of principles (equity, justice, sovereignty) to a very specific legal text, as in the WTO or in many commercial arbitration procedures. Depending on the degree of specificity of this basis for the award, the arbitrators act either more like negotiators seeking a compromise and finally deciding on their own judgement, or more like judges in a court, who must carefully adhere to laws, even if they consider them to be in opposition to an equitable solution to the conflict.

In the recent history of international dispute settlement, it is obviously the latter type of court-like arbitration that is more prevalent (see Kooijmans, 1990: 24). With its clear bias to law-based awards, one of the original advantages of arbitration is less important. Aristotle already signalled that advantage, when he said, "an equitable and moderate man will have recourse to arbitration rather than to strict law (...) because an arbitrator may consider the equity of the case, whereas a judge is bound by the letter of the law. before arbitration was introduced to give equity its due weight" (cf. Pinto, 1990: 65). The proposal to apply arbi-

tration to the sphere of international debt management in the form of FTAPs particularly stresses this original intention and capacity of arbitration to arrive at an equitable solution. Different from the ICSID rules, an FTAP must not be limited to cases where all parties agree on the need of arbitration. As pointed out in the FTAP proposal, a debtor state must be allowed to start an FTAP.

6. *Balancing unequal power in arbitration proceedings*

However equitable an arbitration proceeding seems to be, at least compared to the application of power relations and structural violence (as enshrined in the international economic order), arbitration can also suffer from unequal power relations. The most obvious example of this is the cost involved in running arbitral proceedings. First of all, the party starting an arbitration process usually has to pay a certain minimal fee to the arbitration institution for supervising the proceeding.

For example, it costs 75,000 US\$ for commercial arbitration at the ICC in a proceeding with a sum in dispute of 100 million US\$ or more. Furthermore, the fees for the arbitral tribunal itself also are a financial factor. The more complex the case in dispute and the more formalised the legal basis of the arbitration proceeding, the more human resources, investigation and documentation is needed to protect each side's interests before an arbitral tribunal. International lawyers are a very costly part of the process. The WTO presents the most extreme example of the imbalances in participation in arbitration proceedings.

The framework of WTO agreements and international trade law in general is so extensive that it exceeds the capacity of one person to actually give well-informed legal advice in all the questions involved. The WTO explicitly acknowledges the importance of legal resources in arbitration. "Appropriate access" to the dispute settlement mechanism "is a cornerstone of the new multilateral trading system, and properly understanding crucial to a full participation in the system" (WTO, 2002). To talk about numbers, the US has a permanent delegation of about two dozen trade specialists and lawyers in their mission to the WTO. Many developing countries lack even one representative to follow trade negotiations under way. The difference in resources between the North and the South when it comes to dispute settlement proceedings, is even more striking.

In the WTO arena the lack of jurisprudential resources of developing countries is addressed in two ways. On the one

hand, the dispute settlement mechanism foresees that the WTO secretariat provide some legal advice to developing countries. However the capacities of the secretariat are very limited and, even if well advised by the secretariat, a developing country must at least pay for one own attorney if it is party to a dispute settlement procedure. Besides the internal legal advice from the secretariat, there is an independent "Advisory Centre on WTO Law". This centre was established in 1999 on the initiative of 29 member governments of the WTO, 9 of which were developed countries. "This initiative responds to the urgent need of developing countries and economies in transition to build up their legal expertise in order to be able to participate more fully in the WTO. The WTO is a complex system of rights and obligations, supported by a binding dispute settlement mechanism to ensure compliance. Meaningful participation in the WTO requires a good understanding of these rights and obligations and the ability to participate in its dispute settlement mechanism. Unfortunately many Members face considerable problems due to lack of expertise and human resources in this particular field of international law" (ACWL, 1999).

The general idea that arbitration is not impartial when there is unbalanced access to jurisprudential resources can also be found in the Permanent Court for Arbitration in The Hague. As late as 1995 the Administrative Council decided to set up a "Financial Assistance Fund for Settlement of International Disputes" in the PCA. "There may be instances when States are deterred from recourse to international arbitration or other means of settlement offered by the Conventions because they find it difficult at the time to allocate funds to meet the costs involved. [...] Making funds available to meet costs of this nature could facilitate recourse to arbitration or other means of settlement, thus advancing the aims and purposes of the Conventions, and promoting friendly relations and cooperation among States" (PCA, 1995). The examples of the ACWL and the PCA show that there are ways and also some experience in how to balance unequal economic power relations in arbitral proceedings. In today's international debt management there are already at least two institutions that help level the playing field between debtors and creditors. The United Nations Conference on Trade and Development (UNCTAD) and the London-based institute Debt Relief International assist debtor countries in preparing their cases before negotiating with their creditors. Both institutions could serve as pools of expertise for debtor countries in FTAPs.

7. *Conclusion: Arbitration as a principle for an FTAP*

As the previous chapter has shown, arbitration offers a solution to the settlement of international economic conflicts. Even more, arbitration has a long record in international economic regulation and has proven to be an acceptable tool to basically all states. In historical terms the issue of international debts are not entirely new to arbitration. As early as 1907 the international community of states accepted, that arbitration was a more appropriate means to solve debt-related international conflicts than use of unlimited power politics. Furthermore, by being members of the International Convention on the Settlement of Investment Disputes (ICSID Convention) all creditor and many debtor countries have recognised that arbitration can be a valuable tool in dealing with financial conflicts in the area of investments. The ICSID Convention could be broadened to serve as a basis for international arbitration on debt problems.

Arbitration is based on a set of rules for the arbitration proceedings, as well as on the agreement of the parties involved as to which laws or rules they will submit for the arbitration award. Accordingly, the more clearly the rules of an FTAP panel are codified, for the proceedings as well as judgements, the more an FTAP marks progress toward the rule of law in international relations. However, the greater the degree of formality and laws or rules to be referred to, the more arbitration resembles litigation. This implies that having an equal participation and voice in the proceedings depends on judicial capacities and expertise. This can easily benefit the creditors, for they have the resources to afford the best lawyers and experts. To balance this unequal power in arbitration proceedings, an FTAP should provide independent financial resources and advice in cases where parties to an FTAP lack sufficient resources.

For the evolution of a higher level of the rule of international law and more equitable international economic relations in the field of debt, arbitration should be considered a meaningful step forward. Accordingly, appeals for ad-hoc FTAPs go along also with attempts to arrive at a more institutionalised framework in the long run, e.g. an International Insolvency Court. Depending on the point of view, FTAPs can even have some advantages as compared to an International Court, for example when the exclusion of objections and appeals helps to implement FTAP rulings and award debt relief without being tactically delayed by creditors.

II.3: Legitimacy of claims

by Thomas Fritz

1. The case for a public audit

The important question of how to decide which creditor claims should be deemed legitimate to be integrated into debt negotiations is not adequately reflected on the official agenda. Particularly, the responsibility of creditors for their lending or investment practices has constantly been ignored. But loose lending resulting in economically unviable projects, social or ecological damage, strengthening of corrupt or dictatorial regimes, or fuelling of armed conflicts, contravene internationally agreed norms and standards. The problem is that the majority of these norms are not legally binding, making the prosecution of non-adherence difficult, if not impossible. Nevertheless, if internationally agreed upon norms and standards are supposed to have any sense, they should be taken into account by judging the legitimacy of claims on sovereign debtors.

Social movements, particularly in the South, are strongly demanding acknowledgement of the illegitimacy of debt. As stated by the international network Jubilee South: *"The External Debt of countries of the South is illegitimate and immoral. It has been paid many times over. A careful examination of the origins, development, effects, and consequences of this debt can lead to no other conclusion"* (Jubilee South, 1999). Jubilee 2000 initiatives in the Philippines stress that most of the debts did not benefit the Filipino people and were even used against them: *"Many of these debts supported the Marcos dictatorship and its repressive policies. A significant number of these debts were incurred through fraud, bribery and coercion. Many were used to finance projects that caused massive displacement of communities and terrible damage to the environment. Many were actually debts of private corporations owned by cronies of past and present administrations, which were guaranteed and eventually assumed by the government"* (Unity Statement, 2000).

The Brazilian "Foreign Debt Tribunal", held in April 1999, states that Brazil's excessive indebtedness was generated particularly during 21 years of dictatorial, illegitimate and anti-popular governments, whereby creditors served as their accomplices. Therefore, the Tribunal condemns the Brazilian debt process "as grossly unjust and illegitimate" and proposes: *"An audit of the public foreign debt and of the whole process of Brazil's indebtedness, with the active participation of civil society, so as to ascertain in accounting and legal terms whether there is still debt to be paid,*

from whom it should be collected, and to establish democratic rules for overseeing borrowing" (Foreign Debt Tribunal, 1999). This proposal has been confirmed by the outcomes of the September 2000 Brazilian plebiscite on the external debt, organised by a network of churches, social movements and NGOs. Roughly 5.5 million voters answered the three questions. The second one read: "Should Brazil continue to pay the foreign debt without having a public audit as prescribed by the 1988 Constitution". The other two questions referred to continuation of the current IMF agreement and to the use of large parts of the state's revenue for servicing the internal debt. All questions were answered "No" by +/-95% of the voters (Andrews, 2000).

Such an audit of the external debt is considered to be a useful element of a transparent arbitration process. It would give the opportunity to publicly determine and uncover illegitimate loans, for instance. Furthermore, such a process might facilitate writing off these debts in an internationally recognised manner (Dillon, 2001). Civil societies' or local communities' knowledge of the outcomes of several credit financed investment projects is deemed to be an important contribution for evaluating the legitimacy of claims. Additionally, the demands of social movements should also be taken into account, when decisions about a country's future borrowing or debt servicing are to be made.

2. Determining legitimacy

Determining the legitimacy of foreign creditors' claims should be one element of a transparent arbitration process, within which civil society must have a say. Nevertheless, such a process might be difficult and time-consuming, because there are very few internationally agreed upon criteria for determining the legitimacy of claims, like, for instance, the doctrine of odious debts, which will be described in the following chapter.

After that, the reckless investment practices of export credit agencies will be highlighted, as an example of the current lack of binding social and environmental standards for international lending and investment. Thus, the following paragraphs do not include an exhaustive list of possible criteria for determining the legitimacy of claims. They rather present a few criteria, which are currently being discussed in various international fora, particularly in the NGO community, and point at a few associated problems.

2.1 *Odious debts*

Since the 1980s, social movements in the South have brought up the issue of so-called odious debts being those contracted by despotic regimes for illegitimate purposes. A more recent example is the South African NGO coalition SANGOCO that in 1998 declared credits contracted with the former apartheid regime as odious, because they were used against the population. The legal doctrine of odious debts was developed by Alexander Nahum Sack, a former minister in Tsarist Russia and after the Russian Revolution a professor of law in Paris: *"If a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress the population that fights against it, etc., this debt is odious for the population of all the State. This debt is not an obligation for the nation; it is a regime's debt, a personal debt of the power that has incurred it, consequently it falls with the fall of this power. ... The creditors have committed a hostile act with regard to the people; they can't therefore expect that a nation freed from a despotic power assume the "odious" debts, which are personal debts of that power"* (cited in: Adams, 1991: 165).

Sack addressed the practical problems following from state transformations, such as the overthrow of monarchies and the independence of colonies. In 1918 he had seen the new Soviet government repudiate the debts of the former Tsarist regime declaring them to be personal debts of its predecessors that could not be transferred to the new Soviet government. The Soviet repudiation is one of the few cases of a successful state repudiation. One of the well-known rulings referring to odious debts is the Tinoco Arbitration of 1923. The Costa Rican government repudiated debts entered into by the former dictator Tinoco and, inter alia, the Royal Bank of Canada, and passed the "Law of Nullities". This law was challenged by the British government, but upheld by a ruling of the US Supreme Court. That ruling states that the payments made by the bank were either in favour of Tinoco himself or for the personal use of his brother. As the bank could not prove that the payments were made for legitimate government use, its claims failed (Adams, 1991: 167f.).

Although the doctrine of odious debts had been accepted in international law, legal thinking changed in the course of the twentieth century. States were increasingly made responsible for those who acted in their authority, irrespective of any considerations of legitimacy. This change was to help create a secure legal environment for creditors and investors as well, and accompanied the worldwide

liberalisation of capital flows since the 1970s. Yet, this change could be reversed if debtor governments invoked the doctrine of odious debts again. Perhaps this doctrine could also serve as a tool for civil society struggling against suppression or hazardous investment projects. Accordingly, Sack wrote: *"When a government incurs debts to subjugate the population of a part of its territory or to colonize it with members of the dominant nationality, etc., these debts are odious to the indigenous population of that part of the territory of the debtor State"* (ibid.). Apparently, financing resettlement projects, as, for instance, in Indonesia's outer islands or in the Amazon region, could be deemed odious. According to broader interpretations this doctrine may also cover ill-planned investment projects, which turn out to harm local populations or devastate the environment. Thus invoking the doctrine of odious debts may be a useful feature in a participatory debt restructuring process.

2.2 *Encouraging loose lending: Export Credit Agencies*

The following example of export credit agencies' investment practices clearly reveals the lack of binding social and environmental standards for international lending and investment. It will be shown that this lack poses specific problems for reviewing the legitimacy of claims in the context of a fair and transparent arbitration process.

Export Credit and Investment Insurance Agencies belong to the largest public financial institutions, supporting roughly 8% of world exports. Export credit agencies (ECAs) are governmental or quasi-governmental entities operated by most industrialised countries. They subsidise and promote exports and foreign direct investments of these countries' companies by guaranteeing export credits against the risk of non-payment, or insuring investments abroad against a wide range of political risks. Several ECAs also provide direct loans. Officially supported export credits to developing countries have increased steadily in recent years. ECAs new commitments averaged \$110 billion per year in 1990-96, thus exceeding all bilateral and multilateral development assistance, which averaged \$50 billion in the last decade. In 1996 the total ECA exposure to developing countries amounted to \$463 billion. Also a number of multilateral financial institutions, such as the World Bank and regional development banks, increased guarantees for private investments. In 1997 the World Bank covered private investments worth \$4.5 billion (Van Voorst, 1998). ECAs give a strong incentive for companies to maximise their exports, because they can expect to be bailed out if a deal fails and their counterparts cannot pay. In these

cases ECAs pay off the insured companies at public expenses and the private claim turns into a public claim. Since recipient countries' governments usually – not generally – take over counter-guarantees, the former liabilities of their private corporations turn into sovereign liabilities, which add to their stock of official bilateral debts. Thus, officially guaranteed export credits turn out to be an important debt-creating vehicle. Accordingly, ECAs are the largest official creditors of developing countries. In 1996 export credit related debt accounted for 24% of these countries' total indebtedness, and for 56% of their official debt. Subsequently, debtor countries enter the endless cycle of repeated debt restructurings with the Paris Club; the forum for rescheduling officially guaranteed export credits (ibid.).

ECA exposures are concentrated in a few, mainly middle-income countries. In 1996, the top four recipients, Russia, China, Indonesia, and Nigeria, accounted for 40% of ECAs' total exposures. As the following table shows, for these four countries, export credits accounted for 24%-71% of their total external debt:

Country Exposure	Total External Debt	ECA Exposure	ECA
RUSSIA	129	52.9	41%
CHINA	128	44.8	35%
INDONESIA	120.2	28.2	24%
NIGERIA	34.9	24.8	71%

Source: Fried/Soentoro 2000

Lower income countries like Gabon, Lesotho, Congo and Cameroon also have large portions of export credit related debts. Since export credits are less concessional than other official loans, they make up for a high share of these countries' debt service payments.

About half of all ECA commitments have gone to support large infrastructure projects, mainly in power generation, telecommunications, and transport. A lot of these projects, particularly large-scale dams, power plants, mining projects, roads, oil pipelines, indu-

ECA-Finance in Indonesia

Foreign investors, backed by Export Credit Agencies, supported the 32-year Suharto regime by cooperating closely with businesses run by Suharto family members. In return they gained access to lucrative sectors of the Indonesian economy and, in cases of expulsion of local populations or stifling of labour unrests, they received assistance from the Indonesian military. ECAs financed or guaranteed a lot of environmentally and socially destructive investments, and because of massive corruption these projects were often over-priced. ECA-financed projects were concentrated mainly in four sectors: power, paper and pulp, mining and refineries. In 1995 mainly US- and Japanese ECAs provided a \$2.5 billion financial package for the coal power plant Paiton One in Java, followed by a \$1.7 billion financing package for the power plant Paiton Two, provided by the US Export-Import Bank and the German ECAs Hermes, Kreditanstalt für Wiederaufbau and C&L Deutsche Revision. Both projects have been regarded as economically unviable, because the Indonesian energy sector suffers large over-supplies. Since the Paiton contracts, like the majority of private power investments, did not undergo a competitive international tender, they were heavily over-priced. It is estimated that ECA financed projects cost 37% more than internationally tendered projects. According to Corruption Watch Indonesia, mark-ups in foreign-funded power transmission projects amounted to \$400 million. Suharto's cronies and relatives were the beneficiaries of these over-priced deals. After the fall of Suharto's regime ECAs feared large

losses because the Indonesian government did not assume counter-guarantees for their investments. The ECAs pressured the new Indonesian government to honor these contracts, despite the obvious corruption. In July 1999 ECA representatives warned the Indonesian government that not honoring these contracts would harm new

foreign investments and delay Indonesia's economic recovery. The second largest sector of ECA-backed foreign investments is in the paper and pulp industry, which the Indonesian government plans to expand rapidly. The paper mills rely on the clearcutting of natural or community-managed forests or in some cases on newly planted plantations, thus endangering the livelihoods of indigenous and other forest farming peoples. Communities protesting against forced seizures of land, clearcutting of forests, and the pollution of waterways by paper and pulp factories have repeatedly been threatened by security forces. Despite the ongoing harassment of local communities several ECAs in Germany, Japan, Sweden and Finland have financed these paper mills and pulp plantations (Fried/Soentoro, 2000: 12).

strial facilities, and plantations, had very serious environmental and social impacts. ECAs are also alleged to have supported corrupt and repressive governments, like the Suharto regime in Indonesia.

Based on the negative experiences with a lot of ECA-financed investment projects, non-governmental organisations are demanding reforms of OECD-countries' export credit agencies. Their proposals include:

- Binding common environmental and social guidelines and standards not lower than those of the World Bank and the OECD Development Assistance Committee (DAC). These guidelines should be coherent with international social and environmental commitments and treaties, as, for instance, the conventions of the International Labour Organisation (ILO) or Multilateral Environmental Agreements (MEAs).
- The adoption of human rights criteria based on international human rights conventions, e.g., the UN Covenant on Economic, Social and Cultural Rights.
- The adoption of standards and guidelines to end ECAs abetting of corruption (Jakarta Declaration, 2000).

Including these standards and guidelines into the operations of ECAs is undoubtedly necessary to improve the quality of large investment projects and, accordingly, the quality of lending. But using these and other standards for reviewing the legitimacy of claims in the context of a fair and transparent arbitration process poses specific problems. The main difficulty arises from the fact that such a review is expected to be very time-consuming. Not all of the mentioned standards are internationally agreed upon, like for instance the World Bank's environmental guidelines. On the other hand, standards, which are internationally agreed upon, frequently lack legal means of enforcement, as with the UN human rights covenants or the ILO conventions. Other standards and guidelines are mere recommendations, which might be applied on a voluntary basis, like the DAC guidelines for development agencies.

One of the few examples of a standard that is becoming legally enforceable is the OECD's *"Convention on combating bribery of foreign public officials in international business transactions"* which came into force in February 1999. Since then, bribing foreign officials in order to secure overseas contracts is a criminal offence, which can be prosecuted under the law of the exporting country. The ECAs' practice of covering export credits which include bribes in the total contract value brings them close to complicity with criminal offences (Frisch, 1999). Yet determining the legitimacy of particular ECA guaranteed bank claims would

depend on proceedings in the exporting country, which do take time. Furthermore, proving the illegitimacy of claims because of the corruption involved depends on case-by-case examinations.

3. *Requirements for an FTAP: How to integrate criteria for the legitimacy of claims?*

Because of the practical problems associated with determining the legitimacy of claims, it doesn't seem to be advisable to establish such reviews as preconditions of fair and transparent debt negotiations. Accordingly, it would be too heavy a burden for the proposed FTAP panel to decide the legitimacy of a wide range of particular claims (besides a mere formal review of their eligibility), as long as easy to handle and internationally agreed criteria do not exist. Nevertheless, a public audit of the external debt, which would determine and uncover illegitimate claims, as proposed by the Brazilian plebiscite, is still regarded as an important element of an FTAP. The public debate on certain problematic loan packages as well as uncovering loose lending and corruption could contribute to stricter public surveillance of large infrastructure projects and might foster the development of binding standards for loan contracts on national and international levels. Outcomes or recommendations of such a public audit would then be submitted to the FTAP panel which could be obligated to take the audit's findings into account. Additionally, the panel might be mandated to justify decisions that contravene the audit's recommendations.

II.4: Putting basics needs before debt service

by Philipp Hersel¹⁵

As outlined in the FTAP proposal in Part I, the issue of basic needs plays a central role in determining the amount of debt relief appropriate to overcome the debt crisis of individual countries. Accordingly, a debt crisis is analysed here as being one cause of the persistent crisis of social development in debtor countries. The central message of our FTAP proposal is: people's basic needs must have preference over the claims of creditors, and debts must not be serviced if debt service compromises the fulfilment of basic needs of the population in the debtor countries. What might sound simple at first sight, leads to at least two tricky questions: First of all, how to define basic needs, and secondly, how to assess that debt service compromises basic needs? The following chapter will provide some answers as to how to tackle these questions. When addressing the issue of basic needs there are several debates and ideas to draw from. Here we can only touch on some of them, namely a human rights approach, the basic needs strategy of the 1970s and the more recent focus on poverty alleviation and International Development Goals.

1. *Basic needs, human rights and development*

Before progressing some reservations must be made. While the focus of this chapter is on social human rights and basic needs, this is not to say that the underlying objective of social human development can be achieved by only meeting the basic needs of debtors. Of course, development is a more encompassing goal that is not yet achieved by meeting basic needs. Nor can simply dropping the debts or suspending debt service be a sufficient condition for meeting basic needs or fostering development. An FTAP based on peoples' basic needs is not a magic bullet and cannot substitute for a wider development process in economic, political and social terms.

An FTAP can only be an instrument to reallocate existing resources, but not a mean of providing new money in itself, i.e. it can only secure that existing financial resources are used for basic needs rather than debt service. If there is a general lack of resources for debt service and basic needs alike, an FTAP cannot fill this resource gap. Therefore it does not interfere with claims for reparations, fundamental redistribution of resources from the North to the South,

a new era of development aid or any other claims. They remain untouched by an FTAP. Nonetheless, an FTAP can indirectly help to provide new resources. If a debt problem is sustainably solved by an FTAP, the solution of an actual crisis can help to trigger economic activity. It helps to restore a domestic banking and credit system and thereby helps to finance domestic investment in preferably small and medium enterprises. For foreign direct investment and foreign creditors an FTAP also creates a more predictable economic and financial environment. Any inflows of foreign money however must be carefully regulated to prevent ending up in a new debt crisis in the future.

Finally, there is one potential side effect of an FTAP that must not be underestimated. As pointed out in the proposal in chapter I.1, the outcome of an FTAP greatly depends on the participation and power of civil society in the process. Without intense public observation and monitoring of the proceedings of the FTAP panel, the outcome in terms of released resources for basic needs might be very meagre. On the other hand, bearing the corresponding incentives for participation in mind, an FTAP can significantly contribute to a democratisation process in the debtor country itself (for details see chapter II.5).

2. *Human rights and basic needs*

The next section will approach basic needs by the most fundamental angle, the human rights approach. Which basic needs are protected by human rights standards? The basis for a human rights approach in international debt management is the body of international law. The conviction that human rights do apply to every human being have been expressed and accepted in several historical human rights declarations. In this respect, the Universal Declaration of Human Rights (UDHR) agreed upon in 1948 must be considered as providing a comprehensive set of guiding principles for any policies taking place on the international level. With respect to basic needs the UDHR recognises "the right to social security" (Article 22), "the right to work" (Article 23), "the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services" (Article 25) and "the right to education" (Article 26). Finally, the UDHR states that "Everyone is entitled to a social and international order in which the rights and freedoms set forth in this Declaration can be fully realized" (Article 28).

¹⁵ This chapter draws on a draft paper provided by Oscar Ugarteche.

Social Human Rights according to the International Covenant on Economic, Social and Cultural Rights (ICESCR or Social Covenant)

Article 6

(1) The States Parties to the present Covenant recognize the right to work, which includes the right of everyone to the opportunity to gain his living by work which he freely chooses or accepts, and will take appropriate steps to safeguard this right. ...

Article 9

The States Parties to the present Covenant recognize the right of everyone to social security, including social insurance.

Article 11

(1) The States Parties to the present Covenant recognize the right of everyone to an adequate standard of living for himself and his family, including adequate food, clothing and housing, and to the continuous improvement of living conditions. ...

Article 12

(1) The States Parties to the present Covenant recognize the right of everyone to the enjoyment of the highest attainable standard of physical and mental health. ...

Article 13

(1) The States Parties to the present Covenant recognize the right of everyone to education. ...

(2) The States Parties to the present Covenant recognize that, with a view to achieving the full realization of this right:

- (a) Primary education shall be compulsory and available free to all;
- (b) Secondary education in its different forms, including technical and vocational secondary education, shall be made generally available and accessible to all by every appropriate means, and in particular by the progressive introduction of free education;
- (c) Higher education shall be made equally accessible to all, on the basis of capacity, by every appropriate means, and in particular by the progressive introduction of free education;

...

- (e) The development of a system of schools at all levels shall be actively pursued, an adequate fellowship system shall be established, and the material conditions of teaching staff shall be continuously improved.

However, the UDHR is not an agreed upon treaty but has only recommending status. Nevertheless, its catalogue of human rights have been transformed into two international covenants: the International Covenant on Civil and Political Rights (ICCPR or Civil Covenant) and the International Covenant on Economic, Social and Cultural Rights (ICESCR or Social Covenant). Both covenants are valid bodies of international law, coming into force in 1976. Today 145 states are party to the Social Covenant, and 147 to the Civil Covenant. The Social Covenant specifies the social human rights that were already outlined in the UDHR (see box) and obliges the contracting states "to take steps, individually and through international assistance and co-operation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including particularly the adoption of legislative measures" (Article 2 (1) of the Social Covenant).

Some readers might ask "and?" and doubt the relevance of listing a social human rights catalogue that is obviously neither actively pursued by a majority of states nor sanctioned by any court. It is certainly true that the Social covenant cannot be enforced against any state, either debtor or creditor. Even more, if it could be enforced it would probably be applied first to debtor governments because they have made the least progress in implementing it. However the purpose of this chapter is to look for reference points in favour of any debt management regime that puts basic needs before creditors' claims. Thus it must not be underestimated that the Social Covenant states actual rights. Rights in a material sense that do not stem from individual moral and ethical values (which could be questionable grounds for an international political regime) but are condensed political commitments by statal entities. However poor the practice of social human rights may be, in fact it is an indisputable element of international law and a strong argument in favour of an FTAP. This is even more the case as social rights are rights of entitlement, rights that call for the state to play an active role in their realisation. Thus they must be treated differently than civil and political rights which are, seen in the tradition of legal theory, defensive rights which generally protect the individual from interference by the state¹⁶.

Applied to the management of international debts, social human rights explicitly state the responsibility and, in fact,

¹⁶ E.g. the "right to life, liberty and security of person" constitutes the right of the individual not to be compromised in any of these items by the state.

the obligation of debtor governments to care about the social human rights of their population first, before fulfilling any claims of creditors.

3. *The Social Covenant: debtor protection on the international level*

Advanced national legal systems include the principle of "debtor protection". Individuals are protected by law from their creditors, who cannot claim debt payments if the individual debtor would thereby be deprived of his or her social human rights. In practice, that usually means that a minimum for existence (e.g. sufficient food, clothing, shelter, etc.) is guaranteed, and must not be compromised to fulfil payment obligations stemming from debts. In Germany, for example, creditors can only seize that part of the debtor's income that exceeds the level of public welfare. Article 12 of the German law on public welfare ("Bundessozialhilfegesetz") states: "The necessary livelihood particularly includes food, shelter, clothing, personal hygiene, household equipment, heating, and personal daily needs. Personal daily needs also include a reasonable degree of relationships to the environment and participation in the cultural life."

In some countries, such as the United States, the principle of "debtor protection" explicitly applies to public bodies as well. Chapter 9 of the US code on bankruptcy (Title 11 of the US Code) deals with debt problems of municipalities. If a US municipality is unable to meet its debt service obligations, it must try to find a consensual solution with its creditors. If this procedure fails or is impracticable due to the complex setting of creditors, the case is taken to court. The municipality presents a composition plan for the adjustment of its debts that must be "fair and equitable" (section 943, for specification of "fair and equitable see section 1129(b)(2)). This refers to fairness and equity among the different creditors in the burden sharing of losses in claims. As far as the burden sharing between creditors and debtor is concerned, section 903 clearly states that it is up to the debtor to propose the terms for restructuring. It secures the municipality's right not to compromise its own sovereignty by the plan for the sake of satisfying its creditors. Therefore, when it comes to the ruling about the composition plan by the court, "the court may not ... interfere with:

- (1) any of the political or governmental powers of the debtor;
- (2) any of the property or revenues of the debtor; or
- (3) the debtor's use or enjoyment of any income-producing property."

In its annotation to section 903, the U.S. House of Representatives explicitly linked this sovereignty to a municipality's social policy: "This section makes clear that the court may not interfere with the choices a municipality makes as to what services and benefits it will provide to its inhabitants" (House Report No. 95-595 in United States Code Annotated (USCA) 11 section 903). Obviously, a municipality's duty to secure public services and provide essential social safety nets, enjoy a preferential status against creditors claims. This legally binding commitment to secure basic needs of the people before satisfying the creditors is a clear instance of "debtor protection".

Article 1 (2) of the Social Covenant can be considered to provide "debtor protection" on the international level:

"All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence." Obviously, the right of a state not to be "deprived of its own means of subsistence" enjoys preference before "any obligations arising out of international co-operation". Accordingly, the principle of "debtor protection" also applies in international law.

4. *The basic needs strategy of the 1970s*

But what are the basic needs that "debtor protection" should actually protect? Beyond the indications given by the Universal Declaration of Human Rights and the Social Covenant the 'basic needs approach' might give some insight. During the 1970s, the 'basic needs approach' became the dominant paradigm in the international development debate (for an overview see ILO 1977 and World Bank 1980). "A basic needs approach to development is one which gives priority to meeting the basic needs of all the people. The actual content of basic needs have been variously defined: they always include the fulfilment of certain standards of nutrition, (food and water), and the universal provision of health and education services. They sometimes also cover other material needs, such as shelter and clothing, and non-material needs such as employment, participation and political liberty" (Stewart, 1985: 1). Paul Streeten summarises: "The basic needs approach is concerned with particular goods and services directed at particular, identified human beings. ... The basic needs approach spells out in considerable detail human needs in terms of health, food, education, water, shelter, transport, simple household goods, as well as non-material goods

like participation, cultural identity, and a sense of purpose in life and work, which interact with the material needs" (World Bank, 1980: 7). Obviously, basic needs can be grouped in at least three categories. Firstly, there are needs for the direct human survival (food, water, shelter, clothing etc.). Secondly, there are some essential services such as education and health care that are considered to meet basic needs. Thirdly, needs for participation and political liberties express a more encompassing concept of human basic needs.

The International Labor Organisation (1976) identifies similar categories of basic needs: "First, they include certain minimum requirements of a family for private consumption: adequate food, shelter and clothing are obviously included, as would be certain household equipment and furniture. Second, they include essential services provided by and for the community at large, such as safe drinking water, sanitation, public transport, and health and education facilities." Thirdly, "a basic-needs oriented policy implies the participation of the people in making the decisions which affect them." This third category also includes issues of employment.

The first and the second type of basic needs are primarily met by spending personal or public income on consumption and investment in infrastructure. Food or clothing are things that can usually be bought at the local market (given the income for consumption is available), whereas items like clean water, sanitation, education and health care require a certain level of investment in water supply systems, schools, training of teachers and doctors etc. It is this combination of consumption and investment for basic needs that characterised the basic needs approach in the 1970s. It explicitly recognised the important role of the state in providing the necessary infrastructure to meet basic needs. "A critical component of that approach is for governments of developing countries to provide better access for the absolute poor in their societies to essential public services, particularly basic education, primary health care, and clean water. These fundamental services – combined with the better shelter and nutrition that improved incomes can afford – are the key to the poor's being able to meet their own basic needs" (McNamara in World Bank, 1980: 3).

As far as basic material needs and essential services are concerned, at least two financial conditions to meet basic needs can be identified. First, one needs a sufficient household income for consumption, and secondly, one needs adequate public expenditures¹⁷ on essential services.

Provision of services is directly linked to current public finances and the amount of public resources directed to debt service. The first condition is indirectly influenced by the state as well: through taxation, income transfers and subsidies. The trade-offs between debt service on the one hand and these indirect income instruments and direct spending on essential public services on the other, will be addressed later (see p. 42).

The two dimensions of basic needs -- basic goods and basic services -- correspond to the two realms of "debtor protection" as outlined earlier: debtor protection for the individual to secure the consumption of basic goods, plus protection for municipalities to secure the provision of basic services.

5. *Basic needs today*

A lot of things have happened since the basic needs approach in the 1970s. There was the "official" outbreak of the debt crisis in 1982. There was crisis management and so called "structural adjustment" based on the "Washington Consensus" of neoliberal, market-oriented liberalisation and deregulation policies for debtor countries. Even before the basic needs approach could be fully implemented, it was superseded by the neoliberal paradigm of "more market, less state" in the 1980s.

Growing debt service obligations compromised public spending on basic social services, but also development thinking as a whole generally adopted a more sceptical view on the state and its possibilities to efficiently provide services altogether. Rather, mainstream economists and international organisations such as the World Bank, the IMF and the regional development banks, sought salvation in the privatisation of former public services, with private enterprises offering basic services like transportation, water, energy and communication at market prices. In retrospect, the neoliberal road to development did not deliver the promised results. Overall per capita growth rates in the 1980s and 1990s were no higher than in the period between 1970 and 1980, except for the South East Asian "Tiger" economies (see IMF, 2001). Nor were national incomes distributed in a more favourable way for the poor, in terms of income or basic services. On the contrary, after

¹⁷ Whether these expenditures are considered as to be public consumption or investment depends on the point of view. Today the majority of economists would agree that education and health care are central fields of public investment in a, what they call, "human capital stock".

a period of expansion in the 1970s many achievements at the time – like free admission to primary education and basic health services – stagnated or were even eroded.

Since the early 1990s, the negative impacts of structural adjustment programmes on the social conditions in developing countries have become ever more acknowledged. The World Bank itself recognised that basic social services are essential for growth, and should be provided by the state rather than leaving it to "the market", i.e. the poor themselves (World Bank, 1990). However, as this conclusion was not combined with substantial debt cancellations and the ongoing conditionality of neoliberal economic policies and the retreat of the state in general, there were neither the resources nor the political will to actually put basic needs first.

Even when issues of inequality and poverty were again in the forefront of the development debate in the late 1990s¹⁸, the concern was less with state action for more efforts in basic services or even income transfers to the poor, and more to altering their macroeconomic and societal framework. Indicators for this are key phrases such as "making markets work better for poor people", "helping poor people manage risk" or "empowerment" (World Bank 2000).

We have nothing against empowerment, but such indirect instruments, viewed from the perspective of meeting basic needs, remain rather vague and easily abused by bureaucracies seeking to lay the blame for failures elsewhere. It is therefore a welcome fact that the major international agencies concerned with development, including the IMF and World Bank, plus members of the Development Assistance Committee of the OECD, have committed themselves to pursuing the so-called "International Development Goals" (IDG). These are specific goals to measure the success and failure of international development efforts. The goals were defined at a series of United Nations international conferences in the 1990s on sustainable development, population, human rights, women, social development, etc. And they were confirmed as "The Millennium Development Goals" at the September 2000 UN Millennium General Assembly.

Several of the international development address basic needs:

- "There should be universal primary education in all countries by 2015."

- "The death rates for infants and children under five should be reduced in each developing country by two-thirds the 1990 level by 2015."
- "The rate of maternal mortality should be reduced by three-fourths by 2015."

There are at least two conclusions to be drawn from the IDGs. Firstly, the international community has accepted that developmental progress is best measured in practical social indicators rather than only in abstract macroeconomic categories like growth. Secondly, basic needs are still far from being met in practice, and the international community is either too modest, too disillusioned or simply too uncommitted to really altering the fate of billions of poor people.

However, for our message to put basic needs before creditors claims, the IDGs might be useful just because the institutions committed to the goals are themselves creditors.

6. *Does debt service compromise basic needs?*

Now that we have a clearer view on how to define basic needs, the next step is to find out how much debt service compromises basic needs, and thus should be reduced or suspended. This question is tackled here with an approach already developed in the debate on "debt sustainability" around the Heavily Indebted Poor Countries (HIPC) Initiative. This debate questions how much debt service is sustainable. The IMF and the World Bank have a purely macroeconomic point of view on debt sustainability and define any debt situation to be sustainable if the debt service ratio (debt service payments to export earnings) and the debt ratio (debt stock to export earnings) do not exceed thresholds of 15 respectively 150 percent¹⁹.

Some scholars and NGOs have countered this definition by focusing on the social costs of debt service and thus supported the guideline for an FTAP: debt service can only be sustainable if it does not compromise basic needs. In other words, the meeting of basic needs must come before debt service. But how to measure that? It is certainly wrong to say that after meeting basic needs by income instruments and public services the rest of the state budget can be spent on debt service. Obviously, other public expenditures are necessary as well: general administration, main-

¹⁸ .See Kanbur/Lustig 1999, World Bank 2000, Camdessus 2000.

¹⁹ For a critique of the macroeconomics of this definition see Hersel (1998).

taining a judicial system, police, defence, protection of the environment, public services and infrastructure investments beyond basic needs etc.

The general approach is as follows:

1. The goal to meet basic needs is transformed into a calculation of necessary expenditures or a relative spending target [basic needs spending].
2. There are assumptions or calculations about other necessary public spending [other public spending].
3. There are calculations of what might be reasonable revenues for the state budget [government revenues].
4. a) The expenditures of 1. and 2. are subtracted from 3. and the remaining public budget is available for debt service.
b) The expenditures of 1. are subtracted from 3. and a certain proportion of the remaining budget is available for debt service. [available debt service]

Although these calculations have several weaknesses, they deliver country-specific results and provide for the necessary flexibility. They can therefore serve as a basis for the procedure as well as the claims and expectations brought forward in an FTAP.

There are some reference points for arriving at spending targets for basic needs. First of all, when identifying the amount of debt relief necessary during an FTAP, the debtor government should present a budget plan for its future basic needs and other public spending. As the proceedings of the FTAP panel are public, this budget plan is subject to public scrutiny and comment. When civil society organisations feel that the budget plan does not provide the necessary resources for basic needs, it can claim to be heard before the panel and offer alternative budget plans.

Addison (1996) proposed the following procedure to arrive at spending targets for human development:

1. set specific targets for the achievement of key human development indicators (e.g. reducing child mortality rate by half in five years)
2. calculate the costs associated with expanding the public service appropriate to the target (in this case additional resources for basic health services and targeted nutrition programmes for children and women)
3. estimate the available resources in the respective chapters of the budget (health, nutrition programmes) and assess the scope for redistribution within the chapters (e.g. from high-tech medicine to basic health services)

4. assess the scope for redistribution in the all over budget (e.g. from defence to health)
5. aggregate all calculations for the different human development targets to a social expenditure plan, combine it with the expenditure plan for other public spending (administration, infrastructure, services etc.) and determine the difference between this combined expenditure plan and the future revenue projections. Only if the projected revenues exceed the expenditures, can the remainder be used for debt service.

Addison's proposal would be even more relevant to our question if its spending targets focused only on basic needs rather than human development as a whole, and if the approach were combined with some findings and propositions of Northover/Joyner/Woodward (1998). In a paper of that year done for the aid and development agency of the Catholic Church in England and Wales (CAFOD), Northover/Joyner/Woodward suggested some general rules for calculating reasonable state revenues and the spending necessary for basic health and primary education. They calculate reasonable state revenues to be up to 25 percent of GDP (an imaginary average tax of 25 percent on any income), and exclude all income below the absolute poverty line of 1 US\$ per day per person (purchasing power in 1985) from being taxed.

Based on World Bank estimates, they furthermore assume costs of 16 US\$ and 12 US\$ per person per year for basic health and primary education respectively. According to Northover/Joyner/Woodward (1998) only 20 percent of the remaining revenue should then be spent on debt service. They used their model to analyse the situation of Ethiopia, Tanzania and Zambia and concluded that the first two countries were not able to service any debt (i.e. total debt cancellation) and that Zambia would need four times more debt relief than provided under the then HIPC-Initiative (HIPC-I²⁰).

Hanlon (1998) applied the model of Northover/Joyner/Woodward (1998) to the whole group of 40 HIPC countries and found that the revenues of 10 countries were insufficient to even spend the 28 US\$ necessary for basic health and primary education, let alone any debt service. Accordingly, these 10 countries would need a 100 percent debt cancellation.

²⁰ HIPC-I provided less debt relief than the finally agreed HIPC-II-initiative, as the IMF and the World Bank considered higher debt service thresholds to be sustainable until 1999.

Calculating expenditures for basic needs and resources remaining for debt service

Taxable part of GDP/revenue basis of the state:

- 25 percent of GDP minus the untaxable income below the absolute poverty line (1 US\$ per inhabitant purchasing power parity of 1985 US prices) [Northover/Joyner/Woodward (1998)]

Social expenditure targets to meet basic needs:

- 16 US\$ and 12 US\$ per person per year for basic health and primary education [Northover/Joyner/Woodward 1998]
- 4 percent of GDP for education and health to improve maternal and child mortality in order to meet the International Development Goal (reducing the rate of maternal mortality by three-fourths by 2015) [UNDP 1996]
- 5 percent of GDP on primary and secondary education (mostly at the primary and secondary level) and 3 percent of GDP for public health [Sachs 1998]

Other public spending and debt service:

- up to 20 percent of feasible revenues (revenue basis minus social expenditure targets) for debt service, the remainder for other public spending [Northover/Joyner/Woodward 1998]
- at least 10 percent of GDP for other public spending than social expenditures (public administration: 2 percent; police and defence: 3 percent; infrastructure spending: at least 5 percent of GDP), remaining revenues available for debt service [Sachs 1998]

On average, the 40 countries could only pay one third of the debt service as provided under HIPC-I. He compared these findings with two other ways of calculating necessary public spending presented by UNDP (UNDP 1996, 1997). Firstly, based on calculations of the Human Development Report 1996 (UNDP 1996: 113) he assumes that additional spending of 4 percent of GDP would be necessary to improve maternal and child mortality to meet the respective International Development Goal. Secondly, Hanlon applied a calculation of the Human Development

Report 1997 (UNDP, 1997: 47, 112) that an extra US\$ 80 billion per year must be spent on the 1.3 billion people living in poverty. "This is an additional US\$ 62 per person per year which must be spent on everyone with an income under US\$ 1 per day." (Hanlon, 1998: 4). By calculating these two alternative models he finds that even more countries lack the necessary domestic resources to pay debt service, and that debt cancellation of up to 100 percent for many debtors is inevitable.

Hanlon also refers to some interesting budget considerations made by others. Jeffrey Sachs (1998: 53) has estimated that "a well-designed budget might include current expenditure on education (mostly at the primary and secondary level) of some 5 percent of GDP; public health outlays of some 3 percent of GDP; costs of public administration of 2 percent of GDP; and expenses on police and defence of some 3 percent of GDP.

Infrastructure spending is sure to require at least 5 percent of GDP, even if the government leaves much of the infrastructure finance to the private sector (e.g. for power, telecommunication and ports) and focuses its attention on items (e.g. rural roads) that are much harder to finance through the market.

The total outlays in this illustration total 18 percent of GDP. Evidently, there is virtually no room for debt-servicing, nor for subsidies to households and firms or income transfer programmes other than in health and education."

Applying these various estimates to a group of 81 developing countries²¹ generates significant results (see table below): Based on the revenue basis proposed by Northover/Joyner/Woodward and using estimates of Northover/Joyner/Woodward (first column), Hanlon (second column) and Sachs (third column) for the year 1998 we find that between 48 and 67 countries would need debt relief. Of these, 42 up to 53 countries would need debt service reductions of 50 percent and more, including between 18 and 38 countries that need total debt cancellation (for the methods of calculating see appendix on p. 47).

²¹ A group of the 81 developing countries for which the World Economic Outlook (IMF 2001), the World Development Indicators (World Bank 2001) and the Global Development Finance (World Bank 2000a) databases provide the necessary data. The countries are: Algeria, Angola, Argentina, Bangladesh, Benin, Bolivia, Botswana, Brazil, Burkina Faso, Burundi, Cambodia, Cameroon, Central African Rep., Chad, Chile, China, P.R.: Mainland, Colombia, Congo, Republic of, Costa Rica, Cote d'Ivoire, Dominican Republic, Ecuador, Egypt, El Salvador, Eritrea, Ethiopia, Gabon,

Gambia, Ghana, Guatemala, Guinea, Guinea-Bissau, Haiti, Honduras, India, Indonesia, Iran, I.R. of, Jamaica, Jordan, Kenya, Lao People's Dem. Rep, Lesotho, Madagascar, Malawi, Malaysia, Mali, Mauritania, Mauritius, Mexico, Morocco, Mozambique, Nepal, Nicaragua, Niger, Nigeria, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Senegal, Sierra Leone, South Africa, Sri Lanka, Syrian Arab Republic, Tanzania, Thailand, Togo, Trinidad and Tobago, Tunisia, Turkey, Uganda, Uruguay, Venezuela, Vietnam, Yemen, Republic of, Zambia, Zimbabwe.

Necessary reductions of debt service

Country	Northover et al.	Hanlon	Sachs	País	Northover et al.	Hanlon	Sachs
ALGERIA	62%	4%	61%	NEPAL	88%	100%	100%
ANGOLA	93%	100%	100%	NICARAGUA	80%	84%	97%
ARGENTINA ²²	35%		19%	NIGER	100%	100%	100%
BANGLADESH	100%		100%	NIGERIA	100%	100%	100%
BENIN	78%	100%	100%	PAKISTAN	50%	67%	100%
BOLIVIA	40%		81%	PANAMA	47%		45%
BOTSWANA				PAPUA NEW GUINEA	35%		80%
BRAZIL	26%		18%	PARAGUAY			
BURKINA FASO	100%	100%	100%	PERU	4%		9%
BURUNDI	100%	100%	100%	PHILIPPINES	54%		55%
CAMBODIA		100%	100%	RWANDA	100%	100%	100%
CAMEROON	64%	81%	100%	SENEGAL	72%	100%	100%
CENTRAL AFRICAN REP.	78%	100%	100%	SIERRA LEONE	100%	100%	100%
CHAD	100%	100%	100%	SOUTH AFRICA			
CHILE	26%		12%	SRI LANKA			3%
CHINA,P.R.: MAINLAND				SYRIAN ARAB REPUBLIC			
COLOMBIA	7%		2%	TANZANIA	100%	100%	100%
CONGO, REPUBLIC OF	100%	100%	100%	THAILAND	64%	6%	60%
COSTA RICA				TOGO	57%	100%	100%
COTE D IVOIRE	80%	81%	100%	TRINIDAD AND TOBAGO	11%		
DOMINICAN REPUBLIC				TUNISIA	40%		35%
ECUADOR	58%	3%	75%	TURKEY	33%		26%
EGYPT				UGANDA	61%	100%	100%
EL SALVADOR				URUGUAY	9%		
ERITREA	100%	100%	100%	VENEZUELA	29%		27%
ETHIOPIA	100%	100%	100%	VIETNAM	51%	100%	100%
GABON	36%		35%	YEMEN, REPUBLIC OF	100%	100%	100%
GAMBIA, THE	75%	100%	100%	ZAMBIA	100%	100%	100%
GHANA	73%	94%	100%	ZIMBABWE	80%	69%	87%
GUATEMALA				Total number of countries	65	48	67
GUINEA	45%	52%	100%	with debt service reduction			
GUINEA-BISSAU	100%	100%	100%	Total number of countries with	44	42	53
HAITI		91%	100%	more than 50% debt service reduction			
HONDURAS	68%	44%	90%	Total number of countries with	18	32	38
INDIA	15%	18%	70%	100% debt service reduction			
INDONESIA	86%	81%	91%	(Method of calculations: see Appendix, page 47)			
IRAN, I.R. OF				²² As Argentina is a very urging case at the moment, some more up to date			
JAMAICA	46%		60%	considerations might be apt. Taking into account the decline of GDP in			
JORDAN	65%	14%	69%	Argentina of about 23 percent since 1998 (IMF, 2002) and reflecting the			
KENYA	87%	100%	100%	impact of the devaluation of the peso (70 percent since January 2002)			
LAO PEOPLE'S DEM.REP	71%	100%	100%	by a additional loss of purchasing power of the Argentine's population			
LESOTHO	57%	61%	79%	of 35 percent, the respective figures for necessary debt service reduc-			
MADAGASCAR	100%	100%	100%	tions would be 53% (Northover et al.), 0 percent (Hanlon) and 50%			
MALAWI	100%	100%	100%	(Sachs).			
MALAYSIA	48%		40%				
MALI	100%	100%	100%				
MAURITANIA	85%	100%	100%				
MAURITIUS	40%		28%				
MEXICO	35%		23%				
MOROCCO	52%		63%				
MOZAMBIQUE	100%	100%	100%				

The table above tells us at least two things: First of all, all three basic needs approaches call for a significantly deeper debt relief than any scheme offered by today's debt management. Secondly, the criteria applied to define the required spending on basic needs greatly affect the amount of necessary debt relief. Obviously, even

though general rules for the definition of spending on basic needs would be most welcome, appropriate budget plans can only be developed in a specific FTAP case.

When interpreting these findings in terms of our basic needs approach one must be well aware that the calcula-

tions above only include the necessary public spending on health and education.

Other basic needs such as nutrition programmes, shelter, public transport, essential household equipment etc. are not considered, mainly because there are hardly any estimates for the amount of necessary income transfers or subsidies for the poor required to meet them.

Furthermore, in measuring the necessary reductions of debt service, no attention was paid to any additional macroeconomic limits stemming from the fact that debt service needs to be paid in foreign exchange.

The method for calculating the feasible revenues of the state relies on the assumption that people with high incomes do actually pay 25% income tax. Of course it is more than fair to expect the rich residents of debtor countries to make their contribution to meet the basic needs of the poor. However, experience has shown that particularly in Latin American middle-income countries such as Brazil and some time ago Argentina, the rich have found many ways to avoid tax obligations.

Accordingly, a successful FTAP must not ignore the question of domestic redistribution within the debtor countries. This makes calls for strong public monitoring of FTAP proceedings even more urgent, to prevent debtor governments from using newly acquired resources from debt relief for the additional gratification of the rich in their countries.

7. Requirements for an FTAP which puts basic needs before debt service

If fair and transparent arbitration should serve as a procedural framework for sustainable solutions to debt problems, an FTAP must be based on the principle that meeting basic needs of the debtor country's population has priority over creditors' claims. In practice that means that debtor countries must focus their public spending on expenditures for basic needs before paying debt service. By focusing on basic needs, an FTAP can serve to overcome debt as a structural blockade of development. However it cannot address all problems of development, and thus needs to be integrated into an overall development strategy.

Although the concept of a basic needs strategy appears to be somewhat difficult to realise, an extensive body of thin-

king and literature already exists, addressing basic needs and analysing the foundation of this approach. In addition, there is an impressive core of consensus agreeing that basic needs include:

- material basic needs: sufficient food and access to clean water, shelter, clothing, essential household equipment
- immaterial basic needs: education (at least primary and secondary), basic health services, essential transportation facilities.

Furthermore there is consensus that these basic needs can only be met by

- creating at least a minimum income for all people and
- state provision of basic social services.

Coming from the approach that FTAPs should become the general international regime to manage debt problems, it is important to note that basic needs are more than just intuitive necessities. They are actual entitlements due every human being as expressed in international law. The International Social Covenant acknowledges the basic needs mentioned to be indisputable social rights of the individual, and at the same time calls for an active role to be played by the international community of states to secure these basic needs. Even more, the body of international law protects basic needs as actual entitlements, and gives them clear priority as obligations that a community or a state might have against its international partners. Thus, international law accepts the principle of debtor protection which is common in national insolvency procedures.

Combined with a reasonable calculation of state revenues, these determinations aid in assessing that part of the public budget that can be used for debt service without compromising basic needs.

However, all well-meant references to international law, human rights and entitlements make no difference as long as the subjects of these entitlements and rights -- the people of the debtor countries -- do not claim these rights for themselves and apply the political pressure to make them reality. In the practice of an FTAP, that means that the proceedings and outcomes must be subject to transparency, public accountability and participation of civil society. Without this public pressure and scrutiny there is great risk that the debt reductions will not suffice, and that the proceeds may not be used to fulfil the basic needs of the population. The next chapter will offer some insights as to what form this participation could take, and report on previous experience.

Appendix : Methods of calculation

Figures and sources:

- GDP per capita: GDP per capita of 1998 in US\$ (IMF World Economic Outlook 2001)
- PPP: Purchasing power parity of one US\$ in the respective country 1999 (based on World Bank World Development Indicators 2001)
- P: Inflator of the absolute poverty line: 1 US\$ 1985 = 1,5 US\$ 1998 (based on IMF World Economic Outlook 2001)
- Tax basis per Capita: 25 per cent of [GDP per capita minus income under absolute poverty line] income under absolute poverty line per Capita: [365 days x 1 US\$ in PPP of 1985] = [365 days x 1,5 US\$ in PPP of 1998]
- Debt service paid 1998 in US\$ (World Bank Global Development Finance 2000)

Northover et al. (1998):

- Maximum debt service possible: 20 per cent of [Tax basis - 28 US\$ spending for basic health and primary education per person]
- Necessary reduction of debt service: 1 - [maximum debt service possible/debt service paid]

Hanlon (1998):

Maximum debt service possible:

- Tax basis - [28 US\$ spending for basic health and primary education per person] - [2 percent of GDP for public administration] - [3 percent of GDP for expenses on police and defence] - [5 percent of GDP for infrastructure spending] = Tax basis - [28 US\$ spending for basic health and primary education per person] - [10 percent of GDP]
- Necessary reduction of debt service: 1 - [maximum debt service possible/debt service paid]

Sachs (1998):

Maximum debt service possible:

- Tax basis - [5 percent of GDP for education (mostly at the primary and secondary level)] - [3 percent of GDP for public health] - [2 percent of GDP for public administration] - [3 percent of GDP for expenses on police and defence] - [5 percent of GDP for infrastructure spending] = Tax basis - [18 percent of GDP]
- Necessary reduction of debt service: 1 - [maximum debt service possible/debt service paid]

II.5: Participation within an FTAP

by Thomas Fritz

One of the major requirements for the proposed Fair and Transparent Arbitration Procedure is the broad participation of civil society at all stages of the process. The outcome of such a reformed debt negotiation process will be highly dependent on the possibility and extent of public scrutiny. As has already been mentioned, civil society shall have a say in determining the legitimacy of claims as well as the budgetary amounts necessary to finance basic needs. Furthermore, civil society and particularly the poor should be enabled to define by themselves what they consider as their basic needs. The extent and quality of public participation is crucial for the success of an FTAP, especially in terms of determining a level of debt service payments, which does not restrict government spending for basic social services.

In defining requirements for participation in an FTAP, we can draw on a wide range of experience with participatory approaches in development. When participatory approaches were initially adopted, mainly in the 1960s, they were confined to the realm of development projects. In particular, community development projects tried to involve local people in efforts to improve their communities. However due to changing analyses of the causes of underdevelopment and different explanations for poverty, community development eventually lost its predominance. More and more, poor people were seen as excluded and marginalised both from broader social participation and also from direct involvement in development initiatives. As a result, over the last decade the focus has shifted to participatory approaches, which aim at direct popular involvement in development projects as well as in influencing policy at national and international levels (UNDP, 1997a). To date, relevant experiences of fostering participation in policy processes can mainly be found in NGOs and official donor agencies, such as the UNDP. NGOs' policy advocacy is especially regarded as a field for testing new participation techniques. Lately, international financial institutions (World Bank, IMF, Regional Development Banks) are also beginning to adopt participatory approaches, although these efforts are not considered as overly ambitious.

In this context, the new conditionality of poverty reduction strategies agreed upon by donors at the 1999 Cologne G7 summit and established at the 1999 Annual Meetings of the IMF and World Bank, will give a further impetus for participation in macroeconomic policy processes. Governments

seeking debt relief from the enhanced HIPC-Initiative must prepare Poverty Reduction Strategy Papers (PRSPs) in consultation with civil society, the private sector, local governments, bilateral donors and others. The PRSP has to be endorsed by the boards of the World Bank and the IMF before it forms the basis of their lending programmes.

PRSPs replace the "Policy Framework Papers" which outlined the policy direction and resource allocation for IMF/World Bank lending to countries eligible for concessional assistance. Although the PRSP model was originally developed in the context of the HIPC-initiative, it is expected to form the basis for a policy dialogue in all countries receiving concessional lending from the international financial institutions (Wood, 2000). One important concern is whether the IMF and World Bank are able to judge the quality of a consultation process. Addressing this concern, the World Bank recently published a second draft of best practice guidelines on participation which constitute one chapter of the so-called "Poverty Reduction Strategy Source Book" (Tikare et al., 2001). However, southern governments and civil society were not involved in setting up these guidelines. And NGOs have raised concerns that the IFIs judgement of participation processes might be subjective:

"It is not clear how a decision will be taken if a government comes up with a programme donors want to fund but it did not apply a good process or conversely a good process produced a poor strategy (in the eyes of donors). This is a question which both the Fund and Bank are trying to grapple with. In the end it is likely to come down to donor preferences, political considerations and long-term relationships ..." (Wood, 1999: 13).

Finally, the World Bank and IMF still attach policy conditionality to their lending which will be laid out in Country Assistance Strategies (CAS – in case of the World Bank) and Letters of Intent (LoI – in case of the IMF). Both institutions seem to believe that participation won't challenge the content of structural adjustment programmes, e.g. macroeconomic performance requirements. Instead, the IFIs appear to believe that participation merely enhances civil society's understanding of structural adjustment, thus contributing to better ownership in programme countries.

Accordingly, the chapter on participation of the World Bank's "Poverty Reduction Source Book" merely identifies

risks and limitations to the participation process at the national level (Tikare et al., 2001: 29). Prescribed reform programmes are not even mentioned as potentially limitational factors. Thus NGOs ask whether it is worthwhile participating in the elaboration of poverty reduction strategies, as long as the IMF and other donors do not show any flexibility regarding the macroeconomic framework. It could be argued that one important precondition for effective participatory processes, the willingness to at least consider civil society demands concerning macroeconomic conditionality, still seems to be lacking. On the other hand, broad-based participation in macroeconomic policy processes, such as poverty reduction strategies, could pressure IFIs and official creditors to take a more flexible approach.

1. *What elements constitute participatory processes?*

By using one of the different typologies of participatory processes it is possible to determine who has to be involved, at what stages of the process, and what kind of control mechanisms have to be applied. The following typology, for instance, dubbed the "ladder of participation", spells out intensities or levels of participation (McGee/Norton, 2000):

- Information-sharing
- Consultation
- Joint decision-making
- Initiation and control by stakeholders

According to such a typology, civil society should strive to reach the highest possible level of participation in a fair and transparent arbitration procedure. Being informed and consulted about pending debt negotiations is surely necessary throughout the whole process, but does not seem to be satisfactory. Joint decision-making would allow civil society representatives to make decisions with government representatives about, for instance, budgetary amounts necessary to finance basic social services.

Regarding the initiation of participation in an FTAP it could be argued that this should rather be the task of the central government. The government should at least be held responsible for ensuring a satisfactory level of participation. Its representatives should provide necessary information, and civil society's demands should duly be taken into account. Nevertheless, this will not always be the case, and some governments may be reluctant to do so, particularly if they regard participation as being coerced by foreign creditors. In these cases strong social movements or widely respected civil society representatives could ser-

ve as initiators. Finally, control of the participation process is an indispensable element of an FTAP. Monitoring macroeconomic policies after the implementation of the final FTAP award might foster the government's accountability.

The World Bank's "Poverty Reduction Source Book" suggests another typology. According to the Source Book, there are four building blocks for macroeconomic participation processes (Tikare et al., 2001: 19):

- A. Poverty diagnostics
- B. Macroeconomic policy making and reform
- C. Budgeting and public expenditure management
- D. Monitoring and Evaluation

Let's have a closer look at these elements of participatory processes.

A. *Poverty Diagnostics*

Defining the budgetary outlays necessary to finance basic social services requires thorough examination of the nature and causes of poverty in a particular country and in its different rural and urban areas. Thus it is widely recognised that quantitative data measuring income, consumption or expenditure on the household level have to be accompanied by qualitative data which describe poor people's own perception of poverty. This has led to the develop-

Example: Social Weather Stations

The Social Weather Stations (SWS) project in the Philippines serves as an example for a PPA that allows the poor to rate their own poverty on a quarterly basis. The SWS survey provides a "representative snapshot of poor people's priorities, their awareness of existing services, the constraints and barriers they face in accessing available services, and their satisfaction with the services" (Tikare et al., 2001). Quarterly SWS reports including surveys of self-rated poverty are circulated widely through the media and to government representatives, "who have used the findings extensively to realign service delivery" (ibid.). In the survey of December 2000, for instance, 56% of household heads rated themselves "poor". Among them, the median monthly household budget needed in order not to feel poor was US\$ 105. 12,7% of households had experienced hunger at least once in the last three months. Movements in self-rated poverty since the mid-1980s have been strongly linked to fluctuations in consumer-price inflation and, to a lesser extent, to unemployment.

ment of so-called Participatory Poverty Assessments – PPAs. At the time of their inception PPAs mainly aimed at collecting information by "giving the poor a voice". But over the years PPAs evolved into more complex processes for influencing the formulation of policies at the local and the national level. Tools for conducting PPAs include:

- Well-being rankings: The concept of well-being is broader than poverty. The challenge is to understand people's own definition of well-being. How do they perceive risk, vulnerability or social exclusion and how do households and individuals cope with the decline in well-being?
- Cause-Impact Analysis: This tries to illustrate the perceived causes and impacts of events such as violence, conflict, economic shocks, etc.
- Focus Group Discussions and Individual Interviews
- Visual approaches such as poverty/social maps or cyclical change charts etc.

B. Macroeconomic policy making and reform

Influencing macroeconomic policy-making would surely be the most important "building block" of participation processes. Macroeconomic policies can be divided into two broad areas: monetary and fiscal policy. Monetary policy relates to actions influencing a country's money supply or interest rates. They are of utmost importance for everyone's life, since they affect the rate of inflation, economic growth, levels of unemployment and exchange rates.

Fiscal policies are equally important. They determine government revenues, expenditures, and debts.

Example: The Gender Budget Initiative (GBI), Tanzania

The Tanzania Gender Networking Programme (TGNP) is a non-governmental organisation working to obtain social transformation with a gender focus in all levels of society. The NGO has been pioneering a Gender Budget Initiative (GBI) since mid-1997. The strategy is to influence and transform planning and budgetary processes to utilise participatory techniques and to take into account the practical and strategic needs of marginalised communities, particularly women, poor men, and youth. The concept is not to develop a separate budget for various groups but rather to integrate issues of equitable distribution of resources into all steps and stages of the budgetary process.

To fulfil its stated aims, TGNP has been developing strategic points of entry within the government, Parliament, and civil society. Research was conducted at the national level (Ministries) and district level (related sectors at the district level). Research was done in the Planning Commission and Treasury, as the key sectors in the planning and budgeting process; Health and Education, as vital service providers; Agriculture as essential to the livelihood of most Tanzanians; and Industry and Commerce, given the significance of market/trade liberalisation policies in the globalisation process.

Reports were disseminated to different sectors of society beginning with activist organisations, government departments and external agencies. Findings were shared through working sessions and public forums with civil society, donors, policy makers and technocrats within the researched areas, and various groups of MPs, specifically the Parliamentary Budget Committee. As a result of lobbying, one paragraph on gender was included in the 1999-2000 budget guidelines. In the 2000-01 budget guidelines, two paragraphs were included, which mandated that all Ministry, department and agency (MDA) budget submissions be prepared with a gender focus. In the long-term, the Treasury plans to gender mainstream the budgets of all government sectors.

Lessons/Challenges:

Building capacity at various levels is essential. One of the main obstacles faced by the organisation has been the low capacity of many actors in civil society to analyse and critique macro- and micro-economic issues. Vital to the process is increasing the skills of government actors to link gender issues to budgeting and macroeconomics.

Challenging international macro-economic frameworks is essential. These frameworks, including structural adjustment and the Poverty Reduction Strategy Paper, have marginalised the government and meant that there are fewer resources to support development. Therefore, one role of NGOs is to influence transformation of these processes.

On the revenue side they principally concern the levels and structures of tax. On the expenditure side they concern the priorities for public spending. Still, effective participation in these central areas of economic policy is a rather contentious issue and remains far from being implemented. The IFIs themselves still take the position that certain sensitive areas of policy-making should be insulated from political pressures. This relates not only to important elements of monetary and fiscal policies at the national level but to IFIs' adjustment programmes as well. The World Bank's Source Book (Tikare et al., 2000: 37f.), for instance, confines participation in monetary policy – because of *"the technical nature of these policies"* – to mainly two approaches: information sharing and consultation mechanisms. Decision-making on these issues would still remain far beyond public influence and very often parliamentary procedures as well. Furthermore, opportunities for influencing macroeconomic policy also depend on each country's political system and the design of its parliamentary institutions.

C. Budgeting and Public Expenditure Management

Participatory budgeting remains a little explored field for influencing macroeconomic policy, although a national budget is a very important policy document. Since budgetary decisions affect all citizens they should be subjected to public scrutiny and debate. However, most research projects and NGOs working on budget policy in developing countries exist only for a few years. A lot of countries lack such initiatives altogether.

D. Monitoring and Evaluation

Participatory monitoring and evaluation enables the public to hold governments accountable for their actions. Accountability questions arise in different areas, such as public spending or the delivery of services. Public monitoring helps determine whether government commitments have been fulfilled, and whether development efforts have succeeded or failed. It ensures that governments indeed spend money according to budget allocations. Furthermore, expenditure tracking examines how the spent monies are being used and whether they reach their intended destination. Monitoring public services allows citizens to give feedback on access to and the quality of services.

Conventional monitoring and evaluation involved experts from outside who used standardised procedures and tools to measure performance against pre-set indicators. In contrast, in participatory monitoring and evaluation local peo-

ple, development agencies and policy makers decide together how progress should be measured, and results acted upon. Four principles are associated with this approach (IDS, 1998):

- Participation – opening up the process to include those most directly affected;
- Negotiation – reaching agreement on what is monitored or evaluated, how and when data will be collected and analysed, what the data actually means, how findings will be shared, and action taken;
- Learning – encouraging subsequent improvement and corrective action;
- Flexibility – adapting to continuing changes of the number, role, and skills of stakeholders, and other factors.

A wide range of methods and tools has been developed to carry out participatory monitoring and evaluation. These include: maps, Venn diagrams, diaries, report cards, matrix scoring etc. They all seek to compare the situation before and after a particular project or a set of events.

2. Weaknesses of participation in macroeconomic policy processes

Although there has been a lot of experience with participatory approaches as a whole, their extension into the field of macroeconomic policy is rather new. Consequently, their impact on macroeconomic policy-making is still very weak. In this regard, experiences with IFI approaches to participation are particularly sobering. This is of special importance, since World Bank and IMF still attach strong policy conditionality to their lending, which in the case of the World Bank is laid out in Country Assistance Strategies (CAS). Using the above mentioned "participation ladder" as a reference, McGee and Norton come to the following conclusion:

"Reviews of World Bank CASs, and our knowledge of other donors' assistance strategies, suggest that civil society ,participation' in them rarely extends beyond information sharing and consultation to shared agenda-setting, decision-making or any kind of empowerment for participants. Also, ,participation' is rarely evident in any but the middle stages of the initiative (commenting on a first draft, or contributing ideas as to focal areas), never in the agenda-setting or final drafting stages, or in monitoring and evaluating the policy's implementation. In most examples (...) ,participation' tends to cease as soon as the published CAS is sent to those who commented on the first draft – if indeed the final product is ever shared with them at all" (McGee/Norton, 1999: 63).

Stephen Gill goes even a step further. Analysing the World Bank's approach to participation he argues:

"that the World Bank is attempting systematically to co-opt and channel forces of civil society: a tactic to legitimate the attenuation of democracy in economic policy by increasing participation in safely channelled areas. The priorities in the Bank's agenda for participation and democracy make this clear – proposals are least participatory in the most central areas of economic governance (property rights and macroeconomic policy) – as well as in the area of strategy. (...) Yet greater participation especially by women – but by no means anything approaching direct democracy – is encouraged by the Bank in education (e.g. as school trustees), in health, in the social sector and in the environment..." (Gill, 2000).

The World Bank's strategy towards participation can indeed be characterised as enabling graduated levels of participation in different areas of economic policy according to their perceived sensitivity. The above-mentioned shielding of sensitive areas from political debate clearly revealed this approach. Although the World Bank's Source Book states "that there are positive links between participation and sound macroeconomic policies" (Tikare et al., 2001: 37), the Bank and donor governments still seem to believe that defining "soundness" of macroeconomic policies remains their privilege, one that should not be affected by participation.

Compared to the World Bank's approach, the IMF's understanding of so-called "ownership" seems to be even more problematic. The Fund is currently in the process of reviewing conditionality in its structural adjustment programmes with the aim of "streamlining" conditionality and enhancing country ownership of these programmes. However, the IMF treats public participation as a mere residual objective, as a recently published report shows:

"Ownership is a willing assumption of responsibility for an agreed programme of policies, by officials in a borrowing country who have the responsibility to carry out these policies (...) First, ownership primarily means ownership by the government (...) Broad ownership within the government, parliament, and other major stakeholders in the country is highly desirable (...), but it may not always be a realistic goal. (...) Participatory processes are highly desirable, but narrow processes may be necessary in some cases" (IMF 2001a: 6).

Fund officials still believe that public participation regarding macroeconomic adjustment programmes is not essential, although these programmes severely affect the whole population of debtor countries. Participation is merely understood as a "desirable" process that might enable better understanding of the Fund's macroeconomic prescriptions.

3. Requirements for an FTAP

Broad-based public participation has to be understood as an indispensable element in the context of a Fair and Transparent Arbitration Process. Considering especially the IMF's limited concept of country ownership, it becomes clear that one of the most important requirements for an FTAP is to ensure that participation actually takes place. If this first and foremost precondition is fulfilled, further qualifications can be made. IFIs sometimes argue that it is a sovereign decision of debtor countries whether to conduct participatory processes or not. However, this argument is not very convincing since the G7, the IFIs and other creditors already impose their rescheduling terms and policy conditionalities on debtors. It must be remembered that it was a G7 decision, taken at their Cologne summit, to introduce the new conditionality of poverty reduction strategies. Surely, there will always be country-specific differences, but this should not contravene a strong commitment by creditors and debtors as well to facilitate high-quality participation.

If debt relief efforts are to have a positive impact on the livelihoods of the poor, then their own definitions of basic needs must be heard and taken into account. As we have seen, a rich variety of participatory tools are available to let "the voices of the poor" be heard. Furthermore, the public should be allowed to voice concerns regarding all possible issues which might come up during FTAP proceedings. Participation should not be confined to safely channelled areas as, for instance, narrowly defined poverty reduction schemes or limited basic needs approaches.

The participatory process itself should encompass all elements of the "participation ladder", not just information sharing and consultation. Joint decision-making, control over the process, monitoring and evaluation of the outcomes are equally important features. That is to say, participation has to take place throughout all phases of the process, from designing, to implementing and evaluation.

All who are likely to be affected by the FTAP should know about the proceedings. All parts of civil society, urban and

rural areas, should be represented in the participatory process. Timely provision of all necessary information in an adequate manner is indispensable. It should be proven that public feedback has been taken into account. Surely, the whole process must be sufficiently resourced. Finally, its impacts on policy and poverty have to be made visible.

Conducting better participation cannot guarantee a positive outcome of an FTAP measured in terms of poverty reduction or improved livelihoods. To a large extent, this depends on the power relations between creditors, debtor governments and local populations. Thus, shifting power to the benefit of the poor could be seen as the overarching objective of a high-quality participation process.

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Annex I

Letter to the G7 Heads of States, Finance Ministers and Sherpas and the respective embassies May 2001

"I would go a step further and propose that, in the future, we consider an entirely new approach to handling the debt problem. The main components of such an approach could include ... establishing a debt arbitration process to balance the interests of creditors and sovereign debtors and introduce greater discipline into their relations."

Kofi Annan, Secretary General of the United Nations, Millennium Report

Fair and Transparent Arbitration Processes for the solution and prevention of debt crises of sovereign debt

Hereby we urge you, the Heads of States, Finance Ministers and Sherpas of the Group of Seven (G7) to substantially reform the international debt management procedures at your next summit in Genoa in July 2001.

The undersigned Jubilee movements and organisations suggest the G7 to alter today's management of international debts towards "Fair and Transparent Arbitration Processes for the solution and prevention of debt crises of sovereign debtors".

Historical experience and due lessons

Recurrent negotiations at the Paris Club since 1956 and so-called Structural Adjustment practised for over 20 years indicate that present mechanisms of international debt management lead to no viable solution, forcing debtor governments back to the negotiating table soon after they went before. The debt burden has grown further and the situation of vulnerable groups has deteriorated. Poverty is still on the increase. The Paris Club and the Bretton Woods Institutions have failed to deliver meaningful debt relief by giving too little too late. We therefore advocate that international arbitration be established as part of a New International Financial Framework to solve the debt problem in line with the principles of the protection of human rights and the Rule of Law. We call this new institutional pattern of dealing with debt a 'Fair and Transparent Arbitration Process' (FTAP).

The Procedure of the Rule of Law

OECD governments apply to themselves the Rule of Law which they preach to their debtors. It is the most basic principle of the Rule of Law that no one must be judge in their own case. This principle is flagrantly violated by creditor governments that are judges, jury, experts and bailiffs when it comes to their own claims. In a 'Fair and Transparent Arbitration Process' (FTAP) an impartial body will conduct the negotiation between creditors and the sovereign debtor. Each side – creditors and the debtor – nominate one or two people, who in turn elect a third or fifth person to reach an uneven number to decide by simple majority.

The Precedent of Bottom Line Protection

In almost all legal systems throughout the world the fundamental principle of debtor protection is widely accepted. Accordingly, individual debtors can not be forced to fulfil debt contracts if this endangers their lives or violates their human dignity. The fundamental right of debtor protection must finally be also granted to the world's poor.

A Voice for the Voiceless

It is the poor who are paying the price of the debt burden. As those principally affected they have a right to a voice in negotiations concerning their future. An FTAP will provide them with a forum to represent their views and the possibility to object to proposals made in the arbitration process, if these put the economic, social and ecological future of the population in the debtor country at risk. This procedure must be fair, open, and transparent.

Equal Treatment

All creditors must be treated equally in a FTAP. There must be no preferential creditor status. As the IMF and World Bank also served as advisors to debtor governments this would make them shoulder their part of the risks incurred due to their advice, finally bringing accountability and

financial responsibility to the IMF and the World Bank. Creditors' claims must be assessed with respect to the quality of their lending policies and advice. Debtors must be similarly treated concerning their borrowing practices. Cases of corruption associated with international lending cannot be dealt with presently in debt negotiations. To address the issue of corruption and moral hazard on the creditor as well as on the debtor side, an FTAP must not only solve a debt crisis but must also identify the politically and economically responsible parties. Irresponsible lenders' claims could be declared ineffective whereas foreign bank accounts of corrupt governments must be confiscated to pay off the debts. In this manner of transparency and accountability, a FTAP consistently addresses the issue of financial stability and helps to prevent debt and financial crises in the future.

A Comprehensive Debt Relief Framework

Our proposal for a Fair and Transparent Arbitration Process addresses two central issues of today's debate. On the one hand it provides a comprehensive framework to overcome the fragmented approach to debt relief of the HIPC-Initiative. Simultaneously, FTAP provides a systemic answer to the so far insufficient approaches to "bail in" the private sector in carrying part of the cost of financial crises and to prevent future crises by reducing moral hazard on the private creditors' side.

As we all know, the G7 is the forum that so far decides upon the policy of international debt management. We therefore expect you to pay attention to the shortcomings of today's debt management and to implement an FTAP as a comprehensive alternative framework for the management of international debts.

- Anti Debt Coalition of Indonesia
- Berliner Landesarbeitsgemeinschaft Umwelt und Entwicklung (BLUE 21), Germany
- Broederlijk Delen en Jubilee 2000, Belgium
- Brot für alle, Switzerland
- Campagna per la Riforma della Banca Mondiale, Italy
- Center of Concern, USA
- Centro de Derechos Economicos y Sociales (CDES), Ecuador
- Church of Norway Council on Ecumenical and International Relations
- Coalition Nationale Jubile 3000 Du Mali
- Congregation Justice Committee, Sisters of the Holy Cross, USA
- Debt and Development Coalition Ireland
- Dette & Développement, France
- Diakonie Most, Czech Republic
- Erlassjahr 2000, Germany
- Erlassjahr 2000, Österreich
- Evangelische StudentInnengemeinde in der Bundesrepublik Deutschland (ESG)
- Facultad de Ciencias Económicas de la Universidad de Cuenca, Ecuador
- Freedom from Debt Campaign Pakistan
- Freedom from Debt Coalition, Philippines
- Fundación Intervida, Spain
- Gemeindedienst für Mission und Ökumene der Evangelischen Kirche im Rheinland, Germany
- International Network for Indonesian Development (INFID)
- International Presentation Association of Presentation Sisters
- Japan Network on Debt & Poverty
- Jesuits for Debt Relief and Development International (JDRAD)
- Jubilee 2000 Côte d'Ivoire
- Jubilee 2000 Czech Republic
- Jubilee 2000 Spain
- Jubilee Australia Drop the Debt Coalition
- Jubilee Plus, UK
- Jubilee South
- Jubileo 2000 Red Guayaquil-Ecuador
- Maryknoll Office for Global Concerns, USA
- Movimondo, Italy
- Norwegian Coalition for Cancellation of Third World Debt
- Peru Peace Network, USA
- Red Perú Jubileo 2000
- Sdebitarsi, Italy
- SEDOS Working Group on Debt, Italy

- SHALOM (International Network for Justice, Peace and the Integrity of Creation of the School Sisters of Notre Dame)
- Südwind, Germany
- Swiss Coalition, Switzerland
- The Justice, Peace, and Integrity of Creation Promoters of the USG (Union of General Superiors) and the UISG (Union of International General Superiors)

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Annex II

WORKING DOCUMENT ON A FAIR AND TRANSPARENT ARBITRAL PROCESS.

Here in Guayaquil, Ecuador delegations Jubilee debt campaigns from Ecuador, Argentina, Peru, Bolivia, Colombia, Brazil, Honduras, Ghana, Nigeria, Mali, Mauritius, Philippines, Germany, Britain, Austria, Spain, Australia, and Canada met to consider the systemic debt crises facing poor countries, and to propose alternatives to the current deeply biased unilateral mechanism for the treatment of the debts of developing countries.

We recognise that our proposed new framework is not merely a technical or bureaucratic alternative, but seeks to introduce significant changes to the existing unjust balance of power between international finance and debtor nations and their people.

We met from 9-12th March for debate and discussion and agreed the following:

- the current system of dealing with the debt crises, in which international creditors play the role of plaintiff, prosecutor, judge and jury is unjust, and is designed to protect the interests of creditors, with total disregard for the; fundamental human rights of the people of debtor countries;
- the dominant role given to organisations of creditors, including the Paris Club; the London Club and the IMF, must be replaced by a new, just and transparent framework;
- the current financial architecture for debt management shifts the whole burden of debt crises on to the debtor nation and its people; and protects international creditors from co-responsibility, risk, liability and losses.
- The proposal for a Sovereign Debt Restructuring Mechanism put forward the IMF is deeply flawed in that a) it does not alter the balance of power between sovereign debtor and international creditors; b) and maintains effective creditor control of debtor nations, through the IMF; c) is a non-transparent and unaccountable mechanism; d) does not include HIPC debtor nations; and finally, e) exempts IMF and World Bank loans from debt write off.
- The new financial framework that we propose borrows from internationally accepted legal principles of insol-

vency, and seeks to transform the current system and to provide a just solution to the problem of sovereign debt management and restructuring based on the following principles:

- The establishment of a) an Independent Debt Tribunal and b) a Fair and Transparent Arbitration Procedure.
- An open, transparent and accountable process for this independent tribunal/procedure.
- A continuous process of monitoring and of public hearings and audits of the sovereign debt must be initiated.
- The subordination of creditor interests and debt repayments to the levels of investment needed to meet fundamental human rights (as enshrined in international UN charters and declarations), and the mobilisation of finance for development.
- The recognition that sovereign debt is public debt, and therefore that citizens have a right to actively participate in, and influence the arbitral tribunal/arbitration procedure, and to be central to the outcome of its award.
- The right of the debtor nation to declare a standstill on debt payments by opening the arbitration process, where further debt servicing is likely to violate fundamental human rights.
- The right of debtor nations to impose capital controls and inhibit capital flight.
- The co-responsibility of creditors and the debtor governments for illegitimate debts, be they tainted by fraud, corruption or financially unsound projects; and the power of the tribunal/panel to dismiss those claims, and order the recovery of stolen wealth/assets.
- In place of creditor-determined conditionalities, there should be a new framework providing for a fresh start for the debtor country, and under which the debtor government commits itself to defend human rights, through, amongst other things, social and infrastructure investment, and further commits itself to openness, accountability and democratisation of financial management.

Annex III

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