

Let's Make A Deal

International debt campaigners, along with some nations in Asia and elsewhere, are calling for an arbitration system to help developing countries settle onerous international debts

BY Emma-Kate Symons

As many as 90 poor countries are wallowing in debts that threaten to swamp or have already overtaken the entire value of their economies. At least 40 are a direct result of the global economic crisis, according to the World Bank.

In the wake of the international economic turmoil with its disproportionate impact on development, Supachai Panichpakdi—the secretary-general of the United Nations Commission on Trade and Development (UNCTAD)—urges the international community to help these vulnerable nations, particularly those whose interest repayments exceed their gross domestic product.

Panichpakdi is calling for a temporary debt moratorium similar to that offered to Asian nations devastated by the 2004 tsunami. In harmony with groups representing developing nations, he says poor countries had not caused the global economic meltdown and should not be left paying a steep price in the form of an external debt crisis. Instead of spending to service loans, poor nations need to continue with fiscal stimulus packages

and spending on imports to develop their economies, he says.

Last year, Panichpakdi went even further in a speech at an international conference on the economic crisis and its effect on development. Calling for a deeper analysis of the debts of poor nations, he says the time had come to address the “missing link” in the financial system: a mechanism to deal with sovereign debt insolvency.

Reforming the structure of international finance so that indebted sovereign nations could “call a standstill and seek a restructuring of their debt” was essential, he says. A United Nations (UN) working group has already been formed to examine proposals for an international debt arbitration system for insolvent sovereigns.

All those lobbying for reform agree that the UN should be at the center of any international debt arbitration system, and that the system must underscore the mutual responsibility of lenders and borrowers.

AN ORGANIZED APPROACH

Nongovernment organizations, legal



experts, politicians, and international organizations have long called for a global approach to deal with debtor nations. Not only does crushing debt threaten the survival of developing nations, the issue affects international finance institutions’ ability to maintain development programs that depend on revolving funds. In those funds, debts must be repaid to be circulated back into grants and lending for ongoing development programs in the world’s poorest nations.

With the global economic crisis, the need for an internationally recognized debt arbitration mechanism has become even more urgent, to prevent a further spiral into debt and poverty in scores of

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developing countries seeking money to grow their economies.

Currently, a variety of venues exists for settling debt disputes involving insolvent sovereign nations. These include the Paris Club, the International Chamber of Commerce, the International Monetary Fund (IMF), and the World Bank.

But there are no standard rules. Developing nations complain that creditors have the advantage, leaving them vulnerable to attack from “vulture funds” that repackage and sell the astronomical spiraling debt of bankrupt states.

According to a study by the Aktion Finanzplatz Schweiz (AFP), a Switzerland-based nongovernment

organization, titled *How to Challenge Illegitimate Debt, Theory and Case Studies*, released in November, developing countries still face crippling debt crises, despite multilateral initiatives such as the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative.

The study cites shocking statistics: “In 2007 the world’s developing countries still spent a combined total of approximately \$1.5 billion every day on external debt servicing.”

“Amongst their number are the poorest countries in the world; these low-income countries spent around \$34 million every day on external debt servicing. In the current global financial crisis, many of the countries which

HEAVILY BURDENED Activists in the Indonesian capital of Jakarta call for the canceling of the country’s international debt. Some nations in the region have debt interest payments higher than their gross domestic product.

have benefited from debt relief in recent years now face substantial risk of new debt distress.”

International debt campaign groups such as the Jubilee Debt Campaign, Eurodad (European Network on Debt and Development) and Afrodad (African Network on Debt and Development) continue to clamor for debt cancellation.

They object to loan-based aid for very poor countries and want the uncontrolled debt of bankrupt nations to be wiped out. In March 2009, for example, the Jubilee Debt Campaign called on the IMF, the World Bank, and other lending institutions to cancel debt repayments in Bangladesh and the Philippines.

“ILLEGITIMATE DEBT”

The link between some loan-based aid and poverty and human rights abuses has led to a related campaign to wipe out so-called “illegitimate debt.”

Disagreement abounds regarding the legal definition of this term, but campaigners say such debts are illegitimate because they do not benefit the populations of developing countries.

“This may be because the loan was contracted by a despotic power which then stole the cash, used it to build up their military capabilities or to oppress the people, or because the loan was contracted for ill-conceived and corrupt development projects which failed,” Eurodad says in a report on illegitimate debt.

In November, UN Special Rapporteur Cephias Lumina published his report to the General Assembly on the effects of foreign debt on the enjoyment of human rights, especially



economic, social, and cultural rights. He argued that “an international independent debt arbitration mechanism under the auspices of a neutral, non-lending institution with sufficient global legitimacy—ideally the United Nations—can help resolve unsustainable debt situations.”

But Lumina’s proposal for a mechanism based on “equity, transparency, inclusion, and participation,” that ensures the full participation of all debtors and creditors, went beyond strictly commercial/legal sovereign debt arbitration mechanisms proposed by some who believe the system could imitate the United States’ bankruptcy court system.

Lumina agreed with debt relief campaigners who argue the tribunal could also adjudicate cases of

STRICKEN WITH DEBT Protestors in the Philippines call for debt relief for disaster-stricken countries. Many developing countries in Asia are struggling to pay external debts that some consider “illegitimate.”

illegitimate debt and debt cancellation. Crucially, Lumina says, “It could also assess a country’s ability to service its debt without undermining its capacity to invest in the provision of basic services to its citizens”.

Spurred by Lumina’s work, UNCTAD launched a 3-year project focused on “promoting responsible lending and borrowing, including developing criteria for and assessing the legitimacy of sovereign debt” at a November conference in Geneva with

Debts must be repaid if they are to be circulated back into grants and lending that support continued development in the world’s poorest nations

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officials from more than 90 developing countries.

ORDERLY RESTRUCTURING

While there is widespread agreement on the need for such a transparent international system, the specifics differ from one well-regarded group to another.

Steven Kargman is president of Kargman Associates, a New York City-based firm specializing in international restructuring, cross-border insolvency, and distressed debt, with a special focus on emerging markets. He has teamed up with Christoph Paulus, Professor of Law at Humboldt University, Berlin.

Together they have proposed a sovereign debt tribunal to handle disputes, which is frequently cited in the literature on debt arbitration



HELP WANTED Supachai Panichpakdi—the Secretary-General of the United Nations Commission on Trade and Development (UNCTAD)—has urged the international community to help vulnerable nations repay foreign debts, particularly those whose interest repayments exceed their gross domestic product.

since being presented to the UN General Assembly in 2008. The idea was developed under the auspices of the International Insolvency Institute, a leading limited membership organization of professionals (lawyers, insolvency professionals, judges, and academics) from around the world specializing in international insolvency and restructuring matters.

In an interview, Kargman stresses the need for a more orderly, efficient, and predictable restructuring of sovereign debt.

“We have proposed the establishment of an independent international arbitration tribunal—a sovereign debt tribunal—that would address issues arising in sovereign debt restructurings,” Kargman says. “As a standing body, the sovereign debt tribunal would consist of

leading professionals who have proven expertise in sovereign debt restructuring issues.

“Sovereigns and their creditors could turn to the tribunal if they faced issues in sovereign debt negotiations that they were unable to resolve on their own. The sovereign debt tribunal would address issues specified by the parties, and such issues could range from the very basic, such as verification of creditor claims, to the more elaborate and complex, such as debt sustainability or matters related to restructuring plans.

“The tribunal would benefit from being an independent body providing the parties with a neutral forum as well as from drawing on the expertise of a standing group of experts in the field who would serve as arbitrators for the tribunal.”

The Kargman–Paulus proposal has some support in the legal and academic world. Geske Dijkstra, associate professor in economics at Erasmus University, Rotterdam, has studied the political economy of aid and debt issues. She says in an interview that “arbitration by an independent tribunal (with no money-lending capacity) is a good idea, and better than cancellation in the current situation.”

“Our tribunal does not attempt to prejudge what issues the parties will bring to the sovereign debt tribunal for purposes of international arbitration,” Kargman says.

“That will be for the parties—the lenders and the sovereign—to decide. In turn, any issues that are submitted to arbitration will be the province of the experts who serve as arbitrators for the sovereign tribunal. They will bring their professional expertise to bear in resolving issues that are submitted by the parties for international arbitration. Obviously, there would be no predetermined outcomes—any outcomes would be the result of a neutral arbitration process.” ■