



EURODAD Charter on Responsible Financing

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- Support the empowerment of Southern people to chart their own path towards development and ending poverty.
- Seek a lasting and sustainable solution to the debt crisis, promote appropriate development financing, and a stable international financial system conducive to development.

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Executive summary

In the absence of an international insolvency regime and in the face of the continuing ad hoc and haphazard treatment of the sovereign debt of developing countries, we are demanding a series of contractual changes in loan contracts issued to sovereign states. These measures aim to provide guidance, fairness and certainties to borrower states and lenders as well as protect the citizens and environments of developing nations. The proposal moves away from institution or sector specific approaches to dealing with concerns over 'responsible lending' and 'fair resolution of debt crises' towards *internationally recognised legal standards for responsible financing*.

Eurodad's Charter on Responsible Financing outlines the essential components of a responsible loan. These aim to ensure that terms and conditions are fair, that the loan contraction process is transparent, that human rights and environments of recipient nations are respected and repayment difficulties or disputes are resolved fairly and efficiently. Many of the provisions outlined in Eurodad's charter are drawn from international treaties and conventions to which lender and borrower nations are signatories.

The issue of 'responsible lending' by both official and private creditors has been rapidly gaining ground in international discourses on debt and aid. The main driver of international interest in the former is probably the increased prominence of developing country lenders such as China, India, Venezuela and Brazil among others. This has unsettled many 'traditional' donors and creditors who are arguing – rightly or not – that 'new' lenders will contribute to new rounds of unsustainable and irresponsible debt in developing countries.

But other factors are also playing a role. The Norwegian Government has helped to stimulate discussions around creditor co-responsibility in lending to sovereign states by its October 2006 decision to cancel US\$80mn in debt owed by five countries because the credits had been extended irresponsibly without due consideration for the needs of the recipient countries. NGOs are now intensifying their efforts to gain international recognition of the doctrine of 'illegitimate debt' and have been developing links with legal experts to try to develop this currently underdeveloped area of international law. NGO campaigning efforts have also helped to generate research studies on the issue by both the World Bank and UNCTAD.

2008 will also see a high level forum on aid effectiveness in Accra, Ghana. Most of the world's largest donors have signed-up to the so-called 'Paris Declaration on Aid Effectiveness'. This binds donors to a set of targets as they relate to developing country ownership of development assistance, its focus on poverty reduction and mutual accountability of donors and recipients.

As regards private creditors, the current crisis hitting the US sub-prime mortgage market has also focused international attention on the issue of 'predatory lending' by some banks and the need to enforce more responsible behaviour by lenders. Some commentators have suggested that these same principles be extended to the international lending arena.

Eurodad's Charter on Responsible Financing aims to provide a robust response to these challenges. It outlines what mutual accountability looks like in practice and points to the inadequacies of current policy responses at the international level. Part One of the paper asks why this issue is such a hot topic and critically reviews some of the current measures available to promote responsible lending and resolve debt difficulties. Part Two presents Eurodad's Charter on Responsible Financing.

The proposals outlined in the paper are intended to launch further debate at the international level into this issue. The Monterrey Consensus of 2002 states very clearly that "*debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations.*"¹ In the run-up to the UN Financing for Development Summit in Doha in 2008, countries around the world have a unique opportunity to put these issues at the forefront and to debate seriously the proposals tabled in Eurodad's Charter.

PART ONE: The Current Political Dynamic on Responsible Lending

“Many African countries (and other developing countries) still face an unbearable burden of debt, in spite of the progress that has been made in debt relief. Going forward, however, the challenge is to prevent the recurrence of these debt burdens. The most important step in this direction would be to ensure that more risk is shifted from developing countries to developed [...]. But even with the best designed risk sharing arrangements, circumstances will occur in which countries will be unable to repay what they owe.”²

Over 25 years after Mexico defaulted on its sovereign debt in 1982, marking what many analysts view as the beginning of the modern debt crisis, and despite constant and impressive civil society mobilisations around the globe on the issue of debt, the same haphazard approach to resolving sovereign debt crises remains. Except for a few countries which have been classified as Heavily Indebted Poor Countries (HIPCs), no official process and only the most general guidance has been offered to sovereign borrowers and their creditors as to how to resolve repayments difficulties. In the absence of a fair and predictable debt work-out procedure at the international level, sovereign borrowers have sometimes been able to work through their repayments problems in an orderly and smooth manner, sometimes not. A kind of ‘Wild West’ system has taken over where the fastest gun collects the money and there is little justice (or certainty) in who wins the draw.

Arguably, Iraq secured a more favourable debt outcome than other poorer and more severely indebted nations on both its commercial and bilateral debt obligations. In 2004, Iraq secured an 80% reduction in its bilateral debt obligations by the Paris Club. Iraq is defined as a middle-income country by the World Bank. This represented a write-down of over US\$30bn in bilateral debt. At the same time however, Kenya, a much poorer low-income nation, has only ever managed to secure three separate rescheduling agreements at the Paris Club.³ The argument here is that there is little equity – or transparency – in whether borrower or lender comes out on top and why.

Many civil society organisations have put forward the argument that some debts should not be repaid by sovereign borrowers. This is because lenders extended loans to developing country governments negligently, corruptly or on grossly unfair terms. These debts have commonly been described as illegitimate and/or odious.⁴ Even where loans did not promote the development or benefit the peoples of the recipient nation, they must be repaid under current international norms which dictate that where the borrower is a nation-state, contracts must always be respected. Sometimes, these repayments have seriously compromised the ability of the borrower state to carry out its basic duties of care towards its citizens and corrupt and/or negligent behaviour by lenders has in essence been rewarded.

Many debt campaigners argue that some form of ‘fair and transparent arbitration procedure’ or international insolvency procedure could help to identify incidences of illegitimate debt, as well as legitimate creditor claims.⁵ The procedure would ensure that the basic human rights and needs of the citizens of the borrower nation are protected while legitimate creditors’ claims are dealt with equitably and efficiently where repayment difficulties do arise. It would therefore help to promote responsible lending practices. So far however, there has been a broad reluctance by policy-makers to support a formal international procedure for fair and transparent debt resolution.

The public and private sectors have instead responded with an assortment of voluntary measures designed to reduce uncertainty or promote fairness (among creditors) where debt crises do hit. These include the broader use (since 2001) of ‘collective action clauses’ in sovereign bond contracts⁶ and the private sector’s ‘Principles for Stable Capital Flows and Fair Restructuring in Emerging Markets’ of 2004. These Principles cover “voluntary, good faith negotiations,” “transparency and timely flow of information” and “sanctity of contracts”.⁷ In 2003, the International Monetary Fund (IMF) tabled proposals for a ‘Sovereign Debt Restructuring Mechanism’ (SDRM) but these were soon shelved following objections from among others, the United States Government.⁸

It is important to recognise however that calls for the fair resolution of *existing* debt burdens have been accompanied by calls which demand that current – and future – finance to developing nations be extended in a manner which is transparent, accountable, serves the development needs and protects the peoples and environments of recipient nations. Certainly the last two decades have seen official lenders in particular come under constant pressure and scrutiny from NGOs to ensure that the finance they do extend to sovereign borrowers respects fundamental human rights and protects local environments in recipient nations.

To help ensure responsible and sustainable project finance from official lenders – such as the World Bank, International Finance Corporation (IFC), Inter-American Development Bank (IDB) and other multilateral institutions – these institutions have adopted a series of ‘safeguard policies’ or ‘performance standards’. These claim to offer a certain standard of protection to the peoples and environments of borrower countries.⁹ Private banks have responded with their own set of (voluntary) financing standards as set-out in the ‘Equator Principles’ adopted in 2006.¹⁰

The World Bank and IMF’s ‘debt sustainability framework for low-income countries’ approved in 2006 also takes-up the issue of responsible lending although the framework takes a slightly different approach.¹¹ The framework urges creditors to take into account an economic assessment of a debtor economy’s ‘state of health’ as carried out by the Bank and Fund. If the country signals a high level of ‘debt distress’, future finance should be extended on highly concessional terms (or not extended at all). The aim is to avoid future (and repeated) rounds of unsustainable debt in poorer countries. The framework is voluntary and creditors are ‘urged’ to buy-in to this new instrument. It does not enter into the qualitative aspects of the loan finance on offer nor propose sanctions for lending beyond so-called prudent limits.¹²

The G8 and Paris Club have also recently stepped on to the bandwagon. In June 2007, the G8 outlined the need for a ‘Responsible Lending Charter’.¹³ Proposals for a charter are currently under discussion within the G20 although no concrete outcomes are expected before the G20 meeting in November 2008. The World Bank’s September 2007 discussion paper on odious debt also mentions the importance of improving lending and borrowing practices and outlines a series of voluntary measures which could contribute towards ensuring the ‘fairness’ of loans and that funds are indeed used for developmental purposes.¹⁴

The fact that issues of illegitimate debt and responsible lending are progressively gaining importance in the discourses on development lending is no accident. A series of factors are currently converging at the international level which throw into question outdated and inefficient practices for the management of sovereign debt and have increased calls to develop measures to ensure responsible financing in the future. The following section looks at some of the drivers behind increased international focus on these issues.

Box 1: Major instruments to promote responsible lending and deal with sovereign debt crises

Instrument	Year	Aim	Mandatory or voluntary	Official/private sector initiative
OECD Principles and Guidelines to promote Sustainable Lending practices in the provision of Official Export Credits to low income countries	2008	Encourage prudent lending	Voluntary	Export credit agencies
G20 Charter on Responsible Lending	2007 (on-going)	Promote responsible lending	Voluntary	Official (governmental)
WB “free-rider” policy	2006	Promote ‘prudent’ lending and borrowing	Voluntary	Official
The Equator Principles	2006	Promote responsible lending	Voluntary	Private sector
WB/IMF debt sustainability framework	2005	Promote prudent lending and borrowing	Mandatory assessment, voluntary compliance	Official
Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets	2004	Deal with debt crisis, prevention and resolution problems	Voluntary	Private sector
Collective action clauses	More common from 2003	Deal with debt crisis	Voluntary (but now standard terms in contracts)	Official and private sector
OECD 2003 Recommendation on Common Approaches on Environment and Officially Supported Export Credits	2003	Promote responsible lending	Voluntary	Export credit agencies
IMF lending into arrears policy	1999 and 2002	Deal with debt problems	Conditional ¹⁵	Official initiative with participation of private sector
World Bank social and environmental safeguards/ IFC performance standards/ EIB environmental standards	Various	Promote responsible lending	Some mandatory, others discretionary	Official project loans

Responsible lending: a hot topic

So why are the issues of illegitimate debt and responsible lending currently such hot topics?

The efforts of debt campaign groups around the world to secure international recognition of the doctrines of odious and illegitimate debt have undoubtedly been emboldened by the actions of the Norwegian Government which decided in October 2006 unilaterally to cancel US\$80mn in debt owed by five countries acknowledging “shared responsibility” for the debt burden.¹⁶ The Norwegian Government stated that the credits had been extended without due assessment of the development needs of recipient countries and the materials provided (ships) had been of sub-standard quality. It has also funded two research studies into the issue of odious debt by the World Bank and UNCTAD. Both agencies have recently published discussion papers on the issue.¹⁷ Once a taboo subject, it is increasingly recognised that international organisations and creditors can no longer sweep the mistakes of the past under the carpet and publication of these papers signals an increased openness to discuss illegitimate debt.

But probably the key driver behind increased international interest in these issues is the growing prominence of a number of ‘new’ lenders on the scene. International focus has tended to concentrate on China which has intensified cooperation with a range of Sub-Saharan African countries over recent years. However it is true to say that many developing countries have a far greater choice of financiers than, say, 10-15 years ago. Some of these African countries have recently benefited from substantial debt write-downs under the HIPC Initiative and Multilateral Debt Relief Initiative (MDRI). These debt cancellations have prompted new policy debates at the international level as to how to avoid the rapid re-accumulation of debt by countries which have just had large parts of their debts relieved. The argument – often put forward by so-called ‘traditional’ (or OECD) lenders – alleges that the recently increased lending activities of non-OECD lenders such as China, India, Venezuela or Brazil may serve to make poorer countries’ debts quickly unsustainable again because finance may not be provided on sufficiently concessional terms.

Moreover, some analysts have argued that non-OECD lenders are less inclined to adhere to certain internationally agreed standards or safeguard policies which aim to offer certain minimum protections to the peoples and environments of borrower nations. This could encourage a ‘race to the bottom’ whereby other lenders may be encouraged to abandon their own minimum social and environmental standards. Philippe Maystadt, President of the European Investment Bank (EIB) told the Financial Times recently that, “*the competition of the Chinese banks is clear [...] they don’t bother about social or human rights conditions*”. Mr. Maystadt then went on to suggest that the EIB may rethink its labour and environmental protection standards.¹⁸ While these arguments are quickly advanced by OECD-lenders in policy discussions, they tend to ignore that OECD lenders themselves have extremely poor records in the past as they relate to irresponsible and unsustainable lending practices to developing countries, in particular via nationally sponsored export credit agencies.

The recent actions of so-called vulture funds have also thrown the spotlight on the importance of responsible practices by lenders. Vulture funds are companies which buy developing country debt – often at a significant discount – then sue the country to recover the full face value of the debt (usually plus interest, penalties and legal costs). Such lawsuits have increased over recent years¹⁹ and the Paris Club recently stated: “*These actions free-ride on the debt cancellation granted by other creditors and thus divert resources from poverty reduction expenditures in the debtor country*”.²⁰ Governments around the world have spoken-out in disgust at the recent actions of so-called vulture funds which threaten to wipe-out the small advances made so far in terms of debt cancellation. The actions of litigating creditors have graphically underscored the need for contractual changes within sovereign loan agreements which restrict a creditor’s right to sell a sovereign debt to another party. These measures would in turn be strengthened via small amendments to national legislation which would ban vulture funds from using national courts to pursue litigation against developing nations.²¹

Another factor enriching the debate on 'responsible lending' at the international level is the current crisis hitting the US sub-prime mortgage market and noises by prominent bankers that "*it [is] not the job of central banks to bail out lenders who had lent imprudently*".²² These sentiments echo legislation at the national level in the United Kingdom. The UK's Consumer Credit Act of 1974 – amended in 2006 – places a number of responsibilities squarely on the shoulders of lenders with the aim of protecting borrowers. These include measures to prevent coercion, unreasonable interest rates and independent dispute resolution procedures. British courts are allowed to take into consideration "*all relevant factors*" when assessing whether the loan extended was fair and takes into account the borrower's capacities to repay. If lenders do not comply with the law, the courts can make lenders liable for compensation.²³ Although these principles have not yet been applied where the borrower is a sovereign state, the continuing evolution of domestic consumer law will undoubtedly influence debates on lending at the international level in the future.

These factors are all contributing to increased international attention to the issues of illegitimate debt and responsible lending. However policy measures currently available to help address these concerns are seriously lacking, as the next section shows.

Why current instruments just don't make the grade

There are a number of problems with the policy responses currently available at the international level. The most central concern is probably the *voluntary* nature of the measures currently at borrower's and lender's disposal. The 'Principles for Stable Capital Flows and Fair Restructuring in Emerging Markets' have experienced limited sign-on. The proposed G8 Charter on Responsible Lending is also planned to be a voluntary code of conduct for creditors. Meanwhile, the World Bank and IMF state squarely that, "*the [debt sustainability framework] is not an institutional or contractual mechanism to bind creditors around a certain course of action*". Translated this means that lenders and borrowers can continue to behave as they please, and there is nothing that can be done about it. With respect to international safeguard policies, the last decade has seen a shift away from mandatory policies to flexible principles, 'performance standards' or towards national standards of varying strengths.

The concern is that those lenders that are inclined to sign-up to voluntary codes of conduct are precisely those that are more unlikely to engage in irresponsible behaviour, leaving the door wide open to unscrupulous practices. No voluntary code of conduct can usefully be relied on to promote responsible lending or resolve repayments difficulties equitably where they do arise. Purely voluntary codes of conduct have no enforcement powers and therefore cannot impose any discipline on lenders or borrowers.

Another important gap in current instruments centres on the fact that none question the validity or legitimacy of creditors' claims. Although '*pacta sunt servanda*' (contracts must be respected) is an important economic and ethical principle, all domestic legal systems recognise situations where a contract can no longer be enforced. These include situations where the lender has not exercised due-diligence or has engaged in illegal behaviour; where the terms of the contract are considered unfair; where coercion has been involved; or where the borrower's circumstances change so dramatically that to force the debtor to honour the contract would lead to inhumane distress or a violation of human rights. The basic legal principles of lender liability and shared responsibility have not been applied when the borrower is a developing country however even though a nation state has certain obligations to meet the basic welfare of its citizens. Market theory states that when the link between economic decision-making and risk is severed, efficiency is seriously compromised. Yet as long as the debtor is a nation-state, current institutional arrangements dictate that, technically at least, the credit is valid and therefore legally enforceable. Arguably, this has contributed to reckless and negligent lending by some creditors because they can be confident of the legal enforceability of their contract.

At the same time, it is clearly critical to secure as much *ex ante* certainty for potential lenders to sovereign states as possible, i.e. lenders must be confident in the legal enforceability of their contracts before a loan is made. The importance of this should not be underestimated: in the modern globalised financial environment, the importance of global capital flows to developing nations and emerging market economies is significant. Any reform measures should not discourage responsible, legitimate lending from taking place. It is also critical that any measures proposed not be so complex to implement as to push-up the cost of legitimate sovereign borrowing beyond the point where loans can earn a sufficient rate of return and help support economic growth.

What instead? Towards responsible financing standards

In the absence of an internationally-agreed debt work-out procedure and in the face of the continuing ad-hoc and haphazard treatment of the debt of developing countries, this paper proposes contractual changes to loan contracts. The intention is to provide guidance, fairness and certainties to the parties involved, as well as protect the human rights and environments of developing nations in line with international commitments and norms. The proposal moves away from institution or sector specific responses to concerns over responsible lending and fair resolution of debt crises towards ***internationally recognised legal standards for responsible lending and borrowing***.

Eurodad's Charter for Responsible Financing – as tabled in Part Two of the paper – outlines the essential components of a responsible loan. These aim to ensure that a loan's terms and conditions are fair, that the loan contraction process is legal and transparent, that human rights and environments of recipient nations are respected, that many possible future problems are pre-empted and that repayment difficulties or disputes are resolved fairly and efficiently. Many of the provisions outlined in Eurodad's charter are drawn from international treaties and conventions to which lender and borrower nations are signatories.

The paper aims to help improve the *quality* of lending, and prevent *future* illegitimate and unsustainable debt problems. It argues that all lenders and borrowers should be held accountable to the responsible financing standards outlined in this paper. If these standards are broken, the law is broken and the debt becomes null and void. Lender and borrower nations should enact changes to national legislation to recognise – and agree to abide by – these responsible financing standards. National legislation will also ensure that private financiers are bound by the framework. Our proposals will therefore encourage a race-to-the-top rather than a race-to-the-bottom that some financiers clearly fear.²⁴

The key aim of this paper's proposals is to launch a serious political debate into better policy options than those currently available, and to fill a gap at the international level. Discussions on an ***internationally recognised set of legal standards for responsible lending and borrowing*** – and improvement on the measures tabled in this document – must take place within a broad international process with the serious and equal participation of all concerned stakeholders.

Box 2: From conditionality to responsibility

A common approach to official loan finance has centred around the conditions which lenders have imposed on the borrower as part of the loan package.

Within official finance agreements – such as those entered into between sovereign states and multilateral institutions – these conditionalities have mushroomed in both number and scope over the past two decades. They have moved far beyond the technical aspects of a loan contract which set out details related to the purpose and amount of the loan, repayment schedule, interest rate, loan maturity, disbursement schedule, taxes, fees and compliance with due process of law. There are now conditions which serve a larger economic restructuring (and ideological) purpose or which further substantive governance reforms.

Examples of economic conditionalities include liberalisation of government procurement procedures, divestiture of state-owned enterprises; corporate governance reforms to create an enabling environment for private sector development and external investment and improving fiscal discipline. Governance conditions have encompassed administrative and fiscal decentralisation, tax and judicial reform, policies for participatory monitoring and tracking of public expenditure and for participatory budgeting, constitutional and legislative reforms to facilitate involvement of parliaments and citizen groups in decision-making processes and anti-corruption legislation.²⁵

Such conditions have proved extremely controversial however, with heavy criticism voiced by Southern Governments, the citizens of borrower nations and campaign groups alike. They have been widely described as onerous and harmful to poor populations and as failing to respect democratic processes and state sovereignty in important domestic economic and institutional reform decisions. It is also increasingly acknowledged – including in official circles – that conditions which further substantive economic or political aims have largely failed in their objectives because borrower governments have felt little national ownership over their reform processes.

The contractual changes proposed in this report do not in any shape, size or form aim to further sensitive or ideological aims. Instead they strive to provide an effective *technical* framework to ensure that loan monies are used for their intended purpose(s), that citizens in borrower nations have consented to the loan, that lenders have exercised due-diligence, that terms and conditions are fair, that loan contraction processes are transparent and accountable, some possible future repayment problems are pre-empted and any repayment problems or disputes are dealt with equitably and efficiently.

PART TWO: Eurodad Charter on Responsible Financing

Eurodad Charter on Responsible Financing

PREAMBLE

The history of the sovereign debt crisis since the 1980s has shown that loans have often been extended to developing nations with insufficient regard for the rule of law or citizens' welfare. In many cases, loans were used to buy political support or to fund non-viable projects. Citizens around the world demand the productive and transparent use of financial resources. To prevent repeated rounds of unsustainable and irresponsible lending and borrowing, it is essential to reform current approaches to sovereign lending. We therefore demand that lenders and borrowers sign-up and adhere to the following EURODAD Charter on Responsible Financing.

A. TECHNICAL AND LEGAL TERMS AND CONDITIONS

A. (i) ALL LOANS:

1. **Purpose and amount of loan:** The loan document must state clearly the purpose, amount and beneficiaries of the loan.
2. **Mutual obligations and predictable disbursement:** The borrower commits to spend the funds as stipulated in the loan agreement. The lender commits to deliver the funds predictably as stated.
3. **Compliance with relevant national and international laws:** The parties to the loan must comply with relevant national laws and regulations in the borrower and lender nations. Loans should not be exempted from the responsibilities and accountabilities demanded by national law in the borrower or lender nation. Disregard for applicable laws can render any later claims invalid.²⁶
4. **Legal authorisation to enter into the transaction:** The loan document must be signed by authorised representatives of both borrower and lender. It must show that it has secured the necessary parliamentary and/or other administrative approvals in the borrower country (see C(i)).
5. **Repayment assumptions:** The borrower government and lender must make public the economic 'assumptions' they have made in relation to how the loan is to be repaid, such as the financial position of the borrower and expected rate of return on activities financed.
6. **Interest rates:** The loan document must indicate clearly the type and level of interest rates charged (fixed or variable rates). If variable interest rates are chosen, rates must be given a reasonable and fair upper limit which must be stated in the contract. This offers more predictability and certainty to both parties to the contract. A reasonable upper limit would be 1% above the basic market rate in the lender nation.
7. **Repayment profile:** The contract must provide clear information on grace and maturity periods, and repayment profiles (date and amount of debt service).
8. **Penalties:** There should be no usurious penalty premiums. These should be set at the same rate as the original interest rate, for example if the original loan carries an interest rate of 3%, the penalty premium should carry a maximum interest rate of 3%.
9. **Side-letters:** All details in relation to the loan must be contained within one document. Side letters are not permitted.²⁷
10. **Fees and charges:** The loan document must contain detailed figures and information of any fees charged as part of the transaction (including recipient(s) and purpose(s) of fees). Any such fees should be charged at no more than international market prices for such goods or services.²⁸
11. **Conflict of interests:** The loan document should also spell out any additional role the lender has played in relation to the loan, e.g. if it has acted as advisor/consultant to the borrower in addition to its role as lender. The details of this advice should be public and available on demand.

12. Sale of loan on secondary market: To prevent aggressive actions by litigating creditors, the loan should restrict the creditor's right to assign the debt to another party, i.e. the lender cannot unilaterally sell or assign the debt to other entities. The lender must first obtain the free and informed consent of the borrower. In the event the debt is sold-on, assigned, transferred, restructured or replaced with a successor loan, all provisions as outlined in the original loan agreement apply, such as the provision for independent arbitration and change of circumstance.²⁹

A. (ii) DEVELOPMENT LOANS:

13. Aid effectiveness and poverty focus: Loans that are considered "development loans" must be fully in-line with country-designed development strategies and debt policies. They must respect the key principles of the Paris Declaration on Aid Effectiveness.³⁰

14. Currency of the loan: Official lenders should offer the possibility of borrowing all or part of the loan in local currencies to help balance exchange rate risk.

B. PROTECTION OF HUMAN RIGHTS AND THE ENVIRONMENT

B. (i) ALL LOANS:³¹

- 1. Respect for human rights:** Activities financed must not violate human rights and must not contribute to the violation of human rights. These rights are set out in the internationally recognised human rights treaties and conventions to which either borrowers or lender is signatory.³²
- 2. Needs assessment:** The borrower should provide clear documentation or other evidence which identifies the need for the loan.³³
- 3. Ex ante impact assessment:** The lender has a fiduciary responsibility to ensure that activities financed are legal and viable, as attested by an independent ex ante long-term integrated impact assessment. The lender and borrower should jointly appoint someone who will carry out the ex ante assessment. The loan contract should state who bears the costs of possible risks associated with the project as identified in the ex-ante assessment.³⁴
- 4. Respect for internationally recognised social, labour and environmental standards:** The loan must not support any venture that contravenes internationally accepted minimum standards on social, labour and environmental protection.³⁵

C. PUBLIC CONSENT AND TRANSPARENCY

C. (i) ALL LOANS

- 1. Parliamentary and citizen participation:** The loan contraction process must be transparent and participatory, i.e. parliaments and/or citizens and affected communities in the borrower nation must be given adequate time and information to debate the taking-on of the loan, including purpose, terms and conditions of the loan in accordance with the national constitution.³⁶
- 2. Public disclosure of information:** The loan contract must be available to the public in borrower and lender nations (e.g. transmitted to parliament, available for consultation on request, published on the web, announced in the national press, radio and/or television as appropriate).³⁷
- 3. Language:** The contract must be available in the main national languages (including the language(s) of affected communities) of the debtor nation. Both original and translated versions should have equal validity in a court of law.³⁸

C. (ii) PROJECT LOANS

4. **Progress reports and loan evaluation:** For project loans, there should be regular (e.g. biannual or annual as appropriate) progress reports. There should be a clear timetable for completion of the project. There should be independent and timely evaluation and audit of project loans. Project reports and evaluations must be public.

D. PROCUREMENT

D. (i) ALL LOANS

1. **Public procurement:** Government procurement processes must be open and transparent. The loan contract should carry clear details of tendering processes for those carrying out any work or providing any services.
2. **Agreements between borrower and lender:** The loan must contain details of any host government agreement, production-sharing agreement, power purchase agreement or any other similar accord. It must also contain details of any agreement to repay the loan in goods or services provided by the borrower as well as state clearly the basis for the valuation of these goods or services. Similarly, if the purpose of the loan is the provision of goods or services by the lender, the loan document must clearly state how such goods/services have been valued.
3. **Immunity:** To ensure that service providers are fully accountable, there should be no clauses in loan agreements which give legal immunity for violations of the law in borrower and lender nation to those carrying out any services or work as part of the contract.
4. **Local capacity-building:** Procurement procedures should support the capacity-building of local companies and institutions in line with international agreements and commitments in this regard.³⁹

D. (ii) DEVELOPMENT LOANS

5. **Development loan tying:** development loan contracts should not be tied to the purchase of goods or services from the lender.

E. REPAYMENT DIFFICULTIES OR DISPUTES

1. **Change in circumstance:** The loan must recognise that there will be cases where a dramatic change in circumstances – beyond the will of either borrower or lender – means that the borrower is no longer able to meet its financial obligations on the loan. The contract should state clearly what happens in such circumstances and should allow for a modification of the terms of the agreement. The borrower must provide clear evidence which demonstrates that it is not able to meet its financial obligations on the loan.⁴⁰
2. **Independent arbitration:** The loan document should provide a provision for an independent and transparent arbitration procedure in case of repayment difficulties or dispute (at the request of borrower or lender). There will be a stay on debt repayments while negotiations are underway. The borrower will also be protected from litigation while negotiations are in progress. Borrowers and lenders will abide by the decision of the independent arbitrator and there is a right to appeal.⁴¹
3. **Legal authorisation to negotiate:** Proof of legal power of attorney and negotiation must be provided by both sides of the contract before commencement of any negotiations on the loan.
4. **Loan refinancing:** The details of any restructuring/refinancing agreement must be made public. Any successor loan carries with it the properties of the original loan. Borrowers should not sign sovereign immunity waivers when debts are sold-on.
5. **Cross-default:** The loan document must not contain any cross-default or similar clause.⁴²
6. **Termination of the contract:** There must be clear, fair grounds and requirements for nullification/termination of the contract by either party.

Conclusion

Developing country debt stands at over US\$2.85 trillion, up from US\$2.24 trillion in 2000 and US\$1.3 trillion in 1990. Developing countries paid-out over US\$540mn in debt service in 2005, an almost four-fold increase from US\$146mn in 1990 and many devote large percentages of scarce government revenues to external debt service. This problem also continues to need urgent attention and policy-makers cannot claim that international debt relief initiatives have adequately dealt with sovereign debt problems to-date.

Nevertheless, there is also a clear need to avoid the accumulation of illegitimate and unsustainable debt in the future. The varied instruments currently available to borrowers and lenders to ensure responsible lending and deal with debt problems equitably are severely lacking. Some of the key problems centre on the voluntary nature of various 'safeguard policies' and 'debt resolution principles'. These offer no incentives (or sanctions) for creditors to extend loans responsibly and transparently. And although it is widely recognised that both lenders and borrowers share responsibility for the accumulation of unsustainable and illegitimate debt burdens, scant attention has been paid to the issues of due diligence of financiers and the liabilities of lenders.

Debates about the re-accumulation of irresponsible and unsustainable debt are increasingly capturing the attention of policy makers at the international level. This is due to a range of factors. These include the haphazard way a number of recent debt crises have been dealt with – notably Argentina – and creditors' charges that they were treated unfairly; recent rounds of debt cancellation under the HIPC Initiative and MDRI and the fear that beneficiary countries will immediately build-up new un-payable debt; the increased prominence of a number of non-OECD lenders and fears over a 'race to the bottom' with respect to international social and environmental safeguards policies; increased activities of vulture funds; debates over lenders' duties and responsibilities towards consumers at domestic levels, and the Government of Norway's cancellation of debts on the grounds that they were extended irresponsibly.

The instruments available to borrowers and lenders are however ill-equipped to deal with the challenges going forward of ensuring (and rewarding) responsible lending and avoiding the build-up of unsustainable and illegitimate debt. Indeed, they ensure that unscrupulous lenders continue to have fertile ground and do not face the consequences of their actions.

This paper has argued that lenders and sovereign borrowers should be held accountable to a set of clear ex ante ***internationally recognised legal standards for responsible lending and borrowing***. The proposed framework – as set out in Eurodad's Charter on Responsible Financing – sets binding standards which protect borrowers and lenders. They show that there are certain fundamental values that both parties to a contract must abide by and provide citizens –South and North – with effective tools with which to hold governments, public institutions and lenders fully to account. The standards also help to reinforce both international and national law concurrently.

The primary interests of lenders are clear ex ante rules of the road. If lenders can be assured that the new standards make sense, that implementation costs are not burdensome and that there is predictability and fairness in cases of repayments difficulties or dispute, there should be broad buy-in and the costs of lending should not increase. Borrowers can also be reassured that they will not have controversial, onerous and ideological conditions imposed on them by lenders. There will also be certain minimum standards of protection guaranteed for the peoples and environments of recipient governments. Moreover, via provisions for independent arbitration in cases of repayments difficulties or disputes, both parties to a contract will also be offered further protection.

A set of prospective rules will establish a stable framework to assure current and future investors that there is no danger to legitimate and beneficial lending as well as reassure sovereign borrowers that the human rights of their citizens will be adequately protected. The aim of this paper is to launch a political debate about more credible policy alternatives to those currently on the table in order to prevent repeated cycles of unsustainable and illegitimate debt. We look forward to a lively and public debate and will publish all serious responses received to this paper.

We are positive about the prospects that this issue will indeed be taken-up energetically by policy-makers in developing and developed nations, as well as by the multilateral institutions. In September 2007, World Bank President Robert B. Zoellick stated that; “*Fighting corruption in developing countries is as much the responsibility of developed countries as of developing countries,*” referring to bribes, kickbacks, and other illegal income provided by firms and individuals in developed countries and the hiding of money in developed countries. There is clearly an appetite at the international level to hold lenders and borrowers much more accountable for their actions and to combat corruption, negligence and recklessness in international lending. An *immediate* and first step could be the voluntary adoption – by individual governments or agencies – of the Eurodad Charter on Responsible Financing, and lending only to those who have also adopted the code.

Ultimately, for this type of reform to take place, the agreement of both major creditor *and* developing countries is needed. In particular, developing country governments need to push this agenda forcefully at the international level. Such discussions on a binding set of international legally recognised responsible financing standards – and improvement on the measures tabled in this document – could take place within a broad international process with the serious participation of all concerned stakeholders. The United Nations Financing for Development (FfD) process could be one option. This is a more globally owned and equitable forum than either the G8 or G20 can claim to be. We also suggest that lenders and borrowers develop their own track-records of adherence to the standards, which could then be subject to peer review and public scrutiny.

In a context where there is increasing competition in the aid and loan marketplace, borrower countries are in a stronger position to be able to demand more of international financiers. They – supported by social movements and civil society groups in their countries – should seize the opportunity to table these debates in relevant international forums sooner rather than later.

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(Endnotes)

¹ Monterrey Consensus, 2002, p. 17, para. 47: <http://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf>. Moreover, the final outcome report of the UN FfD's 2005 multi-stakeholder consultations on sovereign debt reveals that in fact, a broad range of stakeholders – public and private sectors – support far greater transparency and predictability in the international debt architecture. The outcome report states that: “The proposal to create a multi-stakeholder working group to explore additional mechanisms to improve debt workouts was widely supported and discussed at length. Participants agreed with the proposal that the working group examine such issues as a code of conduct for sovereign debtors and their creditors, operationalization of the doctrine of “odious debt,” and provision of arbitration or mediation services to facilitate dispute settlement. While there was no agreement on the shape that an additional mechanism or mechanisms should take, there was a feeling that if an assured international debt workout mechanism existed, it would make creditors and debtors more cautious in lending and borrowing, which would be good.” See: p. 9: <http://www.un.org/esa/ffd/msc/sovereigndebt/Debt%20Multi%20Stakeholder%20Geneva%20Report%20-%20final.doc>

² Stiglitz, Joseph and Griffith-Jones, Stephany, Growth with Responsibility in a Globalized World – Findings of the Shadow G-8, Dialogue on Globalization, May 2007

³ See Paris Club: <http://www.clubdeparis.org/>

⁴ There is no universally agreed definition of illegitimate debt. However illegitimate debts can loosely be described as those loans which did not benefit the populations of borrower nations and in some cases did local communities and/or environments grave harm. Professor Alexander Nahum Sack, a Russian legal scholar developed the notion of *odious debt* in 1927. *Odious debts* are defined by three main characteristics: a/ the loan did not benefit the population of the debtor nation and indeed the funds may have been used to oppress the people(s) of that nation (absence of benefit); b/ the population of the debtor nation did not consent to the loan (absence of consent); and c/ the creditor was aware of these facts and yet proceeded to disburse the loan anyway (creditor awareness). *Illegitimate debt* however is a much broader category. It applies for example to ill-conceived development projects which no financier exercising reasonable due-diligence should ever have financed. More recently, the concept of *ius cogens* and its potential application in cases of illegitimate debt has been raised. This argues that any loans which contravened accepted international *ius cogens* norms such as torture, slavery or war of aggression should be deemed invalid.

⁵ The ‘fair and transparent arbitration procedure’ or ‘FTAP’ was first proposed in 1987 by Austrian academic Kunibert Raffer who recommended the internationalisation of Chapter 9 of the US Insolvency Code. Chapter 9 protects national government municipalities in cases of bankruptcy. The key features of Raffer’s model include a neutral decision-making body which arbitrates and decides which debts need to be declared null and void, and which need to be repaid; the rights of both debtor and creditor to be heard by arbitrators; protection of the human, social and economic rights of the citizens of the debtor; the institution of automatic stay and transparency of process and decisions. Internationalisation of this procedure would ensure comparability of treatment between countries and between debts. In cases of financial difficulties or dispute, debtors and creditors should be able to turn to such an independent mechanism as a serious option should they so choose. According to Raffer’s model, arbitration may be heard on an ad-hoc basis. Meanwhile, Alberto Acosta, Ecuadorian economist and Oscar Ugarteche, Peruvian economist have also put forward not dissimilar proposals for the creation of a ‘tribunal internacional de arbitraje de deuda soberana’ or ‘TIADS’ (international tribunal for the arbitration of sovereign debts). Unlike Raffer’s model, the TIADS model would involve the institutionalisation of an arbitration court – possibly under the aegis of the United Nations or International Court of Justice – to hear sovereign debt related disputes and/or repayment difficulties. Acosta and Ugarteche argue for an ‘international financial code’ (código financiero internacional) which would codify the right to be heard before an arbitration tribunal. Eurodad’s charter for responsible lending does not indicate a preference for either model, but argues that borrowers and lenders should have the right to be heard before an independent panel in cases of repayment difficulties or dispute. This panel would also identify incidence of illegitimate debt (and legitimate debt of course).

⁶ A collective action clause (CAC) allows a supermajority of bondholders to agree a debt restructuring

that is legally binding on all holders of the bond, including those who vote against the restructuring. Bondholders generally opposed such clauses in the 1980s and 1990s, fearing that they would compromise 'creditor's rights', although such clauses were long standard in bonds issued under British law. New York law bonds on the other hand, the most common, required unanimity to alter their financial terms, although a technique had been devised to indirectly change the terms with a smaller majority ('exit consents'). Bond-issuing governments generally feared that including CACs would raise their interest rates, if creditors demanded compensation for greater perceived risk. However, after Mexico experimented successfully with CACs in a New York bond in February 2003 without negative effect, they became the new standard. Whether they enable easier coordination of bondholders has not yet been tested.

⁷ See: <http://www.iif.com/emp/principles/>

⁸ In 2003, Anne Krueger, First Deputy Managing Director at the IMF developed proposals for a Sovereign Debt Restructuring Mechanism (SDRM). Some of the main features of the SDRM include: a supermajority of creditors could vote to accept new terms under a restructuring agreement, minority creditors would be prevented from blocking such agreements, negotiations should be based on good faith, there would transparency requirements and sharing of information by the debtor and the creation of a dispute resolution forum. The proposals were abandoned in 2004 following objections by a number of creditor governments and private financiers. Proposals were also criticised by NGOs for, among other reasons, the exclusion of IMF debts from the process of orderly restructuring. For further information, see: <http://www.imf.org/external/np/exr/facts/sdrm.htm>

⁹ See for example, the World Bank's safeguard policies at: <http://go.worldbank.org/WTA1ODEZTO> or the IFC's "performance standards" at: <http://www.ifc.org/ifcext/enviro.nsf/Content/PerformanceStandards>

¹⁰ See: <http://www.equator-principles.com/>

¹¹ For further information on the World Bank/IMF debt sustainability framework, see: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:20261804~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html>

¹² In fact, the reverse is true. In 2006, the World Bank approved its so-called 'free-rider policy'. The policy, entitled '*Managing Risks Associated with Nonconcessional Borrowing*' states that should low-income countries take-on too much non-concessional commercial debt for purposes the Bank does not agree with, it retains the right to reduce (or harden the terms of) that country's access to concessional International Development Association (IDA) resources. No sanctions of any kind are imposed on lenders for lending beyond prudent limits. And although the Bank recognises that "*this does imply a somewhat asymmetric treatment of lenders and borrowers*" it presents no potential policy measures which could be discussed to ensure a more equitable treatment between the two parties. For further information on the policy, see: [http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:21021578~pagePK:51236175~piPK:437394~resourceurlname:FY06grantimplementation%5E\\$%5Epdf~theSitePK:73154,00.html](http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:21021578~pagePK:51236175~piPK:437394~resourceurlname:FY06grantimplementation%5E$%5Epdf~theSitePK:73154,00.html)

¹³ The draft principles currently under discussion are short and extremely weak. They read as follows:
Draft Principles on Responsible Lending

"Over the years the International Community has made remarkable efforts to enhance its support to low-income countries. We believe that, in order to reinforce these efforts, responsible lending policies and practices should be developed and implemented, according to the following principles.

1. Fostering sustainable development

Sustainable development is the ultimate objective of aid and assistance. Finance to developing countries should not compromise the ability of future generations to meet their own needs. This implies that responsible lenders consider the economic, social, environmental and cultural dimensions of their interventions together with long- term financial sustainability.

2. Preserving debt sustainability

Responsible lenders ensure that their lending decisions meet the need for funds of recipient countries in a

way that matches their current and future ability to service debt, in order to avoid the return to the lend-and-forgive cycles that undermine lasting development. To this end, responsible lending towards low-income countries is guided by the World Bank/IMF Joint Debt Sustainability Framework and the country-specific Debt Sustainability Analyses and is provided on terms and conditions fully consistent with them. Responsible lenders help avoid the risk of litigation against HIPC and other low-income countries.

3. Supporting good governance

Good governance is key to sustainable development in its political, social, environmental and economic dimensions. Peace, democracy, rule of law, respect of human rights and fundamental freedoms, broad-based access to health, education and basic services, gender equality and people's participation, effective, accountable and transparent public financial and management institutions and sound economic management are all necessary. Responsible lenders support beneficiary countries that make progress in these fields, enhancing the incentives to good governance and maximising the impact of donor resources in support of development.

4. Ensuring transparency and effectiveness

To strengthen creditor coordination, responsible lenders fully share information on their lending practices to low-income countries. This transparency also contributes to the efforts by recipient countries to use public resources wisely. Responsible lenders also respect the principles of the Paris Declaration on Aid Effectiveness: Ownership, Alignment to partner countries' strategies, Harmonisation, Managing for Results and Mutual Accountability.

¹⁴ See, World Bank, The concept of odious debt: some considerations, 7 September 2007: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,menuPK:64166739~pagePK:64166681~piPK:64166725~theSitePK:469043,00.html>

¹⁵ The IMF will lend to countries in arrears to private creditors if the country shows it is making a 'good faith effort' to resolve its debt crisis.

¹⁶ The countries involved in the Norwegian debt write-off are: Ecuador, Egypt, Jamaica, Peru and Sierra Leone. See: Royal Norwegian Ministry of Foreign Affairs, Cancellation of debts incurred as a result of the Norwegian Ship Export Campaign (1976-80): <http://www.regjeringen.no/en/dep/ud/Documents/Reports-programmes-of-action-and-plans/Reports/2006/Cancellation-of-debts-incurred-as-a-result-of-the-Norwegian-Ship-Export-Campaign-1976-80.html?id=420457>

¹⁷ See: UNCTAD: The Concept of Odious Debt in Public International Law: http://www.unctad.org/en/docs/osgdp185_en.pdf and World Bank: Odious Debt: Some Considerations: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,menuPK:64166739~pagePK:64166681~piPK:64166725~theSitePK:469043,00.html>

¹⁸ Financial Times, EIB accuses Chinese Banks of undercutting Africa loans, 28 November 2006

¹⁹ For the full list of litigations underway against HIPCs, see: <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0,,contentMDK:21050877~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html>

The World Bank estimates that more than a third of the countries receiving debt relief have been targeted with lawsuits by at least 44 litigating creditors, with judgments, awarded in 26 of these cases, of some US\$1 billion (in some cases, public pressure forced the vulture fund to drop the case). The HIPCs facing the most litigation are the Republic of Congo, Guyana, and Uganda with eight, seven and six lawsuits respectively. The bank states that although litigating creditors are based all over the world, higher concentrations are observed in the UK, British Virgin Islands, US. Lawsuits against HIPCs have been filed mainly in London, Paris and New York. Total reported claims under litigation amount to US\$1.9bn.

²⁰ Press release of the Paris Club on the threats posed by some litigating creditors to heavily indebted poor countries, May 22, 2007: See: <http://www.clubdeparis.org/sections/services/communiqués/communiqué-presse-du/viewLanguage/en>

²¹ In order to better protect borrowers, one proposal has been to enact small amendments to national

legislation to prevent vulture funds from using national courts to pursue litigation against developing nations. In June 2006 for example, a proposal was tabled in the French Assemblée Nationale for a law which aimed to place serious obstacles in front of any vulture fund which hoped to use the French courts to seek repayment from a debtor nation by giving French judges discretionary powers to take into consideration “the efforts of other creditors” [to provide any debt relief to the debtor nation in question] “and the capacities of the debtor”. The text is certainly not as strong as it could be and has not yet become law in France but such measures are welcome and are definitely a step in the right direction.

²² Guardian Weekly, “The credit party’s over. For now,” 17 August, 2007

²³ UK Consumer Credit Act 1974 – amended in 2006: http://www.ofc.gov.uk/advice_and_resources/resource_base/legal/cca/CCA2006/

²⁴ Most the provisions in Eurodad’s Charter for Responsible Financing can be applied to a full range of lending, e.g. project loans, export-credit agreements, sovereign bonds, policy support loans (such as modernisation or privatisation loans) and balance of payments loans. There may be some cases however where a particular provision may *not* be relevant to this type of loan, e.g. the provision for an ex ante social and environmental impact assessment would not apply in cases of direct budget support or to sovereign bonds. The provision on the untying of loans to the purchase of lender goods or services would not be applicable to export credit agreements although we suggest ways to dramatically improve the quality of these transactions.

²⁵ For an excellent critical assessment of “types” of loan conditionalities within IFI loan agreements to sovereign states, see: http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Eurodad%20ResponsibleFinancingTan.pdf

²⁶ The loan should comply with relevant legislation in both borrower and lender nation. If the loan violates the constitution of the borrower nation in any way, it should be deemed null and void. Examples of relevant legislation in the lender nation include the Spanish law of December 2006 entitled: “Act Governing the Management of Foreign Debt”. This binds the Spanish Government as a lender to, among other things, tailor loans to “debtor countries’ development requirements and [...] be proportional to their financial difficulties,” and pay special attention to “reducing poverty levels, [...], pursuing sustainable economic growth, [...] as well as to preserving the environment.”

²⁷ Fees and other supplementary charges are often included in loan documentation by reference to a side letter to avoid disclosure. For this reason, side-letters should be avoided.

²⁸ The loan should distinguish between types of fee, e.g. ‘commitment’ fees (which should have a maximum level of 0.5-1%), from fees for ‘services rendered’. These should really be included in the overall loan amount as part of the project being financed. In case they are not, the loan document must contain clear and detailed information on the amount, purpose, recipient and interest rates charged.

²⁹ If only a voluntary code of conduct is adopted as an *immediate* step on the way towards binding international standards, there could be a stipulation that loans can be assigned only to other creditors who have signed up to the Code of Conduct.

³⁰ See the Paris Declaration on Aid Effectiveness, March/April 2005: http://www.oecd.org/document/18/0,2340,en_2649_3236398_35401554_1_1_1_1,00.html The 12 indicators donor countries have signed up to are: partners have operational development strategies; reliable country systems; aid flows are aligned on national priorities; strengthen capacity by coordinated support; use of country public financial management systems; use of country procurement systems; strengthen capacity by avoiding parallel implementation structures; aid is more predictable; aid is untied; use of common arrangements or procedures; encourage shared analysis; results-oriented framework; mutual accountability. See also the UN Millennium Declaration, 18 September 2000: <http://www.un.org/millennium/declaration/ares552e.pdf>

³¹ We recognise that there are some loans, e.g. balance of payments support loans, budget support

its peoples). The burden of proof lies with the borrower in these situations. The debt contract must state clearly the procedures should such eventualities arise. Possible resolution scenarios include: a/ GDP or commodity-price indexed loans to allow for GDP indexed debt service, i.e. a reduction in debt service in cases of external shock or “force majeure”. They could also allow for payments to be linked to the price of a ‘basket’ of the borrowing country’s main commodity/ies; b/ a moratorium on debt service payments (without penalties imposed) to safeguard a state’s vital expenditures and help it to recover more quickly; c/ an ad-hoc arbitration or other independent legal opinion/decision under which both parties agree to share the consequences of such unforeseen circumstances.

⁴¹ See note on FTAP and TIADS proposals for further elaboration. During the arbitration procedure, the borrower would continue to make interest payments on the loan(s) at the standard level charged (i.e. penalty interest rates would not apply). These interest payments may be reimbursed to the borrower subject to the outcome of the independent arbitration.

⁴² A provision in a bond indenture or loan agreement that puts the borrower in default if he/she/the state defaults on another debt obligation.