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Let Countries Go Bankrupt The Case for Fair and Transparent Debt Arbitration

Economists know that protracted maneuvering does not make unpayable debts paid but increases the debt overhang. So-called phantom debts¹ accumulate, which are economically non-existent as they cannot be recovered, but which make things difficult for everyone. History proves that the impossibility of collecting them has to be faced eventually. The choice is between further delays with damaging effects on debtor economies and an orderly, fair, and quick procedure to cancel unpayable debts, bringing debt service in line with the ability to pay.

Such procedures, called insolvency, exist and have been routine for centuries. They are only denied to sovereign states, based on the subterfuge that corporate or individual insolvency does not address sovereignty, nor governmental powers. Legally, this is right. Economically though creditors can choose to apply the essence of insolvency procedures to sovereign debtors. In 1876 private creditors used Egyptian insolvency law as the yardstick to solve Egypt's debt crisis. The administrator appointed to protect creditor interest, Evelyn Baring, did not apply the »lemon squeezer« approach of today's Bretton Woods Institutions (BWIs). He lowered, for example, taxes and postal charges, financed expenditures on public health and education, and encouraged improvements in irrigation. Wages and pensions were paid out in full. After surprisingly few years he was economically successful for creditors and the debtor alike.² A hard nosed 19th century capitalists managed this crisis much better and more quickly than international public sector institutions nowadays. Generally, debtors were treated much more generously in the past, before the BWIs became debt managers. Germany's London Accord, Indonesia's solution of 1969–70, or Poland more recently show that meaningful debt relief can be done quickly if creditors do not oppose it.

The legalistic sovereignty argument is right as far as it goes. But the proposal of sovereign debt

arbitration modeled on the basic principles of US Chapter 9 insolvency – first made in 1987³ – offers a way out. The only successful solution, generally accepted in the case of other debtors, can be easily and immediately applied to countries. Sovereign insolvency can be done.

The discussion on international insolvency subsided around 1990, starting again in the late 1990s, largely due to civil society, especially the Jubilee movement. This renewed interest justifies recapitulating the arguments in the light of the present debate.

The Essence of Insolvency

Insolvency is not an act of mercy but of economic reason, generally recognized as the best way to solve hopeless overindebtedness. After the Asian crash of 1997 (domestic) insolvency procedures were to be improved. For creditors insolvency is part and parcel of lending. It makes them look closely at how their money is spent, denying further loans if the first ones are not put to good use. This fundamental disincentive against misallocation of resources within market economies, by which credit risk becomes relevant, is absent in centrally

1. cf. Kunibert Raffer, »The Necessity of International Chapter 9 Insolvency Procedures«, in: Eurodad (ed.), *Taking Stock of Debt, Creditor Policy in the Face of Debtor Poverty*, Brussels 1998, p. 8.

2. cf. Edouard Domen, »Comment un noble étranger libéra le khédive de sa dette – un conte oriental«, in: *Choisir* (septembre) 1999, pp. 26 ff.

3. Kunibert Raffer, »International Debts: A Crisis for Whom?«, in: H.W. Singer & Soumitra Sharma (eds.), *Economic Development and World Debt*, London & Basingstoke: Macmillan 1989, pp. 51 ff. For details see Kunibert Raffer, »Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face«, in: *World Development* 18 (2) (1990), pp. 301 ff. or papers at <http://mailbox.univie.ac.at/~rafferk5>

planned systems and within the international public sector.

The basic function of insolvency is the resolution of a conflict between two fundamental legal principles: the right of creditors to payments and the principle recognized generally (not only in the case of loans) by all civilized legal systems that no one must be forced to fulfill contracts if that leads to inhumane distress, endangers life or health, or violates human dignity. Debtors, unless they are Southern Countries, cannot be forced to starve their children to be able to pay. Although claims are recognized as legitimate, insolvency exempts resources from being seized. Human rights and human dignity are more important than repayment. Insolvency only deals with claims based on solid and proper legal foundations. For odious debts, for example, no insolvency is needed; these are null and void. Demands for cancelling apartheid debts are therefore based on the odious debts doctrine.

Debtor protection is one essential feature. The other is the most fundamental principle of the Rule of Law: one must not be judge in one's own cause. A neutral entity must assure fair settlements. Insolvency must comply with the minimal demand that creditors must not decide on their own claims. Even at the time of debt prisons creditors were not allowed to do so – in contrast to present international practice, which violates this very basis of the Rule of Law. Creditors have been judge, jury, experts, bailiff, even the debtor's lawyers, all in one. This unrestricted creditor domination is even inefficient from a purely economical perspective. Creditors tend to grant too small reductions too late, prolonging the crisis instead of solving it, as the never-ending story of debt management proves.

Substantial shares of present debts exist only because of unsuccessful management, which has refused necessary reductions over years. This increased debt burden and its economic effects are creditor caused damage. When the debt crisis was declared over during the euphoria at the beginning of the 1990s the World Bank admitted: »*In a solvency crisis, early recognition of solvency as the root cause and the need for a final settlement are important for minimizing the damage.* ... protracted renegotiations and uncertainty damaged economic activity in debtor countries for several years ... It took too long to recognize that liquidity was the visible tip of the problem, but not its root.«⁴

Bank economists quantified the costs of delaying the recognition of the now generally acknowledged solvency crisis as »one decade« lost in development.⁵ It was not mentioned that creditors denying meaningful relief had caused this damage, most notably the BWIs, which have supported this strategy with overly optimistic forecasts. Two thirds of the increase in Sub-Saharan African debt since 1989 are due to arrears.⁶ The World Bank acknowledged: »In many HIPC [Highly Indebted Poor Countries] the negative impact of external debts seems to come more from the growing debt stock rather than from the excessive burden of debt service actually paid.«⁷ Countries pay little, amassing arrears. In spite of this insight, official creditors responsible for this delay qualified as wrong and damaging to debtors by the World Bank go on delaying.

The Usual Objections

The counterarguments usually brought forward are often at odds with logic or even the truth. Even parliamentary questions have been answered misleadingly or incorrectly. General problems have often been presented in a highly selective way as if they would uniquely arise in the case of sovereign insolvency.

An anecdote seems to illustrate the position of creditors most tellingly. The Chapter 9 solution was presented at the Civil Society Forum of the UN's Financing for Development Initiative in November 2000. Pointing out that this meeting had a certain informality the representative of a Southern Country, who found the speaker's reasoning convincing, asked the representatives of creditor governments to produce a convincing argument why it could not be done. An embarrassingly long silence followed before one of the usual arguments

4. IBRD, *World Debt Tables 1992/93*, vol. 1, Washington DC, pp.10 ff (stress in original).

5. M. Ahmed & L. Summers, »Zehn Jahre Schuldenkrise – eine Bilanz«, in: *Finanzierung & Entwicklung* 29(3) 1992, pp. 2 ff.

6. UNCTAD, *Trade and Development Report 1998*, Geneva 1998, p. 127.

7. IBRD, *Global Development Finance 1997*, Washington DC 1997, p. 44.

was finally produced to end it – sovereignty would stand in the way of this solution.

Sovereignty

Although arbitration is a traditional and well established mechanism of international law, seen as compatible with sovereignty by any textbook, it has regularly been asserted that sovereignty would not allow this solution. A study of the Advisory Council of the German Ministry of Economic Cooperation and Development⁸ drew parallels to private insolvencies, especially the »strict supervision« of debtors in Germany to summarize that »political sovereignty and, linked to it, the impossibility to remove governments«⁹ would not permit an international Chapter 9. Answering a parliamentary question by Christoph Eymann in June 2000 the Swiss government argued the U.S. Chapter 9 to be incompatible with sovereignty because »external authorities« would »as a rule« be »appointed to manage the finances of insolvent states and municipalities«.¹⁰ U.S. laws clearly exclude receivership for municipalities. US-states are sovereign regarding debts pursuant to the 11th Amendment. A paper submitted by the German Ministry of Finance (BMF) to the Committee on Finances of the Bundestag¹¹ argued in a more sophisticated way, seeing insurmountable problems in accepting arbitration. Debtors would not waive their sovereignty nor accept arbitral decisions. Neither with regard to Paris Club decisions nor IMF conditionality is any insurmountable sovereignty problem identified.

Debtors borrowing in capital markets routinely waive sovereign immunity. About half the loan agreements are governed by New York, almost half by British law.¹² Some agreements with private creditors foresee arbitration.¹³ Brazil is legally required to insist on arbitration. Paris Club members forced Brazil to change this, and to »exempt specifically ... Paris Club bilateral restructuring agreements«.¹⁴ The impression created by the German Ministry of Finance (BMF) that no debtor would accept arbitration is at severe odds with the truth. The BMF is right, though, that creditor governments are unwilling to do so. Arguing that neutral arbitration panels must replace bankruptcy courts, I used the London Accord as an example,¹⁵ which

foresaw arbitration to settle disagreements between Germany and its creditors. Arbitration has become quite popular recently. The World Trade Organisation (far more than 100 cases already) and the NAFTA Treaty apply it. OECD governments wanted it to be part and parcel of the fiercely debated Multilateral Agreement on Investment. Apparently arbitration is popular, provided it does not safeguard the human dignity of the world's poorest.

U.S. Chapter 9 excludes receivership with utmost clarity (sections 902 and 904). For conflict cases the chapter foresees a trustee with a clearly limited mandate, who cannot take over and operate the debtor as a receiver in private insolvency cases would. Only the municipality's citizens can remove elected officials by voting them out of office. Thus, Chapter 9 is custom-made for sovereigns. One might wonder, though, whether debtors who are that strongly protected would not simply refuse to pay. But economically forced to find a solution to regain economic viability and normal access to capital markets municipalities have to make acceptable offers. The law's history in the U.S. (some 500 cases) proves that it works.

Need for a Treaty

Another often heard argument is that sovereign insolvency would require a detailed treaty, whose negotiation would delay a solution for ages.¹⁶ This, is technically wrong – treaties are but one

8. BMZ-Beirat, »Internationale Insolvenz für Entwicklungsländer«, Stand: 15.2.2000, p. 17.

9. *ibid.*, p. 30.

10. »Schaffung eines Schiedsverfahrens zum Interessenausgleich zwischen Schuldnerländern und Gläubigern«, in: *Motion* of 22 March 2000 (00.3103 Motion), Answer by the Bundesrat <http://www.parlament.ch/afs/data/d/gesch/2000/d%5Fgesch%5F20003103.htm>

11. BMF, »Stärkung der Internationalen Finanzarchitektur – Überlegungen zur Reform des IWF und der Finanzmärkte«, 1 March 2001 (mimeo).

12. Bolívar Moura Rocha, *Development Financing and Changes in Circumstances, The case for Adaptation Clauses*, London: Kegan 1999, p. 34.

13. *ibid.*, pp. 132 ff.

14. *ibid.*, pp. 91.

15. Raffer 1989, p. 60.

16. Cf. e.g. BMZ-Beirat 2000, p. 28, and BMF 2001, p. 22.

option in international law. The London Accord was possible without any OPEC-type institution. The Paris Club, too, functions without treaty.

Lack of Enforcement

In no case can agreements between countries and creditors be enforced like domestic contracts. This is true for dispute settlement within the World Trade Organization and for agreement with the Paris Club or the IMF. International law knows no bailiiff. Attempts to sue sovereigns that had waived immunity and to attach their assets have been largely ineffective.¹⁷ Here, a general problem is presented as if it would exclusively affect insolvency.

Rogoff identifies lack »of enforcement clout« as the main problem, but concedes: »Advocates of international bankruptcy point out that similar problems arise in the case of bankrupt state and local governments, and that the obstacles have not proved insurmountable. For example, Chapter 9 of the U.S. bankruptcy code, which governs municipalities, has proven relatively effective (Raffer, 1990).«¹⁸

Access to Capital Markets

It is said that a country that declares insolvency would lose access to capital markets. If it were true, no reorganized firm could ever get any loans. Daily experience proves this manifestly wrong. Indonesia got debt reduction by de facto insolvency in 1969–70. In the mid-1970s the Pertamina crisis erupted because its public sector had again been able to overborrow. The Deputy Governor of the Bank of England, David Clementi, saw no empirical evidence of »any discernible negative long-term effect of a country's prior debt servicing record on the terms and volume of its borrowing«.¹⁹

The World Bank itself showed »timid attempts« to present Indonesia with its significant debt reduction of 1969–70 »as an alternative model« during the 1980s,²⁰ but it now downplays this case.²¹

Misuse of Recuprated Funds

Since the case for sovereign insolvency is based in great deal on the principle of safeguarding basic social services it is imperative that countries use the resources saved from debt servicing to the benefit of the poor. Concern exists that this might not be done.

A transparently managed fund financed by the debtor in domestic currency is the solution. Discussing with public servants of the G7 and representatives of the German Ministry of Economics, Ann Pettifor proposed such a Fund to guarantee proper use in favor of the poor, and for a fresh start for the debtor economy.²² The Fund's management could be monitored by an international board or advisory council consisting of members from the debtor country and creditor countries. They could be nominated by NGOs and by governments (including the one of the debtor country). The Fund being a legal entity of its own, checks and discussions of its projects would not concern the government's budget, and thus not impinge on the country's sovereignty. Counterpart funds have worked successfully so far, and have frequently been demanded by civil society.

Lack of Need for Insolvency

A standing argument is, that present debt management works well and hence there is no need for insolvency procedures. Written in 2000 the BMZ-

17. Barry Eichengreen, *Toward a New International Financial Architecture, A Practical Post-Asia Agenda*, Washington DC: Institute for International Economics 1999, p. 92.

18. Kenneth Rogoff, »International Institutions for Reducing Global Financial Instability«, in: *The Journal of Economic Perspectives* 13(4) 1999, p. 30.

19. UN, *Recent Developments in the debt situation of developing countries, Report of the Secretary-General*, 26 September 2000 (A/55/422), p. 19.

20. Thomas Kampffmeyer, *Towards a Solution of the Debt Crisis, Applying the Concept of Corporate Compositions with Creditors*, Berlin: German Development Institute 1987, p. 63.

21. IBRD, *Indonesia, Managing Government Debt and Its Risks*, Washington DC & Jakarta 2000, p. 25.

22. Ann Pettifor, »Concordats for debt cancellation, a contribution to the debate«, Jubilee 2000 Coalition UK, 18 March 1999 (mimeo).

study posits that the Brady Plan was successful, right after Ecuador had defaulted on its Brady bonds.²³ The BMF simply states that the Cologne Initiative solves the debt problem of HIPC.²⁴

Space prohibits detailed criticism,²⁵ but suffice it to recall that Ecuador, for example, was at the Paris Club seven times between July 1983 and September 2000 – on average once in less than every three years. This hardly suggests efficient and viable solutions. Assessing the enhanced HIPC initiative on congressional request the US General Accounting Office (GAO)²⁶ points out that maintaining debt sustainability will depend on annual growth rates above 6 percent (in U.S. dollar terms) over 20 years – in four cases including Nicaragua and Uganda even above 9.1 percent. The GAO doubts whether this can be done. It recalls that falling coffee prices increased Uganda's debt-to-export ratio considerably, despite Uganda's debt reduction under HIPC I. In April 2000 the BWIS reduced the projected growth of Uganda's export revenues for 2001–3 by over 16 percent. HIPC II seems built on similarly fragile, optimistic assumptions as HIPC I. Analyzing HIPC I, officially designed to reduce debts to sustainable levels, Raffer²⁷ predicted two years before Cologne that »another round – HIPC II – might already be in the making«. Unfortunately, HIPC II justifies repeating this prediction *mutatis mutandis*.

Implementing Debt Arbitration

To avoid further delays the proposal of international Chapter 9 combined traditional mechanisms: arbitration, and an existing insolvency procedure for debtors with governmental powers. National insolvency laws differ, but the only applicable insolvency model, Chapter 9, was recommended. As discussing procedures can be abused to create a further delay, it is stressed that the blueprint sketched below is but an illustration how insolvency can be implemented easily. Other ways of delivering quick and meaningful relief may exist. If so, they are just as good.

To start the process, the good services of a respected institution would be helpful. The country could »file« for debt arbitration/insolvency by depositing its demand at the UN, e. g. with the Secretary General. Only governments would have the

right to file. It is their sovereign decision. The UN makes the demand publicly known, enabling all creditors to represent their interests appropriately. If the debtor could already present a list of creditors this would speed things up. Creditors register their addresses and the names of people representing them during the procedure at the UN.

Creditors and debtor nominate one or two arbitrators. One per side would have the advantage of a smaller panel. Two are better if creditors cannot easily agree as public and private creditors (Paris and London Clubs) could nominate one person each. Both parties inform the UN whom they have nominated. Civil Society Organizations and public opinion within the debtor country may influence the country's choice. The debtor government may choose to leave nominations either to parliament or the people. Arbitrators could be elected from a roster by voters. Anyone reaching a minimum of supporting signatures by voters would have to be on this roster. Also, one arbitrator may be chosen by parliament and the other by voters. After a change of government the incoming government might be prepared to opt for one of these democratic possibilities.

Neither creditors nor their employees can be nominated. Fairness to other creditors also requests this. They might not be unbiased when deciding on their own claims. »Emerging Markets this Week« addresses this issue: the Bretton Woods Institutions »will be *concerned with protecting their own balance sheets* rather than with fair »burden sharing«. Thus they »are not suited either as arbitrators or as objective regulators of sovereign insolvency procedures«. The publication demands multilateral institutions to »accept accountability for their past lending«, by sharing the burden of debt reduction.²⁸ Unless the problem of official

23. BMZ-Beirat 2000, p. 19.

24. BMF 2001, p. 22.

25. cf. Kunibert Raffer & H.W. Singer, *The Economic North-South Divide: Six Decades of Unequal Development*, Cheltenham: Elgar 2001, pp. 158 ff.

26. GAO, *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges* (Chapter Report, 06/29/2000, GAO/NSIAD-00-161) <http://www.gao.gov>

27. Kunibert Raffer, »Controlling Donors: On the Reform of Development Assistance«, in: *Internationale Politik und Gesellschaft – International Politics and Society* 4–1997, p. 364.

28. no. 26/1999, stress in orig.

debts is solved, payments to private creditors will remain discriminated. Although private creditors had granted a generous reduction of 45 percent under Ecuador's Brady deal, this was only reflected in a very small blip downwards in Ecuador's debt time series. New official money increased debts again. If all creditors had cancelled 30 percent, commercial banks would have saved money. Ecuador would in all probability be economically afloat again. Bailing-in official creditors, as demanded within an international Chapter 9, is necessary. The poorest countries with relatively large shares of multilateral debts need meaningful reductions of these debts for a fresh start.

Nominated arbitrators elect one further person to reach an uneven number. The panel must be absolutely independent, also from the UN. It proceeds on the basis of the main principles of the US Chapter 9, such as protection of the governmental sphere and the population's right to be heard (by representation), deciding on procedural matters as they come up. This is not unusual and makes the process quicker and flexible. The UN might provide one or two persons as secretariat staff, or an office if needed. One has to stress again: no international treaty is needed. The Paris Club works without any, even without any proper legal foundations, based only on the will of creditors. International insolvency can be implemented immediately once important creditor governments agree to respect Human Rights, to apply the Rule of Law and economic reason to their own claims.

Respecting the Rule of Law and Human Rights, arbitration would nevertheless resemble present negotiations in several ways. Creditors and the debtor (re)negotiate, they would just do so before the panel. Good arbitrators encourage both sides to reach a fair and feasible outcome. HIPC II demands the participation of civil society and anti-poverty measures. A transparent process and the population's right to be heard should thus be seen as simply implementing these demands more efficiently. Ideally, creditors, the debtor and the representatives of the population can all agree on the result. If so, there is practically little if any apparent difference to mediation. But one cannot assume this optimal outcome to be the rule. Someone with authority to decide if and when necessary is needed. Mediators have no power to do so, they can only appeal to both sides, provide arguments,

help as a disinterested party. Arbitrators can do so as well, but also decide if necessary.

The independent panel determines which civil society organizations, trade unions, employers' associations, grassroots organizations, or international organizations such as UNICEF are given the formal status of representing the affected population. The parliamentary opposition – if one exists – might also nominate someone. One of the parties, the government or any organisation affiliated with it must not be considered. To nominate these representatives popular vote or collecting signatures are possibilities. In order to give all affected groups a voice, the number of the population's representatives should not be too small. Northern and domestic civil society organizations should be given that status, as Northern organizations cannot be put under pressure by their governments as easily. But during an open, transparent procedure, anyone would have the possibility to comment and to voice their views in public, even without any formal right to speak before the panel, thus influencing public opinion as well as those formally participating. This would assure »a fair and open process devoid of any overreaching however subtle« as demanded in the U.S.. Seconding the Hermes Kreditversicherung, the German Ministry of Economic Cooperation and Development criticizes that civil society organizations would not duly defend the interests of creditors.²⁹ But as creditors are party – thus enjoying more rights than civil society – this should not be reason of concern.

Creditors and the debtor negotiate before the panel. Representatives exercising the population's right to be heard can comment on any topic, present proposals, data, etc. These negotiations produce a set of feasible outcomes, as each side has to support their points by data and arguments. Ideally, agreement between creditors, the debtor and representatives of the population is reached. The main task of arbitrators is determining which percentage of debts is uncollectable, either being phantom debts or because of debtor protection including resources necessary for economic recovery. The settlement must also take creditors' justified

29. BMZ, »Insolvenzlösungen und Insolvenzfeststellungen – Unternehmen und souveräne Schuldner im Vergleich,« <http://www.bmz.de/medien/spezial/insolvenz/a2.html> (downloaded: 10 April 2001, 14:05).

interests duly into account. This is essential. Only a fair mechanism will be as generally accepted as national procedures are. Open and transparent negotiations allowing both parties and the representatives of the population to argue their points and produce supporting evidence, can be expected to reduce the set of feasible outcomes considerably. Differences between the remaining concrete solutions are likely to be relatively small. Thus arbitral awards are likely to affect relatively small sums of money – «peanuts» in the language of a distinguished German banker.

To reduce the costs of participation for Southern civil society organizations the panel could sit in the debtor or a neighbouring country. Technically, a permanent court could handle cases as well. But *ad hoc* panels can be established much more quickly, and too much time has been wasted because of creditors. One may also hope that – once the backlog of cases is gone – debt arbitration will not be needed frequently enough to justify a permanent institution. The very existence of an international Chapter 9 will be a disincentive to the sort of lax lending that happened during the 1970s when lenders assumed that countries would always repay. Finally, *ad hoc* panels are custom made for each case.

The Slow Progress of the Debate

Rich countries' governments, not private interests, have proved to be the main obstacle to applying insolvency procedures to poor countries' debt problems. Ever since it was brought up the idea of insolvency has been fiercely opposed by public creditors, who are not under market discipline. Bankers have been much less inimical. In fact, a banker, D. Suratgar, had proposed the idea early on. Another banker, the late Alfred Herrhausen, was among the most vocal advocates of negotiated debt reduction. A publication by the German Commerzbank, «Emerging Markets this Week»,³⁰ sees «sovereign insolvency procedures» as an option «in cases of extreme borrower distress» to which private creditors would not object. This difference between public and private creditors is explicable. Bankers are used to calculating costs and benefits in strictly economic terms. At one point, the costs of (re)negotiations – which com-

mercial banks, unlike the public sector, have to pay and earn themselves under market conditions – start to exceed expected payments. Insolvency is a professional and economic solution known from everyday business.

In 1990 the Working Group Swissaid/Fastenopfer/Brot für alle/Helvetas/Caritas submitted the idea of international insolvency to the Swiss Bundesrat, supported by two papers by Prof. K.W. Meessen (Augsburg/Geneva) and myself. The Swiss Parliament took it up. Switzerland tried discreetly to discuss the proposal internationally, but stopped when no other government signaled any interest. When the proposal was again addressed in Parliament³¹ in 2000, the Swiss government had changed its view.

The lack of reactions to the Swiss initiative might partly be explained by official euphoria about new capital flows to Latin America. The World Bank declared the debt crisis over. The 1990s were touted as years of hope and recovery³² until the Mexican crash.

After 1994 Alan Greenspan, Chairman of the Federal Reserve System, suggested thinking about international insolvency. The Financial Times reported that Treasury Secretary R. Rubin said he carefully avoided the term «international bankruptcy court» but that some procedures to work out debt obligations were needed. In the Wall Street Journal of 10 April 1995 Jim Leach, the Chairman of the U.S. Congress' House Banking and Financial Services Committee, wrote: «What is needed today is a Chapter 11 process for the global financial system, a technique to keep nation-states and their people from the impoverishing implications of insolvency.» Mentioning Chapter 9 briefly, he specifically emphasised its implicit understanding that local government must continue to function. Informally raising the issue at the Halifax G7 summit it was even considered but finally not done. New euphoria on capital flows to East Asia eclipsed the Mexican shock.

30. no. 26/1999 (October 15).

31. Motion of 22 March 2000; see fn. 11 above.

32. For quotes v. Kunibert Raffer, «Is the Debt Crisis Largely Over? – A Critical Look at the Data of International Financial Institutions», in: Richard Auty & John Toye (eds.), *Challenging the Orthodoxies*, London & Basingstoke: Macmillan 1996, pp. 23 ff.

At the end of the 1990s international arbitration based on U.S. Chapter 9 has gained some currency again. Many years of failed attempts by creditors to find a solution may be one explaining factor. But the main reason is the strong lobbying by civil society campaigns for meaningful debt relief. Jubilee 2000 UK, the first Jubilee campaign taking up the issue, demanded the cancellation of unpayable debts. To determine the unpayable part international arbitration based on Chapter 9 was demanded. The word insolvency – even more radical then – was not used by the official platform. The German and Austrian Erlassjahr campaigns followed suit, expressly demanding international Chapter 9 insolvency for states. So did the Tegucigalpa Declaration, or the German Commission *Justitia et Pax*, which published a paper just before and for the Cologne Summit.³³ Internationally, however, particularly in the South, the term arbitration is usually preferred. Presently a global NGO working group on FTAP (Free and Transparent Arbitration Process) is pursuing the issue.

UNCTAD³⁴ renewed its proposal of an international Chapter 11 insolvency, initially made in 1986. It also referred to international Chapter 9 and its arbitration mechanism.³⁵ In the Chapter on Sub-Saharan Africa UNCTAD demands to apply the key principles. This would dictate an immediate write-off of all unpayable debt determined on the basis of an independent assessment of debt sustainability.³⁶ UNCTAD doubts whether an international bankruptcy court applying international insolvency rules laid down in the form of an international treaty ratified by all members of the UN can be expected to be established easily. This doubt is wholly shared by most proponents of Chapter 9 insolvency. Therefore they propose ad hoc panels, not a court acting on the basis of virtually universal ratification. This is, for example, the official position of Erlassjahr 2000 Germany, repeatedly stated by their spokesperson Jürgen Kaiser.

After the Asian crash corporate insolvency is seen as essential to avoid future crises. The Reports on the International Financial Architecture recommend it strongly, but avoid insolvency with regard to sovereign debtors. The Working Group on International Financial Crises demanded that the international community provide »in exceptional and extreme circumstances ... a sovereign debtor with legal ›breathing space‹ so as to facilitate

an orderly, co-operative and negotiated restructuring«.³⁷ Emulating insolvency features, such as debt reduction by qualified creditor majority or »Collective Action Clauses« for sovereign bond contracts, was recommended as a critical contribution to »creating the institutional structure needed to encourage orderly workouts«,³⁸ because a »binding insolvency regime for sovereign debtors is unlikely«.³⁹ The Report admits that »a purely voluntary approach« might not work because »the government may not have the bargaining power to obtain sustainable terms«.⁴⁰ It remains to be asked why it shied away from the obvious conclusion – the need of an independent entity empowered to decide.

The OECD⁴¹ has come around to accepting insolvency: »Moreover, an international lender of last resort and an international bankruptcy court could help to prevent financial panics altogether.«

Although the IMF is still a bulwark against insolvency, Michael Camdessus suggested »some sort of Super Chapter 11 for countries« in the *Financial Times* of 17 September 1998. One has to ask why he demanded the legally unviable variant of a Chapter 11, not Chapter 9. Chapter 11 – made for firms – does not have the transparency of Chapter 9. It is comfortably closer to the IMF's tradition of behind-closed-doors decisions. No evidence is known that he tried to put his obvious conclusion into practice.

The Chapter 9 proposal has been widely discussed in Germany. Due to Erlassjahr 2000 it has received attention by the Bundestag and the administration. On 22 April 1999 the German Parliament requested the government to examine it.

33. *Justitia et Pax*, »Neue Wege zur Lösung der internationalen Schuldenfrage«, Stellungnahme der Deutschen Kommission *Justitia et Pax* zur Internationalen Schuldenfrage, Bonn, 27 May 1999 (mimeo).

34. UNCTAD, *Trade and Development Report 1998*, Geneva 1998, pp. 89 ff.

35. *ibid.*, p. 91.

36. *ibid.*, p. 130.

37. OECD (ed) Reports on the International Financial Architecture Report of the Working Group on International Financial Crises, http://www.oecd.org/subject/fin_architecture 1998, p. 37.

38. *ibid.*, p. 21.

39. *ibid.*, p. 19.

40. *ibid.*, p. 30.

41. *OECD Economic Outlook*, no. 65, June 1999, p. 191.

The Advisory Council of the Federal Ministry of Economic Cooperation and Development (BMZ) commissioned the report mentioned above. A question by the CDU/CSU parliamentary group in March 2000 requested information about what the Federal Government had done to fulfil the Parliament's request, whether it considered initiating such a mechanism, if so on what basis and what concrete steps had been taken. The Bundestag's Finance Committee held a public Hearing on the evolution of international financial markets, debts and international insolvency on 14 March 2001.

Italy's Parliament passed a law on debt relief. Its article 7 requests the Government to try to obtain a ruling from the International Court of Justice on the consistency between present debt management and the general framework of legal principles and human and people's rights.⁴²

In the UK the Treasury Committee of the House of Commons⁴³ published the proposal of international Chapter 9 insolvency with symmetrical treatment of international financial institutions as a measure to bring financial accountability to the IMF in an appendix of the document reproducing their hearings. In 2000 the International Development Committee of the House of Commons published its 9th Report on The Effectiveness of EC Development Assistance.⁴⁴ Although the topic is not debt issues specifically a submission of mine was published as Appendix 10, suggesting an international Chapter 9 as the necessary precondition for any meaningful development cooperation in overindebted ACP countries.⁴⁵

Urging that »debt cancellation should become part of the dialogue within the ACP-EU Partnership and that the EU should encourage other donors also to take measures to relieve or cancel debt«⁴⁶ the ACP-EU Joint Parliamentary Assembly demanded fair and transparent arbitration process (FTAP) in 2000. It called for an International Debt Arbitration Panel to restructure or cancel debts where debt service has reached such a level as to prevent the country providing necessary basic social services.⁴⁷

After the default of Ecuador's Brady-bonds civil society – possibly best represented by the demands contained in the paper by the Confederation of Ecuador's Indigenous Nationalities (CONAIE) – demanded a debt-for-development swap

of all present debts, as well as international arbitration to solve problems of future overindebtedness. It was demanded that debt service be replaced by payments into a »Fondo Social Ecológico« to finance social, cultural and ecological programmes (including education).⁴⁸ CONAIE refers specifically to U.S. municipalities. It also refers to Ecuador's experience with counterpart funds created in connection with debt reductions by Belgium, Switzerland and with partial debt reductions by Germany. Especially the Swiss case, the »Fondo de Contravalor Ecuatoriano Suizo« is presented as highly successful. Finally, the paper refers to Germany's London Accord of 1953 (which offered generous terms to a debtor whose situation was perceptibly better than Ecuador's, the basically similar Indonesian case in 1969–70, and the more recent cases of Poland and Egypt to show that demands for meaningful debt reduction are technically possible.

AFRODAD, a platform of African NGOs, has taken up the demand for international arbitration, stressing the same concerns as CONAIE. Speaking of »institutional imbalances« AFRODAD becomes undiplomatically explicit: »As is said in West Africa: In a Jury of Foxes (the Creditors), the Chickens (the Debtors) are always the guilty!«⁴⁹ AFRODAD explicitly addresses the responsibilities of creditor countries and the effects of exogenous factors that might be influenced by creditors, such

42. Legge 25 Luglio 2000, no.209: »Misure per la riduzione del debito estero dei Paesi a più basso reddito e maggiormente indebitati, in: *Gazzetta Ufficiale* n.175 del 28 luglio 2000.

43. *Fourth Report: International Monetary Fund*, London: Stationery Office 1997, Appendix 12, Submission by K. Raffer, pp. 159 ff.

44. International Development Committee of the House of Commons, »The Effectiveness of EC Development Assistance«, 9th Report, London: Stationery Office 2000.

45. *ibid.*, pp. 79 ff.

46. ACP-EU Joint Parliamentary Assembly, »Resolution on ACP-EU partnership and the challenges of globalisation« (ACP-EU 2976/A/00/fin), para 24.

47. *ibid.*, para 26.

48. CONAIE, »Propuesta de solución a la deuda externa – La Confederación de nacionalidades indígenas del Ecuador (CONAIE) a los gobiernos que conforman el Club de París«, Quito, 10 de septiembre de 2000 (mimeo).

49. AFRODAD, »International Arbitration Court on Foreign Debt« (AFRODAD.IAC.I, 2000) (mimeo).

as denied market access, trade imbalances or declining terms of trade. An arbitration court is demanded which should expressly deal with both the issues of debt and of retrieval of money stolen by leaders and put into foreign banks. Compared with an international insolvency in the strict sense, AFRODAD's variant is more ambitious and addresses problems at the root of the debt crisis in a more direct and comprehensive way. Of course, problems such as Northern protectionism cannot be ignored within an international Chapter 9. The question of market access, for instance, is inseparably linked to the percentage of debt reduction needed for a debtor to reach economic viability.

In the U.S., the »Global Sustainable Development Resolution« drafted in 1999 by Congressman Bernie Sanders called for an international insolvency mechanism based on U.S. Chapter 9. More recently, the then Secretary of the Treasury, Larry Summers, said in an interview: »Even the toughest private lenders write off their bad debts. That's what governments – and private lenders – need to do with bad loans they have made.«⁵⁰

In his Millenium Report Kofi Annan demanded a »debt arbitration process to balance the interests of creditors and sovereign debtors and introduce greater discipline into their relations«.⁵¹ Meanwhile – one may assume: under strong pressure – he totally took back his courageous demand, speaking of mediation not arbitration.⁵² He retreated even one step further, demanding an »independent« mediator, assisted by the IMF and other experts. This would not change creditor domination, but it might produce the wrong impression that something had changed.

Chapter 9 international insolvency was presented and discussed at the Civil Society Hearings of »Financing for Development« in New York in November 2000.⁵³ The High-Level Regional Consultative Meeting on Financing for Development, Asia and Pacific Region (Jakarta, 2–5 August 2000) called for an international bankruptcy procedure as an area for regional co-operation.⁵⁴ It demanded that it must be »ensured that private debt does not become government debt«. As long as governments are denied insolvency relief the option of socializing private losses – as happened in Asia – will remain unduly attractive.

In the academic debate, Rogoff presents an international Chapter 9 as a means to stabilize the

international financial system. He states that with enhanced global and regional political institutions »ideas like a global bankruptcy court or an international system of financial regulation may not seem so far fetched«.⁵⁵

Listing »Raffer's International Bankruptcy Court« in his »Architecture Scorecard« Eichen-green mentions quite a few arguments in favor of insolvency, but he eventually comes down on the side of new clauses (e. g. majority voting clauses) in bond contracts as the »only practical way«, as »infinitely more realistic than ... some kind of supranational bankruptcy court empowered to cram down settlement terms«.⁵⁶ These clauses make sense, and he is right that there is not yet any political will of official creditors to allow insolvency. He is wrong, though, in thinking of a supranational institution, ad hoc arbitration panels to be dissolved when no longer needed would do.

The progress towards a reasonable solution to the problem of excessive sovereign indebtedness is slow. The main obstacle is the unwillingness of official creditors to relinquish their dictatorial power over debtors in favor of an economically efficient solution that safeguards human rights and respects the Rule of Law. It appears that logic and facts cut little ice. A great deal of political lobbying is necessary, but one must not give up hope that a child's life expectancy will eventually depend a bit less on whether (s)he is born in a heavily indebted municipality within an OECD-country or in a heavily indebted country in the South. ◀

50. *Time*, 24 July 2000, p. 45.

51. Kofi Annan, »Freedom from Want«, Chapter in: *We, the People, The Role of the United Nations in the 21st Century*, New York 2000, p. 38.

52. Kofi Annan, »Report of the Secretary-General to the Preparatory Committee for the High-Level International Intergovernmental Event on Financing for Development«, Final Draft: 8 December 2000, pp. 63 f.

53. <http://www.un.org/esa/ffd/NGO/1100hear/Panel3Statements.htm#raffer>

54. http://www.unescap.org/drpad/fin_dev/report-sesi.htm

55. Rogoff 1999, p. 40.

56. Eichengreen 1999, p. 67.