
XXXII

POLISH YEARBOOK
OF INTERNATIONAL LAW

2012

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CONTENTS

ARTICLES

Wojciech Sadurski

Democratic Legitimacy of the European Union: A Diagnosis and Some Modest Proposals9

Roman Kwiecień

Does the State Still Matter? Sovereignty, Legitimacy and International Law45

Anna Wyrozumska

Execution on an Embassy Bank Account75

Malgorzata Fitzmaurice

Some Reflections on Legal and Philosophical Foundations of International Environmental Law89

Susana Camargo Vieira

Governance, Good Governance, Earth System Governance... and International Law111

Alice de Jonge

What Are the Principles of International Law Applicable to the Resolution of Sovereign Debt Crises?129

Mia Swart

The Lubanga Reparations Decision: A Missed Opportunity?169

Adam Bodnar, Irmina Pacho

Targeted Killings (Drone Strikes) and the European Convention on Human Rights.....189

Aleksandra Dłubak

Problems Surrounding Arrest Warrants Issued by the International Criminal Court: A Decade of Judicial Practice209

Maurizio Arcari	
Limits to Security Council Powers under the UN Charter and Issues of Charter Interpretation.....	239
Natividad Fernández Sola	
The European Union as a Regional Organization within the Meaning of the UN Charter.....	259
Dagmar Richter	
Judicial Review of Security Council Decisions – A Modern Vision of the Administration of Justice?.....	271
Pavel Šturma	
Does the Rule of Law also Apply to the Security Council? Limiting Its Powers by Way of Responsibility and Accountability.....	299
Andreas Zimmermann	
The Security Council and the Obligation to Prevent Genocide and War Crimes	307
POLISH PRACTICE IN INTERNATIONAL LAW	315
Oktawian Kuc	
<i>Krstić Case</i> Continued	315
Amicus curiae briefs in <i>Janowiec and Others v. Russia</i>	325
BOOK REVIEWS	401
POLISH BIBLIOGRAPHY OF INTERNATIONAL AND EUROPEAN LAW 2012	427

*Alice de Jonge**

WHAT ARE THE PRINCIPLES OF INTERNATIONAL LAW APPLICABLE TO THE RESOLUTION OF SOVEREIGN DEBT CRISES?

Abstract

This article explores the accepted and emerging international law principles applicable to the resolution of sovereign debt crises. The need for agreement on a set of guiding principles and mechanisms for resolving such crises is highlighted. The history of debt moratoriums, exchange controls and bailouts as instruments for dealing with sovereign debt crises is first outlined. The article then turns to an examination of alternatives to these policy options. Both market based and statutory approaches to sovereign debt restructuring are examined. The article ends with recommendations on a set of guiding principles for choosing between the various policy options available when a sovereign debt crisis is threatened.

INTRODUCTION

Sovereign insolvency has early precedents.¹ Philip II of Spain had to declare moratoriums on the repayment of Spanish debt in 1557, 1560, 1575 and 1596 – largely due to the rising costs of various military enterprises.² Many other sovereigns have defaulted on payment of international debts since that time. On each occasion, almost

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¹ It can be argued that technically speaking, a sovereign cannot be declared bankrupt or insolvent. There are no insolvency laws which apply to a (state) sovereign. However, the International Law Association called its study group on the problems of sovereign financial distress the “Sovereign Insolvency Study Group” and the term “sovereign insolvency” is used here to refer to the situation where a sovereign is in a distressed or insolvent financial condition, as opposed to one of a legal nature.

² For discussion and detail see M. Drelichman & H.-J. Voth, *Lending to the Borrower from Hell: Debt and Default in the Age of Philip II*, ebook, available at <http://econ.as.nyu.edu/docs/IO/12549/Voth20paper.pdf> (last accessed 12 February 2013). See also M. Drelichman and H.-J. Voth, *The sustainable debts of Philip II: A reconstruction of Spain's fiscal position, 1560-1598*, http://www.crei.cat/people/voth/voth_sustainabledebts.pdf (last accessed 12 February 2013).

without fail, extensive debate over the legal and economic aspects of sovereign debt crises have followed, just as they have followed recent financial crises in Iceland and Greece. Given the likelihood that such crises, and such debates, will continue to occur in the future, there is an evident need for agreement to be reached on a coherent set of guiding principles and procedures to facilitate the resolution of such crises.

In its 2010 report to the International Law Association's Hague Conference, the ILA Sovereign Insolvency Study Group identified four broad policy pathways forward when it comes to handling sovereign debt crises:

- First, there is the option of doing nothing, so that sovereign debt defaults or financial difficulties continue to be dealt with exclusively by voluntary negotiation and agreement between creditors and debtor state; as has happened for the last one thousand years at least.
- Second, a minimal layer of legal rules to govern the conduct of the insolvency could be created in the form of a limited provision for creditor voting on a debt restructuring plan.
- Third, a more comprehensive layer of legal rules could be put into place which would reflect relevant aspects of private sector insolvency reorganisation regimes. The rules would not have any mandatory application and in many cases would not be used, just as occurs in the corporate arena when financial difficulties are dealt with by way of private agreement ("workouts"). The sovereign insolvency reorganisation regime would provide a background against which debtor-creditor negotiations would take place.
- Fourth, a different style of insolvency regime could be designed which would emphasise stronger creditor rights and in which debtor protections would not be the kind of feature they are in domestic insolvency regimes. Again, the legal regime would most be there as a background against which negotiations take place.³

The aim of this article is to explore the (international law) principles which should be taken into account when choosing amongst these policy options, and in reaching agreement on a global mechanism for resolving sovereign debt crises. The principles explored are those of general international law. In asking what international law has to say about the way in which sovereign debt crises should be handled I turn to the various sources of international law as recognised in article 38 of the Statute of the International Court of Justice.⁴

Part 1 of this article examines existing treaties and other international instruments in order to establish whether or not they are based on a common set of principles relevant to the handling of sovereign debt crises. Part 2 then turns to examine international custom (state practice and *opinio juris*) related to sovereign debt crises. Such an examination

³ Sovereign Insolvency Study Group (Ph. Wood Q.C., Chair), *State insolvency: options for the way forward*, International Law Association, The Hague Conference (2010), pp. 5-6.

⁴ Statute of the International Court of Justice, available at <http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0>.

provides an insight into the history of the way in which such crises have been handled – an insight which is particularly important given the scarcity of internationally accepted codifications governing this area of international relations. It also allows for a more in-depth discussion of the published scholarship on the topic of how sovereign debt crises should be dealt with.

1. TREATY-BASED RULES AND PRINCIPLES RELEVANT TO THE RESOLUTION OF SOVEREIGN DEBT CRISES.

In this part I argue that with globalization and increasing interdependence among countries, the need for multilateral “rules of the game” in various dimensions of economic relations has become an increasing preoccupation of international treaties and other instruments. An examination of these instruments allows me to isolate the following principles as universally agreed upon grounds upon which a future regime for managing sovereign debt crises might be built:

1. respect for the sovereign equality of all nations and good faith cooperation in the resolution of such crises;
2. recognition that all states share responsibility for ensuring sovereign debt crises are resolved in a manner which best protects the human rights of all those affected;
3. recognition that such shared responsibility may impose common but differentiated obligations on states depending upon the particular circumstance of each sovereign debt crisis.

The United Nations (UN) Charter provides a good starting point. In particular, the Charter imposes an obligation on all members to cooperate in good faith in finding solutions to economic and related problems. Art. 55 provides:

With a view to the creation of conditions of stability and well-being which are necessary for the peaceful and friendly relations among nations based on respect for the principle of equal rights and self-determination of peoples, the United Nations shall promote:

(...)

higher standards of living, full employment, and conditions of economic and social progress and development;

solutions of international economic, social, health and related problems.

Issues of economic sovereignty rose to prominence during General Assembly (GA) debates of the New Economic Order in the mid 1970s. In 1974 the GA voted on the exercise of sovereignty over economic activities in the *Charter of Economic Rights and Duties of States* (the ERD Charter).⁵ The ERD Charter was passed by 120 votes in

⁵ General Assembly Resolution 3281 (XXIX) A/RES/29/3281 (12 December 1974) 29th Sess., Agenda item 48.

favour, 6 against (Belgium, Denmark, GDR, Luxembourg, the UK and the USA) and 10 abstentions. The ERD Charter asserts that:

Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without any outside interference, coercion or threat in any form whatsoever.⁶
Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.⁷

The ERD Charter further elaborates on the sovereign equality of states in the management of financial and other resources and in the resolving of financial and monetary problems (most notably in Art. 2, 8, 10, 17 and 32).

Art. 11 of the ERD Charter refers to the duty of all States to cooperate in adapting international organisations to the changing needs of international economic co-operation. Art. 34 then seeks to ensure that the ERD Charter is included on the GA agenda at every 5th session for discussion, an undertaking which was honoured at every 5th session for the next 30 years.⁸ In June 2004, the Secretary General recommended, in a Report to the Economic and Social Council, that the GA and the Security Council should consider discontinuance of the quinquennial review of the ERC Charter's implementation.⁹ The recommendation was made on the basis that consideration of the ERD Charter could be deemed implicit in the overall framework of implementing the outcomes of major UN conferences and summits.¹⁰ In particular, it was suggested that the biennial high-level dialogue established to monitor the implementation of the Monterrey Consensus of the International Conference on Financing for Development was more than adequate as a mechanism for dealing with issues raised within and by the ERD Charter. Since that date, references to the Charter have disappeared from GA agendas.¹¹

The legal status of the ERD Charter is highly disputed, with at least some parts of it considered by many to have been essentially discredited as forming part of international customary law.¹² Art. 2 of the ERD Charter has been a particularly notable target

⁶ *Ibidem*, Art. 1.

⁷ *Ibidem*, Art. 2(1).

⁸ See e.g. A/RES/39/163, 17 December 1984, Meeting No 103, Charter of Economic Rights and Duties of States.

⁹ Implementation of the Charter of Economic Rights and Duties of States: Report of the Secretary-General, UN Doc A/59/99 – E/2004/83, General Assembly Economic and Social Council, GA 59th Sess., Item 12 of the preliminary list A/59/50 and Corr. 1 and 2 (18 June 2004).

¹⁰ *Ibidem*, para. 3.

¹¹ Based on a website search conducted in November 2012. *But see* Towards a New International Economic Order, GA Res A/Res/64/209 (on the report of the Second Committee (A/64/422/Add.1), 64th Sess., item 55(a) (12 March 2010), indicating that the concerns of the ERD Charter still come before the GA on a regular basis. See also Unilateral economic measures as a means of political and economic coercion against developing countries, GA Res A/Res/64/189 (on the report of the Second Committee (A/64/418/Add. 1), 64 Sess. (9 February 2010).

¹² See e.g. C.N. Brower & J.B. Tepe Jr, *The Charter of Economic Rights and Duties of States: A Reflection or Rejection of International Law?* 9(2) International Lawyer 295 (1975).

of attack.¹³ It purports to recognise a sovereign right of states to expropriate foreign property, subject only to the payment of compensation in accordance with the laws of the expropriating state. In *Texaco Overseas Petroleum Co and California Asiatic Oil Co v Libya*,¹⁴ the tribunal found that, at least on the issue of compensation standards, the 1962 *Declaration on Permanent Sovereignty over Natural Resources* (Resolution 1803 (XVII))¹⁵ was to be preferred as a source of customary international law. Resolution 1803 (XVII) had received consensus not just from a majority of states, but from a majority of states belonging to relevant representative groups, including both capital exporting and capital importing nations. In the view of the tribunal, this was enough to indicate “without the slightest doubt universal recognition of the rules therein incorporated.”¹⁶ In accordance with these rules, the tribunal applied an international standard, rather than a national standard, for the payment of compensation in cases of expropriation, and held that the appropriate remedy was *restitutio in integrum*.¹⁷

As the tribunal noted in the *Texaco* arbitration, when the Group of 77 first submitted its draft ERD Charter to the GA, the GA was invited to adopt the ERD Charter as “a first measure of codification and progressive development” within the field of international law of development. However, because of the opposition of several states, this description was deleted from the text submitted to the vote of the assembly, thereby further detracting from its potential value as a source of customary international law.¹⁸

Yet the ERD Charter also contains principles that do command a wide degree of adherence. As the Economic and Social Council noted in 2004, the Charter was initiated with a view to improving the functioning of the global economic system and, to this end, seeks to codify a number of principles, rules and norms, relating to international economic relations.¹⁹ Two principles are particularly important in this context – first, the principle of respect for the sovereign equality of all nations, including substantive equality in treaty relations. Second, the 1974 *Declaration on the Establishment of a New International Economic Order*, expressly calls upon the world community to recognise the need for “[p]referential and non-reciprocal treatment for developing countries, wherever feasible, in all fields of international economic co-operation whenever possible.”²⁰ The 1974 Declaration also recognises the idea that obligations can be “common but differentiated” when it calls for “[t]he strengthening, through individual

¹³ See e.g. B.H. Weston, *The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth* 75(3) *American Journal of International Law* 437 (1981).

¹⁴ 17 ILM 1 (1978).

¹⁵ GA Res 1803 (XVII), 17th Sess., (14 December 1962), adopted 87 votes to 2, with 12 abstentions.

¹⁶ 20 ILM 1 (1981), p. 87. Also published at 53 ILR 389 *et seq.*

¹⁷ *Ibidem*.

¹⁸ 20 ILM 1 (1981), p. 88.

¹⁹ GA Economic and Social Council, A/59/99-E/2004/83 (18 June 2004), *supra* note 9, para. 2.

²⁰ Declaration on the Establishment of a New International Economic Order, Sixth Special session, GA Doc A/RES/S-6/3201 (1 May 1974), para. 4(n).

and collective actions, of mutual economic, trade financial and technical cooperation among the developing countries, mainly on a preferential basis.”²¹

The principle of common but differentiated obligations is, perhaps, most well known in the area of international environmental law.²² The idea that developed and developing countries have different roles to play in the amelioration of environmental problems was formalized in principle 7 of the 1992 Rio Declaration on Environment and Development.²³ Principle 7 recognises that “[i]n view of the different contributions to global environmental degradation, States have common but differentiated responsibilities.”²⁴ It then continues: “[t]he developed countries acknowledge the responsibility that they bear in the international pursuit of sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command.”²⁵

The principle of common but differentiated responsibilities was also incorporated into the UN Framework Convention on Climate Change.²⁶ Its relevance to sovereign debt crises lies in the answer it provides to those who insist that debts must be paid, regardless of the hardships thereby imposed on the debtor state and its citizens. The principle of common but differentiated responsibilities says that all parties involved, both creditors and debtor, have responsibilities in ensuring that the crisis is resolved in a manner that is best able to protect human rights and preserve a decent standard of living amongst those affected by the crisis.

Nor can it be argued that the principle of common but differentiated responsibilities, while relevant to international efforts aimed at combating climate change, is not relevant to purely economic relations or to arms length economic transactions. For the principle

²¹ *Ibidem*, para. 4(s). The NIEO sought to put into place projects such as the 1976 Integrated Programme for Commodities and its companion Common Fund for Commodities established in 1980 (see G. Corea, *Taming Commodity Markets – The Integrated Programme and the Common Fund*, UNCTAD (1992)); and the Industrial Development Cooperation Agreement adopted by the UN Industrial Development Organization in 1980: see Third General Conference of the United Nations Industrial Development Organization, Thirty-fifth session, Industrial development co-operation, GA Doc A/RES/35/66/.

²² Ph. Sands, *Principles of International Environmental Law* (2nd ed.), Cambridge University Press, New York: 2003, p. 231. See also T. Stephens, *Multiple International Courts and the ‘Fragmentation’ of International Environmental Law*, 25 Australian Yearbook of International Law 227 (2007), pp. 236–42.

²³ United Nations Declaration on Environment and Development (13 June 1992) 31 ILM 874, reproduced in P.W. Birnie & A. Boyle (eds.), *Basic Documents on International Law and the Environment*, Oxford University Press, Clarendon: 1995, pp. 9–14.

²⁴ *Ibidem*.

²⁵ *Ibidem*.

²⁶ United Nations Framework Convention on Climate Change (9 May 1992) 1771 UNTS 165. This treaty, which seeks the “stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system” (Art. 2). Art. 3(1) provides that the Parties will protect the climate system “on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities. Accordingly, the developed country Parties should take the lead in combating climate change and the adverse effects thereof.”

is one which is increasingly found in the economic area, most notably in international trade conventions. Examples include:

- Modification of Article XVIII of the General Agreement on Tariffs and Trade (the GATT)²⁷ in 1954-55 to include Article XVIII-B which allowed developing countries to use quantitative restrictions for balance of payments purposes.
- Establishment of the United Nations Conference on Trade and Development (UNCTAD) in Geneva, 1964,²⁸ and the creation of the Committee on Trade and Development in the GATT.
- Addition of Part IV of Trade and Development in GATT in 1965. Part IV expressly recognises both the link between trade and development and (in Article XXIV) the fact that “there is a wide gap between standards of living in less-developed countries.” Article XXIV then goes on to provide, *inter-alia*, that:

Given the continued dependence of many less-developed contracting parties on the exportation of a limited range of primary products, there is need to provide in the largest possible measure more favourable and accepted conditions of access to world markets for these products (...)

The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.

- Adoption of the Enabling Clause in 1979 at the end of the Tokyo Round, signifying political recognition by developed countries that special and differential treatment is an essential part of attracting and retaining developing countries within the system.²⁹
- The Agreement on the Global System of Trade Preferences among Developing Countries, which expressly recognises the principle that least developed countries are not required to make concessions on a reciprocal basis.³⁰
- Similarly, the WTO’s Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPs Agreement) refers, in Art. 66, to “the special needs and requirements of least-developed country Members, their economic, financial and administrative constraints, and their need for flexibility to create a viable technological base”, and allows such Member countries additional time to implement

²⁷ Article XVIII of GATT expressly recognises that it may be necessary for states “in the early stages of development” to take protective or other measures affecting imports “in order to implement programmes and policies of economic development.”

²⁸ See further <http://www.unctad.org/>.

²⁹ Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries. Decision of 28 November 1979 (L/4903), available at the WTO official website http://www.wto.org/english/docs_e/legal_e/tokyo_enabling_e.pdf.

³⁰ Art. 3.f of the Agreement on the Global System of Trade Preferences among Developing Countries, Belgrade, opened for signature 13 April 1988, reprinted in 27 International Legal Materials (1988), p. 1204 (entered into force in 1989, now with 44 ratifications): see History of UNCTAD at <http://www.unctad.org/>.

the provisions of the TRIPs Agreement.³¹ The needs of least developing and least developed WTO Members are also recognised in Art. 67, which provides for developed countries to provide various forms of technical assistance to their less fortunate counterparts.³²

As regards the particular problem of sovereign debt, the inception of the Heavily Indebted Poor Countries (HIPC) Initiative in 1996 and the ensuing reforms in the policy and practice of official development financing, about which more shall be said below, marked a turning point in international economic relations.³³ The HIPC Initiative and its siblings, the Enhanced HIPC Initiative and the Multilateral Debt Relief Initiative (MDRI) led to unprecedented cancellations of debt stock for low-income countries and provoked widespread public interest in the issues of debt and development. The HIPC and MDRI initiatives both demonstrate how and why the principle of common but differentiated obligations is relevant to sovereign debt situations.

The HIPC Initiatives and the MDRI both recognise that the World's two major sovereign credit suppliers, the World Bank and the International Monetary Fund (IMF), have certain obligations built into their Articles of Agreement to support member nations burdened by debt. The Articles of Agreement of the World Bank and the IMF also provide guidance as to how creditor nations might approach their relationship with debtor nations facing fiscal crises – that is, with flexibility and respect for the sovereign right of debtor nations to control the making and implementation of their own economic policies within the boundaries of international law. Article IV, Section 4 of the Bank's Articles of Agreement provides that a member state suffering “from acute exchange stringency” may apply to the Bank for a relaxation of the conditions of payment. If the Bank is satisfied that such relaxation is justified, it may, *inter alia*, “... make arrangements with the member concerned to accept service payments on the loan in the member's currency for periods not to exceed three years upon appropriate terms.”³⁴

In a situation where a member state defaults on one or more loans made, participated in, or guaranteed by the Bank, Art. IV Section 7 provides that the Bank “shall make such arrangements as may be feasible to adjust the obligations under the loans, including

³¹ GATT Secretariat, *The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts*, Geneva: 1994, Annex IC, pp. 365-403.

³² *Ibidem*. The 1994 International Tropical Timber Agreement provides another example of differential treatment, but one where states are not differentiated according to their level of economic development. Instead, votes for producer countries are allocated partly according to their respective shares of the world's total tropical forest resources: International Tropical Timber Agreement, Geneva, 26 January 1994, reprinted in 33 ILM 1014 (1994).

³³ For details see IMF Factsheet, *Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative* (September 2011), available at <http://www.imf.org/external/np/ext/facts/hipc.htm>; *The Enhanced HIPC Initiative – Overview*, The World Bank, available at <http://web.worldbank.org>; and IMF Factsheet, *The Multilateral Debt Relief Initiative* (September 2011), available at <http://www.imf.org/external/np/ext/facts/mdri.htm>. For discussion see C. Tan, *Life, debt and human rights: Contextualising the international regime for sovereign debt relief*, University of Warwick School of Law, Legal Studies Research Paper No. 2011-09.

³⁴ IBRD Articles of Agreement, Article IV, Section 4(c)(i) (as amended at 16 February 1989).

arrangements under or analogous to those provided in Section 4(c) of this Article.” Section 4(c) of Art. IV specifically provides that:

If a member suffers from an acute stringency, so that the service of any loan contracted by the member or guaranteed by it or one of its agencies cannot be provided in the stipulated manner, the member concerned may apply to the Bank for a relaxation of the conditions of payment. If the Bank is satisfied that some relaxation is in the interests of the particular member and of the operations of the Bank and of its members as a whole, it may take action under either, or both, of the following paragraphs with respect to the whole, or part, of the annual service:

(i) The Bank may, in its discretion, make arrangements with the member concerned to accept service payments on the loan in the member’s currency for periods not to exceed three years upon appropriate terms regarding the use of such currency and the maintenance of its foreign exchange value; and for the purchase of such currency on appropriate terms.

(ii) The Bank may modify the terms of amortization or extend the life of the loan, or both.

The IMF Articles of Agreement is one of the most widely subscribed international conventions existing today.³⁵ Art. XV.2 of the GATT expressly recognises that it is the IMF which is the primary international organisation responsible for investigating, providing advice and making determinations regarding the resolution of problems concerning monetary reserves, balances of payments or foreign exchange arrangements.³⁶ IMF instruments and practices thus provide an important source of guidance on the problem of sovereign state indebtedness. In particular, IMF deliberations on the problem of sovereign debt crises have consistently emphasised the need to achieve “cooperative solutions negotiated between the debtor country and its creditors, building on effective dialogues established in advance.”³⁷ Meeting this need certainly appears to be a major aim of the SDRM proposal which emerged from the IMF in the earliest years of the 21st century.

The IMF Articles recognise that states have a sovereign right to implement their own economic policy measures, including fiscal, exchange and monetary measures, in order to deal with any crisis or other situation that may arise. For example, Art. VIII,

³⁵ Articles of Agreement of the International Monetary Fund (adopted 27 December 1945, entered into force 27 December 1945) UNTS 39. 187 members as at November 2011.

³⁶ Para. 2, “In all cases in which the Contracting Parties are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultation, the Contracting Parties shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Article of the [Fund] (...)”

³⁷ IMF, *Involving the Private Sector in the Resolution of Financial Crises – Restructuring International Sovereign Bonds*, prepared by the Policy Development and Review and Legal Departments, presented at the Executive Board Meeting 01/8, 24 January 2001, Part V Concluding Observations, p. 27.

Section 2 of the IMF's Articles of Agreement impliedly recognises, while imposing limits on, member states' ability to put into place measures which restrict payments and transfers for current transactions. Examples of measures which restrict payments for current transactions include where a government centralizes all foreign exchange transactions, and as a result the hard currency needed by local institutions to service their foreign currency debts falls into arrears. Exchange guarantee regulations, whereby the government promises to make exchange available in the future to debtors at preferential rates if local debtors forego the opportunity to satisfy foreign-exchange debt obligations sooner, have a similar effect.³⁸ In such cases, the exchange control regulations effectively impose a moratorium or stoppage on the payment of the international debt. Art. VIII, Section 2(a) of the IMF Articles provides, in relevant part, that "...no member shall, without the approval of the fund, impose restrictions on the making of payments and transfers for current international transactions."

It is therefore open for the IMF to approve the imposition of exchange controls by a heavily indebted nation so as to effectively defer the making of payments on foreign debt. Moreover, should such approval be given, creditors could not seek to enforce payments in violation of approved exchange control regulations. This is because article VIII Section 2(b) provides: "[e]xchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territory of any member ...".³⁹

In 1984, Debevoise argued in favour of the potential for Art. VIII(2)(b) to be used to stay creditor actions against debtor countries. He argued that IMF approval of exchange controls under Art. VIII(2)(a) should be enough to ensure that courts would refuse to enforce any payment contract in contravention of such controls.⁴⁰ Courts have had problems in reaching a consistent interpretation of the term "exchange contract"; some applying a "narrow" construction and other adopting a "broad" construction. As Debevoise notes, some courts have refused to rely on Art. VII(2)(b) to stay creditor actions against debtor countries typically because the court has refused to regard the term "exchange contract" as sufficiently broad to cover loan agreements. Other refusals have relied on a finding that "the defendant had not met its burden of demonstrating that the currency regulations relied upon were 'maintained or imposed

³⁸ M. Pearce, *Moratoriums on Foreign Sovereign Debts: A study of the public international law relating to moratoriums on foreign sovereign debts imposed unilaterally by the debtor state*, a sub-thesis submitted in partial fulfilment of the degree of Masters in International Law, Australian National University, December 1987, 2.4.

³⁹ See also Decision No. 1034-(60/27), adopted June 1, 1960. For discussion see H. Elizalde, *The International Monetary Fund and Current Account Convertibility*, paper presented at the IMF Seminar on Current Developments in Monetary and Financial Law (Washington DC, 24 May – 4 June, 2004).

⁴⁰ See further, W. Debevoise, *Exchange Controls and External Indebtedness: A Modest Proposal for a Deferral Mechanism Employing the Bretton Woods Concepts*, 7 *Houston Journal of International Law* (1984), pp. 157-68.

consistently with the Fund Agreement’.”⁴¹ Debevoise identifies a number of ways to overcome these legal obstacles. For example, IMF approval of exchange controls could be accompanied by a statement that the subject member’s exchange restrictions, including those on the making of payments and transfers for certain current international transactions, were maintained or imposed consistently with the Fund Agreement. Second, an official IMF interpretation of Art. VIII(2)(b) could be used to provide greater legal certainty for courts asked to enforce foreign payment contracts. The interpretation could clarify a broad interpretation of the term “exchange contract” in Art. VIII(2)(b) “to include any contract providing either for payment or transfer of foreign exchange, or for an international transfer or payment (that is, a payment between a resident and a non-resident, or a transfer of funds from one country to another).”⁴²

The other provision in the IMF’s Articles of Association relevant to sovereign nations experiencing financial instability is Art. VI. It provides that Members may not use the Fund’s general resources to meet a large or sustained outflow of capital (with one exception). Instead, the IMF may “request a member to exercise controls to prevent such use of the general resources of the Fund.” The members of the IMF have thus recognised that the imposition of capital controls is to be preferred as a means of preserving financial stability when there is a “large or sustained outflow of capital.” Art. VI (Section 3) expressly guarantees that “Members may exercise such controls as are necessary to regulate international capital movements” (subject to certain important limitations⁴³). Capital controls imposed with IMF imprimatur under Art. VI have the benefit that they seem not to be subject to the problems of domestic court interpretation suffered by Art. VIII capital controls. Art. VI (Section 2) further ensures that IMF members are entitled to make reserve tranche purchases to meet capital transfers where necessary. This is another possible avenue for alleviating sovereign financial distress that perhaps should be made more use of.

The ILC’s 2001 Draft Articles on Responsibility of States for internationally wrongful acts (the Draft Articles)⁴⁴ also provides a valuable framework of principles within which the rights and responsibilities of states struggling to deal with sovereign debt crises can and have been considered. In the Argentine Gas Sector cases of the middle-late

⁴¹ K. Rogoff & J. Zettelmeyer, *Bankruptcy Procedures for Sovereigns: A History of Ideas, 1976-2001*, 49(3) IMF Staff Papers 470 (2002), p. 479.

⁴² *Ibidem*, pp. 479-480, noting that in January 1988, the IMF Legal Department did in fact propose, in an internal report, “that consideration be given by the Executive Board to the adoption of an authoritative interpretation of Article VIII, Section 2(b)”, using the wording cited here.

⁴³ Section 3 goes on to provide that “no members may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2.”

⁴⁴ Adopted by the International Law Commission at its 56th Sess. (2001), available in *Report of the International Law Commission on the work of its Fifty-third session*, Official Records of the General Assembly, Fifth-sixth session, Supplement No. 10 (A/56/10) chp. IV.E.1.

2000's⁴⁵ for example, the ICSID tribunals considering those cases agreed that Art. 25 of the Draft Articles reflected the relevant rules on the defence of necessity in customary international law. The tribunals differed on how they dealt with Argentina's "necessity defence", however, and only the *LG&E v Argentina* tribunal accepted Argentina's argument that the country was in a state of necessity at least for a certain period for which reason it should be (at least partially) exempted from responsibility for any losses caused by its actions in response to an economic crisis.⁴⁶

Force Majeure was not argued in the Argentine *Gas Sector* cases, but if climate change or some other "irresistible force or (...) unforeseen event" should trigger a sovereign debt crises in future, then Art. 23 of the Draft Articles may well provide an important basis upon which the world community might craft its response to such a crisis. The scope of this article does not allow for a more detailed discussion of how debtor states have or might defend themselves against the claims of persistent creditors, but the potential for the principles of necessity and force majeure, as enshrined in the Draft Articles, to play an important role in any discussion of legal rights and liabilities needs to be highlighted. Other principles enshrined in the Draft Charter, such as those dealing with compensation, might equally prove important in such discussions.

2. INTERNATIONAL CUSTOM, AS EVIDENCE OF A GENERAL PRACTICE ACCEPTED AS LAW

Since the earliest days of Westphalian sovereignty,⁴⁷ nations have dealt with international debt crises in a variety of different ways. Indeed, responses to sovereign debt

⁴⁵ Action taken by the Argentine government in response to its 2001 economic and political crisis resulted in the greatest wave of claims by foreign investors against a single host country in recent history. Of the over forty claimed filed by the end of the decade, four involved claims under the US-Argentina BIT by four US investors in Argentina's gas transportation and distribution utilities – CMS, Enron, Sempra, and LG&E. In all four cases, ad hoc tribunals established under the World Bank's International Centre for Settlement of Investment Disputes (ICSID) rules found Argentina liable for its actions. The damage awards, three of which exceeded \$100 million, were among the highest ever rendered by an ICSID tribunal: *CMS Transmission Co. v Argentine Republic*, ICSID Case No. ARB/01/8, Award (12 May 2005); *LG&E Energy Corp. v Argentine Republic*, ICSID Case No. Arb/02/1, Decision on Liability (3 October 2006); *Enron Corp., Ponderosa Assets, L.P. v Argentine Republic*, ICSID Case No. Arb/01/3, Award (22 May 2007); *Sempra Energy Int'l v Argentine Republic*, ICSID Case No. Arb/02/16, Award, P 391, 28 September 2007. For a (very) detailed discussion of these cases see J. E. Alvarez & K. Khamsi, *Chapter 10: The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime*, in: K.P. Sauvant (ed.), *The Yearbook on International Investment Law and Policy 2008/2009*, pp. 379-478.

⁴⁶ *LG&E Energy Corp. v Argentine Republic*, ICSID Case No. Arb/02/1, Decision on Liability (3 October 2006), paras. 239-242. For discussion see C. Frutos-Peterson, *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v Argentine Republic (ICSID Case No. ARB/02/1)*, *Introductory Note, Cases, ICSID Review-Foreign Investment Law Journal* (2006), pp. 150-154.

⁴⁷ R.H. Jackson & P. Owens, *The Evolution of World Society*, in: J. Baylis & S. Smith (eds.), *The Globalization of World Politics: An Introduction to International Relations*, Oxford University Press, New York: 2005, p. 53.

crises, by both debtor states and their creditors, have been as diverse as the many paths leading to such crises in the first place. While numerous calls have been made for the establishment of a single set of consistent principles for dealing with sovereign debt crises,⁴⁸ so far the world community has not been able to agree even on the need for such a set of principles. And so sovereign debt crises continue to end up in default, either partial or total (e.g. Argentina, Mexico, Peru and other south American states in the 1980s),⁴⁹ bailout (as with Greece in 2010-2012) and/or one of a variety of approaches to sovereign debt restructuring.⁵⁰

2.1 Debt moratoriums, exchange controls and bailouts

2.1.1 Debt moratoriums

One common response to impending or actual sovereign insolvency has been the unilateral declaration of a debt moratorium by the debtor state, sometimes, but not always, following consultation with creditors. A debt moratorium is a delay in the payment of debts or obligations. It may take the form of a complete cessation of debt payments, either permanently or for a limited period of time, or a partial cessation.⁵¹ A debt moratorium can (usually) be seen as a unilateral attempt by a debt-burdened state to bring about a restructuring of its debt.⁵²

A state-declared suspension in the payment of international debts can be the by-product of wars, revolution or civil conflict. For example, Turkey, Bulgaria and Austria-Hungary suspended debt payments to enemy country creditors at the beginning of World War I; Italy, Turkey and Japan did the same at the beginning of World War II. Mexico (1914), Russia (1917), China (1949), Czechoslovakia (1952), and Cuba (1960) repudiated their debts after revolutions or communist takeovers. Some countries, such as Austria (1802, 1868) and Russia (1839), defaulted after losing wars; others, such as Spain (1831) and China (1921), defaulted after enduring major civil wars.⁵³ However,

⁴⁸ See the literature summarized in Rogoff & Zettelmeyer, *supra* note 51, pp. 470-502.

⁴⁹ For discussion see O. Sunkel & S. Griffith-Jones, *Debt and Development Crises in Latin America: The End of an Illusion*, Oxford University Press, New York: 1986; M. Pastor, *Managing the Latin American Debt Crisis: The International Monetary Fund and Beyond*, in: G.A. Epstein, J. Graham & J. Gordon Nembhard (eds.), *Creating a New World Economy: Forces of change and plans for action*, Temple University Press, Philadelphia: 1993.

⁵⁰ See the summary of existing approaches to sovereign debt restructurings in International Monetary Fund, *Reviewing the Process for Sovereign Debt Restructuring within the Existing Legal Framework* (prepared by Policy Development and Review, International Capital Markets, and Legal Departments), 1 August 2003.

⁵¹ Early examples include Turkey in 1876, Argentina and Uruguay in 1890. For discussion see F. Sturzenegger & J. Zettelmeyer, *Debt Defaults and Lessons from a Decade of Crises*, MIT Press, Massachusetts: 2006.

⁵² S. L. Schwarcz, *Sovereign Debt Restructuring Options: An Analytical Comparison*, Harvard Business Law Review, Fall 2011 (Draft dated 12 July 2011 downloaded at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1872552), pp. 9-12.

⁵³ Sturzenegger & Zettelmeyer, *supra* note 51, p. 4.

a majority of sovereign defaults and debt restructurings that have occurred since the early nineteenth century – including almost all that have occurred since the late 1970s – do not in fact belong to this category, but reflect more subtle interactions between domestic economic politics and shocks to the economy, including changes in the external environment.⁵⁴ Sturzenegger and Zettelmeyer have noted the way in which defaults of this type are bunched in temporal and sometimes regional clusters, corresponding to boom-bust cycles in international capital flows.⁵⁵ For example, a number of Latin American countries defaulted or restructured debt when the post-World War I lending boom ended in the bust of the 1930s. The mid 1980s saw another cluster of defaulting states – including Argentina, Cuba, Dominican Republic, Ecuador, Mexico, Panama and Venezuela in 1982, and Brazil, Chile, Costa Rica, Peru and Uruguay in 1983. This cluster of defaults followed the 1970s boom in bank lending to developing countries.⁵⁶ Elsewhere in the world, capital flows to Africa in the 1970s were triggered by African decolonisation and independence – followed again by defaults and/or restructurings throughout that continent – Liberia in 1980, followed by Madagascar, Senegal and Uganda in 1981; Malawi in 1982, Morocco, Niger, Nigeria, Senegal and Zambia in 1983 and Tanzania in 1984.⁵⁷

Debt moratoriums have typically been partial in nature, aimed at significantly reducing rather than stopping debt payments altogether. Examples include Peru in 1985 when the government of President Alan Garcia refused to allow more than 10% of export earnings to be used for debt payment (the so-called “Ten Per Cent Solution”).⁵⁸ Other states have similarly reduced the amount of interest they were willing to pay – Serbia in 1895,⁵⁹ Portugal in 1892⁶⁰ and Greece in 1893.⁶¹ A unilaterally declared debt moratorium may also affect only a percentage of the debtor country’s creditors, leaving some unaffected. For example, Ecuador entered a technical moratorium on

⁵⁴ *Ibidem*.

⁵⁵ *Ibidem*, pp. 4-10.

⁵⁶ The 1970s lending boom was not only kept alive but reinvigorated after the oil price shock of 1973-74 led to high oil earnings in search of investment: *ibidem*.

⁵⁷ Dates taken from Table 1.1 in Sturzenegger & Zettelmeyer, *supra* note 51, p. 7.

⁵⁸ Discussed as a “tragic failure” by W. G. Tarpley, *Only a Debt Moratorium Can Save Iceland*, published at [rense.com](http://www.rense.com), downloaded on 1 November 2011 at <http://www.rense.com/general87/nly.htm> (p. 10 of 18).

⁵⁹ W. A. Dunaway, *Emerging Issues in the 21st Century World System: New theoretical directions for the 21st century world-system*, Greenwood Publishing Group, Westport, Connecticut: 2003, p. 98, noting that almost all of the Serbian debt accumulated between 1878 and 1895 was converted to a new loan carrying smaller interest charge in 1895.

⁶⁰ *Ibidem*, noting that Portugal received more favourable treatment from its creditors than either Serbia or Turkey at the time, benefiting from both a reduction of interest to 3 percent and a reduction of capital owed to between 50 to 75 percent of the original issues.

⁶¹ E. Borchard & J. S. Hotchkiss, *State Insolvency and Foreign Bondholders: General Principles*, Yale University Press, New Haven: 1951, p. 124, noting that for many years after 1893, Greece paid only 30% of its coupon interest. Also noting that Portugal’s reduction of interest payments for several years after 1891 amounted to two-thirds reduction of total interest owing.

its foreign debt on 14 November 2008.⁶² President Rafael Correa stopped payments on 3.2 billion in bonds due 2012 and 2030 in December 2008 and March 2009, saying the securities were “illegitimate” and “illegal”.⁶³ Ecuador did, however, continue payments to its 2015 bondholders, thereby minimising the reputational costs of a more comprehensive default.⁶⁴

A moratorium on sovereign debt payments might conceivably be suggested or offered by or on behalf of creditors.⁶⁵ Such proposals are rare, however, and the role of creditors is usually restricted to trying to reduce their overall potential losses and maximising the gains to be achieved from negotiating a restructuring of debt – as was seen when Pakistan’s debt was rescheduled in 2001.⁶⁶

Proponents of debt moratoriums argue that it is a sovereign decision by the government of a nation to suspend payment of debt to its creditors, in the event that to do otherwise would do irreparable harm to the welfare of its citizenry.⁶⁷ For example, a number of commentators called for Iceland (in 2009) and Greece (2010-2012) to universally declare a debt moratorium as a preferable alternative to the imposition of harsh austerity measures imposed as part of a debt rescheduling and/or bailout arrangement.⁶⁸

Even putting aside questions about their legality, unilaterally declared sovereign debt moratoriums present obvious problems. First, debtor nations who default, even if only partly, on their debt, must bear the reputational costs of such default – costs which may make access to finance difficult for many years to come. Where fresh finance

⁶² P. Cailleteau, *Rating Action: Moody’s downgrades Ecuador’s ratings*, 14 November 2008, available at <http://www.moodys.com>. See also S. Kueffner, *Correa Defaults on Ecuador Bonds: Seeks Restructuring* (Update4), Bloomberg 12 December 2008, available at <http://www.bloomberg.com>; F. Salmon, *Market Movers: Ecuador’s Idiotic Default*, Bloomberg, 12.12.2008, available at <http://www.Portfolio.com>. For more detailed discussion see A. C. Porzecanski, *When Bad Things Happen to Good Sovereign Debt Contracts: The Case of Ecuador*, 73 *Law and Contemporary Problems* 251 (2010).

⁶³ MercoPress, *China loans and oil prices boost Ecuador economy two years after default*, MercoPress, 26.06.2011, available at <http://en.mercopress.com>.

⁶⁴ *Ibidem*.

⁶⁵ For example, Reverend Tim Costello called for creditors to allow a two year moratorium on Pakistan’s debt following devastating floods in 2010 to allow that nation to assist those displaced by the floods, and noting that Pakistan in 2010 was spending three times as much servicing its debt as it was spending on health services for its own people: Making Health Global, *Tim Costello’s Plea for Pakistan*, 01.09.2010, available at <http://makinghealthglobal.com.au>. Reporting on the 63rd UN DPI NGO (Department of Public Information Non-Government Organisations) Conference held in Melbourne, 31 August – 1 September 2010.

⁶⁶ For discussion and other examples see IMF, Policy Development and Review Department, *Cross-Country Experience with Restructuring of Sovereign Debt and Restoring Debt Sustainability*, 29 August 2006.

⁶⁷ See e.g. K. Raffer, *An International insolvency procedure for sovereign States*, in: E. Dommen (ed.), *Debt Beyond Contract: finance and the common good*, *supp no. 2*, Observatoire de la Finance, Geneva: 2001, pp. 69-78.

⁶⁸ Tarpley, *supra* note 58. See also *Address on Iceland and the IMF Debt Moratorium Tobin Tax*, Delivered by Birgitta Jonsdottir of The Movement in the Icelandic Parliament, 5 October 2009.

is accessible, it typically becomes so at a more expensive rate, since the risk of future default will be priced into the cost of credit. New loans also raise questions about the point at which (new and old) creditors should be informed and/or consulted about the possibility of a debt moratorium, as well as questions about the need to ensure that all creditors are treated equally following the imposition of such a moratorium.

Moreover, as Schwarcz notes, unilaterally declared debt restructurings not only pose systemic risks, but tend to be disorderly as well:

Because unilateral debt restructuring is merely default cloaked in semantics, it could pose the same threat of systemic risk as any other manifestation of default. Furthermore, given anticipated creditor opposition, any unilateral restructuring attempt could well be disorderly, generating multiple lawsuits. I therefore regard unilateral debt restructuring by a sovereign debtor as a normatively undesirable alternative to a bailout.⁶⁹

2.1.2. Exchange Controls

As Paul Krugman has noted exchange controls used to be the standard response of countries faced with balance-of-payments crises: “[e]xporters were required to sell their foreign-currency earnings to the government at a fixed exchange rate; that currency would in turn be sold at the same rate for approved payments to foreigners, basically for imports and debt service.”⁷⁰

There is no doubt that countries are free to impose exchange controls to protect the value of their local currency, so long as such controls are imposed consistently with that country’s existing international obligations. Exchange controls and other moratory laws prohibiting or restricting payments of foreign debt are often associated with periods of social, political and/or economic stress. For example, the French moratory laws passed on several occasions during the 1870-71 Franco-Prussian War. In *Roquette v Overman*,⁷¹ the English High Court upheld the legality of a French moratory law in a suit upon a bill of exchange accepted and payable in France.

The principle of sovereign equality of states implies that all states are entitled to implement whatever fiscal, monetary and exchange measures they see fit. This is recognised, *inter alia*, by several provisions of the IMF Articles of Agreement. Art. VIII, for example, expressly recognise the right of all sovereign states to impose exchange controls and to cooperate with each other in making exchange control regulations more effective. When Malaysia was threatened with fallout from the Asian financial crisis of 1997-98, the response of the Mahathir government was to impose foreign exchange

⁶⁹ Schwarcz, *supra* note 52, pp. 10-11; citing A. Gelpern, *What Bond Markets Can Learn From Argentina*, 24 *International Financial Law Review* 19 (2005), p. 21; noting that Argentina faced thousands of lawsuits, including dozens in New York and over a hundred in Europe, during and after its unilateral debt restructuring.

⁷⁰ M. Khor, *Asia should impose foreign exchange controls says Krugman*, Third World Network, citing television interview, CNBC programme *Asia in Crisis* on 29 August 1998 and citing 192 *Third World Economics* (September 1998), pp. 1-15.

⁷¹ (1875) LR 10 QB.

restrictions (September 1998) aimed at protecting the integrity of the local economy and the value of the Ringgit. Michael Camdessus, then Managing Director of the IMF, the IMF itself, and other commentators as well, complained bitterly at the imposition of these restrictions.⁷² Despite the fuss, however, in the end critics had to recognise that regardless on their own views on the wisdom of the Malaysian measures, the country had only exercised its IMF membership rights, including the right to exercise sovereign autonomy in domestic financial policy making.⁷³

China also escaped the most negative impacts of the Asian Financial Crisis, and was in fact able to cut interest rates during the crisis so that financial activity remained buoyant.⁷⁴ China maintained a fixed exchange rate at the time, and was able to cut interest rates without threatening its money supply because it maintained a non-convertible currency – in other words, exchange controls. While China's exchange controls have often been evaded, and have been a source of corruption,⁷⁵ during the Asian financial crisis they did give China a degree of policy flexibility that other countries envied.

Likewise, no one has challenged the legality of decisions by America and other governments to engage in measures such as monetary (quantitative) easing in response to trade-related and other debt burdens. The argument here is that the use of fiscal, monetary and exchange rate policy tools needs to be kept in mind as a possibility whenever the need to deal with a sovereign debt crises is being considered. For example, when a sovereign debt restructuring is being negotiated, negotiators should consider the possibility of allowing the debtor state to pay at least some of what is internationally owed in its own currency. Such arrangements are already possible in the case of World Bank loans under Art. IV of the Bank's Articles of Agreement, as discussed in part 1 above.

⁷² M.-A. Tourres, *The Tragedy That Didn't Happen: Malaysia's Crisis Management and Capital Controls*, Institute of Strategic and International Studies (ISIS), Kuala Lumpur, Malaysia: 2003. See also S.D. Sharma, *The Malaysian Capital Control Regime of 1998: Implementation, Effectiveness, and Lessons* 27(1) Asian Perspective 77 (2003); and M. Billington, *Malaysia's Challenge to IMF: A Lesson on 'Method'*, Executive Intelligence Review (13 August 2004); a review of this essay is available at http://www.larouche.com/other/2004/book_reivews/3132malaysia_v_imf.html (last accessed 10 April 2013).

⁷³ M. Khor, *Malaysia institutes radical exchange, capital controls*, Third World Network, citing 192 Third World Economics (1-15 September 1998). See also E. Kaplan & D. Rodrik, *Did the Malaysian Capital Controls Work?* (revised, February 2001, John F Kennedy School of Government, Harvard University, Cambridge), available at <http://www.hks.harvard.edu/fs/drodrik/Research%20papers/Malaysia%20controls.PDF> (last accessed 10 April 2013) and J. N. Bhagwati, *In Defense of Globalization*, Oxford University Press, New York: 2007, p. 206.

⁷⁴ R.C.K. Burdekin, *China and the Depreciating US Dollar*, 79 Asia Pacific Issues (January 2006) (East-West Center). See also E. Denters, *Manipulation of Exchange Rates in International Law: The Chinese Yuan*, ASIL Insights (November 2003); and C. D. Zimmermann, *Congress Continues to Attack Currency Manipulation as China Defuses G-20 Pressure For Now: the International Law Issues*, 14(19) ASIL Insights (30 June 2010). See also Khor, *supra* note 70.

⁷⁵ *China's capital controls lead to corruption*, The Globe and Mail, 19.06.2011.

2.1.3 Bailouts

The recent financial woes of Greece, Ireland, Portugal and other nations have re-invigorated debate over the circumstances in which defaulting countries should be bailed out, if at all.⁷⁶ As Schwarcz explains, the problem in the case of Greece was that an orderly debt restructuring was impractical, while a default was believed to have the potential to bring down the world financial system. This is a growing problem. As global capital markets increasingly embrace sovereign bonds, the potential for a nation's debt default to trigger a larger systemic collapse increases as the network of debtor-creditor relationships spreads. This, in turn, gives rise to the problem of "too big to fail".⁷⁷ Advanced economies are now familiar with the problem of the large bank which is perceived as being too big to fail because its default could trigger an economic domino effect. The result is that such banks are often the ones to receive a bailout from public funds. This can foster moral hazard: anticipating a bailout, the bank may lack incentive to take a prudent economic course. Likewise, nations – even those as small as Greece – can be seen as too big to fail if their default could trigger a wider economic collapse. This too can foster moral hazard – indeed sovereigns are arguably more likely to engage in morally hazardous behaviour than banks, which can be liquidated. The Greek government, for example, did little to impose fiscal austerity even as debts accumulated.⁷⁸

Bailouts can also be extremely expensive – in both financial and human terms. The initial Greek bailout costing USD 110 billion in 2010 eventually needed to be supplemented by further allocations of bailout funds bringing the total cost to over USD 300 billion by some estimates.⁷⁹ The European Union (via the European Financial Stability Facility) and the IMF have essentially shared the costs of the Greek bailout, so that the burden is shared between a large number of countries, generating unrest amongst those who do not see why their own country should pay such costs. The hardships imposed on the people of Greece as a result of the strict austerity measures that are the other part of the bailout package also need to be factored into the costs equation. The rest of this article explores debt-restructuring alternatives to bailouts. The

⁷⁶ E. Kirschbaum, *Germans overwhelmingly oppose Greek bailout: poll*, Reuters, Business & Financial News, Breaking US & International News (26 February 2012), available via <http://www.reuters.com/>; Shearman & Sterling LLP, *Euro Rescue Package Backed by German Federal Constitutional Court – German Parliament Approves Plan to Boost the Lending Capacity of the Eurozone Bailout Fund (EFSF)* (3 October 2011).

⁷⁷ S. Schwarcz, *Facing the Debt Challenge of Countries That Are 'Too Big To Fail'*, in R. W. Kolb (ed.), *Sovereign Debt: From Safety to Default*, Robert W. Kolb Series, Book 605, John Wiley & Sons, Inc., Hoboken, New Jersey: 2011.

⁷⁸ *Ibidem*; see also Papatreou *Tries to Prop Up the Pillars*, Economist, 19.12.2009, p. 48.

⁷⁹ T. Durden, *The Cost of The Combined Greek Bailout Just Rose To Euro320 Billion in Secured Debt, Or 136% of Greek GDP*, Zero Hedge 11.02.2012, available at <http://www.zerohedge.com/news/>. See also C. Greenberg, *McMorris Rodgers Calls on Administration to Vote Against New Greek Bailout at Thursday's IMF Meeting*, Conservative Outlooks, 12.03.2012, available at <http://conservative-outlooks.com/>; and *EFSF contributes Euro 109bn to Greek bailout*, Irish Times, 16.03.2012, available at <http://www.irishtimes.com/>.

inquiry is important because the world is now at the stage where it cannot just allow the problem of sovereign debt to keep recurring; each time being dealt with on an *ad hoc* basis. The potential consequences of failure to properly manage such crises in future are too devastating to rely on such arbitrary approaches.

2.2. Reaching a new consensus: Market based solutions or a statutory framework?

As noted above, the current system for sovereign debt restructuring is characterized by a diversity of approaches reflecting the diversity in the circumstances of each sovereign restructuring event.

In 2002 Kenneth Rogoff and Jeromin Zettelmeyer examined in detail the history of ideas relating to procedures for resolving sovereign debt crises.⁸⁰ They find a growing consensus on what the underlying problems and causes of sovereign debt crises are, but no consensus on how to resolve them. Proposals have ranged from contract based solutions (also referred to as market based solutions) to statutory solutions; and from approaches focussing on reforming national laws to proposals emphasising the need for an international law approach. As the debate continues, recent sovereign debt crises continue to demonstrate “the limitations of our current framework for dealing with”⁸¹ such crises. As Waibel notes, there is an urgent need to “upgrade our toolbox to deal with a potential wave of sovereign defaults in many parts of the world.” In this section I explore state practice in sovereign debt restructurings and identify five key features that any future attempt to create a more coherent framework for resolving sovereign debt crises should possess. I also argue that these features should preferably be agreed upon in the form of an international instrument, which does not need to be in the form of a detailed treaty, but which should be recognised as codifying generally accepted custom on the question of how sovereign debt crises should be resolved.

2.2.1. Market based solutions

In the absence of any agreement on a uniform approach to resolving sovereign debt difficulties, the market has been relied upon almost entirely in handling such problems. “Market-based” debt reduction schemes became more common during the 1980s,⁸² a period in which many South American countries were encouraged to take the initiative in reducing their debt stock by buying back debt at discounted prices, swapping bank loans for local currency that had to be invested in domestic equity (debt-equity swaps), or exchanging loans against discounted “exit bonds” with

⁸⁰ Rogoff & Zettelmeyer, *supra* note 41.

⁸¹ M. Waibel, *Iceland's Financial Crisis – Quo Vadis* 14(5) ASIL Insight (1 March 2010).

⁸² See J. Williamson, *Voluntary Approaches to Debt Relief*, Institute for International Economics, Washington: 1988; and J. Sachs, *Testimony to the Subcommittee on International Trade of the Committee on Finance*, United States Senate, US Govt Printing Office, Washington: 13 May 1986, pp. 58-90.

lower principal or interest.⁸³ Buybacks characterised the approach taken by Bolivia and Brazil in the late 1980s, while debt-equity swaps were used in Argentina, Brazil, Chile, and Mexico and exit bonds used in Mexico and Argentina.⁸⁴ However, such approaches soon came under criticism from several angles. Some authors argued that any efficiency gains from market-based solutions would mostly benefit creditors, not debtors.⁸⁵ In addition, it became clear that market-based schemes suffered from a similar free-rider problem as unilateral debt-forgiveness or negotiations with uncoordinated creditors: participation in the scheme had the effect of increasing the repayment probability to the holdouts that chose *not* to participate.⁸⁶ Indeed, the pure market-based approach mostly failed to achieve large scale debt reduction and the approach most commonly preferred has been one which combines some market-based elements with coordinated negotiations and public sector/official avenues of fresh financing. Examples include the Brady plan, the London Club (BAC) and the Paris Club. Recent (since 2000) research emerging from the IMF has concerned itself with how to more systemically resolve sovereign debt crises through better coordination of public and private sector involvement.⁸⁷

2.2.2. Statutory solutions

Recognising the deficiencies and risks inherent in the current approach of relying on a variety of *ad hoc* free market solutions, a number of commentators have called for the

⁸³ Often such approaches were justified by an argument that it was in the interests of both debtor and creditors to eliminate “debt overhang” as quickly as possible through speedy debt reduction. The debt overhang argument is that so long as the burden of potential future debt repayments exceeds the ability of a debtor nation to pay, investment becomes so expensive to make it viable. The debt servicing burden creates such a deterrent to investment (either domestic or from international creditors) that efficient economic growth becomes virtually impossible: see J. Sachs, *The Debt Overhang of Developing Countries*, in G. Calvo et al. (eds.), *Debt, Stabilization and Development: Essays in Memory of Carlos Diaz-Alejandro*, Basil Blackwell for WIDER, Oxford: 1989, pp. 80-102; P. Krugman, *Financing v Forgiveing a Debt Overhang*, 29 *Journal of Development Economics* 253 (1988); P. Krugman, *Market-Based Debt Reduction Schemes*, in: J.A. Frenkel, M.P. Dooley & P. Wickham (eds.), *Analytical Issues in Debt*, IMF, Washington: 1989, pp. 258-78.

⁸⁴ W.R. Cline, *International Debt Re-examined*, Institute for International Economics, Washington: 1995, pp. 212-15.

⁸⁵ J. Bulow & K. Rogoff, *The Buyback Boondoggle*, 2 *Brookings Papers on Economic Activity* 645 (1988); J. Bulow & K. Rogoff, *Sovereign Debt Repurchases: No Cure for Overhang*, 106 *Quarterly Journal of Economics* 1219 (1991); and M. Dooley, *Buy-Backs, Debt-Equity Swaps, Asset Exchanges and Market Prices of External Debt*, in: J. A. Frenkel, M.P. Dooley & P. Wickham (eds.), *Analytical Issues in Debt*, IMF, Washington: 1989, pp. 130-50.

⁸⁶ E. Helpman, *Voluntary Debt Reduction: Incentives and Welfare*, in: J.A. Frenkel, M.P. Dooley & P. Wickham (eds.), *Analytical Issues in Debt*, IMF, Washington: 1989, pp. 279-310; and J. Sachs, *Efficient Debt Reduction*, in: I. Husain & I. Diwan (eds.), *Dealing with the Debt Crisis: A World Bank Symposium*, World Bank, Washington: 1988, pp. 239-57.

⁸⁷ IMF Policy Development and Review and Legal Departments, *Involving the Private Sector in the Resolution of Financial Crises – Restructuring International Sovereign Bonds*, IMF, Washington: January 2001; IMF Policy Development and Review Department, *Cross-Country Experience with Restructuring of Sovereign Debt and Restoring Debt Sustainability*, IMF, Washington: 29 August 2006.

establishment of a single set of consistent principles for dealing with sovereign debt crises, preferably enshrined in a single international convention or other instrument.⁸⁸ Several such proposals have called for the establishment of an international debt reorganization procedure modelled on national reorganization laws for (insolvent) incorporated entities (e.g. Chapter 11 of the US Bankruptcy Code)⁸⁹ and bankrupt municipalities (e.g. Chapter 9 of the US Bankruptcy Code).⁹⁰ Schwarcz identifies two main models that have been proposed for sovereign debt restructuring. First, Schwarcz himself has proposed the establishment of a sovereign debt restructuring convention (SDRC).⁹¹ Second, the IMF has also recognised the need for a set of generally accepted principles for resolving sovereign debt difficulties. The IMF's then First Deputy Managing Director, Anne Krueger, proposed in November 2001 the establishment of a sovereign debt restructuring mechanism (SDRM).⁹² Both models are based on the same research, and the two are essentially the same although different in some details. The differences are, however, instructive and provide clear options for debate and choice in the development of a statutory scheme for sovereign debt restructuring. According to Schwarcz, the main differences are first, that the SDRM excludes claims from foreign governments, whereas the SDRC allows such claims but provides that each such claim constitutes its own separate class. Second, the SDRM requires the debtor nation to decide in advance which debts to restructure there-under and which debts, if any, to either not restructure or to restructure outside the SDRM, whereas the SDRC allows the debtor nation to decide how to restructure its debts at the time it files its debt restructuring plan. Third, a more significant difference, is that the SDRM, unlike the SDRC, includes a procedure that could implement a temporary stay on litigation against the sovereign.⁹³ Schwarcz argues

⁸⁸ See the literature summarized in Rogoff & Zettelmeyer, *supra* note 41.

⁸⁹ E.g. K. 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. 25. See also B.C. Barnett, S.J. Galvis & G. Gouraige Jr, *On Third World Debt*, 25 *Harvard International Law Journal* 83-151 (1984); A. Pettifor, *Chapter 9/11? Resolving International Debt Crises: The Jubilee Framework for International Insolvency* (January 2002), available at <http://www.jubilee2000uk.org>; S.L. Schwarcz, *Sovereign Debt Restructuring: A Bankruptcy Reorganization Approach*, 85 *Cornell Law Review* 101 (2000).

⁹⁰ E.g. A.N. Malagardis & M. Nitsch, *Living with Sovereign Debtors: The Debt Crisis of Developing Countries and International Insolvency Rules*, Interdependence, Special Issue, Foundation for Development and Peace, Bonn: 1988; K. Raffer, *International Debts: A Crisis for Whom?*, in: H.W. Singer & S. Sharma (eds.), *Economic Development and World Debt*, Macmillan Press, London: 1989, pp. 51-62; and K. Raffer, *Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face*, 18(2) *World Development* 301 (1990). Whether or not Chapter 9 is in fact a better guide for sovereign bankruptcy than Chapter 11 remains controversial.

⁹¹ Schwarcz, *supra* note 89, noting especially the draft SDRC provided in the appendix at 1020-22. See also S. L. Schwarcz, *Idiot's Guide to Sovereign Debt Restructuring*, 53 *Emory Law Journal* 1189 (2004).

⁹² A. Krueger, *A New Approach to Sovereign Debt Restructuring*, Address given at the Indian Council for Research on International Economic Relations, New Delhi, India, 20 December 2001. See also International Monetary Fund, *Proposals for a Sovereign Debt Restructuring Mechanism (SDRM)*, available at <http://www.imf.org/external/np/exr/facts/sdrm.htm> (A Factsheet, January 2003).

⁹³ Schwarcz, *supra* note 52, pp. 13-14.

that such a stay is not essential, because of the nature of debtor nation sovereignty and the limited ability of creditors to seize national assets, even those that may be located outside of a debtor nation.⁹⁴ Accepting that a stay on litigation is not necessary, however, does not mean that it remains undesirable. A stay on litigation may be desirable, as a matter of principle, even if only to reinforce the need for cooperative action on all sides of the restructuring plan.

While some commentators consider that the SDRM/SDRC is a proposal that has died a natural death and is no longer seriously considered feasible, others, including Schwarcz, have renewed their advocacy of such a statutory scheme for sovereign debt restructuring with vigour, arguing that the recent financial woes of Greece, Ireland, Portugal and other nations have demonstrated yet again the need for such an alternative to the current invidious choice between expensive bailouts or inefficient, cumbersome and time-consuming market-based debt restructuring negotiations.⁹⁵

Perhaps the closest the world has so far come to agreeing on a standardised approach to resolving sovereign debt crises is the HIPC initiative, introduced partly as a result of the Jubilee 2000 campaign of the 1990s.⁹⁶ The Jubilee campaign called for a framework based on the work of Professor Kunibert Raffer from the University of Vienna who had long been calling for an international insolvency framework modelled on Chapter 9 of the US Bankruptcy Code.⁹⁷

HIPC was launched in 1996 and followed soon thereafter by enhanced HIPC (sometimes referred to as HIPC II) in 1999. The enhanced HIPC Initiative was aimed at providing faster, deeper, and broader debt relief and at strengthening the links between debt relief, poverty reduction, and social policies. To be considered for HIPC assistance, a country must fulfil four key conditions.⁹⁸ The first two conditions – eligibility to borrow from World Bank and IMF interest-free and subsidized loan programs and the existence of a unsustainable debt burden that cannot be addressed through traditional debt relief mechanisms – are aimed at identifying countries most in need of assistance. The third and fourth conditions – the need to establish a “track record of reform and sound policies through IMF and World Bank supported programs” and the need to develop a “Poverty Reduction Strategy Paper through a broad based participatory process in the country” – appear aimed at reassuring creditors that the debtor country is “deserving” of assistance.⁹⁹

⁹⁴ *Ibidem.*

⁹⁵ Schwarcz, *supra* note 52.

⁹⁶ The Jubilee 2000 campaign generated the first global petition – a petition which called for the cancellation of the unpayable debt of the poorest countries by the year 2000 under a fair and transparent process, and was signed by 24 million people.

⁹⁷ A. Pettifor, during a Panel discussion at the IMF’s Sovereign Debt Restructuring Mechanism (SDRM) Conference, Washington DC, 22 January 2003, transcript available at <http://www.imf.org/external/np/exr/seminars/2003/sdrm/index.htm> (last accessed 10 April 2013).

⁹⁸ IMF Factsheet, *Debt Relief under the Heavily Indebted Poor Countries (HIPC) Initiative* (September 2011), available at <http://www.imf.org/external/np/ext/facts/hipc.htm>.

⁹⁹ *Ibidem.*

The requirement to develop and implement a Poverty Reduction Strategy to qualify for HIPC assistance can facilitate transparency and civil society participation in countries where both are in short supply.¹⁰⁰ A PRS can also serve to link local stakeholder knowledge and views together with advice from independent experts, thereby avoiding some of the pitfalls of Structural Adjustment Programmes which became evident following the 1997 Asia Crisis and the 1998 Reviews of the Enhanced Structural Adjustment Facility (ESAF) lending framework.¹⁰¹ Yet PRSPs have also been extremely problematic, and can be complicated by local factors in unforeseen ways.¹⁰²

Moreover, when legal and policy reforms are put into place simply because they are required as a condition of receiving IMF/World Bank assistance, they are often less than successful.¹⁰³ Condition 3 of enhanced HIPC requires a country to demonstrate that it “has established a track record of reform and sound policies through IMF and World Bank supported programs” in order to reach “decision point”. In order to reach “completion point”, the country must demonstrate a “further track record of good performance under programs supported by loans from the IMF and World Bank”, and show that it has implemented satisfactorily key reforms agreed at the decision point. These requirements allow the IMF and World Bank to impose conditionalities on countries seeking HIPC relief without any formal requirement to consult beforehand.¹⁰⁴

¹⁰⁰ Pettifor, *supra* note 97.

¹⁰¹ K. Christiansen & I. Hovland, *The PRSP Initiative: Multilateral Policy Change and the Role of Research*, Working Paper 2003/216, Overseas Development Institute, London, August 2003, p. viii; available at <http://www.odi.org.uk/resources/download/145.pdf> (last accessed 10 April 2013). See also *Making Poverty Reduction Strategies Work – Good Practices, Issues and Stakeholder Views*, A Contribution of German Development Cooperation for the 2005 PRSP Review (May 2005) available at http://siteresources.worldbank.org/INTPRS1/Resources/PRSP-Review/gtz_makingprswork.pdf (last accessed 10 April 2013); and M.J. Sizya, *The role cooperatives play in poverty reduction in Tanzania*, paper presented at the UN in observance of the International Day for the Eradication of Poverty, 17 October 2001.

¹⁰² A detailed discussion is not possible here, but see E. Zuckerman, ‘Engendering’ Poverty Reduction Strategy Papers (PRSPs): the issues and the challenges, 10(3) *Gender and Development* 88 (2002); N. Hunter, J. May & V. Padayachee, *Lessons for PRSPs from Poverty Reduction Strategies in South Africa*, paper presented at the Third Meeting of the African Learning Group on the Poverty Reduction Strategy Papers, 3-5 December 2003, Addis Ababa, Ethiopia (Economic Commission for Africa, 2002).

¹⁰³ C. H Lee, *To thine ownself be true: IMF conditionality and erosion of economic sovereignty in the Asian Financial Crisis*, 24(4) *University of Pennsylvania Journal of International Economic Law* 875 (2003).

¹⁰⁴ The power that this places in the hands of the IMF and World Bank becomes even more open to criticism because the two bodies are so often perceived as undemocratic in their decision making: A. Giron, *International Monetary Fund: From Stability to Instability: The Washington Consensus and Structural Reforms in Latin America*, 29 March 2011, available at <http://www.aliciagiron.com/2011/03/29/international-monetary-fund-from-stability-to-instability-the-washington-consensus-and-structural-reforms-in-latin-america/>. See also P-P. Kuczynski & J. Williamson, *After the Washington Consensus: Restoring Growth and Reform in Latin America*, Institute for International Economics, Washington DC: 2003. See further G.A. Sarfaty, *Why Culture Matters in International Institutions: The Marginality of Human Rights at the World Bank*, 103(4) *American Journal of International Law* 647 (2009), and M. Darrow, *Between Light and Shadow: The World Bank, the IMF, and International Human Rights Law*, Hart Publishing, Oxford: 2003.

The HIPC Initiative has also been criticised for taking so long to provide significant relief to countries burdened by debt and for failing to provide the kind of exit relief that was promised at the beginning of the process. For example, Ann Pettifor points out that countries such as Argentina and Uganda remained in deep economic trouble even after several IMF programs involving loan disbursements and conditionalities.¹⁰⁵ It remains true, however, that other driving forces, including historical and structural ones, rather than deficiencies in the HIPC process as such, were arguably at fault.¹⁰⁶ Moreover, by the end of 2011, of the 39 countries eligible or potentially eligible for HIPC initiative assistance, 32 countries (nearly all from Africa or Central America), were receiving full debt relief from the IMF and other creditors¹⁰⁷ after reaching their “completion point”.¹⁰⁸ Four other countries (Chad, Comoros, Cote d’Ivoire, Guinea) had reached their decision points and were receiving some interim debt relief, while three further countries identified as potentially eligible for HIPC assistance had not yet reached their decision points (Eritrea, Somalia and Sudan).¹⁰⁹ In these countries, many challenges remain, including meeting the basic requirements of peace and stability, delivery of basic services and reasonable levels of corruption free governance.¹¹⁰ But the successes and failures of the HIPC initiative provide valuable lessons. For example, one challenge still remains ensuring that eligible countries get full debt relief from *all* their creditors, not just the IFIs.¹¹¹

2.3. Extracting principles from state practice

The rest of this Part argues that five requirements for any future agreement on how to deal with sovereign debt crises can be identified from the experience of state practice in this area:

1. an enforceable requirement of collective action by all creditors, such that minority creditors would be bound by a restructuring once it was agreed to by a large enough majority;

¹⁰⁵ Pettifor, *supra* note 97.

¹⁰⁶ *Ibidem*. See also C.M. Reinhart, K. Rogoff & M.A. Savastano, *Debt Intolerance*, National Bureau of Economic Research Working Paper, 2003/9908 (August 2003), available at <http://www.nber.org/papers/w9908>. Specifically on the case of Argentina, see R. Olivares-Caminal, *Legal Aspects of Sovereign Debt Restructuring*, Sweet & Maxwell, Andover: 2009.

¹⁰⁷ About 45 percent of HIPC funding comes from the IMF and other multilateral institutions, with the remaining amount coming from bilateral creditors: IMF Factsheet, *Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative*, (information current as at December 2011), available at <http://www.imf.org/external/np/exr/facts/pdf/hipc.pdf> (last accessed 10 April 2013).

¹⁰⁸ IMF Factsheet, *Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative*, (information current as at December 2011), available at <http://www.imf.org/external/np/exr/facts/pdf/hipc.pdf> (last accessed 10 April 2013).

¹⁰⁹ IMF Factsheet, *The Multilateral Debt Relief Initiative*, September 2011, available at <http://www.imf.org/external/np/exr/facts/mdri.htm> (last accessed 10 April 2013).

¹¹⁰ *Ibidem*.

¹¹¹ Pettifor, *supra* note 97, pointing out that smaller multilateral institutions, non-Paris Club official bilateral creditors and commercial creditors, together accounting for around 25% of total HIPC costs, had only delivered a small share of their expected debt relief by late 2003.

2. an enforceable, indefinite stay on any attempted legal action in national courts by a “hold-out” creditor demanding repayment during the negotiation process;
3. the ability of the debtor nation to obtain fresh finance quarantined from the restructuring process;
4. the right of the debtor state to design and propose its own policies and appropriate policy undertakings, with safeguards to ensure that creditors are treated properly; and
5. the establishment of an independent umpire body, either permanent or on an *ad hoc* basis, to oversee negotiations, the creditor voting process, compliance with undertakings and dispute resolution.

I do not seek to argue that these principles have the status of customary law, but rather that they are principles around which state practice appears to be gradually coalescing. In addition, part III of this paper will argue that they are principles which find support, and are grounded within, more general principles of international law found in widely accepted international treaties and other instruments.

2.3.1. Collective action requirement

At least since the 1820s, creditors have sought to coordinate in their negotiations with debtor states nearing or in default. Weak coordination across creditors and prolonged negotiation periods made early efforts inefficient, but this changed after 1868 when the British Corporation of Foreign Bondholders (CFB), the most institutionalised and powerful creditor association in history was established.¹¹² The power of the CFB came from its ability to use specialised committees to negotiate agreements with individual debtor countries,¹¹³ and also because the London stock exchange adopted a practice where it would refuse to list new bonds by debtors that the CFB advised were in default. The CFB model proved so successful that similar organisations were eventually set up in France and Belgium (1898), Switzerland (1912), Germany (1927), and the United States (1933).¹¹⁴ The CFB and its counterpart organisations in other countries remained active until the 1950s, when the last defaults of the 1930s¹¹⁵ were settled.

The structure of international lending shifted after 1950 from bonds dispersed among thousands of holders in a handful of creditor countries to loans by a few

¹¹² Sturzenegger & Zettelmeyer, *supra* note 51, p. 11, citing P. Mauro and Y. Yafeh, *The Corporation of Foreign Bondholders, Issues 2003-2007*, IMF Research Department Working Paper, 2003 and P. Mauro, N. Sussman & Y. Yafeh, *Emerging markets and financial globalization: Sovereign bond spreads in 1870-1913 and today*, Oxford University Press, New York: 2006, Chapter 7.

¹¹³ These agreements were then presented to a general meeting of bondholders for approval. While the agreement, if approved, was not legally binding on individual bondholders, “holdouts” did not generally pose a problem, in part because the changes of successful legal action against sovereigns were much lower than they are today. As a result, the CFB effectively had control over the sovereign debtor’s access to the London market: Sturzenegger & Zettelmeyer, *supra* note 51, p. 11.

¹¹⁴ R.P. Esteves, *Qui custodiet quem? Sovereign Debt and Bondholders’ Protection Before 1914*, University of Oxford, Department of Economics, Economics Series Working Paper, 2007/323, available at <http://www.economics.ox.ac.uk/Research/wp/pdf/paper323.pdf> (last accessed 10 April 2013).

¹¹⁵ Except for those of some Soviet bloc countries that had repudiated their pre-war debts: F. Sturzenegger & J. Zettelmeyer, *supra* note 51, p. 12.

hundred commercial banks. By the mid-1970s most bank lending was channelled through syndicates involving groups of typically ten to twenty banks. In the late 1970s when several developing country debtors began to experience debt servicing difficulties, a coordinated negotiating procedure for the restructuring of commercial bank debt began to emerge: the Bank Advisory Committee (BAC), also referred to as the “London Club”. The London Club process works in a very similar fashion to the CFB, and continues to play a role today.¹¹⁶ However, most debt crises and restructurings between 1998 and 2010 have focused on sovereign bonds held by a heterogeneous group of mostly non-bank creditors. And most bondholder representation in restructurings since 1998 have been, at best, *ad hoc*. A number of approaches have been used to rapidly achieve broad creditor agreement to restructuring proposals. Examples include take-it-or-leave-it offers to exchange existing bonds for new ones with payment streams of lower present value. These offers have often been preceded by informal discussions with creditors, but rarely formal negotiations. They have worked well so long as the terms of the exchange offer – usually designed with the help of an investment bank as financial advisor – were more attractive than the alternatives of uncertain litigation or sale at depressed prices.¹¹⁷ Another powerful mechanism to maximise coordinated creditor agreement is to make bond swap offers contingent on their acceptance by a supermajority of creditors (typically 75% but sometimes up to 85%). While not removing altogether the free-rider problem, this does allow creditors to be reassured that any bond swap agreement which eventuates will in fact reduce the debtor country’s debt burden by a large enough amount to ensure a corresponding improvement in debt service capacity. Other devices that have helped achieve high participation rates include the use of majority amendment clauses (e.g. in Ukraine’s debt exchange) and changes in the *non-payment* terms of the old bond contracts (exit consent).¹¹⁸

Exit consent is a device which has been used to increase the acceptance rate amongst creditors and to discourage hold-outs. Exit consent is the technique developed in Ecuador’s sovereign debt restructuring in 2000 (and later used in the Uruguay sovereign debt restructuring), by which the holders of defaulted bonds who agree to swap their old bonds in an exchange offer, at the moment of accepting such exchange offer, grant their consent to amend certain terms of the old bonds. The amendments to the terms of the old bonds automatically come into effect when the required majority of bondholders have accepted the exchange offer. The amendments inevitably make the old bonds less attractive, forcing remaining bond holders to enter into the exchange agreement.¹¹⁹

¹¹⁶ For example, both the Russian and Pakistani debt crises were resolved, in large part, through agreements with BACs: *ibidem*.

¹¹⁷ *Ibidem*, pp. 14-15.

¹¹⁸ *Ibidem*.

¹¹⁹ For more detailed discussion, see the analysis of exit consents in sovereign bond exchanges undertaken by Buchheit and Gulati: L.C. Buchheit & G.M. Gulati, J. Garcia-Hamilton Jr., R. Olivares-Caminal & O.M. Zenarruza, *The Required Threshold to Restructure Sovereign Debt*, 27 *Loyola of Los Angeles International and Comparative Law Review* 101 (2005).

Collective action clauses and exit consents are useful tools in helping to limit the holdout problem and encourage private creditors to act collectively. It is worth noting that in the course of difficult sovereign debt restructuring negotiations, private creditors acting collectively have also had the support of their own government, which will usually have an interest in early resolution of the debt crisis.¹²⁰ So far as sovereign creditors are concerned, at least since the 1950s coordination has typically been achieved by working through the Paris Club. The Paris Club is an informal forum, serviced by the French Treasury, at which the major creditors agree to take a common approach to restructuring the repayment schedules on each of the individual loans owed to each of the member countries' government agencies or offices, or sometimes they agree to reduce the amount of outstanding debt itself.¹²¹ The obvious problems with this mechanism are first, that not all creditor governments are members of the Paris Club. Second, the Paris Club mechanism excludes consideration of debts owed to the multilateral institutions, although it does demand "comparable treatment" from all other creditors including commercial banks and private creditors. Moreover, debtor countries express genuine concern about the effectiveness and lack of impartiality of the Paris Club, the heavy cost in terms of time consumed in individual negotiations with many creditors, and the fact that creditors can apply pressure in bilateral rescheduling.¹²²

A number of authors have stressed the need for a mechanism enabling a supermajority of creditors of all types (public and private, and across the broad range of credit instruments) to make the terms of a restructuring binding on all other creditors.¹²³ This is necessary, it is argued, as the only sure way to reduce unnecessarily prolonged negotiations and to prevent free-rider problems.¹²⁴ Some writers have suggested that the free rider problem could adequately be addressed by more ambitious use of collective action clauses in debt contracts. This was the approach preferred by Glenn Hubbard, then Chairman of President Bush's Council of Economic Advisers, in a speech given in January 2003 at an IMF conference in Washington.¹²⁵ Drawing on ideas put forth by John Taylor,

¹²⁰ For example, when the UK government intervened diplomatically during CFB settlement negotiations with countries like Honduras and Guatemala. The CFB was also able to successfully negotiate settlements with major problem debtors including Spain, Portugal, Greece, Turkey, Peru, Mexico, Brazil and Argentina with various forms and guises of British government involvement and support: P. Mauro & Y. Yafeh, *The Corporation of Foreign Bondholders*, IMF Research Department Working Paper, May 2003.

¹²¹ See further E. Cosio-Pascal, *The Emerging of a Multilateral Forum for Debt Restructuring: The Paris Club*, UNCTAD Discussion Paper No. 192 (November 2008) (UNCTAD/OSG/DP/2008/7).

¹²² *Ibidem*.

¹²³ Ch.G. Oeschli, *Procedural Guidelines for Renegotiating LDC Debts: An Analogy to Chapter 11 of the U.S. Bankruptcy Reform Act*, 21(2) *Virginia Journal of International Law* 305-341 (1981); B.J. Cohen, *Developing Country Debt: A Middle Way*, in: *Princeton Essays in International Finance*, Princeton University Press, Princeton: 1989, p. 173.

¹²⁴ Schwarcz, *supra* note 52.

¹²⁵ Discussed in: S. Vaknin, *The Bankrupt Sovereign: The Sovereign Debt Restructuring Mechanism (SDRM)* (Written 24 January 2003, updated April 2005, January and August 2011), pp. 2-3, available at <http://samvak.tripod.com/brief-sovereigndebt01.html>. See also Sovereign Debt Restructuring Mechanism (SDRM) Conference, 22 January 2003, Washington DC, keynote address by G. Hubbard, agenda available at <http://www.imf.org/external/np/ext/seminars/2003/sdrm/index.htm> (last accessed 10 April 2013).

then Treasury Undersecretary for International Affairs, Hubbard proposed to modify all sovereign debt contracts pertaining to all forms of debt to allow for majority decision making, the pro-rata sharing of disproportionate payments received by one creditor among all others and structured, compulsory discussions led by creditor committees.

Yet such a contractual approach suffers from serious flaws. It is not clear why creditors would voluntarily forego their ability to extort from other lenders and from the debtor an advantageous deal by threatening to withhold their consent to a laboriously negotiated restructuring package. Nor would a contractual solution tackle the thorny issues of encompassing different debt instruments and classes of creditors, or coordinating action across jurisdictions. These complexities explain much of the weakness of current collective action clauses in debt contracts.¹²⁶ Such clauses are typically confined to certain types of sovereign bonds, whereas what is wanted is a more comprehensive restructuring across a broad range of indebtedness, potentially including different types of bonds issued under different jurisdictions, bank loans and trade credits. It would be theoretically possible to develop a “super collective action clause” that would provide for restructuring of a give instrument on the basis of an affirmative vote by a supermajority of all creditors of all types. But creditors are unlikely to agree to the uniform inclusion of such a clause in all relevant instruments, and even were this unlikely result achieved, there would be no guarantee that the clause would be uniformly interpreted and applied across a range of national jurisdictions.¹²⁷

Given the persistent legal obstacles to the smooth implementation of sovereign debt restructurings, Krueger proposes the establishment of a statutory basis for collective action through universal treaty obligation. This would ensure uniformity of text and allow a single institution to be given the authority to ensure uniformity of interpretation, thereby avoiding problems of forum shopping and free-riding by creditors seeking to avoid inclusion in the wider restructuring agreement.¹²⁸

The most obvious problem identified with the idea that collective action is necessary is that different types of creditors and different types of debt may demand and/or require different treatment. For example, to what extent should official creditors (multilateral institutions) or government creditors be treated differently to private creditors?¹²⁹ Should sovereign debt owed to domestic creditors be treated differently to international

¹²⁶ A.O. Krueger, *New Approaches to Sovereign Debt Restructuring: An Update on Our Thinking*, address delivered at the Conference on *Sovereign Debt Workout: Hopes and Hazards*, Institute for International Economics, Washington DC, 1 April 2002.

¹²⁷ *Ibidem*.

¹²⁸ *Ibidem*.

¹²⁹ According to the IMF Policy Development and Review Committee: “No one category of private creditors should be regarded as inherently privileged relative to others in a similar position. When both are material, claims of bondholders should not be viewed as senior to claims of banks” (IMF Policy Development and Review and Legal Departments, *Involving the Private Sector in the Resolution of Financial Crises – Restructuring International Sovereign Bonds*, (IMF, Washington: 24 January 2001), p. 27).

The committee does not go further, however, to suggest that official and/or government creditors should be treated on an equal basis with private creditors.

debt? Any new sovereign bankruptcy mechanism would have to find a way of dealing with each of these different types of creditors with their different debt instruments. As will be further argued below, this would probably best be achieved by establishing a specialised panel or tribunal capable of overseeing, coordinating and evaluating all relevant creditors and their different claims.

2.3.2. Stay on legal action

Today, sovereign debt defaults typically lead to years of haggling amongst bankers and bondholders. It is a costly process, injurious to the distressed country's future ability to borrow. Moreover, both creditors and debtors have a perverse incentive to aggravate the situation. The more calamitous the outlook, the more likely are governments and international financial institutions to step in with a bailout package, replete with soft loans, debt forgiveness, and generous terms of rescheduling. This encourages the much-decried "moral hazard" and results in reckless borrowing and lending.¹³⁰ A carefully thought-out international sovereign bankruptcy procedure with a well-managed stay on legal action will take away the ability of any single creditor to "blackmail" the debtor and other creditors using the threat of a holdout, and should also serve to impose time limits on the negotiation process. That is, a legal stay on actions against the debtor should be automatic and universally binding, but it should also be time limited. The discipline of such a time limit would provide an incentive for the debtor to enter and conclude negotiations in good faith and as effectively as possible. It should always be possible for the debtor and a super-majority of creditors to extend the legal stay on action if it expires when negotiations are nearing a conclusion.

A 1985 court decision, *Allied Bank International v Banco Credito Agricola de Cartago*,¹³¹ illustrates both the possibility that a single creditor can "hold out" and the tenuous nature of protections against the claims of such a creditor. In 1981 Costa Rica had suspended debt payments to a 39-member bank syndicate. A restructuring agreement was subsequently reached with all creditors but one, Fidelity Union Trust of New Jersey, which sued through an agent, Allied Bank. A US Court of Appeals initially upheld a lower court ruling in favour of three Costa Rican banks that had acted on behalf of Costa Rica, arguing that:

Costa Rica's prohibition of payments of its external debt is analogous to the reorganization of a business pursuant to Chapter 11 of our Bankruptcy Code (...) Costa Rica's prohibition of payment of debt was not a repudiation of the debt but rather was merely a deferral of payments while it attempted in good faith to renegotiate its obligations.¹³²

¹³⁰ Vakinin, *supra* note 125; see also *A New Approach to Sovereign Debt Restructuring: An IMF Proposal*, Transcript of an IMF Economic Forum, Panel discussion at the IMF's Sovereign Debt Restructuring Mechanism (SDRM) Conference, Washington DC, 22 January 2003, available at <http://www.imf.org/external/np/tr/2003/tr030122.htm> (last accessed 10 April 2013).

¹³¹ 566 F. Supp. 1440. US District SDNY (8 July 1983). Discussed in M. Leigh, *Allied Bank International v Banco Credito Agricola de Cartago*, 78 *American Journal of International Law* 441 (1984).

¹³² *Ibidem*.

Upon rehearing the case in March 1985, however, the court reversed itself after the US Department of Justice argued that contrary to the court's initial assumptions, the US government did not agree with "Costa Rica's attempted unilateral restructuring" but instead supported an IMF-guided renegotiation procedure, "grounded in the understanding that while parties may agree to renegotiate conditions of payment, the underlying obligations to pay nevertheless remain valid and enforceable." In the end, the court ruled that "The Costa Rican government's unilateral attempt to repudiate private, commercial obligations is inconsistent with the orderly resolution of international debt problems."¹³³ While validating the claim of a holdout creditor, however, the decision still left the problem of how to find and attach assets within the forum not protected by sovereign immunity. Holdout creditors have not been slow in finding ways to overcome these obstacles, as the Elliott case of 2000 (discussed below) demonstrated.

Holdout creditors have arguably become *the* major problem for sovereign debt restructuring since the early 1990s, when the international financial architecture for sovereign borrowing changed from syndicated bank loans to sovereign bonds. The new bond-based structure led to the creation of a secondary market for such instruments and consequently to an exponential growth in the number of bondholders. Under the New York laws applicable to most sovereign bond instruments, bondholders are not obliged to negotiate restructurings of the debt or to accept the terms of an exchange offer. The Elliott case has further demonstrated how a single creditor can undermine a sovereign debt restructuring scheme through persistent legal actions. The case concerned the New York-based hedge fund Elliott Associates, LP chasing recovery of a distressed debt owed by the Republic of Peru.

In October 1995, Peru's government announced its Brady deal, under which the relevant Bank Advisory Committee had agreed to exchange Peru's defaulted commercial bank loans for "Brady Bonds". Following this announcement, between January and March of 1996, Elliott purchased a total of USD 20.7 million (face value) in commercial bank loans¹³⁴ at the distressed price of about USD 11.4 million.¹³⁵ Immediately after completing its acquisition, while Peru was still negotiating with the Bank Advisory Committee the term sheet of its Brady deal, Elliott started making demands for full payment. When in October 1996 Peru issued instructions to execute the Brady Exchange Agreement, Elliott refrained from participating in the proposed Agreement, and instead filed suit against Peru. However, the court refused Elliott's motion to attach

¹³³ 757 F2d 516 (2d Cir 1985), para. 26. See further B. Trubitt, *International Monetary Fund Conditionality and Options for Aggrieved Fund Members*, 20 Vanderbilt Journal of Transnational Law 665 (1987).

¹³⁴ In the form of 1983 Letters of Agreement of *Banco de law Nacion* and *Banco Popular del Peru* which had been guaranteed by Peru.

¹³⁵ See Ambassador Philip S. Kaplan, Patton Boggs LLP, *Memorandum prepared by Peru's outside counsel addressed to Peru's Minister of Economy, Mr Carlos Bologna, about the Elliott Associates Settlement*, p. 1. Available at http://www.mef.gob.pe/Caso_E/frame_pdf.htm. See also Ministry of Economy and Finance of Peru, *Final Report About the Elliott Associates case*, p. 1, available at http://www.mef.gob.pe/Caso_E/frame_pdf.htm3 (last accessed 10 April 2013).

the collateral for the Brady deal closure, and also denied a summary judgment motion subsequently filed by Elliott. The Brady Exchange Agreement was thus able to proceed to closure on 7 March 1997.¹³⁶

On 22 June 2000 the district court for the Southern District of New York finally rejected Peru's defences (which had been through a number of hearings) and ordered judgment in favour of Elliott. In its decision, the court authorised Elliott to recover from the defendants the sum of USD 55,660,831.56, representing the principal amount and past due interest up to judgment date. The court also authorized the execution of the decision against any property of the defendants used for commercial purposes in the United States.¹³⁷ As a result of this decision, Peru was forced to adopt a completely new strategy for receiving funds and satisfying international financial obligations otherwise than through financial centres in the US. Peru's attempts to develop such a strategy was further hampered by Elliott's renewed attempts to attach Peruvian assets abroad, including in Germany, Holland, Belgium, England, Luxembourg and Canada.¹³⁸

Not wanting to risk having the money attached by Elliot, Peru failed to lodge its first Brady body coupon interest payment with the Chase Manhattan Bank (its fiscal agent) on 6 September 2000 for payment to bondholders as required by the terms of the Brady deal. This failure triggered a 30 day grace period, placing Peru's legal advisers under pressure to find a way of getting interest monies to bondholders otherwise than through a US bank before the deadline of 7 October 2000.¹³⁹ On 21-22 September 2000, Elliott filed an *ex parte* motion in New York seeking restraining orders against Chase, the Bank of New York, Morgan Guaranty Trust Company of New York and Depository Trust Company of New York – one of the three clearing houses charged under the Brady plan with distributing the Brady bond interest payments. Also on 22 September, Elliott filed an *ex-parte* motion before the Commercial Court of Brussels, Belgium in order to prevent Euroclear of Belgium – another of the three clearing house distributors of Brady bond payments – from receiving or paying out cash from Peru intended to pay interest on the Brady bonds. Although the court denied Elliott's motion at first instance, Elliott's appeal in the 8th Chamber of the Brussels Court of Appeals was successful, and the restraining order against Euroclear and against Chase Manhattan was granted in the terms requested by Elliott. The key argument presented by Elliott and accepted by the Brussels Court of Appeals was that Peru was trying to use Euroclear to violate the principle of equal treatment of creditors, allegedly derived from the *pari passu* clause contained in the original loan agreements held by Elliott.¹⁴⁰

¹³⁶ E.L. Sandoval, *Sovereign Debt Restructuring: Should we be worried about Elliott?*, in: H. Scott & H. Jackson (eds.), *Harvard Law School International Finance Seminar*, Cambridge, MA, May 2002, pp. 9-10, available at <http://www.law.harvard.edu/programs/about/pifs/llm/sp44.pdf> (last accessed 12 February 2013).

¹³⁷ *Elliott Associates L.P. v Banco de la Nacion*, 2000 WL 1449862 S.D.N.Y., 29 September 2000.

¹³⁸ Sandoval, *supra* note 136, pp. 12-15.

¹³⁹ *Ibidem*, p. 15.

¹⁴⁰ *Ibidem*.

What the Allied Bank case and the Elliot case demonstrate is the need for any stay on legal action by holdout creditors to be enforceable across all relevant jurisdictions. It is difficult, if not impossible, to achieve this aim even in the most well drafted contractual agreement. As recognised by the IMF Legal Department in 1995, an international treaty or other similar instrument is necessary to ensure a uniform approach between legal systems.¹⁴¹

The IMF's 2001 SDRM proposal for a statutory approach to handling sovereign debt crises¹⁴² expressly recognises the importance of ensuring that the debtor is protected from legal action after the suspension of payments and while negotiations take place. There needs to be a stay on legal action – of fixed duration, but preferably one which could be renewed if the restructuring was not agreed within the original stay period. Creditors would need to be given adequate assurances that their interests were being protected during the period of the stay. In particular, the indebted sovereign would have to undertake that resources would not be dissipated e.g. by making payments to non-priority creditors before agreement was reached with all creditors.

2.3.3. Economic policy undertakings

Krueger's 2001 SDRM proposal also envisages a requirement that:

the debtor would have to conduct its economic policies in a way that would help put the country back on the road to growth and viability. Implementation of an IMF-supported program would be one way to provide these assurances. Creditors would have an interest not only in monetary, fiscal and exchange rate policies, but also in bank restructuring, the integrity of the domestic payments system, the operation of the domestic bankruptcy regime, and the nature of any exchange and capital controls.¹⁴³

This is the most controversial part of the Krueger proposal, and brought an immediate response from NGO spokespersons such as Ann Pettifor from Jubilee Research. The essence of the objection to requiring debtor nations to enter into economic policy undertakings is the damage it inflicts on any idea of state sovereignty. Respect for state sovereignty requires that a state be free to independently make its own domestic economic policy decisions. When other aspect of the debt restructuring mechanism, such as the power to determine what level of debt servicing by the sovereign debtor is sustainable, are also under IMF control, then for Pettifor and others, the SDRM simply places far too much power in the hands of the IMF. Pettifor accuses the SDRM of being a “self-defeating rescheduling mechanism”:

We believe that this process is being driven by institutional self-interest because the sovereign debt restructuring mechanism would enhance the role of the Fund and would

¹⁴¹ International Monetary Fund Legal Department, *Note on an International Debt Adjustment Facility for Sovereign Debtors*, EBS/95/90, 26 May 1995 (unpublished, Executive Board Internal Report); cited in Rogoff & Zettelmeyer, *supra* note 41, p. 486.

¹⁴² Krueger, *supra* note 92.

¹⁴³ *Ibidem*, p. 5.

enshrine the international role of the Fund in law.¹⁴⁴ (...) we believe the sovereign debt restructuring mechanism is not fair (...) because the IMF shapes the outcome (...) in advance of the process. (...) the IMF by determining debt sustainability in advance pre-empts the process. The IMF effectively under the SDRM writes the plan, the composition plan. As IMF determines economic policies, the IMF not the debtor, or even a combination of the debtor and the creditor, writes the economic plans.¹⁴⁵

IMF and/or creditor-imposed conditionalities arguably detract from a number of international law principles, particularly those given prominence during General Assembly debates of the New Economic Order in the mid 1970s (discussed below). While creditors may justifiably ask to be satisfied that the debtor nation does have a strategy for moving forward towards solvency, they should not be able to simply impose policy conditionalities as they (the creditors) see fit. Debtors, just as much as creditors, have an interest in ensuring that national economic policies are conducted in a way calculated to put the country back on the road to viability. The point has been made that many debtor countries lack (because they cannot afford), the expertise needed to implement good quality economic policies.¹⁴⁶ This is where the World Bank and the IMF could prove useful, as they could provide independent advisers to work with debtor governments on the design and implementation of economic policy, including poverty reduction strategies. The key seems to lie in reaching a balance between retaining the sovereign independence of the debtor on the one hand, and providing reassurance for creditors that the economic system they are exposed to is being properly run on the other.

2.3.4. Availability of fresh finance

Fresh money is nearly always useful, if not vital, to a crisis-ridden sovereign debtor in a number of ways. It can help to limit economic dislocation, provide trade credit, finance payments to priority creditors, and provide resources for a return to generalized debt servicing. The need for new financing has been recognised as part of a number of previous proposals for a debt restructuring mechanism.¹⁴⁷ For example, in 1979 when the Group of 77 developing countries drew up a proposal for the creation of an “International Debt Commission” during a meeting in Arusha, the proposal included a particular emphasis on new financing.¹⁴⁸ Sachs and Schwarcz observed at the time that the under-provision of new private finance had led to an over-reliance on IMF and public-sector crises lending, with all the moral hazard implicit in such

¹⁴⁴ Pettifor, *supra* note 97. Transcript of an IMF Economic Forum: “A New Approach to Sovereign Debt Restructuring: An IMF Proposal”, Panel discussion at the IMF’s Sovereign Debt Restructuring Mechanism (SDRM) Conference, Washington DC, 22 January 2003, 6, available at <http://www.imf.org/external/np/tr/2003/tr030122.htm>.

¹⁴⁵ *Ibidem*.

¹⁴⁶ B. J. Cohen, *A Global Chapter 11*, 75 *Foreign Policy* 109 (1989).

¹⁴⁷ For discussion see Rogoff & Zettelmeyer, *supra* note 41, pp. 472-3.

¹⁴⁸ Group of 77, *Arusha Programme for Collective Self-Reliance and Framework for Negotiations*, reprinted as Annex IV in *Proceedings of the United Nations Conference on Trade and Development*, Fifth Session, Manila, Volume I, Reports and Annexes, 127-77 (1979).

bailouts.¹⁴⁹ Over 20 years later, in order to encourage and facilitate the provision of fresh finance, the IMF's proposed new SDRM recognised the need to encourage the provision of fresh finance by requiring that any new financing provided by private creditors after the introduction of a stay would be quarantined from the restructuring.¹⁵⁰

It was not until a policy initiative introduced during the 1980s that the IMF was willing to lend into arrears. The IMF's policy prior to 1986 was to lend only if the projected balance of payments needs of a country were fully financed. In other words, if bank creditors refused to reschedule a country's debts, the Fund would normally suspend access to its own money. IMF lending into arrears first appear in the context of a stand-by arrangement with Bolivia in June 1986, and was formally adopted as part of the IMF's debt strategy in May 1989.¹⁵¹ Under the new policy, arrears to commercial banks were generally tolerated. By 1998, the policy was extended to include tolerance for arrears to bondholders. From the perspective of solving the collective action and incentive problems associated with sovereign debt restructuring, this had two consequences. First, in principle, debtors could now receive IMF support after a payments suspension, while negotiations with creditors were in progress. This made the prospect of declaring a unilateral moratorium less daunting and weakened the bargaining position of private creditors, who were "no longer allowed to determine whether an [IMF] arrangement would be approved." Second, it gave the IMF an instrument with which to exert leverage over a defaulting debtor. Cooperative debtor behaviour during negotiations with creditors could be rewarded through lending into arrears.¹⁵²

One possibility would be the establishment of a special fund to support the implementation of a new SDRM. The fund could provide fresh finance to countries needing to restructure their debt under the terms of a new SDRM, and could also be used to pay for the operations of an independent body charged with overseeing such restructurings. The fund could even be financed by a "Robin Hood" tax (sometimes referred to as a Tobin Tax)¹⁵³ imposed on international financial transactions and recommended by some as a means of curbing harmful speculative financial flows.¹⁵⁴ To

¹⁴⁹ Sachs, *supra* note 86; Schwarcz, *supra* note 89.

¹⁵⁰ Krueger, *supra* note 92.

¹⁵¹ J.M. Boughton, *Silent Revolution: The International Monetary Fund, 1979-1989*, IMF, Washington: 2001, pp. 485-98.

¹⁵² A. Haldane & M. Kruger, *The Resolution of International Financial Crises: Private Finance and Public Funds*, Bank of Canada Working Paper 2001/20 (November 2001), p. 8. Rogoff & Zettelmeyer, *supra* note 41, p. 479.

¹⁵³ After the original proposal for a currency transaction tax (as a means of enhancing the efficacy of macroeconomic policy) made by James Tobin in his Janeway Lectures in 1972 (published as J. Tobin, *The New Economics One Decade Older: The Eliot Janeway Lectures on Historical Economics in Honour of Joseph Schumpeter*, 1972, Princeton University Press, Princeton: 1974.

¹⁵⁴ M. ul Haq, I. Kaul & I. Grunberg (eds.), *The Tobin Tax: Coping with Financial Volatility*, Oxford University Press, New York: 1996. See also P. Wahl & P. Waldow, *Currency Transaction Tax – a Concept with a Future: Chances and Limits of Stabilising Financial Markets Through the Tobin Tax*, World Economy, Ecology and Development Working Paper (Bonn, 2001).

those who argue that “easy” access to fresh finance serves to reduce the cost of default for debtors and thus make defaults more frequent, Rogoff and Zettelmeyer point out that this may well in fact be an improvement over the current situation.¹⁵⁵ It may be better – more efficient – to have occasional low-cost debt restructuring than more infrequent but disastrous crises. If that is the case, it is not obvious that the cost of capital would rise, because even though the likelihood of debt restructurings might rise, creditor losses contingent on debt restructurings would fall. Moreover, even if the cost of capital does increase, and the average volume of capital flows declines, this may be welfare improving if it goes along with a higher stability of capital flows.¹⁵⁶

A reduced volume of more stable capital flows may also help to restore, or at least may reflect, the kind of market discipline that exists when “creditors bear the consequences of the risks they take”. As the IMF Policy Review and Development Committee has noted: “[p]rivate credit decisions need to be based on an assessment of the potential risk and return associated with a particular investment, not in the expectation that creditors will be protected from adverse outcomes by the official sector.”¹⁵⁷ In other words, banks which have lent to sovereign debtors beyond that debtor’s ability to repay should not expect to be bailed out.

2.3.5. Independent oversight and dispute-resolution

One of the earliest proposals for sovereign debt restructuring that recognised the need for an independent oversight body was the Group of 77 1979 proposal for the creation of an International Debt Commission. As put forward to the 5th UN Conference on Trade and Development (UNCTAD) in June 1979, the Debt Commission would consist of:

eminent public figures with recognised knowledge and experience of debt problems and economic development. Any interested developing country which believes it has, or may have a debt problem could address itself to the Commission. The commission will: (i) Examine the debt and development problems of the requesting country; (ii) In the light of such examination (...) make recommendations on measures required to deal with the debt problem in the broader context of development including measures of debt reorganisation and additional bilateral and multilateral finance; (iii) Convene a meeting of all parties concerned with a view to implementing the recommendations under (ii) above.¹⁵⁸

Two years later, in 1981, Christopher Oeschli also emphasised the need for a independent “examiner, a monitoring party which does not displace the debtor from control of its business” as part of a sovereign debt restructuring mechanism that would

¹⁵⁵ Rogoff & Zettelmeyer, *supra* note 41, pp. 497-98.

¹⁵⁶ *Ibidem*.

¹⁵⁷ IMF, *Involving the Private Sector in the Resolution of Financial Crises – Restructuring International Sovereign Bonds*, Prepared by the Policy Development and Review and Legal Departments, presented at the Executive Board Meeting 01/8, 24 January 2001, Part V Concluding Observations, p. 27.

¹⁵⁸ Group of 77, *supra* note 148.

be based on Chapter 11 of the US Bankruptcy Reform Act of 1978.¹⁵⁹ In 1995, the IMF Legal Department favoured the establishment of a semi-independent arbitration body to oversee sovereign debt restructurings – a body which, it was suggested, could be established through an amendment of the IMF's Articles of Agreement.¹⁶⁰ This was the same year that Jeffrey Sachs delivered an influential lecture in which he suggested that the IMF was so inefficient in its lending role that it should instead be reorganised to assume the role of an international bankruptcy court.¹⁶¹

Other commentators, including Barnett, Galvis and Gouraige¹⁶² and Cohen¹⁶³ have called for the creation of a new permanent International Debt Restructuring Agency established by multilateral convention. Others have proposed that *ad hoc* facilitation panels could be established as part of each sovereign debt restructuring process.¹⁶⁴ In each case, the role of the independent oversight body would be to verify creditor claims, supervise voting processes, resolve disputes and oversee the reaching and implementation of a final restructuring agreement. A number of commentators have emphasised the need for the new body to be independent of the multilateral institutions, especially the IMF. James Hurlock, for example, rejected suggestions for an IMF-based bankruptcy tribunal on the grounds that “the Fund is ill-suited to the role of neutral arbiter of sovereign debt disputes because of its political nature and voting structure.”¹⁶⁵

In 2001, Anne Krueger, discussing an IMF proposal for an SDRM, recognised the need for “independent arrangements for the verification of creditors’ claims, the resolution of disputes, and the supervision of voting.”¹⁶⁶ If the new, independent body established to fulfil these functions also has the job of overseeing access to a pool of fresh lending to crisis-ridden states (funded via a Tobin tax), then the body will need to be a permanent one. If not, then *ad hoc* arbitration bodies could be established, possibly appointed via an IMF dispute settlement understanding modelled on the WTO Dispute Settlement Understanding.¹⁶⁷

¹⁵⁹ For discussion see Rogoff and Zettelmeyer, *supra* note 41, pp. 473-4.

¹⁶⁰ IMF, *Note on an International Debt Adjustment Facility for Sovereign Debtors*, EBS/95/90, 26 May 1995 (unpublished, Executive Board Internal Report).

¹⁶¹ J. Sachs, *Do We Need an International Lender of Last Resort?*, Vol 8 Frank D. Graham Lecture at Princeton University, (20 April 1995). “IMF practices should be reorganized such the IMF plays a role far more like an international bankruptcy court and far less like the lender of last resort to member governments.” (p. 14), available at <http://www.hks.harvard.edu/cid/>.

¹⁶² Barnett et al., *supra* note 89.

¹⁶³ Cohen, *supra* note 123, p. 173. See also Cohen, *supra* note 146.

¹⁶⁴ A. de Jonge, *An international debt-relief forum*, in: E. Dommen (ed.), *Debt Beyond Contract*, Observatoire de la Finance, Geneva: 2001, 79, pp. 91-93.

¹⁶⁵ J. Hurlock, *The Way Ahead for Sovereign Debt*, Euromoney (August 1995), pp. 78-9.

¹⁶⁶ Krueger, *supra* note 126, p. 6. According to Krueger, this would “help reassure investors that they need not worry about the potential for fraud, for example if a country were deliberately to issue debt to friendly creditors in sufficient quantities to give them a supermajority to impose a big haircut on all creditors.”

¹⁶⁷ Annex 2 of the WTO Agreement, in *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, 33 ILM 1225 (1994).

The need for flexibility in developing solutions to sovereign debt crises was emphasised above. It can be argued that the creation of a permanent oversight body or set of rules could lead to a lack of flexibility as such legal institutions have a tendency to become fixed and more rigid in their ways and procedures over time. It may well be that *ad hoc* independent arbitration – plain vanilla style international law – is therefore to be preferred. The Jubilee campaign has drawn on Raffer's scholarship to demand a fair, transparent arbitration procedure in the resolution of sovereign debt crises.¹⁶⁸

Existing arbitral tribunals that are well accepted internationally and have good track records offer possible fora for independent (fair and transparent) arbitrations. The World Bank's International Centre for the Settlement of Investment Disputes (ICSID) is one such forum. On 4 August 2011, the ICSID Panel decided (by a majority of two to one) to accept jurisdiction and proceed to a hearing on the merits in a dispute between the government of Argentina and a class of 60,000 holders of defaulted Argentine bonds.¹⁶⁹ The dispute being arbitrated arose following the Argentine government's 2001 declaration of a moratorium on service of its outstanding debts owed to foreign creditors. As Argentina emerged from the devastating economic crisis that led to the moratorium, in 2005 the government offered to exchange the defaulted debt for new debt instruments, paying approximately thirty-five cents in the dollar. Although about 76% of Argentina's creditors participated in the restructuring, the debt held by creditors that refused to participate was still massive.

The hold-out creditors filed hundreds of lawsuits against Argentina in New York, Germany, Italy and elsewhere to collect on the defaulted debt, but they have found the judgments in their favour hard to enforce. The Argentine government has refused to pay, and many creditors could not find attachable Argentine assets to levy against. Other holders of defaulted Argentinian debt have sought arbitration of their claims. Arbitration has several advantages over litigation – arbitral awards can be enforced under the 1958 New York Convention or ICSID Conventions, with simpler procedures and broader reach than the procedures for enforcing a foreign judgment. There are hundreds of bilateral investment treaties (BITs) providing for arbitration of investor claims against sovereigns, either before ICSID or under other rules. ICSID arbitration

¹⁶⁸ See e.g. K. Raffer, *Debt Relief for Low Income Countries: Arbitration as the Alternative to Present Unsuccessful Debt Strategies*, WIDER Discussion Paper 2001/113 (October 2001), World Institute for Development Economic Research, UN University, Helsinki/Helsingfors, <http://www.wider.unu.edu/conference/conference-2001-2/conference2001-2.htm> (last accessed 10 April 2013). See also A. Krueger, *Sovereign Debt Restructuring and Dispute Resolution* (6 June 2002), available at <http://www.imf.org/external/np/speeches/2002/060602.htm> (last accessed 10 April 2013); and K. Halverson Cross, *Arbitration as a Means of Resolving Sovereign Debt Disputes*, 17(3) *American Review of International Arbitration* 335 (2006).

¹⁶⁹ *Abaclat and Others (Case formerly known as Giovanna a Beccara and Others) v Argentine Republic*, ICSID Case No ARB/07/5, Decision on Jurisdiction and Admissibility (4 August 2011), available at <http://italaw.com/documents/AbacialDecisionJurisdiction.pdf> (last accessed 10 April 2013). Discussed in K. Halverson Cross, *Investment Arbitration Panel Upholds Jurisdiction to Hear Mass Bondholder Claims Against Argentina*, 15(30) *ASIL Insights* (21 November 2011).

also has the advantage that ICSID awards generally have enjoyed a high rate of voluntary compliance.¹⁷⁰

Beginning in March 2006, Task Force Argentina (TFA), an association of eight major Italian banks, distributed to Italian holders of defaulted Argentine debt a request to sign a mandate for TFA to represent them in pursuing an ICSID arbitration claim against Argentina. In September 2006, after over 180,000 bondholders had accepted TFA's mandate, TFA filed on their behalf a request for arbitration against Argentina. Argentina contested the tribunal's jurisdiction to hear the bondholders' claims.

In May 2010, Argentina initiated a second offer in exchange defaulted debt for new debt instruments. Sixty-six percent of the hold-out creditors participated in this offer. Claimants that participated in the 2010 exchange offer withdrew from the ICSID claim, leaving approximately 60,000 bondholders.¹⁷¹

Until *Abaclat and Others (formerly Giovanna a Beccara and Others) v Argentine Republic*, no tribunal had ever addressed whether bonds constitute an "investment" for the purposes of the ICSID Convention. Nor had any tribunal addressed the question of whether consent to investor-state arbitration in a BIT (such as the Italy-Argentina BIT at issue in the case) extended to mass claims, let alone the further question of whether ICSID's procedural rules allow for a mass claims (or class action) procedure.¹⁷²

The ICSID tribunal in *Abaclat* found, first, that the sole criterion as to whether the bonds at issue constitute an 'investment' for purposes of the ICSID Convention is whether the bonds fall within the definition of investment provided for in the relevant BIT (i.e. the Italy-Argentina BIT). This approach departs from previous ICSID decisions that articulate additional criteria, including the duration of the investment and the significance of the investment to the host state's development.¹⁷³

Second, the tribunal acknowledged that the ICSID framework is silent as to mass proceedings, but found that it would run counter to the purpose of the Italy-Argentina BIT and to the spirit of ICSID to interpret such silence as a prohibition on mass proceedings. Similarly, while the tribunal acknowledged that it would not be able to examine group claims in the same careful way it could with individual claimants, this consideration was weighed against the consequences of rejecting the bondholders' claims for lack of admissibility – an outcome which could, in the tribunal's view, result in a "shocking" denial of justice to the claimants. It should be noted that this finding stands contra to the approach taken by the US Supreme Court in the context of commercial arbitration. In *Stolt-Nielsen SA v Animal Feeds Int'l Corp.*,¹⁷⁴ the Court found that "the differences between bilateral and class-action arbitration are too great for arbitrators

¹⁷⁰ Halverson Cross, *supra* note 169.

¹⁷¹ *Ibidem*.

¹⁷² *Ibidem*.

¹⁷³ *Ibidem*, citing *Abaclat*, pp. 362-367; See also Ch.H. Schreuer, *The ICSID Convention: A Commentary* (2nd ed.), Cambridge University Press, Cambridge: 2009, pp. 128-34, and M. Waibel, *Sovereign Defaults before International Courts and Tribunals*, Cambridge University Press, Cambridge: 2011.

¹⁷⁴ 130 S. Ct. 1758 (2010).

to presume (...) that the parties mere silence on the issue (...) constitutes consent to resolve their dispute in class proceedings.”¹⁷⁵ It should also be noted that Georges Abi-Saab, the arbitrator Argentina appointed to the Abaclat tribunal, issued (on 28 October 2011) a strong dissent from the majority’s decision concluding that the tribunal lacked jurisdiction to hear the bond-holders claims, *inter-alia* on the ground that devising new procedures to handle mass claims would both exceed the tribunal’s powers and deprive Argentina of its procedural rights to individual adversarial examination of differentiated claims.¹⁷⁶ Argentina had also argued, as a point of policy, that allowing arbitration would only encourage hold-out creditors, and thereby further complicate efforts to modernize the sovereign debt restructuring process.¹⁷⁷

Yet used properly, arbitration in sovereign debt disputes may have the very opposite effect. Arbitration clauses in sovereign debt instruments may be more acceptable to creditors than, for example, collective action clauses but could be structured to have a similar effect in precluding hold-out creditors. An agreement to abide by the results of mass action arbitration would be seen as fair and transparent, and if made binding on all holders of debt issued by a particular sovereign, or on all holders of a particular debt type, could be used to preclude legal action by hold-out creditors.

Any panel established to resolute disputes in a sovereign debt restructuring would need to have an agreed basis of legal authority. It should have authority not only to evaluate creditor claims, but also any challenges by the debtor to the legal validity of the original debt. For example, it may need to investigate whether or not the debt properly belongs to the sovereign challenging the existence of an obligation, or whether coercive measures were involved in the original contracting of the sovereign debt.¹⁷⁸

The final part of this article examines widely accepted international instruments containing principles relevant to the resolution of sovereign debt crises.

CONCLUSION

Sovereign debt crises are not going to disappear, from the landscape of global economic relations. In this article, I have attempted to identify principles of international law, drawn from treaties and state practice, which should be kept in mind in the resolution of sovereign debt crises, and in designing a new mechanism to bring about such resolution. These are:

1. respect for the sovereign equality of all nations, including respect for state sovereignty in debtor-country economic policies moving forward, with the help of independent expert advice when requested;

¹⁷⁵ *Ibidem*, p. 1776.

¹⁷⁶ Abaclat, *supra* note 169, Professor Georges Abi-Saab, Dissenting Opinion, p. 48 (28 October 2011), available at http://italaw.com/documents/Abaclat_Dissenting_Opinion.pdf (last accessed 10 April 2013).

¹⁷⁷ Halverson Cross, *supra* note 169, p. 3.

¹⁷⁸ See *e.g.* claims that Iceland was “pressured” into bailing out its banks in favour of international creditors: Waibel, *supra* note 81; Tarpley, *supra* note 58.

2. a requirement of good faith cooperation in the resolution of sovereign debt crises, including a collective action requirement for creditors;
3. recognition that all states share responsibility for ensuring sovereign debt crises are resolved in a manner which best protects the human rights of all those affected;
4. recognition that such shared responsibility may impose common but differentiated obligations on states depending upon the particular circumstance of each sovereign debt crisis;
5. an extendible, fixed-period stay on legal action by creditors;
6. access to fresh financing when certain conditions are met, with access overseen by an independent body; and
7. the establishment of an independent body to oversee all other aspects of resolving the crisis, including dispute resolution.

While principles 1-4 listed above are widely accepted, their precise meaning and how they should be implemented remains open to debate. Principles 5-7 listed above can be considered more in the nature of *lex ferenda* than *lex lata*, and will probably need to be enshrined in a widely-ratified treaty before they are accepted as part of international law. The politics surrounding the negotiation of such a treaty may well depend on the vagaries of the international financial system and its continued stability. Attempts from within the IMF to formulate such a treaty have not so far been successful. It may well be that the ILC, as a forum relatively free from politics, may be a more appropriate place within which the foundations of such a treaty might be laid down. Yet the history of attempts at crisis prevention suggests that the opposite is true, and that in the future debt crises may well continue to be dealt with as a political problem, rather than as a legal issue.¹⁷⁹ The example of the European Union in the years since 2008 demonstrates the difficulties that even this group of economically and politically rather homogenous States has experienced in establishing rules for their national fiscal and economic policies. Moreover, the impact of each crisis at the global level appears to have been escalating ever since the first Mexican crisis of the early 1980s. In such a climate, States typically become more defensive and less able and willing to cooperate. It is to be hoped that before this happens, the world community will realise that the “band-aid” style of handling sovereign debt crises – by addressing specific problems and loopholes in existing mechanisms only as they are highlighted by each new crisis – will no longer suffice.

¹⁷⁹ Ch. Walter, *Debt Crisis*, in *Max Planck Encyclopedia of Public International Law*, Oxford University Press, New York: 2011, para. 47.