El Norte – Finnish Journal of Latin American Studies No. 2, December 2007
ISSN 1796-4539

Oscar Ugarteche
Univercidad Nacional Autónoma de México

Alberto Acosta
Presidente de la Asamblea Constitiuyente de Ecuador

Global Economy Issues and the International Board of Arbitration for Sovereign Debt (IBASD)

Abstract

At the beginning of the XXIst century, the international financial architecture that existed for the second half of the XXth century has become obsolete. The division between domestic and international issuance has disappeared in the bond market, the largest debtor is the largest economy, the reserve currency has become permanently damaged, conventional law used for financial contracts belongs to the largest debtor and corruption has stymied in Wall St as well as in emerging markets. We propose some elements for a new international financial architecture: an International Board of Arbitration for Sovereign Debt, accompanied by an International Financial Code, with audits done before any negotiation. Conditionality is proposed as related to economic, social and cultural rights in order to meet the MDGs.

Keywords: Global, foreign debt, bond markets, international law, audits, orderly workouts

Why an international board of arbitration for sovereign debt

The Board proposed herein is an initiative arising from the historical experience of Latin America's foreign debt. There are previous debt workout proposals by Schroeder & Berensmann (2005), Anne O. Krueger (2002) Jürgen Kaiser (2002), Kunibert Raffer (1990)[1], Sachs (1989) among the most outstanding. The old debt problem experience (Ugarteche, 1986, Marichal, 1989) is that balance of payments difficulties are generated by drops in export commodity prices which usually go hand in hand with sharp increases in international interest rates and with credit flow reversals. This normally leads to a massive balance of payments problem, devaluation, and debt payment difficulties.

The new experience is that balance of payments problems arise from bank runs, which create a liquidity gap. (Jeanne and Wyplosz, 2001) What has been observed after the 1990's is that contemporary financial crises are closely related to bank runs. The financial rescue issue in the event of bank runs has three facets:

1. Who puts up the money.
2. Where the money goes.
3. How much money the rescuers provide, if any.

This three-faceted issue of financial rescues has the following current solutions:

1. Who puts up the money? The Treasuries of the G7 through the IMF.
2. Where does the money go? Commercial banks in the countries that have borne the dual drain.
3. How much money do rescuers provide? The liquidity gap.

One further question remains: Do debtor countries want to freely shoulder the additional emergency debt? If the situation is that they cannot cover quotas of N amount, is it reasonable to expect them to be able to pay quotas of N+ *x?* Somewhere the debtor should be able to meet its creditors and work out a feasible payback schedule that will allow the economy to recover while bondholders and other creditors get their money back.

The international system currently has two debt workout mechanisms. One is the Paris Club for official debt. The other is the London Club for bank debt. There is currently no mechanism to solve problems with bondholders, because both the United States *Council of Foreign Bondholders* and Great Britain's *Foreign Bondholders Protective Council*, were deactivated, after developing country sovereign bonds were no longer floated after the 1950's. Nor is there any mechanism or forum for debt workouts with multilateral lending agencies. Currently, in either situation as described above there is no proper debt workout system. (Ugarteche, 2007) It has been argued that market friendly solutions do not require this. Argentina proved the opposite, however.

Norway has proposed in the Soria Moria Declaration, 2005 to *"lead the way in the work to ensure the debt cancellation of the poorest countries´ outstanding debt in line with the international debt relief initiative. The costs of debt cancellation must not result in a reduction of Norwegian aid, cf. the adopted debt repayment plan. No requirements must be made for privatization as a condition for the cancellation of debt. The Government will support the work to set up an international debt settlement court that will hear matters concerning illegitimate debt."* This could be a step in the direction of a settlement court that resolves not only illegitimate debt but further, international debt problems in the spirit of the proposal made at the League of Nations in 1930 for dealing initially with unpaid US Confederate debt. This might be an international court for sovereign debt in other words, although the existing legal basis is centered on using New York law and British law, mostly. For this to happen, an international financial law would need to be agreed upon at the UN level that recognizes this tribunal as the place to solve those issues.

Corruption, odious debt and illegitimate debt

A recurring theme in the last decade's literature is odious and invalid debts. What makes them so, how can they be recognized, and what about corruption? An odious debt is incurred to oppress the people, and it is a doctrine established in 1898 when the US Government refused to acknowledge Cuba's debts to Spain for the Spanish-American War. Adams (1991), Kremer & Jayachandran (2002) and Hanlon (2002) have written on this topic, showing how this old issue is being conceptually revisited.

Corrupt debts are those violating the criminal laws of the creditor country, the debtor country[2], or both, and punishable in either judicial jurisdiction. An illegitimate debt, in turn, is legal, and earmarked for worthy purposes, but is handled fraudulently for improper gain. The clearest example is the Philippines' Bataan nuclear reactor, built for 2.5 billion dollars by Bechtel, under supervision by the International Atomic Energy Agency and the US Atomic Energy Commission, to install a Westinghouse reactor. It has never operated because it was built on a geographical fault and split open. (Ugarteche, 1999) Didn't anyone realize this would happen? Or was it a juicy deal and work had already begun when they learned of the problem, so they kept on anyway? Another example is Bolivia's Klockner tin smelter, built by German engineers in Bolivia at 4,200 meters altitude.(Ugarteche, 1999) The oxygen supply there is insufficient to operate the plant at all, but it is also over-sized beyond the supply of ore. It doesn't work, but it must be paid for. In Ecuador,(Pazmiño, 2002) the Norwegian ship export campaign case comes to mind.(Civic Commission to Control Corruption, Ecuador, 2002) These are just a few examples of the many illegitimate debts, where customers ought to be entitled to return the product and get their money back. (Vitale, 1986; Olmos, 1995, Hanlon, 2002)

The Norwegian Government has phrased its export loans policy mistake the following way:

> In 1988-89, the Brundtland Government conducted an evaluation of the Ship Export Campaign, in which the campaign was criticized for inadequate needs analyses and risk assessments. The main conclusion was that this kind of campaign should not be repeated.

The argument that follows is that

> It is now generally agreed that the Ship Export Campaign was a development policy failure. As creditor, Norway shares part of the responsibility for the resulting debts. By canceling these claims, Norway takes the responsibility for allowing Ecuador, Egypt, Jamaica, Peru and Sierra Leone no longer to be obliged to service the remainder of these debts (Ministry of Foreign Affairs, Norway, Annex to press Release No 118/06 02.10.06)

The statement of a policy failure in terms of development is not a policy failure in terms of the profits made by the shipping firms that knowingly sold ships, which were useless for ocean sailing. The fact that the eight Governments bought these ships in god faith does not preclude the previous knowledge of their uselessness in open sea. Further, the fact that the Governments were not able to pay those debts does not mean that the private firms that sold those ships did not make a handsome profit paid for by the Norwegian Export Guaranty. The object of the ship

export campaign had little to do with development from this angle and more to do with activating a dieing shipping industry in Norway with Government support through these export credit guarantees.

If it was the case of a television set bought on credit from a department store that turned out useless after three months use, either the department store would replace it for a new one, or it would give the customer his money back. In the same way, these problems should void the loans and the money already paid in should be returned to the Debtor State, plus an indemnity to be defined, considered as moral suasion so these cases do not happen again.

Elements to take into account for a Board of Arbitration

1. Suspensions of collection and how they should be done

The literature repeatedly discusses "suspensions of payment", as to who declares and when, that the debtor cannot be charged any more; and *standstill*, when payments have been suspended or debts are being reorganized. It would be ideal for all creditors to simultaneously suspend collection while arranging how to reschedule payments. This would ensure that no creditor could stay off the list as a free rider. A bondholder standstill could be coordinated with a standstill by official creditors (Club of Paris). However, since international financial agencies have a preferred creditor status, they do not suspend collection, but benefit from a *standstill*. (Ruiz, 2003) They are free riders, from the debtor's standpoint. Do they warrant this preferred creditor status since they do not lend when the going gets rough? The weight of these agencies in some economies is greater than private sector and bilateral debts, particularly in new borrowing during the 1990s. The smaller the economy, the greater the weight of international financial institutions as creditors. The standstill would then have to include all types of creditors in order to be functional.

Who recognizes that a country is unable to meet its obligations? This is a fundamentally ethical issue. There is a contract committing the debtor to pay and the *pacta sum servanda* principle provides two possibilities if the economic horizon looks dim. The first possibility is for the debtor State government to announce that it will request a reorganization of its debts, which it can do without necessarily having started a payment crisis or eroding its international reserves. This approach enables it to stave off a worsening of the national crisis, which if it exploded could lead to a run on the banks and devaluation, ending in default on the public debt. The debtor would have to be able to announce the problems it is facing and request debt reorganization to reduce pressure on its balance of payments, its fiscal revenues, or both.

If, after the Brazilian crisis, Argentina had devalued – which would have been logical – the next step would have been to call for a reorganization of her debts. There would have been no bank run, no successive devaluations due to having dammed up the peso devaluation, losing international competitiveness vis-à-vis their main trading partner; nor would their foreign debt have risen unnecessarily between 1999 and 2001, to keep the fixed exchange rate. (Mussa, 2002) They would not have been in straits due to a lack of liquidity to keep the exchange rate stable. Argentina held the fixed exchange rate and camouflaged the international reserve level by issuing *bullet bonds,* with the blessing of the international overseer, the IMF. (Mateo, 2004)

In order to pull this off, the international supervisor, who ought to act as an international auditor providing markets with "reliable information" and vouching for it, under-estimated the seriousness of the lagging trade and did not indicate that deposits were being transferred from pesos to dollars within Argentina, much less that these dollar deposits were being transferred abroad. (Felix, 2001)

The second possibility is that a creditor is the one who applies for cessation of charges, and then brings the debtor to the negotiation table or to a bankruptcy court. (Meron, 1957) That is a worse case scenario, more damaging to the international system. It would be optimal for debtor countries to apply for collection suspension at their discretion, before a crisis explodes and for creditors to do so only if the debtor fails to meet its payments

2. Where to apply for a standstill

There are several points of view about where to apply for *standstill* and reorganization. Krueger (2002) proposes for the gateway to be the IMF. However, this agency cannot ever play this role, for several reasons:

a. It shares responsibility for economic management through "letters of intention".
b. It is not a neutral body, since it serves the interests of the major official creditors.
c. It is an economic advisor, creditor and even judge to rule on the country's status; that is, it cannot guarantee impartiality, which goes against the logic of the Rule of Law anywhere in the civilized world.
d. Its discredit, loss of credibility and of legitimacy.

Loan history shows that bond issues are a private contract between parties, and that although some of those parties are public, the domain is private. That is, the jurisprudence is private and therefore suits over bonds have historically been held in the *International Tribunal of Paris.* That was the case in Dreyfus vs. Peru, 1921, (Marichal, 1982) in which holders of bonds issued by Peru through the Dreyfus firm, guaranteed by guano, charged the government of Peru, which had to issue bonds to pay off the old debt, by a ruling of the Arbitration Court set up in the International Chamber of Commerce (ICC) at the bondholders' request.(Sack, 1927) So, there are mechanisms, which could be improved and updated or complemented. They should not be replaced until the International Board of Arbitration for Sovereign Debt is set up by an international agreement signed by the majority of nations, following the principles of the International Penal Court. Equally, experience has shown that Paris Club cases are complex and that the legal domain for them is public, as the correspond to bilateral official loans.

So two different processes need to be started in the ideal world: It is clear that on the one hand a United Nations Commission for International Public Law is required but that equally a mechanism should be created for the internationalization of international private financial law, and that both of them will define an International Financial Code.

Raffer (1990, 2001) proposed for that "the arbitration panel could sit anywhere, including the debtor or its neighboring country" (Raffer, 2001). He does not make a point of the "neutral State" that is neither a creditor nor a debtor, i.e. that no national court in a creditor nor debtor country

must be allowed to chair and decide. However, Eichengreen (2000) rejected that idea because courts must operate as do bankruptcy courts on the national level. Eichengreen feels that such panels would not be such a good idea, and would have no chance of success, because creditors will not allow others to get involved in a negotiation between the two parties; they won't want to give officials the responsibility to settle such crucial issues. Eichengreen proposes a standing committee of creditors, without binding (judicial) enforcement powers. The moral hazard would be very high, (Del Ariccia et al, 2001). There is also the political issue of whether creditors would be willing to give such formidable powers to a worldwide court (Eichengreen, 2000).

Our proposed neutrality refers to the legal code. To date, applicable private international financial law belongs to the creditors and refers to mostly New York and London law, which is irrelevant in a globalised world. An international financial code (that does not belong to neither creditors nor debtors but to all parties) will have to ensure that public and private creditors are able to collect guarantees, while protecting debtors, whether they are public or private. The authors propose to avoid *taking advantage* of the largest debtor's own jurisprudence, by using an international jurisprudence, an international financial code, analogous to the International Code of Commerce, except that the precision must be made for both public law and private law in different commissions and processes.

The considerations for UNCITRAL, the United Nations Commission on International Trade Law (UNCITRAL) established by the General Assembly through Resolution 2205(XXI) of December 1966, recognizes that disparities in national laws governing international trade created obstacles to the flow of trade, and it regarded the Commission as the vehicle by which the United Nations could play a more active role in reducing or removing these obstacles. "The General Assembly gave the Commission the general mandate to further the progressive harmonization and unification of the law of international trade. The Commission has since come to be the core legal body of the United Nations system in the field of international trade law."

The precise sense of UNCITRAL is expressed below:

"*Considering* that international trade co-operation among States is an important factor in the promotion of friendly relations and, consequently, in the maintenance of peace and security

Recalling its belief that the interests of all peoples, and particularly those of developing countries, demand the betterment of conditions favoring the extensive development of international trade.

Reaffirming its conviction that divergences arising from the laws of different States in matters relating to international trade constitute one of the obstacles to the development of world trade.

Having noted with appreciation the efforts made by intergovernmental and non- governmental organizations towards the progressive harmonization and unification of the law of international trade by promoting the adoption of international conventions, uniform laws, standard contract provisions, general conditions of sale, standard trade terms and other measures.

Noting at the same time that progress in this area has not been commensurate with the importance and urgency of the problem, owing to a number of factors, in particular insufficient co-ordination and co-operation between the organizations concerned, their limited membership or authority and the small degree of participation in this field on the part of many developing countries.

Considering it desirable that the process of harmonization and unification of the law of international trade should be substantially co-ordinated, systematized and accelerated and that a broader participation should be secured in the furthering progress in this area".

The spirits of cooperation in order to facilitate the flows of trade are evident in the considerations above. This same spirit should be repeated in order to facilitate and bring order to public and private financial flows which have grown substantially during the 1990's and have become more global as more developing economies and Governments become new lenders and more instruments are available.

The issue of sovereignty is complex. A country applying for arbitration would be, to some degree, acknowledging its inability to make payments, and submitting to whatever the Board decides under the international financial law applicable. Such rulings must result in a rescheduling of payments for all creditors, in the form of an exchange of instruments with a haircut, if the case warrants it, or a payment extension, if it be more adequate. This final decision must be supervised by an inspection authority who informs creditors of the developments of the debtor. Being an insolvency procedure, all litigation is barred. However, a stay clause should be stipulated on loan contracts (or bond issues) conditional of payment problems.

While reaching payment agreements for debts that qualify, their payback conditions must be negotiated, and linked to economic, social and cultural human rights(Ugarteche, 2006)[3]. The new agreement principle is based on economic justice, so we maintain the concept proposed by Raffer (1990, 2000, 2001a, 2001b) that there must be protection for social spending, as provided by Chapter 9 of the US Bankruptcy Law, which regulates municipalities' bankruptcies, while protecting their governmental power and advance towards meeting the MDGs.

The International Board of Arbitration for Sovereign Debt is not the first level of negotiation, but the last in a process of debt refinancing. It will be used when the system and instruments are too rigid to reschedule payments or revisit contracts' validity through a friendly agreement between the parties.

In any event, in practice, the tacit acceptance of payment difficulty – within a new legal framework – protects debtors so they can survive, recover and then even pay all they can, with the possibility of returning soon to the international financial market. This will require reducing impoverished countries' contractual weakness, including contingency clauses in bonds, so that, under adverse contexts, the cost will not fall solely on the debtor; and the burden will be shared.

We propose including contingency clauses in credit instruments, with two components: to make it possible to refinance them, and to share costs with creditors. If history has shown that raw

material prices fall, interest rates rise, and credit flows are shut off, and that these factors precipitate a payment crisis, we understand that debt crises are actually income crises, when export and fiscal revenues fall short of covering total public debt payments.

These clauses must provide that, if export earnings shrink because of problems beyond the control of the debtor's national economy, debt collection can be suspended, in order to prevent critical damage while enabling orderly, timely retreat. Evidently, if the debtor government does not want such a clause, it can decide not to have it; there will always be freedom in suspending payment or collection. Some suggest that the contingency clause might increase the country risk[4] and therefore the risk premium; and will encourage more restricted use of foreign borrowing[5]. The evidence from the use of contingency clauses since 2002 is that they affect neither.

The second component of the contingency clause is the possibility of refinancing the debt using "class action clauses", whereby if a qualified majority of bondholder creditors are willing to sit down and negotiate a refinancing agreement, then all bondholders will be represented. That is, no creditor could refuse to be represented, to avoid such actions as made by vulture funds and free riders. The Elliot case for Peru and Panama make this evident.

3. Who are the parties

Bondholders are now, as in the 19th century, a substantial category of investors for some countries. They have historically been organized under two institutions: the London *Corporation of Foreign Bondholders*,(Mauro & Yafeh, 2002) created in the mid-19th century and the Washington *Foreign Bondholders Protective Council, Inc.*, created later in the 1930s. Negotiation meetings of the *Foreign Bondholders Protective Council, Inc.* with debtor governments have been held at the US Department of State offices.(Ugarteche, 2007)

Negotiation meetings of the *Corporation of Foreign Bondholders* have been held in London's Courts, and when no solution has been reached they have appealed to the International Chamber of Commerce in Paris. Both the *Corporation of Foreign Bondholders* and the *Foreign Bondholders Protective Council, Inc.* have represented the corporate interests of bondholders pursuant to national legislation used as jurisprudence for sovereign loans (US and British law, in New York and London courts). (Mauro & Yafeh, 2002)

In a truly global world, there ought to be an *International Corporation of Foreign Bondholders* and an *International Association of Public Creditors* uniting all governments, whether in G7 / G8 or not. There should also be an *International Association of Debtors* to gather (as in the other cases) all necessary precedents for negotiation, but within a global framework solely for debt. All these associations will be parties to the *International Board of Arbitration for Sovereign Debt*. The other creditor parties are easier to identify and to call together for collection purposes, being international financial institutions or companies. On the debtors' side, governments cannot be left unaided. The active participation of "civil society" is also required.

The International Board of Arbitration for Sovereign Debt and international financial institutions

An issue analogous to standstills is the question of who invited creditors to sit down at the negotiation table with the debtor. If the gateway is for example, UNCTAD, a high-level official of that Agency, who will gather the parties so they can choose an arbitration court with an even number of members, will extend this invitation. The chairperson will be chosen by the arbiters and will constitute the tie-breaking odd number.

The arbitration court arrangement, incorporated in the London Agreement for the German debt (Abs, 1991) on 27 February 1953[6], according to Kaiser (2002) and Hersel (2003), had five members, two chosen by the creditors, two by the debtors and a fifth by the four arbiters. Following this principle, the arbitration panel will have the mission of assessing debts to ascertain which are legitimate and which are not, disqualifying those that are not. The panel will have the capacity to call a standstill and suspend collection, to protect the assets and spending defined in the new international financial code, as well as creditors' rights. The main features of this proposal include protection for social spending, automatic standstill once bankruptcy is applied for, and the community's right to sit in the procedure for restructuring the debt (Raffer, 1990).

Krueger (2002) proposes for the arbitration court to have the power to enforce agreements reached between majority creditors and the debtor on all creditors, to count out free riders. This will eliminate the vulture funds problem. Standstills will include the capacity to freeze judicial processes against the debtor, brought by creditors jointly or separately, in order to carry out the negotiations properly. When lawsuits are suspended, this will reduce pressure by creditors (to confiscate as many State assets, bank accounts abroad, etc. as possible), which could interfere with the Debtor State's national economy and prompt recovery.

A central issue in Krueger's writing (2002) is protection for creditors' interests. Krueger feels that debtors would not be obliged to pay lower-priority creditors (since multilateral financial agencies are high-priority). This ranks creditors beyond the formal hierarchies of guaranteed / un-guaranteed or public / private loans. Krueger suggests elimination of *pari passu* as a principle among creditors. Secondly, debtors would have to follow policies assuring the value of assets. Guarantees, in her view, are in application of policies under agreements with the IMF or the implementation of policies agreed with the IMF, or IMF support for policies implemented. After the Asian (Ding et al, 1998; Ghosh et al, 1999) and Argentine experience, this last argument does not hold.(Stiglitz, 2002) We equally believe *pari passu* should be broadened to all categories of creditors as there seems to exist no material reason for preferential treatment of multilateral loans.

Only if conditions incorporate economic, social and cultural rights can they be taken as guarantees for the Debtor State because they will have the support of public opinion and thus be irreversible. Otherwise, as we have seen in Argentina, the IMF does not guarantee anything at all, neither for creditors nor the debtor in spite of economic conditions ill conceived advice and (mis) placed policies Economic, social and cultural rights are the basis for meeting the MDGs. Thus far, the IMF has been an obstacle to achieving them beit through fiscal adjustment

policies centered on cutting social expenditures or through the more recent objections to foreign aid for the MDGs because of monetary supply /inflation issues.

Krueger maintains that creditors have interests going beyond exchange, fiscal and monetary policies (the IMF's strict domain), having clear interests in other policies, such as national bank restructuring (domestic bank bail-outs), ongoing operation of the domestic payment system, the national bankruptcy system, and the nature of exchange-rate control measures that may be applied. Creditors may have interest in control over capital to keep it from slipping away (as in the Argentine *corralito* in January 2002). The priority financing required to un-block the financial crisis and finance national economy reactivation must go hand-in-hand with the debt reduction needed for that purpose, combining the two instruments to renew the debtor national's economic capacity. This should be arranged in a timely manner to pre-empt what happened with the "Hoover year" (1931-1932)[7] when standstill arrived in the early 1930s, with the Great Depression already under way. Creditors, says the IMF (2002), require a mechanism for asset verification, dispute resolution and supervision of voting. These are classic roles of this type of arbitration court.

Fundamental elements of the International Board of Arbitration for Sovereign Debt

The International Board of Arbitration for Sovereign Debt, from the standpoint of debtor governments, must incorporate all categories of creditors. It must be a setting in which private creditors and bondholders, G7 and non-G7 governments, and multilateral agencies are all subject to homogenous treatment. For this purpose, international legislation should not leave any creditors out of the negotiations. That is, those documents not presented by the deadline for creditors' meetings should lose their power for collection. This should be part of the new international jurisprudence to get rid of free riders once and for all.

A minimum requirement to get the Board working is the immediate dissolution of the Paris Club as a framework for negotiation. This does not mean that creditors cannot meet to discuss their own positions (in Paris or anywhere else) – debtors should do the same. The Club must no longer be where restructuring agreements are negotiated or decided, or where creditors impose conditions on debtors. The Paris Club has neither solved debtors' payment problems, nor gotten creditors their money back, but has led to a long list of unsuccessful debt reduction schemes, from the Toronto Terms in 1988 to the Cologne Terms I 1999 and then the three G7 agreements to forgive the debt of the poorest, severely indebted countries (CADTM, 2005)

1. *Basic principles for Board operation and to constitute the International Financial Code:*

    a. Paying foreign debt cannot ever curb human development or threaten environmental balance. The issue is not only solving debt problems, but also creating a more stable, equitable economic system to benefit all of humankind.
    b. It is not acceptable under International Law for foreign debt arrangements to be instruments of political pressure, for a creditor State or an agency controlled by

creditor States to impose unsustainable conditions on a debtor State, as reflected especially in structural adjustment. (Sack, 1927)

c. The conditions of any arrangement must be based on economic, social and environmental human rights. Such conditions must be internationally agreed on to be recognized and must establish positive conditions, to prevent the resources released to be spend on weapons, wastefully, or to uphold sultanic governments, for example.

2. On the basis of these principles, *an international financial code* must be created, agreed to by all, and followed by all creditors and debtors[8]. This will grant a certain independence from the national power wielded by the largest creditors, or by the largest debtors, and grant greater equity both to minority creditors and to debtors in general.

3. *Debt Audits* The starting-point for any solution, including arbitration, lies in identifying legally acquired debts that can be repaid, distinguishing them on the basis of the doctrine of odious and corrupt debts.(Fatorelli, 2003) With an audit[9], with active citizen participation, illegal and illegitimate debts can be detected, especially those undertaken by dictatorial governments; moreover, suspending payment of such debts could become a barrier helping prevent such dictatorial adventures. (Acosta 2003, Acosta & Ugarteche, 2005,). Odious and corrupt debts must be voided, establishing that international loan corruption involves two parties, and both are responsible. Such loans must not only be canceled, but the debtor countries that have been cheated must be indemnified. (Fatorelli, 2003) The responsible parties on both sides must receive comparable punishment.

4. *Civil society participation.* This will require active participation by "civil society" in monitoring international loans, to prevent the interested parties from controlling inspection mechanisms for new loans and audits for previous loans. New agencies are required that comprise neither debtor governments nor creditors, but national and international civil society, understood as a UN loan auditor office ascribed to the secretariat of the IBASD, who will feed itself of professionals from federations of auditors, associations of jurists and accountants' guilds, who will report their findings directly to the Board. Equally an international civil society debt observatory with watchtowers in different continents would oversee this process.
5. The principle of *pari passu* (proportionality) must be established among all creditors, not only private bank creditors or bondholders. That is, multilateral, bilateral and private debt must be negotiated using the same criteria. interest rates, payback period, weight of debt reduction, interest calculations method, etc.(Teitelbaum, 2002; Raffer, 1990)

6. *Fiscal conditions*. To service debt that was undertaken and renegotiated with final agreements under legitimate conditions, clear parameters must be established in fiscal terms, so that debt service still to be paid will not affect social investments or minimize development potential (i.e. domestic savings capacity). The conditionalities used for problem solving must hinge on economic, social and cultural human rights (first and foremost), fiscal surplus and trade surplus. In commercial terms, there must be a surplus as a prerequisite for debt service. As a complement, an arrangement is required that will encourage purchase by creditor countries of what indebted countries produce.[10]

7. *Reasons for default* must be established so that ***force majeure*** will be treated differently than *mis-management*. International trade contracts must include safeguard clauses (contingency clauses, as in the 1953 German arrangement) for default, which are aired before the International Board of Arbitration by the International Chamber of Commerce of Paris when disputes arise. The same should be with loans.

8. *Place.* This Board could be set up up in Geneva, where the technical secretariat could be placed as the United Nations' (DMFAS) special foreign debt unit is located there– independently of the IMF. Meanwhile, mechanisms must provide for selecting arbiters independently of creditors' interests and debtors' pressures. Normally, these forces exist because arbiters are advocates for the interested parties in other actions, and do not want to lose their customers. Arbiters must be solely involved in the Board's arbitrations, and must be excluded from the possibility of other private dealings as long as they are arbiters in Geneva.

9. The IMF must be accountable to the United Nations General Assembly for its actions and for developments with countries. A formal Government agreement must be reached in order to create a control body accountable to the UN General Assembly. This is not what is now called "external evaluation office" which is really internal to the institution but a non IFI evaluation office. There should exist a system of penalties, so that the General Assembly will not be passive but active, taking responsibility for cases in which IMF mistaken forecasts endanger the domestic economy of the debtor, or the international economy, or World Bank policies made things worse in the country.

10. Empowering an international network of civil-society organizations in each country to oversee international agencies' actions. So, when the wrong advice is given, as in Argentina, international financial institutions can be made accountable and brought to justice for their errors and actions. These organizations will report to their governments and to a standing commission to supervise international agencies under the United Nations. Institutions' work would be evaluated every year.

11. To achieve all these extended benefits, we follow the recommendation of Schipani (2001: 35), to establish "principles of justice by which we must be governed, seeking those that will avoid consequences constituting human and people's rights violations, and to once again affirm, with greater certainty and stability, such rules for economic life[11]. It is germane to recall how lack of equity in relations between creditors and debtors has caused many debt process problems, financial uncertainty, and frequent governance issues in emerging economies.

In conclusion, the challenge lies, not in forcing under-developed countries down a one-way street, trying to do a better job at the same kinds of tasks assigned up until now, simply to insist that the stronger party must be right. The viability of debtor countries must not be compromised by economic conditions that drive their people into unemployment, migration, informality and violence. The purpose of economics is to achieve well-being for the people, and the aim of justice is to make sure that this will happen. International financial institutions must assist in this process.

The challenge to resolve conflicts regarding unpaid foreign debt calls for redoubled political effort on a global scale, gathering forces in the South and the North, grounded in respect for countries' specific realities. We believe a new international board of arbitration, sustained on international financial law, with conditionality based on economic, social and cultural rights, and international audits previous to negotiations in order to assure the legitimacy of the loans, can assist to the construction of a new international financial architecture. A solid ethical commitment must be made to construct a fairer international order and more democratic, balanced institutions that can unmask possible traps often set in the devious management of external debt, turning it into eternal debt.

Bibliography

Abs, Hermann J. *Entscheidungen 1949-1953. Die Entstehung des Londoner Schuldenabkommen*,. Hase & Koehler, Mainz, 1991

Acosta, Alberto, *La deuda eterna – Una historia de la deuda externa ecuatoriana*. Quito: Libresa (Fifth edition being prepared), 1994ª

_____"Lösungsansätse für die Auslansverschuldungskrise der unterentwickelten Lände" (Proposed solutions for the foreign debt crisis of under-developed countries), paper prepared for a Public Hearing (Anhörung) on "Entwicklung der internationalen Finanzmärkte, zur Verschuldungsfrage und zu einem internationalen Insolvenzrecht" (Development of international financial markets, on the topic of indebtedness and an international right to bankruptcy), in the German Parliament, Berlin, 14.03.2001

_____"Auditoría da divide e(x)terna: a base para uma solucao global, justa e transparente" in Fatorelli, Maria Lucia, *Auditoria da dívida externa: questao de soberanía*. Campanha Jubileo Sul, Contraponto, Rio de Janeiro, 2003. Pp. 97-110

Acosta, Alberto, et al. *El otro riesgo país – Indicadores y desarrollo en la economía*. Quito: ILDIS, D3E & Abya-Yala, Quito, 2005

Adams, Patricia, *Odious debts*. *Loose lending, corruption, and the Third World's Environmental Legacy*. Canada: Earthscan, 1991

Atienza, Jaime, *La deuda externa del mundo en desarrollo. Teoría, realidad, alternativas*. Madrid: Akal, 2002

Biggs, Gonzalo, *La crisis de la deuda latinoamericana frente a los precedentes históricos*. Buenos Aires: Grupo Editor Latinoamericano, 1987

Civic Commission to Control Corruption, *Informe de investigación – Ministerio de Economía y Finanzas – La deuda externa ecuatoriana con el gobierno de Noruega,* Quito, 2002

Commissao Especial do Senado para Divida Externa, *Relatório, marco,* rapporteur: Senator Fernando Enrique Cardoso, Federal Senate, Brasilia, 1988

Comité por l'annulation de la dette du Tiers monde, "Las campañas en contra de la deuda señalan lo inadecuado de la propuesta del G8 sobre la deuda" in http://argentina.indymedia.org/news/2005/07/306851.php, 2005.

Corporation of Foreign Bondholders
First Report of the Council, London, 17th February, 1874
Thirty-second Annual Report of the Council, London, October, 1905
Thirty-seventh Annual Report of the Council, London, 1910
Fiftieth Annual Report of the Council, London, 1923
Fifty-fifth Annual Report of the Council, London, 1928
Fifty-seventh Annual Report of the Council, London, 1930

Dell'Aricia, Giovanni, Isabel Schnabel, & Jeromin Zettelmeyer. "Moral hazard and international crisis lending: a test". *IMF Working Paper* 02/181, 2002

Ding, Wei, Ilker Domac, and Giovanni Ferri "Is there a Credit Crunch in Asia?", World Bank Policy. Research Working Paper No. 1959, 1998.

Eichengreen, Barry, *International Monetary Arrangements for the 21st Century*. Washington D.C: The Brookings Institution, 1994.

_____*Globalizing Capital. A History of the International Monetary System*. Princeton University Press, Princeton, N.J, .1996.

_____*Hacia una nueva arquitectura financiera internacional. Propuesta después de la crisis asiática*. Institute of International Economics. Mexico City: Oxford University Press, 2000.

Fatorelli Carneiro, María Lucia *Auditoria da dívida externa: questao de soberanía*. Campanha Jubileo Sul , Contraponto, Rio de Janeiro, 2003

Felix, David, "Repairing the Global Financial Architecture. Painting over Cracks versus Strengthening the Foundations". *Foreign Policy in Focus*, Special Report No. 5, Albuquerque, N.M., September, 1999.

____ "Is Argentina the Coup de Grace of the IMF's Flawed Policy Mission?" *FPIF Policy Report,* November, 2001.

Fritz, Thomas & Philipp Hersel, "Proceso de Arbitraje Justo y Transparente. Una nueva vía para resolver crisis de deuda." Blue 21 & Misereor, Berlin, August, 2002

Ghosh, Swati and Atish R. Ghosh, "East Asia in the Aftermath: Was there a Crunch?" IMF Working Paper 99/54, 1999

Hanlon, Joseph, "Defining illegitimate debt and linking its cancellation to economic justice". Working Paper. Open University, London, and ms. Oslo: Norwegian Church Aid, 2002.

Hersel, Philipp, "Las Londoner Schuldenabkommen von 1953 – Lehren für eine neue Handels- und Schuldenpolitik zwischen Schuldnern und und Gläubigern", Erlassjahr 2000, Siegburg, 2000.

INTERNATIONAL MONETARY FUND, *The Design of the Sovereign Debt Restructuring Mechanism—Further Considerations*, Prepared by the Legal and Policy Development and Review Departments (In consultation with the International Capital Markets and Research Departments), Washington DC, November 27, 2002

Jeanne, Olivier and Charles Wyplosz *The international lender of last resort: how large is large enough? IMF* Working Paper 01/76, Washington DC., 2001

Jubilee & New Economics Foundation , *Capítulo 9-11 Para resolver las crisis de la deuda internacional: la Jubilee Framework, estructura para la insolvencia internacional*, London, 2002

Jochnick, Chris, "Nuevos caminos legales para enfrentar la deuda: una petición a la Corte Mundial", in Jochnick, Chris & Pazmiño, Patricio (editors); *Otras caras de la deuda - Propuestas para la acción*. Caracas: Nueva Sociedad & CDES, 2001.

Kaiser, Jürgen, "Deuda Externa: Hacia un Proceso de Arbitraje Internacional." In *Perú Hoy. Elecciones y Regionalización*. Lima: Desco, 2002.

Kremer, Michael and Seema Jayachandran "Odious debt". NBER, working paper 8953, Washington D.C. 2002.

Krueger, Anne O. *A new approach to sovereign debt restructuring*, IMF Washington D-C, April, 2002.

Marichal, Carlos, *A Century of Debt Crises In Latin America*. Princeton, NJ: Princeton University Press., .1982.

_____"Evitando futuras crises da dívida en América Latina: licoes da história e algumas propostas" in *Auditoria da dívida externa: questao de soberanía*. Campanha Jubileo Sul, Contraponto, Rio de Janeiro, 2003

Mateo, Isabelle, "Report on the Evaluation of the Role of the IMF in Argentina", 1991–2001, IEO, IMF, (2004a) in
http://www.imf.org/External/NP/ieo/2004/arg/eng/index.htm

Mauro, Paolo and Yishay Yafeh, "The Corporation of Foreign Bondholders" IMF Working Paper WP 03/107, Washington DF.C. May 2002

Meron, Theodor "Repudiation of *Ultra Vires* State Contracts and the International Responsibility of States", *International and Comparative Law Quarterly*, 1957, vol 6, p 289,

Mussa, Michael, *Argentina and the Fund: From Triumph to Tragedy,* Policy Analyses in International Economics 67, IIE, Washington DC, 2002.

Olmos, Alejandro, *Todo lo que usted quiso saber sobre la deuda externa y siempre se lo ocultaron*. Buenos Aires: Editorial de los Argentinos , 1995.

Raffer, Kunibert, "Applying Chapter 9 Insolvency to International Debts: an Economically Efficient Solution with a Human Face" in *World Development, Vol. 18,* 1990, No. 2, pp.301-311.

_____"Vor- und Nachteile eines Internationalen Insolvenzrechts", in Dabrowski, Martin, Eschenburg, Rolf & Gabriel, Karl (editores); *Lösungsstrategien zur Überwindung del Internationalen Schuldenkrise*. Berlin: Duncker & Humboldt, Berlin , 2000.

_____"Let Countries Go Bankrupt - The Case for Fair and Transparent Debt Arbitration", in *Politik und Gesellschaft - International Politics and Society*, Friedrich Ebert Stiftung, Bonn, 2001a ,

_____"Lo que es bueno para Estados Unidos debe ser bueno para el mundo. Propuesta de una declaración universal de insolvencia", in Jochnick, Chris & Pazmiño, Patricio; *Otras caras de la deuda - Propuestas para la acción*. Caracas: Nueva Sociedad & CDES, 2001b.

_____"Debt Relief for Low Income Countries: Arbitration as the Alternative to Present Unsuccessful Debt Strategies" in WIDER, UNU, Helsinki (2001c) http://www.wider.unu.edu/conference/conference-2001-2/parallel%20papers/4_1_raffer.pdf

Ruiz Díaz Balbuena, Hugo, "La deuda odiosa o deuda nula: del problema de la nulidad del acto jurídico a la responsabilidad de las IFIs y de las multinacionales", http://lainsignia.org/londres.html, 2002 also in Fatorelli, Maria Lucia, *Auditoria da dívida externa: questao de soberanía*. Campanha Jubileo Sul, Contraponto, Rio de Janeiro, 2003

Pazmiño Freire, Patricio "El caso de la deuda ilegítima con Noruega", http://lainsignia.org/londres.html, Noviembre, 2002.

Sack, Alexandre N,. *Les Effets de les Transformations de les Ètats sure leur Dettes Publiques et autres Obligations Financières,* Paris: Recueil Sirey, 1927.

Sachs Jeffrey, "Efficient Debt Reduction" in *Dealing with the Debt Crisis*, The World Bank, Washington, 1989, pp.239-256

Schroeder, Frank & Kathrin Berensmann "A Proposal for a New International Debt Framework (IDF) for the Prevention and Resolution of Debt Crisis in Middle-Income Countries." Paper presented at the Multi-Stakeholder Consultation on Systemic Issues . - Lima, Peru, February 17-18, 2005

Schipani, Sandro *Debito internationale dell' America Latina e principi generali del diritto – Contributi per una ricerca*. Rome: Universita degli Studi di Roma "Tor Vergata", 2001.

Stiglitz, Joseph, "The World Bank at the Millennium" *The Economic Journal*, vol. 109, No. 459, Nov. 1999, pp.F577-F597.

_____*Globalization and Its Discontents*, Norton, New York, 2002

Suárez Buitrón, Paula , *Deuda Externa – Juego de Intereses – Lecciones del Acuerdo de Londres*. Quito: ILDIS & Jubileo 2000 Red Guayaquil, 2003

Teitelbaum, Alejandro, Paper presented at the International Seminar: *La deuda y las instituciones financieras internacionales frente al derecho internacional*, CADTM, Brussels, 10 - 11 December 2001 (mimeo)

Toussaint, Eric, *La deuda externa del tercer mundo*, Caracas: Nueva Sociedad, 1997

____ "Pistas para alternativas" in Fatorelli, Maria Lucia *Auditoria da dívida externa: questao de soberanía*. Campanha Jubileo Sul, Contraponto, Rio de Janeiro, 2003.

Ugarteche, Oscar, *Genealogía de la arquitectura financiera internacional; una visión desde América latina*. Ms. Tesis doctoral U de Bergen, 2007, https://bora.uib.no/bitstream/1956/2319/1/PhD_Thesis_Oscar_Ugarteche.pdf

____"Los Desc y la deuda externa en América Latina 1980-2003" in Alicia Yamin *Derechos económicos, sociales y culturales en América latina del invento a la herramienta*, Plaza Y Valdés/Idrc , México D.F., 2006, pp. 403-424.

_____Proposal for a new international financial architecture: Towards an International Board of Arbitration, in http://r0.unctad.org/dmfas/pdfs/ugarteche.pdf, UNCTAD, Geneva, June, 2005.

_____"Post Bretton Woods: los problemas de la economía global, y un Tribunal Internacional de Arbitraje para la Deuda Soberana", in Acosta, Alberto & Falcón, Fander (editors); *Asedios a lo imposible – Propuestas económicas en c, construcción*, ILDIS-FES & FLACSO-Ecuador, Quito., 2005

_____ "Repensando una propuesta global para un problema global" in *La Utopía de Otro Mundo Posible*, *Alternativas* Año II No. 28, Managua 2004, pp. 113-130

_____**"**Una propuesta global para un problema global: hacia un tribunal internacional de arbitraje sobre deuda soberana" in Nueva Sociedad, Caracas, No. 183, Jan.-Feb,. 2003, pp. 119-133,

____"Hacia un Tribunal Internacional de Arbitraje para Deuda Soberana" paper presented at the third Congress on Globalization and Development, Asociación de Economistas de América Latina, La Habana, January 2003

____"A favor de un Tribunal Internacional de Arbitraje para la Deuda Soberana" *Cuadernos de discusión* No. 2, América Latina en el Sistema Mundial, Universidad de Cuenca & Universidad de Alicante, Cuenca, 2003

____ *El Estado Deudor - Economía política de la deuda: Perú y Bolivia 1968-1984*. Lima: Instituto de Estudios Peruanos, 1986.

___ "La economía política de la deuda: Notas sobre el caso de Nicaragua 1961-1980", Documento de trabajo, Banco Central de Nicaragua, February, 1986b

Vega Vega, Juan, *La deuda externa, delito de usura internacional*, La Habana, 1987.

Vitale, Luis, *Historia de la deuda externa latinoamericana y entretelones del endeudamiento externo argentino*, Sudamericana-Planeta: Buenos Aires, 1986

Endnotes

1 The bibliography includes several contributions by Kunibert Raffer; this proposal was also championed by Jubilee 2000 and New Economics Foundation (2002).

2 A paradigmatic case of legal violation is as denounced in Argentina by Alejandro Olmos (1995).

3 As a point of reference, with all their limitations, any agreement for debt service (excluding corrupt or odious debts) must be linked to achieving the United Nations Millennium Development Goals, for instance.

4 This statement does not entail an uncritical acceptance of the constraints and geopolitical repercussions of the so-called "country risk". (On this topic, see Acosta et al. 2005).

5 From a quantitative perspective internationally, there would be no major difficulties if the process starts with a massive annulment of the public foreign debt of impoverished countries. The solution will involve, among other things, establishing a legal, legitimate system leading to creditors' accepting shared responsibility; creditors will have to take some losses, which will not be so serious as to jeopardize the world economic system, but will be required to cope with the world's accelerating process of impoverishment.

6, In 1971 Indonesia had a favourable debt agreement, coordinated by Abs, the German banker who led the renegotiations of the German debt in 1953. It is important to remember that, at the time, the Indonesian solution was considered unique and not applicable in general. The alternative granted that country was explained because of the political desire to support the government that had "lessened the Communist threat". Similar financial treatments were repeated years later y the Paris Club with Poland, to facilitate its economic recovery after concluding the Communist regime in the 1980s; with Egypt, to ensure their loyalty during the gigantic war operation against Irak in 1991; and with Pakistan in late 2001, amidst the so-called "war against terrorism".

7. Cf. a broad discussion of this issue in Ugarteche (2007).

8. Under such a code, mechanisms must be developed to control international- capital flows, such as applying the Tobin Tax and eliminating all fiscal paradises. At the same time, ecological debt claims must be reinforced – in which under-developed countries are the creditors.

9. For this purpose, nothing could be better than a multi-criterion audit (not just financial), addressing among others environmental issues.

10. Other positive conditionalities could be devised, such as debt stock reductions that are directly proportional to creditors' trade restrictions; that is, the more tariff barriers creditor countries put up, the more debt relief they grant. Equally, there must be an end to the widespread practice whereby those who negotiate on behalf of their countries from developing countries are then given highly-paid positions with the WB, IMF, IDB, CAF, and so on.

11. In the German case, creditors' action is noteworthy: Over half a century ago, they were more efficient in economic terms and much more reasonable than the WB, IMF or Paris Club conditions at present. It appears as if there existed two rules of the game: one for developed economies, and another one for the rest (Ugarteche, 2007)

12. Valuable proposals regarding the legal status of the debt have also been made by Teiltelbaum (2001).