
CHAPTER 9

Ways Forward

Like slavery and apartheid, poverty is not natural. It is man-made and it can be overcome and eradicated by the actions of human beings.

Nelson Mandela, former South African president,
speaking in support of the Make Poverty History campaign

In September 2000, building upon a decade of major United Nations conferences and summits, world leaders came together at the UN headquarters in New York to adopt the UN Millennium Declaration. World leaders committed their nations to a new global partnership to reduce extreme poverty. They set out a series of time-bound targets, with a deadline of 2015, that became known as the Millennium Development Goals. Whilst there has been considerable success in addressing the problems of unsustainable debt, vulture funds have so far been equally successful in hindering poor countries' progress towards the MDGs. The past decade has been marked by significant changes in debt restructuring patterns, each apparently better than the previous one (see Chapter 8, International Initiatives). But debt restructuring has been less successful than expected.

To tackle the obstructive actions of vulture funds, it is important to note again that debt problems are inextricably linked to the political, economic and social factors prevailing in both creditor and debtor countries. Legislative efforts by the Belgian, UK and other governments demonstrate the need for strong political will to tackle the problem of unsustainable debt and its consequences.

This chapter highlights further solutions which call for new, far-reaching reforms to deal with the problem of unsustainable debt and lawsuits, with a view to controlling vulture fund activities, albeit indirectly.

The proposed solutions discussed here are:

- An international framework to restructure sovereign debt
- An international arbitration court
- A regulatory framework for public financial management

9.1 International framework for restructuring sovereign debt

Debt restructuring has taken different forms as outlined in Chapter 2, Loan Agreements, and Chapter 5, Debt Management. The Baker and Brady Plans were proposed in the 1980s and 1990s. The IMF introduced the HIPC Initiatives of 1996 and 1999 and the Multilateral Debt Relief Initiative in 2005. At present the Debt Reduction Facility is helping control debt reduction and has had positive outcomes.

In 2003, a solution to allow orderly debt restructuring known as the Sovereign Debt Restructuring Mechanism (SDRM)⁹⁰ was proposed. Countries facing huge debts start restructuring very late, to the detriment of both the sovereign debtor and its creditors. The SDRM sets out an orderly structure for debt restructuring. It provides for a majority of creditors to reach an agreement that is binding on all the other creditors involved. This mechanism would automatically stop creditors from opting out and litigating against sovereign debtors. In addition, it provides greater safeguards for creditors so they can feel that their interests are protected.

However, the proposal faces strong opposition and has not yet been launched. Its strongest opponent has been the investor community. The belief is that this mechanism will limit creditors' rights and will hamper the efforts of sovereign debtors to repay their debts. In addition, it is argued that the SDRM is incomplete in that it does not cover debts owed to the IMF or other multilateral institutions.⁹¹

The SDRM appears to have lost credibility with the acceptance of CACs. In addition, it is thought that its implementation may increase the cost of borrowing. The proposed role of the IMF as a 'bankruptcy court' is thought to infringe the principle of neutrality as it would give the IMF conflicting roles as creditor and arbiter.

It is argued that a proper framework for orderly debt restructuring would provide a solution to the problem of hold-out creditors and the rush to court when sovereign debtors fail to repay. However, the framework should be comprehensive and should treat all players in the financial market equitably.

9.2 International arbitration court

At present lawsuits take place in different jurisdictions. For vulture fund creditors, this may not be a problem as they can afford reputable and costly law firms. But sovereign debtors may find it difficult, in terms of both capital and human resources, to represent themselves in court. Whilst some sovereign debtors opt for arbitration, they face the same difficulties.

Arbitration is an alternative method of resolving a dispute outside the traditional court system. It is argued that this will be to the advantage of the sovereign debtor

if the debt proceedings are heard before an international arbitration court or tribunal that is a centralised and specialised body with expertise which the indebted countries lack. There are several reasons to opt for this mechanism. It is envisaged that an international arbitration court would employ similar processes in all debt disputes and provide consistency. In the international courts, debtors feel they have unequal power: this would be avoided before an arbitration court. An arbitration court would hold a more neutral position. Unlike judges, arbitrators would not be bound by their countries' policies; they would be experts in related matters and would also look at social, economic and cultural factors.

It is argued that such a court should be established by an international treaty after a study of existing conventions and treaties, under the United Nations Commission on International Trade Law (UNCITRAL) model. Not only should treaties on arbitration and recognition of foreign judgments be considered, but also economic and social rights.

Basically, the method proposed here will involve international bodies and states. An international convention or treaty will need to be agreed and an international arbitration court set up under the treaty. In order to be bound by and subject to the court, countries will need to ratify the treaty.

Again, this is a measure which involves consultation at many levels; consequently it may be a long time before an end result is finally achieved.

9.3 Regulatory framework for public financial management

A regulatory framework for public financial management is seen as one way to deal with the problems of poverty, poor debt management and the damaging lawsuits suffered by HIPC countries. This means the creation of an international debt framework that sets out codes and standards for managing public debt and the relationships between sovereign debtors and their creditors. It is believed that such a framework will create a more predictable situation and help prevent crises. If a crisis does arise, then the framework will also provide an appropriate solution and course of action.

The Legal Debt Clinic considered the speech made by Gordon Brown, then UK Chancellor of the Exchequer, at the 2002 IMF Spring meeting (see box below).⁹²

The Clinic carried out a survey of many Commonwealth countries to identify their needs. The responses showed that most of the HIPC countries have very outdated laws pertaining to debt management and borrowing. There has been no regulation of governments' fiscal and monetary policies although it is arguable that there is a strong link between the strength of a government's fiscal and monetary policy and its external debt. In order to achieve high levels of growth and economic stability, a

stable fiscal and monetary policy is necessary. In 1996 New Zealand became the first country to pass a Fiscal Responsibility Act, with the aim of bringing its budget deficit under control.

Strengthening the international financial system

In a world of ever more rapid financial flows, we know that capital is more likely to move to environments which are stable and least likely to stay in environments which are, or become, unstable. And we know that countries who need capital most are, at the same time, the most vulnerable to the judgments and instabilities of global financial markets. So for every country, rich or poor, macroeconomic stability is not an option but an essential precondition of economic success. ... It is in the interests of stability – and of preventing crises in developing and emerging market countries – that we seek a new rules-based system, under which each country, rich and poor, has a responsibility to adopt agreed codes and standards for fiscal and monetary policy for the financial sector and for corporate governance. This adoption of clear transparent procedures would improve macroeconomic stability, deter corruption, provide to markets a flow of specific country by country information that will engender greater investor confidence and reduce the problem of contagion. ... And where countries do operate transparent and effective systems, fully monitored by the international community, they have the right to expect the support of the international community if hit by financial contagion.

Gordon Brown, UK Chancellor of the Exchequer, 2002

In April 2008 the Legal Debt Clinic presented a document proposing a fiscal responsibility framework to HIPC finance ministers at the Commonwealth Ministerial Debt Sustainability Forum Meeting in Washington.⁹³ In July 2008, the same proposal was presented to Commonwealth law ministers at their meeting in Edinburgh, Scotland.⁹⁴ At the time the Clinic was making this proposal, Nigeria was the only African country to have passed a Fiscal Responsibility Act.

Whatever the law is called, a fiscal responsibility framework should follow five basic principles. These are:

- Transparency in the setting of fiscal policy objectives, the implementation of fiscal policy and the publication of the public accounts;
- Stability in the fiscal policy-making process and in the way fiscal policy impacts on the economy;
- Responsibility in the management of the public finances;
- Fairness, including between generations; and

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- Efficiency in the design and implementation of fiscal policy and in managing both sides of the public sector balance sheet.

The main characteristics of proper public debt management – transparency, accountability and reporting mechanisms – were almost non-existent in most of the countries included in the needs assessment conducted by the Legal Debt Clinic.

The lack of legal measures setting out transparency, accountability and reporting requirements in many countries has allowed them to suffer from the profligate attitudes of their governments. A fiscal responsibility law framework adapted to each country's needs is the most appropriate way in which indebted countries can tackle this problem.

On the other hand, most of the Francophone indebted countries have passed a basic common regulation regarding such a framework. It appears that this has helped some of the western Francophone countries to pave the way for stability in their economies. The indebted Commonwealth countries may need to work together to develop a similar framework incorporating the principles set out above.

Following the financial crisis of 2008, the UK Government concluded that legislation to ensure accountability and transparency was needed as never before. It passed the Fiscal Responsibility Act in February 2010, creating a legal requirement to secure sound public finances and placing a binding duty on the government to implement it. By legislating for fiscal responsibility, the UK Government aimed to halve the budget deficit, as noted in the Queen's speech in 2009:⁹⁵

My Government's overriding priority is to ensure sustained growth to deliver a fair and prosperous economy for families and businesses, as the British economy recovers from the global economic downturn. Through active employment and training programmes, restructuring the financial sector, strengthening the national infrastructure and providing responsible investment, my Government will foster growth and employment.

As the economic recovery is established, my Government will reduce the budget deficit and ensure that national debt is on a sustainable path. Legislation will be brought forward to halve the deficit.

The Legal Debt Clinic supports the setting up of a robust framework for fiscal responsibility, with mechanisms for accountability, transparency and reporting. An appropriate institutional set-up dealing with debt management should operate within such a framework to ensure the correct economic strategy in the long term to achieve sustainable debt. The Clinic advocates an international regulatory framework for public financial management comprising the concepts of fiscal responsibility, appropriate codes of conduct for borrowing, settling loan repayments and regulating both borrowers and lenders.

Conclusion

The three proposed solutions discussed in this chapter – an international framework to restructure sovereign debt, an international arbitration court and a regulatory infrastructure for public financial management – go beyond the operations of vulture funds and deal with wider reforms to deal with the problems of sovereign debt.

The lessons to apply here are:

- International reforms are needed to deal with vulture fund lawsuits; these are not simply a domestic issue for a sovereign country.
- A more regularised and focused method of dispute resolution will cause less harm to sovereign countries and their economies. It will also avoid unnecessary costs, huge legal fees and unknown legal principles.
- On the national level, better regulation of fiscal policies with greater transparency, reporting and accountability will help effective debt management.
- The financial crisis of 2008 and the Asian crisis of 1997 should be analysed to learn lessons about how to avoid unsustainable debts and lawsuits.
- All the institutions involved must assume responsibility, including donors, sovereign debtors, commercial creditors and international financial institutions. There needs to be responsible borrowing, but also responsible lending. Only a code of conduct can regulate these matters

Further reading

- 'Fiscal Responsibility Laws – More Popular Than Ever Thanks to the Crisis', posted by Holger van Eden, available at <http://blog-pfm.imf.org/pfmblog/2009/08/fiscal-responsibility-laws-more-popular-than-ever-thanks-to-the-crisis.html>, accessed on 24 May 2010
- Model Fiscal Responsibility Framework, available at <http://www.thecommonwealth.org/document/181889/34293/35232/181429/clmm2008.htm>
- Report to Commonwealth Finance Ministers on Work done by the Legal Debt Clinic, at <http://www.thecommonwealth.org/files/202185/FileName/CommonwealthSecretariatlegaldebtclinicApril09.ppt>, accessed on 20 March 2010.