

AFRODAD POLICY BRIEF

CALL FOR ESTABLISHMENT OF A
FAIR AND TRANSPARENT ARBITRATION MECHANISM ON DEBT

Policy Brief
No. 1/2002

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Introduction

The persistence of the debt crisis faced by the severely indebted low-income countries and the inability of the international community to find both immediate and sustainable solutions has raised concern and the need for structural changes at the global level to resolve the problem. There are many facets to the debt crisis but the fundamental weakness is that the Creditors, who constitute the donors, continue to dominate the decision making regarding how to resolve the Debt crisis. For many years now, the Debt Relief Initiatives such as the Initiative for Heavily Indebted Poor Country (HIPC) have been designed by donors to safeguard their interests. This reflects a lack of global governance to protect the interests of the weak debtor nations and their people. A democratic or rights-based framework for resolution of the current debt crisis is therefore necessary.

It is important to note from the outset that the debt problem is inextricably tied to other factors (political, economic and social) prevailing in both creditor and debtor countries. These factors, more than the absence of a dispute settlement system, are mainly responsible for the current level of Southern debt. The other contributory factor to the persistence and magnitude of the current Debt crisis is the **intransigence** of some Northern creditors (states, international financial institutions and commercial banks) in the face of calls for debt cancellation or reduction. The need for a Fair and Transparent Arbitration mechanism is therefore based on the absolute need to resolve the power imbalance between the Creditors and Debtors.

Background and Rationale for Arbitration:

Arbitration is one of the alternative methods of resolving a dispute outside the traditional court system. In this process a third independent party would provide a final decision on a dispute between two parties.

Dispute in the arbitration process can be defined to include the existence of divergent or opposite views which cannot be reconciled by two parties and which therefore requires a third party to make a decision on which view should prevail, depending on the arguments presented by the two parties. Arbitration agreements allow for settlement or final decisions to be made on grounds other than purely legal principles, such as considerations of justice, equity and human rights.

In the case of the Debt problem faced by severely indebted low income countries all over the world, there are the divergent or opposite views between the Debtors and the Creditors that should be subjected to Arbitration. These include:

a). *The absolute need for cancellation of official bilateral and multilateral debts:*

While the debtors have made undisputed and legitimate claims and demands for debt cancellation, the creditors on the other hand claim that debt cancellation is not the action needed to resolve the problem. So the question of whether or not there should be debt cancellation presents itself as a clear subject of arbitration. The Calls for debt cancellation have been made in the following contexts (to name a few):

- Jubilee 2000 movement, which collected millions of signatures from all over the world calling for total debt cancellation. The Call was ignored by the Creditor governments and international Financial Institutions.
- The Secretary General's Report of December 2000 to the Financing for Development Preparatory Committee Meetings noted the difficult situation of debt confronting severely indebted low-income countries; no matter how skilled their economic management is. The Report noted that there are cases where debt cancellation could be called for.
- The Third United Nations Conference on the Least Developed Countries (UN LDC-III) which was held in Brussels in May 2001 fully acknowledged that the external Debt overhang of the majority of LDCs constitutes an obstacle to their development efforts and growth. Debt service takes up a large part of the scarce budgetary resources that could be directed to productive and social areas. The same conference acknowledged that the debt overhang harms the internal and external investment climate. While the Debtors called for debt cancellation the Creditors opted for providing ODA with the view to ensuring that these countries do not fall back into arrears¹. Clearly, this type of debt relief is directed at safe guarding loan repayments to the creditors rather than work towards the interest of the people of the Debtor countries.
- The African Ministers of Finance meeting in Addis Ababa in November 2000 as part of the Regional Meetings on Financing for Development called for an independent body, that would not be unduly influenced by the interest of the creditors, to examine the situation of HIPC and other Debt stressed countries in respect to debt reduction, conditionalities and other issues related to the Debt problem. The Ministers called for the provision of a debt-servicing moratorium, including accrued interest, in order to allow African countries to find durable solutions to their debt problems.

¹ United Nations General Assembly Doc. A.Conf.191/11 8 June 2001: Programme of Action for the Least Developed Countries Adopted by the Third UN Conference on LDC in Brussels, 20 May, 2001. See section on Debt and in particular paragraph 86.

- The High Level Panel led by Mr. Ernesto Zedillo appointed by the UN Secretary General to provide expert opinions of various issues in the context of Financing for Development process, recognised the existence of the Debt crisis and the inadequacies of the current Debt relief initiative, to the extent of anticipating a HIPC-III.

b). Reassigning the responsibility for the Debt crisis and burden partitioning where that might be necessary.

Currently, the assumption of the current Debt relief Initiatives is that the Debtor countries are solely responsible for the crisis. While accepting part of the responsibility, due to lack of proper debt management, corruption and other shortcomings, the Debtors point to the large impact of the external factors that have been identified to have contributed to the Debt crisis including the existence of a global trade regime in which the Debtor countries continue to suffer declines in terms of trade and ongoing lack of global market access; natural disasters and factors introduced by inappropriate policy advice by IMF and the World Bank as well as the push factors in lending, to mention a few. Creditors never seen to be part of the problem, which they obviously are.

c). Debt Mitigatory Measures are ineffective and insufficient

The way to resolve the debt crisis remains a point of divergence too as reflected in the fact that Creditor initiated and imposed Debt Relief Initiatives such as HIPC and refinancing of loans do not address the Debt crisis adequately. They are meant to protect the interests of the Creditors and that of international financial system rather than that of Debtors countries and in particular their people. The divergence of approaches by Creditors and Debtors on how the problem should be resolved is generally very clear. The divergence lends itself to arbitration if a fair, equitable and sustainable solution is to be found.

d). Arbitration for specific types of loans

There is a need for Arbitration on specific types of Loans or debt in particular the odious and illegitimate debts, which are categorised to include the following:

- Debts that cannot be serviced without causing harm to people and communities. It is a violation of human rights to repay debt at the expense of meeting human development needs.
- Debts incurred by illegitimate debtors and creditors acting illegitimately, which includes odious debts and loans misused through corruption.

- Debts incurred from illegitimate uses such as projects that did not benefit the people as was intended.
- Debt incurred through wrong policy advice or a result of external factors over which debtors have no control.
- Debt in which the money was actually stolen and banked in the North

e.) Criteria for Debt Relief

One of the major reasons for the lack of political will to resolve the debt crisis is that the Creditors see the protection of the international financial system as the basis of decision. Debtors on the other hand argue that a human rights criterion would better reflect the so-called partnership that is expected to exist between the developed countries and the developing countries. In this regard, debt repayment at the expense of human development is clearly a violation of human rights. The criteria used for making the decision on whether or not to have debt cancellation lends itself to arbitration.

f).). Return of wealth stolen from developing countries and held in the rich countries.

Instruments and Institutions:

There is a need to find an appropriate instrument and institution to deal with the special case of the Debt problem. Existing instruments such as the Permanent Court of Arbitration based in The Hague could be used for arbitrations on Debt. The other options include; the United Nations Commission on International Trade Law (UNCITRAL) could either have its mandate extended to include Debt issues or setting up of a new Commission specifically for Debt. We also argue that in the end, the optimal solution is to set up an International Arbitration Court on Debt through a Treaty¹

Establishment of an International Arbitration Court:

The unique problems of debt call for establishment of a special court. Many arbitral institutions in the world do not restrict their modes of settling disputes to one mode. They employ methods and processes, which are appropriate for each particular dispute. It would not be appropriate to enhance current mechanisms such as the Paris

¹ See AFRODAD The Efficacy of establishing an International Arbitration Court on Debt

Club by introducing arbitration panels to hear possible disputes between Debtors and Creditors because such a club which is in fact a cartel can still intimidate Debtors under the guise of debt negotiation. The imbalance in bargaining power between the Creditors and Debtors calls for the establishment of a neutral and impartial arbitral institution.

The establishment of a unique arbitral institution to deal with the problem of debt is further justified by the fact that similar institutions have been set up before to deal with unique problems. Some of these similar institutions, which we may emulate, are *The International Centre for Settlement of Investment Disputes (ICSID)* and *The Permanent Court of Arbitration*.

It is desirable that an International Treaty set up the proposed Court under the auspices of the United Nations. Members of the United Nations in Article 3 of the United Nations Charter have agreed to "*settle their international disputes by peaceful means in such a manner that international peace and security, and justice are not endangered*". A General Assembly Resolution of 1970, after quoting Article 2 (3), of the UN Charter proclaim that:

"States shall accordingly seek early and just settlement of their international disputes by negotiation, inquiry, mediation, conciliation, arbitration, judicial settlement, resort to regional agencies or arrangements or other peaceful means of their choice"⁴

Establishing the proposed Court under the auspices of the United Nations, would be the most logical step. In this regard, many Conventions relating to arbitration have been enacted. These include: The Protocol on Arbitration Clauses of 1923 (24-09-1923), The Convention on the Execution of Foreign Arbitral Award of 1927 (26-09-1927), The Convention on the Recognition and Enforcement of Foreign Arbitral (New York), 1958 (10-06-1958), The United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules (15-12-1976), UNCITRAL Conciliation Rules (4-12-1980), UNCITRAL Model Law on International Arbitration (21-06-1987), and UNCITRAL Notes on Organising Arbitral Proceedings (14-06-1996),

The Court could be established by a Treaty which is basically an agreement between parties on the international scene as was done in dealing with finding solutions to the serious indebtedness of the Federal Republic of Germany after the second World War².

¹ General Assembly Declaration on principles of International Law Concerning Friendly Relations and Cooperation among states in accordance with the Charter of the United Nations, G.A. Res. 2625 (XXV), October 24, 1970. The resolution was adopted by the General Assembly without a vote. See also J.G. Merrills, *International Dispute Settlement*, 2nd Ed. Cambridge (Supra), at P2

² see AFRODAD: The Efficacy of establishing an International Arbitration Court on Debt (2002)

The other advantage of setting up the Court under the UN would be that the UN has historical memory of these processes. More importantly, the UN is well placed in terms of global governance and safeguarding the interests of the marginalised people of this world.

Structure of the Court

The Court could be composed of not more than five arbitrators from both the Debtor and Creditor sides with an independent arbitrator to ensure impartiality. This kind of composition has been used in other arbitral tribunals. However, such a court could also maintain a panel of arbitrators from which parties can choose. It would have a secretariat to provide the necessary organisational support. Existing facilities such as courtrooms, library, and consultation rooms belonging to the Permanent Court of Arbitration in The Hague could be accessed. etc.

Stay of Proceedings

It is a common feature of court and arbitral proceedings for parties to apply for stay of proceedings pending disposal of arbitral proceedings. Under this power, repayment of particular disputed loans could be frozen, stayed or suspended until the Court makes a decision. This power may be vested in the court by treaty and the Rules of the court. The idea is to maintain the status quo until an² action is disposed of.

CONCLUSION

There is a need for finding an appropriate instrument and institution to deal with the special case of the Debt problem. Existing instruments such as the Permanent Court of Arbitration based in The Hague, the United Nations Commission on Trade could either have its mandate extended to include Debt issues or a new Commission specifically for Debt could be established. We also argue that in the end, the optimal solution is to set up an **International Arbitration Court on Debt** through a Treaty