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FINANCE AND LAW: UNDERSTANDING THE INSTITUTIONAL AND FUNCTIONAL ROLE OF THE INTERNATIONAL MONETARY FUND DURING SOVEREIGN DEBT CRISIS SITUATIONS

by
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1. INTRODUCTION

The rise of the United Nations and its specialized agencies as fora for cooperation in various aspects of international relations had the positive effect of introducing new methods of creating rules of customary law and general principles of law. In the case of specialized agencies, scientific and technical progress requiring new approaches necessitated the generation of "new rules of law-making which often tend to deviate from traditional treaty processes (whenever unsuitable in modern conditions) and from some of the tenets of jurisprudential orthodoxy."[2] These specialized agencies have facilitated the adoption of law-making treaties, conventions and treaty-like texts and in some of the agencies' constitutions the power to unilaterally generate technical rules or standards have been fully entrusted upon these organizations.[3]

One of the most influential specialized agencies in the area of international economic relations which now performs an important role in resolving the international debt crisis is the International Monetary Fund. The practices of this specialized agency in the monetary field have become an important process of either law-making by custom or by the generation of general principles of law.[4] One writer remarked that frequent interpretation and modification of the IMF treaty regime is necessary on account of the constant adjustment that the IMF had to undertake to adapt to changing conditions of the world financial equilibrium.[5] Its practice of conditional balance of payments financing in the form of stand-by or extended arrangements (SBA), for instance, has given rise to a set of norms which has been extensively relied upon in most modern sovereign debt renegotiations. The dependence of international lenders, whether official or private, upon the surveillance authority of the IMF over its heavily indebted members has been expressed in a complex system of documenting new international loan and restructuring or rescheduling agreements linked either formally or informally to the IMF-SBA. This paper aims to discuss this "new" role that the IMF-SBA has assumed in the current renegotiation process as applied to the situation of highly indebted members consisting of developing and developed States.

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[2] C.H. Alexandrowicz, The Law-Making Functions of the Specialized Agencies of the United Nations (Sydney: Angus and Robertson, in assoc. with the Australian Institute of International Affairs, 1973), 1.

[3] *Id*. at 3-4.

[4] *Id.* at 5.

[5] *Id.*.

2. BRETTON WOODS SYSTEM AND THE DEVELOPMENT OF NEW INTERNATIONAL ECONOMIC RULES

The "beggar thy neighbor" policy which promoted extreme economic nationalism among the industrialized nations and triggered the "trade wars" before the Second World War became a grim reminder of the harshness of an international economic environment which paid lip service to customary international rules of commerce which either existed or were evolving at that time. In fact Professor Georg Schwarzenberger observed that during the inter-war period, the assumption that "As long as the economic mechanisms of international trade were allowed to operate more or less automatically, a bilateral framework for the standard international economic law sufficed" had been abandoned by states.[6]

The need for a system of international economic rules to address the abuses committed by states in the exercise of near absolute economic sovereignty before the Second World War was urged as early as 1941 by Professor Quincy Wright in his speech before the American Society of International Law when he argued that

> International Law is . . . ill adapted to the present interdependent world. The economic sovereignty of States must be limited by rules of positive law if a more stable and prosperous world order is to be achieved.[7]

He suggested six approaches under international law to achieve this goal: first, the development of the concept of abusive exercise of powers by international tribunals; second, the development of the concept of basic human right to trade limited only by reasonable governmental control in the public interest; third, the establishment of an international economic commission charged with the task of conciliating claims and controversies arising from unjust governmental acts of business concerns; fourth, the founding of an international economic organization which could investigate and publicize the commercial practices of states; fifth, the negotiation of bilateral treaties on the basis of reciprocal and unconditional most-favored-nation treatment gradually reducing tariffs and eliminating other obstructions to trade; and sixth, through multilateral treaties, the evolution of a code of fair practice in international commerce could be evolved.[8]

In response to the experience of the 1930s and anticipating the economic needs after the war, the United States and Great Britain led other Allied powers at Bretton Woods, N.H. in 1942 in designing the post-World War II international economic

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[6] Georg Schwarzenberger, "The Province and Standards of International Economic Law", INT'L & COMP. L.Q. 2 (1948): 413.

[7] Quincy Wright, "International Law and Commercial Relations", AM. J. INT'L L. PROC. 2 (1940-41): 37.

[8] *Id*. at 37-38.

system based on a "directed order, a treaty order of made norms" as one contemporary writer described it.[9] Professor Andreas Lowenfeld recalls the distinction between the American and British expectations of this new economic order as follows:

> For the United States, the essential policy objective was the reconstruction of a multilateral system of world trade. In the words of Secretary of the Treasury Henry Morgenthau, new international financial institutions were conceived as 'the alternative to the desperate tactics of the past — competitive currency depreciation, excessive tariff barriers, uneconomic barter deals, multiple currency practices, and unnecessary exchange restriction — by which governments vainly sought to maintain employment and uphold living standards. The British statement of goals, though similar in purport, was more modest, and reflected the prospect that the United Kingdom would occupy a debtor's position at the war's end: 'Our long-term policy must ensure that countries which conduct their affairs prudently need not be afraid that they will be prevented from meeting their international liabilities by causes outside their control.[10]

Out of these policy objectives emerged proposals to establish a trade organization (whose function now rests upon the General Agreement on Tariffs and Trade)[11], an international bank (International Bank for Reconstruction and Development or World Bank)[12] to provide capital for the reconstruction of Europe and an international institution composed of professional economists which will promote international monetary cooperation and provide temporary financing for countries facing severe balance of payments situation (International Monetary Fund).

In the international monetary field two plans were proposed again by the United States and Great Britain. While both proposals recognized the need for governments to assume the obligation to maintain the value of their currencies and to change applicable rates of exchange based on a set of rules enforceable by an international organization, they debated in regard to the issue of providing resources to countries requiring adjustment on account of serious balance of payments difficulties.[13] Mr. John Maynard Keynes, then a special consultant to the British Treasury, sought to convince the participating states of the need to make credit "more

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[9] Roessler Frieder, "Law, de facto Agreements and Declarations of Principle" GERMAN Y.B. INT'L L. 21 (1978): 30 .

[10] Andreas Lowenfeld, International Economic Law, International Monetary System 4 (2nd. ed., New York: Matthew Bender and Co., Inc., 1984), 14-15.

[11] *See generally* John Jackson and William Davey, Legal Problems of International Economic Relations (2nd. ed., Minnesota: West Publishing Co., 1986).

[12] For a concise history of the World Bank *see* Asher and Mason, The World Bank Since Bretton Woods (Washington, D.C.: Brookings Institute, 1973).

[13] Lowenfeld, *supra* note 9, at 16-17.

or less automatically available at the request of a member"[14] to which Mr. Harry Dexter White of the United States, then Secretary Morgenthau's assistant for international finance, took exception by proposing that the international monetary institution should be empowered to require the borrowing member to bring its international accounts into balance.[15] This difference was eventually resolved at the conference in 1944 during which the (original) Articles of Agreement of the IMF was adopted. Suffice it to note that the imposition of conditions were viewed to be necessary with respect to the use of Fund resources.[16]

3. NORM-CREATING FUNCTION OF THE INTERNATIONAL MONETARY FUND ARTICLES OF AGREEMENT

Customary or conventional international law had consistently recognized in the past that "a State is entitled to regulate its own currency."[17] Although central banks had adhered to the use of the gold standard in the past for the purpose of balance of payments adjustments and domestic monetary policy control, Sir Joseph Gold observed that the so-called "rules of the game . . . were not regarded as binding on states."[18] He argued, therefore, that this "traditional attitude toward the rules of the game makes the achievement of Keynes and White all the more remarkable," because "both were aware that they were proposing a new legal order in international monetary relations."[19]

With the creation of the IMF, legal norms have arisen constituting the "Law of the Fund". These legal norms have been hierarchically classified into three main categories, namely: (i) the Articles of Agreement, accepted by members; (ii) the by-laws, resolutions, and other decisions of the Board of Governors, and (iii) the rules and regulations and other decisions of the Executive Board.[20]

Gold opined that "the Articles are a treaty, and, therefore the law of the Fund includes the applicable norms of treaty law and of other aspects of public international law."[21] The provisions of the Articles have been construed to be paramount in relation to the other legal norms,[22] but in so far as individual norms within a class are

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[14] *Id.* at 16.
[15] *Id.* at 17.
[16] IMF Articles of Agreement, Article V, Section 3(a).
[17] Joseph Gold, The Rule of Law in the International Monetary Fund (Washington, D.C.: IMF, 1980), 2.
[18] *Id.* at 3.
[19] *Id.*
[20] *Id.* at 5.
[21] *Id.*
[22] *Id.*

concerned no ranking exists.[23] For instance, the statement of purposes in Article I of the Agreement according to Gold "[does] not represent an order of precedence."[24]

Legal norms under the Articles may be viewed as either mandatory or permissive. A mandatory norm is one which prescribes "specific prohibitions for members."[25] Gold cites as an example Article VIII, Section 2(a) of the amended Articles which obligates a member "not to impose restrictions on the making of payments and transfers for current international transactions unless [it] is authorized by the Articles or approved by the Fund."[26] On the other hand, a member may be allowed under several norms "to adopt measures, take actions, or pursue policies provided that certain conditions are observed."[27] Article VI, Section 3 according to Gold fits into this category. This provision declares "that members may apply controls to regulate international capital movements, provided that these controls are exercised in a manner that will not restrict payments and transfers for current international transactions or will not unduly delay transfers of funds in settlement of commitments."[28] Several norms are deemed permissive according to Gold.

Decisions of the Fund's organs that are formulated in general terms have been a major source of new legal norms.[29] However, it has occurred that previous decisions for individual members have evolved into a general decision expressive of an established Fund practice.[30] An example typically cited to illustrate this development is the decision of the Executive Board of March 2, 1969 on the "use of the Fund's General Resources and Stand-By Arrangements" wherein the said body laid down the guidelines on conditionality for the use of the Fund's resources and for stand-by arrangements. This decision was incorporated in the Articles of Agreement during the second amendment thus fully establishing its legality.[31]

In regard to the legal effect and the consequence of a violation of decisions of the Fund, Gold is of the view that a distinction must be made between "those . . . that require members to behave in a particular way because that conduct is explicitly or implicitly made obligatory by the Articles . . . [and] those that make recommendations or provide guidelines for conduct."[32] In so far as the Fund is concerned, non-compliance with decisions requiring specific action is automatically a breach of

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[23] *Id.*
[24] *Id.*
[25] *Id.* at 7.
[26] *Id.*
[27] *Id.* at 7.
[28] *Id.* at 7-8.
[29] *Id.* at 9.
[30] *Id.* at 9-10.
[31] *Id.* at 10.
[32] *Id.* at 11.

obligation but non-compliance with recommendations or guidelines must first be established "to be neglect of an obligation under the Articles as well."[33]

4. MANDATE OF THE INTERNATIONAL MONETARY FUND

In this section three purposes of the IMF which have considerably affected sovereign debt renegotiations in the post-World War II period will be briefly discussed. Emphasis will be given to the practice of conditionality and the legal aspects of the stand-by arrangements.

Article 1 of the amended Articles of Agreement enumerates the following purposes of the Fund:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems

(ii) *To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.*

(iii) to promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) *To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.*

(v) *To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.*

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members. (Italics mine)

4.1 DEVELOPMENT AS A SECONDARY PURPOSE

Gold maintains that it is clear from the history of the Fund's creation that

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[33] *Id.*

"development is not a direct purpose."[34] In support of this argument he referred to Mr. H.D. White's distinction in his proposed plan at the beginning of the Bretton Woods meetings in 1942 of the functions of the two financial institutions: one "to stabilize foreign exchange rates and strengthen the monetary systems of the United Nations"; and the other, "to provide capital for economic reconstruction, to facilitate rapid and smooth transition from war-time economies to peacetime economies, to provide relief for stricken people during the immediate post-war periods, to increase foreign trade and permanently increase the productivity of the United Nations."[35] As we are now aware, the two functions have been divided between the Fund and the World Bank, respectively. According to Gold, while the Articles of Agreement of the Fund[36] state in its first article that it will "facilitate the expansion and balanced growth of international trade, and . . . contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy," the reference to "development" in paragraph (ii) must be interpreted in the light of the history of the negotiations which led toward its adoption.[37]

The Indian delegation's proposed draft of the paragraph, deemed to be the most definitive statement invoking a direct involvement of the challenged on the ground that the proposal, which read

> To facilitate the expansion and balanced growth of international trade, *to assist in the fuller utilization of the resources of economically underdeveloped countries* and to contribute thereby to the maintenance in the world as a whole of a high level of employment and real income, which must be a primary objective of economic policy; . . . (Italics mine)[38]

described more the function of the World Bank and would fall beyond the means of the Fund as a source of financing.[39] After intense negotiations according to Gold the Indian delegation declared in a press release that, "the Fund cannot directly assist but can facilitate these aims in pursuing its purpose of the expansion and balanced growth of international trade."[40] The proper view insofar as the Fund's responsibility is concerned, as Gold suggests, is "expressed in the phrase 'to contribute thereby,' but if the Fund's contribution is indirect, the language of the provision is not a 'one-way

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[34] Joseph Gold, ". . . To Contribute Thereby to . . . Development . . .' Aspects of the Relations of the IMF with Its Developing Member COLUM. J. TRANSNAT'L L. " S10 n.2 (1971): 267.
[35] *Id.*
[36] IMF Articles of Agreement *as amended*.
[37] Gold, *supra* note 33, at 270-276.
[38] *Id.* at 272-273.
[39] *Id.* at 273.
[40] *Id.* at 276.

pendulum' because the aims are recognized as 'primary objectives of economic policy."[41]

4.2 "FREEDOM FOR PAYMENTS" AND EXTERNAL DEBT SERVICE

The mandate in paragraph (iv) has become increasingly relevant in the management of external debts of developing country borrowers particularly during the seventies and eighties. Pursuant to this mandate accompanying provisions have been laid down by the drafters of the Agreement.

Sec. 2(a) of Article VIII of the amended version provides:

> (a) subject to the provisions of Article VII, Sec 3(b), and Article XIV, Section 2, *no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions*.[42] (Italics mine)

The term "restrictions" as it has been defined in the Fund's law and practice refers to "governmental prohibition of, limitation on, or hindrance to the availability or use of exchange in connection with current international transactions."[43] It has been distinguished from the term "control" in that the latter may entail "a procedure that is not unreasonable as a condition precedent to a payment or transfer . . . to assumable statistics or . . . to prevent the illicit transfer of capital."[44] This procedure does not amount to a breach of the obligation under the Fund's Articles of Agreement.

The other term which needs to be clarified under the abovementioned provision is "current international transactions." Article . . . (d)[45] defines current transactions as follows:

> (d) Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:
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> (1) *All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities*;

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[41] *Id.*

[42] *See* IMF Articles of Agreement, art. VIII, § 3(b) & XIV, § 2.

[43] Joseph Gold, International Monetary Fund and Private Business Transactions (Washington, D.C.: IMF, 1965), 7.

[44] *Id.* at 8.

[45] This is formerly art. XIX(i) of the original IMF Articles of Agreement.

> (2) *Payments due as interest on loans and as net income from other investments*:
>
> (3) *Payments of moderate amount for amortization of loans or for depreciation of direct investments;*
>
> (4) *Moderate remittances for family expenses*;
>
> The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions. (Italics mine)

It is implied from the provision that members are free to restrict capital transfer particularly when read with Article VI, Section 3 which states that "members may exercise such controls as are necessary to regulate international capital movements…"[46] But Gold emphasized that the "recognition of the right of members to limit or prevent capital transfers does not apply to those categories of transactions that would be considered capital but for the fact that the Articles declare them to be current."[47] This is supported by the qualification in the same provision just cited to the effect that "no member 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."

4.2.1 PHILIPPINE APPLICATION: AUTOMATIC DEBT SERVICE

It is instructive to note a Philippine case related to debt service which demonstrates the Philippine Supreme Court's deference to the other branches of government on financial policies which pay due regard to international financial obligations.

At issue in *Guingona v. Carague* (196 SCRA 221)[48] was the constitutionality of the automatic appropriation for debt service in the 1990 budget authorized by P.D. No. 81, entitled "Amending Certain Provisions of Republic Act Numbered Four Thousand Eight Hundred Sixty, as Amended (Re: Foreign Borrowing Act), by P.D. No. 1177, entitled " Revising the Budget Process in Order to Institutionalize the Budgetary Process in Order to Institutionalize the Budgetary Innovations of the New Society," and by P.D. 1967, entitled "An Act Strengthening the Guarantee and Payment Positions of the Republic of the Philippines on Its Contingent Liabilities

[46] Gold, *supra* note 42, at 13.
[47] *Id.* at 13.
[48] 196 SCRA 221

Arising Out of Relent and Guaranteed Loans by Appropriating Funds for the Purpose."

Petitioners-Senators argued that the appropriation for debt service violates Section 5, Article V of the 1987 Philippine Constitution which states:

"The State shall assign the highest budgetary priority to education x x x"

The budget for 1990 showed that debt service outranked education.

Secondly, the petitioners argued that the decrees were deemed inconsistent with Section 29 (1) Article VI of the Constitution, i.e.,

> "Sec. 29 (1). No money shall be paid out of the Treasury except in pursuance of an appropriation made by law."

The Supreme Court of the Philippines upheld the constitutionality of the decrees. Of interest to a State-Party to the Fund was the Court's pronouncement as follows:

> "As to whether or not the country should honor its international debt, more specially the enormous amount that has been incurred by the past administration, which appears to be the ultimate objective of the petition, is not an issue that is presented or proposed to be addressed by the Court. Indeed, it is more of a political decision of Congress and the Executive to determine in the exercise of their wisdom and sound discretion."

In honoring the debts inherited from the Marcos administration, the protection of the credit standing of the country was a primary consideration of Congress and the Executive.

A subsequent attempt at raising the issue had been struck down by the Court. Thus, in *Philippine Constitution Association v. Enriquez* (235 SCRA 506)[49], the Supreme Court noted that the vetoed provision in the General Appropriations Act of 1994 on the Appropriation for Debt Service in excess of the P37.9 Billion allocated for education is "clearly an attempt to repeal Section 31 of P.D. No. 1177 (Foreign Borrowing Act) and E.O. No. 292, and to reverse the debt payment policy."[50]

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[49] 235 SCRA 506

[50] *Id.* at 532

4.3 USE OF THE FUND'S RESOURCES: BALANCE OF PAYMENTS FINANCING

Paragraph (v) of the statement of purposes expresses the financial function of the IMF. The IMF administers a pool of resources derived mainly from subscriptions of its members determined by quotas assigned to the latter. Before the Second Amendment of the Articles of Agreement in 1978 the subscription of each member based on its assigned quota was made payable 75 percent in its currency and the rest in gold.[51] Under the present arrangement each member is assigned a quota expressed in special drawing rights.[52] Many of the rights and duties of membership under the Articles of Agreement have been determined based upon quota assignment. An example of this is found in terms of the extent of financial assistance a member can avail of in times of balance of payments difficulty.[53]

The temporary character of the use of the Fund's resources is emphasized with the insertion of the word "temporarily" before the phrase "available to them" during the First Amendment of the Articles of Agreement in 1968. In Decision No. 102-(52/11)[54] the Fund had interpreted the temporary character of its balance of payments financing scheme as not exceeding three to five years at the most.[55]

As the paragraph also suggests, it is the Fund's policy to make its resources available under "adequate safeguards". This policy is aimed not only to protect the level of resources in the Fund's holding but primarily to ensure that the transaction will be consistent with the principal purpose of "the achievement of a multilateral system of payments and transfers for current international transactions in order to promote international trade and the benefits that flow from it."[56] It is, therefore, essential from the Fund's point of view that in making the use of its resources available, a member engaging in such a transaction would be expected to pursue an "economic and financial program . . . consistent with the purposes of the Fund."[57] The concept of economic development supported by the provision of the Fund's resources is otherwise known in Fund practice as the doctrine of conditionality. This institutional policy has also given rise to a unique instrument called the stand-by arrangement which guarantees access by a member seeking to engage in a transaction

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[51] Joseph Gold, International Monetary Fund and International Law: An Introduction (Washington, D.C.: IMF, 1965), 22.

[52] For a detailed discussion of SDRs, *see* M.R. Shuster, Public International Law of Money (Oxford: Clarendon Press, 1973), 198-225.

[53] Joseph Gold, Financial Assistance by the International Monetary Fund: Law and Practice (2nd. ed., Washington, D.C.: IMF, 1980), 22-23.

[54] Gold, *supra* note 47 at 23.

[55] *Id.*

[56] Gold, *supra* note 51, at 4.

[57] *Id.*

for balance of payments reasons. Conditionality and the stand-by arrangements have now become a central feature of the Fund's financial function and, in fact, the principal consideration in most instances before international creditors agree to a renegotiation of sovereign debts. Reliance by the international creditors upon the authority of the Fund to recommend politically sensitive economic adjustment measures upon sovereign debtors through the policy of conditionality has filled a void in the sovereign debt renegotiation procedures which emerged in the 1970s and 1980s.

5. THE DOCTRINE OF CONDITIONALITY AND THE DEVELOPMENT OF THE STAND-BY ARRANGEMENT

The Fund observes the practice of setting quantitative limits on the use of its resources.[58] These quantitative limits are described as "the amounts defined by the Fund's 'tranche policies', in which the Fund has clarified the kinds of policies it will expect members to follow for the purpose of avoiding balance of payments problems if they wish to use the Fund's resources, and the kind of scrutiny that the Fund will give to members' requests to use the Fund's resources."[59] Conditional use of the Fund's resources essentially carry the following important elements: (a) the need on the part of the member to adopt policies intended to overcome its balance of payments problem; (b) consistency of these policies with the purposes of the Fund; (c) the member's policies should be able to correct the problem within a "temporary" period; and, (d) the policies must aim to increase the reserves of the member to enable it to repurchase its currency immediately consistent with the temporary character of the use of the Fund's resources.[60]

It has been argued by Gold that conditionality is not aimed at changing the basic character or the organization of a member's economy and he stresses in fact that "the social objectives or priorities of a member are accepted as beyond negotiation, subject to the proviso that the policies to promote them will permit the member to achieve a sustainable balance of payments position."[61] Furthermore, in assessing the severity of the policies expected of a member Gold points out that the Fund considers a number of factors among which are "the hardships for the population or sectors of it, the political difficulties for the government in introducing and following policies of adjustment, the period of adjustment, and the volume of resources made available."[62]

58 Joseph Gold, The Stand-By Arrangements of the International Monetary Fund (Washington, D.C.: IMF, 1970), 12.
59 *Id*.
60 Gold, *supra* note 51, at 19.
61 *Id*. at 20.
62 *Id*. at 20-21.

In the application of standards of conditionality the Fund makes a distinction based on its tranche policies. It has been mentioned earlier that the member's quota is determinative of the extent of the member's rights and privileges among which is the amount of resources it can request from the Fund. Originally, the members were obliged to comply with their quota partly in gold and partly in their own currency. The significance of this distinction between the gold and currency contribution is explained as follows:

> The practical significance of the gold tranche as originally defined was that it was equal to a member's net economic contribution to the Fund . . . The rest of the member's currency subscription did not have the same significance because it was only a potential economic claim against the member until the currency was put in the hands of others. Because the gold tranche at any particular moment was equivalent to the net economic contribution that a member had made to the Fund up to that time, the standards applied by the Fund to requests to make gold tranche purchases were the least searching. The Fund sought to give as automatic a treatment to these requests as could be reconciled with the Articles.[63]

A second amendment in 1978 modified the original definition of the gold tranche.[64] The term "reserve tranche" was introduced and came to be understood as the "excess of a member's quota over the Fund's holdings of its currency after excluding holdings of the member's currency obtained by the Fund in transactions under policies that the Fund decides shall lead to these exclusions."[65] In determining the reserve tranche today the Fund excludes holdings of the member's currency resulting from transactions or requests under their facilities intended to meet specific needs of a member caused by other difficulties.[66] As in the case of the gold tranche, Art IV, Section 3(c) of the Agreement provides that "requests for reserve tranche purchases shall not be subject to challenge."

Purchases by a member that necessarily go beyond its net economic contribution are governed by the "credit tranche policy".[67] This policy has been regarded as the central or basic policy on the conditional use of Fund's resources.[68] For purposes of determining the kind of conditionality which should be applied to a purchase beyond the reserve tranche, the Fund had distinguished in practice between the first credit tranche and the upper credit tranches. A purchase in the first credit tranche has the effect of raising the Fund's holdings of the purchasing member's currency from an amount equal to its quota to no more than 125 per cent of quota

[63] Gold, *supra* note 56, at 13-14.
[64] Gold, *supra* note 51, at 27.
[65] *Id*.
[66] For a discussion of other facilities, *see id*. at 29-37.
[67] *Id*. at 27-29.
[68] *Id*. at 27.

after excluding the holdings obtained under other facilities.[69] On the other hand, an upper credit tranche purchase increases the Fund's holdings of the purchasing member's currency from 125 per cent of quota to no more than 200 percent of quota also after excluding the holdings from the other facilities.[70] The upper credit tranche is divided into three tranches of 25 per cent of quota each, and standards of conditionality become more severe as a member increases its purchase within these tranches.[71] Substantial justification is required when making a request for transactions in the upper credit tranches.[72]

The main instrument utilized by the Fund in making its resources available in the credit tranches is called a stand-by arrangement.[73] Under Article XXX of the Agreement the stand-by arrangement is defined as follows:

> . . . a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specific period and up to a specified amount.[74]

According to Gold, the Fund emphasized in its earlier practice the analogy of a confirmed line of credit when granting a stand-by arrangement.[75] This view is supported by a decision of the Fund dated February 13, 1952 in which the Managing Director was quoted to have considered the availability of drawing from the Fund's resources within a period of 6 or 12 months.[76] In the same year the Fund adopted its first general policy on the use of the stand-by arrangement.[77] Decision No. 155-(52/57) of October 1, 1952 contained the following essential points:

1. Stand-by arrangements would be limited to periods of not more than six months. They could be renewed by a decision of the Executive Board.

2. In considering the request for a stand-by arrangement or a renewal of a stand-by arrangement, the Fund would apply the same policies that are applied to requests for immediate drawings including a review of the member's position to make purchases of the same amount of exchange from the Fund.

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[69] *Id*. at 28.
[70] *Id.*
[71] *Id.*
[72] *Id.*
[73] A more recent treatment of the SBA is found in Joseph Gold, The Legal Character of the Fund's Stand-By Arrangements and Why It Matters (Washington, D.C.: IMF, 1980).
[74] This is a new provision.
[75] Gold, *supra* note 54, at 29.
[76] Decision No. 102-(52/11); February 13, 1952, in *id*., app. D.3.
[77] *Id*., app. E.

3. Such arrangements would cover the portion of the quota which a member would be allowed, under Article V, Section 3, to draw within the period provided in the arrangement. However, this does not preclude the Fund from making stand-by arrangements for larger amounts on terms in accordance with Article V, Sec. 4.

4. A charge of 1/4 of 1 per cent per annum would be payable to the Fund at the time a stand-by arrangement is agreed. This change would be payable in gold (or United States dollars in lieu of gold) or the member's currency as specified for other charges by Article V, Section 8(f). In the event a stand-by arrangement is renewed, a new charge at the rate of 1/4 of 1 per cent per annum would be payable to the Fund.

5. A member having a stand-by arrangement would have the right to engage in the transactions covered by the stand-by arrangement without further review by the Fund. The right of the member could be suspended only with respect to requests received by the Fund after: (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions either generally (under Article XVI, Section 1(a)(ii) or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of the member.[78]

A subsequent decision modified the general policy by introducing, among other provisions, a statement recognizing an extended arrangement under the following circumstance:

> . . . If a member believes that the payments problems it anticipates (for example, in connection with positive programs for maintaining or achieving convertibility) can be adequately provided for only by a stand-by arrangement of more than six months, the Fund will give sympathetic consideration to a request for a longer stand-by arrangement in the light of the problem facing the member and the measures being taken to deal with them. With respect to stand-by arrangements for periods of more than six months, the Fund and the member might find it appropriate *to reach understandings additional to those set forth in this decision*.[79] (Italics mine)

The effect of the new policy was a movement away from the original concept of a confirmed line of credit toward the additional understandings.[80] Through these understandings the Fund had introduced "protective clauses" such as the obligation to consult and the observance of performance criteria or specific policies in a member's

[78] *Id*. at 245-246.
[79] Decision No. 270-(53/95), December 23, 1953 in *id*., app. E.2.
[80] *Id*. at 29-30.

program which give the Fund an assurance that the objectives of the stand-by arrangement are being realized.[81]

An in-depth examination of the stand-by arrangement in 1968 led to a number of important conclusions on the use of protective clauses and the characterization of the stand-by arrangement. It was decided that the Fund policies and practices on the use of its resources, including tranche policies, would continue to apply subject to the following:

> 1. Appropriate consultation clauses will be incorporated in all stand-by arrangements.
>
> 2. Provision will be made for consultation, from time to time, with a member during the whole period in which the member is making use of the Fund's resources from a stand-by arrangement.
>
> 3. Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche.
>
> 4. Appropriate phasing and performance clauses will be used in all stand-by arrangements other than those referred to in paragraph 3, but these clauses will be applicable only to purchases beyond the first credit tranche.
>
> 5. Notwithstanding paragraph 4, in exceptional cases phasing need not be used in stand-by arrangements that go beyond the first credit tranche when the Fund considers it essential that the full amount of the stand-by arrangement be promptly available. In these stand-by arrangements, the performance clauses will be so drafted as to require the member to consult the Fund in order to reach understandings, needed, on new or amended performance criteria even if there is no amount that could still be purchased under the stand-by arrangement . . .
>
> 6. Performance clauses will cover those performance criteria necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives, but not others. No general rule as to the number and content of performance criteria can be adopted in view of the diversity of problems and institutional arrangements of members.
>
> 7. In view of the character of stand-by arrangements language having a contractual flavor will be avoided in the stand-by documents.[82]

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81 *Id*. at 30.

82 Decision No. 2603-(68/132), September 20, 1968, in *id*., app. E.6.

Increased use of the stand-by arrangement during the seventies by the developing countries required further clarification of the Fund's policy of conditionality and the framework of the stand-by arrangement. The new guidelines on conditionality were approved by the Executive Board in its decision of March 2, 1979.[83] The important aspects of the Fund's new policy on the use of its resources were as follows:

1. Members should be encouraged to adopt corrective measures, which could be supported by use of the Fund's general resources in accordance with the Fund's policies, at an early stage of their balance of payment difficulties or as a precaution against the emergence of such difficulties. The Article IV consultations are among the occasions on which the Fund would be able to discuss with members adjustment programs, including corrective measures, that would enable the Fund to approve a stand-by arrangement.

2. The normal period for a stand-by arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the stand-by arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years.

3. Stand-by arrangements are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letters of intent.

4. In helping members to devise adjustment programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payment problem.

xxx xxx xxx

7. The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources in the credit tranches when it is his judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out. A member may be expected to adopt and carry out a program consistent with the Fund's provisions and policies . . . these cases the Managing Directors will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.
8. The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the non-discriminatory treatment of

[83] *See* Lowenfeld, *supra* n.9, DS 228-230.

members.

9. Performance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact.

Paragraph 5 of the new guidelines reiterates paragraphs 1 and 2 of the 1968 decision while paragraph 6 corresponds with the previous paragraph 3. And the first sentence of paragraph 9 merely reiterates the sixth paragraph of the old decision. Paragraph 10 requires a provision for review in programs extending beyond one year where a member is unable to establish in advance one or more performance criteria, or in which an essential feature of a program can not be formulated as a performance criterion at the beginning of a program year on account of substantial uncertainties concerning major economic trends. The final two paragraphs of the present decision mention the Fund's assessment of the member's performance under the programs and the conduct of studies of programs supported by stand-by arrangements.

The process of approving a stand-by arrangement consists of several stages.[84] Initially, negotiations are conducted almost exclusively between the requesting member's representatives (usually the Governor of the Central Bank and/or the Minister of Finance) and the Fund's mission whose function is "to arrive at a thorough understanding of the member's policies so as to be able to explain them to the Fund and to follow their progress" and "to assist the member in the preparation of its letter of intent (by making) available the Fund's knowledge of the experience of other members in dealing with difficulties comparable to those of the host member."[85] A letter of intent and the stand-by arrangement are drafted with the understanding that "the mission must refer them to headquarters".[86] These stand-by documents are submitted to the Managing Director and the staff for discussion before a decision is made by the Managing Director to recommend to the Executive Directors their approval of the stand-by arrangement based on the letter of intent.[87] The letter of intent is signed by the Governor of the Central Bank and/or the Minister of Finance upon completion of the discussions and transmitted to the Managing Director whose responsibility is to submit to the Executive Directors a memorandum containing the proposed stand-by arrangement and the letter of the intent.[88]

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[84] Gold, *supra* note 56, at 40-44.
[85] *Id*. at 41.
[86] *Id.*
[87] *Id.*
[88] *Id*. at 43.

5.1 LEGAL CONSEQUENCES OF THE ARRANGEMENT: COMPARISON BETWEEN IRISH AND PHILIPPINE LAWS

In a more recent discourse on the legal enforceability of the IMF stand-by arrangements, one writer inquired into the difficulty of attributing legal rights to a member-State of the Fund when entering into the arrangement.[89] He opines that a distinction may have to be made between the first stage of the process, i.e., entry into the stand-by arrangement and the actual purchase – repurchase transaction which entails actual drawing from the Fund.[90] The latter, according to Dumitrescu, should be considered a bilateral legal contract.[91]

The stand-by arrangement with Ireland is a case in point.[92] Art. 29.5.2 of the Irish Constitution provides:

> The State shall not be bound by any international agreement involving a charge upon public funds unless the terms of the agreement shall have been approved by *Dail Eireann*.

Dail Eireann is the lower house but principal chamber of the Irish Parliament.

Dumitrescu explains that

> As long as the Irish State did not assume any legal obligations whatsoever, there was no international agreement put in place, and therefore Art. 29.5.2 was not applicable. But, at the next stage, for the Government to be able to proceed with the actual purchase transaction, assuming obligations on behalf of the State, the prior approval of *Dail Eireann* was constitutionally required.[93]

In the context of the Philippine setting and its history of renewals of stand-by arrangements, there has never been an occasion to submit any arrangement for concurrence by the Philippine Senate. The provision in Section 20, Article 7 of the Constitution comes closest to a requirement applicable to stand-by arrangement wherein

> The President may contract or guarantee foreign loans on behalf of the Republic of the Philippines with the prior concurrence of the Monetary

[89] Adrian Dorel Dumitrescu, "A Legal Right not Legally Right: Remarks on the IMF Stand – by Arrangements' Legal Enforceability," Journal of International Banking Law and Regulation, 26 (10), (2011): 473-475.
[90] *Id.*
[91] *Id.*
[92] *Id.*
[93] *Id.*

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If, by following the Irish experience, one admits the Fund's legal position that stand-by arrangements should not have the status of an international agreement, the stage of the actual drawing with the Fund in tranches may be interpreted as falling within Section 20 of Article 7 of the Philippine Constitution. This will not be categorized as a treaty or international agreement under Section 21 of Article 7 which requires concurrence by the Philippine Senate.

6. SOVEREIGN-DEBT RENEGOTIATION PROCESS AND THE IMF STAND-BY ARRANGEMENT

According to Gold, the uniqueness of the stand-by arrangement as a form of financial assistance is expressed in the various ways by which the instrument can be used to address a wide range of problems.[94] Even before the financial crisis in the 1970s and early 1980s the Fund had envisioned the influence of the stand-by arrangement in the decision of international lenders, both official and private, in extending loans to the Fund's members.[95] Gold describes the Fund's approval of a stand-by arrangement for a member as useful whenever the member is concerned with the "creation of international confidence" and as a matter of fact such decision constitutes a "leading international judgment on the soundness of a member's policies."[96]

Another important use of the stand-by arrangement which has gained wide acceptance among the international lenders is its catalytic role in the renegotiation of sovereign debt.[97] This role connected with debt relief strategies for most developing country borrowers in the 1970s and 1980s actually grew out of a general policy for the Fund's membership which was defined in its Annual Report of 1965 as follows:

> The Fund has the opportunity to assist in preventing a recurrence of the need for debt renegotiation when a stand-by arrangement is being negotiated parallel to the debt refinancing, . . . mutual benefits can be derived from commitments given to the Fund under a stand-by arrangement, since if adequate measures to restore the payments balance are implemented, there can be assurance that such problems as the accumulation of arrears will not recur.[98]

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[94] Gold, *supra* note 56, at 36-40.
[95] *Id*. at 37.
[96] *Id*.
[97] E. Walter Robichek, "The IMF: An Arbiter in the Debt Restructuring Process", COLUM. J. TRANSNAT'L L. 23 (Winter: 1984): 143-154.
[98] Gold, *supra* note 56, at 39.

As a result of the above-mentioned policy, interlocking agreements have become commonplace, and, in fact, institutionalized in sovereign debt renegotiation procedures. In the succeeding discussion, the legal ties which have arisen between the sovereign debtors and their various creditors in the light of the provisions embodied in these interlocking agreements will be examined.

6.1 PARIS CLUB RESCHEDULING PROCESS

Rescheduling of debt-service payments on loans extended by, or guaranteed by, the governments or the official agencies of the creditor countries has customarily been conducted through the so-called "Paris Club".[99] The Paris Club history dates back to 1956 when a group of European creditor governments convened a meeting in Paris with Argentina for the purpose of outlining an arrangement to enable the latter state to resume orderly trade and payments relations, and to provide for the renegotiation of supplier credits insured by the participating creditor governments.[100] Since that time creditor states have adhered to a set of practices and procedures during renegotiations with a debtor state.

The Paris Club meetings have usually been held in Paris under the chairmanship of an official of the French Treasury. There is no formal legal organization to speak of despite the existence of an uniform process observed during the meeting with the debtor state. One writer explains that this non-legal approach

> . . . reflects the creditor point of view that the debtor rescheduling is an extraordinary event justified in only the most extreme circumstances. If the Paris Club were viewed as a permanent institution, it would be an admission that rescheduling is a normal financial transaction. This would undermine the concept of the sanctity of contracts, and would encourage debtor countries to seek debt relief.[101]

Another writer suggests, however, the political advantage enjoyed by the creditors through the present characterization of the Paris Club meetings:

> The *ad hoc* nature of the Club is also frustrating to debtors because it allows political considerations to color a primarily financial process. For example, the renegotiation terms accorded Indonesia in 1970 did not reflect the cautious and essentially commercial approach accorded Ghana in the same year . . . In part, the Indonesian terms were due to the political orientation of

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[99] See generally Alexis Rieffel, "The Paris Club, 1978-1983", COLUM. J. TRANSNAT'L L. 23 (Winter: 1984): 83-110.

[100] Albert C. Cizauskaus, "International Debt Renegotiation: Lessons from the Past", WORLD DEV. 7 (1979): 201-202.

[101] Rieffel, *supra* note 99, at 91-92.

that country toward the capitalist bloc after a coup in the 1960's.[102]

Three underlying principles govern the financial relationship between the participating official creditors and the debtor state, and among the creditors themselves, whether participating or not. Firstly, there must be a strong evidence of imminent default as "when a debtor country's uses of foreign exchange, which are usually projected for one year in advance, exceeds its sources."[103] Secondly, debt relief is coupled with conditionality. It has become the practice of creditors participating in the renegotiation within the Paris Club to make debt relief conditional "upon the existence of an economic program supported by a borrowing arrangement with the IMF, involving drawings in the upper credit tranches."[104] A debtor state which is not a member of the IMF is expected to negotiate directly with the creditor governments on policy reforms similar to those contained in the IMF stand-by arrangements entered into by a member.[105] Finally, the principle of burden-sharing engages creditors to "provide relief that is commensurate with their exposure in the debtor country."[106] Excluded from the operation of this principle are the multilateral lending institutions such as IMF, World Bank, the major regional development banks (Inter-American Development Bank, Asian Development Bank, and African Development Bank), European Investment Bank, and the OPEC Special Fund.[107]

The Paris Club process is actually initiated by a debtor state through a formal request sent to the Chairman. Invitations are sent out to creditor governments having significant exposure in the debtor state. Participating governments have come almost exclusively from the OECD although in some developing countries such as Abu Dhabi, Israel, Argentina, Mexico and South Africa have appeared as creditor participants.[108] Representatives of the Fund, the World Bank, the United Nations Conference on Trade and Development (UNCTAD) and concerned regional development bank are also present to provide material information and technical advice as regards the debtor state seeking rescheduling. Negotiations normally proceed in stages which involve a debtor's presentation, statements by the representatives of the multilateral financial institutions (particularly an evaluation of the debtor's proposed economic stabilization polices under an IMF stand-by arrangement), and a closed meeting of delegates from the creditor governments.[109] The whole exercise is usually concluded after two or three days.

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[102] Robert V. Hawn, "The Renegotiation of Official International Debt: Whose Club is it?", U.C. DAVIS L. REV. 17(1984): 873.
[103] Rieffel, *supra* note 99, at 84-85.
[104] *Id.* at 85-87.
[105] *Id.* at 86.
[106] *Id.* at 87-90.
[107] *Id.* at 87.
[108] *Id.* at 92.
[109] For a more detailed account of the proceedings in a Paris Club meeting, *see id.* at 97-99.

Official creditors sign *ad referendum* an agreement known as the "Agreed Minute"[110] which outlines the broad terms of rescheduling. The terms of the agreement or informal understanding are recommended by the representatives of these official creditors to their respective governments for incorporation into bilateral agreements with the debtor concerned. While Agreed Minutes are clearly not international treaties, it has been argued that their character is that of "an international agreement entailing political, non-legal obligations . . . (creating) a shared expectation of all actors concerned that debt restructuring will take place according to the terms of the document."[111] In an earlier analysis of the implication of this type of agreement, Professor Oscar Schachter noted two aspects which may be useful in arriving at a better appreciation of the character of the obligation:

> One is internal in the sense that the commitment of the state is 'internalized' as an instruction to its officials to act accordingly . . . The political commitment implies, and should give rise to, an internal legislative or administrative response. These are often specific and determinate acts.
>
> The second aspect is 'external' in the sense that it refers to the reaction of a party to the conduct of another party. The fact that the states have entered into mutual engagements confers an entitlement on each party to make representations to the others on the execution of those engagements . . . By entering into an international pact with other states, a party may be presumed to have agreed that the matters covered are no longer exclusively within its

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110 Some Agreed Minutes may be found in the following rescheduling agreements between the United States and some of its developing country borrowers: Agreement Regarding the Consolidation and Rescheduling of Certain Debts, February 6, 1974, United States — Chile, 25 U.S.T. 1757, T.I.A.S. No. 7908; Memorandum of Understanding Regarding the Consolidation and Rescheduling of Certain Debts, June 17, 1974, United States - Chile, 25 U.S.T. 2712, T.I.A.S. No. 7940; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, July 3, 1975, United States — Chile, 28 U.S.T. 5602, T.I.A.S., No. 8649; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, June 17, 1977, United States - Zaire, 28 U.S.T. 7621, T.1.A.S. No. 8731; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, July 28, 1980, United States — Zaire, 32 U.S.T. 9907, T.I.A.S. No. 9907; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, October 24, 1980, United States — Turkey, 32 U.S.T. 3688, T.I.A.S. 9909; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, May 17, 1980, United States — Sudan, 32 U.S.T. 9952, T.I.A.S. No. 9952; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, United States - Liberia, May 7, 1981, T.I.A.S. No. 10156, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, September 24, 1981, United States — Turkey, T.I.A.S. No. 10432, p. 16; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, September 27, 1981, United States — Pakistan, T.I.A.S. No. 10246, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, August 26, 1982, United States — Senegal, T.I.A.S. No. 10475, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, November 1, 1982, United States — Liberia, T.I.A.S. No. 10528, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, March 10, 1983, United States — Romania, T.I.A.S. No. 10683, p. 14; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, March 10, 1983, United States — Malawi, T.I.A.S. No. 10684, Annex D.

111 Michael Bothe & Josef Brink, "Public Debt Restructuring, the Case of International Economic Co-operation", GERMAN Y.B. INT'L L. 7 (1986): 105.

> concern. When other parties make representations or offer criticism about conduct at variance with the undertakings in the agreement the idea of a commitment is reinforced, even if it is labeled as political or moral . . .[112]

One writer has maintained that the above tests are clearly applicable to the Paris Club renegotiations in that "each creditor in a Paris Club agreement instructs its administration to enter into a subsequent binding, bilateral agreement with the debtor . . . (and) the state's commitment to the agreement is externalized by allowing each state to offer representations or criticism regarding the behavior of commitment of the other states privy to the agreement."[113] On the part of the debtor state there is an understanding that it should have an arrangement with the Fund in upper credit tranches and that it consents to the Fund informing the Chairman of the Paris Club regarding the status of their (debtor state-Fund) relationship.[114] Future renegotiation of debt service payments have also been made conditional upon the continued eligibility of the debtor state to make purchases under the upper tranche conditionality of the Fund.[115] Bilateral agreements implementing the terms of the Agreed Minute, however, do not contain provisions which tie-up performance criteria under the stand-by arrangement with the Fund unlike the restructuring agreements forged by the private commercial banks with a debtor state.[116] This may be explained by the fact that in the renegotiation of sovereign debts owed to the private commercial banks no elaborate procedure comparable with the Paris Club process exists to date.

Attempts at formulating sovereign debt renegotiation policies on the international level have been conducted under the auspices of the UNCTAD. As early as 1967, the UNCTAD has stirred discussions in regard to the improvement of official debt renegotiations.[117] A significant instrument adopted by the Trade and Development Board was Resolution 132 (XV) of 15 August 1975 endorsing the recommendation of the *ad hoc* Group of Governmental Experts which provided, among others, that "on the initiative of debtor developing countries, *ad hoc* meetings may be convened, with participation of major creditor countries concerned and of interested developing countries to examine at the international level a debtor's solution in a wider development context, prior to debt renegotiations in the customary

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[112] Oscar Schachter, "Twilight Existence of Nonbinding International Agreements", AM. J. INT'L L. 71 (1977): 304.

[113] Hawn, *supra* note 102, at 863-864.

[114] *See* various Agreed Minutes, *supra*. note 110.

[115] *Id.*

[116] This shall be discussed further in the next section.

[117] *See* the Report of the Committee on Invisibles and Financing Related to Trade on its Second Session (April 1967), Official Records of the Trade and Development Board, 5th Sess., Supp. 3 (TD/B/118 Rev. I and Rev. II conn. 1).

forums."[118] Subsequently, at a Conference on International Economic Cooperation held in Paris in 1977-1978 the positions of the creditor group and the debtor states became more defined but no agreement was arrived at on a common framework for debt renegotiation.[119] A joint proposal by the United States and the European Economic Community crystallized the basic concepts and principles adhered to by these creditor countries in the official debt renegotiation process:

(ii) *The debtor would undertake a comprehensive economic programme designed to strengthen its underlying balance of payments situation. This programme would, as a general rule, be worked out with, and monitored by the IMF.*

(iii) Debt reorganization and the programme of economic measures would take into account the development prospects of the debtor country, thereby enabling it to continue debt service payments and restore its creditworthiness and to increase its capacity to discharge its debt servicing obligations over the longer term.

(iv) The modalities of the debt reorganization would be determined flexibly, on a case-by-case basis, taking into account, on the other hand, the economic situation and prospects of the debtor country, the development prospects and the factors causing the debt service difficulties and, on the other hand, the legitimate interests of the creditors. It should also be recognized that the country's implementation of its viable economic policies is essential to the long-term effectiveness of a rescheduling exercise.

(v) Debt reorganization would cover official and officially guaranteed debt with a maturity of over one year.

(vi) Consolidation periods would normally be kept relatively short and generally would not extend, as to future maturities, beyond the year in which the reorganization is undertaken.

(vii) Equality and non-discrimination among all creditors, including those not participating in the creditor club is an essential principle underlying the operation of debt renegotiations. Creditor countries with minor debts due, which frequently include developing countries, would generally, however, be excluded from the multilateral debt negotiation.

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[118] United Nations Conference on Trade and Development, Official Records of the Trade and Development Board, Resolution 132 (XV)*: "The increasing burden of debt-serving in developing countries*".

[119] Hawn, *supra* note 102, at 875, and *see further* Ursula Wasserman, "UNCTAD: The External Indebtedness of Developing Countries", J. WORLD TRADE L. 12: 74-79.

(viii) In respect of its private non-officially guaranteed debt, the debtor country would be expected to negotiate debt reorganization with private creditors on terms similar to those agreed in the creditor club for its official and officially guaranteed debt.

(ix) Debt reorganization arrangements would provide for flexibility to review the situation at the end of the consolidation period in the light of unforeseen circumstances. They would also provide for accelerated repayments in an agreed manner if the debtor's economic situation improved more rapidly than anticipated.[120]

Official creditors stressed the distinction between a default or imminent default situation, which would be dealt with through creditor clubs, and cases of longer term structural problems, which would be considered expeditiously and individually in an appropriate forum.[121] In the latter case, the creditors recommended the following procedure: first, the developing country concerned would, before the problem has reached crisis proportions, request an examination by the World Bank or another appropriate multilateral development finance institution mutually agreed upon; second, if, after examination of the request, further steps seemed necessary, the institution would analyze the economic situation of the country; third, if the institution found that the development prospects of the country in question were seriously hampered, it would contact the aid donors to discuss urgently the country's need; fourth, donor countries and the recipient country would take the conclusions of the institution's analysis into serious consideration; and, finally, where the analysis led to broad agreement that the developing country was encountering long-term financial difficulties impinging unduly on its development progress, donor countries would, to the best of their abilities, enhance assistance effort directed toward increasing the quantity of aid in appropriate forms and improving its quality, in response to the developing country, for its part, demonstrating its willingness to take corrective measures on its own behalf, in so far as it was able.[122]

The developing countries submitted two proposals, one dealing with immediate and generalized debt relief[123] and another on the future debt reorganization.[124] Of particular interest in the second set of proposals were the guidelines suggested by the developing countries for reorganization operations:

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[120] "Debt Problems of Developing Countries", draft resolution of the Trade and Development Board, United Nations Conference on Trade and Development Doc. No. TD/B/L498, (March 8, 1978). This joint proposal of the European Economic Community and the United States was presented at the earlier Conference on International Economic Co-operation. *See* annex to the *Report of the Conference on International Economic Co-operation* in Doc. No. A131/476/Add.1.

[121] Wasserman, *supra* note 119, at 77.

[122] *Id.* at 78.

[123] *Id.* at 79-80.

[124] *Id.* at 80-81.

First: Creditor and debtor countries should ensure that reorganization would be completed expeditiously in order to reduce to the minimum any uncertainties associated with them.

Second: Measures to be adopted should be consistent with an accepted minimum rate of growth of *per capita* income.

Third: International and national policy actions to be adopted should be consistent with the socio-economic objectives and priorities of the country's development plan, and should be conducive to restoring the country to its development path as quickly as possible.

Fourth: The provision of new flows and the terms of debt renegotiation should be on a long-term basis consistent with the country's long-term financial and developmental needs as reflected in the analysis.

Fifth: The terms and conditions of rescheduling the official and commercial debts should be no harsher than the softest terms prevailing for the same kind of loans at the time of reorganization.

Sixth: Provisions should be included to facilitate additional flows or accelerated repayments if the analysis proved either too optimistic or too pessimistic with respect to the pace of the country's recovery.[125]

Developing countries called for the establishment of a more permanent institutional machinery empowered to convene, organize and supervise reorganization operations based on a set of internationally agreed principles and procedures.[126] Noticeably absent from the proposal is the commitment to undertake a comprehensive economic programme under the auspices of the IMF.

As a compromise, the creditor states and the developing country borrowers agreed on four basic concepts which would govern future debt renegotiations. The guidelines embodied in UNCTAD Resolution 165 (S-IX) of 11 March 1978 were as follows:

(a) International consideration of the debt problem of a developing country would be initiated only at the specific request of the debtor country concerned;

(b) Such consideration would take place in an appropriate multilateral framework consisting of the interested parties, and with the help as appropriate of relevant international institutions to ensure timely

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[125] *Id*. at 82.
[126] *Id*. at 83.

action, taking into account the nature of the problem which may vary from acute balance of payments difficulties requiring immediate action to longer term situations relating to structural, financial and transfer of resource problems requiring appropriate longer term measure;

(c) International action, once agreed by the interested parties, would take into due account of the country's economic and financial situation and performance, and of its development prospects and capabilities and of external factors, bearing in mind internationally agreed objectives for the development of the developing countries;

(d) Debt reorganization would protect the interest of both debtors and creditors equitably in the context of international economic co-operation."[127]

Upon the suggestion of the Trade and Development Board, the Secretary-General of the UNCTAD convened a meeting of an intergovernmental group of experts at Geneva on October 2, 1978 which laid down the detailed feature of the multilateral debt negotiation process.[128] After three plenary meetings the group produced an informal note which served as a provisional document but deemed as non-operational in character.[129] The work was endorsed by Trade and Development Board in resolution 222 (XXI) of September 27, 1980.[130] Under paragraph 4 of the detailed features it is mandated that

> international action . . . (a) Should be expeditious and timely; (b) Should enhance the development prospects of the debtor country, bearing in mind its socio-economic priorities and the internationally agreed objectives for the development of developing countries; (c) Should aim at restoring the debtor country's capacity to service its debt in both the short term and the long term, and should reinforce the developing country's own efforts to strengthen its underlying balance-of-payments situation; and, (d) Should protect the interests of debtors and creditors equitably in the context of international economic cooperation.[131]

Studies on the conduct of multilateral debt renegotiations within the framework of the Paris Club have shown that there has been little progress with regard to the implementation of the detailed features.[132] The focus on the restoration of debt servicing capacity in the short term have failed to enhance the development prospects

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[127] Debt and Development Problems of Developing Countries, UNCTAD Res. 165(IX), (Mar. 11, 1978).
[128] U.N. Doc. No. TD/B/730, annex, at 1.
[129] *Id.*
[130] UNCTAD Resolutions and Decisions Supplement No. 1, (Sept. 1980).
[131] U.N. Doc. No. TD/B/980, at 11.
[132] U.N. Doc. No. TD/B/945.

of the debtor states.[133] Fund conditionality, however, has become central and an essential element in seeking a solution to the debt problem of these states. The multi-year restructuring agreements (MYRAs) concluded by official creditors with some debtor states required continued Fund assistance in designing economic programs and monitoring their implementation by these debtor states.[134]

6.2 COMMERCIAL BANKS AND PRIVATE DEBT RESTRUCTURING AGREEMENTS

In the 1960s and the early 1970s, some developing country borrowers, such as, Argentina, Brazil, and Chile, have already engaged in private debt rescheduling with commercial banks[135] but the method adopted by the lenders was characteristically *ad hoc* in nature without any coordination among themselves. As signs of imminent or even actual defaults by a number of heavily indebted non-oil producing developing countries emerged in the later 1970s, private commercial banks finally recognized the need for a more enlightened approach toward alleviating the debt-service payments difficulty of the debtor states. In comparing the earlier reschedulings and those which transpired in the latter part of the 1970s one writer observed that:

> What distinguished the reschedulings of the later 1970s, then, was not so much their novelty as their scope. Instead of the relative handful of banks, often from a single country that once had been involved in negotiations, there were now 100, 200, or more . . . And where a few million dollars were once at issue, the stake had grown to the hundreds of millions, or, in some cases, billions of dollars.[136]

The banks' new approach was tested through the agreement between Zaire and its bank creditors in November, 1976.[137] An analysis of the succeeding rescheduling process between 1976 and 1980 identified some interesting features which now form part of the so-called "London Club" renegotiation process: First, banks began to reschedule medium-term syndicated Eurocredits.[138] Second, bargaining was conducted by a steering committee of half a dozen or so lead banks on behalf of all commercial bank creditors.[139] Third, creditor banks became bound by the doctrine of "fair treatment" whereby each bank was expected to participate in debt

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[133] U.N. Doc. No. TD/13/945, at 1.

[134] *See* K. Burke Dillon and Cumersindo Oliveros, Recent Experience With Multilateral Official Debt Rescheduling (Washington, D.C.. IMF, February 1987), 14-16.

[135] Richard-Huff, The Rescheduling of Country Debt: Is a More Formalized Process Necessary? in Group of Thirty, Risks in International Lending, (New York: Group of Thirty, 1982), Appendix B, at 49.

[136] *Id.*

[137] Lewis D. Solomon, "Developing Nations and Commercial Banks: The New Dependency", J. INT'L ECON. L. 12 (1978): 346.

[138] Huff, *supra* note 135, at 50.

[139] *Id.* at 51.

relief in proportion to its existing exposure.[140] Fourth, the banks suggested the adoption of economic programs by debtor states under close surveillance of the IMF through stand-by credit arrangements.[141]

Bank lending to developing country borrowers since the late 1970s remarkably decreased. But during the "Mexican rescue" in 1982, the IMF assumed a leading role in the renegotiation process by virtually dictating commercial lenders to refinance Mexico (and eventually future defaulting debtor states) in exchange for the banks' insistence upon the debtor states undertaking painful economic austerity measures monitored by the IMF.[142] A former General Counsel of the World Bank described the Mexican rescheduling in 1982 as "the beginning of a new era in debt rescheduling, one aspect of which is the emerging cooperative roles of governments, central banks and the Fund.[143] The involuntary nature of commercial bank involvement in refinancing scheme received further reinforcement under the Baker Plan in 1985.[144] Baker's request for combined financing from private creditors and multilateral institutions was coupled with the condition that debtor states continue to adopt adjustment programs which must be agreed before additional funds are made available, and should be implemented as the funds are disbursed by these institutions.[145] This strategy was designed mainly to encourage more commercial bank participation in balance of payments financing, which the IMF alone could not adequately provide in favor of several debtor states.

Cooperation between the IMF and the commercial banks in the management of the debt crises, however, has led the banks to devise ways of establishing a formal linkage between IMF stand-by arrangements and private loan agreements. The practice among the syndicate banks reveals a tendency to bind debtor states to extremely tight "protective clauses" in standard Euro-dollar loan agreements and collective restructuring agreements. Subsequent paragraphs will illustrate this established linkage.

Firstly, the purpose clause of a syndicated term loan Agreement may provide, for instance, that

The proceeds of the Loans shall be applied in or towards providing financing

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140 *Id.*

141 *Id.* at 53-55.

142 *See* the introductory remarks by the Chairman during the *78th Annual Meeting of the American Society of Int'l Law Proc.*, April 12-14, 1984, p. 301.

143 *Id.* at 301-302.

144 "Statement of the Honorable James A. Baker, III, Secretary of the Treasury of the United States before the Joint Annual Meeting of the International Monetary Fund and the World Bank on October 8, 1985 in Seoul, Korea," INT'L LEGAL MATERIALS XXV (March 1986): 412.

145 *Id.* at 414.

> for investments included in the economic plan of the Republic of _________ for 1987 or other productive projects *in the context of the stablisation policy agreed between the Borrower and the International Monetary Fund . . .* [146] (Italics mine)

Secondly, parallel financing by commercial banks with the IMF has increasingly made a linkage between new money drawings under either a syndicated term loan agreement or restructuring agreement and the purchases by IMF members under a stand-by arrangement or similar facility. Paragraph 4 (entitled "Draw Down") of the specimen syndicated term loan agreement provides the following:

> Subject to the terms of this Agreement (*including* but not limited to *the conditions set forth in Clause 12*), loans will be made to the Borrower at anytime and from time to time during the commitment period . . .[147] (Italics mine)

Clause 12 referred to under paragraph 4 refers to "Conditions Precedent" to loans. Section (2) of Clause 12 states, on the other hand, that

> The obligations of each Agent and each Bank hereunder are subject to the further precedent that, both at the time of the request for and at the time for the making of each Loan, *the representations and warranties of the Borrower set out in Clause 13(1) are true and accurate on and as of such times as if made at each such time* and no Default has occurred and is continuing or would result from the proposed loan.[148] (Italics mine)

Among the standard representations and warranties required of a debtor state in Clause 13(1) is a provision which relates to IMF membership stating that

> The Borrower is a member in good standing of the International Monetary Fund and *no limitation or restriction has been imposed on its use of the resource; thereof.*[149] (Italics mine)

In relation to the-above-quoted representation, banks have maintained in practice that amounts under the syndicated term loan agreement or the restructuring agreement shall be disbursed "only when the program on the basis of which they agreed to reschedule or provide new financing is in place and progressing successfully."[150] One writer has expressed the view that the use of compliance with performance criteria under the IMF stand-by arrangement as an express condition

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[146] A. Arora, G.A. Penn, and A.M. Shea, The Law and Practice of International Banking (London: Sweet and Maxwell, 1987), 399.

[147] *Id.* at 400.

[148] *Id.* at 410. *Id.* at 413.

[149] *Id.* at 413.

[150] ASIL Proceedings, *supra* note 142, at 312.

would have the effect of incorporating directly all of the performance criteria into the new money or restructuring Agreement.[151]

> Finally, Clause 16 on "Events of Default" includes the following circumstance:
>
> (c) any representation, warranty or statement made or deemed to be repeated in this Agreement or in any notice, certificate, statement or the Information Memorandum delivered, made or issued by or on behalf of the Borrower hereunder or in connection herewith or any information provided by the Borrower to any of the Agents, the Managers and the Banks hereunder shall be at anytime incorrect in any respect or any such representation, warranty or statement would, if made or repeated at any time with reference to the facts and circumstances then subsisting, be incorrect in any respect at that time . . .[152]

Subsequent commercial loan documentation had also incorporated as covenants and events of default commitments by debtor-states to undergo a closer surveillance. The February 26, 1986 Restructuring Agreements between Venezuela and its commercial bank creditors contained the following pertinent clauses:

> SECTION 10.02 *Covenants of the Republic*. So long as any Credit or any other amount payable by the Obligor or the Republic under this Agreement shall remain unpaid, the Republic agrees as follows:
>
> (e) *Monitoring Procedures. The Republic will complete the implementation of, and maintain, the Monitoring Procedures as provided in Schedule 6 to the Restructuring Principles*. The Republic agrees that any changes limiting the Monitoring Procedures (including, without limitation, any limitation thereof which affects the scope of any of the Annual Economic Programs to be prepared as described in Part 1 of the Monitoring Procedures, the implementation and maintenance of the procedures for the monitoring of the Venezuelan economy described in said Part 1, expanded as provided in the last paragraph of said Part 1, or the nature or extent of the consultations with international agencies described in Part 2 of the Monitoring Procedures) shall be mutually agreed by the Republic and the Overall Majority Banks before being implemented.
>
> (f) *Reporting and Information*. The Republic will furnish to the Servicing Bank the following:
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> xxx xxx xxx

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[151] Lee C. Buchheif and Mark A. Walker, Legal Issues in Restructuring of Commercial Bank Loans to Sovereign Borrowers, in Sovereign Lending, Managing Legal Risk, eds. Michael Gruson and Ralph Reisner. (Great Britain: Euromoney Publications, 1984), p. 150.

[152] Arora, Penn, and Shea, *supra* note137, at 416.

(iii) Promptly after the same becomes available to the Republic, a copy of each report referred to in the last paragraph of the description of the Monitoring Procedures set forth in Schedule 6 to the Restructuring Principles (including, without limitation, each report specifically referred to in the fourth and penultimate paragraphs of Part 2 of said Monitoring Procedures).

(iv) Within 30 days after the end of each calendar quarter, information concerning the Republic's consultations with international agencies (such as the Inter-American Development Bank, the IBRD and the IMF) described in the first paragraph of Part 2 of the Monitoring Procedures, and a comprehensive description of the preceding quarter's major macroeconomic policies and objectives, plans and assumptions, a statement of specific and quantified economic targets, and an update of the short and medium-term fiscal, economic and financial objectives of the Plan de la Nacion then in effect.

xxx xxx xxx

SECTION 11.01 *Events of Default*. If any of the following events ("*Events of Default*") shall occur and be continuing:

xxx xxx xxx

The Overall Majority Banks shall notify the Overall Coordinating Bank (through the respective Overall Servicing Banks) that they have determined in their reasonable judgment that any of the following events or conditions has occurred (provided that, in the case of a determination contemplated by clause (iii) below, such determination shall have been notified by the Overall Coordinating Bank to the Republic and 30 days shall have elapsed since the date of such notice):

xxx xxx xxx

(ii) *Based on the information furnished pursuant to Section 10.02 (f) hereof and the corresponding provisions of other Restructuring Agreements and the Relending Facility. Agreement, the results of the economic program of the Republic of Venezuela are or will be materially incompatible with a viable external payments position consistent with continuing debt service*; or

(iii) The reporting and consultation procedures outlined in the Monitoring Procedures are not being implemented as contemplated by the Monitoring Procedures;

xxx xxx xxx[153]

This brief review of sovereign loan documentation shows increasing dependence of international private lenders upon the surveillance authority of the IMF over its members. While banks have the tendency to adopt a more formal linkage with IMF stand-by agreements there is a more cautious attitude on the part of the IMF officials to reinforce this legal tie. Not only does the IMF interpretation of the legal nature of stand-by arrangements prohibit this formal linkage but, more importantly, the IMF could not risk losing the confidence of its developing country members who have continually exerted their best efforts to respect the evolving renegotiation procedure.

7. SOVEREIGN DEBT CRISIS BEYOND 1990S: NEW PARADIGMS AND MECHANISMS

After the series of sovereign debt crises in the 1970s and 1980s, new situations of financial crises confronted the international community. There is also the realization that for some highly indebted states, the traditional conditionality approach of the Fund had failed. Demands for a more flexible treatment of existing sovereign debts were conceded by the Fund and other creditors.

Another crucial stage of the financial crisis in the 1990s, was the turmoil in 1997 involving economies of Asian states, such as, Thailand, Malaysia, Korea and the Philippines. The Fund would respond with conditionality which included not only macroeconomic policy but also financial sector and corporate restructuring, capital accounts, and trade liberalization.

The Eurozone debt crisis involving peripheral member–states triggered by the financial crisis in the United States between 2007-09 would bring about new financial mechanisms to bailout member-States.

7.1 THE IMF AND LOW-INCOME DEVELOPING COUNTRIES

Low-income members hold less than 10 percent of the institution's voting power and a roughly similar share of its quotas, which are based on the relative size of each member's economy. Low-income members are a large group within the IMF, however; comprising 78 countries (see Table A in the Appendix). They make up more

[153] "Monitoring Procedures in Venezuelan Restructuring Agreements", INT'L LEGAL MATERIALS 25 (1986): 480-481 .

than 40 percent of the organization's membership.

The purposes of the IMF, as set out in Article I of the Articles of Agreement, apply to the low-income members as much as to all the others. Former First Deputy Managing Director Stanley Fisher made this point clear in his farewell remarks to the Executive Board: "The issue is not whether the Fund should take an interest in poverty, but whether it should continue working, and working better, with its poorest member countries. The answer to that is yes: as a universal financial institution, we have to stay involved with all our member countries."[154] Subsequently, the Executive Board of the IMF adopted a statement, "The Role of the Fund in Low-Income Member Countries," to serve as an operational framework for the Fund's work with low-income member countries. The statement defines the Fund's role as one of providing policy advice, financial programs, and assistance in capacity building to low-income member countries in its areas of expertise and in accordance with its institutional mandate.

Involvement of the IMF with its low-income members generally takes the form of various lending and structural arrangements. From the perspective of donors and investors, such lending is typically assumed to boost the credibility of a multilateral's seal of approval, as a multilateral that lends money has a stronger incentive to monitor the quality of the policies being implemented in a member-State than one that plays a strictly surveillance role. This, among other reasons, allows the IMF to exercise conditionality, affecting the nature of policies implemented by the recipient country's government rather than simply monitoring their quality.[155] From the point of view of borrowing countries, conditionality may also provide a way of sorts to undertake decisions that, although desirable *ex ante*, would be difficult to carry out ex post.[156] It has been observed that this blend of conditionality and a multilateral organization helps offset the intrusiveness of the former in the national sovereignty of a borrowing country, allowing the intrusion to be more politically feasible and legitimate.[157] Furthermore, conditionality offers a way for further resources to be mobilized by providing other lenders with greater confidence that an appropriate reform program will be implemented and that, as a result, sound policies will return the economy to a path of sustainable growth.

IMF concessional lending is provided through the Poverty Reduction and Growth Facility (PGRF) at a fixed interest rate of 0.5 percent. The grace period for

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[154] James Boughton, "Does the World Need a Universal Financial Institution?" WORLD ECON. 6, no. 2 (2005): 27-46 .

[155] International Monetary Fund, "The Role of The Fund In Low-Income Countries" (2004).

[156] Dani Rodrik, *TFPG Controversies, Institutions, and Economic Performance in East Asia*, (NBER Working Paper No. 5914, 1997.

[157] Niall Ferguson, "The House of Rothschild: Money's Prophets" (1998), 1798-1849.

concessional loans is comparatively longer than that for standard IMF arrangements. A borrowing low-income member begins repaying a loan five and a half years after the disbursement of the first tranche, while the grace period for a standard credit tranche is two and a half years, which can be extended up to three and a quarter years. The maturity of a concessional arrangement is, at ten years, five years longer than that of a standard IMF arrangement. In addition to PRGF-supported programs, lending on concessional terms is available for post-conflict members through the Emergency Post-Conflict Assistance. Established in 1995, the facility provides assistance to members with urgent financing needs unable to develop a comprehensive economic program due to severe capacity limitations in the aftermath of a conflict. The facility — which often plays a valuable role as a bridge to a subsequent PRGF — has a subsidized interest rate of 0.5 percent for low-income members and a maturity between 3 and a quarter and 5 years.

7.2 DEBT RELIEF FOR LOW INCOME COUNTRIES AND THE HIPC INITIATIVE

Since the 1980s, there have been various efforts by members of the international community to alleviate the debt burden of low-income countries (LICs). In the late 1980s, industrial countries, primarily members of the Paris Club, first agreed to reschedule low-income countries' debts on concessional terms in the context of the so-called Toronto[158] terms. By the mid-1990s, there was a general recognition that the debt problems of the low-income countries were more structural and permanent in nature than it was initially thought.

Consequently, under what came to be known as Naples terms, Paris Club creditors were forgiving two-thirds of low-income countries' eligible debts. Despite these efforts, some low-income countries, especially those in sub-Saharan Africa, continued to face heavy external debt burdens and difficulties in servicing them, sometimes repeatedly resorting to debt rescheduling. This often reflected a combination of factors, including a lack of perseverance with structural and economic reform programs, a deterioration in their terms of trade, poor governance, civil unrest, and also a willingness of creditors to continue to provide new loans.

In the mid-1990s, increasing poverty and a general perception of development failure in many of the least developed countries, primarily in sub-Saharan Africa, coincided to intensify the pressure for a strategy to deal with the LIC debt crisis. The

[158] The Toronto terms were granted in October 1988. They provide for a concessional rescheduling with a reduction in the net present value (NPV) of eligible debt of up to one-third of debt. The Naples terms, granted from January 1995, effect a two-thirds reduction in the NPV of eligible debt.

complex relations between heretofore relatively distinct groups of actors started to come together and influence official thinking on the issue. The growing influence of civil society, with NGO networks at its forceful core, transformed the international debt regime through political reach into the higher echelons of international governance, especially with the G-7 governments and the Development and Interim Committees of the Bretton Woods institutions. The alliance's efforts led to a call by the governing body of the World Bank at its annual meetings in 1994 and 1995 to study multilateral debt and develop an effective strategy to deal with the issue.

Within the World Bank, concern was already growing about the rising debt problem for a large number of its poorest borrowers, particularly in the Africa Region. At first the voices were disjointed; they were also discounted under the presumption that the poor countries had a short term cash-flow constraint that was readily amenable to policy reform. The major tool in this strategy was structural adjustment programs, which provided the resources to get through the short-run problems and targeted much needed policy reforms.

By the early 1990s however, it had become clear that structural adjustment programs were not working as expected. Lack of ownership of reform programs combined with governance dysfunctions, weak public expenditures management, and inadequate emphasis on infrastructure, private sector development, and agricultural productivity had hindered supply responses to macroeconomic policy adjustment.

To address increasing concerns about LIC debt, especially the rapidly increasing multilateral debt, the World Bank established a working group to assess the magnitude of the multilateral debt problem and develop possible mechanisms to deal with it. The group sought to complement the World Bank's existing instruments and traditional mechanisms[159] for providing relief for bilateral and commercial debt. The mechanism proposed by the group, a "multilateral debt fund," was deliberately designed to be a concerted and comprehensive effort to effectively deal with the HIPC (Heavily Indebted Poor Countries) debt problem.

The development community quickly embraced the idea, which soon translated into the proposal for the HIPC Initiative put forth by the World Bank and the IMF in 1996. Through more uniform rules, the HIPC Initiative marked a significant advance from traditional debt relief mechanisms for eligible LICs. It transformed the debt regime toward more open and accountable norms, and introduced some key

159 "These traditional mechanisms may be summarized as: the adoption of stabilization and economic reform programs supported by concessional loans from the IMF and the World Bank; flow rescheduling agreements with Paris Club creditors on concessional terms followed by a stock-of-debt operation after 3 years of good track records under the IMF arrangements and the rescheduling; agreement by the debtor country to seek at least comparable terms on debt owed to non-Paris Club bilateral and commercial creditors; new financing on appropriately concessional terms.

innovations, including, for the first time, a systematic treatment of multilateral debt, the notion of debt sustainability, and the focus on poverty reduction.

The major evolution of the treatment of sovereign debt was the move from debt collection, to debt rescheduling, to aid and structural adjustment, to debt "sustainability," to forgiveness and poverty reduction — what one G-7 officially called the "slippery slope of debt."[160] The resulting momentum brought about the original HIPC Initiative and the Enhanced HIPC Initiative.[161]

The HIPC Initiative was new in several important ways. The HIPC Initiative involved all creditors. For the first time, World Bank and IMF debt became eligible for relief. The Initiative also provided for the write off of all creditor debt stock rather than just yearly relief on repayments — it was a permanent relief deal that could not be reneged upon later. Until HIPC, bilateral creditors would only write off a certain amount of debts owed them: 33%, 50%, or 67%. The concept of committing to writing off an amount of debt that would take debt levels down to a "sustainable" level was a real shift in debt relief policy.

There are two requirements to be eligible for HIPC status. First, HIPC is only for the poorest countries. This is defined by which countries are eligible to receive assistance from the International Development Association (IDA) arm of the World Bank. IDA countries are defined as having a GDP per capita of $885 or less. Second, a State's debt burden must be large enough to be considered unsustainable. HIPC defines "debt sustainability" as a ratio of debt to exports. A country's total debt burden must be more than 150% of its annual exports in order to qualify for relief.

In recognition of the need to address the debt burden of the low-income countries, the international financial community has over the past decade introduced and implemented a wide range of instruments which were designed to alleviate the debt burden of these countries. In general, for the different categories of creditors, the main trend has been a move towards increasing the concessionality of external assistance to the low income countries.

The "traditional" mechanisms for addressing the debt problems of low income countries are: the adoption of stabilization and economic reform programs supported

160 Madhur Gautam, "Debt Relief For The Poorest: An OED Review Of The HIPC Initiative" (Worldbank Publications, 2003).

161 The 1996 Initiative was enhanced following extensive consultations with interested parties from civil society and the Group of Seven (G-7) countries. The Enhanced HIPC Initiative launched in late 1999 by the IMF and World Bank Executive Boards, aimed to provide broader, faster, and deeper debt relief to a larger number of countries.

by concessional loans from the IMF and the World Bank; flow rescheduling agreements with Paris Club creditors on concessional terms followed by a stock-of-debt operation after 3 years of good track records under the IMF arrangements and the rescheduling; agreement by the debtor country to seek at least comparable terms on debt owed to non-Paris Club bilateral and commercial creditors; and new financing on appropriately concessional terms.

Once States qualify for HIPC classification, they must comply with strict macroeconomic requirements prescribed by the IMF, known as Structural Adjustment or Austerity Programs. It often takes years to implement these policies before any debt cancellation is delivered. States must also be in an agreement with the IMF to borrow more money in order to remain eligible for debt relief through HIPC.

When a country meets the requirements to the satisfaction of the World Bank and IMF, they reach what is called Decision Point. At Decision Point, a State receives interim debt service relief. In other words, what the country pays each year (debt service) is reduced, but the actual amount of debt (debt stock) has yet to be cancelled. Most States begin to benefit from debt service reduction immediately, putting the savings into health, education and other development goals. States must stay "on-track" with implementing the economic policies required by the IMF in order to continue to receiving this interim debt relief. In at least nine cases the IMF has suspended debt relief because countries were listed as "off-track" with their IMF program. The World Bank also reserves the right to cut off interim relief to a country if they are not following through with their IMF requirements.

At what is called Completion Point, States exit the HIPC program. Two things are required to reach the HIPC completion point. First, States must remain "on-track" with their IMF economic conditions, even when those policies can be harmful to domestic industry, the poor, and the environment. Second, States must design and implement for one year a Poverty Reduction Strategy Paper (PRSP) under the guidance of the World Bank and IMF.

7.3 THE ASIAN TIGER ECONOMIES AND DEBT CRISIS

Sometime in 1997 fast emerging economies in East Asia were struck by financial turmoil. Prior to this event, it has been observed that “Asian countries had experienced low budget deficits, relatively low public debt, inflation in single digits, rapid economic growth, and high savings and investment rates.”[162]

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[162] Catherine H. Lee,“To Thine Own Self Be True: IMF Conditionality and Erosion of Economic Sovereignty In The Asian Financial Crisis”, U. PA. J. INT’L ECON. L. 24 (Winter 2003): 875.

The causes of the Asian financial crisis was not the typical balance of payments problem, but commentators would cite a range of issues, such as, corruption, vulnerability of the financial sector due to under-regulated expansion of capital and financial markets.[163] The Fund officials would sum these up as a failure of internal management in need of a broader set of structured reforms.

While Malaysia, Thailand, and the Philippines did not see fit to resort to the Fund's stand-by arrangement, Korea, on the otherhand, sought a three-year stand-by arrangement with a combined package of commitments, apart from the Fund, totaling $58.4 Billion. The arrangement included the following conditionality:

(a) fiscal and monetary tightening, including a tax increase, a budget cut, and an increase of the interest rate;

(b) institutional reforms, including establishing an independent central bank, closing 'bad' private financial institutions, and accelerating the approval of foreign entry into the domestic financial sector;

(c) trade and financial liberalization, and imposing of GAPP;

(d) review of corporate governance and structure; and

(e) labor market reform.[164]

The implementation of these tough programs was heavily criticized by Korean workers, in particular, on account of the job losses, business closures and loss of purchasing power.[165] In fact, it has been posited that the Fund's conditionality in Asia "went far beyond its stated purpose in the Articles of Agreement."[166] But Fund officials would cite South Korea's current success as a "vindication of the IMF's conditionality."[167]

7.4 EUROLAND CONTAGION

Speculative mortgage lending by United States financial institutions, and

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[163] Ibid.
[164] Ibid., 6
[165] Ibid., 6
[166] Ibid., 7
[167] Ibid., 8

trading of resultant derivative securities by international banks in the decade after the Asian financial crisis triggered the sovereign debt crisis in Eurozone between 2009-2011. At least five countries in the Eurozone had to resort to bailout packages, namely, Greece, Portugal, Ireland, Italy and Spain.

The causes of the Eurozone debt crisis may also be further attributed to some extent to the fact that "powerful original members of the EEC, such as Germany, were eager to develop a large and competitive Eurozone, and so allowed less solvent EU nations to adopt the euro even if they had failed to fulfill the criteria outlined by Maastricht."[168] These so called peripheral member-States had opted for growth strategies that reflected their own history, politics, and social structure engaging in high levels of consumption, in the case of Greece and Portugal, and investment booms in so far as Ireland and Spain are concerned.[169]

Unlike the situation of developing country borrowers in the 1970s and the 1980s, peripheral member-States of Euroland would have the benefit of their Regional Organization, the EU, assisting them during the crisis situation. Another institutional layer of possible financial and technical assistance may be made available before even availing of the Fund's resources under conditionality. The options toward economic recovery, however, will not be as easy for these peripheral member-States even within the context of austerity measures under the Eurozone.[170]

Emergency financial support to member-States of Euroland during debt crisis had been packaged as follows: (a) European Financial Stability Facility, and, (b) European Financial Stabilization Mechanism.[171]

The adoption of these mechanisms reflects the gap at the inception of the entry into the Maastricht Treaty of 1993, wherein there were no rules to ensure effective monitoring and supervision of fiscal policies of member-States.[172] This was initially addressed by the 1999 Stability and Growth Pact, which, on the otherhand, did not have permanent and effective legal instrument to provide financial assistance to Euroland Members in serious debt crisis.[173]

The legal justification for the bailout mechanisms had been derived from Art.

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[168] Christopher Alessi, The Eurozone in Crisis, Council on Foreign Relations, 23 July 2012, *Available at* http://www.cfr.org.en/eurozone_crisis/22055, p. 3.

[169] The Greek and Eurozone Turmoil: A Crisis With Deep Roots, Third World Network. *Available at* http://www.twnside.org.sg/title2/resurgence/2011/253/cover02.htm, p.3.

[170] Ibid.

[171] Sideek M. Seyad, "A Legal Analysis of the European Financial Stability Mechanism", J.I.B.L.R 26, no.9 (2011): 421-433.

[172] Ibid.

[173] Ibid.

122(2) of the Treaty on the Functioning of the European Union (TFEU) which states:

> Where a Member-State is in difficulties or is seriously threatened by natural disasters or exceptional circumstances beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member-State concerned…[174]

The "exceptional circumstances" test in the provision has been interpreted to cover "serious deterioration in the international and economic environment," even if one may treat the situation of some peripheral member-States as attributable to pure fiscal mismanagement.[175]

The distinction between the EFSF and EFSM is that the former is funded by Euroland members while the latter is jointly funded by Euroland members and the IMF. EFSM is also permanent in nature.

The EFSM is the equivalent of an IMF stand-by arrangement with the following features:

(1) A member is experiencing severe financial disturbance;
(2) Proof that the disturbance is beyond its control;
(3) Proof that the member could not by itself raise money;
(4) Submission of an economic and financial adjustment program; and,
(5) Involvement of other EU institutions, such as, Court of Auditors and European Anti-Fraud Office.[176]

The EFSM takes the form of a loan or credit line.[177]

In terms of management, the mechanism will have a Board of Governors consisting of Ministers of Finance of the member-States of the Euroland.[178] The EU Commission on Economic and Monetary Affairs, the IMF, and the European Central Bank assess the actual funding needs of the beneficiary member-State, on the basis of which, the Board of Governors will mandate the Commission to negotiate a macro-economic adjustment program with the member-State.[179]

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174 Ibid., 4
175 Ibid.
176 Ibid., 6
177 Ibid., 6
178 Ibid., 12
179 Ibid., 13

An interesting analogy with the 1980s sovereign debt renegotiations is the use of a "collective action clause" by which private lenders will be required to cover losses of any future Euroland member-States.[180] A restructuring plan with private sector creditors will have to be negotiated by the member-State which may lead to various changes to the contracted obligations in the form of rescheduling, lower interest rate, longer delay or even lower principal payment.[181]

With the Eurozone crisis, the IMF has assumed a more calculated role in close cooperation with the European Union's major financial decision-makers. It is of interest to note the adoption of IMF stand-by arrangement taking into account institutional financial framework of the European Union.

8. CONCLUSION

The legal arrangements between sovereign borrowers and their creditors indicate a growing recognition of a "shared responsibility" in the on-going crisis management of sovereign debt problems. Despite the strong arguments for unilateral state action by several heavily indebted developing country borrowers in the past, there has been an acceptance of less confrontational means of addressing differing views and approaches. It is thus evident that international actors in the global debt crisis have affirmed in practice an obligation to negotiate instead of exercising unilateral actions.

The remarkable shift of sovereign debt crisis from developing countries in Africa, Latin America and Asia to developed countries of Euroland is of current interest. Obviously, the capacity of the citizens of peripheral countries in the Eurozone to undergo strict austerity measures leaves much to be analyzed compared with the experiences of less developed countries. The tolerance for pain and suffering arising from immediate reduction in the standard of living in developed countries has been demonstrated to be marginal unlike the less privileged in developing countries.

Critics of the IMF have often cited the need to review IMF prescriptions in light of universally recognized human rights norms and principles. The World Bank Report on "Equity and Development" is one example.[182]

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180 Ibid., 13

181 Ibid., 13

182 Steven A. Ramirez, "Taking Economic Human Rights Seriously", LOY. U. CHI. L. J. 42 (Summer 2011): 713. *Available at* Westlaw,p.1.

Another attempt to address the issue is the 2012 ILO/Worldbank Joint Synthesis Report entitled, "Inventory of Policy Responses to the Financial and Economic Crises,"[183]

The Report favored growth with social protection during global financial crises.[184]

The present writer, in his earlier study, has also inquired into the responsibility of international economic institutions, like the IMF, in instances where prescribed adjustment programs have failed to take into account social protection or even undermined the political and economic sovereignty of debtor states.

In this regard, more creative ways must be pursued in designing economic policies which would lead to an adjustment with a human face.

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[183] In forthcoming vol. 57 (2012) of The Ateneo Law Journal, p.5.

[184] Diane A. Desierto, "Growth versus Austerity: Protecting, Respecting, and Fulfilling International Economic and Social Rights During Economic Crises", *Id.*

Appendix

Table A

LOW INCOME MEMBERS OF THE IMF
(As of 2006)

Afghanistan
Albania
Angola
Benin
Bhutan
Bolivia
Burkina Faso
Burundi
Central African Rep.
Cambodia
Cameroon
Cape Verde
Chad
Comoros
Congo, Democratic Rep.
Congo, Rep.
Cote d'Ivoire
Djibouti
Dominica
Eritrea
Ethiopia
Gambia
Georgia
Ghana
Grenada
Guinea
Guinea-Bissau
Guyana
Haiti
Honduras
India
Kenya
Kiribati
Kyrgyz Rep.
Lao, P.D.R.
Lesotho

Armenia
Azerbaijan
Bangladesh

Liberia
Madagascar
Malawi
Maldives
Mali
Mauritania
Moldova
Mongolia
Mozambique
Myanmar
Nepal
Nicaragua
Niger
Nigeria
Pakistan
Papua New Guinea
Rwanda
Samoa
Sao Tome and Principe
Senegal
Sierra Leone
Solomon Islands
Somalia
Sri Lanka
St. Lucia
St. Vincent
Sudan
Tajikistan
Tanzania
Timor-Leste
Togo
Tonga

Uganda
Uzbekistan
Vanuatu
Vietnam
Yemen, Rep.
Zambia
Zimbabwe

Table B

ORIGINAL AND ENHANCED HIPC INITIATIVE

Element	Original	Enhanced
Stated objectives levels, subject to exit from rescheduling, plus	To bring the country's debt down to to remove the debt overhang	Maintains the original focus sustainable satisfactory policy performance permanent free up resources for higher social spending aimed at poverty reduction to the extent that cash debt-service payments are reduced.
Qualification criteria	IDA-only countries (poverty) Unsustainable level of debt after full use of traditional mechanisms Strong record of policy performance 41 countries eligible, 29 expected to qualify	Same. Applied retroactively to include countries already past decision or completion points under the original framework. 41 eligible in 1999, currently 42, of which 38 are expected to qualify.
Debt sustainability	*Guiding principle*. Target overall debt sustainability to provide a durable exit strategy from the rescheduling process	*Principle for change*: Provide a clear exit from unsustainable debt burden to remove the debt overhang and provide an appropriate cushion against exogenous shocks.
Indicative Targets	Target range for main indicator: NPV debt-to-exports: 200-250% NPV debt-to-revenue: 280% with export/GDP: 40%; revenue/GDP: 20%	Uniform application of single target: NPV debt-to-exports: 150% NPV debt-to-revenue: 250% with export/GDP: 30%; revenue/GDP: 15%
Calculation of relief	Fixed at completion point, based on projections of debt indicator for completion point	Fixed at decision point, using actual data on NPV debt for year prior to decision point and 3-year average for exports
Time of relief delivery	Completion point (CP), irrevocable commitment	Decision point: on an annual basis, interim relief is bulk of anticipated post-CP relief, it is irrevocable

Forward-locking assessments	Debt sustainability analysis to project profile of key debt indicators	Same
Performance criteria	*Guiding principle*. Action only after the debtor has shown, through a track record, the ability to put to good use whatever relief is provided	*Principle for change*: To strengthen the incentives for debtor countries to adopt strong programs of adjustment and reform
For decision point	3-year track record of macroeconomic stability and policy reform	Same plus interim or full PRSP
For completion point	Further 3-year track record of macroeconomic stability and policy reform	Maintenance of macroeconomic stability Completion of PRSP, plus one-year PRSP implementation for E-HIPC Performance benchmarks for structural and social reforms
Interim period	3 years	Flexible, with the introduction of floating CP
Creditor participation	*Guiding principle*: Comprehensive debt relief action: coordinated among all creditors involved with broad and equitable participation New external finance to be on appropriately concessional terms	*Principle for change*. Same plus debt relief should be additional to reinforce the wider tools of the international community to promote sustainable development and poverty reduction

Source: Gautam, Madhur. Debt Relief For The Poorest: An OED Review Of The Hipc Initiative, 2003 THE WORLD BANK., Washington, D.C.

Table C

HIPC COUNTRIES, as of May 2006

Completion Point	Decision Point	Pre-Decision Point
Benin	Burundi	Central African Republic
Bolivia	Chad	Comoros
Burkina Faso	Congo, Rep.	Cote d'Ivoire
Cameroon*	DRC	Eritrea
Ethiopia	Gambia	Haiti
Ghana	Guinea	Kyrgyz Republic
Guyana	Guinea-Bissau	Liberia
Honduras	Malawi	Nepal
Madagascar	Sao Tome and Principe	Somalia
Mali	Sierra Leone	Sudan
Mauritania**		Togo
Mozambique		
Nicaragua		
Niger		
Rwanda		

Senegal
Tanzania
Uganda
Zambia

Source: World Bank

* *Cameroon reached completion point on May 1, 2006*

** *Mauritania has since been excluded from the MDRI because the IMF determined that macroeconomic management has gone off-track.*