

## VI. DEBT BURDEN OF DEVELOPING COUNTRIES : AN EVALUATION OF RESCHEDULING PROCESS

### (i) INTRODUCTION

1. The item "Debt Burden of Developing Countries" has been on the work programme of the AALCC since its Kathmandu Session (1985). During the succeeding years the matter was under active consideration by an Expert Group Meeting at New Delhi (November 1986) as well as by the successive sessions of the AALCC. The Secretariat produced several studies on the subject for consideration of the AALCC.<sup>1</sup> The study entitled "Legal Aspects of International Loan Agreements" was submitted to the Singapore Session of the AALCC (1988). During that session, the AALCC decided to circulate the study in view of its importance to the entire membership of the Group of 77.

2. During its Nairobi Session (1989), the AALCC while considering a report on the debt burden prepared by the Secretariat directed the Secretariat to prepare a study dealing with the legal aspects of rescheduling of loans and debt relief with a view to formulating workable legal guidelines for rescheduling and debt relief. Accordingly, the Secretariat prepared a preliminary study on the various aspects of rescheduling of debts. During the Beijing Session (1990), the AALCC took note of that study and asked the Secretariat to continue to update it and commence formulation of a set of legal guidelines on this aspect. In the Cairo Session (1991), this item could not be taken up due to lack of time. Nonetheless, the Secretariat kept on monitoring the developments and updating its study. At the thirty-first session of the AALCC held in Islamabad (Pakistan) in January-February 1992, the Secretariat presented a revised study entitled "Debt Burden of Developing Countries - Legal and Policy Aspects of Rescheduling of Loans". Unfortunately, the study could not be taken up for discussion at that session due to lack of time. However, in view of the importance of the topic for the developing countries, the study is being reproduced in the following pages.

<sup>1</sup> The Debt Burden of the Developing Countries: A Preliminary Study on the Problems and Prospects (AALCC/XXV/9 and Add. 1); Report of the Expert Group Meeting on Debt Burden of Developing Countries (AALCC/XXVI/16); The Debt Burden of Developing Countries: New Developments, Debt Management and Formulation of Principles relating to Debt Relief (AALCC/XXVII/88/9); Legal Aspects of International Loan Agreements (AALCC/XXVII/99/9-A); Legal and Policy Aspects of Rescheduling of Loans: A Preliminary Study (AALCC/XXIX/9/12).



1. The debt crisis faced by the developing world continues unabatedly affecting their development process. There was, however, a marked difference in the regionwise distribution of the debt burden. The external debt of the Asian developing countries stood at \$ 336 billion (approximately). The debt in Africa was largely unchanged at \$ 195 billion (approximately) owing mainly to continued official concessional lending, debt cancellations and the negative valuation effect of the stronger United States dollar.<sup>2</sup> Available figures put the total debt burden of the developing world (including short-term debt) at \$ 1,265 billion.<sup>3</sup> As the external debt position worsens, Asian and African nations are increasingly devoting energies and scarce resources, which otherwise should have gone to promoting development, to grappling with the debt crisis. The net inflow of capital to the developing countries in general has been showing a massive negative trend.<sup>4</sup>

2. At the Eighteenth Special Session of the United Nations General Assembly on International Economic Co-operation held from 16 to 28 April 1990, Member States adopted by consensus a declaration in which it is stated that "a durable and broad solution of the external debt problems of the developing debtor countries, should continue to be given urgent attention, and the serious debt-servicing problems of some other countries should be further addressed with a view to an early solution. Recent initiatives and measures to reduce the stock and service of debt or to provide debt relief for developing countries should be broadly implemented. Relief measures should aim at the resumption of vigorous growth and development in these countries and should address all types of bilateral debt of debtor developing countries. Serious consideration should be given to continuing to work towards a growth-oriented solution of the problems of developing countries with serious debt-servicing problems, including those whose debt is mainly to official creditors or to multilateral institutions."<sup>5</sup>

3. The proposals enunciated by the United States Treasury Secretary Mr. Brady (popularly known as 'Brady Plan') for alleviating debt and debt-service in 1989 seems to have made some significant contribution in achieving

2 *The Effects of the External Debt and the External Debt Servicing on the Industrial Development of the Developing Countries*, UNIDO, IDB, 7/20, 6 September 1990. It should be noted that about 90 per cent of the debt of African countries is represented by their long-term borrowings, or their drawings from IMF. The remaining 10 per cent is short-term debt. Further an important feature of the African debt is that over 96 per cent of the long-term debt was either publicly contracted or publicly guaranteed, and is thus sovereign debt.

3 *Ibid.*

4 During 1988, for example, while the net inflow of capital to the developing countries was to the tune of \$ 92 billion, the outflow of resources and the capital by way of debt service touched \$ 142 billion. See *The World Bank Annual Report, 1989*, p. 27.

5 *Current Trends and Policies in the World Economy* quoted in *World Economic Survey 1990* United Nations 1990, p. 8. The item "External Debt Crisis and Development" has been included in the agenda of the forty-sixth session of the General Assembly (A/46/250).



the above stated purpose. This was, however, made possible due to official support extended by international financial institutions including IMF and World Bank. But, it should be noted that these proposals have touched only a part of the debt burden problem. The official support by these financial institutions has, operationally, taken the form of more concessional rescheduling terms for official bilateral debt and the provision of official resources to facilitate market-based debt and debt-service reduction for commercial bank claims.<sup>6</sup>

4. In order to assist the General Assembly in its efforts to enlarge the area of international agreement on policy approaches to the problems of developing countries debts, at the end of 1989 the Secretary-General of the United Nations appointed Mr. Bettino Craxi, former Prime Minister of Italy, as his Personal Representative on Debt.<sup>7</sup> After extensive consultations Mr. Craxi submitted his report in October 1990. This report contains an extensive analysis of the origins, evolution, scope and character of debt problems facing developing countries and proposes policy remedies. It also sets the debt crisis in the context of international economic relations and deals thoroughly with the need for increasing financial flow to developing countries.

5. Despite these initiatives, it has been felt that the current implementation of the Brady Plan for debt and debt service reduction, although very important, does not go far enough towards an alleviation of the debt problem. Current rescheduling exercises involving only the rescheduling of interest and repayments of obligations lead to the piling of new obligations to old ones thus increasing the long-term burden and the "debt-overhang". Further, the debt crisis is a manifestation of the malfunctioning of the world economy at a time of great turbulence. It inevitably raises serious questions about the way in which global economy is functioning.

6. A recent UN study outlines important changes in the functioning of world economy, especially between 1980 and 1990.<sup>8</sup> It identifies changes in the relative position of countries in the world economy with large shifts of income between them. This change accelerated marginally due to further globalization and interdependence among countries. This study further points out that the "structure of production and trade shifted from primary production towards manufactures and even more markedly towards services." However, the stagnation in international trade in the early 1980s raised serious concern about

6 *Ibid.* The results emanating from the implementation of these proposals are worth noting. Mexico, for example, has signed an agreement with its commercial bank creditors which has reduced its outstanding liabilities by \$ 6.8 billion and its debt-service payment on an additional \$ 22.5 billion resulting in an annual savings of \$ 1.4 billion. The Philippines has also concluded a bank financing arrangement composed of new money (\$ 0.7 billion) a cash buy-back (\$ 1.3 billion) and debt restructuring. Concurrently, Costa Rica, Morocco and Venezuela have also reached similar agreements in principle under the new scheme. See: *External Debt and Industrial Development*, UNIDO/IDB/7/19, 21 August 1990.

7 *Trade and Development Report, 1991* UNCTAD.

8 *Supra*, n. 5.

the international trading system. It is important to recall that the protectionism increased in the late 1970s and early 1980s as a response to rising unemployment in the industrialized countries. Trade barriers continued to proliferate. The multilateral trading system, conceived as an arrangement based on the principles of transparency and non-discrimination, was being eroded.

8. With a view to strengthen the multilateral trading system, the GATT Ministerial Meeting in 1982 approved an elaborate programme of work. This meeting was followed by a special session of GATT in 1986 which decided to commence a full-scale multilateral trade negotiation. In its scope and complexity, the Uruguay Round of negotiations launched at that session was the most ambitious round of trade talks so far. It brought under the purview of GATT rules major sectors such as agriculture and textiles, the inadequacy of the GATT dispute settlements and enforcement machinery, the role and needs of the developing countries, safeguard measures and, indeed the fundamental issues of balance of rights and obligations under GATT. Further, the evolution of the world financial and trading system had brought into prominence the new and complex issues of services, intellectual property and trade-related investment.<sup>9</sup>

9. The four-year preparatory work could not conclude, as scheduled, at the Brussels Ministerial meeting held from December 2-7, 1990, due to a deadlock between the United States of America and the European Community (EC) nations over farm subsidies. The EC, however, had offered to cut farm subsidies by 30 per cent over 10 years beginning in 1986. But what worries the US and the Cairns Group of food producing countries (comprised of Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, Philippines, Thailand and Uruguay) is the way EC's Common Agricultural Policy works. Instead of paying subsidies directly to farmers, the EC guarantees prices and buys up surpluses at those prices. It then has to pay further export subsidies so that the surpluses can be sold competitively at the lower world prices. Despite these differences the negotiations have continued since January 1991 to finalise this multilateral exercise. Recently, Mr. Arthur Dunkel, Director-General of the General Agreement on Tariffs and Trade (GATT) submitted a 500-page document outlining the most ambitious plans ever to liberalize global commerce. Negotiating Governments have until January 13, 1992 to respond to the draft Uruguay Round trade accord which Mr. Dunkel called "the best possible balance across the board". However, the continuing disagreement over farm subsidies threaten to block the progress of any talks; France already has said it will oppose the draft; EC also has so far maintained its consistent stand.

10. The efforts to revitalize the global economy during 1980s have not yielded any perceptible results. As pointed out, the position of developing countries in international trade and finance has substantially weakened further,

9 *Uruguay Round Papers on Selected Issues*, UNCTAD/ITP/10/1989; Chakravarti Raghavan, *Recolonization: GATT the Uruguay Round and the Third World*, Third World Network, 1990; *Trade and Development Report, 1991*, UNCTAD.



widening the gap between developing and the developed countries. External indebtedness continues to be a main factor in the economic stalemate of the developing countries. Their capacity to service debt was seriously weakened as interest rate grew and terms of trade deteriorated. This problem has contributed to the fall in investment and the cessation of new financial flows. Outlining the "Challenges and opportunities for the 1990s" the Declaration adopted by the UN General Assembly at its Eighteenth Special Session on International Economic Co-operation and Development, April 1990, called for<sup>10</sup> . . . "finding an early and durable solution to the international debt problems meeting the increasing needs for development finance, creating an open and equitable trading system and facilitating the diversification and modernization of the economies of developing countries, particularly, those that are commodity-dependent, are conditions for the revitalization of growth and development in the developing countries in the 1990s and require continued concerted efforts".

11. At the international level, efforts have been consistently made especially at the UN level, to alleviate the problem of debt and its servicing by developing countries. The United Nations Industrial Development Organisation (UNIDO), for example, has adopted certain programmes and activities which specially address the external debt problem.<sup>11</sup> The main thrust of these activities is directed towards the mobilization of financial resources for industrial development and a comprehensive strategy, via technical co-operation for industrial restructuring and rehabilitation. The UN Secretary-General in his statement addressed to the Second Committee of the UN General Assembly, referred to the need for developing countries themselves to reform their economies in order to cope more effectively with the crisis and made full use of opportunities for future growth.<sup>12</sup> Further, he also identified the need for making public sector more efficient and also to encourage investments in private sector so as to improve productivity. Investment in human resource development must also be accorded high priority.

12. In the light of above initiatives UNIDO's investment technical co-operation programmes aim, in one way or another, at :<sup>13</sup>

- (a) identifying viable investment opportunities in developing countries, backed by serious local investors seeking one or more foreign investment resources, including finance, technology, expertise, training, market access, etc.
- (b) assisting the local investors in the formulation of these investment opportunities and in identifying and contacting potential foreign suppliers of investment resources, as well as in negotiating co-operation agreements; and

<sup>10</sup> *Supra*, n. 5.

<sup>11</sup> *Ibid*.

<sup>12</sup> UNGA; A/C.2/44SR.26.

<sup>13</sup> *External Debt and Industrial Development*, UNIDO, IDB/7.19. 21 August 1990.

- (c) upgrading national, individual and institutional capabilities in investment project identification, formulation, screening and promotion as well as improving the investment climate in developing countries.

13. While the above set of market initiated measures have been applied mostly in the case of Latin American heavy debtors, the creditor governments have been adopting rescheduling as the remedy for a vast majority of the low income countries. In certain cases debts have been waived by the creditor countries. Nevertheless, the main policy plank for debt relief in the case of low income countries has been rescheduling.

#### *Evolution*

14. The roots of the debt crisis can be traced to the rising expectation for rapid economic growth mainly in the countries of Asia, Africa and Latin America. During 1960s and 1970s, when majority of the Afro-Asian countries became independent, devastated by colonial exploitation they had no capital to fuel the rapid economic growth that they hoped for.<sup>14</sup> They had, therefore, to invite foreign investment to come to the newly independent nations and do business on terms favourable to the investor.<sup>15</sup> As a result of this policy, many of these countries enacted investment codes which guaranteed full ownership of equity, generous tax concessions and unrestricted repatriation of profits. All these incentives, however, failed to attract requisite amount of foreign investment in substantial quantity. Therefore, they had little option left, but to borrow to finance development and growth.<sup>16</sup>

15. During 1970s, the first oil-price shock occurred and forced many Asian-African countries to resort to heavy external borrowing. Subsequently, there was a decline in the price of primary commodities which affected the debt repayment capacity of the debtor countries. This resulted in the variation of amount of funds to be "recycled" to debtor countries, and the increase in interest rates further aggravated the debt problem, with the creation of severe balance of payment difficulties. In addition, several debtor countries had to face precarious internal political and economic turmoil due to civil wars, government derelictions, natural calamities such as drought, desertification and population explosion. The countries also need to construct and maintain physical infrastructure to support expanding agricultural and industrial activities. These are long-term tasks requiring sustained international support and cooperation, especially in finance, trade investment, science, technology and training.<sup>17</sup>

<sup>14</sup> Jacob Hailo-mariam, "Legal and other Justification for Writing Off the Debts of the Poor Third World Countries : The Case of Africa South of the Sahara." *Journal of World Trade Law* 1990, p. 56.

<sup>15</sup> Jomo Kenyatta, *Suffering Without Bitterness* (East African Publishing House, Nairobi, 1968), pp. 76-92, Quoted in Hailo-Mariam, *Supra*, note. 14

<sup>16</sup> John A. Bohn, "Government Response to the Third World Debt : The Role of the Export and Import Bank" *Stanford Journal of International Law*, 1985, pp. 461.

<sup>17</sup> Y. Seyyid Abdulai, "Africa's External Debt : An Obstacle to Economic Recovery". *The*



16. After the crisis of repayment faced by Mexico in 1982, a spate of rescheduling began at the behest of the creditors.<sup>18</sup>

However, the methods and procedures adopted for rescheduling have been controversial and the results have not been as expected by the debtors.<sup>19</sup> The rescheduling of the existing debts are done primarily by two associations namely, Paris Club and London Club. Paris Club is an association of official creditors i.e., governments. It is not a legal body but an *ad hoc* group of western governments under the chairmanship of the French Treasury officials who have been meeting since 1956 to renegotiate the debt of countries falling behind in debt service payments. The London Club is primarily made up of private creditors.<sup>20</sup>

#### Debt Relief

17. The proposed solutions for the debt burden could be summarized as being rescheduling, refinancing and capitalization i.e., conversion of the debt to assets in the debtor country. It should be noted that the rescheduling and capitalization of the interest have been the main debt relief for most Asian-African countries. Debt-equity swap forwarded as debt relief mechanism, for example, is considered to be of little practical use in Africa. The equity to be swapped for the debt are the equities of State-owned enterprises, known in Africa generally as parastatals and which are mostly bankrupt. It is well known that most of the State-owned enterprises have, in fact, not even been able to cover running costs, let alone make profit.<sup>21</sup>

18. Exporting more funds in the form of loans or as direct foreign investment has also been termed as a solution. This, it is argued, would stimulate the economy, by generating more export surplus. However, the inflow of foreign investment has been so far subject to stringent rules and regulations, especially in Africa. Even the Baker Plan under which, commercial banks were to increase their exposure by slightly more than 2 per cent per year was of little benefit to Asian-African countries. Commercial banks since the Baker Plan contributed only \$ 0.2 billion to Africa, in contrast to their contribution of \$ 1.8 billion to Latin America.<sup>22</sup>

#### Rescheduling

19. The countries burdened with the mounting arrears of debt may find it difficult to repay the debt in keeping with the scheduled terms and conditions. Factors ranging from balance of payment difficulties, to managing their own internal resources, may result in such an unhappy position. Mexico, for example, in 1982 declared its first unilateral moratorium on the debt servicing process. In such a case, it may become necessary to reorganise the whole debt; the repayment arrangement between debtor and creditor may, either have to be 'renegotiated' or 'reorganised' from time to time.<sup>23</sup>

20. Generally, 'debt rescheduling' means any change or modification in the payment arrangement of an existing debt. In other words, new repayment terms and conditions are settled in the light of new realities relating to an existing debt. The 'debt rescheduling' involves the payments of principal and/or interest falling due in a specified interval being deferred for repayment on a new schedule.<sup>24</sup> Functionally, debt relief has a more wider application; it involves 'any deferment or cancellation of arrears or of scheduled payments or any interest rate concession granted by a creditor.'<sup>25</sup> 'Debt restructuring,' on the other hand, is a form of debt reorganization in which the entire schedule of amortization payments relating to an existing stock of debt is modified normally to extend the period of repayment.<sup>26</sup> It should be noted that 'rescheduling' will not in anyway minimise the burden of debt. It is, in fact, a short term measure in overcoming growth factors in the debtor countries.

21. The approach of Paris Club (an association of official creditors i.e. governments) to countries applying for the rescheduling of official debt has generally been to treat debt problems as if they were essentially balance of payment problems resulting from excess aggregate demand. As in most cases of commercial debt rescheduling, debtor countries are required to reach satisfactory agreement with IMF on Structural Adjustment Programme (SAP). The rescheduling of debt when granted is limited to consolidating periods of approximately the same length as country's stand-by programme with IMF, often, only for one year. The Paris Club proceedings, however, do not consider the overall situation such as the long-run dynamic effect of a loan, debt management relation to the evolution and the link between service obligations and productive capacity of a debtor nation. The London Club, on the other hand, provides a forum for the rescheduling of debts owed

OPEC Fund for International Development, 1990, p. 13.

18 For a detailed discussion on "Rescheduling Measures" adopted in Mexico. See, Enrique Castro Tapia, "Mexico's Debt Restructuring", *Columbia Journal of Transnational Law*, Vol. 23, No. 1, 1984.

19 See, AALCC Doc. XXV/9, pp. 22-25.

20 For details see: Karen Hudec, "Co-ordination of Paris and London Club Reschedulings", *New York University Journal of International Law and Politics*, 1985, Vol. 17, Nos. 3, pp. 560-562.

21 Jacob Haile-Mariam and Berhanu Mengistu, "Public Enterprises and the Privatisation Thesis in the Third World", *Third World Quarterly*, October 1988, pp. 1565-1587.

22 *Ibid.*

23 The amount of rescheduled debt service rose from under 5% of actual debt service in the three years before the crisis (1980-82) to over 20% in each of the succeeding three years. In 1986, \$ 73 billion of rescheduling was negotiated involving 24 countries. In seven years (1980-86) \$ 320 billion was renegotiated involving 52 countries and \$ 28 billion was bank debt.

24 Alexis Rieffel, "The Paris Club, 1978-1983", *Columbia Journal of Transnational Law*, Vol. 23, No. 1 1984 pp. 83-104.

25 *Ibid.*

26 *Ibid.*



to the commercial banks. It also insists on the same conditionalities, namely, prior agreement with IMF relating to Structural Adjustment Programme and the sovereign debtor should have undertaken a Paris Club rescheduling.

22. The debtor countries negotiating under Paris Club must be in a situation of "imminent default". Such a situation arises "when a debtor country uses of foreign exchange which are usually projected for one year in advance, exceed its sources."<sup>27</sup> In addition, it is the perception of the creditor that the debtor is in the imminent threshold of default and that he needs the relief. The other aspect of debt rescheduling is the conditionality, that a debtor must have an IMF sponsored/approved structural adjustment programme as a pre-requisite for acquiring eligibility for rescheduling. However, normally such adjustment programmes are supported by a borrowing arrangement with IMF involving drawings in the upper tranches.<sup>28</sup>

23. The conditionalities put forward by the IMF generally are of the following nature<sup>29</sup> :

- (a) Liberalization of external trade and payments and in particular, the removal of import controls, foreign exchange controls and other protectionist measures;
- (b) The removal of restrictions on the activities of foreign capital, such as discrimination against foreign capital, removal of limitations on the transfer of profits;
- (c) The devaluation of national currencies;
- (d) The reduction of State subsidies for food, health and transportation;
- (e) Changes in budgetary policies intended to reduce direct and indirect taxes on companies and to increase direct or indirect subsidies for companies (e.g. provision of investment finance, infrastructure, and industrial outputs);
- (f) A reorientation of national economic policy and development towards increased promotion of production for export, with the concomitant neglect of areas producing for domestic demand consumption.
- (g) State intervention in the determination of wages and other incomes;<sup>30</sup>

27 The sources include exports of goods and services, workers' remittances, private and official transfers, loan disbursements foreign investment, borrowing from the IMF, and foreign exchange reserves.

28 Upper credit tranches means borrowings by a member of 25% of its quota because drawings in the first credit tranches do not require meaningful policy reforms by the member country.

29 For a brief critical evaluation of IMF conditionalities see: Folker Frobel, Jürgen Heinrich, Otto Kreye, "The Global Crisis and Developing Countries", in *Trade and Development*, UNCTAD, No. 5, 1984. Also see Wilfried Burg and Gunther Thole, "IMF Policies and their Adverse Consequences for Human Rights in Bulletin, *GDR Committee for Human Rights* No. 3, 1986, pp. 164-174.

30 This conditionality could lead to political instability. For example, when the Venezuelan

Further, it should be noted that while both Paris and London clubs work in tandem with the IMF, the debtors are prevented from acting collectively. For example, during the Paris Club proceedings while the creditors appear collectively with greater cohesion, the debtor is made to face the group of creditors unilaterally thus curtailing bargaining power to protect the country's interests and priorities.

#### *Rescheduling Agreements*

24. The rescheduling agreements are generally of two kinds. The first set of agreements are among the sovereign States for their official and officially guaranteed loans. Such agreements (whether they are original loan agreements or restructuring ones) are governed by the principles of public international law.<sup>31</sup> The second set of restructuring agreements take place between sovereign borrowers from developing countries and the commercial banks of the OECD countries. The credit arrangements between the sovereign borrowers and commercial banks are governed generally by what is known as "syndicated loan" agreements. The "syndicated loans" are a very complex and technically difficult process which give rise to equally complex legal dimensions.

25. The syndicated loans are advanced by a consortia of banks mostly situated in the financial centres, such as New York, London, Paris and Tokyo.<sup>32</sup> Generally, there are no governmental or inter-governmental regulations of these consortia, which means they are not bound to observe the normal requirements or restrictions of banking. These consortia, for example, do not observe certain critical requirements such as the reserve that a bank must keep in respect of its operations. Even the interbank transactions are carried on very informally, adopting some times flexible methods to meet a large demand. Such operations could lead to disastrous situations in case of non-compliance by any one of them. The Eurodollar Market has its own rules for establishing the London-Inter Bank Offered Rate (LIBOR) of interest which fluctuates periodically.<sup>33</sup>

Government implemented "price rise" so as to fulfil IMF conditionality it faced a severe resistance from the people which finally resulted in the death of 300 people and more than 2000 were injured.

31 Georges R. Delaume, *Legal Aspects of International Lending and Economic Development* (Octava Publication) 1967, pp. 97-102; Mann, "Reflections on a Commercial Law of Nations", *British Yearbook of International Law*, Vol. 29, 1957.

32 "Consortium" reflects the sophisticated organisational capacity and the institutional solidarity. Gongolo Bigi, "Legal Aspects of the Latin American Public Debt", *CEPAL Review*, No. 25, p. 171.

33 LIBOR is a variable interest rate which fluctuates according to the market in London. This rate represents the amount which a bank operating on the London Inter Bank Market pays to another bank operating on the same market for a Eurodollar deposit, for a term of not longer than one year. The US counterpart is known as the US Prime Rate.



26. There are two fundamental purposes behind these consortia loans. Firstly, the possibility of mobilizing more reserves; secondly, the proportionate reduction in the risk to each member in the consortium. So it is organized through a mandate letter from a loan applicant authorising a bank to act as the lead manager bank. At the same time the applicant sends a memorandum giving detailed information on his economic and financial situation. The mandate letter and the information memorandum then enable the lead bank to invite other banks to participate in the formation of a consortium. And it establishes a separate legal relationship which is independent of the loan contract between lead bank and the borrower.

#### *Guidelines For Rescheduling*

27. The debt rescheduling and renegotiation process between sovereign debtors and their creditors has evolved into a highly specialised and complex practice. It should be noted that prior to 1973, sovereign States obtained most of their credit from multilateral institutions such as the IMF and the IBRD, from bilateral loans from other States, or from the sale of bonds. However, during the 1970s the combination of increased energy costs, aggressive use of funds from private commercial banks, and the demand for credit for development projects and for financing the servicing of existing debt resulted in dramatic increase in external borrowing by developing countries.<sup>34</sup>

28. Further, in the 1980s the recession in the development countries and an increase in the worldwide supply of petroleum contributed to decreased demand for exports from developing countries, reduction in the amount of funds to be "recycled" to the developing countries and higher interest rates. Because of the limited foreign exchange potential, particularly through commodity exports, some developing countries of Asia and Africa have been facing enormous balance of payments deficits. Hence, they have failed to pay back the principal of and interest on medium and long-term loans that were incurred four or five years earlier, and which required further loans to finance current debt service and development projects.

29. Upon finding itself faced with such a severe balance of payments deficit, a developing country is forced to consider the necessity of some form of debt rescheduling or renegotiation.<sup>35</sup> Following is a brief account of various steps to be taken while rescheduling or renegotiating debts, specially keeping in view the interests of developing countries.<sup>36</sup>

30. First of all, the sovereign debtors may consider the necessity for employing an expert legal counsel to assist in the preparation of a renegotiation/rescheduling plan. Such a decision may be necessary on the following grounds: (i) the country's lack of experience in the area of rescheduling/renegotiation; (ii) the applicability of foreign law to govern such agreements; and (iii) the country's lack of sufficient personnel to deal with several hundred lenders spread throughout the world.

31. Secondly, review of the data available concerning sovereign's external debt portfolio and legal system, as well as expressed intention of its creditors to decide which types of debt are capable of being rescheduled and how much additional credit, if any, will be needed.<sup>37</sup> (There are, however, going to be difficulties in obtaining accurate data which eventually will have to be accepted and appreciated by all parties concerned). It is also important to determine who are the borrowers of external debt; for example, the sovereign itself, government entities, private sector companies. If the sovereign debtor does not have a comprehensive debt registration system already in place, it may be necessary to begin collecting data from the various governmental and non-governmental borrowers in order to reach an informal decision as to which debt to include in the rescheduling plan, and to establish feasible target figures and schedules for completion of the plan.

32. Next step is to review the sovereign's exchange control regulations and constitutional and political framework to determine what legislative or executive action may be necessary to implement the rescheduling plan and also to assess the likelihood of political opposition to the rescheduling ... to examine constitutional requirement and political climate before structuring the plan. Review should also be made of the sovereign's payment and exchange control systems to determine the most practical way to structure future payments and promote internal compliance with the plan.

33. To prepare as comprehensive a proposal as possible before approaching the different groups of creditors is vital. In addition to the basic financial terms of a proposal, such as whether to request any additional credit, or better interest rates and repayment terms, three basic formulations must be defined<sup>38</sup>:

- (a) *Classes of Affected Debtors*: This will depend on the view of available data. Sovereign debtor must also decide whether each of the affected debtor should be party to the renegotiation agreement or whether a single government agency or bank should act on behalf of all.
- (b) *Classes of Affected Creditors*: The basic groups of creditors that the sovereign must consider are, international lending institutions (IMF, IBRD), governments (both as direct lenders and as guarantors of

34 James B. Hurlock, "Advising Sovereign Clients on the Renegotiation of their External Indebtedness" *Columbia Journal of Transnational Law*, Vol. 23, 1984, p. 29.

35 On the balance of payments problems and the role of Transnational Banks: See, generally *Foreign Direct Investments: Debt and Home Country Policies*, ST/CTC/SER. A/20, July 1990.

36 *Supra*, n. 34, p. 29.

37 As regards the incentives for investments in developing countries and other related issues: See: *Supra*, n. 35, p. 25.

38 *Supra*, n. 34, p. 29.



commercial bank debts), public debt holders, and commercial bank lenders and suppliers. International lending institutions and public debt holders usually are excluded from rescheduling plans on policy grounds and since they provide basic funding for stability and development projects of the sovereign.

- (c) *Types of Affected Debt* : One of the first steps in establishing the categories of affected debt is to fix a cut-off date based on the date that the debt is incurred or on the date that the debt falls due, or on some combination of both.

#### *Negotiating the Agreements*

34. This stage begins once the above requirements are met. Generally, the cornerstone of the negotiation package has been the sovereign's arrangement with the IMF. This, however, usually creates great difficulties to developing countries as IMF imposes performance criteria and conditionalities. The final group of creditors to be approached are commercial lenders, which may consist of 500-600 banks at a time. So, commercial lenders usually appoint a group of 10-15 of the banks with the largest exposure in the debtor country as a steering committee to deal with the major issues and to act as liaison with the banks at large.

35. Initial negotiations will focus on the basic terms of rescheduling plan. Subsequently, a summary of the principal terms of the debt reschedule will be prepared. This will include, the definitions of affected debtors, affected creditors, affected debt and the payment schedule. Briefly, following three are the important provisions that are negotiated<sup>39</sup> :

- A. *Negative Pledge Clause* : It limits the sovereign's ability to incur future debt that will rank ahead of the obligations governed by rescheduling agreement. It should, however, be noted that such a restriction may have impact on the sovereign's daily banking and commercial activities.
- B. *Gross Default Clause* : It links together the various groups of lenders by making it a default under the rescheduling agreement if a default occurs under any other agreement to which the sovereign or any governmental entity is a party. This clause requires that all lenders should be treated equally.
- C. *Material Adverse Change* : The lenders will insert a default clause which permits each individual lender to declare a default if it determines that a "Material adverse change" in circumstances threatens the sovereign's activity to repay its obligations.

Finally, it should be noted that these negotiations can take several months. Agreements on the terms of rescheduling plans may have to be

<sup>39</sup> *Ibid.*

reached after thorough consultations. All these modifications, however, will have to meet the domestic requirements of both sovereign debtors and creditors so as to legalise renegotiated plan.

#### *Conclusions*

36. The rescheduling process is only a temporary measure and it only brings a short-term relief. It has been argued that unless the underlying economic causes such as decline or stagnation of exports, coupled with increased import burdens, are fully addressed, the debt problem is merely postponed and renewed negotiations become necessary a year or two later.<sup>40</sup> The process of debt reorganisation should have a longer perspective and should be designed to provide sufficient time over which structural adjustment measures can be implemented.<sup>41</sup>

37. The Common African Position on rescheduling outlines clearly the consequences of postponing debt service payments through rescheduling. Rescheduling also does not adequately deal with the issue of how the portion of the principal not rescheduled should be financed in future, nor does it provide for rescheduling of previously rescheduled loans. Moreover, it carries heavy costs in terms of fees and additional interests on rescheduled debts.<sup>42</sup> Further, it has been strongly urged that the rescheduling method adopted should be based on the development and investment needs of each country, as well as on a realistic assessment of the country's repayment capacity taking into consideration expected growth of export earnings, import requirements and expected financial inflows as well as budgetary situation.<sup>43</sup>

38. A special focus on possible new and workable relief measures for Asian-African low income countries is required now since existing initiatives (including Baker and Brady Proposals) practically address themselves to selective category of debtors on the basis of commercial and strategic interests. Debt problem of low income Asian-African region requires to be addressed within the framework of objective realities coupled with consideration of the welfare of the peoples concerned. It is necessary to identify concrete debt relief measures which suit the debtor countries of Asia and Africa. Such measures can be initiated for discussion and implementation through regional organisations and other UN bodies.

39. It has been suggested that the borrowers (i.e. debtor developing countries) instead of examining the legal aspects of rescheduling separately, examine the implications of the overall context of the international credit relations. The study relating to these issues has already been placed before the AALCC. Further, it has been suggested that a study of formulation of

<sup>40</sup> *Special Memorandum by the Economic Commission of Africa : Conference of Ministers on African Economic and Social Crisis (United Nations, 1984), p. 49.*

<sup>41</sup> *Ibid.*

<sup>42</sup> *Ibid.*

<sup>43</sup> *Ibid.*



a set of legal guidelines and model agreements that could form the basis of future borrowings from both official and commercial creditors can also be undertaken. In this regard, it is extremely important to take into account the differences in the legal systems and regulations concerning the rescheduling of debts in the debtor as well as in the creditor countries so as to formulate an acceptable model. The present study has made an attempt to outline generally the procedures followed in the negotiation of 'rescheduling agreements'.

40. Further, as mentioned earlier, with the present high interest rates, plunging commodity prices, increased exclusion of African exports from the markets of the industrialized world and persistent natural calamities, there is no prospect of most African countries ever being able to pay their debts in the foreseeable future. By way of a possible solution, many including the World Bank have recently suggested that the African countries may seek from the creditor countries as well as the private and multilateral financial institutions "a programmed gradual total write-off of the debt".<sup>44</sup> Therefore, the only effective solutions to the problem of the African debt, particularly in Sub-Saharan Africa, are essentially within the realm of political goodwill of the major donor countries rather than in any other debt relief measure such as rescheduling. The African countries, however, must accept realistic economic restructuring as well as creating the necessary political climate if they are to expect debt relief from these countries.

## VII. LEGAL ASPECTS OF PRIVATISATION

### (i) INTRODUCTION

1. At the thirtieth annual meeting of the AALCC held in Cairo in April 1991, it was noted by the AALCC's Standing Sub-Committee on International Trade Law Matters that in the economies of most of the Member States of the ALLCC, public sector enterprises or undertakings (PSEs or PSUs) played an important role and that their economies were dominated by such enterprises. It was further noted that in recent years, various multilateral financial and monetary institutions had put pressures on developing countries to go in for privatisation of these undertakings, making it virtually a precondition for the grant of financial assistance and the extent thereof. The Sub-Committee, taking note of these developments, requested the AALCC Secretariat to commence a study on the legal issues involved in the matter of privatisation with the final objective of preparation of a guide on legal aspects of privatisation in Asia and Africa. The principal aim of such a guide would be to assist the Member Governments in carrying out privatisation programmes in a manner which is not detrimental to their national economic interests.

2. Since the preconditions, basic methods and procedures for privatisation and the legal issues involved were likely to vary from one country to another, the view was expressed that it would be necessary for the Secretariat first to collect the relevant information from the Member Governments so that it is able to identify the policy and legal issues involved before it commences its study on the topic. Consequently, the Secretariat prepared a questionnaire to facilitate the Member Governments to furnish the required information. That questionnaire was circulated by the Secretary-General of the AALCC vide his letter dated the 30th of July 1991 requesting the concerned authorities in the Member Governments to respond to the questionnaire as early as possible.

3. Unfortunately, only the Governments of the Republic of Singapore and Thailand responded to the questionnaire prior to the thirty-first session of the AALCC scheduled to be held in Islamabad (Pakistan) in January-February 1992. However, in view of the topical importance of this matter for the Member States and with a view to facilitating discussion at the Islamabad Session, the Secretariat prepared and presented a preliminary study on the topic. The questionnaire circulated by the Secretariat and the responses thereto by the Governments of the Republic of Singapore and Thailand were appended to that study.

<sup>44</sup> *Supra*, n. 14, p. 79.



#### Discussions and Decisions Taken at the Islamabad Session

4. At the Islamabad Session, the matter was discussed in the Standing Sub-Committee on International Trade Law Matters.

5. The *Assistant Secretary-General* (Mr. Essam Abdul Rehman Mohamed) while introducing the preliminary study on the topic (Doc. No. AALCC/XXXI/Islamabad/92/14) stated that the topic was included in the work programme of the AALCC in pursuance of a recommendation made by the Trade Law Sub-Committee at the last session of the AALCC held in Cairo in April 1991 and the mandate entrusted to the Secretariat related to studying the legal issues involved in privatisation with the final objective of preparation of a guide on legal aspects of privatisation in Asia and Africa.

6. Since the policy prescriptions, basic methods and procedures as well the legal issues involved in privatisation were likely to vary from one country to another, the Secretariat was advised that before it commenced a substantive study of the topic, it should first collect the relevant information from the Member Governments. Consequently, a questionnaire was prepared to facilitate the Member Governments to furnish the required information. Since that questionnaire was responded to only by the Governments of Singapore and Thailand, it was difficult for the Secretariat to prepare an indepth study. Consequently, the study submitted to the present session was only a preliminary one intended to facilitate the discussion and for indication of the direction in which the Secretariat must pursue further work.

7. Explaining the contents of preliminary study, the Assistant Secretary General pointed out that the study was in two parts, the first part being devoted to the socio-economic aspects of privatisation and the second part addressed to legal issues that might be involved in the process of privatisation. One tentative conclusion of the Study was that Governments of developing countries in the Afro-Asian region in their transition from the mixed economy to a market-oriented economy would have to carry out their privatisation programmes in a phased manner keeping in view their national interests as well as the need to align their economies with the global economy. The other tentative conclusion was that since privatisation could be carried out in two stages, the first stage consisting in the initial sale of shares of a Public Sector Undertaking to public at large upto a ceiling of 49 per cent and the second stage consisting in the sale of such shares to the extent of giving effective control to the private companies; the first stage might not require wholesale economic and legal restructuring but that would be necessary at the second stage.

8. As the Secretariat was required to elaborate the preliminary study in the light of the information requested from the Member States, the Assistant Secretary-General requested the Sub-Committee to recommend to the Plenary to urge the Member Governments which had not responded to the Secretary-General's letter to kindly do so at the earliest to enable the Secretariat to carry out the mandate entrusted to it.

9. The Sub-Committee expressed its appreciation for the Governments of Singapore and Thailand for providing the information desired by the Secretariat. The other delegations attending the Sub-Committee assured the Sub-Committee that they would contact the concerned authorities in their respective Governments and request them to furnish the information as desired by the Secretariat.

10. The *Representative of UNIDROIT* advised that in addition to seeking information from Member Governments, the Secretariat should also take into account the privatisation programmes under way in East Germany as well as in other States of the Eastern Europe and assured to make available to the Secretariat some literature in that regard. He also advised that since it would be somewhat difficult for the Member Governments to respond to the AALCC's questionnaire, it would be better for the Secretariat to request the Member Governments to furnish relevant literature on their programmes and texts of agreements on privatisation.

11. The Sub-Committee noting that the topic of privatisation had acquired immense importance for the developing countries in view of the far reaching structural changes taking place in the global economy having an impact on their national economies, *decided to request the Plenary to urge the Member Governments which had not responded to the Secretary-General's questionnaire to do so at the earliest and/or furnish any relevant documentation to the AALCC Secretariat.*

12. The above recommendation was endorsed by the Plenary of the AALCC.