DIALECTICS ON INTERNATIONAL LEGAL REGIME IN SOVEREIGN DEBT CRISIS

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1. A FEW GENERAL COMMENTS

/./ *Introduction: Slow progress in TRIMS*'

Developed world draws cold feet[2] in taking TRIMS to its logical trends. But in order to ensure global development m the ordinary course of economic rational the low-end secondary industry[3] has to be relocated or at least out-sourced to the developing world while the developed world to take a strategical position in the high-end industrial products and services. It is not economically rational to

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[1] Trade Related Investments in WTO legal regime.

[2] One of the demands of the developing countries is that WTO negotiations should now deal with the actualization of TRIMS, but developed countries are not in favor to take any immediate steps.

[3] Secondary industry comprises basic core sector industry, which is fundamental to industrialization. This industrial sector requires unrestricted flow of cheap and unskilled workers. The theory of industrialization suggests that industrialization is a wholesome process, it starts at the place where there is abundant supply of cheap workers and in which place materials could be comparatively cheaply collected. With the passing of time the skill level of the workers would increase in the neighborhood. Increase of skills would bring technology progress and demand for increase of wages. The core industry or low end product industry then has to give way to higher skill industry, such as a spinning industry giving way to weaving industry and then to dying, tanning and chemical industry. Ultimately the place may be known for fabric and design industry, which requires workers of high skills or drugs and pharmaceutical industries. That is how low-end product evolves into high-end products. So, any basic industry prepares the place gradually to service sector industries to grow ultimately whereas low-end industry penetrates in the countryside. In brief, this is the history of industrialization, and theory of industrial dynamics.

carry on secondary industry producing low-end product to be carried on in the developed world with high subsidy under the protection of tariff or non-tariff barrier as well as preventing industrial outsourcing especially when primary sector is not open due to various reasons both of locational (economic) and political compulsion. This is not only against the dynamics of industrial civilization but is also against the philosophy of GATT.[4] Developed world have more comparative strength to relocate the human resources in the high-end industrial enterprises and in services. Any backtrack of the developed world may endanger its own industrial capitalism.[5] It is true that the developed world argue for a compatible legal order to facilitate the investment flow in the developing world by way of natural consequence of industrial dynamics. A trustworthy economic and legal system would be albeit necessary for rapid investment-flow across the world. One of the important limbs in the total 'system structure' for facilitating the quick flow of investment is a *trustworthy and efficient* sovereign debt crisis management mechanism.

1.2 Complexity of the issue

Adam Smith wrote in 1776, "when it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open and avowed bankruptcy is always the measure which is both least dishonorable to the debtor, and least hurtful to the creditor." So failure of a sovereign debt is neither a new development nor a new experience in the global economic phenomena. There are however, too many complexities in dealing with sovereign debt. *First,* sovereign debt does not have collateralization on creating security interest nor is there any clear perception of priority principle in the claim settlement. *Second,* who shall declare that a sovereign is a bankrupt or is facing a near bankrupt situation because of liquidity crunch and is requiring the restructuring of its debt? *Third,* who shall

* **Free** trade in goods, services and free flow of investment through out the **world,** without any barrier, can only ensure global development and maximize **freedom** - this is the fundamental philosophy underlying GATT. " It is now argued that the danger of capitalism lies in capitalism.

administer the restructuring of the assets? *Fourth,* what would be the economic power of a nation-state in bankruptcy situation in so far as the running of the government of the country and in its macro-economic management? *Fifth,* What is going to happen if asset-restructuring scheme fails and there is an insolvency situation? *Sixth,* how would the claims be settled and in what priority? Who would determine the priority situation? *Seventh,* what would be the extent of power of the committee of creditors both on settlement of past debt and for drawing future debts? *Eighth,* how would the disputes be resolved between the creditors *inter se* and between any creditor and the debtor-nation? *Ninth,* how and in what methods would one settle national claims and international claims, sovereign claims and individual claims (specifically in government guarantee in private contracts)? *Tenth,* how to resolve actions in multilateral forums? *Eleventh,* what would be path for obtaining discharge from such an economic mess especially in view of the sovereignty attributed to the political status to the debtor member-state? *Twelfth,* Who shall determine which debt to restructure and which not? All these and many others are the naughty issues.

1.3 New Complexities

The new dimension that is added to the above complexities is the methodological complexities in the present situation of sovereign debt. During the last two decades there has been a paradigm shift in the methodology of acquiring debt. With the development of international financial and debt markets and architecture of market instruments the earlier system of bilateral and syndicated contractual model of acquiring debt is no longto- a dominating phenomenon.[6] Sovereigns now acquire debt through debt

[6] Krueger is right in arguing that 'Developments in the composition of international sovereign borrowing over the past decade - notably the shift away from syndicated bank loans towards traded securities as the principal vehicle for the extension of financial credits to sovereign - have improved the efficiency of international capital markets. I particular, they have broadened the investors base for financing the emerging market sovereigns and have facilitated the diversification of risks.' (*A new approach to sovereign debt restructuring, p 6,* IMF 2002).

instruments directly linked up with market. This dominating phenomenon has been accentuated due to newly liberated developing countries in the post -war period taking aggressive role in governance and in the development of economy of a country. Governments of the developing countries are now playing the lead role in economy building by indulging into all types of commercial activities. Naturally, sovereign debts are now not confined and related to sovereign functions, more debts are needed for ordinary commercial functions. Results were immediate. There are innumerable numbers of creditors who do not have continuous relation with the sovereign-debtor and are only interested in the timely repayment of the claim with full interest agreed upon. These claimants do not have any permanent interest in the sovereign debtor's domestic affair. That brings uncertainty over the proposal of debt restructuring itself resulting in hesitation, buying of time and delay that causes further depletion of asset value.[7]

In the early system of syndicated institutional loans the institutions and the sovereign debtor used to reach agreements in the interest of both the parties. Creditors used to have continued business and the sovereign could have the facility of restructuring the claims. Naturally up to early 1980s there was less problem on settlement and there was higher incentives for such settlements. With the development of market mechanism number of creditors became huge and diversified; interest of the creditors became very specific and spaced in a short time. So, coordination between claimants and claims became a challenge in 1990s. As a result, in the last decade or so, IMF was continuously engaged in the deliberation on the problem. The experience of 1990s spread over in number of countries like Bolivia, Cote d'lvorie, Ecuador, Nigeria, Argentina,

Ibid, Krueger rightly argues, 'This leads to considerable uncertainty among all participants as to how the restructuring process will unfold, and contributes to reluctance by the sovereign, its creditors, and the official sector to pursue a restructuring , other than the most extreme circumstances. This in turn, increases ihe likely magnitude of the loss of asset values, which is harmful to the interests of both debtors and creditors.'

Krueger puts it thus: 'During the past several years there has been extensive discussion inside and outside the IMF on the need to develop a new approach to sovereign debt restructuring.' (pi).

South Korea, Turkey, Pakistan, Russia, Ukraine, or Mexico did not provide any uniform methodology of solution. But each time there was something like a fire-fighting arrangement and IMF was involved in crisis management. Hence, the intense debate on sovereign bankruptcy system is understandable though one may not have sympathy with a private law philosophy and architecture of bankruptcy system in such a World of wide discrepancy in income generation and distribution through the liberal capitalist democratic and global legal framework.

It is, nevertheless, worthwhile to discuss about a rule-based international mechanism premised on multipartite agreement. WTO agreement with all its limitations is a specific example of the fact that nation-states of today are not averse to rule-based framework[9] with inbuilt equity and justice mechanism taking into account wide diversity of resource and income generation.

1.4 Patterns of debt crisis and crisis management

Unless one understands the nature of the crisis one may not prescribe the therapy for the crisis management. Sovereign debt crisis may occur in different ways. A country facing the depreciation of domestic currency may face crisis on account of unhedged foreign currency debt.[10] Such a problem may happen due to private sector foreign currency debt or it may also happen due to the sovereign guarantee system in the public sector foreign currency debt.[11] In the case of private sector foreign currency debt

[9] The Reserve Bank of Australia Bulletin, August 2002 observes, "Fortunately, there has been significant progress is addressing the types of vulnerabilities that led to the Asian crisis, and there is also greater awareness of appropriate policy responses to the onset of crisis, including the possible imposition of temporary capital controls. Furthermore, the increased focus on cooperative solutions in dealings between sovereigns and their creditors may also be helpful in suggesting procedures or contractual terms by which private sector debt crisis can also be addressed more effectively. (p 62)

[10] In the case of the Asian crisis countries,(especially Korea, Thailand and Indonesia) the problems were largely problems of servicing unhedged private sector foreign currency debt following the depreciations of the domestic currency. (Reserve Bank of Australia Bulletin, August 2002, pa 61).

[1'] In the case of Brazil or Korea such a type of crisis occurred.

the solution lies on the national legal provision of the country on cross-border bankruptcy law. In the case of sovereign guarantee a satisfactory remedy has to be devised so that sovereign debt can remain within sustainability and the crisis can be managed efficiently.

1.5 International legal framework

Let us at the outset discuss a few dominating principles of public international law developed in the post-UN era including the basic content of UN Charter, Briton-wood agreement and the declaration of Philadelphia, which are required to be respected notwithstanding the pressure being built upon cracking the contour of these basic principles. As for example, the principle of sovereignty is radically changing in international law and relations, especially in the last decade. Legally speaking, can a sovereign become a bankrupt? A question like this would have been dispensed with as a stupid one about two decades ago. Now at least diere are people who would shoot back, 'why not'? Krueger even argued with the analogy of "corporation model"[12] to plead for a rule-based Sovereign Debt Restructuring Mechanism (SDRM-//te) within the structural fold of IMF.[13] The general principle of sovereignty that lies in the fundamental of the UN systems is now being circumvented both politically and economically, politically dsough the floor of the Security Council or otherwise and economically through multipartite treaties binding the sovereign both politically and economically. That does not mean that all nations are agreeable to bring private law principles from municipal laws to be implanted in the international law. The traditional concept that international law between the sovereign nations are still normally required to follow basic principles like, equality, non-interference, impartiality, mutual respect, and cooperation between the nation-states. In spite of the rapid change in the concept of sovereignty, it would be imprudent to think that a

[n] A corporation faces the bankruptcy proceedings soon it faces financial crisis *m* the form of cash crunch. In US such corporation face what is known as 'chapter IP proceedings.

[°] *Ibid*, 'Existing Rehabilitation Models and their limitation,' p 10-11, which would be critiqued later.

direct discussion on a sovereign to be declared bankrupt would make a sense in the present set up of international relations. It is, therefore, necessary to discuss the above proposals in the context of historical compulsions of the last two decades or so.

1.6 Doctrine of equality in international trade law:

International trade law under WTO regime has included the principle of equal treatment among the member-states through adaptation of two principles, viz., MEN status to all member nation-state and non-discrimination between domestic and foreign parties. The principle of non-discrimination is punctuated with adequate disclosure provisions, information sharing and domestic institutional methods. The member-states demonstrated in all fairness the wisdom in economic diplomacy in full participatory procedure. Therefore, it can now be envisaged that the member-states of UN financial institutions would also be ready to deal with any issue of financial crisis through participatory model within the paradigm of international legal framework. [5]

2. CRITICAL REVIEW OF SOME SUGGESTIONS

2.1 A few proposals for sovereign debt crisis management:

Sovereign debt crisis has now become a regular feature in the international economic relation. The problem and method of tackling sovereign debt crisis is now loudly being talked about among the economists[16] and also in the international economic

[14] I agree with Mr. Truman when he observes, 'My view is that an international bankruptcy court for sovereign debt would be *useful* in addressing those problems, it would be *desirable* (largely for the reasons advanced by Sachs), but it is not now *feasible.* It is closer to being feasible today than when I participated in drafting the Group of Ten's (1996) Rey Report, but it is still not feasible because the intellectual and foundation has not yet adequately laid.'

[15] WTO model of multilateralism and plulilateralism are two models that may also be experimented in debt crisis management.

E.g., J. Sachs, *'Do we need an International Lender of the Last Resort,' Graham Memorial Lecture,* (Princeton University, 1995).

institutions specially IMF.[17] In the last quarter of a century several developed,[18] developing[19] and least developed countries[20] faced the problem of debt crisis and tried to settle the problem in one or the other *ad hoc* recourse, such as, making a new agreement with the creditors to restructure the credit line or taking time extended for the payment or simply refusing to settle the issue until the economy eases. Naturally, creditors are now raising their voice to deal with the situation. Some times back, Sachs, Bulow, Truman, Haldane and Kruger wrote some papers on the issue suggesting some crisis management,system. IMF also prepared a draft policy paper and circulated the same among the member-states. In all these papers several arguments were formulated in order to deal with the problem of inability of a sovereign nation to regularly service its debt. As for example, (1) One of the leading positive economists, Professor J. Sachs argued in detail about the necessity of having a transparent rule of law in the international economic system so as to make it possible for a nation-state to be dealt with on such bankruptcy situation. He argued in favor of a sovereign bankruptcy law with an international bankruptcy court to settle the claims against the nation-state in the best possible way, such as having an agreement on asset restructure. (2) Bulow however argued that it would be necessary in the international economic legal regime to have a regular system on Sovereign Debt Restructuring Mechanism (SDRM) so as to streamline and trim the area of governance in a sovereign-state. Many states, according to him, indulge in ordinary commercial activities (which is not the job of a government and indulging in business activities without knowing the rule of the game) and endanger the economic management of the state. Similarly, international financial institutions did squander funds in the name of welfare. He does not mink that the sovereign bankruptcy is in itself an answer to the problem. He goes for a total systemic restructuring of the macro-

IMF (Legal and Policy Development and review Departments).The design of *e Sovereign Debt Restructuring Mechanism - further considerations', A paper **caxulated** to members on November 27, 2002. * As **for** example, Russia and Turkey.

As **for** example, Asian crisis especially in Korea, Thailand and Indonesia. The **example** also extends to Argentina, Brazil, and Mexico. [31] As for example, Bolivia, Cote d'lvoire, Ecuador and Nigeria.

economic management of the sovereign-debtor. (3) Truman, on the other hand, suggested the establishment of a 'rescue fund' within the present legal framework of IMF for helping in restructuring debt of a country facing debt crisis. He argued that any SDRM mechanism has to be evolutionary because the international community has also to be ready for such a system. (4) Ms. White identified three issues in the problem, viz., rouge creditors, priority of claims, claims restructuring procedure and deal. For that Ms. White pleaded for some international institutional framework and would not mind a Bankruptcy court. (5) Ms. Anne Krueger argued for a predictable, orderly, and rapid process for debt restructuring on the basis of a multipartite treaty within the framework of IMF for establishing the structure of SDRM-//Y. (6) Taylor, however, proposed a market oriented and decentralized SDRM structure in the form of SDRM-*very-lit.*

2.2 Jeffrey's international bankruptcy court

Professor Sachs argued in length how occasional creditors could be 'rouges' threatening a national economy because of their immediate and casual attitude and without having any concern for and interest in the national economic revival. He argued in length on making a case for an international rule-based system where the debtor would have a definite route for economic restructure and revival. He argued for mobilization of more resources by the International Financial Institutions (IFI) for architecturing the financial revival of countries facing financial crisis. Professor Sachs has several presumptions. *Firstly,* if there can be bankruptcy proceedings to be conducted against a corporate entity; there is a possibility to have a bankruptcy law against the state as an entity. *Secondly,* the presumption is that the harassed sovereign debtor would likely to come before the bankruptcy court seeking facilities of restructure. *Thirdly,* the International Financial Institutions are free to determine their own course of action and would be quite willing to place a substantial fund at the disposal for sovereign debt restructuring as required by the sovereign state from time to time. All these suppositions are made on the basis of some quick conclusions without taking into account the nature of the

international law and plurilateral agreements, especially Britonwood system.

Professor Sachs did not take into full account the possibility of the committee of creditors to be dominated by those 'rouge' creditors. Besides that, can we now take a private law principle in the public law structure especially when complex constitutional matters are involved? Will he be able to advocate such a proposal to be worked out within the fifty states of the United States? A bankruptcy court, even accepted within the domain of international law. cannot be established and given effect to without the consent of the involved states. Which state would come forward to destabilize its economic structure? If International Funding Institutions are so generous to facilitate the states to restructure their obligations, why do you need a bankruptcy court? The issue can be sorted in round table between the parties and the IFIs. How do you set priority of the claims once the IBC (International Bankruptcy Court) comes into existence without the participation in an agreement of all parties in the determination of priority? The proposal of IBC is too premature an idea; it is not a solution. Taylor argued that it would be very good to bring all sovereign under a definite rule of law regime, but that would take a long time to bring parties to some consensus.

2.3 Bulow 's concept of debt restructuring

Bulow's concept of IBC is completely opposite to what Jeffrey suggested. According to him International Financial Institutions (IFI) and the funding agencies have poured in too much of resources in order to pamper the inefficient and aggressive governments. Governments can neither do business nor they ought to be allowed to do the same. According to him any restructuring of debt system must have to be a precondition of disciplining the government within the government functions. Governments are required to withdraw from commercial functions. Based on financial discipline only restructuring is to be allowed. Therefore, he is totally against any further funds of International Financial Institutions (IFIs) to be misused for debt restructuring unless

sovereign-debtor agrees to withdraw from the commercial functioning and needs special consideration for withdrawal.

So Bulow's proposal comprises for an asset-restructuring proposal of a sovereign-debtor with a complete and fair disclosure.[21] The principle of equality is in no way to be looked into. He argued that unless there is a regular system for debt restructuring the debtor-nation would never achieve the discipline in the system of governance. A quick restructuring mechanism would be able to direct the economy in the desired path that can save the interest of both, sovereign-debtor and the creditors. Only such a total restructuring would give a new life to the economy of the nation facing debt crisis. According to him such a legal regime can be established by a multipartite agreements under the care of IMF. Bulow's suppositions are also untrue. His theory of IBC is as defective as that of Sachs. Moreover, he brings dangerously the fiscal and monetary management system of debtor country under heavy scrutiny. He refuses to believe that government of a state has commitment to its people. There are several political and economic compulsions intertwined. It would be impossible for any financial institutions, like IMF, to monitor the complexity of political economy under the ministerial system of a state. This is not only politically unwise but it is next to impossibility.

2.4 Krueger 's SDRM-lite

Kruger in his paper attempted to develop a voluntary mechanism for debt restructuring by a sovereign state. His Sovereign Debt Restructuring Mechanism (SDRM) is based on two challenges to any established system, *firstly,* the present uncertainty in crisis management in debt servicing does no good to the debtors and the

[21] *Ibid.*, Para 24 of page 10 on Restructuring Agreement as follows: When a sovereign debtor proposes a restructuring agreement, it would also be required to provide information as to how it intends to treat claims that are not to be restructured under the SDRM. This will enable holders of registered claims to make a decision regarding the sovereign's proposal with full knowledge of how other claims are to be treated. See also para. 98.

creditors, *secondly*, there are several financial constraints of the debtor on any collective mechanism.[23] This SDRM is based on two basic principles. (l)-It is absolutely applicable on voluntary submission. A state party shall have to request for debt •estracturing.[24] (2) It is to be invoked only in very limited circumstances.[25] Kruger's mechanism is analogous to any corporate rehabilitation plan model having four steps as suggested by him. The mechanism starts with a stay on creditors for enforcement of their claims during the period of restructuring ■egotiations. This has to have measures to protect the interest of the creditors during the stay period. Then starts the mechanism that would facilitate negotiations for new financing during the proceedings of restructuring. Finally, there must be a mechanism to bind the parties to an agreement reached for restructuring on the basis of negotiations with the qualified majority. Kruger went on to

~ Kruger put the same as follows: 'But the greater diversity of claims and ■■crests has also made it more difficult to secure collective action from creditors vftcn a sovereign's debt service obligations exceed its payments capacity. This has reinforced the tendency for debtors to delay restructuring until the last passible moment, increasing the likelihood that the process will be associated *mtt* substantial uncertainty and loss of asset values to the detriment of debtors ad creditors alike.'

B "Of course, difficulty in securing collective action is only one of a number of ■kaors that have that have made sovereigns extremely reluctant to restructure ■nr debt. Even if mechanisms for debt restructuring are improved, concerns dma economic dislocation, political upheaval and long term loss of access to capital markets will make countries loath to default on their debt service obligations in all but the most extreme circumstances.'

* "Use of the mechanism would be for the debtor country to request; and not for ■c IMF or creditors to impose. If the debtor and creditors were able to agree to ■esmicturing between themselves, they would of course be free to do so without kavBig to invoke the mechanism.'

3 "Specifically, when the debt burden is clearly unsustainable. In other words, Ac mechanism would be invoked where there is no feasible set if sustainable ■•croeconomic policies that would enable the debtor to resolve the immediate crisis and restore medium-term viability unless they were accompanied by a senificant reduction in the net present value of the sovereign debt. In such cases, the country concerned would probably already have been implementing corrective policies, but would have reached the point where financial viability ceald not be restored without substantial adjustment in the debt burden. Coantries that are judged to have sustainable sovereign debt burdens may on •cession need to approach their creditors for a reprofiling of scheduled obligations. But it is not intended that an SDRM should be used for such cases.

explain the mechanism taking the details of the corporate debt-restructuring model. The emphasis is on majority restructuring. The mechanism has to come into operation based on the assessment of IMF because, * according to Kruger IMF is technically the most competent body to assess as to in what stage the mechanism would have to come into operation. There has to be enough incentives for the debtor to come forward to volunteer the reconstruction, and there must be an IMF supported program for protecting the interest of the creditors.[26] Any additional finance needed during the process of restructuring would have to be given by agreement the priority. During the restructuring proceedings the Committee of creditors has to play a very significant role for (a) arriving an agreement on restructuring; (b) assisting the debtor to adopt policy that protects value of the assets; (c) agreeing on the priority financing during the process and, (d) working with the IMF for quick restructuring of the assets so that the debtor has enough incentive to seek restructuring in time.

He argued further that unless there is a regular system for SDRM the debtor-nation would never achieve the discipline in the system of governance. A quick SDRM would be able to direct the economy in the desired direction that can save the interest of the both the debtor and creditors and give new life to the economy of the nation facing debt crisis. According to him such a legal regime can be established by a multipartite agreements only under the care of IMF.

In the scheme the IMF oversees the process of restructure and as such, the pivot of the whole mechanism. The contractual binding character is not formalized with any dispute resolution system because that might have further irritants. But what would attract the debtor to come forward in response to sufficient incentive in the face of even political upheaval has not been explained. Kruger must have taken lesson number one from the functioning of World

'There would have to be assurances that the debtor would conduct policies in a fashion that preserves asset values. If, throughout the stay, the member was implementing an IMF-supported program or was working closely with the IMF to elaborate policies that could be supported with the use of IMF resources, this would provide many of these assurances.'

Trade Organization (WTO). In WTO system dispute resolution mechanism has a significant role. In fact WTO has taken a shift from the international legal scheme under UN system, especially where WTO has a dispute resolution body with compulsory jurisdiction. And the decision of the dispute resolution body is binding on the parties; non-fulfillment of obligation would attract sanction. This is an import of private law system imported into the public law through multilateral and plurilateral negotiations and agreements. Kruger's article may indicate the logic, 'if WTO can, why IMF can not!'

2.5 Taylor's[27] market mechanism

Taylor preferred a market driven and immediate system of crisis management based on contractual conditionality but with enforceable mechanism[28]. Taylor was in favor of market friendly contact system because it is immediately capable of being enforced and has a strong moral base in a market system. The present uncertain system has a very adverse effect on the US investors in ihe bond market. There is a strong feeling that US government has done a precious little for protecting the interest of the US investors against the whims of the sovereign debtors. The main problem in me bond market is that there is no definite system of enforcement of bond contract. Besides, bond condition, *inter alias,* includes hundred percent bondholders to agree to any system of readjustment in case of crisis in meeting of obligation by the debtor. Taylor argued that substantial majority should have the

'" Under Secretary of Treasury for International Affairs, US in 2002. ^{M} fai our view, the most practical and broadly acceptable reform would be to ■we sovereign borrowers and their creditors put a package of new clauses into ■Kir debt contracts. The clauses would describe as precisely as possible what tappens when country decides it has to restructure its debt. In this way the contracts would create a more orderly and practicable workout process. Such daces represent a decentralized, market-oriented approach to reform because «Mh the contracts and the workout process described by the contracts are •aermined by the borrowers and lenders on their own terms. lBap-j7www.ustreas.bovt/press/releases/po2056.htm, page 2).

Currently, the clauses in many bonds require the consent of 100 percent of the hoadholders to change the financial terms. Thus, a small minority can prevent a ■esructuring that the majority of bondholders feel is in their best interest.

right to take decisions on the restructuring of the debt. The substantial majority may also buy out the minority interest. Substantial majority shall have the right to take decisions for protecting the value of assets underlying the debt. The debtor and the substantial creditors shall have to take all decisions for restructuring the debt. Taylor emphasized the 'collective action' clause in bonds to be replaced by 'substantial majority action' clause. According to Taylor the weakest issue is the absence of quick and efficient dispute resolution mechanism. As such, there must be effective mechanism for enforceability of the contract as included in the bond framework. With the effective system of enforcement mechanism the global flow of investment may increase number of times.

3. THE DRAFT OF IMF

3.1 A brief outline

IMF formulated a comprehensive suggestion paper[32] on dealing with the sovereign debt crisis initially with the voluntary submission by a sovereign debtor to opt for the crisis management system and once the option is exercised, the state to be bound to observe a compulsive monitoring system during the restructuring phase. The restructuring phase has detail procedural advisory mechanism and a dispute resolution system with compulsory jurisdiction closely resembling the WTO multilateral dispute resolution model. IMF's paper is the revised version of Kruger's

'Majority action clauses are now in sovereign bonds issued under UK law. However, sovereign bonds issued under New York law generally and by tradition have no such clauses. There is no legal reason why such clauses could not be included.'

[31] The three action plan that Taylor suggested are: a package of new collective action clauses; guidelines for borrowers and lenders as they set the detailed terms of these clauses; and incentives-including financial incentives to encourage countries to adopt such clauses.

" IMF (Legal and Policy Development and review Departments), 'The design of the Sovereign Debt Restructuring Mechanism - further considerations' A paper circulated to members on November 27, 2002.

SDRM model added with a WTO model of dispute resolution mechanism. A sovereign debtor under the scheme would be absolutely free to take a decision for submitting to debt restructuring mechanism. The sovereign debtor would decide which debt to come under the restructuring and which debt to be kept out of the system. It would also exercise the option at its own time. There are two factors that are to be remembered here. *Firstly,* a sovereign debtor would be expected to respect the advise of the **IMF** for the purpose of submission to such a restructuring mechanism because IMF is the expert and impartial body engaged in the pursuit of constantly reviewing the economic position of each country. And *secondly* there should be a sufficient incentive in opting for such restructuring without delay. The present experience is that a sovereign debtor hesitates to come for such an option until the economy of the country is badly damaged and the asset is irreparably depleted. The incentive based arrangement with **the** IMF would ensure that advise of IMF is always seriously taken. There must be sufficient scrutiny against adventurism but at the same time, incentive must be adequate for taking right decisions at **the** right time. Here is the importance of full disclosure • of information[33].

In order to facilitate a timely action, as a part of full and complete disclosure, the sovereign debtor is required to submit three comprehensive lists with discriminatory treatment that the debtor proposes to apply. These three lists are: (1) The *First list* comprising the debts that are proposed to be restructured within SDRM; (2) The *second list* including the list of debts that are proposed to be restructured-outside SDRM, and (3) The third list comprising the categories of debts that are not to be restructured **and** that the state would settle the debts according to the terms of **the** debts.

" More recently, Bank of England's Deputy Governor Mervyn King had an interesting observation. While he thought that the Fund's work on SDRM may **ndeed** help reduce the costs of crisis, it is a question mark whether it could **provide** the sufficient incentives to safeguard against future crisis. He identifies **two** missing links in the international financial architecture. The first is what he **calk** presumptive access limits and the second is an active-lending-into-arrears **policy** in cases where debt payment standstills are needed.

The Committee of creditors as a part of their right to accept the proposed discrimination has a right to stipulate conditions for their support, such as, (a) shifting of claims in the non-impaired list (third list) to SDRM list; and (b) expansion of the non-impaired list with the priority claims of the institutional organizations and creditors on new financing as a part of restructuring process and priority assigned pursuant to a vote by the Committee. Such participatory process of discriminatory treatment sounds logical. We have to examine the extent of the debtor's right to discrimination in the light of the creditors' right. But let us first examine the agonizing conditionality to the proposal of SDRM in the draft form.

The note of the RBI submitted on that paper, emphasized several conditions for such a crisis management regulatory mechanism. Such a crisis management strategy has to be (a) within the structural framework of public international law; (b) based on jurisdiction on voluntary basis of the sovereign member country; (c) with mutual cooperation and understanding and (d) not in conflict with the macroeconomic management system of the member country so that it does not in any way stand to restrict or impair in any way the economic structural design and financial sector management of the member. The RBI comment also pointed out that the mechanism has to be compatible with the human right legal regime of the World.

The suggested design of the IMF on the Sovereign Debt Restructuring Mechanism deserves a critical review in the light of the previous discourse and observations.

3.2 Notable features of the proposed SDRM

The proposed SDRM contains the following basic structure that is in conformity with the basic principles of modern internationa law, such as, (1) respect to sovereignty;[34] (2) voluntary submissioi

[34] Sixth principle laid down in page 7 of the paper as follows: The mechanisr should not interfere with the sovereignty of debtors. The mechanism could nc be activated without the sovereign's request. Accordingly, the sovereign woul only seek to activate the mechanism when it had formed a judgment that th

to the jurisdiction; (3) recognition of the power of the sovereign to exercise discretion to declare one debt unsustainable and another, not[36]; and (4) mutual cooperation facilitating participative system based on incentive for both sovereign debtor and creditors[37] to resolve the issue. (5) The system is also projected as an impartial one with an independent judicious body of experts in Sovereign Debt Dispute Resolution Forum (SDDRF).[38] Thus the adamancy of sovereignty argument in public international law has been made amenable with a judicial body. There is nothing in an international judicial body so long there is voluntary submission and self-performance. Voluntary submission is taken care of by sufficient motivational incentives for agreeing debt restructuring. The catch-point however, is the right of the committee of creditors to twist the hand of the sovereign debtor on the compilation of lists of debts for the restructure. The question of equal treatment for all debts, internal and external, is a matter left to the parties to include in the agreement. Once there is a submission the rest of the procedure is absolutely binding against the sovereign-debtor including a sanction in case of non-fulfillment of obligations under the contract.

3.3 Which debts are unsustainable?

The definition of unsustainable debt is not provided in the draft. In common sense, a debt becomes unsustainable when its servicing is

features of the SDRM would enhance its capacity to restructure its debt rapidly and in a manner that limits economic dislocation.

[35] *Ibid,,* page 9 regarding Activation, runs as follows: Consistent with the principle of sovereignty, the mechanism could only be activated at the initiative of the member. When activating the mechanism, the member would represent that it had formed the judgment that its debt was unsustainable.

[36] *Ibid,* principle 2 in page 6 stipulates that SDRM is only to be used on debts decided to be unsustainable. In page 13 para 32 provides thus "Notwithstanding the likely need for a broad restructuring, a debtor may decide to exclude certain types of claims from a restructuring, particularly where such exclusion is needed to limit the extent of economic and financial dislocation.

[37] *Ibid,* page 7, principle no. 7 suggesting thus: The framework should establish incentives for negotiation.

[38] *Ibid,* page 11, para 28 starts as follows: 'The Sovereign Debt Resolution Forum (SDDRF) would be established in a manner that ensures independence, competence, diversity and impartiality.'

untenable. Theoretically speaking, debt of a state may be bilateral or consortium or institutional. Debt may relate to Sovereign function of the State or may relate to a commercial function undertaken by the State. In the developing world a state in its governance includes a whole list of activities for the development of the country, which are otherwise done by commercial enterprises in a liberal democratic and developed world. The basic philosophy in a developed liberal economy is that let the government govern; regulator regulate and market players, play. All players are commercial private enterprises. All such activities are generally related to trade, industries and commerce. Sovereign activities in the governance is restricted to national security, internal and external, generally indicated as 'law and order' and 'defense'; general administration of law and justice; management of external relations, revenue and regulatory administration in money and currency. The cost of governance is to be met out of the revenue generated by taxation.

An external or internal debt unless the same is bilateral, is generally drawn through debt instrument traded in the financial market. Even in bilateral agreement a debt is to meet any contractual agreement having commercial import. In a developing state, the government increases the agenda of activities engaging it in commercial activities directly or indirectly. In a developed liberal economy in government functions there are more and more private participation. As for example, even in government procurement there are presence of detail rules and guidelines for participation of private parties. Therefore, purity in government functions is a vanishing point. Any claim related to commercial activities (even a deal in arms and ammunition is also a commercial activity) is to be included in eligible claims. Such claims include, *inter alias*, (a) A sovereign debt i.e., money borrowed or a credit advanced; (b) sovereign guarantee on repayment of loan or credit advanced; (c) payments under debt instruments; (d) liability under financial derivatives like currency and interest swaps; (e) payment required for supply of goods and services; (f) payment due under lease; (g) payment needed under letter of credit, bankers' acceptance and bonds, and (h) payment for liability on eligible claims under judgment-debt.

So, there are difficulties in determining whether a debt related to an activity is commercial or sovereign function of a state. Arms deal, for instance, in some states is restricted to security function of the state. Similarly, all manufacturing activities in arms, ammunitions, and other instruments used by armed forces are in the exclusive domain of the state. But in most of the others, manufacturing of arms and ammunition and selling of the same is an ordinary commercial venture under special license of the State. Public utility services are important function of the state now in many developing and developed states. In many others these are carried on as commercial ventures. As such, the test of 'what the private entity' can do, can hardly meet the criteria for distinction of claims. The only valid distinction is domestic debt *versus* foreign debt. The recommended principle is that the claims governed by the domestic law of the sovereign and subject to the exclusive jurisdiction of the courts of the country, is to be restructured outside the SDRM.

It may be argued that a long list of caveat on the committee of creditors would reduce the operational efficiency of the SDRM. In such an argument there is an emphasis given on 'mental set' that SDRM is needed when a sovereign is in a bankrupt situation. The analogy of insolvency or bankruptcy does not apply in the sovereign condition. There may be near-symptoms in the failure of a sovereign to maintain debt servicing. Though in international law a sovereign is treated as a *corpus-sole* having corporate-aggregate status, yet a sovereign is not like a corporation. National resources are not the properties to be similarly handled like a corporation, as it does in case of assets belonging to it. A debt may become unsustainable for very many reasons. Say for example, in India any sovereign debt used for the development of agriculture does not immediately raise the tax revenue of the state because agriculture being a states' subject, does not benefit the Center. Agricultural income being generally kept outside the taxation regime in the states, the aggregate revenue of the Center and the states does not increase. There is a presumption underlying each debt that a debt if properly used in its rational economic sense, would generate the tax revenue thereby sustaining it with adequate resource generation for timely repayment of the debt. It may not always happen in the

similar way for various reasons. Such reasons may include, uneconomic and unviable use of debt, corruption and siphoning of the fund, consistent economic failure, infrastructure building not immediately generating revenue, tax-base not increased, sudden economic downturn in the economy of the country, excessive deficit in trade balance, obstacle to capital in-flow, national emergency and may other reasons.

3.4 Some agonizing issues

There are agonizing issues in the process of treatment to debts under SDRM since the economy of a sovereign state is dynamic. The two issues are (i) what about future debts, can the Committee put any restrictive covenant on the growth of future debt; and (ii) what about the extent of power of the Committee to regulate the expenditure of the state? The draft avoided any explanation on the two intrigued matters. But paragraph 32 of the draft[39] raises the two and some other complexities as well that requires elucidation.

3.4 (a) Present versus future debt

All future debts naturally increase the burden of the debtor outside the SDRM unless SDRM is only a switch action, that is, 'a momentary' one time action requiring very short time and space for the entire process to be completed from proposal to execution. But that is neither possible nor contemplated. So all future debts not linked up with the debt servicing ability under SDRM can be objected by the Committee because the same increases the burden

[39] *Ibid.*, Para 32 of page 13 runs as follows: Notwithstanding the likely need for a broad restructuring, a debtor may decide to exclude certain types of claims from restructuring, particularly where such exclusion is needed to limit the extent of economic and financial dislocation. By way of example, a debtor may decide to exclude trade credit and certain types of domestic money market instruments (such as Treasury Bills) so as to preserve its continued ability to mobilize these types of financing. Clearly, creditors holding instruments that are to be covered by a restructuring will take a keen interest in the design of the proposed financing package, and will want to ensure that exclusions from a restructuring serve to help preserve a debtor's capacity to generate resources for debt service, rather than increasing the burden on those included in the restructuring.

on those included in the restructuring. The only ground on which the sovereign debtor may seek exemption under the present draft is 'economic and financial dislocation'.

3.4 (b) Creditors' objection on sovereign's expenditure

Rationalizing and rightsizing the expenditure of the sovereign-debtor is directly connected with its capacity to generate resources for debt servicing. Shall the Committee or the Fund have power to insist on any issue related to the budgetary process of the sovereign-debtor opting for debt restructuring under SDRM? The transparency and disclosure norms are applicable on the debtors, that too, very rightly. The debtor must also be clear about the extent of right of the creditors. Paragraph 32 includes some phrases and parts of speech, which have very long and severe implications. The right of the creditors must be very clear *vis-a-vis* obligations of the debtors opting for SDRM. The draft completely betrays on the issue. It is quite natural for the creditors to demand that any budgetary provision on revenue generation and revenue use including any provision for subsidy is in conflict with the interest of the creditors. But there has to be balancing of interest because international law does not anticipate any 'imposition' nor it allows any subjection of people's interest due to any international agreements between the nations'.[40]

3.4 (c) Extent of economic and financial dislocation

It would be really complex issue to determine the extent of economic and financial dislocation to come outside the clutch of the Committee of creditors. This is the sovereign's prerogative and in a democratic system an essential part of the political economy. Any externality is considered in the international law interference in the internal matters of a sovereign. But from the point of view of the interest of the creditors this is a vital issue of interest of them. One may certainly argue that in the absence of credit worthiness one may be asked to bow to any conditionality. But this may lead

All UN institutions are created subject to the Charter of the UNO holding that the body is created by the agreement between the peoples of the world.

to an argument for attaching common law vitiating factor of undue-influence in international agreement.

3.4 (d) General exclusion

All International agreements on finance, trade, commerce and investments contain general exclusionary provision for national security, food security, public health, public interest and public morality. But excepting economic and financial dislocation nothing is included in the draft. This seems to be very peculiar. The space for self-determination on which debt could be excluded from the scheme of restructuring is interpretatively narrow. The test is that (a) debtor's ability to generate resources for debt servicing is retained and (b) burden of those creditors included in SDRM ought not to be increased.[41] These two conditions are not mutually exclusive. Resource generation for security interest; food security; poverty alleviation; public health; and sustainable development are not excluded from the rumblings of the dispute resolution system. In all trade related economic legislations of global understanding between the nations contain these minimum exceptions. Any procedure of SDRM that may ultimately affect the national security of the country or its future growth is likely to be suspected as a vitiating factor. The incentives generated under various paragraphs of the paper[42] sounds to be insignificant concession for a debtor to come forward for restructuring. The mental framework of the creditors is quite apparent even before this multipartite treaty is in the process of conception. The private sector creditors strongly argue to include even bilateral claims to be included in the

[41] *Ibid*, Para 32 in page 13 stipulates thus: 'Notwithstanding the likely need for a broad restructuring, a debtor may decide to exclude certain types of claims from a restructuring, particularly where such exclusion is needed to limit the extent of economic and financial dislocation. By way of example, a debtor may decide to exclude trade credit and certain types of domestic money market instruments (such as treasury bills) so as to preserve its continued ability to mobilize these types of financing. Clearly, creditors holding instruments that are to be covered by a restructuring will take s keen interest in the design of the proposed financing package, and will want to ensure that exclusions from a restructuring serve to help preserve a debtor's capacity to generate resources for debt service, rather than increasing the burden on those included in the restructuring.'

[42] *Ibid*, See principle 7 noted above

SDRM . If SDRM would compel the debtor to allow committee of creditors[44] to seat on judgment on the macro-economic management system of the state through budgetary process there would be few takers of SDRM on voluntary basis.

3.5 Limited choice to the sovereign debtor

Let us now arrange in sequence all conditionality of SDRM to critically review the entire picture of the argument in the following order, (i) Only the central government of the member (debtor-country) would be able to activate the SDRM.[45] (ii) The debtor has really a very limited choice of keeping any claim excluded from the unsustainable credit line. Perhaps trade-credit or a few domestic money market instruments, like Treasury bill, public debt instrument, may be excluded, (iii) In the aggregate financing package such concession would be approved if only the same do not impair the debt-servicing capacity of the debtor, (iv) The Committee of creditors may claim to have the right to review all such budgetary proposals.[46] (y) The debtor shall have the responsibility of being completely transparent.[47] That shall mean

Ibid, para 74 of page 23 reads as follows, 'During the most recent discussions, the preliminary view of the Executive Board was the official bilateral claims should be excluded from the SDRM, at least initially, but that close coordination would be needed between Paris Club and SDRM restructurings. Nevertheless, the private sector has expressed the strong view that inclusion of official bilateral creditors within SDRM - albeit as a separate class - would be critical if the SDRM is to establish a framework that provided for greater inter-creditor equity. The private sector has also expressed a concern that Paris Club restructurings may not address the sustainability of a sovereign debt since it typically deals only with a window of claims failing due, rather than with the stock of debt, and, for that reason, often relies on repeated rescheduling.'

[44] *Ibid*, para 21 of page 10 provides, 'As a means of encouraging active and early creditor participation in the restructuring process, a representative creditors' committee would be given a role under the SDRM to address both debtor - creditor and inter creditor issues.

[45] *Ibid*, page 14 para 37

[46] *Ibid*, page 13, para 32 quoted earlier.

[47] *Ibid*, page 14 para 37 stated thus: Only central government of a member would be able to activate the SDRM. Once activated, all eligible claims on the central government could be brought into the SDRM restructuring process. For this purpose, the central government would include all administrative divisions and agencies that form part of the central government's budgetary process.

that the debtor shall have to place before the Committee accounts of all claims whether to be covered under SDRM or not. (vi) Any violation of the transparency rule shall attract the breach of member's obligation under the Articles of Agreement of the Fund[48]

That makes the complete circle of the plight of the debtor-nation. The Committee of creditors, as for example, may have continuing objections on the subsidy-structure in government expenditure holding that any subsidy is against the interest of the creditors. The Committee may also like to insist on the fiscal discipline. This shall put the political economy of the member under a cloud of doubts. Any debate on the expenditure on public interest like PDS may lead SDRM in this form, to be contested on the ground of violation of human right as well.

3.6 Government accounting system

Many newly independent and most of the developing nations still could not convert their accounting system into modern accounting practice and are still continuing with 'cash-basis' accounting system. Even in government accounting in big countries like India and China a lot is needed to modernize the system. The creditors may insist on the asset based accounting to lay their hands on assets, which may be a de-motivator for the sovereign debtors to change to modern accounting system. A transparent accounting system needed by creditors would be seen as interference because that would be used as evidences. A thorough and detail accounting and audit system would lead to understanding of the use and misuse of debts. SDRM would in itself require detail and scientific accounting and audit practice. No report can be transparent unless accounting procedure is itself not unquestionable. As such SDRM would call for a transparent and detail accounting and audit

Ibid, page 11 para 26 suggested,'It is recommended that the provision of false information by the sovereign during the restructuring process constitute a breach of the member's obligations under the Articles of Agreement. With respect to sanctions for non cooperation or inappropriate use of the mechanism, it is recommended that the Fund would rely on its existing financial policies, including its lending into arrears policy.'

practice. In many developing countries accounting and audit system is so defective that there would be a requirement of building capacity in the governance for switch over to introduction of such a system of government accounting and audit practice. The Committee of creditors would naturally insist on maintaining accounting system according to the norms laid down in international standard. That may cause serious doubt-in the mind of the sovereign debtor about the intention of the creditors. Asset accounting would lead to exercise of the creditors' right on government assets, including immovable properties, which a sovereign would not like to be divested with.

3.7 Dispute resolution body

One of the guiding principles in the draft is that the SDRM framework would establish incentives for a negotiation, not a detail blueprint for a restructuring.[49] Such a multilateral treaty-based incentive framework is a very litigative method; WTO dispute resolution system is a pointer in view. Whereas the submission to jurisdiction may be voluntary and discretionary, the procedure must be rule based to provide the strength of certainty; predictability and definiteness. There may be a best practice code that may be developed as a procedural system. But the system cannot be allowed to fail under the weight of its own. The draft outlined the procedure of appointing the Sovereign Debt Dispute Resolution Forum (SDDRF) to ensure independence, competence, diversity and impartiality.[50] The draft also enlisted the powers of the Forum,[51] which *inter alias,* include functions of three dimensions, *viz.*, administrative, dispute resolution, and Injunctive relief. The draft has various provisions that would generate

Ibid., para (bullet) 7 in Part II, page 7 suggesting, 'The process, of restructuring sovereign debt is relatively complex, requiring the resolution of a number of difficult substantive and procedural questions. To the extent possible, these issues should be resolved through the give-and-take of negotiations and, therefore, the mechanism should not be designed in a manner that presumes a particular outcome. For example, while the SDRM will identify the types of debt that could *potentially* be subject to a restructuring, whether all or only some of that debt is restructured will depend on the outcome of negotiations.'

[50] *Ibid.,* para 28 page 11.

[51] *Ibid.,* para 29 page 12.

litigations. The dispute resolution body would find it difficult to resolve disputes in such open-ended assignment of functional responsibility. As for example, under SDRM there would be a range of claims identified that could be potentially restructured, but it would be for the debtors to propose the subset of eligible claims that would be covered in restructuring and this is likely to require consultation between debtor and its creditors so as to ensure that the proposed framework could attract, broadly speaking creditors' support. One may wonder in these four sets of agenda where would be the striking equilibrium of interests of the contesting parties!

4. CRITICAL MICRO ISSUES IN IMF'S DRAFT

4.1 Eligible vis-a-vis non-eligible claims

(i) Privileged debt: A sovereign seldom goes for collateralized borrowing. This is done by public entities. Sometimes under the contract a special right is created on the creditor to foreclose some asset on the failure of payment. Sometimes a share of revenue receipts is to be deposited into an escrow account until the payment is made. Any privilege assigned in the contract of borrowing of a sovereign or any public entities is an agreement to ascribe special treatment and the promise must be regarded. Hence secured claims may be forming a separate queue for settlement and restructuring.

(ii) Domestic debt: There is an argument for maintaining the principle of equality and non-discrimination amongst foreign and domestic debts. In a country like India, there is no discrimination between domestic and foreign debt of a corporate body under its corporate law when the entity goes on the process of liquidation. Unless there is any, security interest specially creating a right in favor of any claimant, all claimants are in one line with equal rights. Domestic debt is treated under domestic law and in the domestic courts. That is no reason why any discrimination can be made between the two. Similar restructuring scheme may be applicable though through two forums.

(iii) Bilateral creditors: Foreign sovereign debts may be (a) institutional; (b) multipartite or consortium such as Paris club's lending; (c) bilateral and (d) trade credit. All such lending have bilateral overtone. What special rational argument can there be to treat bilateral lending in different footings unless the party lending stipulates a special condition by way of contract. Any claim excepting the secured ones opting for a separate route should not have any incentive to be treated separately, unless the claim is due to some purpose to be categorized in exceptions (such as, national security, food security, public health, economic and financial necessity etc). I consider the incentive for the claimants of all categories excepting the secured ones should be equally forceful and proportionately applicable.

(iv) Trade creditors: What would be the reason to distinguish between the trade and financial credit excepting that these are different on the time scale? That is not enough reason for a separate treatment.

(v) Institutional credit: Credit offered by International organizations has a different connotation and understanding and hence may not fall under common SDRM. Similarly, Lending of Paris club has different inbuilt mechanism of restructuring. Naturally, these are exempted from the list under SDRM. If the Fund is kept out of SDRM, why any misstatement on the part of the sovereign-debtor be treated as the violation of the Agreement of the Fund?

4.2 Identity of the debtor

A government Company and a Public Corporation are assigned separate personality-character like any other corporations. These institutions have their own assets and liabilities not clubbed with that of the sovereign. These *corps juries* Institutions are subjected to domestic law and domestic courts. Therefore, these institutions though radiating in the name of the sovereign owner, need not be clubbed in SDRM. They must be allowed to operate separately on their own strength and weaknesses provided there is no other continued financial link, budgetary or otherwise, and inflow-outflow of resuurces with and in relation to the sovereign.

4.3 Activation

Activation of SDRM brings the incentive of restructuring the debt of the sovereign in the form of repudiation or reduction of the claim, rescheduling of payment, redesigning of the conditionality and financing the restructuring. The claimants have the incentive of protection of the marketable assets from deteriorating asset value, reassurance in the creditworthiness of the sovereign, and participation in the economic decision making of the sovereign-debtor so as to ensure the protection of interest of the claimants. This advantage is very critical and therefore is sufficient incentive. According to the basics of the public international law within the UN paradigm a sovereign may only be stipulated to volunteer into the operation of international law.

4.4 Provision for information, registration and verification

SDDRF is the centre point in the procedure once the Activation takes place. With the global notification given by SDDRF two sources of information collection shall be activated. All claims are required to be registered with the SDDRF within the stipulated time and secondly the sovereign debtor would provide all known information regarding the indebtedness. These information would lead to preparation of three lists, First with claims proposed to be restructured under SDRM by the debtor; Second with the list of claims to be restructured outside SDRM and third claims intended not to be restructured. Another list is also required to be prepared with the claims having collateral security interests indicating the value of the security-interest. This list may be a part of the claim-list 2 under the head, claims to be paid off and/or restructured within the collection value of the security-interest. The registered claim requires verification by the SDDRF. Any claim not contested by the debtor is to be taken as verified. The verification must be complete with all conditionalities attached to the claim. This may become a litigious process because the litigation is not necessarily between the debtor and a creditor of a claim, the litigation may be inter- creditors as well on various aspects of the credit. Facilities

must be accorded to the SDDRF for impartial verification to have access to all records and documents by all parties concerned.

4.5 Stay of enforcement

There is inherent limitation to the rights of claimants against a sovereign. It is justified in arguing that sovereigns ought to bind themselves with a positive moral framework, which the multipartite world bodies are able to administer through an agreed code of behavior. On one side, there is the procedure of implementation of the resolution of the Security Council and on the other the nations have agreed to adapt a rule-based course in the WTO. The agreement of SDRM would be something in line with the later agreements. As such, the agreemental principles must have enclosures in the form of rules on the practices to be followed. Some such related issues are: (a) should there be generalized stay on credit enforcement; (b) what should be the extent of the undue influence and in what circumstances; (c) should the structured majority vote be the only way of restraint on the creditors to stay of enforcement of contract; (d) should there be any parallel to fraudulent transfer of the domestic law on insolvency, such as unreasonable preference and (e) what would be the extent of common law principles like sovereign immunity and sovereignty non-attributable to separate entities?

To my understanding international community, in the form of global bodies are becoming gradually more powerful through a 'rationally consciousness' as the positive moral strength. While a sovereign is immune, the principle of 'non-binding stand' becomes morally weak in a contract paradigm. Any inability or refusal to pay a debt has far reaching consequence in the economic relation of the sovereign with others in financial market. No sovereign of our time can remain neutral to externalities. Besides, a sovereign has the way to distance it from entities. As for example the reserve of the central bank cannot go to meet the debt of the sovereign. Similarly reserves of the public corporations are also not liable to be applied for the purpose of SDRM. Any creditor wanting to bring an action against a sovereign to realize the claim under the contractual terms shall have disincentive to stand alone, so much

so, that the 'disincentive' in itself has the bonding effect uniting the creditors for a common mechanism of recovery and restructuring. Formulation of the detail procedural rule based on the philosophy analogous to insolvency or bankruptcy of a person and entity would be not a rational approach. For such a procedural rule it is better determined in the way of trade negotiations because multilateral or plurilateral agreements are better result oriented for procedural regulations. Certain basic principles may be agreed upon at the outset within which the rule-frame can be worked out. As for example, would you distinguish the sovereign debtors from any other institutional debtor based upon any acceptable criteria? What about the principle of non-discrimination, equality of treatment, expert assistance in financial restructuring? What about debt due to national security, food security, public health or development? A rational discrimination works all right in the framework of WTO. There is no reason why the same pattern of negotiations may not succeed in the case of the Fund. The present policy paper is a facilitator. In that sense Box 1 rules are good suggestions for a creditor opting to stand-alone.

4.6 Valuation of claims

For the purpose of inter-creditors relation, valuation of claims in a common denominator would be necessary. SDDRF has to have a clear operational understanding as to when the claims would require to be converted into the denominator currency of the debtor. Generally speaking the currency risk is covered by currency swaps and the interest rate fluctuation by interest rate swaps. So, expression of a claim in a common currency denominator to see the inter-creditors relation is very important issue. To my understanding the cut off date for the purpose could be the date of activation. The date shall also operate as a circuit breaks in market operation of the debt instruments. The 1980's experience can be evaluated for the purpose. However, for general terms the SDDRP may have a list of certified valuer of assets for the purpose of finalizing restructure of claims.

4.7 Creditors participation

The Creditors' Committee has to play a very critical role in SDRM if it has to succeed as a codified rule based system. The committee's first job is to start negotiating with the sovereign to consider the structural proposal, outline of which was to be submitted by the debtor. The negotiation is complex, and keeping the balance of the conflicting interest in the inter-creditors relation is typical. The committee may come in conflict with the regular budgetary functioning of the sovereign. The draft talks about best practice and experience on the functioning of the committee but does not enumerate the same. A definite procedural code on best practices can be drafted provided the policy dimension could be identified. The paper contains only two procedural policies, viz., empowering the committee to address all debtor-creditor and inter-creditor issues.

The debtor-creditor issues are complex as indicated in Part I of this paper. Any analogues mind-set in bankruptcy system and procedure would not help in this respect. Bankruptcy is essentially a private legal system whereas the SDRM system has to be applied in the public law paradigm under the international legal order. As such, any restrictive mechanism on the sovereign power to address the financial and economic need of the nation shall backfire SDRM. One has to be careful about the power of the committee of creditors on the budgetary framework of the sovereign. Not only the thresholds of voting is to be debated, even the character of 'voting' by the committee in the participatory system may have some disturbing consequence. One can review the participatory process only if one can outline the power of the Committee and the nature of the impact of the voting on any proposal of the sovereign. The intricate questions are: (1) Can the Committee participate on the taxation system and structure; (2) Can the committee participate in commenting and voting on the allocation of funds including provision of subsidies; (3) Can the committee vote on the public debt, internal and external; (4) Can the Committee comment

" One line in the note pointed to this issue hinting on the debtor's capacity to generate resources for debt service, at page 13, Para 32

on the instruments and marketing management on public debt instruments; (5) Can the Committee insist on fiscal discipline? If any of these questions has the answer 'yes', one has to respond to the same with knowledge of constitutional governance!

5. LEGAL FRAMEWORK

5.1 The jurisprudential framework ofSDRM

SDRM under the proposed draft has been designed to be fitted within the framework of the Agreement of the Fund. This will put Fund under an additional burden but facilitating inter-member relations. One may wonder if Fund's claim is not in the SDRM why the sanction for non or wrong-disclosure should attract violation of the terms of the Agreement of the Fund. However, if the debt restructuring is put into the part of the Agreement of the Fund, it shall require legal reform. If there is no mental block of the members with the 'bankruptcy legal regime'[53] and claim restructure is based on the mutual co-operation, respect to sovereignty, and non-interference in macro-economic management of the sovereign, SDRM can be subsumed within the international legal paradigm of the Fund. But there is a consequence on Fund. Since there is a talk on the balancing of the interest of the sovereign debtor and the creditors, including those who claim under bilateral agreement, the Fund has the risk of been thrown into the controversy of ultimate management of balancing of interest. The Fund has now to determine the extent of involvement of the Fund in administering the SDRM. The present form of SDDRF as proposed is likely to operate as an economic tribunal like the Sovereign Bankruptcy Court designed in the paper written by Professor J. Sachs and others rather than facilitating participatory mechanism of dispute resolution with a procedure of detail inquiry. In that situation the Fund may be always engaged in the litigation process of adducing evidences. If Fund has any interest in SDRM, that is that the Fund facilitates a 'debtor-

Para 235 of the draft puts the reader seriously to think that such a mental block does still exists in dealing with sovereign debt in the line of personal insolvency law application.

creditor' settlement for debt restructuring. Fund may even facilitate additional financing for the purpose. Therefore, jurisprudentially it would be prudent to keep SDRM at a safest distance as an autonomous body with its dispute resolution institution, SDDRF. This requires a certain codified structure and a detailed procedure for the mechanism to adhere to best practices.

The second strategy may be that the SDRM be developed by a separate multipartite agreement as a separate body with its own conditionality to which 'International Organizations' in the creditor's role may also approach for restructuring. In such a case the Agreement of the Fund may also not require readjustment. Paris Club did not require any initiative of the Fund to design its scheme of debt restructure. The Fund may only recommend a code for the SDRM agreement acceptable to nation-members of the agreement. Once the agreement is arrived the SDRM with all its other bodies including independent and certified valuers and the dispute resolution bodies should be independent. Fund may only assist the functioning of the mechanism. Personally I would rather prefer such type of legal arrangement, independent of IMF like, say, UNCITRAL.

5.2 SDR June?[4]

The draft disappointed me in the sense that it does not contain any provision for constituting a Sovereign Debt Reconstruction Fund. Whatever is the legal structural framework of SDRM, whether 'Fund SDRM' or 'independent SDRM', constituting a 'SDR Fund' for the purpose of claim restructuring would have facilitated the economic reconstruction of the sovereign debtor within a short time! The SDR Fund could be constituted by the contribution of both the creditors and debtor nations and with some subsistence grant from the IMF.

5.3 Adjustment of national laws

It is quite logical to argue that member-states ratifying the change in the Agreement of the Fund or agreeing to and ratifying a

[4] In the line of Rescue Fund suggested by Professor Truman.

separate multilateral agreement on SDRM have to adjust the national legal regime in line with the Agreement or the Treaty as the case may be. If we do not have any mind to explain in full rights of the creditors of a sovereign-party in the light of insolvency or bankruptcy system then there would be only one requirement, that is, that the national law on bankruptcy and insolvency must have to deal with cross border claims in settling all claims of individuals and entities. Claims against the insolvent party, which are also claims against the sovereign at the same time, are at the discretion of the sovereign to settle whether under SDRM or under the state legal regime.

6. CONCLUDING REMARKS

6.1 Is there any hidden agenda?

While sharing the agony of the investors from US, one may even record another agony in the developing world about a hidden agenda in the program being a politically sensitive economic issue. It may now be argued that US-EU lobby is interested 'to establish democracy and market economy' throughout the globe at any cost. So it might be doubted that Debt Restructuring Mechanism through IMF with a Dispute Resolution Body having compulsory jurisdiction and power to validate sanction, would have a hidden agenda, too. The opinion of the Under Secretary Taylor can be interpreted as suggesting that one of the fundamental purpose of the mechanism is to down-size the official sector in the country of the sovereign debtor[55]. There is no denying the fact that in many developing countries public sector takes a lead economic role in building the economy especially in matters of public interest. Infrastructure building, public distribution system, transportation, construction work, industrial development - in all these public

'Limiting official sector support when countries reach unsustainable debt situations is also a key element of our emerging market strategy. Large official sector support packages for countries with unsustainable debt effectively bail out private investors holding high-yield debt instruments. It is becoming clearer that official sector support in such cases is being limited to a significant degree'. (http://www.ustreas.gov/press/releases/po2056.htm)

sector plays a big role. In Banking, Insurance, and Financial Institutional sector - the role of public sector has b'een phenomenal especially through out sixties and seventies of the last century. Pro-market economists identify this public sector as the number one enemy of the market economy, suggesting that private players are only the key and competent players in market economy. Same are the economists patting China for economic reform through 'market socialism'! What is the message? Any such predetermined notion would create more stumbling blocks than clear understanding of mutual strengths and weaknesses.

6.2 Use and misuse of International Institutions

In Kruger's article, the decisive role of IMF has been significantly pointed out. IMF has to take key decisions on activation of stay on creditors action, extension of the stay and the approval of restructuring agreement.[56] These decisions are not taken on judicious note by any judicious body. These are supposed to be taken on mere economic rationale. Unfortunately, the track record of the organization is not such that one can eliminate consideration of international politics, of at best, political economy! One may say, 'he who pays would play the tune'. The restructuring agreement would then be the product of arm-twisting, an agony that a newly liberated country would again suffer from! Unfortunately, there is no developing countries' Fund!

'In the light of the central role that IMF financing plays, one could envisage a framework that empowered the IMF to make key decisions regarding its operation. Bearing in mind the key features described in the previous section, these decisions would include the following: (i) First, *activation of a stay in creditor action* would require a request by the sovereign debtor and IMF endorsement. Such endorsement would be based on the IMF's determination that the member's debt is unsustainable and that appropriate policies are being - or will soon be - implemented, (ii) Second, *any extension of the stay* would require a determination by the IMF not only that adequate policies continue to be implemented but also that the member is making progress in its negotiations with its creditors, (iii) Third, *IMF approval of a restructuring agreement* that **had** been accepted by the requisite majority of creditors would be a condition for its effectiveness. Such approval would be based on a determination that it provides for sustainable debt profile' *(ibid).*

I would rather conclude by a cautionary diplomatic note, suggesting that the issue may be taken slow in IMF now because in post-Cancun there is enough mistrust created in WTO working mechanism. In the short run we might agree on the conditionahty on Bond contract. In the long run there may be an attempt to move to an independent Dispute Resolution Body. In between, the Fund must muster a 'Reconstruction Fund' for helping the economy under stress. A graduated and calibrated dialogue would assuage the feeling of the developing and least developed countries. However, I strongly believe that multilateral trade treaties should work well. One of the tests of its neutral working is that all nations are unhappy on the dispute resolution system of WTO. However, if you cannot make everyone happy, the best alternative of neutrality is perhaps to make everybody unhappy!