



**UNCTAD**

# **UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT**

## **PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING, INCLUDING DEVELOPING GUIDELINES AND CRITERIA FOR ASSESSING LEGITIMACY OF SOVEREIGN DEBT**

### **OBJECTIVES**

- 1. Create a forum for the study and documentation of the practices and standards on responsible sovereign lending and borrowing and related consensus-building activities. This will include inter alia the analysis of new sovereign lenders, their lending practices and impacts on future debt sustainability.**
- 2. Develop a set of guidelines to promote responsible sovereign lending and borrowing and invite a discussion on the possible use of such guidelines as criteria for assessing legitimacy of sovereign debt.**
- 3. Promote the discussion on the different options for a structured approach to resolving defaults and disputes between sovereigns and private creditors.**
- 4. Create a global debt portal targeted at borrowers, lenders, policy-makers, debt managers and researchers.**

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## **PROMOTING RESPONSIBLE SOVEREIGN LENDING AND BORROWING, INCLUDING DEVELOPING GUIDELINES AND CRITERIA FOR ASSESSING LEGITIMACY OF SOVEREIGN DEBT**

### **PROJECT SCOPE**

UNCTAD, with its proven track record in consensus-building, will initiate an in-depth study of guidelines and procedures to promote responsible sovereign lending and borrowing and to document best practices in this area. This is a project under the broad heading of Promoting Responsible Sovereign Lending and Borrowing. This involves technical and empirical research and analysis of different issues, including inter alia, the development of a set of guidelines to promote and foster mechanisms to enhance responsible sovereign lending and borrowing. Eventually, the guidelines could lead to the establishment of criteria to assess whether the sovereign lending and borrowing has been performed in accordance with internationally accepted principles.

Project activities on these issues along with research work of UNCTAD on related issues will form the core content of an internet portal to be established and managed by UNCTAD.

### **INTRODUCTION**

Academics, multilateral organizations and NGOs have contributed considerably to the on-going debate on sovereign debt. No agreed principles for responsible sovereign borrowing and lending exist. There are widely differing views of what constitutes responsible practices, which is hardly surprising when so many interested parties are involved. A different approach which can be part of an international consensus is therefore needed. The existing codes of conduct<sup>1</sup> in relevant areas may provide inspiration as to what that approach could look like.

In addition, in 2007 Norway commissioned two technical studies on odious debt to UNCTAD and the World Bank, which constitute the first attempts at the multilateral level to examine the legal and public policy implications of the issue. UNCTAD's Discussion Paper

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<sup>1</sup> See e.g. Council on Foreign Relations, 'Roundtable on Country Risk in the Post-Asia Crisis Era: Identifying Risks, Strategies, and Policy Implications. Key Recommendations from Working Group Discussions 10/99 - 9/00'; INSOL International, 'INSOL Lenders Group Global Principles for Multi-Creditor Workouts'; and the Code of Conduct for Emerging Markets (this code was drafted by the Emerging Markets Creditors Association; Emerging Markets Trade Association; Institute of International Finance; International Primary Market Association; International Securities Market; Association Securities Industry Association; and, the Bond Market Association).

on “The Concept of Odious Debt in Public International Law”<sup>2</sup> by Professor Robert Howse examines the concept of odious debt in public international law and highlighted the ongoing debate, applicability and contemporary relevance of the issue. However, the issue of the “odiousness” is only one aspect related to responsible sovereign borrowing and lending. Therefore, arriving at one exclusive definition of odious and illegitimate debt is not the main purpose of this project. The main objective of this project is to focus more on the fostering of the system as a whole by means of prevention rather than focusing on the ex-post effects, taking into account not only the large number of parties involved but also the multi-faceted nature of the debts to be studied.

The project will build consensus around a set of guidelines to promote responsible sovereign borrowing and lending.

## **WHY LENDERS AND BORROWERS SHOULD BE INTERESTED**

Since the 1990s, we have experienced several default episodes with severe consequences for both borrower and lenders, such as the well known case of Argentina’s default in 2001-2002, with a substantive number of outstanding creditors and multiple litigation cases. In addition, the SDRM proposal made by the IMF failed to gain momentum and has been taken off the international agenda for discussion. Other issues such as the “odiousness” of the debts of a sovereign as grounds for limiting its obligations to repay debt incurred by previous governments has also been raised for consideration.

An increasing interest in engaging in responsible lending and borrowing has been observed during recent years both from the lender and from the borrower side. Borrowers, especially from developing countries, have brought the issue to the fore by questioning lending motives, the lenders' active involvement in projects gone wrong and the use of borrowed funds by previous governments. One example is the undertaking by the Ecuadorian Debt Audit Committee. Other countries have been thinking along the same lines and voiced their concern in public but have not gone as far as Ecuador that in November 2008 published the Final Report of the Integral Auditing of the Ecuadorian Debt<sup>3</sup>.

In 1988-89, the Norwegian Government conducted an evaluation of the Ship Export Campaign, in which the campaign was criticized for inadequate needs analyses and risk assessments. In March 2007, the Government of Norway unilaterally wrote off claims related to their Ship Export Campaign of the 1970s. The main conclusion was that this kind of campaign should not be repeated. It is now generally agreed that the Ship Export Campaign was a development policy failure. As creditor, Norway understands that it shares part of the responsibility for the resulting debts. The Norwegian Government avoided categorizing the debts, but instead stated that several factors indicated that it would be inappropriate to reclaim the debts.

Other donors have increasingly highlighted the significance of building international consensus in this area. At the 2007 Annual Bank-IMF Meetings, the German Minister of Development Cooperation placed the issue in its wider context and highlighted the need for

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<sup>2</sup> Howse, Robert, “The Concept of Odious Debt in Public International Law”, UNCTAD Discussion Paper No. 185, July 2007.

<sup>3</sup> Internal Auditing Commission for Public Credit of Ecuador, Ministry of Economy and Finances of Ecuador, created on 9 July 2007 by Executive Decree 472.

working on a more responsible attitude towards lending and reconsider the possibility of furthering developing the international debt regime to ensure long-term debt sustainability<sup>4</sup>.

A unilateral repudiation of debt is hardly a realistic option, because it would have a negative effect on the country's reputation and it would cost the country too dearly with respect to new financing and investments. Therefore, the resolution of such issues could be facilitated if lenders and borrowers could refer to an agreed set of standards to observe during the negotiation of a credit facility. The parties would then not only have a common reference point in the case of a dispute, but they would also be encouraged to avoid making obvious errors during the negotiation phase. The National Supreme Audit Offices should have a deep-seated interest in a set of commonly accepted guidelines for international borrowing and lending by their governments.

## **WHY UNCTAD SHOULD WORK ON THESE ISSUES**

The annual United Nations General Assembly resolution on external debt has repeatedly stressed the importance of promoting responsible borrowing and lending, an issue that was also addressed at UNCTAD's 6<sup>th</sup> Debt Management Conference in November 2007.

In conjunction with the Debt Management Financial and Analysis System (DMFAS) Programme, UNCTAD has become a major partner in international initiatives to promote capacity-building in debt management, to engage in related policy discussions and to co-ordinate among national and multilateral agencies. The Debt and Development Finance Branch (DDFB), of which DMFAS is a major component, conducts policy research on external debt and development financing. The Branch regularly reports to the General Assembly on behalf of the UN Secretary General on durable solutions to the external debt problems of developing countries.

The moment is opportune to build upon UNCTAD's experience to seek "maximum synergies between analytical and operational activities" as mandated in paragraph 40 of the Accra Accord. The project will bring together research and operational activities within the context of strengthened consensus building – maximizing the three pillars of UNCTAD's work programme.

Illegitimate debts are normally negotiated, signed and (fully or partly) implemented before problems surface. UNCTAD is in a privileged position to study this phenomenon and could promote the issue of guidelines and warning signals to be observed during the time potentially illegitimate debts are negotiated. Such guidelines could also be applied in assessing outstanding sovereign debt which is deemed as illegitimate by both debtors and creditors.

UNCTAD could facilitate, channel information and create awareness of the present debate on illegitimate debt among NGOs, academics and, increasingly, sovereigns.

## **OUTCOMES & ACTIVITIES OF THE PROJECT**

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<sup>4</sup> Ms. Heidemarie Wiczorek-Zeul, Federal Minister for Economic Cooperation and Development, Germany, DC/S/2009-0005, April 26, 2009

It is expected that the project will entail the following concrete outcomes and related activities:

1. UNCTAD will coordinate and be the secretariat to an Ad-hoc Expert Working Group (Expert Group) to act as a source of technical and policy analysis that will inform the discussion on factors that could promote responsible sovereign borrowing and lending.

The Expert Group will be composed of individuals who act in their own professional capacity. Selected subject matter experts will be invited to its meetings. This group will not represent any national or outside interests other than the fostering of responsible sovereign lending and borrowing. The first Expert Group meeting will be held in Geneva in November 2009.

2. Develop guidelines to promote responsible sovereign lending and borrowing. In consultation with interested international organizations, academics and international and national NGOs, and based on the technical examinations under 1 above, the Expert Group will draft the Guidelines.
3. Promote discussion on the options for a structured approach to resolving defaults and disputes between sovereigns and other creditors.
4. Create a forum for the study and documentation of the practices and standards on responsible sovereign borrowing and lending and related consensus building activities. In this sense, besides the outcome of 2 above, other activities will be organized to achieve this outcome. These include:
  - 4.1. The organization of symposiums based on a call for papers on the area of the project. The outcome will be published as a series of papers in an edited collection. The tentative date for the first symposium is February/March 2010.
  - 4.2. In parallel and irrespective of the call for papers, mentioned in 4.1 above, a series of commissioned working papers will be published to enhance the discussion and research on the topic area.
5. Set up a web-based global debt portal in the form of a multi-stakeholder, multi-purpose platform on debt and development finance (DebtPortal) which will also include the DebtNet discussion forum. DebtPortal will provide global access to a range of documents and other reference resources useful to policy makers, researchers, debt managers and decision-makers involved in debt management in general.