



RESPONSIBLE SOVEREIGN LENDING AND BORROWING: THE VIEW FROM DOMESTIC JURISDICTIONS

A Comparative Survey Written for the
United Nations Conference on Trade and Development

By Matthias Goldmann
Senior Research Fellow
Max Planck Institute for Comparative Public Law and International Law
Heidelberg, Germany

February 2012 Version

Table of Contents

Table of Contents	2
Acknowledgements	3
Executive Summary	4
A. Introduction	7
B. Methodology	10
C. A Comparative View on Sovereign Borrowing and Lending	12
1. Formal Requirements of Responsible Sovereign Lending and Borrowing: Principles 1, 2, 3, 8, 10 and 11	12
(a) Agency, Principles 1 and 8	13
(i) <i>General Duty of Agents to Act in the Public Interest, Principles 1 and 8</i>	13
(ii) <i>Corruption, Principles 1 and 8</i>	14
(b) Due Diligence and Disclosure, Principles 2 and 11	15
(i) <i>Lender Due Diligence, Principle 2</i>	15
(ii) <i>Disclosure of Borrowings, Principle 11</i>	17
(c) Ensuring Due Authorization, Principle 3	18
(d) Transparency of Borrowers' Decisions, Principle 10	19
2. Material Requirements of Responsible Sovereign Lending and Borrowing: Principles 4, 6, 13 and 14	23
(a) Responsible Credit and Lending Decisions, Principles 4 and 14	23
(i) <i>Responsible Lending, Principle 4</i>	24
(ii) <i>Responsible Borrowing, Principle 14</i>	25
(b) International Cooperation, Principle 6	30
(c) Debt Management and Audits, Principle 13	31
3. Responsible Project Financing: Principles 5 and 12	32
4. Restorative Measures: Principles 7, 9 and 15	34
(a) Defenses: Principle 9	34
(i) <i>Defenses Originating in the Circumstances of the Conclusion of the Loan</i>	34
(ii) <i>Financial Necessity as a Defense outside Insolvency Proceedings</i>	35
(iii) <i>Financial Necessity as a Trigger for Insolvency Proceedings</i>	38
(b) Restructurings: Principles 7 and 15	39
D. Sovereign Lending and Borrowing – Not So Different After All?	42
E. Overview of the Legal Qualification of the Principles	42

Acknowledgements

It has been a great privilege and pleasure to collaborate for this study with a wonderful group of highly qualified researchers from all over the world. I am immensely grateful for their superb country reports which they drafted within a very short period of time as well as the useful feedback:

Argentina:	Florencia Lebensohn
Brazil:	Renata Fialho de Oliveira and Rui Dias
Chile:	Camila Saffirio and Alberto Coddou
China:	Chen Yifeng
Egypt:	Hossam Loutfi and Omaia Elwan
France:	Matthias Schmidt
India:	Saurabh Bhattacharjee, Vishwas H. Devaiah, and Vaneeta Patnaik
Japan:	Machiko Kanetake
Mexico:	Max Alberto Diener Sala
Nigeria:	Francis Chukwu
Russia:	Sergey A. Golubok
Tanzania:	Romuald Haule
UK:	Michael Waibel
United States:	Samuel B. Litton

At the institute, I am grateful for the invaluable help of my Research Assistant Miriam Freier, as well as to Professor Dr. Armin von Bogdandy for the support and latitude granted to me while working on this study. Last but not least, I would like to thank Dr. Juan Pablo Bohoslavsky from UNCTAD for inspiring comments.

Executive Summary

This study critically scrutinizes the UNCTAD Principles on Responsible Sovereign Lending and Borrowing in order to find out to what extent the Principles reflect existing or emerging general principles of law, guiding principles recognized in domestic jurisdictions, emerging principles, or mere structural principles. For this purpose, the study uses comparative law. It analyzes whether and to what extent there is a homogeneous understanding among fifteen selected jurisdictions¹ of principles relating to responsible sovereign lending and borrowing across different jurisdictions, how the legal status of such principles may be characterized, and whether any of these principles has the status of a general principle of law.

Agency, Principles 1 and 8: All jurisdictions under examination recognize that government agents are under an obligation to act in the public interest. Frequently, this obligation is of a constitutional nature. Such obligations tend to be more extensive in civil law jurisdictions where disciplinary measures are available for minor infractions, in addition to criminal sanctions. The latter are usually reserved for grave cases such as fraud, bribery, or defalcation.

All jurisdictions under examination criminalize corruption and bribery in relation to domestic officials. All of them have ratified at least one international or regional convention to that effect. The prohibition to bribe foreign officials is less widely implemented and less frequently enforced as comparable crimes on the domestic level.

Informed Decisions, Principle 2: In all jurisdictions under examination, legislation on consumer credits obliges lenders to pass on sufficient information for borrowers to understand the implications of the loan. Apart from consumer credits, however, there is little uniformity. Some jurisdictions impose significantly more demanding due diligence requirements on lenders than others. It seems difficult to extrapolate the principles applicable to consumer loans to sovereign debt transactions to the extent that structural information asymmetries between sovereign borrowers and their lenders cannot be presumed for all states.

Due Authorization, Principle 3: Under domestic private law, it is generally irrelevant for the validity of a contract concluded between private parties whether the agent of the borrower has been properly authorized to carry out the transaction. Exceptions apply if the lender is of bad faith. Also, the situation is sometimes remarkably different for contracts involving public entities, which are often considered void in the absence of proper authorization.

Responsible Lending, Principle 4: Civil law jurisdictions tend to impose specific obligations on lenders to ensure that their loans do not overburden their borrowers. In addition, in a significant number of jurisdictions, third party creditors enjoy the protection of rules about the responsibility for abusive credits which would only delay bankruptcy.

¹ Argentina, Brazil, Chile, China, Egypt, France, Germany, India, Japan, Mexico, Nigeria, Russia, Tanzania, United Kingdom, United States.

Project Financing, Principles 5 and 12: Most jurisdictions require environmental impact assessments. Not all jurisdictions go beyond this standard and explicitly require lenders to conduct specific financial and social impact assessments, even though they might be required by international standards. Post-disbursement evaluations are standard for Official Development Assistance and an emerging practice for other government-sponsored projects.

International Cooperation, Principle 6: In almost all jurisdictions under scrutiny, UN sanctions need to be implemented in order to take effect.

Restructurings, Principles 7 and 15: Certain general principles of insolvency law seem to enjoy virtually universal acceptance. Those principles include the automatic stay of other proceedings, the equality of borrowers with respect to payments, the priority of creditors holding collateral or privileges which are in the public interest, and majority decision-making by creditors. These principles could also be applied to international negotiations about, and procedures for, the rescheduling of sovereign debt. The increasing use of Collective Action Clauses and the exclusion of sovereign debt in some recent BITs points towards a consolidation of sovereign debt restructuring mechanisms on an international level.

Defenses, Principle 9: Loans resulting from corruption or extended in violation of UN sanctions are generally void. In some jurisdictions, lenders might also incur civil liability if the granting of a loan amounts to complicity in human rights violations. Natural disasters are widely recognized as a defense against claims of lenders, while the concept of odious debts remains fuzzy. By contrast, economic deteriorations rarely count as a defense. Although there are some notable cases, mostly based on the *clausula rebus sic stantibus*, the materialization of economic risks usually does not count as a reason for the modification of contractual terms. This strict rule, however, is generally justified by the possibility to file for bankruptcy. Such filing usually requires the inability of a debtor to make due payments.

Transparency of Borrowers' Decisions, Principle 10: In all examined jurisdictions, the approval of debt and guarantees is regulated by increasingly transparent procedures. Usually, debt instruments require the approval of the legislature, although the role of the legislature may vary. In some jurisdictions, the legislature needs to approve of every tranche, while other legislatures set a debt ceiling. In again other jurisdictions, the influence of the legislature is indirect, relying on its right to levy taxes. Not all jurisdictions set up medium-term financial frameworks with specific debt targets, although their number is growing. Borrowings by sub-state entities either require the approval of the central government or the administration, or a no-bailout rule provides incentives for such entities to avoid over-borrowing.

Disclosure of Borrowings, Principle 11: Almost all jurisdictions under consideration recognize a right of access to information, sometimes on a constitutional basis. A wide range of information about the state budget as well as about debt, maturities, interest rates, etc., is usually available on the internet.

Adequate Management and Monitoring, Principle 13: All jurisdictions examined have put in place post-disbursement audits. Most jurisdictions have independent, external audit offices. They may answer to the legislature or to the executive. Their reports are usually made public. Most jurisdictions have also established debt management offices.

Responsible Borrowing, Principle 14: There is a significant trend across jurisdictions to enact budget rules preventing sovereign debtors from over-borrowing. Sometimes they form part of the constitution. Particularly widespread is the use of the Golden Rule, under which debt is only acceptable for capital expenditures generating revenues greater than the interest charged upon the state. Other states use numerical debt ceilings referenced to different macroeconomic indicators. All these restrictions usually permit some degree of countercyclical deficit spending. Restrictions often apply to federal and municipal entities. The potential of international peer review mechanisms for the fostering of sustainable borrowing might not yet have been exhausted.

A table at the end of this study provides an overview on the suggested qualification of each principle.

A. Introduction

The UNCTAD Principles

The UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing (the Principles)² represent the outcome of an international collaborative effort involving experts from academia,³ civil society, and international financial institutions, as well as input received from governments and other stakeholders.⁴ The Principles aim at building consensus on the rules to be applied to sovereign debt transactions, debt management, and debt resolution in case of a debt crisis. They comprise preventive as well as restorative principles, addressing duties of both lenders (Principles 1 through 7) and borrowers (Principles 8 through 15).

As regards the preventive aspects, the principles aim at fostering sustainable and less pro-cyclical borrowing in a broad sense. On the one hand, Principles 1, 2, 3, 8, 10, and 11 provide guidance on predominantly formal and procedural aspects of sovereign lending and borrowing which should foster these goals. On the other hand, Principles 4, 6, 13 and 14 primarily address material standards of prudential borrowing which states should observe if they wish to avoid heaping up an economically unsustainable level of sovereign debt. Principles 5 and 12 on project financing cover both prudential aspects and questions of legitimacy. As regards restorative aspects, the Principles acknowledge the fact that there is no single accepted international mechanism for sovereign debt rescheduling. The interplay of Principles 7, 9, and 15 suggests some standards which might be conducive to a fair, timely and equitable resolution of debt crises caused by imprudent borrowing and lending or unexpected external shocks.

Of course, formal and material, procedural and substantive aspects mutually reinforce each other in many ways. The preceding taxonomy is merely a guide to understanding the structure of the Principles. It does not imply that each principle should be read out of context in artificial separation from the rest of the Principles.

Purpose of the Present Study

The present study critically scrutinizes the UNCTAD Principles in light of the current state of domestic and international law. It attempts to establish to what extent the Principles correspond to existing legal obligations of borrowers and lenders. In order to assess each Draft Principle accordingly, the study uses comparative law. It analyzes with respect to each principle whether and to what extent there is a homogeneous understanding of the

² The study is based on the Consolidated Principles of 10 January 2012, available at http://www.unctad.info/upload/Debt%20Portal/Principles%20drafts/Principles%20Consolidated_jan%2010.pdf.

³ See, in particular, L.C. Buchheit and G.M. Gulati, "Responsible Sovereign Lending and Borrowing", UNCTAD Discussion Paper No. 198 (2010).

⁴ For more information on the project see <http://www.unctad.info/en/Debt-Portal/>.

underlying issues across different jurisdictions or in international law. To the extent that the proposed principles find support in a large number of domestic jurisdictions and probably even in international treaties and practice, the legal character of these principles needs to be distinguished. For this purpose, I use the following taxonomy of principles:⁵

1. Some principles might reflect existing international law, in particular **General Principles of Law** in the sense of Article 38(1)(c) of the Statute of the International Court of Justice (ICJ). Those principles are applied in case of lacunae in customary or conventional law. They are usually extrapolated from domestic legal orders by means of comparative law and analogy.⁶ Most legal orders should be familiar with general principles, but not necessarily all.⁷

In addition, general principles of law should be applicable in nearly all legal orders, domestic and international, private and public ones alike. Thus, principles which are contingent upon the existence of specific institutions which only exist on the domestic level, or only in public and not in private law, may not be considered general principles.⁸ For example, basic parliamentary practices, even though in use in all democratically elected parliaments, may hardly become general principles, because they might be inapplicable in private law contexts.

2. Other common rules might be characterized as **guiding principles**, i.e. standards enjoying broad, though not necessarily universal acceptance in domestic and/or international legal orders. In contrast to General Principles of Law, their application may be more controversial. Also, guiding principles can be more specific to a particular sector of domestic or international legal orders, such as insolvency law or budgeting rules.
3. Again other principles might be called **emerging principles**. In contrast to guiding principles, they express more a trend than a settled conviction. They are about to gain support among domestic and/or international legal orders, but their acceptance may not yet be as broad as that of guiding principles.
4. Finally, **structural principles** are concepts used for descriptive purposes which guide the organization and analysis of a legal order, but do not have a legal character or represent an emerging trend. For the purposes of this study, for a rule to amount to a structural principle, it needs to exist in several legal orders, yet without reflecting a clear trend or normative preference.

⁵ This follows largely the taxonomy proposed by A. v. Bogdandy, "General Principles of International Public Authority: Sketching a Research Field", 9 *German Law Journal* (2008) 1909-38, at 1910ff.

⁶ H. Lauterpacht, *Private Law Sources and Analogies of International Law* (Archon, Hamden 1977 (orig. 1927)), 67ff. – From this type of general principle of law, one needs to distinguish general principles of international law, cf. G. Gaja, "General Principles", in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law* (2007), margin notes 17ff. They are not relevant for this study.

⁷ According to Gaja (note 6), margin note 16, the International Court of Justice is reluctant to recognize general principles when it would require controversial discussions of comparative law.

⁸ V.D. Degan, *Sources of International Law* (Nijhoff, The Hague 1997), pp. 99ff.

As this is in the first place a comparative study of domestic legal orders, I generally avoid the issue of the existence of rules of customary international law on the subject. This would require an extensive review of state practice in international relations, which would be beyond the scope of the present study.⁹

Jurisdictions under Consideration

The study is based on a set of 15 country reports, usually written by postdoctoral or doctoral fellows, professors, or practitioners with intimate knowledge of the jurisdictions concerned. The jurisdictions under consideration include

from the African Group of States:

- Egypt
- Nigeria
- Tanzania;

from the Asian Group of States:

- China
- India
- Japan;

from the Eastern European Group of States:

- the Russian Federation;

from the Latin American and Caribbean Group of States:

- Argentina
- Brazil
- Chile
- Mexico;

from the Group of Western European and Other States:

- France
- Germany
- the United Kingdom
- the United States of America.

The countries have been selected with a view to a fairly balanced geographic representation, although the limit on the number of reports that could be included led to some difficult compromises and possible lacunae. Beyond geographic representation, additional criteria such as economic significance, regional significance, the desire to

⁹ On this cf. M. Waibel, "Out of thin Air? Tracing the Origins of the UNCTAD Principles in State Practice", forthcoming 2012.

include the principal legal systems of the world¹⁰ as well as countries with different debt histories guided the selection of the jurisdictions.

Interestingly, the study ended up comprising a large number of federal states (Argentina, Brazil, Germany, India, Mexico, Nigeria, Russia, US). Although this was not intended, it might be justified because of the particular difficulties faced by federal states which need to coordinate the issuance and management of debt on different levels of government.

Public debt in the jurisdictions under consideration reaches very different levels. Some jurisdictions currently face debt crises or faced them in the past decades (e.g. Argentina, Mexico, Russia, Tanzania), some are at present highly indebted with debt levels exceeding 80% of GDP (Japan, France, Germany, Egypt), some states have mediate levels of aggregate debt of 60%-80% of GDP (Brazil, US), others enjoy debt levels of less than 40% of GDP, which might be the consequence of past restructurings or sustainable debt practices (e.g. Chile, China, Nigeria, Russia, Tanzania). Certainly, there is no fixed point where the debt/GDP ratio becomes unsustainable. Generally, the more stable and economically prosperous a country is, the more debt it might incur without high interest rates.¹¹ To take an example, while Egypt and Germany have similar debt/GDP ratios, coupon rates of Egyptian sovereign bonds amount to 14% or more, while the interest rate for German government bonds with 2 years maturity is below 1% at the time of writing. Therefore, the study comprises states at different stages of economic development, ranging from some developed states to a large number of emerging economies and some states from the developing world.

B. Methodology

The country reports follow a detailed questionnaire which requests not only information about issues mentioned in the Principles, but also includes contextual questions, relating amongst others to principles of domestic public and private law.¹² The purpose of those additional questions is to allow a meaningful assessment of the legal qualification of the proposed principles, and of the possibility of analogies from private to public law, as well as from domestic to international law.

Comparative Law

Comparative law is about comparing functions, not terminologies. It rests on the conviction that every legal system deals with fundamentally similar economic, political,

¹⁰ According to Zweigert and Kötz, a legal family is characterized by common historic roots, a distinctive mode of legal thinking, comparable legal institutions, sources of law, and underlying legal ideology. See K. Zweigert and H. Kötz, *An Introduction to Comparative Law*, 3rd edn. (OUP 1998), 67ff.

¹¹ C. Reinhart and K. Rogoff, *This Time is Different* (2009), 27ff.

¹² The questionnaire is available at <http://ssrn.com/abstract=1958314>.

and social problems.¹³ Certainly, it is not easy to identify similar economic, political, or social problems. What looks similar at first sight might have different implications in different societies. Also, different legal rules for similar problems might stem from different cultural traditions or epistemological structures, which the functional approach tends to overlook.¹⁴ However, in the case of public debt issues, such difficulties of comparative law are mitigated by the fact that the legal framework for public debt instruments are relatively homogeneous all over the world, and that cultural differences are considerably less significant for budgeting rules than for family or criminal law. Also, sovereign debt crises are administered by a number of international institutions, formal ones like the International Monetary Fund, or informal ones like the Paris and London Clubs. It seems therefore possible to identify similar structures and functions and to compare the law applicable to them.

This study mainly compares the law as a normative phenomenon, not as social reality. Although some of the items mentioned in the questionnaire refer to actual enforcement, one could blame it for its blindness towards social reality. Certainly, the actual role of law and its relationship with politics might be different from one society to another.¹⁵ However, the purpose of this study is predominantly normative. It inquires to what extent the Principles reflect existing *normative convictions*, not necessarily existing *social reality*.

Analogies

In domestic contexts, with the exception of criminal law, courts often use analogies in order to fill lacunae in the law. An analogy requires (1) a lacuna in the positive law which appears to be normatively inconsistent; (2) and a second legal rule which appears to be normatively appropriate to fill the lacuna by virtue of a general principle expressed in that second rule.¹⁶

Some international lawyers have raised doubts about analogies. They fear that analogies might unduly extend the international obligations to which states have given their consent.¹⁷ The International Court of Justice (ICJ), by contrast, has taken recourse to analogies in a number of cases. For example, in the *Nicaragua* case, it applied principles of treaty law to unilateral declarations pursuant to Article 36(2) of its Statute.¹⁸ Indeed,

¹³ Zweigert/Kötz (note 10), 34ff.

¹⁴ On cultural differences J. Bell, "Comparative Law and Legal Theory", in W. Krawietz, N. MacCormick, G. Henrik von Wright (eds), *Prescriptive Formality and Normative Rationality in Modern Legal Systems* (Duncker & Humblot 1995), 23-31, at 26; on structural differences G. Samuel, "Comparative Law and Jurisprudence", 47 *International and Comparative Law Quarterly* (1998) 818-36, at 827ff.

¹⁵ Cf. U. Mattei, "Three Patterns of Law: Taxonomy and Change in the World's Legal System", 45 *American Journal of Comparative Law* (1997), 5-41, at 12ff.

¹⁶ K. Larenz and C.-W. Canaris, *Methodenlehre*, 3rd edn. (Springer, Heidelberg 1995), 202ff. For a powerful defense of analogical reasoning see L.L. Weinreb, *Legal Reason. The Use of Analogy in Legal Argument* (Cambridge University Press 2005), 65ff.

¹⁷ E.g. D. Anzilotti, *Corso di diritto internazionale*, vol 1, 4th ed. (Athenaeum, Rome 1955), p. 106.

¹⁸ ICJ, *Case concerning Military and Paramilitary Activities in and against Nicaragua* (Jurisdiction and Admissibility), ICJ Rep. 1984, p. 392, at 420; for further examples see A. Bleckmann, "Analogie im

analogies appear to be a necessary element of every legal order properly so speaking. They are almost inevitable since it is impossible to lay down a specific rule for every case which may ever arise.¹⁹

There is also an intimate connection between analogies and general principles of law. Unless the latter originate genuinely on the international level, they consist of extrapolations of widely shared concepts of domestic private or public law to the international level.²⁰ For example, the concept of estoppels, usually considered a general principle of law, derived from domestic legal orders where it enjoys almost universal acceptance, albeit with varying terminology. Comparative law is thus at the basis of such general principles. It is a prerequisite for any transfer of legal principles from domestic law to the international level.

However, analogical reasoning has its limits. Explicit opposing rules render analogical arguments impermissible. Also, the specific institutional context of domestic and international levels of government need to be taken into account when considering whether an analogy might be appropriate, or whether the widespread acceptance of a rule in domestic legal orders might justify considering it as the expression of a general principle of law. The subsequent study needs to take into account these limitations.

C. A Comparative View on Sovereign Borrowing and Lending

This section discusses the results which derive from a comparative reading of the country reports. In line with the functional approach of this study, it follows the taxonomy of the principles set out in the introduction, distinguishing principles aimed at fostering formal requirements for responsible lending and borrowing (1.), at material requirements for responsible lending and borrowing practices (2.), at responsible project financing (3.), as well as at restorative measures to be taken in case of debt crises (4.). As has been emphasized above, this taxonomy should not be understood as implying that the principles listed under each heading *only* target formal or material aspects. Rather, I fully recognize the interrelated nature of many of the principles. Formal and material requirements mutually reinforce each other, and restorative measures must be tailored so as to complement, not to jeopardize standards of responsible lending and borrowing.

1. Formal Requirements of Responsible Sovereign Lending and Borrowing: Principles 1, 2, 3, 8, 10 and 11

Völkerrecht", 17 *Archiv des Völkerrechts* (1977-78) 161-180; S. Vöneky, "Analogy in International Law", in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law* (OUP 2008), margin notes 7ff.

¹⁹ Weinreb (note 16), at 13.

²⁰ Cf. Lauterpacht (note 6), at 60ff.

(a) Agency, Principles 1 and 8

Principle 1 – Agency: Lenders should recognize that government officials involved in sovereign lending and borrowing transactions are responsible for protecting public interest (to the State and its citizens for which they are acting as agents).

Principle 8 – Agency: Governments are agents of the State and, as such, when they contract debt obligations, they have a responsibility to protect the interests of their citizens. Where applicable, borrowers should also consider the responsibility of lenders' agents toward their organizations.

Explanation: On a general level, Principles 1 and 8 stipulate that public officials are required to act in the public interest and are prohibited from pursuing private ends. Lenders must recognize such duties (i). The explanation of their implications specifically refers to corruption and bribery as particularly evident and grave violations of fiduciary duties. It makes reference to domestic law as well as international and regional conventions against bribery in order to determine the legality of behavior (ii).

(i) General Duty of Agents to Act in the Public Interest, Principles 1 and 8

Results: All jurisdictions under examination recognize some duty to act in the public interest. Frequently, they have the status of constitutional duties,²¹ or are set out in sometimes comprehensive statutory codifications.²² The content of these duties varies. Generally, in civil law jurisdictions, they comprise a host of different, specific duties, such as a duty of loyalty, of impartiality and efficiency. Disciplinary measures are available to enforce these duties, while only a core of them may be enforced with criminal law sanctions.

The situation is different in common law jurisdictions, where disciplinary sanctions are usually unknown. Courts in the United Kingdom recognize fiduciary duties of local public officials towards their taxpayers, but those duties can hardly be enforced. Only behavior amounting to the crime of “misconduct in public office” may lead to enforcement. As a criminal sanction, this crime has received a narrow interpretation by courts. The situation is similar in the United States. Under 18 U.S.C. §§ 1341-60, failure to provide “honest services” may lead to criminal sanctions. In *United States v. Mandel* (1979), the Federal Court of Appeals for the 4th Circuit gave a broad reading to the honest services provision, which resembles the broad understanding of duties to act in the public interest in civil law jurisdictions. However, the Supreme Court subsequently narrowed the reach of the honest services provision. In 1988, Congress enacted § 1346, reinstating the honest services provision. Again, in *Skilling v. United States* (2010), the Supreme Court gave this provision a relatively narrow reading, concluding that it prohibited “at least bribes and kickbacks”. It added that a broader reading may raise due process concerns. This

²¹ Brazil, Chile, China, Germany, Japan, Mexico, Nigeria.

²² Argentina, Russia, Tanzania, United States.

reasoning reveals that the Supreme Court did not imply that, outside the narrowly defined scope of criminal law, public servants may behave as they want, but that criminal sanctions may not be an appropriate sanction in all cases where the acts of public officials are not in conformity with the public interest.

That broad duties to act in the public interest are not completely foreign to common law jurisdictions follows from the fact that in corporate or agency contexts, US law recognizes broader fiduciary duties. Also, Nigeria is a common law jurisdiction which acknowledges a broad range of duties geared towards preventing the abuse of public funds. And in India, a duty of public servants to act in the public interest underlies all administrative law. It is implicit in the oath of office.

In conclusion, there is a broad conviction across the examined jurisdictions that public officials need to act in the public interest, even though only some violations might entail criminal sanctions. In its abstract form, without prejudice to the specific content of this duty in specific jurisdictions, it has the status of a general principle of law.

(ii) Corruption, Principles 1 and 8

Results: Most jurisdictions under examination have ratified or at least signed the UN Convention against Corruption, and most states have ratified the respective regional conventions such as the OECD Anti-Bribery Convention and the Interamerican Convention against Corruption.

In all examined jurisdictions, domestic criminal law criminalizes the giving and acceptance of bribes and other favors to *domestic* public officials. Those provisions largely overlap with criminal sanctions for the violation of fiduciary duties. The precise content of these provisions varies. In some jurisdictions they are quite far-reaching, criminalizing even indirect forms of corruption where there is no direct connection between the undue favor and a particular act or forbearance on the part of the public official.²³ Aiding and abetting such crimes as well as their attempt is also commonly punishable.

The situation looks somewhat different in respect of favors given to *foreign* officials or officials of international organizations. Criminalization of such acts is still less widespread. Presently, India is considering adopting such legislation, while Russia enacted such legislation in 2011. Sanctions for the bribery of foreign or international officials are sometimes less heavy than those which may be imposed for bribery committed in a purely domestic context.²⁴ Also, the scope of the criminal provisions is sometimes more narrow. For example, German law only criminalizes the giving of favors to foreign officials or officials of international organizations if the desired act or forbearance would be in

²³ E.g. India, Japan, United States, Argentina. However, in India, prosecutions require the approval of the appropriate authority.

²⁴ E.g. Brazil.

violation of that official's duties.²⁵ By contrast, if it comes to actual enforcement of provisions against the bribery of foreign officials, besides United States, Germany is among the more positive examples with a handful of cases each year. Many states seem to have little actual implementation of such provisions; in some cases, very few or no cases have been reported.

But in spite of the differences between domestic and foreign cases, and even though there are some deficits in enforcement, it can be said that there is a widespread and growing conviction among the states examined that domestic, foreign or international officials may not be bribed in order to conclude any kind of transaction in violation of the official's fiduciary duties.

(b) Due Diligence and Disclosure, Principles 2 and 11

Principle 2 – Informed Decisions: Lenders have a responsibility to provide information to their sovereign customers to assist borrowers in making informed credit decisions.

Principle 11 – Disclosure: Relevant terms and conditions of a financing agreement should be disclosed by the sovereign borrower, be universally available, and be freely accessible in a timely manner through online means to all stakeholders, including citizens. Sovereign debtors have a responsibility to disclose complete and accurate information on their economic and financial situation that conforms to standardized reporting requirements and is relevant to their debt situation. Governments should respond openly to requests for related information from relevant parties. Legal restrictions to disclosing information should be based on evident public interest and be used reasonably.

Explanation: Responsible lending and borrowing cannot be expected to come forward without sound information.²⁶ This idea requires lenders to exercise due diligence and ensure their borrowers understand the terms of the engagement (Principle 2). And only if lenders have full knowledge of a borrower country's financial situation, they will be able to make reasoned decisions and market discipline is likely to work as an effective constraint on sovereign borrowing (Principle 11).

(i) Lender Due Diligence, Principle 2

Results: Almost all jurisdictions under examination have put in place legislation for the regulation of consumer credits.²⁷ In most jurisdictions, borrowers have to provide consumers with sufficient information about the contractual conditions before the loan

²⁵ Cf. § 1 Gesetz über die Bekämpfung der Bestechung ausländischer Amtsträger im internationalen Geschäftsverkehr, BGBl. II (1998) 2327.

²⁶ Cf. Implications of Principle 4, fifth bullet point.

²⁷ The exception seems to be Tanzania.

is concluded.²⁸ Some jurisdictions do not require a high degree of due diligence, but rather rely on the borrower's own foresight. In the European Union, those duties are rooted in an EU directive. It does not require lenders to ensure that the borrower has *actual* knowledge, since EU law generally holds consumers to be capable of managing their own affairs provided they receive all relevant information.²⁹ In China there is at present no comprehensive consumer loan regulation. However, China has enacted some regulations applicable to private mortgage loans. Likewise, some US states have adopted legislation against predatory lending practices. Egypt recognizes some basic rights of consumers against unfair practices, under which consumers may rescind contracts.

By contrast, other legal systems have put in place more demanding regulations, which do not only protect consumers. The law of Argentina especially recognizes information asymmetries between the parties to a contract, especially if the contract requires trust among the parties.³⁰ This is considered to be the case for the contractual relationships between financial institutions and their customers. Other jurisdictions recognize even further-reaching duties of due diligence. Indian law obliges lenders to ensure that the borrower has full knowledge of the implications of the contract. Under Japanese law, the principle of good faith requires the party setting up a contract to explain its terms to the other party. Also, banks are required to provide specific explanations if the borrower is an individual or the owner of a small business. In France, the Code monétaire et financier stipulates a duty of financial institutions to inform their clients.

In sum, the widespread nature of consumer loan regulations gives rise to a guiding principle. In spite of many differences in the details, almost all jurisdictions recognize that there is a structural information asymmetry between consumers and financial institutions, which justify requiring diverging forms of due diligence from lenders. Apart from consumer protection, however, practices diverge. Although most jurisdictions recognize some form of a duty of loyalty of banks towards their customers, this does not necessarily charge them with the responsibility to ensure their clients understand all contractual terms. This fact makes it difficult to extrapolate the rules applicable to consumer loans to sovereign debt transactions. While some states, in particular developing ones with less sophisticated budget control systems, might actually stand in a relationship of asymmetrical information towards their lenders, this is not necessarily true for all states, or all states of a certain level of economic development. States are still generally presumed to be sovereign and capable of mastering their financial affairs, although the growing degree of sophistication of modern governance puts this notion under stress.³¹ For these reasons, one could at best speak of an emerging principle which reflects a good sense of realism, reasonable banking practice, and basic ideas of fairness.

²⁸ In Argentina, where Art. 42(1) of the Constitution entitles consumers to the protection of their economic interests, Communication A 4621 (2007) of the Argentine Central Bank requires financial institutions to inform consumers of the interest rate and total financial costs of a loan, and specifies the form in which this information has to be presented in order to ensure that consumers are able to understand.

²⁹ E.g. ECJ *Margarine*, C-261/81, judgment of 10 November 1982.

³⁰ Art. 909, Civil Code.

³¹ Cf. on the related problem of reporting obligations K. Davis and B. Kingsbury, "Obligation Overload. Adjusting the Obligations of Fragile or Failed States", draft, November 2010, available at <http://www.iilj.org/courses/documents/HC2010Dec01.DavisKingsbury.pdf>.

(ii) Disclosure of Borrowings, Principle 11

Results: The country reports reveal that in all jurisdictions examined, domestic debt instruments are exempt from the disclosure obligations which apply to commercial securities. Therefore, transparency of the financial situation of a borrowing state is essential in order to allow for market discipline.

Most jurisdictions recognize a general right of access to information and public records. Sometimes this right has a constitutional basis, such as in Brazil, Mexico, and also in India, where the right to obtain information is considered as an aspect of fundamental rights protection. In France, this right has been characterized as a “liberté publique”, which means that decisions on requests for access to information are subject to judicial review. In Tanzania, a general right of access to information is recognized in the constitution. However, it has not been further spelled out in legislation. Even though the current President has promoted the transparency of government and the administration, access remains difficult. In jurisdictions without a constitutional right of access to information, such a right has been granted on a legislative basis in most areas of government and administration. This right is generally held to comprise access to budgetary information. The only exception is Egypt, where traditional principles of administrative secrecy prevail.

Nevertheless, in all states under examination, including Egypt, information on the budget is available on the internet, sometimes in English translations where the official language is not English. The information revealed about the budget mostly includes detailed information about outstanding debt, maturities, rates, contractual terms³² and other specifications. It is usually made available on the website of parliament or the Treasury, and it is updated sometimes on a quarterly, sometimes on a day-to-day basis. Exemptions to the right of access to information apply where the protection of privacy, national security and other essential interests so requires. Some jurisdictions like Japan and Germany explicitly mention fiscal interests and possible market disruptions as reasons for denying access to information.

On the whole, it seems possible by now to characterize the right of access to information, including budgetary information, as a guiding principle which is about to become a general principle of law. The publication of information on the budget and debt corresponds to a guiding principle, given to its widespread acceptance.

³² Exception: China.

(c) Ensuring Due Authorization, Principle 3

Principle 3 – Due Authorization: Lenders have a responsibility to determine, to the best of their ability, whether the financing has been appropriately authorized and whether the resulting credit agreements are valid and enforceable under relevant jurisdiction/s.

Results: The comparative survey reveals differences in treatment between agreements concluded between private parties and agreements in which a public party is involved. In the jurisdictions under examination, it generally does not affect the validity of a credit transaction between *private* parties if the agent of the borrower oversteps internal limits of his powers which do not affect his agency powers, as long as the lender is of good faith and has reason to presume that the borrower has been duly authorized.³³ The doctrinal concepts and terminology used to achieve this result vary. Thus, in the United Kingdom, the principal may be estopped from invoking the agent's lack of authority, while lenders in Germany and the United States may rely on apparent authority. Irrespective of these principles, banks in most jurisdictions require proof of authorization when concluding a loan agreement with an agent.

Agreements concluded with public counterparties receive a different treatment in a number of jurisdictions:³⁴ Unauthorized loans are considered void even if there might have been apparent authority or a case of estoppel. This difference in treatment seems to derive from the idea that limitations on the authority of state agents and representatives of public entities are presumed to be known, and that public entities also need to be protected against unauthorized acts of their agents. This position finds support in the famous *Tinoco Concession Arbitration*, in which the Costa Rican government had violated its internal law.³⁵ The Tanzanian rule which stipulates that members of the government are to be considered authorized when concluding loan agreements for the state confirms the general rule that other public officials may not automatically be presumed to be duly authorized. Similarly, under international treaty law, only Heads of State and Government and Foreign Ministers may be presumed to have unlimited authority to conclude binding international obligations.³⁶

Although widespread, this conviction is not universally shared. In the case *First Fidelity vs. Antigua and Barbuda* (1989), the Federal Court of Appeals for the 2nd Circuit held that the authority of state representatives such as an ambassador may be presumed under the apparent authority doctrine.³⁷ Although this is the only notable case that was reported, other jurisdictions also do not seem to treat public borrowers differently from private ones.³⁸ It should, however, be noted that the US or its states or entities were not

³³ E.g. Brazil, China, Germany, Japan, France, UK, USA.

³⁴ E.g. Brazil, China, Germany, Japan, Nigeria.

³⁵ *Great Britain v. Costa Rica*, 18 *American Journal of International Law* (1924) 147.

³⁶ Cf. Art. 7(2)(a) of the Vienna Convention on the Law of Treaties.

³⁷ 84 *American Journal of International Law* (1990) 560. The court eventually rejected the claim for reasons of state immunity.

³⁸ E.g. India, Chile.

parties to the agreement at issue and that US courts might not consider it their duty to enforce the internal law and public policy interests of other states.

In light of these findings, it would be difficult to conclude that there is a general principle of law to the effect that loans to public borrowers are always invalid unless properly authorized. Nevertheless, since this rule applies in many jurisdictions, it might be characterized as an emerging principle which reflects good and reasonable practice. And the analysis of comparative private law renders the conclusion that there is a general principle of law that for a contract to be valid, the counterparty (borrower) needs to have at least prima facie authority, while the other party (lender) must not be of bad faith in this respect.

(d) Transparency of Borrowers' Decisions, Principle 10

Principle 10 – Transparency: The process for obtaining financing and assuming sovereign debt obligations and liabilities should be transparent. Governments have a responsibility to put in place and implement a comprehensive legal framework that clearly defines authorities, procedures, responsibilities and accountabilities. They should particularly put in place arrangements to ensure the proper approval and oversight of official borrowings and other forms of financing, including guarantees made by State-related entities.

Explanation: In the first place, this principle addresses the formal requirements for approval and oversight. In this respect, this principle is a corollary of the third principle. Lenders may only be held to ensure proper authorization if the approval process is transparent. Researchers were therefore asked to assess the transparency of the domestic approval of public debt, and in particular to provide information about the involvement of the legislature. The underlying assumption is that such involvement may reinforce the transparency of borrowings. In addition, transparent procedures for debt approval might enhance prudential borrowing practices, since it increases the likelihood that unsustainable debt practices will be criticized and stopped. Insofar as this is the case, the idea of transparency relates closely to that of responsible borrowing (see Principle 14 below).

Results: The transparency of borrowings touches upon the general issue of fiscal transparency. This topic has received much attention by policy-makers during the last decade. It was in particular the IMF who promoted fiscal transparency among its members.³⁹ Its programme for fiscal transparency relates to both the decision-making process as well as the transparency of fiscal data. While the latter is addressed by Principle 11 (see above), the findings concerning the decision-making process are discussed here. Many of the countries under examination have made their fiscal process more transparent over the last few years. In particular, emerging countries have adopted fiscal responsibility laws which strengthen transparency and accountability in the

³⁹ E.g. IMF, Manual on Fiscal Transparency (2007).

decision-making process.⁴⁰ The European Union recently adopted the European semester, an ex-ante review of domestic budget proposals on Union level.⁴¹ In light of these developments, which leave almost none of the states under consideration unaffected, one might speak of a guiding principle of transparency in fiscal policy-making.

Issues of particular significance for the transparency of the decision-making process include the involvement of the legislature, mid-term financial frameworks, and transparency on the level of sub-state entities. Each of these issues deserves specific consideration.

Influence of the Legislature

In all examined jurisdictions, the legislature is involved in the adoption of the budget and the approval of borrowings. Beyond that, however, there are many differences in detail. As regards the approval of the budget, the relationship between the legislative and executive powers varies from one jurisdiction to another. In most jurisdictions under examination, and in particular in the United States,⁴² the legislative bodies play a central role in the adoption of the budget. France's 2001 organic law on financial bills expanded the powers of parliament. It is now entitled to receive detailed information and performance estimates about proposed expenses from the executive in the course of the budgeting process. Except for the United States, jurisdictions with bicameral legislatures tend to concentrate budgeting powers in one chamber.⁴³

By contrast, in some jurisdictions, the role of the legislature is a more reactive one. For example, in Chile, the budget proposal is considered approved unless parliament vetoes it within 60 days. In India, parliament needs to approve the annual financial statement, but may not modify some of its items. In the UK, the executive could in principle make expenses without parliamentary approval, but the influence of Parliament is guaranteed by its exclusive right to levy taxes. In this way, Parliament may only decrease expenditures proposed by the government. Government presents a budget report twice a year, which includes data on spending and debt. There is no budgeting committee for ex-ante examinations of the budget.⁴⁴ In China, the National Peoples' Congress adopts the budget, but may not amend it. While additional revenues do not require budget amendments, additional debt always needs legislative approval.⁴⁵

⁴⁰ Cf. I. Lienert, "Should Advanced Countries Adopt a Fiscal Responsibility Law?", IMF Working Paper No. 254 (2010).

⁴¹ Article 2-a, Regulation 1466/97 as amended by Regulation 1175/2011, Official Journal L 306, 23 November 2011, 12 ff.

⁴² Regarding its budgetary powers, Congress has been characterized as the most powerful parliament in the world. Cf. J.R. Blöndal, D.-J. Kraan and M. Ruffner, "Budgeting in the United States", 3 *OECD Journal on Budgeting* (2003), No. 2, p. 18.

⁴³ I. Lienert, M.-K. Jung, "The Legal Framework for Budget Systems", 4 *OECD Journal on Budgeting* (2004), No. 3, 70f.

⁴⁴ On budgeting committees see *ibid.*, 71f.

⁴⁵ Art. 53, Chinese Budgetary Law. For a detailed analysis see S. Deng and J. Peng, "Reforming the Budgeting Process in China", 11 *OECD Journal on Budgeting* (2011), No. 1, 75-89.

Beyond these differences, in many of the jurisdictions examined, the budget is concretized in a process extending over various stages from pre-budget proposals to the final vote (if applicable). Also, the budgets of the examined jurisdictions generally included the budgets of the armed forces. The exception is Chile, whose armed forces are entitled to 10% of the revenues of the state-owned copper mining company, which are kept off the budget. However, in 2011, a bill has been introduced in order to abolish this privilege.

Like the annual budget, decisions about the incurrence of debt and the extension of official guarantees are subject to legislative approval in practically all jurisdictions under examination. Such approvals are sometimes made in connection with the adoption of the annual budget law. Notable exceptions to this rule are India and the UK, where public debt, strictly speaking, does not require legislative approval. However, in both jurisdictions, parliament has indirect control over public debt through its power over the budgetary process or taxation. In addition, the Indian constitution grants parliament the power to set a debt ceiling, which it has not done yet, and to limit the total amount of official guarantees, of which it has made use.

The extent to which the legislature controls the incurrence of debt also varies. In the United States, Congress has delegated the power to borrow money to the Treasury Department up to the exhaustion of a specific debt ceiling. Beyond that, Congress has imposed a “pay-as-you-go” rule which is meant to impose self-discipline on congressional spending. After the Gramm-Rudman-Hollings Act of 1985 had been declared unconstitutional, which set obligatory debt ceilings, Congress enacted legislation requiring every legislative project creating expenses or cuts in revenues not provided for in the budget to identify a source of funding (pay-as-you-go).⁴⁶ Pay-as-you-go later became a House and Senate rule and has been reintroduced with broad exceptions into legislation in 2010.⁴⁷ So far, the rule did not prevent aggregate debt to rise, making it necessary to raise the Congressional debt ceiling repeatedly. – A similar pay-as-you-go rule applies in Argentina. In Germany, the federal government may veto any legislative project which reduces revenues or causes costs not provided for in the current budget.⁴⁸ However, it should not come as a surprise that this rule remained largely without any practical impact in a parliamentary system of government.

In the UK, the Treasury enjoys considerable discretion regarding the issue of bills and loans. By contrast, in Brazil, the Chamber of Deputies approves of each tranche specifically within debt limit set by the Senate. In Germany, the Constitutional Court decided in 2011 that parliament must not only approve of the total amount of guarantees extended to credit operations by international institutions, but that the budget committee needs to approve of each credit facility set up by such institution with the consent of the German government, provided that it involves financial risks for

⁴⁶ Cf. the Budget Enforcement Act (1990) which succeeded the Gramm-Rudman-Hollings Act and expired in 2002.

⁴⁷ Statutory Pay-As-You-Go Act, 12 February 2010, Public Law 111-139.

⁴⁸ Art. 113(1) of the Basic Law.

Germany of a considerable quantity.⁴⁹ In Chile, the legislative approval of debt with maturities exceeding the presidential term requires a higher majority.

A minority of the jurisdictions under examination allow the executive to take recourse to emergency borrowings under certain, restrictive conditions.⁵⁰ Most jurisdictions, however, require such borrowings to be subject to parliamentary approval.

In sum, since the legislature is involved in borrowings in all jurisdictions under examination, either directly or indirectly by virtue of its power over the budget or taxation, one could speak of a guiding principle. It could not be considered a general principle of law because it hinges on the political system in place in a particular state. Not all UN Member States have parliamentary assemblies on the domestic level. Beyond that, there is great variance in detail. In general, it seems that in jurisdictions influenced by the common law, with the notable exception of Nigeria, the legislature plays a more reduced role. Some models like the pay-as-you-go rule have the status of structural principles, but are too context-sensitive to be considered emerging principles.

Medium-term Financial Frameworks

The comparative survey reveals that not all countries under examination develop and maintain medium-term financial frameworks. The more developed economies and some emerging ones now use this planning tool.⁵¹ Sometimes they expand over three years, like in case of Germany or France, and sometimes over five years, like in Mexico, the UK and the United States. China and India use five year plans which contain growth targets, but do not include deficit or debt targets. EU legislation obliges the member states to set up medium-term budgetary frameworks extending over at least three years,⁵² to submit stability programmes defining, *inter alia*, a medium-term budgetary objective ranging between -1% of GDP and surplus, as well as adjustment paths towards that objective.⁵³ Considering the fact that medium-term financial frameworks have gained such popularity during the last decades, one might consider their establishment an emerging principle.

Sub-state Entities

Although transparency is on the rise for the budgets of sub-state entities, there is little uniformity regarding their treatment.⁵⁴ Among federal states, one can distinguish two competing structural principles. The first is what I call the “control model” and the second is the “incentive model”. Under the former, state debt is subject to federal

⁴⁹ Bundesverfassungsgericht, judgment of 7 September 2011, Case 2 BvR 987/10 et al.

⁵⁰ Argentina, Brazil, France, India. The issue is currently under debate in the United States. In the UK, government does not require parliamentary approval for the incurrence of debt (see supra).

⁵¹ Reported for Germany, France, Chile, Japan, Nigeria, and the UK. In the US, the case is controversial.

⁵² Articles 9-10, Directive 2011/85/EU, OJ L 306, 23 November 2011, 41-47.

⁵³ Article 2a, Regulation 1466/97 as amended by Regulation 1175/2011, Official Journal L 306, 23 November 2011, 12ff.

⁵⁴ This term is meant to comprise federal states, devolved administrations, and local governments.

approvals or debt ceilings.⁵⁵ Under the latter, federal states enjoy budgetary autonomy, including the right to borrow money. In the US, instead of mechanisms of control, a strict no-bailout rule imposes budgetary discipline. Germany seems to be moving from the incentive model to the control model. It recently introduced a dynamic constitutional debt ceiling for state budgets.⁵⁶ Also, being part of the Euro area and subject to its Stability and Growth Pact, there was a need to establish a committee of federal and state governments charged with the task of ensuring overall budgetary stability.⁵⁷

In most jurisdictions under examination, the budgets of local governments are subject to governmental approval or supervision.⁵⁸ This has proved to be very effective as a means for curbing structural deficits.⁵⁹ Also, local governments can increase transparency by taking a decision in town councils or, like in China, local peoples' congresses.

2. Material Requirements of Responsible Sovereign Lending and Borrowing: Principles 4, 6, 13 and 14

(a) Responsible Credit and Lending Decisions, Principles 4 and 14

Principle 4 – Responsible Credit Decisions: A lender has a responsibility to make a realistic assessment of the sovereign borrower's capacity to service a loan based on the best available information and following objective and agreed technical rules on due diligence and national accounts.

Principle 14 – Avoiding Incidences of Over-Borrowing: Governments have a responsibility to weigh costs and benefits when seeking sovereign loans. They should seek a sovereign loan if it would permit additional public or private investment, with a prospective social return at least equal to the likely interest rate.

Explanation: Principles 4 and 14 are closely intertwined. Both lenders and borrowers need to take precautions in order to avoid unsustainable borrowing practices. While Principles 2 and 11 address information as a prerequisite of sound decision-making, Principles 4 and 14 take issue with the substance of the decisions which lenders and borrowers must take. Principle 4 stipulates the precautions lenders should take in order to avoid losses by defaulting credits, including a careful assessment of the borrower's

⁵⁵ E.g. Argentina, Brazil, India, Mexico. Devolved administrations in the UK may only borrow to meet short term cash flow needs.

⁵⁶ See below, C.2.b.ii.

⁵⁷ Gesetz zur Errichtung eines Stabilitätsrates und zur Vermeidung von Haushaltsnotlagen, 10 August 2009, BGBl. I (2009) 2702.

⁵⁸ E.g. Brazil, Germany.

⁵⁹ U. Wagschal, "Allheilmittel oder Budgetmimikry: Wie wirksam sind Verschuldungsgrenzen zur Haushaltskonsolidierung?", 9 *Journal for Comparative Government and European Policy* (2011) 352-382, at 361.

financial capacity and avoiding undue political influence. Principle 14 sets out the internal measures lenders should take in order to keep their debt at sustainable levels. International surveillance mechanisms might guide these efforts.

(i) Responsible Lending, Principle 4

Results: Domestic bank regulation in a significant number of the jurisdictions under examination obliges lenders to assess the capacity of borrowers to service their loans. The exact content of these obligations varies. Lenders usually have to exercise greater care when dealing with consumers. The law of Argentina requires commercial lenders to collect extensive documentation about the income and patrimony of the borrower, including information about the profitability of the company or project to be financed.⁶⁰ German law requires financial institutions to collect information about the economic situation of borrowers of large commercial credits and to assess the creditworthiness of consumers before extending credit to them. In other jurisdictions, such as France, China,⁶¹ Japan, and Mexico, banking regulations require strict income assessments in order to avoid over-borrowing. Mexican law, for one, contains detailed regulations for the assessment of a borrower's financial capacity, requiring consideration of both quantitative and qualitative indicators. At the other end of the scale, Russia, Nigeria, the UK and the US do not have such rules in place. In the UK, however, government is obliged to examine the capacity of the potential beneficiary of a guarantee before extending it.

Thus, the dividing line on this issue runs largely between civil law and common law jurisdictions. This stands in the way of qualifying such prudential rules as general principles of law. Nevertheless, considering the role of the lack of information about borrowers and of loans extended to "NINJAs" (persons without income, job, and assets) during the global financial crisis, one might well qualify the common essence of such standards of responsible credit decisions as an emerging principle of financial regulation. Extrapolating this principle to sovereign lending, as proposed by Principle 4, does not seem to be unwarranted, since its underlying ratio, the protection of lenders, is also to be considered in the context of sovereign debt.

Another aspect which corroborates the duties stipulated in Principle 4 is the fact that in many of the examined jurisdictions, banks which do not carefully examine the financial capacity of borrowers face liability.⁶² Abusive creditors may have to bear the damage caused to other creditors of an insolvent company by an unwarranted postponement of insolvency proceedings facilitated by a loan extended only in order to delay insolvency and possibly to benefit from such delay. The abusive character of a loan agreement may not be assumed lightly. Most jurisdictions require not only knowledge of the bank of the

⁶⁰ The Regulation contains some exceptions for minor credits and mortgage loans. Cf. Central Bank of Argentina, Regulation of June 2011, http://www.bcra.gov.ar/pdfs/macro/macro_normativo.pdf, at 8.

⁶¹ Those rules only apply to commercial banks.

⁶² J.P. Bohoslavsky, *Créditos Abusivos* (Abaco, Buenos Aires 2009), 215ff.; F. Di Marzio, *Abuso nella concessione del credito* (Ed. Scientifiche Italiane, Naples 2004), 167ff.

insolvency of the borrower, but also some form of fraudulent intent.⁶³ While domestic law differs on some details, there seems to be such a degree of consensus on this issue that one might speak of a general principle of liability for abusive lending.

(ii) Responsible Borrowing, Principle 14

A significant number of states have taken measures to avoid over-borrowing going beyond the procedural safeguards addressed by Principle 10, such as the requirement of a legislative approval for borrowings. Although procedural safeguards might create incentives for prudential borrowing practices, the recent debt history in particular of the developed world shows that they might not suffice in order to protect states against excessive, unsustainable levels of public debt. Indeed, while procedural safeguards might help to ensure that governments respect the interests of the present population, future generations have no voice in the approval process. Such considerations seem to be the reason for a remarkable move towards material restrictions on sovereign borrowing. A growing number of states have adopted provisions which aim at keeping debt at a macroeconomically sustainable level.⁶⁴

The nature and content of these provisions varies greatly. In some states, debt or deficit ceilings are included in the constitution or in legislation. Other governments introduced debt ceilings in the form of non-binding commitments. The content of these rules sometimes reflects diverging fiscal policy approaches. While some rules are relatively rigid, others allow for more flexibility in counter-cyclical spending. The following text focuses on the main models in use in the jurisdictions under examination, namely the Golden Rule and numerical debt ceilings.⁶⁵

Under the Golden Rule, debt may only be incurred for investments which generate revenues exceeding the cost of financing. In Nigeria, government may only borrow for capital expenditures and human development at low interest rates and reasonably long amortization periods.⁶⁶ In the UK, an informal golden rule applies which requires government to borrow only for investments and not in order to fund structural deficits. The Mexican constitution allows deficit spending for projects which directly increase public revenue, but otherwise contains a zero deficit rule. An exemption applies in case

⁶³ France (Sec. 650, Code de commerce); Germany (Sec. 826, German Civil Code, cf. Federal Court of Justice, judgment of 9 December 1969, NJW (1970), 657ff.); United States (Sec. 548 Bankruptcy Code); UK (Sec. 213 and 214, Insolvency Act). Similar restrictions apply in Chile. Argentina, by contrast, only requires negligence. Cf. Bohoslavsky (note 62), at 281ff.; J.P. Bohoslavsky, "Lending and Sovereign Insolvency: A Fair and Efficient Criterion to Distribute Losses among Creditors", 2 *Goettingen Journal of International Law* (2010) 387-412.

⁶⁴ Some countries include those rules in their fiscal responsibility laws. However, fiscal responsibility laws are mainly about issues of transparency and accountability, cf. Lienert (note 40).

⁶⁵ For further approaches cf. U. Wagschal, "Allheilmittel oder Budgetmimikry: Wie wirksam sind Verschuldungsgrenzen zur Haushaltskonsolidierung?", 9 *Journal for Comparative Government and European Policy* (2011) 352-382, at 358ff.; A. Schick, "Post-Crisis fiscal Rules: stabilising Public Finance while Responding to Economic Aftershocks", 10 *OECD Journal on Budgeting* (2010) issue 2, 1-18.

⁶⁶ Fiscal Responsibility Act (No. 31, 2007), Sec. 41.

of national emergencies.⁶⁷ The constitution of Brazil also contains a Golden Rule, but exempts borrowings approved by parliament for specific, defined purposes from its scope of application.⁶⁸

The German constitution contained a Golden Rule from the late 1960s until 2009. It did not prevent an enormous increase in public debt during that period. In the opinion of some observers, the Golden Rule suffered, first, from an overly broad definition of “capital expenditure”, which included expenditures not generating any direct revenue, if at all, and second, from generous exceptions for periods of general economic deterioration as well as for separate budgets.⁶⁹ In light of this experience, Germany opted for a flexible numerical deficit ceiling in 2009 modelled after a Swiss rule from 2001. Accordingly, the cyclically-adjusted annual net budget deficit may not exceed 0.35% of nominal GDP. The deficit may be larger during cyclical downturns, but such additional debt needs to be levelled out during times of economic prosperity. Actual deficits in excess of the deficit allowed under this rule need to be tracked and consolidated once their sum exceeds 1.5% of GDP.⁷⁰ An exception from these limits applies in case of natural disasters.⁷¹ The proceeds arising from new debt are not subject to any restrictions. Some of the concepts of this rule are unclear. The effectiveness of the rule hinges on their interpretation.⁷²

While Spain has already followed the German example, in France, a legislative project to introduce a similar debt ceiling did not materialize in 2011. Nevertheless, as a member of the Euro area, France is subject to the European Stability and Growth Pact and the rules on budgetary discipline stipulated in Article 126(2) of the Treaty on the Functioning of the European Union. Those rules cap budgetary deficits at 3% of GDP and aggregate debt at 60% of GDP. Economic deteriorations might justify larger debt ratios.⁷³

In addition, and in order to reinforce the credibility and implementation of the deficit and debt ceilings under the Stability and Growth Pact, the Heads of State and of Government of the European Union, with the exception of the United Kingdom, recently agreed on a draft of a Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.⁷⁴ After ratification it will oblige the member states to adopt constitutional deficit ceilings. The draft agreement follows closely the German model and

⁶⁷ Art. 73(viii) of the Mexican Constitution. Additional exceptions apply for monetary policy and conversion operations.

⁶⁸ Art. 167(iii) of the Constitution of Brazil.

⁶⁹ The concept of capital expenditure (“Investition”) is defined in German Law on Budgetary Principles (Haushaltsgrundsatzgesetz), Sec. 10 (3), No. 2. Among others, capital expenditures comprise expenditures for all construction projects and for all credits extended by the federal government, whatever public revenue or other economic benefit they may generate, if at all. The previous version of Article 115(2) contained an exception for separate budgets.

⁷⁰ Art. 109(3) and 115(2) of the Basic Law.

⁷¹ Art. 115(6) of the Basic Law. Such debt is conditional upon the adoption of a repayment plan.

⁷² For a critical analysis cf. H. Kube, “Article 115”, in: Maunz and Dürig (eds.), *Commentary to the Basic Law*, vol. 7 (2009), margin note 140ff.

⁷³ The meaning of these terms is specified in Regulation 1467/97, as amended by Regulation 1056/2005.

⁷⁴ The January 2012 draft of the treaty is available at <http://www.european-council.europa.eu/media/579087/treaty.pdf>.

obliges states to achieve a balanced budget on a cyclically-adjusted basis comprising all levels of government. According to Article 3(1)(b) of the Treaty, a country will be considered to be in compliance with the balanced budget rule if it achieves the medium-term objectives as defined under the Stability and Growth Pact. The cyclically-adjusted deficit may not exceed 0.5% of nominal GDP. In contrast to the new German debt ceiling, the draft agreement allows for temporary deviations from the balanced budget rule in “exceptional circumstances”, which are defined as an unusual event outside the control of the state. Such deviations may, however, not endanger medium-term fiscal sustainability.⁷⁵ The reference to sustainability makes this exception more restrictive than the exception contained in the old German Golden Rule for periods of general economic deterioration. Further, Article 4 of the Treaty as well as secondary legislation obliges states to reduce their aggregate debt at an average rate of one twentieth per year if it exceeds the threshold of 60% of nominal GDP.⁷⁶ Failure to comply with recommendations of the Council concerning the prevention or correction of an excessive deficit entails semi-automatic sanctions which can only be avoided by a negative vote of the Council.⁷⁷

Following the EU example, Mercosur established similar numerical targets of 3% of GDP for annual deficit and 40% of GDP for overall deficit in 2000;⁷⁸ and the Andean Community followed a year later with targets of 3% and 50% respectively.⁷⁹ Those targets were stipulated in a presidential declaration and a report. These documents are not legally binding, although of highest political significance.

Chile has adopted an even more restrictive numerical debt ceiling. Under its Structural Balance Policy Rule, higher revenues during periods of prosperity need to be netted out with lower revenues during economic downturns. The rule aims at a surplus of 1% of GDP in order to meet future contingent liabilities such as guaranteed minimum pensions. The rule was first introduced in 2001. After the successful completion of a trial period as a non-binding commitment, it was cast into legislation in 2006, yet without specifying a surplus target.⁸⁰ So far, the rule has stabilized financial conditions and increased the financial credibility of the Chilean government.⁸¹

The Indian Financial Responsibility and Budget Management Act obliges government to reduce the fiscal deficit to 3% of GDP, and the revenue deficit to zero by 2008-2009. The

⁷⁵ Ibid., Art. 3(3).

⁷⁶ Article 2(1a), Regulation 1467/1997 as amended by Regulation 1177/2011, OJ L 306, 23 November 2011, 33-40.

⁷⁷ Arts. 4, 5 and 6, Regulation 1173/2011, OJ L 306, 23 November 2011, 1-7.

⁷⁸ Declaración presidencial sobre metas y mecanismos de convergencia macroeconómica, Florianópolis Summit, 15 December 2000, available at <http://www.cancilleria.gov.ar/portal/screi/mercosur/cumbres/declaracion2.html>. ⁷⁹ Final Report of the Fifth Regular Meeting of the Andean Community Advisory Council of Treasury or Finance Ministers, Central Banks, and Economic Planning Officers, 21 June 2001, para. 4, available at <http://www.comunidadandina.org/ingles/documentos/documents/caracas21-6-01.htm>.

⁸⁰ Fiscal Responsibility Law (Law No. 20.128).

⁸¹ J. Rodríguez et al., “Structural Balance Policy in Chile”, 7 *OECD Journal on Budgeting* (2007), p. 59, at 74ff.

target has not been met. The last two Finance Commissions, a constitutional body convoked every five years, recommended non-binding aggregate debt ceilings of 75% and 68% of GDP respectively.

Brazil, Nigeria and the UK have committed to numerical debt ceilings in addition to their golden rules. In Brazil, the Senate has set the aggregate debt ceiling at 60% of current net revenues. In Nigeria, the aggregate fiscal deficit shall not exceed 3% of the estimated GDP or any level deemed sustainable by the National Assembly. The ceiling may be exceeded if the President determines the presence of a threat to national security.⁸² In the UK, the non-binding Sustainable Investment Rule requires government to keep debt at a level of 40% of GDP.⁸³ The 2010 Fiscal Responsibility Act stipulates targets for the reduction of net borrowings and net debt until 2016.

Numerical debt ceilings do not need to use GDP as a point of reference. In fact, this might be a problematic indicator for developing states with a large informal sector where GDP is neither easy to measure, nor a good indicator for public revenue. Thus, the Tanzanian debt ceiling is set at a ratio of the country's foreign exchange earnings, and the aggregate service cost may not exceed 30% of the average annual recurrent revenue.⁸⁴

Other debt ceilings, such as the one of the US, set absolute limits without reference to any economic indicators. As Congress may lift this limit if need arises, this rule, just as the pay-as-you-go rule mentioned earlier in relation to Principle 10, is at the crossroads of procedural and substantive rules.

The question of the effectiveness of debt ceilings does not allow for a simple answer. Much depends on the application of a rule, the availability of sanctions and the economic situation of the state applying it.⁸⁵ The numerical deficit rule included in the recent draft agreement for the European Union effectively reduced the structural deficit in Switzerland,⁸⁶ while the problems of the Stability and Growth Pact are well known. Informal commitments seem to work well in the UK.⁸⁷ Rules which work well for the reduction of structural deficits might not be sufficient for a decrease in the overall debt level.⁸⁸

Federal and Local Entities

It is common for federal states to put in place not only procedural, but also substantive provisions limiting the debt that may be incurred by federal entities. Some of these provisions are the result of sub-national debt crises.⁸⁹ Thus, in Argentina, the debt of

⁸² Fiscal Responsibility Act (No. 31, 2007), Sec. 12.

⁸³ Cf. HM Treasury, Code for Fiscal Stability (1998), p. 16.

⁸⁴ Section 3, Government Loans, Guarantee and Grants Act of 1974, as amended in 2003.

⁸⁵ P. Manasse, "Deficit Limits, Budget Rules and Fiscal Policy", IMF Working Paper No. 120 (2005).

⁸⁶ Wagschal (note 65), at 375.

⁸⁷ *Ibid.*, at 379.

⁸⁸ *Ibid.*, at 368.

⁸⁹ L. Liu and M. Waibel, "Subnational Insolvency: Cross-Country Experiences and Lessons", World Bank Policy Research Working Paper 4496 (2008), 3ff.

provinces may not exceed 15% of governmental transfers to these entities. The Brazilian debt ratio applies to all levels of government. The German constitution applies the same numerical debt ceilings to states,⁹⁰ and budgetary framework legislation requires all levels of government to spend money in efficient and parsimonious ways.⁹¹ In India, if states owe money to the Union government, they need its consent if they want to incur additional debt.⁹² Mexican states are prohibited from taking on external debt and need to register their domestic debt with the federal government. In the United States, federal law does not limit borrowings by states. However, almost all states have adopted some restrictions on debt. There is a great variety of different approaches. Some states require government to propose a balanced budget. In the State of New York, for example, new debt requires a referendum.⁹³ Other states require supermajorities for new debt.⁹⁴ Again, procedural and material restrictions flow into one another. There is a controversial debate about the effectiveness of these rules.⁹⁵

Local governments are often subject to Golden Rules. For example, in Germany, their budgets are subject to a Golden Rule allowing only for capital expenditures.⁹⁶ China imposed a strict zero deficit rule in 1994, prohibiting local governments from incurring budget deficits or issuing bonds.⁹⁷ However, local governments set up highly leveraged investment vehicles. Now that this “off-balance sheet” debt has reached a critical level, the central government set up a pilot programme under an exception contained in the 1994 rule in order to facilitate debt management. Shanghai was the first city to issue bonds under this rule.⁹⁸

Interim Conclusion

By way of an interim conclusion, it is possible to state that there is at least an emerging principle, if not a guiding one, that states and other public entities should set up material restrictions to sovereign debt. Not all countries have adopted such policies, but their number is steadily on the rise. However, the approaches pursued vary widely. The Golden Rule, numerical ceilings referenced to economic indicators or without such reference are structural principles at best. This means that although countries usually follow one or several models, no model may be considered to fit all cases. Indeed, some of these models are of recent origin and still need to pass the test of practice. Nevertheless, all these models virtually have in common that they do not prohibit countercyclical deficit spending. This may be considered a guiding principle.

⁹⁰ Art. 109(3) of the Basic Law.

⁹¹ Sec. 6 of the Law on Budgetary Principles (Haushaltsgrundsätze-gesetz).

⁹² Art. 293(3) of the Constitution.

⁹³ However, this requirement is not considered to apply to debt for capital expenditures by state enterprises.

⁹⁴ For an overview see Wagschal (note 65), at 369ff.

⁹⁵ E.g. R. Inman, “Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU”, NBER Working Paper No. 5838 (1998).

⁹⁶ E.g. Section 87(1) of the Law on Local Communities of the State of Baden-Württemberg.

⁹⁷ Article 28, Budget Law of the People’s Republic of China, 1994.

⁹⁸ Cf. “The bounty of the muni: Shanghai borrows in its own name for the first time in decades”, *The Economist*, 19 November 2011.

The effectiveness of such restrictions is very difficult to assess in advance, since much depends on the specific context as well as on application. It seems that neither broad exceptions, nor highly severe rules are a guarantee for success, since they invite for abuse or evasion strategies.

International Mechanisms

There are several international mechanisms which aim at enforcing budgetary discipline. Member States of the European Union are subject to a budgetary review process under the Stability and Growth Pact.⁹⁹ Although the deficits of this process as it currently stands have become notorious, enforcement of the rules of the Pact has now become semi-automatic.¹⁰⁰ The Andean Community set up a surveillance mechanism in 2003 for the fiscal convergence targets of 2001. Apart from these peer review mechanisms, some international organizations provide data analysis. Periodic publications such as the IMF Fiscal Monitor, the OECD Economic Outlook as well as Government at a Glance and the World Bank Public Expenditure Reviews provide extensive data and policy analysis. Thus, although the potential of peer review has not been fully explored in all regions of the world, one might speak of an emerging principle. However, any further steps in this direction might have to make precautions in order to safeguard the rights of domestic parliaments.

(b) International Cooperation, Principle 6

Principle 6 – International Cooperation: All lenders have a duty to comply with United Nations sanctions imposed against a governmental regime.

Explanation: Principle 6 requires lenders not to lend to governments in violation of sanctions imposed by the United Nations. Such sanctions will usually be decided by the UN Security Council. The consequences of a violation of UN sanctions on loan agreements are addressed by Principle 9 (see below).

Results: In as good as all jurisdictions under examination, sanctions imposed by the UN Security Council need to be implemented in domestic law. Without an act of implementation, usually through a legislative act, or an executive order, or both, no direct legal consequences may derive from UN sanctions in domestic legal orders. States failing to implement UN sanctions may incur state responsibility under international law, though. The only exception to this pattern is Egypt. Its recently abolished constitution of 1971 was understood by legal scholarship as putting binding decisions by the UN Security Council on a par with directly applicable treaty law. Unfortunately, there is no case law on the issue. But in any event, the practical difference was marginal. The administration

⁹⁹ Art. 121, 126(3)-(14) TFEU.

¹⁰⁰ See above note 77.

still needed to specify the concrete steps to be taken in order to comply with the provisions of a sanction.

As regards decisions with a sanctioning character of UN bodies other than the UN Security Council, no relevant practice exists. In the absence of implementation, such sanctions might still entail reputational consequences.

(c) Debt Management and Audits, Principle 13

Principle 13 – Adequate Management and Monitoring: Debtors should design and implement a debt sustainability and management strategy and ensure that their debt management is adequate. Debtor countries have a responsibility to put in place effective monitoring systems, including at the sub-national level, that also capture contingent liabilities. An audit institution should conduct independent, objective, professional, timely and periodic audits of their debt portfolios to assess quantitatively and qualitatively the recently incurred obligations. The findings of such audits should be publicized to ensure transparency and accountability in debt management. Audits should also be undertaken at sub-national levels.

Explanation: Post-disbursement audits are essential for ensuring the success of prudent debt practices. At the same time, they foster the legitimacy of public expenditures, i.e. the goal that public funds should be spent for the purposes for which they have been appropriated. Debt sustainability and management strategies ensure better control over, and transparency of, the issuance of sovereign debt. Medium-term financial frameworks, addressed above in the context of Principle 10, are one aspect of such strategies. This section discusses the institutional aspect, namely the establishment of debt management offices.

Results: All jurisdictions under examination conduct periodic post-disbursement audits. Taking into account that it would be odd to consider rules contingent upon the existence of certain institutions as general principles of law,¹⁰¹ one can conclude that independent audits are a guiding principle.

The conduct of audits varies from one jurisdiction to another. Some jurisdictions choose quarterly intervals, while others conduct annual examinations.¹⁰² In a number of jurisdictions, audits are prescribed by the constitution.¹⁰³ The reports are generally made public – another guiding principle. Some states only conduct internal audits within each institution, while most states have put in place separate (external) bodies for this purpose (emerging principle). Some of these bodies answer to parliament (like the GAO in the United States or the Bundesrechnungshof), others report to the executive (such as the Egyptian Central Auditing Organization or the Nigerian Fiscal Responsibility

¹⁰¹ This is the same ratio applied to Principle 10 above.

¹⁰² E.g. Chile, China, UK.

¹⁰³ E.g. Argentina, Germany, Japan.

Commission). Most auditors are required to have a high level of education, and most external auditing institutions enjoy independence.¹⁰⁴ Both rules could be characterized as guiding principles. Some jurisdictions require external audits; and federal entities or local communities sometimes have separate auditing offices.¹⁰⁵

Debt management is mostly in the hands of debt management offices. Sometimes, as in the case of Argentina and Egypt, they form part of the ministry of finance. In Germany, the debt management office is formally a private company. This has the consequence that a lack of authorization of the DMO does not affect the validity of issued debt, as would normally be the case if the DMO was a public entity.

3. Responsible Project Financing: Principles 5 and 12

Principle 5 – Project Financing: Lenders financing a project in the debtor country have a responsibility to perform their own ex ante investigation into and, when applicable, post-disbursement monitoring of, the likely effects of the project, including its financial, operational, civil, social, cultural, and environmental implications. This responsibility should be proportional to the technical expertise of the lender and the amount of funds to be lent.

Principle 12 – Project Financing: In the context of project financing, sovereign borrowers have a responsibility to conduct a thorough ex ante investigation into the financial, operational, civil, social, cultural and environmental implications of the project and its funding. Borrowers should make public the results of the project evaluation studies.

Results: All jurisdictions under examination require environmental impact assessments for infrastructural projects. However, only few jurisdictions go beyond this standard and require government to conduct specific assessments of the financial implications of a project. A recent example is the Tanzanian Public Private Partnership Act (2010) which requires government to conduct cost-benefit analyses. A similar rule is in place in Mexico. Brazil requires social impact assessments, and so does the proposed Indian Land Acquisition, Rehabilitation and Resettlement Bill.

Apart from these specific impact assessments, general land use law requires governments or administrators to take into account a whole host of different interests when planning or approving an infrastructural project. Also, as has been mentioned above, if legislation is passed in order to enact such projects, it requires in some jurisdictions the appropriation of specific funds.

Thus, while the conduct of *ex ante* environmental impact assessments appears to have reached the status of a guiding principle applicable in all jurisdictions and for both

¹⁰⁴ E.g. Brazil, France, Germany, Japan, Mexico, Nigeria, United States, UK.

¹⁰⁵ E.g. Argentina, China, Germany.

lenders and borrowers, the same does not hold true for financial and social impact assessments. However, the recent update of the OECD Guidelines for Multinational Enterprises (2011) requires enterprises, and thus, private lenders, to conduct “risk-based due diligence” when operating abroad.¹⁰⁶ This gives support to the position that financial and social impact assessments may have reached the status of emerging principles.

Post-disbursement monitoring and evaluation has become state of the art in the field of Official Development Assistance (ODA). On the international level, the World Bank, regional development banks and the OECD have made efforts to make development aid more results-oriented. The most visible manifestation of this policy is the 2005 Paris Declaration, which contains a commitment to monitor and evaluate the results of development assistance.¹⁰⁷ The OECD Development Assistance Committee has adopted principles for evaluation, which guide domestic ODA agencies.¹⁰⁸ Post-disbursement evaluation at the World Bank comprises interim, terminal and ex-post impact evaluation.¹⁰⁹ Domestic ODA agencies of important donor states follow roughly the same pattern and require multiple evaluations at different stages during and after a project cycle.¹¹⁰ The requirement of post-disbursement evaluation might have reached the status of a guiding principle for ODA.

Beyond ODA, post-disbursement monitoring and evaluation are less common, but increasingly used government techniques. For example, US federal law on housing and urban development requires lenders, recipients and agencies to monitor the progress of projects and the correct use of assigned funds.¹¹¹ In the UK, the evaluation of central government spending follows a standard procedure. Chile started monitoring and evaluation of government programmes in the 1990s, Mexico set up a National Council for the Evaluation of Social Policy in 2004,¹¹² and India followed in 2011 with the establishment of an Independent Evaluation Office for key government programmes. German development bank KfW regularly carries out post-disbursement evaluations of its lending schemes for domestic recipients. On the other hand, post-disbursement evaluation is not the standard for certain infrastructure projects carried out by the German government itself, such as road construction. The situation is similar to France, where only some agencies are subject to evaluation.¹¹³ Given these mixed results, post-disbursement project monitoring and evaluation may be characterized as an emerging principle at present, although the facts revealed a clear trend towards increasing post-disbursement control.

¹⁰⁶ See Part II.A.10 of the OECD Guidelines for Multinational Enterprises.

¹⁰⁷ OECD, *The Paris Declaration on Aid Effectiveness and the Accra Agenda for Action* (2005/2008), 12f.

¹⁰⁸ OECD, DAC Principles for Evaluation of Development Assistance, OCDE/GD(91)208.

¹⁰⁹ World Bank Operational Directive OD 10.70, “Project Monitoring and Evaluation” (1989, revised in 2004), para. 2.

¹¹⁰ E.g. France, Germany, Japan, USA.

¹¹¹ Code of Federal Regulations, Title 24.

¹¹² B. Briceno and M.M. Gaarder, “Institutionalizing Evaluation: A review of international experience”, Department for International Development (2009).

¹¹³ J.-C. Barbier, “La gestion et l'évaluation du service public de l'emploi en France dans la décennie 1990. Matériaux pour une réflexion comparative internationale”, Documents de Travail du Centre d'Economie de la Sorbonne (2007), 31f.

4. Restorative Measures: Principles 7, 9 and 15

(a) Defenses: Principle 9

Principle 9 – Binding Agreements: A sovereign debt contract is a binding obligation and should be honored. Exceptional cases nonetheless can arise. A state of financial necessity can prevent the borrower's full and/or timely repayment. Also, a competent judicial authority may rule that circumstances giving rise to legal defense have occurred. When, due to the state of financial necessity of the borrower, changes to the original contractual conditions of the loan are unavoidable, Principles 7 and 15 should be followed.

Explanation: In case of non-performance of a loan, lenders might sue the debtor state before domestic or international courts and tribunals. In this situation, legal defenses operationalize the principles on responsible sovereign lending and borrowing, adding an element of enforcement to their preventive function. Principle 9 spells out the grounds which may give rise to legal defenses. Some defenses may originate in the circumstances of the conclusion of the loan agreement, such as corruption in the borrowing process (cf. Principles 1 and 8) or the violation of UN sanctions (cf. Principle 6) (i). Other defenses may arise from a state of financial necessity, provided that it results from events beyond the debtor state's control, such as natural disasters or perhaps market deteriorations. They may only be invoked as long as the situation of financial necessity prevails (ii). A situation of financial necessity may also trigger restructurings (cf. Principle 9) (iii).

(i) Defenses Originating in the Circumstances of the Conclusion of the Loan

Results: All jurisdictions under examination acknowledge that loan agreements which violate the rules addressed in Principles 1, 6, and 8 do not have to be honored. Once UN Security Council sanctions have been implemented in domestic law, contracts violating those provisions are null and void. The situation is the same for contracts resulting from acts of corruption. In all jurisdictions under examination they are considered null and void. Some investment tribunals have come to the same conclusion. Being thus recognized both in domestic and international law, the nullity of contracts resulting from corruption or in a violation of binding international sanctions should be considered a general principle of law.

Another question is whether the odious character of certain debt gives rise to a defense. The concept of odious debt refers to otherwise valid debt agreements, whose proceeds were used for illegitimate purposes. The existence of a customary rule or a general principle of law to the effect that the odious character would render a debt agreement invalid is contested. Earlier case law, such as the above-mentioned *Tinoco Arbitration*, as

well as state practice on this issue is the subject of controversial discussions.¹¹⁴ There is no need to rehash this discussion here in detail. Suffice it to add some additional materials from the countries surveyed.

First, in the aftermath of the Spring 2011 revolution, the new Egyptian leadership faced the burden of high external debt. Several G8 countries made commitments for debt relief, mostly in the form of debt swaps (i.e. the proceeds from the loans will finance projects or investments in the country). While commentators from Egypt invoked the concept of odious debt in order to justify such relief, donor governments mostly emphasized their desire to support the emerging democratic government.¹¹⁵

Second, the debate about the liability of financial institutions for serious human rights abuses has been fuelled by a suit for damages filed by children of individuals who disappeared in Argentina in the 1970s against several international banks. Based on the reasoning of the Nuremberg Military Tribunal in the *Flick* case, which established criminal responsibility for lenders of criminal regimes,¹¹⁶ Plaintiffs argue that the military government would not have been able to commit such human rights abuses had it not received loans from the defendants. No decision has been rendered in the case so far.¹¹⁷ However, in the event of a decision in favor of the plaintiffs, one might think about possible effects of such liability on the validity of a loan agreement. The damages are owed to the victims and not to the debtor state and therefore cannot be offset against each other.¹¹⁸ But it would be difficult to imagine a lender to receive interest payments from such a loan and earn money from what might constitute a violation of peremptory international law, entailing both civil and criminal liability.

(ii) Financial Necessity as a Defense outside Insolvency Proceedings

Results: Customary international law recognizes necessity as a defense, which found expression in Article 25 of the Articles on State Responsibility. On a general level, it is

¹¹⁴ Sceptical as to the existence of relevant state practice: Tai-Heng Cheng, "Renegotiating the Odious Debt Doctrine", 70 *Law and Contemporary Problems* (2007) 7-31, at 14ff.; S. Michailowski, *Unconstitutional Regimes and the Validity of Sovereign Debt* (Ashgate 2007), at 37. But see R. Howse, "The Concept of Odious Debt in Public International Law", UNCTAD Discussion Paper No. 185 (2007), at 8f., who argues that the role which the concept of odiousness has played in negotiations and the reason it has provided for adjustments may well reflect relevant state practice in recognition of that concept.

¹¹⁵ Cf. M.B. Sheridan, "Administration planning \$1 billion debt relief for Egypt", *Washington Post*, 8 May 2011; S. Ammous, "Mubarak's odious debt", www.project-syndicate.org.

¹¹⁶ "It remains clear from the evidence that each of [the defendants] gave to Himmler, the Reich Leader SS, a blank check. His criminal organization was maintained and we have no doubt that some of this money went to its maintenance. It seems to be immaterial whether it was spent on salaries or for lethal gas." *United States vs. Flick (The Flick Case)*, Case No. 5, 6 Trials of War Criminals Before the Nuremberg Military Tribunals Under Control Council Law No. 10 (1952), 1217-23.

¹¹⁷ Case of Leandro Manuel Ibáñez & María Elena Perdigue v. Banks, see J.P. Bohoslavsky and V. Ogenhaffen, "The Past and Present of Corporate Complicity: Financing the Argentinean Dictatorship", 23 *Harvard Human Rights Journal* (2010) 157-203.

¹¹⁸ Under German law, tort damages generally cannot be offset with other claims, see Sec. 393 of the German Civil Code. However, other jurisdictions do not have such a rule.

accepted that the economic survival of a state is among the “essential interests”, which might trigger this defense.¹¹⁹ However, the conditions under which this defense may be invoked in case of a sovereign debt crisis are controversial. In the *Serbian Loans* case, the Permanent Court of International Justice ruled out the economic deteriorations after World War I as a case of *force majeure* and ordered Serbia to service its loans.¹²⁰ Decades later, in a claim concerning Argentine sovereign bonds, the German Constitutional Court did not find enough evidence of state practice allowing the invocation of necessity by a state against claims raised by private individuals before domestic courts, even though it acknowledged the existence of this defense in customary law as regards relations between states. The opinion was heavily criticized by Judge Lübke-Wolff who argued that necessity should be recognized as a general principle of law.¹²¹ Recent arbitration awards rendered diverging opinions. They generally recognize that economic crises might amount to a state of necessity, but disagree on the application of the elements of this defense, in particular of the requirement that the defendant state did not contribute to the crisis.¹²²

As a result, one might conclude that although the concept of necessity has the status of a general principle of law,¹²³ its application in sovereign debt crises remains unsettled.¹²⁴ This brings principles derived from domestic law into the focus. Like in international law, in the domestic legal orders under examination, the recognition of a defense arising from a situation of financial necessity entitling the debtor to an adjustment of payment terms outside of insolvency proceedings or in order to avoid them depends on the reasons which caused the state of necessity.

Natural disasters are widely recognized as triggers for a defense against contractual claims.¹²⁵ In civil law jurisdiction, this idea is often operationalized by the concepts of responsibility and *force majeure*.¹²⁶ In common law jurisdictions, courts apply the doctrine of frustration.¹²⁷ In either case, the debtor is not liable for the (temporal) non-performance of the contract. The widespread acceptance of this principle in domestic legal systems and the fact that it also finds support in international law¹²⁸ qualify it as a general principle of law.

The situation is far more complex if it comes to situations of financial necessity induced by economic causes, such as inflation, market deterioration, or else. Generally, all

¹¹⁹ H. Schier, *Towards a Reorganisation System for Sovereign Debt* (Nijhoff 2007), 69ff.

¹²⁰ Permanent Court of International Justice, Series A, No. 20 (1929), 3ff.

¹²¹ Bundesverfassungsgericht, Case 2 BvM 1/03 et al., Decision of 8 May 2007, BVerfGE 118, 124.

¹²² Cf. M. Waibel, “Two Worlds of Necessity in ICSID Arbitration: CMS and LG&E”, 20 *Leiden Journal of International Law* (2007) 637-648

¹²³ E.g. S. Schill, “Der völkerrechtliche Staatsnotstand in der Entscheidung des BVerfG zu Argentinischen Staatsanleihen – Anachronismus oder Avantgarde?” 68 *ZaöRV* (2008) 45-67.

¹²⁴ Given that the necessity defense leads to a temporal stop of payment obligations, but not to an adjustment of payment terms or restructuring, one might doubt also whether necessity is always appropriate for achieving a sustainable solution of debt crises, cf. Waibel (note 122).

¹²⁵ E.g. Argentina, Brazil, France, Germany, China, Mexico, Nigeria, USA, UK.

¹²⁶ Argentina, France, China, Japan, Mexico (*force majeure*) ; Germany (responsibility).

¹²⁷ India, Nigeria, UK.

¹²⁸ Art. 23, Articles on State Responsibility.

jurisdictions under examination are hesitant to recognize unforeseeable economic developments as possible grounds for defense. Instead, debtors are expected to file for insolvency. Nevertheless, some jurisdictions are stricter than others and do not allow for any exception, while others grant debtors a defense and a right to contractual adjustments in cases of extreme hardship. Under the common law doctrine of frustration, economic deteriorations do not justify the adjustment of loan agreements, whether the borrower is a private person or a sovereign. Nevertheless, the US Supreme Court recognized that the contract clause of the US constitution does not prevent states from impairing contracts if it serves an important public purpose.¹²⁹ Also, in *EM Ltd. v. Argentina*, the US Court of Appeals for the 2nd Circuit recognized that restructurings might be of “critical importance to the economic health of a nation” and vacated orders of restraint and attachment concerning Argentina’s assets.¹³⁰

Civil law jurisdictions accept exceptions to contractual performance obligations more easily – at least in theory. This may be the consequence of the high importance which the principle of good faith enjoys in these jurisdictions. Nevertheless, such exceptions may not be presumed lightly. In case of financial necessity, the doctrinal basis of such exceptions is usually not the defense of necessity, but the *clausula rebus sic stantibus*. This clause, presumed to be implicit in every contract, might be a candidate for a general principle of law since it also applies in international law¹³¹ and resembles the common law doctrine of frustration. Although the application of the *clausula rebus sic stantibus* is tied to demanding requirements, there are some precedents in which courts applied it in order to grant the defendant a right to the adjustment of contractual terms in situations of general economic deterioration.

A famous historic case in which general economic deterioration gave rise to contractual adjustments under this doctrine is the decision of the German Imperial Court (Reichsgericht) of 1918. Post-war economics and the revolution of 1918 had led to an unprecedented hyper-inflation. The court held it necessary to adjust contractual terms in order to maintain the contractual equilibrium stipulated at the time of the conclusion of the contract.¹³² Nevertheless, subsequent case law emphasized that such risks need to be distinguished from business risks (or, *mutatis mutandi*, from risks deriving from excessive sovereign debt). If business risks materialize, the contractual terms will not be adjusted because the contract is held to make a provision as to which party has to bear those risks. In addition, the existence of insolvency procedures justifies this line of reasoning. Only in cases of extreme hardship, borrowers might be entitled to a modification of payment terms. Such circumstances may, however, not be lightly presumed.

¹²⁹ *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977).

¹³⁰ Summary order of 23 May 2005, no. 05-1525-cv.

¹³¹ Art. 62, Vienna Convention on the Law of Treaties. On the problems of its application to debt instruments governed by international law see Schier (note 119), 52ff.

¹³² RGZ vol. 103, p. 328ff., English translation of the case: http://www.utexas.edu/law/academics/centers/transnational/work_new/german/case.php?id=954.

It seems that the decision of Germany's Imperial Court found little support in other jurisdictions. Shortly before the Imperial Court, the French Conseil d'Etat had decided in *Compagnie d'éclairage de Bordeaux* that an unexpected, sharp increase in the price of fuel may justify price adjustments. However, the Cour de Cassation rejected this line of reasoning. Also, other civil law jurisdictions which recognize the *clausula rebus sic stantibus* would not accept financial necessity arising from economic deterioration as a trigger for its application.¹³³ In the course of the Russian debt crisis in the late nineties, the judiciary decided in a series of cases that this event did not provide a reason for the adjustment of contractual terms.

Thus, in the end, there is little practical difference between civil law jurisdictions in which the *clausula rebus sic stantibus* is more a theoretical defense, and common law jurisdictions which do not recognize economic deteriorations as a ground for defense in the first place, although some recognition is given to public interests.

(iii) Financial Necessity as a Trigger for Insolvency Proceedings

Results: The comparative survey reveals two principal reasons which entitle creditors or debtors to file for insolvency in domestic jurisdictions. The first reason is so-called balance-sheet insolvency, i.e. the situation that a company's liabilities exceed its assets. Some jurisdictions recognize balance-sheet insolvency as a triggering event,¹³⁴ while it is the sole reason for corporate insolvency in India. One could therefore say that balance-sheet insolvency is probably not more than a structural principle. In addition, it seems impossible to apply it to states which have no balance-sheet.

The second reason which might trigger insolvency proceedings is illiquidity, sometimes imprecisely referred to as cash-flow insolvency. It is defined as the inability of a debtor to pay its debts as they fall due. Although the material and procedural conditions for the determination of illiquidity might diverge, this reason is recognized in all surveyed jurisdictions. In India, it is recognized for private insolvency only. By contrast, other states recognize even the threat of illiquidity as a trigger for reschedulings, sometimes only voluntary ones.¹³⁵ Illiquidity, or the inability to service one's debt, therefore has the potential of getting recognition as a general principle of law. Unlike balance-sheet insolvency, it is applicable to states.¹³⁶ A state's inability to pay its debts as they fall due would trigger negotiations in one of the international venues for sovereign debt restructurings. It seems safe to assume that this reflects established practice provided that the defaulting state is willing to enter into such negotiations.

However, the difficulty with this principle lies in the determination of a state's inability to pay its debts, as opposed to its unwillingness. Domestic legal orders apply rather formal

¹³³ E.g. Argentina, Brazil, Egypt, Mexico.

¹³⁴ E.g. China, Germany, Japan, United Kingdom, United States.

¹³⁵ E.g. France, Germany.

¹³⁶ J.A. Kämmerer, "State Bankruptcy", in R. Wolfrum (ed.), *Max Planck Encyclopedia of Public International Law* (2009), marginal note 2.

criteria for the determination of illiquidity, e.g. unsuccessful enforcement action, actual default on due payments of a certain amount, or fraudulent attempts to protect property from creditors. Those criteria cannot be extrapolated to sovereign debtors. They are fundamentally different insofar as they possess the power to tax, but also bear responsibility for the essential needs of an entire population. Thus, while in the abstract the inability to service one's debt might be considered a trigger for insolvency proceedings in all cases, including sovereign debtors, the application of this principle in the latter case needs to follow criteria to which comparative law has little to contribute. The only conclusion which might be drawn from the comparative survey is that it is the financial rather than the general economic situation of a person or enterprise which justifies the commencement of insolvency proceedings. The causes of the state of financial necessity matter little for the question *whether* negotiations should be commenced, although they might have a significant impact on its outcome. It is therefore recommendable to use the term "financial necessity" as included in the consolidated version of the Principles, instead of "economic necessity" as contained in the second draft of November 2011. Alternatively, it might be advantageous to draft this aspect of Principle 9 in more abstract terms and refer to the inability of a state to service its debt, or threat thereof. Practice might develop more specific criteria.

(b) Restructurings: Principles 7 and 15

Principle 7 – Debt Restructurings: In circumstances where a sovereign is manifestly unable to service its debts, all lenders have a responsibility to behave in good faith and with cooperative spirit to reach a consensual rearrangement of those obligations. Creditors should seek a speedy and orderly resolution to the problem.

Principle 15 – Restructuring: If a restructuring of sovereign debt obligations becomes unavoidable, it should be undertaken promptly, efficiently and fairly.

Explanation: Under current international law, in the absence of any formalized, legally binding restructuring mechanism, sovereign borrowers as well as sovereign lenders may opt for holdouts and prevent timely, efficient, equitable and sustainable restructurings. Collective action clauses are used in order to reduce the likelihood of lender holdouts. Market discipline should ideally prevent borrower holdouts, i.e. the refusal of governments to enter into negotiations about consolidation measures in exchange for restructurings or debt relief. Holdouts may also be less likely if restructurings are perceived as fair and equitable. In this respect, some of the items in the questionnaire aim at investigating whether it is appropriate to distil certain general principles of law from the practice of domestic legal orders.

Results: Although particular aspects of domestic insolvency law might be quite different from one jurisdiction to another, certain basic principles of insolvency laws enjoy acceptance in all examined jurisdictions, and probably beyond. Those principles comprise the principle of a single insolvency procedure excluding other court proceedings and of a

stay on claims and attachments of the assets of the debtor,¹³⁷ the equality of creditors with respect to payment conditions (*par conditio creditorum*), the right to pro rata payments of creditors in the same priority class (*pari passu*),¹³⁸ the priority of secured creditors or creditors enjoying privileges which are in the public interest,¹³⁹ and that of decision-making by majority.¹⁴⁰ Therefore, it does not seem to be far-fetched to consider these principles as general principles of law.

Some of these principles applicable in private insolvencies may apply *mutatis mutandi* to sovereign insolvencies by virtue of their status as general principles. Others may be of little practical relevance. For example, most sovereign debt is unsecured. But in any case, the application of these principles is contingent upon the existence of a comprehensive procedure for restructuring which includes all creditors. Otherwise, principles like the equality of haircuts would lose their purpose. The crucial question for the application of those general principles of law on the international level is therefore whether the various informal arrangements such as the Paris or London Clubs reach this threshold and can be considered as competent and authoritative resolution mechanisms (which, should this question be answered in the affirmative, would of course have to make arrangements for a fair representation of all lenders). Whether this condition is met is beyond the scope of this study. The award rendered in the *Abaclat* case seems to point in this direction.¹⁴¹ The United Kingdom Debt Relief (Developing Countries) Act of 2010 gives heavily indebted poor countries a defense against claims insofar as private claimants do not grant debt relief to defendant states proportionate to the relief granted, or expected to be granted, by public lenders under the HPIC initiative. The Act thereby recognizes that HPIC restructurings should prevail over individual suits, just like insolvency proceedings. From a functional point of view, one could say that the Act applies the principles of a single insolvency procedure and of equitable burden-sharing to cases of sovereign default before domestic courts. Given the worldwide support for the HPIC initiative, this Act could well be considered as an expression of an emerging principle that HPIC debt relief is an insolvency proceeding which renders the mentioned general principles applicable.

Prior to the formal initiation of insolvency proceedings, most jurisdictions do not recognize the principle of good faith as a basis for the borrower to request a modification of the payment terms. An exception is the case of abusive credits mentioned above,¹⁴² which typically occur shortly before a company files for insolvency and require fraudulent intent on the part of the abusive lender. Beyond such cases, some civil law jurisdictions recognize a right of debtors to claim a modification of payment terms under narrow conditions in cases of extreme hardship or if insolvency can thus be avoided.¹⁴³

¹³⁷ International Law Association, "State insolvency: Options for the way forward", Report of the Sovereign Insolvency Study Group (2010), 23.

¹³⁸ *Ibid.*, 28.

¹³⁹ *Ibid.*, 23 and 27.

¹⁴⁰ *Ibid.*, 26.

¹⁴¹ Assuming the existence of an informal institutionalization of reschedulings: ICSID, *Abaclat et al. v. Argentina*, Decision on Jurisdiction and Admissibility (Case No. ARB/07/5), para. 40.

¹⁴² Section C.2.b.i.

¹⁴³ E.g. Germany, Mexico.

In most jurisdictions examined, a duty to act in good faith or to cooperate with the borrower is accepted *after* the borrower has filed for insolvency or after the creditors have requested such filing. The United States, although the concept of good faith or equivalent principles are not foreign to the common law,¹⁴⁴ is the only jurisdiction examined where creditors are not necessarily obliged to act in good faith during the insolvency procedure because of its adversarial nature. In consideration of this, it seems that the duty to act in good faith during insolvency proceedings is only a guiding principle, not necessarily a general principle of law.

With few exceptions, most domestic legal orders do not allow sub-state entities to file for bankruptcy. Where this is the case, like under Chapter 9 of the US Bankruptcy Code, which governs insolvencies of municipalities, it is interesting to note that creditors enjoy significantly fewer rights compared to regular insolvencies of private entities. German states did not make use of the possibility provided in federal law to subject local communities on their territory to the standard procedures governed by the insolvency act.¹⁴⁵ They seem to prefer ad hoc administrative arrangements which might be less respectful of creditors' rights and also prevent them from taking decisions affecting the members of the community concerned. These facts show that adversarial proceedings might not be fully appropriate for insolvent public entities.

Collective Action Clauses are nowadays widespread. They are the standard for debt instruments issued under English law, unless they include trust deeds, which fulfil a similar function. Since 2003, bonds issued under New York law also frequently contain collective action clauses. In Germany, a legislative amendment in 2009 facilitated the inclusion of such clauses in bonds governed by German law.¹⁴⁶ They are also popular among foreign debt issued under Japanese law.¹⁴⁷ From among the jurisdictions under examination, Argentina, Chile, Egypt, Mexico, and Nigeria include Collective Action Clauses. From 2013 collective action clauses will be included in all Euro zone government bonds. This move towards majority decisions corroborates the acceptance of the majority principle as a general principle of law (cf. *supra*). It also works towards consolidating the number of potential fora in which reschedulings may be arranged.

The jurisdictions under examination follow very different policies regarding the inclusion of sovereign debt claims under Bilateral Investment Treaties (BIT). China, Germany, India, Japan, Nigeria, Russia and the UK use BITs which contain broadly phrased definitions of the term investment, even if they are not as explicit about it as the Argentine-Italian BIT. For example, the 2005 German Model BIT understands as investments, among others, "claims to money which has been used to create an economic value". This might include sovereign bonds, although the reference to the creation of economic values does not render this conclusion compelling. By contrast, Chile and Mexico explicitly exclude sovereign debt, and the recent US-Uruguay BIT exempts sovereign debt instruments

¹⁴⁴ A.E. Farnsworth, *The Concept of Good Faith in American Law* (Saggi 1993); R. Zimmermann/S. Whittaker (eds.), *Good Faith in European Contract Law* (CUP 2000).

¹⁴⁵ § 12, Insolvency Act (Insolvenzordnung).

¹⁴⁶ Gesetz über Schuldverschreibungen aus Gesamtimmissionen, 31 July 2009, BGBl. I (2009) 2512.

¹⁴⁷ Y. Liu, "Collective Action Clauses in International Sovereign Bonds", IMF Working Paper (2002), 6.

from arbitration as long as negotiated restructurings are ongoing.¹⁴⁸ If this should become a new trend, it would be a further indicator towards the institutional consolidation of international efforts for the restructuring of sovereign debt. So far, however, it seems hardly possible to identify a clear direction in which this development is moving.

D. Sovereign Lending and Borrowing – Not So Different After All?

This study has examined domestic as well as international law in search of various types of principles applicable to sovereign debt crises. It reaches the conclusion that most of the principles contained in the Principles are to be qualified as generally accepted guiding principles, or as emerging principles. Some of them might even be considered to have acquired the status of (emerging) general principles of law. There is no principle contained in the Draft which would not, at least on an abstract level, find some support among the domestic legal orders under examination.

E. Overview of the Legal Qualification of the Principles

<i>No. Principle</i>	<i>Legal Qualification</i> ¹⁴⁹
1 Agency	General principle of law
1 Informed Decisions	Guiding principle (structural asymmetries between lenders and consumers require due diligence in case of consumer loans)/ Emerging principle (lender due diligence in case of non-consumer loans)
3 Due Authorization	General principle of law (prima facie authorization) Emerging principle (invalidity of loans to public entities without proper authorization)

¹⁴⁸ Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (2005), Annex G, Section 1, available at http://www.ustr.gov/archive/assets/Trade_Agreements/BIT/Uruguay/asset_upload_file748_9005.pdf.

¹⁴⁹ For the meaning of those categories, see supra p. 8f.

- | | | |
|----|------------------------------|--|
| 4 | Responsible Credit Decisions | Emerging principles (duty of lender to assess borrower's capacity)

General principle of law (responsibility for abusive credits) |
| 5 | Project Financing | Guiding principle (<i>ex ante</i> environmental impact assessment by lenders)/

Emerging principle (duty of private lenders to conduct social and financial impact assessment) |
| 6 | International Cooperation | General principle of law (contracts violating sanctions are null and void, cf. Principle 9) |
| 7 | Debt Restructurings | General principles of law (see Principle 15) |
| 8 | Agency | General principle of law |
| 9 | Binding Agreements | General principles of law (nullity of contracts resulting from corruption or in a violation of binding international sanctions; natural disasters give rise to a defense for reasons of economic necessity)

General Principle of Law (inability to pay due debts triggers insolvency proceedings) |
| 10 | Transparency | Guiding principles (transparent fiscal policy-making; involvement of legislature)

Emerging principle (medium-term financial frameworks)

Structural principles (pay-as-you-go; incentive model vs. control model in federal states) |
| 11 | Disclosure | Guiding / general principle of law (right of access to information)

Guiding principle (public availability of budgets) |
| 12 | Project Financing | Guiding principle (<i>ex ante</i> environmental impact assessment by borrowers; post-disbursement evaluation of ODA)/ |

- Emerging principle (post-disbursement project evaluation in general).
- 13 Adequate Management & Monitoring Guiding principles (conduct of audits; high level of education of auditors; independence of external auditors; publicity of reports) /
- Emerging principle (external auditors)
- 14 Avoiding Over-Borrowing Emerging or guiding principle (material restrictions on sovereign borrowing) /
- Structural principles (different models) /
- Guiding principle (countercyclical deficit spending permissible) /
- Emerging principle (international surveillance of fiscal policy)
- 15 Restructuring General principles of law (interdiction of parallel proceedings; stay on claims during restructurings; equality of creditors; right to pro rata payments; priority of secured creditors; majority decision-making)¹⁵⁰
- Guiding principle (good faith during insolvency proceedings)
- Emerging principle (HIPC debt relief is an insolvency procedure which renders the above-mentioned general principles of law applicable).

¹⁵⁰ The application of these principles depends on the existence of a restructuring procedure.