

Commonwealth Secretariat



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**LEGAL REFERRAL SERVICE (HIPC CLINIC)
AND THE WAY FORWARD**

Paper by Commonwealth Secretariat

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**“Too often in recent history liberal governments have been
wrecked on rocks of loose fiscal policy”**

Franklin D. Roosevelt

EXECUTIVE SUMMARY

In 2003, the Commonwealth Heads of Government, at their Abuja Meeting encouraged the advisory and consensus building work of the Commonwealth Ministerial Debt Sustainability Forum¹, (CMDSF) and encouraged its efforts to help Heavily Indebted Poor Countries (HIPC) in achieving sustainable exit from their debt problems. In view of the serious threats of litigation and actual litigation against the Sovereign Debtors, Member States sought legal assistance. After receiving the mandates from the Law Ministers, in 2005, (Ghana) and the Finance Ministers Meeting in 2006, (Sri Lanka), a Legal Referral Service was established in September 2006². This Legal Referral Service, known as the HIPC Clinic, has been operating and assisting the HIPC Member States in resolving their debt in litigation. The Clinic has also been conducting training programs to build capacity within the Attorney General's Office and the Ministry of Finance in debt negotiation matters of our Member States.

2. The establishment of the Clinic and its programme for sensitising Legal and Finance officials of the Commonwealth countries in negotiation and renegotiation of debt agreements was welcomed at last year's CMDSF meeting.

3. After the Caribbean workshop, conducted in November 2006, the Clinic has also conducted a second regional Seminar, in December 2007 for the African HIPC States. Nine countries were invited: Cameroon, Ghana, The Gambia, Malawi, Mozambique, Tanzania, Sierra Leone, Uganda and Zambia. Unfortunately, The Gambia was unable to participate.

4. Since August 2007, the Resident Legal Adviser has sought the collaboration of Pole Dette³ in order to be able to organise a training seminar which will benefit the Francophone African Countries, in debt negotiation and renegotiation matters. It is intended that this Seminar will take place in May 2008. The Pole Dette will be funding the participation of the Countries' officials and the Clinic will be conducting the training in the Workshop.

5. After having assisted the Member States in some litigation matters and conducted the training seminars, the Clinic is looking at the way forward in order to ensure that Member States regress to unsustainable debt situations after receiving debt relief. The Clinic is proposing a more comprehensive approach to address unsustainable debt and is aiming for a proper legal framework regarding fiscal policies. It is believed that it would be timely to move towards enacting Fiscal Responsibility Laws (FRL). These Laws will enable Member Countries to strengthen their fiscal policies as well as improve transparency and accountability. Better fiscal policies are the only solution to avoid a situation of unsustainable indebtedness once again. The FRL has the wherewithal to put an end to financial recklessness and can promote a prudent and wise management of public funds and resources.

6. The economic stability of many countries has already been under threat during the nineties, from debt crises, banking crises and currency crises. Over the years, successive governments have engaged in fiscal profligacy which has culminated in adverse

¹ Previously known as the Commonwealth HIPC Ministerial Forum (CHMF)

² A Study was commissioned by the Commonwealth Secretariat which recommended the establishment of the Legal Referral Service within the Legal and Constitutional Affairs Division of the Commonwealth Secretariat.

³ Pole Dette consists of two organisations namely, the BEAC (Banque des Etats de L'Afrique Centrale/Central Bank for Eastern and Central African countries) and the BCEAO (Banque Centrale des Etats de L'Afrique de l'Ouest/Central Bank for the West African Countries)

macroeconomic consequences for our Member States. Fiscal vulnerability has been on the rise, with debt sustainability problems compounded by fiscal decentralisation and fragile domestic banking systems.

7. An increasing number of countries⁴ have adopted or are adopting the fiscal responsibility framework to tackle problems of financial recklessness. The FRL aims to redirect governments at all levels to cultivate a fiscal behaviour that will promote prudent and sound financial management of public funds. The adoption of it also demonstrates the formal expression of the political will to maintain fiscal discipline.

8. The Clinic intends to sensitise Member States in FRL and to help them draft and apply such laws to their country. FRLs are an important element of preventive measures designed to pre-empt litigation related to sovereign debt in distress.

⁴ List of countries having introduced the FRL are Argentina, Brazil, India, Canada, Chile, New Zealand, Nigeria, Venezuela, Sweden, United Kingdom and United States

INTRODUCTION

A. BACKGROUND OF LEGAL REFERRAL SERVICE

Ministers will recall that in Abuja, Nigeria (December 2003), the Commonwealth Heads of Government Meeting (CHOGM) recognised that the debt burden in developing Member States constituted a major obstacle in allocating resources to develop key socio-economic sectors. They acknowledged the need for a deeper, broader and more flexible approach to debt relief and debt cancellation in order to achieve long-term debt sustainability. Heads of Government welcomed the advisory and consensus building work of the Commonwealth HIPC Ministerial Forum (CHMF) and encouraged its efforts to help Heavily Indebted Poor Countries (HIPCs) in achieving an exit from unsustainable debt. They reaffirmed their commitment to a successful HIPC Initiative.

2. At the third CHMF meeting, on 26-28 February 2003, in Dar es Salaam, Tanzania, Finance Ministers were concerned about the increasing number of HIPCs facing litigation by their Creditors. They called for a facilitative mechanism that would assist HIPCs and Sovereign Debtors. The Legal and Constitutional Affairs Division (LCAD) of the Commonwealth Secretariat thereupon commissioned a Paper on the strategies to deal with "Sovereign Debt in Distress". It will be recalled that this Paper was submitted to the Meeting of Senior Officials of Commonwealth Law Ministries (SOLM) in October 2004. The Paper addressed both the Financial and Legal Aspects of Creditors' litigation and proposed the establishment of a "One Stop Legal Referral Service" within the appropriate Division of the Commonwealth Secretariat, being LCAD. The Senior Officials commended the "Sovereign debt in distress" suggestion as to the possible role of the Commonwealth Secretariat in providing a legal Clinic for advice and access to expertise on dealing with.

3. In March 2005, in Maputo, Mozambique HIPC Finance Ministers met and recalled the proposals for 'rapid reaction legal assistance' by the Commonwealth Secretariat expressing the hope that this would be implemented without delay. Finally, at the Commonwealth Law Ministers Meeting (LMM) in October 2005, in Ghana, Law Ministers endorsed the proposition of the setting up a Legal Referral Service and to move as quickly as possible to render legal services to Sovereign Debtors. The Finance Ministers, at their CHMF Meeting held in September 2006, in Colombo, Sri Lanka, further approved the establishment of the said Legal Referral Service.

4. The Legal Referral Service, also known as the HIPC Clinic, has been operational since mid-September 2006. A Resident Legal Adviser is operating the Clinic within the Law Development Section (LDS) of LCAD. The Clinic is working in collaboration with the Economic Affairs Division (EAD) and the Special Advisory Services Division (SASD) of the Commonwealth Secretariat. The Legal Referral Service is able to provide the following assistance:

- (a) in house legal advice to HIPC countries or Member countries which are facing or likely to face debt litigation;
- (b) advising Sovereign Debtors on a bilateral basis as they seek assistance on their loan agreements; suggesting renegotiation arrangements and debt management strategies;

- (c) addressing requests from Sovereign Debtors on a bilateral basis, seeking assistance;
- (d) conducting regional seminars to create awareness of loan agreements; debt relief and the restructuring processes;
- (e) information from a database which has been created and maintained with respect to loan agreements;
- (f) access to financial and legal experts; database of case laws; and
- (g) negotiation support for Member States at the different stages of the loan agreement process.

5. The HIPC Clinic has been set up with the mandate to reach out to all HIPC Commonwealth countries and, where there is a partnership, to Non-Commonwealth States as well. In this respect it has been interacting closely with the Organisation Internationale de la Francophonie (OIF), to work with the Franco HIPC States which are also facing litigation by their creditors. The project to work in collaboration with OIF, for Francophone countries, is in the pipeline. However, the Clinic has been able to seek collaboration from Pole Dette towards a joint seminar in “Debt Negotiation and Renegotiation Aspects”, in Cameroon in May 2008, for training Officials of the Francophone countries.

Basis of operation of the Legal Referral Service- Confidentiality of Paramount Importance

6. Ministers are advised that the HIPC Clinic has had to operate on a basis of strict confidentiality. After its inception it became clear to the Resident Legal Adviser that in order to help Member States to succeed in their cases, confidentiality was very important. In this respect, the usual Attorney and Client privileges apply. This approach has enabled the Clinic to function effectively whilst granting assistance to Member States. It is recognised that debts of a sovereign nature are also politically sensitive. The Clinic is desirous of assisting and yet not compromising the sensitive nature and confidentiality of such information.

B. REPORT OF ACTIVITIES UNDERTAKEN AND PROJECTED

Modus Operandi of Regional Meetings on Debt Negotiation and Renegotiation

7. Since its inception from September 2006, the HIPC Clinic has conducted two Regional Training Seminars on “Debt Negotiation and Renegotiation” for the benefit of the Caribbean and African Member States. It has worked in collaboration with the Economic Affairs Division and the Special Advisory Services Division in the delivery of these Training Seminars.

8. In both Seminars, Officials from both the Attorney General’s Offices and Ministries of Finance were called to participate. The Report of the Meeting of the Caribbean countries has been circulated to all the Law and HIPC Finance Ministers and that of the Ghana Meeting will be circulated shortly.

9. The Workshops aim to build the necessary know-how and expertise within the Officials in matters regarding litigation by creditors. In addition, it seeks to build the capacity to negotiate better terms in the Loan Agreements. During the Seminar, the following issues have been considered:

1. The Borrowing Process and the Loan cycle
2. Legal Aspects of Loan Negotiation
3. Litigation on Debt in distress
4. Legal Aspects of Debt Re-Negotiation
5. Financial Aspects of Sovereign Debt in Distress
6. Debt Rescheduling options
7. Strategies for New Borrowing and Refinancing
8. Institutional Arrangements in Debt Management
9. The role of the lawyer in the Borrowing Process

10. The blend of officers from the Ministry of Justice/Attorney General's Office and Ministry of Finance created a highly interactive discussion in the first Regional Meeting. It revealed the importance of these two respective Ministries working closely together when negotiating and contracting a loan on behalf of the Government. It became apparent that there was a lack of communication and proper consultation between these two Offices, which then resulted in a Loan Agreement which was not safe for signature by the Sovereign Debtor. The act of omitting the involvement of the Attorney General's Office from when the negotiation process starts resulted in putting the Sovereign Debtor in a weak position when being taken to Court by the Creditors. The prevailing arrangements of sending the loan agreements to be vetted by the Attorney General's Office at the very last stage of the loan agreement process, was concluded not to be the best practice. There was a unanimous acceptance of the serious handicap that this omission has been causing and how deeply it has been affecting all the Member States.

11. From the African Regional Meeting, there has been a request that the words "HIPC" be refrained from use. Following this request, it has been proposed that the Legal Referral Service be known as the Debt Legal Clinic instead of the HIPC Clinic.

Workshop for the Caribbean Region on Debt Negotiation and Renegotiation

12. In November 2006, in Kingston, Jamaica, the first training Seminar was held for Caribbean Member States. The following Member States were represented at the Meeting by a Legal and a Finance Official: Antigua & Barbuda, Bahamas, Barbados, Dominica, Grenada, Guyana, Jamaica, St Lucia, St Kitts & Vincent, Suriname and Trinidad & Tobago.

Workshop for the African Region on Debt Negotiation and Renegotiation

13. In December 2007, the second regional meeting was held for the African Member States in Accra, Ghana. The following countries were represented: Cameroon, Ghana, Malawi, Mozambique, Tanzania, Sierra Leone, Uganda and Zambia. Again an official from each Ministry of Justice/ Attorney General's Office and Ministry of Finance were able to attend.

Workshop in Cameroon on Debt Negotiation and Renegotiation for Francophone countries

14. Following up on a bilateral visit in Yaoundé in August 2007, the Clinic has received a request to collaborate with the Pole Dette for the training of Officers from the Ministry of

Justice/Attorney General's Office and Ministry of Finance in "Debt Negotiation and Renegotiation Aspects".

15. The Workshop which was earmarked to take place in Cameroon in March 2008, had to be postponed and will now be held in May 2008. The Pole Dette organisation is co-funding the Workshop with regard to the participation of its Member States and the Clinic is overseeing the training aspects. The countries which are to participate in this Seminar will be Benin, Burkina Faso, Cameroon,, Comoros, Congo, Cote D'Ivoire Chad, Centrafrique Republic, Guinea Bissau, Mali, Niger, Senegal and Togo.

16. Ministers are again advised that they will be provided with the Report at the conclusion of that Workshop.

Creating Awareness and Sensitisation through Publications

17. As Ministers have discerned, the Debt Legal Clinic, being a completely new innovation, has had a challenge to meet. It had to act in a swift manner to provide the quick response needed by its Member States. Working in collaboration with two other pertinent Divisions – the Economic Affairs Division and the Special Advisory Services Division it also aimed to create maximum awareness of its presence and the services it has been offering.

18. The Resident Legal Adviser has also been able to seek collaboration from a legal firm based in UK, the DLA Piper and the African Development Bank. It is important to mention that both organisations have contributed towards the conduct of our Seminar in Ghana in December 2007. Participants had the privilege of hearing the Solicitor who had instructed the Republic of Zambia in the Donegal International Case which was heard in London in February 2007. The participants also had the possibility to interact with the consultants from DLA Piper and African Development Bank. The model Loan Agreements circulated by the African Development Bank's Legal Counsel has also been very helpful and informative.

19. In this regard, Member States have been duly informed about the Clinic's role and existence at the Commonwealth Secretariat. Information on its work has been sent to all through the Newsletter of the Law Development Section (LDS) of LCAD. Further as advised above, Reports have been distributed to Law and Finance Ministers. In this respect, the Clinic is now aiming to sensitise its Member States through its own publication which will provide updates and current advice regarding fiscal laws, judgements and policies.

20. The Resident Legal Adviser of the Debt Legal Clinic has been attending Meetings of Commonwealth Finance Ministers, as well as the Law Ministers Meetings to sensitise them too of the work of the Clinic as well as to report to the Meetings of the CMDSF.

21. The HIPC Clinic also utilises the internet to disseminate information and its web pages are located at: http://www.thecommonwealth.org/Internal/140503/157583/hipc_clinic

Bilateral Meetings and Legal Assistance

22. For the past year, the Clinic has been garnering requests for assistance on a bilateral basis. Following the last CHMF Meeting in April 2007 and requests of assistance, the Resident Legal Adviser undertook visits to Zambia, Cameroon and Uganda. A major

outcome of these visits has been the establishment of increased collaboration and creation of links between the Ministry of Finance and Justice/Attorney General's Office.

23. The Resident Legal Adviser also assisted to a proceeding in a Tribunal in London, regarding a civil dispute for US\$160 million, against the Republic of Zambia at the London Court of International Arbitration.

C. SUSTAINABLE DEBT, SMALL STATES AND THE WAY FORWARD

24. The Caribbean Seminar highlighted that while their component States are not classified as HIPC, they are becoming increasingly indebted. It was observed that circumstances peculiar to that region should be taken into account in the loan negotiation process since Small States are subject to much vulnerability. It was recognised by all the participants that their vulnerability to global climate change and natural disasters such as hurricanes, have been a major drawback in their debt repayment abilities and in maintaining a sustainable level of debt. Their frailty also arose, as Small States suffer, from an inherent exposure to adverse shocks beyond the country's control. This constrains their options in pursuing sustainable development goals. The Small States have high dependence on international trade, a narrow range of exports and have limited options for diversification.

25. The experience and challenges seen in the Small States of the Caribbean are replicated elsewhere. The Heads of Government, in the Kampala Meeting, in 2007, stressed the need for small states to build their economic resilience by making appropriate interventions in four areas namely: macroeconomic strategy, microeconomic market efficiency, good governance and social cohesion.

26. The Debt Legal Clinic is ready to address the promotion of macroeconomic stability through the dissemination of the fiscal responsibility laws. It is also ready to help Member States to resolve their domestic debt issues which have also been on the rise.

D. FISCAL RESPONSIBILITY LAWS:

“Fiscal rules can be taken as a social agreement and that fiscal discipline is a critical element of a country's good governance.”

27. The Fiscal Responsibility Laws are meant to make the Government of the day responsible for fiscal management and ensuring long term macro economic stability. This law caters for an institutional framework binding the Government of the day to pursue a prudent fiscal policy and casts the responsibility on the Government to ensure inter-generational equity in fiscal management. The law will help to institutionalise and formalise the observance of fiscal discipline. The law can enable a more sustainable fiscal deficit, make revenue forecasts and spending plans affordable; government will be accountable to the people and hence, there will be greater transparency to the public.

28. Several countries have incorporated such a law and its benefits have been seen in action over the years. New Zealand enacted the law in 1994 and the latest has been Nigeria in December 2007. Some of the other countries are Argentina, Brazil, Columbia, Ecuador, India, Peru, United Kingdom and United States.

29. Briefly the provisions in the Fiscal Responsibility Laws will cater for the following:

- ensuring that the government will not commit itself to spending money without ensuring that it has the necessary funds in place to begin with;
- putting strict controls on government borrowing. The Laws will also stop the government from irresponsibly raising new loans which they are unable to repay;
- inputting measures that will oblige the government to spend its money in a more responsible manner;
- forcing the government to plan its revenue raising measures and spending priorities three years in advance. It will make it more difficult for the government to borrow money at random in order to plug unexpected gaps in funding. The government may only borrow money to fund new capital expenditure projects and on approved terms laid down in the law;
- barring the government from borrowing money to fund routine items of recurrent expenditure such as staff salaries; and
- imposing conditions on new borrowings which are designed to ensure that any government agency contracting a loan will have the means to repay it. All new government loans need to be contracted on competitive terms and at reasonable rates of interest, without excessive fees and commissions.

30. The above list is not fully exhaustive and has been illustrated here by way of example. By adopting such a law it is aimed to avoid a build up of external and internal debt to the point where the government can no longer meet its repayment obligations. It will also stop failures of grandiose projects because money promised to fund the projects failed to materialise. These rules can be imposed as a statutory provision, a constitutional amendment or a code of policy. Making these rules enforceable through the law remains an effective way of ensuring that they will be diligently complied with. Whilst there will never be a one size fits all solution, the policies and rules may be adapted according to the each country's economic, political and social situations.

E. CONCLUSIONS

31. Ministers will recognise that the HIPC Initiative was innovative in its attempt to seek a comprehensive approach to debt reduction and management of debt. The Debt Legal Clinic, in pursuit of the Post-HIPC scenario seeks to assist government implement the Fiscal Responsibility Laws to help to maintain a sustainable level of debt.

32. Ministers are invited to give approval to the:

- Continuous efforts of the Debt Legal Clinic in providing assistance, as required by highly indebted Member States, including Small States which are heavily indebted, in the various forms and activities proposed; and
- To sensitise and implement the Fiscal Responsibility Laws in Member States' laws. FRLs are an important element of preventative measures designed to pre-empt litigation related to "sovereign debt in distress".