

Eurodad Charter on Responsible Financing

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**Maintaining Debt Sustainability: the Challenges and Safeguards for
Managing New Opportunities for External Financing**

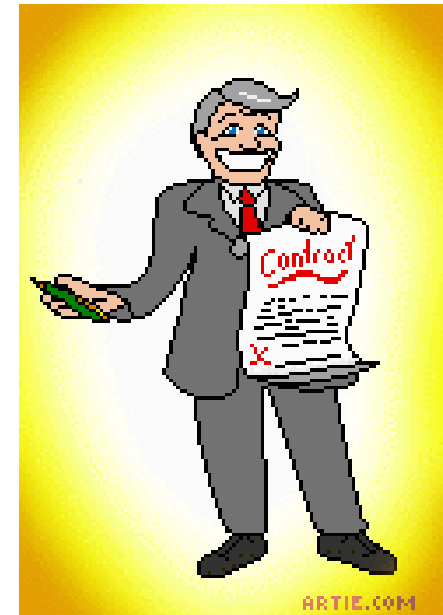
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Responsible lending: a hot topic

Ecuador's official debt audit commission

- Question to lender: How could you draw-up such a skewed loan agreement?
- Question to borrower: Why did you sign an agreement on such unfavourable terms?



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Responsible lending: a hot topic

Key Drivers

- Post HIPC and MDRI: policy debate has shifted to how to avoid the rapid re-accumulation of unsustainable and irresponsible debt in beneficiary nations
- Increased prominence of a number of “new lenders” (China, India, Brazil, Venezuela, South Korea, Kuwait, Saudi Arabia)
- WB-IMF debt sustainability framework for low-income countries presented as the ‘magic bullet’ to avoid new debt build-up



Current responses insufficient and limited

Current measures just don't make the grade

- Why did countries become so dramatically over-indebted? Provision of poor quality finance, often extended for political purposes, badly invested by borrower, scant regard for social, environmental concerns by lender and borrower, loan pushing and defensive lending practices
- WB-IMF debt sustainability framework for low-income countries:
 - Provides no assessment of “quality” of finance on offer
 - Voluntary coordination tool for lenders
- Noises over a ‘race to the bottom’:
 - “the competition of the Chinese banks is clear [...] they don't bother about social or human rights conditions” (Philippe Maystadt, President, EIB in November 2006)



One and the same?

- Prudent lending?
- Sustainable lending?
- Responsible lending?



What Instead?

Eurodad Responsible Financing Charter

- Clear ex ante and ex post rules of the game: only way to enforce (and reward) responsible lending and borrowing behaviour
- Internationally recognised standards for responsible lending and borrowing to apply to all loans issued to sovereign states or covered by a sovereign guarantee



Eurodad Responsible Financing Charter: Key principles

Legal and financial terms and conditions:

- **Purpose and amount of loan: aid effectiveness & poverty focused.** Loan must be driven by national needs assessment and growth strategy
- **Mutual obligations and predictable disbursement:** The borrower commits to spend the funds as stipulated in the loan agreement. The lender commits to deliver the funds predictably as stated
- **Assessment of financial position of borrower** and assumptions used to calculate how borrower will reimburse the loan
- **Fair interest rates and penalties policies** (reasonable and fair upper limit);
- Compliance with relevant **national and international legislation**;
- **Fees and charges:** loan must give details of any fees charged as part of transaction (purpose, amount, recipient). Side-letters not permitted
- **Conflict of interests:** The loan document should also spell out any additional role the lender has played in relation to the loan
- **Restrict right to sell loan on secondary market**



Eurodad Responsible Financing Charter: Key principles

Transparency and accountability

- **Parliamentary and citizen participation and consent:** (provision of adequate time and information in appropriate format)
- **Full public disclosure of information (press, radio, web etc.):** Loan document should be available to citizens on request
- Loan contracts must be available in **main national languages**



Eurodad Responsible Financing Charter: Key principles

Protection of human rights and the environment

- **Respect for human rights:** activities financed must not violate human rights treaties
- Positive independent ex ante long-term **integrated impact assessment** of viability of project and details of how risk will be shared between signatories
- Loan must comply with **social, labour and environmental standards** as embodied in international agreements
- Independent **evaluation and audit**



Eurodad Responsible Financing Charter: Key principles

Procurement

- **Government procurement processes must be open and transparent:** loan must carry clear details of those carrying out any work
- Loan must carry details of any **host government agreements, production-sharing agreements, power-purchase agreements** or any agreement to repay the loan in goods or services provided by the borrower
- **Local capacity-building:** procurement procedures should support the capacity-building of local companies and institutions



Eurodad Responsible Financing Charter: Key principles

Repayment difficulties or disputes

- **Change in circumstance:** The loan must recognise that there will be cases where a dramatic change in circumstances – beyond the will of either borrower or lender – means that the borrower is no longer able to meet its financial obligations on the loan
- **Fair and transparent arbitration procedure:** Loan document should provide for an independent and transparent arbitration procedure in cases of repayment difficulties or dispute
- **Cross-default:** Loan document must not contain any cross-default or similar clause
- The details of any loan refinancing agreements must be public



Conclusion

- Ultimately both lenders and borrowers need to be held accountable for their decisions: **clear ex ante and ex post rules of the road** needed to ensure responsible behaviour
- Move away from traditional top-down conditionality approach: citizens South & North are provided with tools to hold their governments to account
- Forward-looking rules will not solve problem of existing debt burden in many development nations: “debt not done” (US\$2.7 trillion in 2005 up from US\$1.3 trillion in 1990)
- Given greater choice, developing nations should demand more of their financiers



Thanks

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