HAS NORWAY BEEN A RESPONSIBLE LENDER?

A shadow report of the Norwegian Debt Audit

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SLUG is an umbrella organization with more than 40 affiliated organizations. Our work consists of raising awareness, campaigning and political lobbying on debt cancellation and responsible lending. Read more about our work, our demands and our principles at www.slettgjelda.no

SLUG
SLETT U-LANDSGJELDA

Contents

Sammendrag på norsk

Da den norske regjeringen slettet gjelden etter skipseksportkampanjen i 2007 på bakgrunn av kreditors medansvar, var dette et viktig skritt mot mer rettferdig utlånspolitikk. Gjelda etter skipseksportkampanjen var feilslått utviklingspolitikk, den ble lansert for å fremme norske interesser og kom ikke utviklingslandene til gode. Seks år senere har regjeringen bestilt en offentlig gjeldsrevisjon for å vurdere om det er mer av utviklingslands gjeld til Norge som skyldes uansvarlig utlånspolitikk. Den norske gjeldsrevisjonen er et tydelig tegn på at den norske regjeringen tar sitt ansvar som utlåner på alvor, noe som er unikt i internasjonal sammenheng. Dette bryter med den historiske forståelsen av gjeldsbyrder, hvor ansvaret fullt og helt har blitt lagt på låntakerlandet.

I denne skyggerapporten, presenterer Slett U-landsgjelda (SLUG) et sivilsamfunnsperspektiv på noen prosjekter finansiert gjennom norske lån i Indonesia, Egypt og Myanmar. Hensikten er å evaluere hvorvidt Norge har opptrådt som en ansvarlig långiver. For å vurdere dette, anvendes to sett med prinsipper for ansvarlig utlån. Det første settet er prinsipper som nylig har blitt lansert av FN-konferansen om handel og utvikling (Unctad). Når den offisielle gjeldsrevisjonen nå tar i bruk disse prinsippene, blir det første gang prinsippene anvendes i praksis. Dermed handler ikke den norske gjeldsrevisjonen bare om å avdekke svakheter i norsk utlånspraksis, men også om å operasjonalisere og vurdere Unctad-prinsippene. Unctad-prinsippene er imidlertid vage og åpne for tolkning. Derfor analyserer denne rapporten viktige implikasjoner og svakheter ved Unctad-prinsippene. I tillegg til Unctads prinsipper, anvender denne rapporten også Det europeiske nettverket for gjeld og utviklings (Eurodad) charter for ansvarlig finansiering. Charteret går mer i detalj enn Unctad-prinsippene og er lettere å operasjonalisere.

Prosjektene rapporten tar for seg i Indonesia innebærer salg av miljøteknologi på 90-tallet. I 2009 ga SLUG ut en rapport om Indonesias gjeld til Norge[1] som fastslår at disse prosjektene var feilslått utviklingspolitikk. De norske eksportørene brøt avtalene de hadde inngått og istedenfor bølgekraftverk og marin miljøteknologi, satt Indonesias befolkning igjen med en gjeldsbyrde for prosjekter som aldri ble realisert, og som ble tatt opp av Suhartos illegitime regime. Prosjektene illustrerer alvorlige svakheter i kontrollmekanismene som tillot at de i det hele tatt ble satt i gang, samt manglende oppfølging i etterkant. Gjelden Indonesia har etter disse prosjektene er helt klart illegitim og burde slettes.

Prosjektet denne rapporten tar for seg fra Egypt illustrerer de grunnleggende utfordringene knyttet til mangelen på lokal økonomisk utvikling i prosjekter finansiert gjennom eksportkreditter, selv når de stemples som «utviklingsfremmende». Kun en brøkdel av midlene går til lokal virksomhet, og dermed skaper selv de største byggeprosjektene få muligheter for lokale bedrifter. Videre innebar ikke prosjektet i Egypt en åpen anbudsrunde, selv om dette var påkrevd av egyptisk lov. Rapporten tar også for seg norske investeringer i egyptiske statsobligasjoner i 2007, en periode da det egyptiske regimet ble stadig mer autoritært. Gitt at utstedelsen av statsobligasjoner frigir statlige ressurser som kan brukes fritt, er det problematisk å investere i statsobligasjonene til undertrykkende regimer. Studien som presenteres av Myanmars gjeld er et tydelig eksempel på hvordan bistandspenger kan gå til prosjekter som kjøperen faktisk ikke er interessert i eller har behov for, og på hvordan diplomatisk press kan brukes for å fremme donorens kommersielle interesser. Den norske regjeringen har allerede slettet denne gjelden, som en del av slettingen av gjelden etter Skipseksportkampanjen.

Prosjektene rapporten tar for seg er tydelige eksempler på uansvarlig utlån. Den viktigste motivasjonen for prosjektene var å fremme norske kommersielle interesser, prosjektene førte med seg få eller ingen utviklingseffekter, og lånene gikk alle til illegitime regimer.

Rapporten identifiserer en lang liste av brudd med både Unctad-prinsippene og Eurodad Charteret. Norge må nå ta ansvar som kreditor og slette denne gjelden unilateralt og uten betingelser. Dette vil være i tråd med den presedensen den norske regjeringen satt da den slettet gjelden etter Skipseksportkampanjen, og slettingen vil signalisere at regjeringen tar sitt ansvar som utlåner på alvor. Like viktig er det at regjeringen gjennomgår dagens utlånspraksis for å sikre at den er i tråd med Unctads prinsipper for ansvarlig utlån og Eurodads charter for ansvarlig finansiering. Slik vil den kunne hindre mer uansvarlig utlån i fremtiden.

Sammendrag av anbefalinger til norske myndigheter

- Slett gjeld som stammer fra uansvarlig utlån. Dette inkluderer gjelden Indonesia og Egypt skylder Norge.
- Implementer Unctad-prinsippene, som tolket i denne rapporten, for alle typer utlån, også lån gjennom investeringer i statsobligasjoner.
- Arbeid for at de multilaterale utviklingsbankene opptrer som ansvarlige långivere.
- Frem Unctad-prinsippene for ansvarlig utlån internasjonalt og skap debatt om hvordan de best kan tolkes.
- Frem offentlige gjeldsrevisjoner internasjonalt og del norske erfaringer.

1: Magnus Flacké, *Is Indonesia´s Debt to Norway Illegitimate?* (Oslo: SLUG and INFID, 2009).

Executive Summary (English)

It was an important step for debt justice when the Norwegian government in 2007 cancelled debt on the basis of its co-responsibility as a creditor for a number of failed development projects in the 1970s. Now, six years later, the government has commissioned an official audit to evaluate whether there is more developing country debt owed to Norway that resulted from irresponsible lending. This is groundbreaking, as it is the first time such an audit has been commissioned by a creditor, breaking with the historical legacy of placing full responsibility for debts on the debtor alone.

This shadow report presents an independent civil society perspective on the official debt audit, and fulfils an important function in providing oversight of the government. Any differences in the outcomes of the official audit and this report are likely to spur debate around responsible lending and the notion of illegitimate debt. This report evaluates selected claims from projects in Indonesia, Egypt and Myanmar to evaluate whether Norway has acted as a responsible lender. To evaluate the claims, this report employs the recently launched principles for promoting responsible lending and borrowing from the UN Conference for Trade and Development (the UNCTAD principles), and the European Network on Debt and Development (Eurodad) Responsible Finance Charter.

The official audit commissioned by the government employs the UNCTAD principles, and this initiative is an important step towards implementing these principles in practice. It is the first time that an audit is conducted along the principles' lines and is as such an important pilot project, both in order to uncover weaknesses in Norwegian lending practices, and to provide fruitful feedback to the international principles. However, the UNCTAD principles are vague and open to interpretation. This report thus first provides an analysis of the key implications and weaknesses of the UNCTAD principles, before employing these and the Eurodad Charter on the selected case studies.

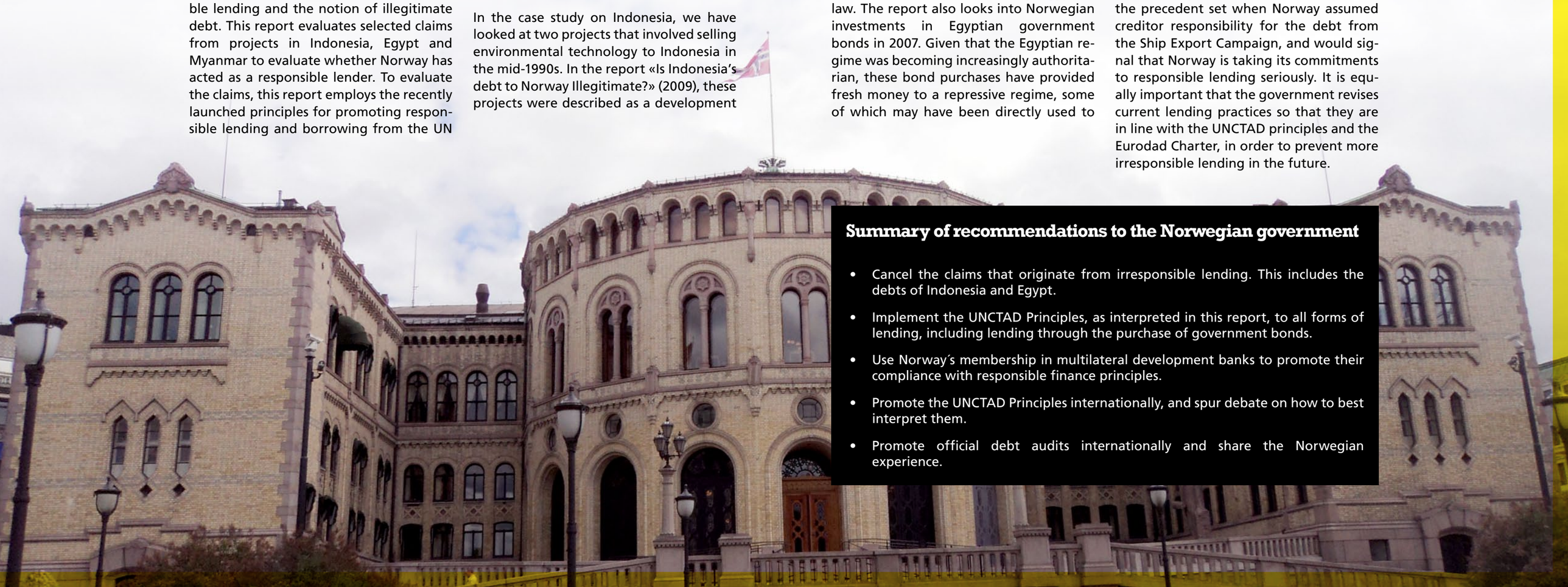
In the case study on Indonesia, we have looked at two projects that involved selling environmental technology to Indonesia in the mid-1990s. In the report «Is Indonesia's debt to Norway Illegitimate?» (2009), these projects were described as a development failure and the Norwegian exporters failed to fulfil the contract. Instead of a wave power plant, and technology to monitor changes in the marine environment, the people of Indonesia were left with debts from projects that never yielded any developmental benefits, and that had been contracted by the illegitimate regime of Suharto. These projects illustrate striking weaknesses in the mechanisms that allowed for the commissioning of the projects, and the lack of a proper mechanism to find a solution when the Norwegian exporters failed to deliver. The Indonesian debt resulting from these projects is clearly illegitimate, and should be cancelled.

The Egypt project illustrates the fundamental challenges involved in projects backed by export credits, yet also being approved as «developmental». Only a fraction of the money can be spent locally, which means that even large construction projects provide few opportunities for local businesses. Furthermore, this project was not the outcome of an open bidding round, which was required by Egyptian law. The report also looks into Norwegian investments in Egyptian government bonds in 2007. Given that the Egyptian regime was becoming increasingly authoritarian, these bond purchases have provided fresh money to a repressive regime, some of which may have been directly used to finance repressive actions against Egyptian citizens.

The case study from Myanmar serves as a clear example of how aid money can be spent on projects where the official buyer is not interested nor in need of the product that the donor has to offer, but where diplomatic pressure can be used to promote the donor´s commercial interests. Norway has already cancelled this debt, as it formed part of the Ship Export Campaign.

These case studies constitute examples of irresponsible lending. The main motivation for the projects in the case studies was to promote Norwegian commercial interests, there were few, if any developmental impacts and the loans were all granted to illegitimate regimes.

This report has identified a long list of violations of the UNCTAD principles and the Eurodad Charter. Norway must now assume creditor responsibility for these debts and cancel it unilaterally and unconditionally. This would be in line with the precedent set when Norway assumed creditor responsibility for the debt from the Ship Export Campaign, and would signal that Norway is taking its commitments to responsible lending seriously. It is equally important that the government revises current lending practices so that they are in line with the UNCTAD principles and the Eurodad Charter, in order to prevent more irresponsible lending in the future.



Summary of recommendations to the Norwegian government

- Cancel the claims that originate from irresponsible lending. This includes the debts of Indonesia and Egypt.
- Implement the UNCTAD Principles, as interpreted in this report, to all forms of lending, including lending through the purchase of government bonds.
- Use Norway´s membership in multilateral development banks to promote their compliance with responsible finance principles.
- Promote the UNCTAD Principles internationally, and spur debate on how to best interpret them.
- Promote official debt audits internationally and share the Norwegian experience.

Introduction

Who benefits when Norway supports commercial projects by Norwegian companies in developing countries? All bilateral debt that developing countries currently owe to Norway originates from Norway's export credit system. Export credits provide state backed guarantees to companies that aim to export Norwegian products. When exporting to developing countries, some of these projects have also been supported with funds from the aid budget. These types of projects run the risk of promoting Norwegian commercial interest at the expense of the interests of the importing country. This was what had happened during the Ship Export Campaign in the 1970s, when Norwegian ships were exported to developing countries in order to save the Norwegian shipping industry. In 2007, when the Norwegian government cancelled the debt from the Ship Export Campaign unilaterally and without conditions, it explicitly assumed creditor co-responsibility, recognising that the campaign had been a development failure and that there had been inadequate needs analysis and risk assessments. The main motivation had been to save the ailing Norwegian ship industry and promote Norwegian commercial interests, rather than promote development in the countries buying the Norwegian products.

In 2008, The Norwegian Coalition for Debt Cancellation (SLUG), Changemaker and the Norwegian Church Aid started campaigning for an official audit of all the remaining claims on developing countries. Could there be more examples of Norwegian commercial interests being promoted under the guise of development? An audit was required to go carry out an evaluation of all of the remaining debt, and after years of campaigning, the Norwegian government announced that an audit would be carried out in 2012/2013.

This shadow report presents a civil society perspective on the official debt audit[2], and fulfils an important function in providing oversight of the government. Any differences in the outcomes of the official audit and this report are likely to spur debate around responsible lending and the notion of illegitimate debt. A civil society perspective is necessary to provide an independent evaluation of whether Norway has acted as a responsible lender, and to put the audit in a broader context of debt justice.

Both the official debt audit and this report employ a set of principles launched by the UN Conference on Trade and Development (UNCTAD) in 2012. The aim of these principles is to promote more responsible lending and borrowing between countries. Although the principles represent a positive first step towards stronger regulation to ensure responsible finance, they are broad and vague, especially when compared to the more detailed requirements outlined in the Responsible Finance Charter developed by the European Network on Debt and Development (Eurodad). SLUG had initially been advocating for the official audit to include a reference to the Eurodad charter as well as the UNCTAD principles, and for the audit to investigate all Norwegian claims on developing countries, bilateral and multilateral. Unfortunately, the Eurodad charter is not included in the official audit, and the audit only investigates bilateral claims, while also excluding claims originating from government bonds. Nonetheless, the official audit is a vital step towards promoting the UNCTAD principles and responsible lending more generally.

This report applies the UNCTAD principles and the Eurodad charter on a limited number of case studies, and presents SLUG´s interpretation of the UNCTAD principles. The first section of the report is an analysis of the UNCTAD principles and outlines some of the key issues that should be included when making use of the principles, in order to best ensure responsible lending. Given that this is the first time that the principles have been employed in practice, it is important to provide an independent civil society interpretation of the principles to contribute towards their operationalization. The second part analyses case studies from Indonesia, Egypt and Myanmar, evaluating whether the projects fulfilled the requirements of the UNCTAD principles and the Eurodad Charter.[3] This part also analyses the Norwegian purchase of Egyptian government bonds, and whether this complied with the UN principles and Eurodad charter.

Norway is the first creditor country to carry out a debt audit of its claims on developing countries, and by this sets an important example. We expect the government to ensure that its stated intention of creating debate about odious and illegitimate debt and responsible lending is followed up internationally. Based on the outcomes of the official debt audit and this report, we expect that the government will assume responsibility for any loans that are deemed illegitimate and cancel these unilaterally and unconditionally.

2: The government audit of Norwegian claims on developing countries will be referred to as the «official debt audit».

3: Past and present guidelines and procedures of GIEK will not be used in the evaluation as in the official audit.

Photo: Sosialistisk Venstreparti

On August 15th, 2012 the Minister of International Development Heikki Holmås announced that Norway will carry out a debt audit

The official audit

The mandate of the official debt audit that is being carried out by the auditing company Deloitte is to:

«(..) study the origin of the Norwegian public claims on developing countries, through an assessment of whether the lending (guarantee issuance) and borrowing was done according to past and present procedures, guidelines and rules. The main output of the exercises will be normative. The audit will train a spotlight on issues such as responsible lending and «odious debt», start a debate, and promote a more responsible lending policy.»*

The official audit makes use of the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing, as well as past and present procedures and rules of the Norwegian export credit agency GIEK.

The debt audit covers all bilateral debt to Norway from developing countries, which includes claims on Egypt, Indonesia, Myanmar, Pakistan, Somalia, Sudan and Zimbabwe. The total claims (excluding late interests) stand at NOK 961.7 million. All the debt had its origins in export credits covering 34 contracts where Norwegian companies exported goods or services. The debt audit does not include Norwegian claims on developing countries through multilateral institutions, nor does it include debt created through the purchase of government bonds in developing countries.

* The Norwegian Ministry of Foreign Affairs, «Tender Document: Audit of the Developing Countries' Public Debt to Norway 2013,» (Oslo: 2012).

Part 1: Principles for responsible lending and borrowing – Interpretations and implications

The UNCTAD Principles

Irresponsible lending and borrowing practices have caused numerous debt crises and contributed to economic stagnation and impoverishment of heavily indebted developing countries. The global financial crisis that started in 2008 raised awareness and opened a window of opportunities for working towards better and more responsible lending and borrowing practices. In 2009 the United Nations Conference on Trade and Development (UNCTAD) began a three-year project on promoting responsible sovereign lending and borrowing. One of the key goals of this project was to develop a set of guidelines that would apply to sovereign states[4] and to build international consensus around these. A multi-stakeholder expert group that included government representatives, academics and civil society was set up to develop the guidelines, and in 2012 the Principles on Promoting Responsible Sovereign Lending and Borrowing were launched.

The 15 principles encourage increased responsibility on the part of lenders and borrowers. There are seven principles that are directed towards sovereign lenders, and eight principles that are directed towards sovereign borrowers. These cover a range of issues, but are generally aimed at improving transparency and accountability. The principles do not create new rights or obligations in international law, but rather serve as a collection of basic principles and best practice.[5]

A step in the right direction

Clearly, the UNCTAD principles did not revolutionise lending when they were launched in 2012. However, the fact that such international principles have been defined and launched is an important first step towards more responsible lending and borrowing practices. The principles recognise the responsibilities of the sovereign lender, which in itself constitutes a positive development. Many of the principles are aimed at improving transparency and accountability on the part of both the lender and the borrower, which can contribute to more responsible lending.

Unfortunately, the principles are not binding, thus sovereigns that fail to abide by the principles cannot be sanctioned. However, this is not necessarily a bad thing. In fact, law professor Anne Gelpern argues that the fact that they are not binding, and came out of a broad multi-stakeholder process, makes it possible to achieve wide consensus around them. If the principles were binding, it would have required a process where they would have become even more watered down, as is often the case for UN resolutions.[6] Gelpern argues that soft law can generate a «compliance pull» that can encourage creditors and debtors to abide by the principles. Disclosure and reporting becomes important, which can be linked to existing institutions to monitor compliance. Monitoring can also be used in name-and-shame strategies, to encourage compliance with the principles.[7]

UNCTAD is currently working on gathering widespread support for the principles. At the moment, the following 13 countries have endorsed the principles: Argentina, Brazil, Cameroon, Colombia, Gabon, Germany, Honduras, Italy, Nepal, Norway, Mauritania, Morocco and Paraguay.[8] For the principles to take root, it is necessary that more countries recognise the principles and publicly state that they intend to abide by them.

In Norway's official audit that is currently ongoing, the debts are evaluated on the basis of the UNCTAD principles, as well as rules and regulations that applied at the time the loans were made and the relevant OECD guidelines. This is an important step forward and shows that the principles can be implemented in practice. However, given that the principles are not very detailed or clearly delineated, the outcome of the audit will depend on how the principles are interpreted. Further, the interpretation of the principles is likely to affect how other countries will employ the principles in the future.

The principles can be interpreted widely, and are likely to be understood differently by various actors. A civil society interpretation of the principles is necessary in order to highlight where the weaknesses of the principles lie, in particular with regards to defining illegitimate debt. Civil society has an important role to play here to provide checks-and-balances on government. The following subchapter contains SLUG´s interpretation of the principles. Hopefully, the Norwegian government will consider this interpretation when implementing the UNCTAD principles, and in its continued work on defining illegitimate debt and promoting responsible lending. This interpretation is meant to spur debate and contribute to developing the principles further. A summary of the implications and weaknesses of the principles can be found in annexure 2.

4: Hereafter referred to as «sovereigns».
5: UNCTAD, *Principles on Promoting Responsible Sovereign Lending and Borrowing* (Geneva: UNCTAD, 2012), 4.

6: Gelpern interviewed in Ingrid Harvold Kvangraven, *Fra prinsipper til handling. Etter UNCTAD: Veien mot mer ansvarlig utlån og lånopptak* (Oslo: SLUG, 2012), 13.
7: Anne Gelpern, *Hard, Soft, and Embedded: Implementing Principles on Promoting Responsible Sovereign Lending and Borrowing* (Geneve: UNCTAD, 2012), 16.
8: Information from Pål Børresen, Senior Sovereign Debt Expert at UNCTAD, received on the 25th of July 2013. Also see UNCTAD, «*PRSLB Endorsements*,» http://www.unctad.info/en/Debt-Portal/Project-Promoting-Responsible-Sovereign-Lending-and-Borrowing/Endorsements/. Accessed on 08.08.2013.


Photo: NASA

UNCTAD principles on Promoting Responsible Sovereign Lending and Borrowing

Responsibilities of lenders	
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).
2. Informed Decisions	Lenders have a responsibility to provide information to their sovereign customers to assist borrowers in making **informed credit** *decisions*.
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.
4. Responsible Credit Decisions	A lender is responsible 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.
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.
6. International Cooperation	All lenders have a duty to **comply with United Nations sanctions** imposed against a governmental regime.
7. Debt Restructurings	In circumstances where a sovereign is manifestly unable to service its debts, all lenders have a duty 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.

Responsibilities of Sovereign Borrowers	
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.
9. Binding Agreements	A sovereign debt contract is a binding obligation and should be honoured. Exceptional cases nonetheless can arise. A **state of economic 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 economic necessity of the borrower, changes to the original contractual conditions of the loan are unavoidable, Principles 7 and 15 should be followed.
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 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.
11. Disclosure and Publication	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 standardised 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 to be used reasonably.
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.
13. Adequate Management and Monitoring	Debtors should design and implement a **debt sustainability and management strategy** and to 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.
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**.
15. Restructuring	If a restructuring of sovereign debt obligations becomes unavoidable, it should be undertaken **promptly, efficiently and fairly.**

A civil society interpretation of the UNCTAD principles

Responsibility of sovereign lenders

Principle 1: Agency

This principle states that the sovereign lender must recognise that the government officials of the borrowing country are responsible for protecting public interest (towards the state and its citizens). This can be interpreted in a narrow way by understanding this simply as a principle to prevent corruption of public officials. However, that the lender must recognise the responsibility of the sovereign borrower to protect public interest can have more extensive implications. The principle can also be interpreted to mean that it is problematic to lend to a regime that does not represent nor act in the interest of its citizens. The doctrine of odious debts articulated by Sack in 1927, argues that debt that is incurred by an illegitimate regime, against the interests of the people and without its consent, and where the creditor was aware of this, is not the responsibility of a successor regime.[9] Given that the principle states that the sovereign borrower has a responsibility to protect the interests of its citizens, and that the lender must recognize this, SLUG interprets this principle as a responsibility to avoid odious debt, on the part of both lender and borrower. The implication is that the lender has a responsibility to either avoid lending, or go to extra lengths to ensure that the loan does benefit the population in cases where the regime is odious.

When interpreted in this way, by recognizing principle 1, lenders should also recognize that giving odious loans carries the risk of future repudiation by a successor regime, if the new regime can prove that the debt is odious.

The interpretation of the responsibility of the sovereign borrower to protect public interest also carries another important dimension. It should be interpreted to include the responsibility of the state to protect the fundamental rights of its citizens, and allow sufficient public funds for this purpose. This will be discussed in relation to principle 7 and 15, where it becomes important in relation to debt restructurings. Further, the imposition of harmful policy conditionalities by lenders, either tied to the initial loan, or as a part of a restructuring, contradicts the responsibility of the sovereign borrower to protect the interests of its citizens.

9: According to Sack «…if a despotic power incurs a debt not for the needs or in the interest of the State, but to strengthen its despotic regime, to repress its population that fights against it, etc., this debt is odious for the population of the State.» Further: «The debt is not an obligation for the nation; it is a regime's debt, a personal debt of the power that has incurred it, consequently it falls within this power.…The reason these 'odious' debts cannot be considered to encumber the territory of the State, is that such debts do not fulfill one of the conditions that determines the legality of the debts of the State, that is: the debts of the State must be incurred and the funds from it employed for the needs and in the interest of the State. 'Odious' debts, incurred and used for ends which, to the knowledge of the creditors, are contrary to the interests of the nation, do not compromise the latter – in the case that the nation succeeds in getting rid of the Government which incurs them – except to the extent that real advantages were obtained from these debts.» Sack quoted in Robert Howse, «*The Concept of Odious Debt in Public International Law*,» in Discussion Paper No. 185 (Geneva: UNCTAD, July 2007),

Photo: Kjetil Ådildsnes

Box 1: Illegitimate debt

Illegitimate debt can refer to debt that is unfair, improper or objectionable, or against the law. The subcategory 'odious debt' refers to debt that is incurred by an illegitimate regime, against the interests of the people and without its consent, and where the creditor was (or should have been) aware of this. Examples of odious debt includes the debt incurred by the apartheid regime in South Africa, the debt incurred by the regime of Saddam Hussein in Iraq, and the debt from the Marcos regime in the Philippines. Estimates of debts incurred by dictatorial regimes are as high as $500 billion, and the people of these countries should not have to pay for debts that were incurred to suppress them.

The concept of illegitimate debt is wider than odious debt, and encompasses debt from ill-conceived or failed development projects which caused large social and environmental damage and debts that were incurred for illegitimate purposes or with illegitimate conditions. The limits of what defines illegitimate debt are not set in stone, but will have to be developed over time. An important way of contributing to defining the concept of illegitimate debt is for countries to conduct debt or claims audits, so that the legitimacy of the loans can be assessed.

To read more about illegitimate debt, see: Joseph Hanlon, Defining Illegitimate Debt and Linking its Cancellation to Economic Justice (Oslo: Norwegian Church Aid, 2002), Sarah Williams, Unfinished Business: Ten Years of Dropping the Debt (London: Jubilee Debt Campaign, 2008) and UNCTAD, "The Concept of Odious Debt in Public International Law," (Discussion paper 185: 2007).

Principle 2: Informed Decisions

This principle states that the lender must provide information that enables the borrower to make an informed credit decision. Given the increased complexity of loans and financial instruments this is undoubtedly a positive step. However, the principle does not specify what kind of information should be provided. SLUG therefore takes this opportunity to propose a concrete interpretation of the principle, which is in line with the Eurodad Charter[10]: The lender must provide all details of the loan in a single document. This must include specifications of the type and level of interest rates charged, and if the interest rate is variable, a fair upper limit should be set. Further, all details regarding grace and maturity periods and repayment profiles must be provided, as well as details of fees and charges. Any penalty premiums must be clearly stated, and these should be at a maximum rate no higher than the original interest rate. Finally, all information should be publicly available.

Principle 3: Due Authorization

This principle states that the lender must check that the financing has been properly authorized, that the agreement as such is consistent with applicable law, and the lender should not complete the agreement if these criteria are not fulfilled. The principle only refers to applicable law, which can refer to the legal framework that the parties have agreed should apply. However, this should also be interpreted more widely, to mean that the agreement should not breach of the laws of the borrowing country or those of the lender. Proper authorization, when seen in conjunction with principle 1 (regarding the responsibility of the sovereign borrower towards its citizens), should mean that the national parliament has given authorization for the loans.

The Eurodad Charter is more specific on this, and has a requirement that parliaments, citizens and affected communities «must be given adequate time to debate the loan or investment (…)» and that all loans must «comply with national laws».[11] This has bearing in the case of a possible debt restructuring. If due authorization was not granted, or the loan contravened national laws, the creditor in question should later have a weaker claim for repayment than other creditors that acted prudently. The debtor government could argue that the debt is illegitimate and should not be repaid if the loan was contracted in contradiction with national law. A clear example of this was the debt contracted by the Argentine military dictatorship from 1976-1983 that was taken up in contradiction with Argentinean law and

10: See section A(i) in Eurodad, *Responsible Finance Charter* (Brussels: European Network on Debt and Development, 2011), 14.

11: See section F(i)1 in ibid., 18.

was ruled illicit and illegitimate by Judge Jorge Ballesteros in 2000.[12]

Principle 4: Responsible Credit Decisions

According to this principle, the lender is responsible for making a realistic assessment of the sovereign borrower´s capacity to repay. This is aimed at avoiding the risk of potential default at a later stage, which would also impact negatively on other creditors. The principle makes reference to due diligence rules and that lenders should consider the broad and real financial scenario. The principle further requires that lenders must conduct a serious assessment of the borrower´s repayment capacity regardless of their own geo-political interest in the loan agreement. Beyond what the principle states, a further implication is that lenders that extend loans to refinance the debt of a country that already has repayment difficulties must exert increased levels of due diligence. If a lender knowingly extends a loan that puts the borrowing country at risk of default at a later stage, the lender can be said to have acted imprudently. In a possible debt workout, the debtor country can argue that lenders that acted irresponsibly are not entitled to full repayment. Further, creditors that acted irresponsibly should have to shoulder a greater part of the burden of debt reduction than creditors that acted prudently.

The IMF has faced on-going criticism of their debt sustainability analyses that are often unrealistic and too optimistic.[13] Given that the IMF plays an important role as a creditor, it is necessary to have an independent body (such as UNCTAD) develop debt sustainability analyses. This would improve the basis upon which lenders can make responsible credit decisions.

Principle 5: Project Financing

According to this principle, lenders have a responsibility to perform their own ex ante investigation into the likely effects of the project, and when applicable a post-disbursement monitoring of the use of the loan. The principle specifies that the likely effects include 'financial, operational, civil, social, cultural and environmental implications'. This does not explicitly state that the human rights impacts of the project should be assessed, although human rights impacts and labour standards can be interpreted to form part of the 'likely effects.' According to SLUG´s interpretation of this principle, both ex ante impact assessments and post-disbursement monitoring must include an assessment of the impacts described above, including those affecting human rights and labour standards.

Principle 5 does not deal with the question of «loan tying», where a condition for receiving the loan is to purchase goods or services from the lender. The Eurodad Charter explicitly states that loan contracts must not be tied to the purchase of goods or services from the lender.[14] Loan tying has often resulted in poor project financing that has been more geared towards the lender´s interest in selling goods or services than towards the developmental aims of the borrower country. The principle also lacks a reference to guidelines that ensure that project financing is in line with national development priorities of the borrowing country, as required by both the OECD guidelines and Eurodad Charter.[15]

Principle 5 is particularly relevant when examining Norwegian bilateral claims on developing countries. All these claims originated in export credits, where private or public entities in the borrowing countries bought goods or services from Norwegian companies, with state guarantees, most often given on both sides.[16] Export credits are problematic for a range of reasons, but in particular because there is a risk that developmental impacts do not materialise when the commercial interests of the lender are very strong, as was the case with the Norwegian Ship Export Campaign. The ex ante assessment of project financing by the lender (and the borrower) should carefully assess possible and likely impacts, with particular emphasis on the developmental impacts and whether the project is in line with the development priorities of the sovereign borrower. This is particularly relevant when it comes to mixed credits, where the loan or credit includes a proportion of aid money that should go to furthering developmental aims.

Principle 6: International Cooperation

This principle states that all lenders have to comply with UN sanctions against a particular regime, and should not participate in financial transactions that 'violate, evade or hamper such sanctions'. Although this principle is narrow in the sense that it only demands that lenders must not finance regimes that face UN sanctions, it implicitly recognises that the lender has a responsibility in terms of what kind of regime it finances through its lending. SLUG interprets principle 6 to mean that if a lender does not comply with UN sanctions against a given regime, they take on the risk of debt repudiation by a future democratic regime. Legitimate successor regimes cannot be held liable for debt incurred by a previous illegitimate regime when the lender was aware of the risk and chose to give the loan in breach of UN sanctions.

Moreover, SLUG asserts that the responsibility of the lender should extend beyond

12: Hanlon, *Defining Illegitimate Debt and Linking its Cancellation to Economic Justice*, 31.
13: A recent report from the IMF itself conceded that the Fund´s assessments of debt sustainability «may sometimes have been too sanguine», see IMF, «*Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework*,» http://www.imf.org/external/np/pp/eng/2013/042613.pdf. Accessed on 11.08.2013. Also see SLUG, «*Fortsatt svake analyser av gjeldsbærekraft*,» http://slettgjelda.no/no/tema/internasjonale_finansinstitusjoner/verdensbanken/artikler/Fortsatt+svake+analyser+av+gjeldsbærekraft.b7C_wlzK3C.ips. Accessed on 13.08.2013.
14 Principle E(i)3, see Eurodad, *Responsible Finance Charter*, 17.
15: Section C(i)1, see ibid., 16. Also see point 4 (c) in OECD, «*Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low Income Countries* (April 2008 Revision),» http://www.oecd.org/tad/xcred/sustainable-lending.htm. Accessed on 11.08.2013.
16: In the case studies evaluated in part 2, a counter-guarantee from the host country was required in all the projects. However, according to Nikolai Owe at GIEK, the practice of requiring a counter-guarantee has become less frequent in recent years, as most projects are now purely commercial projects where counter-guarantees are not a requirement from GIEK.

Box 2: Export credits and the Ship Export Campaign

In order to support export industries, many governments issue credits and guarantees through Export Credit Agencies (ECAs). These agencies issue guarantees to export industries and financial institutions, and enable companies to engage in projects that would otherwise be too risky. ECAs guarantee against political risk and other non-commercial risks, so that the exporting company can be certain of payment for the exported goods and services. Put simply, export credits are a way of supporting national export industries.*

The main problem with export credits is the risk that the commercial interest of the exporter becomes a more important factor and a stronger driving force than the development impacts in the borrowing country. In the case of mixed credits, a loan is given (backed by a guarantee) to a developing country, where a certain part of this is given as a grant. In these cases in particular, it is assumed that the project will have positive developmental effects. However, many projects that were made possible through export credits have had damaging impacts on the environment, contributed to human rights violations and have not yielded the expected development results.

The Norwegian Ship Export Campaign from the 1970s is a good example of export credits that were given to further the commercial interests of the lender country, while not promoting development in the recipient countries. Norway gave export credits to projects to sell Norwegian ships to developing countries, but many of the ships were of poor quality, some were never delivered and some were not properly built for the purpose they were meant to be used for. Mixed credits meant that a grant element was included and that the Norwegian development agency was involved, but the commercial interests in selling the ships often trumped concerns about the developmental impacts in the host country. In 2007 the government of Norway cancelled the debt from the Ship Export Campaign (for Ecuador, Egypt, Jamaica, Peru, and Sierra Leone, with Burma and Sudan receiving cancellation once the countries became eligible for multilateral debt relief). When cancelling these debts, the Norwegian government explicitly assumed creditor co-responsibility for the failure of the Ship Export Campaign and the lack of development that resulted from it.**

*** To read more about export credits and the Ship Export Campaign, see: Øygunn Sundsbø Brynildsen, Exporting Goods or Exporting Debts? Export Credit Agencies and the Roots of Developing Country Debt (Brussels: Eurodad, 2011) and Kjetil G. Abildsnes, Why Norway Took Creditor Responsibility - the Case of the Ship Export Campaign (Oslo: SLUG and ForUM, 2007).**

Box 3: Unpayable debt and debt sustainability

The debt sustainability analyses of the IMF and the World Bank have been heavily criticised for being unrealistic in their assumptions about future repayment capacities, and for failing to detect early warning signs of debt distress.*

Beyond the question of making realistic predictions about a country´s ability to sustain a certain debt level, the IMF approach is flawed in terms how sustainability is conceptualised. The IMF definition of sustainable debt level is based on macroeconomic indicators and does not consider the government´s ability to protect its population's basic needs, and social and economic rights. Civil society organisations have deemed debts above this level to be «unpayable». The Human Rights Council has also called for the consideration of a sovereign´s ability to create conditions for the realisation of human rights to be included in analyses of debt sustainability.**

* See IMF´s admission that their debt sustainability analysis has serious shortfalls: IMF, «Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework.» Also see SLUG, «Fortsatt svake analyser av gjeldsbærekraft.» and

** Human Rights Council, «Report of the Independent Expert on the Effects of Foreign Debt and Other Related International Financial Obligations of States on the Full Enjoyment of All Human Rights, Particularly Economic, Social and Cultural Rights, Cephas Lumina,» http://www.ohchr.org/Documents/HRBodies/HRCouncil/RegularSession/Session20/A-HRC-20-23_en.pdf Accessed on 11.08.2013.

complying with UN sanctions, and that the lender must lend responsibly to ultimately avoid the creation of illegitimate debt.

Principle 7: Debt Restructurings

Principle 7 allows for a debt restructuring in the case where a sovereign is «manifestly unable to service its debt». In this situation, all lenders have a responsibility to act in «good faith and with cooperative spirit to reach a consensual re-arrangement of those obligations». The creditors should further «seek a speedy and orderly resolution to the problem». Without using the term explicitly, it also includes a reference to vulture funds[17], describing these companies as acting abusively.

The principle does not recognise the fundamental problem regarding the lack of fairness when there is no independent third party to decide on the claims in the case of restructuring or debt cancellation. This is a major flaw in the international financial system, as there is no corresponding mechanism to fulfil the functions of national bankruptcy law in the case of sovereign states. On the one hand, the principles are a collection of best practices, and do not purport to introduce new obligations or rights, and from this perspective could not be expected to include a reference to an independent mechanism. However, the principles could have required that new contracts should include an arbitration clause, which does not require the establishment of any new mechanism. With such a clause, in the event of a dispute or repayment problems, the case could be referred to an independent arbitration panel that could be established ad hoc. This would allow independent evaluation of the situation of the debtor, the character of the debt, and an independent judgement on how the situation should be resolved. The Eurodad Charter recognises this problem and states the need for an independent and transparent debt workout procedure.[18]

Moreover, there are several terms in principle that need to be more clearly defined. The term «manifestly unable to service its debt» can be interpreted in many ways, which relates to the question of debt sustainability. Most civil society organisations working on debt argue that debt sustainability should be understood as a sovereign´s ability to fulfil its basic duties towards its population through public services. Such an interpretation is also in line with principle 1, which recognises a sovereign´s responsibility to protect the interests of its population. Moreover, who gets to define when a sovereign is «manifestly unable to service its debt» is highly contested. Ideally, an independent party should perform this evaluation, rather than involved parties such as the IMF and the World Bank.

Regrettably, the reference to lenders acting in «good faith» and the need to work for a «consensual re-arrangement,» conceals the power imbalance that exists between an insolvent sovereign and its creditors. «Consensual re-arrangement» is unlikely to produce a fair result in such a situation without an independent third party with decision-making power. This is an important shortcoming of the principles.

Furthermore, whereas this principle refers to the responsibility of the lender to seek a «speedy and orderly solution», the corresponding principle for the responsibility of the borrower (principle 15), states that the restructuring should be «undertaken promptly, efficiently and fairly.» There is an imbalance here, as the sovereign debtor is expected to treat its creditors «fairly» (presumably according to the seniority of the debt), whereas the lender has no corresponding responsibility to treat the debtor fairly. The latter would have necessitated giving the debtor the opportunity of an independent debt workout procedure, instead of having to rely on the goodwill of creditors. If a lender indeed seeks to act in «good faith», such a mechanism must be employed.

Responsibilities of sovereign borrowers

Principle 8: Agency

This principle mirrors principle 1, as it recognises the responsibility of the sovereign borrower to protect the interests of its citizens. Thus, it must also be seen in connection with illegitimate debt. Principle 8 points out that when sovereign states borrow, the debt binds future administrations and generations. The sanctity of contracts does imply that future regimes have to repay the debt contracted by the previous regime. However, as established by Principle 1, the case of odious debt is an exception to this. Given the responsibility of both the lender and borrower to recognise that the sovereign borrower has to act in the interest of its population, odious debt is a clear breach of this responsibility. If the regime is illegitimate, the debt incurred does not benefit the population and the lender knew or should have known of this, then the debt is also illegitimate, and should not be repaid.

The responsibility of the debtor to protect the interests of its citizens should also have implications when it comes to repayment. If debt service means that the state is unable to provide basic services to its people, then the state is not fulfilling its responsibility towards its population. This should be taken into account in any restructuring (relating to principle 7 and 15).

Principle 9: Binding Agreements

This principle states that although debt contracts should be honoured, there are exceptional cases where the debtor is either in a «state of economic necessity» that prevents timely repayment, or «a competent legal authority may rule that circumstances giving rise to legal defense have occurred». There are several terms in this principle that need to be defined.

The term «state of economic necessity» is vague, and could be interpreted merely as a sovereign in severe financial distress. However, SLUG interprets the principle more widely, especially when taking principle 1 and 8 into account, regarding the responsibility of the sovereign borrower towards protecting the interests of its citizens. When a sovereign is unable to cover the basic needs of its population and promote development due to its obligation to service its debt, this should be considered as part of the case to argue that the sovereign is in a «state of economic necessity.» Professor Kunibert Raffer supports this view, arguing that an evaluation of a country´s ability to invest in the social sector to reach the UN Millennium Goals should form part of the understanding of the term «economic necessity».[19]

Furthermore, «circumstances giving rise to legal defense» must also be defined. In Principle 9, it is stated that creditor complicity in the corruption of borrowing officials

17: «Vulture funds» refers to companies that purchase debt on the secondary market at a highly discounted rate, to later claim back the full amount from the debtor. This presents a serious challenge to debt restructurings where all creditors are expected to share the costs of reducing the debt burden of the debtor in question.

18: See principle G(i)2 in Eurodad, *Responsible Finance Charter*, 18.

19: Raffer in Kvangraven, *Fra prinsipper til handling. Etter UNCTAD: Veien mot mer ansvarlig utlån og lånopptak*, 7.

or transactions that hamper or violate UN sanctions are examples of such circumstances. However, this does not give sufficient direction for the principles to have much bearing on illegitimate debt. In the example of Argentina for instance, a court ruled that Argentina´s debt stemming from the military dictatorship was illicit and illegal. In SLUG´s understanding of this principle, such circumstances must also give rise to legal defence. The «circumstances» referred to must therefore be interpreted to mean more than solely corruption and violations of UN sanctions, as only a wider interpretation can address the question of illegitimate debt in a more comprehensive manner.

Principle 10: Transparency

This principle aims to ensure transparency in the process of lending and borrowing, and stresses the need to have proper legal frameworks in place to define procedures responsibilities and accountabilities. It is further stated that representatives of the legislature «should ideally be involved in the decisions about whether, and how to incur the debt», and that it is necessary to ensure proper approval and oversight of official borrowing, including for guarantees made by state bodies. This latter part is of importance in the context of the Norwegian debt audit, as all the debt that is being audited stems from export-credits guaranteed by the state.

The formulation regarding the role of parliamentary oversight: that representatives in the legislature «should ideally» be involved, does not carry sufficient strength. The Eurodad Charter is more explicit when stating that all loan contracts must show that it has «secured the necessary parliamentary and/or administrative approvals in the borrowing country.»[20] As discussed under principle 3, transparency and proper authorization, when seen in conjunction with principle 1 (regarding the responsibility of the sovereign borrower towards its citizens), must mean that the national parliament must give authorization for the loans.

Principle 11: Disclosure and Publication

Both principle 10 and 11 regarding transparency, disclosure and publication can contribute to more responsible lending. Principle 11 states that lenders must be given sufficient information to analyse the risk of their investment decision, if the lender is to be expected to bear this risk. Further, the principle states that a sovereign that does not provide full disclosure will be «ill-positioned to argue that its creditors have a moral responsibility to participate in any necessary workout of the loan down the road.»[21]

For the information obtained through improved transparency and disclosure by the borrower to have substantive effects on lending decisions, the lender should face a risk of negative consequences if they fail to behave responsibly. This again highlights the need for a fair and independent arbitration mechanism to function as an insolvency procedure that could differentiate between creditors that have acted prudently when making the loan, and creditors that did not. Whether the sovereign borrower has followed principle 10 and 11 should be considered in such a procedure.

Principle 12: Project Financing

According to principle 12, 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.» As with principle 5 regarding lenders, SLUG interprets this to include an assessment of impacts on human rights and labour standards. The assessment must include substantive public consultations with affected communities and civil society organisations.

The principle also notes that the debt remains payable, even if the sovereign later «comes to regret the design or the commissioning of the project.»[22] This principle fails to recognise that the sovereign borrower must have the right to refuse full payment of the debt if the lender has acted imprudently, or if there has been a breach of contract.

Principle 12 further refers to the need for borrowers to conduct their own assessments independent to that of the lender, as there are «many examples of lenders that have tempted sovereigns to commission unnecessary or even harmful projects (…)».[23] The joint responsibility of both sovereign borrowers and lenders must be recognised for ensuring that project loans benefit the development of the borrowing country. As already discussed under principle 5, project loans must be in line with the national development priorities of the sovereign borrower, and not be tied to the purchase of goods or services from the lender.

Principle 13: Adequate Management and Monitoring

This principle refers to the responsibility of debtors to have a debt sustainability and management strategy, effective monitoring systems and independent regular audits. Establishing a debt management office is encouraged to achieve greater cohesion, better management and improved long-term debt strategies. Although the principle duly refers to the responsibility to have «independent, objective, professional, timely and periodic audits,» and that the results should be publicised, this is aimed mainly at improving debt sustainability and transparency.[24] The question of whether audits should deal with the nature of the debt is not raised explicitly, but for SLUG a debt audit means an evaluation of the nature of debt as well. Debt audits should indeed assess whether the loans were contracted in accordance with the principles and assess whether the debt was contracted legally with due authorization (in accordance with principle 3), whether it was taken up and used in the interest of the population (principle 1 and 8), whether the creditor provided sufficient information about the risks (principle 2), whether in the case of project financing ex ante assessments were made by both the borrower and lender (principles 5 and 12), and whether the process was transparent with proper approval and oversight (principle 10 and 11). If a narrow interpretation of the principles is employed, these will not be sufficient to assess the legitimacy of the debt burden. A thorough debt audit should further assess the legitimacy of the debt, by examining how it was contracted, by what regime, for what purposes and whether it benefited the population and the development of the country.[25] If a claim is deemed illegitimate in a debt audit, the sovereign borrower should be able to demand cancellation.

Finally, principle 13 does not specify the role of democratic institutions and citizen participation in debt management and monitoring although it does state that the results of the audits must be made public.

Principle 14: Avoiding Incidences of Over-Borrowing

When contracting a loan, the sovereign borrower has a responsibility to weigh costs and benefits, and should take out loans with a «prospective social return at least equal to the likely interest rate.» According to Raffer, there are challenges related to applying this principle to low-income, cash-strapped economies. Many countries will face financial difficulties when the social returns do not come to fruition as quickly as the debt servicing becomes due. Further, the loan is often taken up in hard currency, whereas the social returns will accrue in domestic currency that might not be worth as much. Raffer therefore argues that cash-strapped economies should not be looking at social returns, but rather equal financial returns to interest rates when choosing whether to take up a loan. This implies that efforts to achieve the Millennium Development Goals in the poorer countries should be financed mainly by grants and not loans.[26]

In addition, this principle must be seen in conjunction with principle 13, which outlines strategies for responsible debt management.

Principle 15: Restructuring

As discussed under principle 7, the system of international finance lacks a fair and independent mechanism to deal with sovereign debt. Ideally, there should be an international debt court to fulfil the function that bankruptcy courts have in national jurisdictions. However, this will take many years to establish. In the meantime, an ad-hoc arbitration procedure can

20: See principle (A(i)4) in Eurodad, *Responsible Finance Charter.*

21: UNCTAD, *Principles on Promoting Responsible Sovereign Lending and Borrowing*, 10.
22: Ibid., 11.
23: Ibid.
24: Ibid.
25: CSOs gave input on the principles, and suggested that debt audits should assess the legitimacy of the debt and that illegitimate and unpayable debt identified in the audits must be cancelled.
26: Kunibert Raffer, «*Improving Debt Management on the Basis of UNCTAD's Principles*,» in *Sovereign Financing and International Law: The UNCTAD Principles on Responsible Sovereign Lending and Borrowing* (Oxford: Oxford University Press, forthcoming conference volume). See section 4, paragraph 3.

provide the independent judgement that is lacking today. Such a procedure should also evaluate the legitimacy of claims. One way to ensure more responsible financing is to include arbitration clauses in new loan contracts.

Principle 15 states that restructuring can take place if the sovereign is in a state of economic necessity, without defining what the term economic necessity entails. The principle further states that the restructuring should be «proportional to the sovereign´s needs.» In accordance with the responsibility of the state to protect the interests of its citizens, SLUG interprets economic necessity not only as financial inability to service the debt, but also when the sovereign is unable to cover the basic needs of its population. The sovereign should be able to argue the need for restructuring on this basis, and also demand a debt reduction or cancellation that frees up sufficient funds for the state to be able to fulfil its fundamental obligations towards its citizens. The Eurodad Charter (in section G(I)2 on dispute resolution) requires that new debt sustainability criteria for the country in question be established that takes into account basic development needs. The principle also states that all stakeholders (including citizens) should share an equitable burden of adjustment and/or losses. This should be interpreted to mean that the lenders also have to take their fair share of the loss in a restructuring.

Furthermore, principle 15 emphasises that the restructuring must be done in an efficient and transparent manner that does not arbitrarily discriminate between creditors, and that it should be a consensual rearrangement. There are however good reasons to discriminate between creditors, albeit not in an arbitrary fashion. Creditors that have behaved prudently when lending should be given priority over creditors that have been lending irresponsibly and recklessly. This can be assessed on the basis of the principles. To discriminate between prudent and imprudent lenders in debt restructurings will contribute towards reintroducing risk. If lenders see that there is a greater risk of losing their money in a possible future debt restructuring if they lend irresponsibly, this should increase the risk hence reduce irresponsible lending.

The principle further emphasises the voluntary nature of the involvement of the creditors, and that the restructuring should be a consensual rearrangement. It is a major weakness in the principles, and in the global financial system, that there is no independent debt workout mechanism that can hold lenders and borrowers accountable.

Missing links

Illegitimate debt

One of the key objectives of UNCTAD´s project on responsible sovereign lending and borrowing in addition to developing the guidelines was to open up for a discussion on the possibility of using these guidelines for assessing the legitimacy the debt of sovereigns.[27] However, as discussed above[28] the UNCTAD principles do not provide a sufficient basis upon which to assess the legitimacy of debt, unless they are interpreted to mean much more than what is explicitly stated. The responsibility of the sovereign borrower to protect the interests of its citizens, and the responsibility of the lender to recognize this, could be interpreted in a way that precludes loans that go against the interests of the citizens. Odious debts taken up by illegitimate regimes would be a clear case in point, as with the example of the debt from the Argentinean military regime. However, odious debt is only part of the broader notion of illegitimate debt. An audit or another form of review of a given debt burden would be necessary to establish how the debt was contracted and how the money was spent in order to evaluate the legitimacy of the debts.

The reference to the need to hold audits in principle 13 does open a space for debtor countries to evaluate their debt burdens, and in the process assess the legitimacy of the debt. Ecuador performed an extensive audit of their debt burden in 2008, and Norway is the first creditor country to conduct an audit of the debt it is owed by developing countries. While a thorough audit can help establish the relevant facts to evaluate the legitimacy of a given debt, there is still a need for independent and fair judgement on what should be done about a debt burden.

27: UNCTAD, «*Objectives of the Project*,» http://www.unctad.info/en/Debt-Portal/Project-Promoting-Responsible-Sovereign-Lending-and-Borrowing/About-the-Project/Objectives/. Accessed on 08.05.2013.
28: See in particular the discussions under principles 1,3,6,8 and 9.

A fair and transparent solution

The second key missing element in the principles is the lack of a reference to debt arbitration in cases where the sovereign debtor faces repayment difficulties or a dispute arises over the claims. Dr. John Williamson, who formed part of the UNCTAD expert group, argues that debt arbitration is necessary, and that it should be encouraged through including a reference to arbitration in original loan contracts.[29] The need for a fair and independent arbitration mechanism is discussed under principle 7 and 15, and had a reference to arbitration been included in the principles, this would have made them more effective in promoting responsible finance. According to Professor of economics at the University of Massachusetts, Dr. Léonce Ndikumana, the severe imbalance of power between creditors and the sovereign debtor (in particular with small debtor countries) remains, even with the principles in place, as they are not binding and creditors do not face any consequences should they choose not to follow the principles.[30] If an arbitration clause were to be included in new loan contracts, an independent body could decide on how to deal with the debt, should the sovereign be unable to pay, or if other disputes arise. Consequently, the power imbalance that exists between creditors and debtors would be reduced, as an independent body would make the decision. In an arbitration procedure, the sovereign debtor would also be able to present evidence (possibly already gathered through an audit) on whether the debt burden is illegitimate. It is necessary to reintroduce risk to make the sovereign lending and borrowing more responsible. This could be achieved by discriminating between responsible and irresponsible lenders in a debt restructuring or arbitration process. This would encourage greater care on the part of the lender to ensure that all the correct procedures have been followed and that the loan is in fact contracted to benefit the population of the borrowing state.

The Eurodad Responsible Finance Charter

The Eurodad Responsible Finance Charter was developed by the European Network on Debt and Development to promote responsible finance.[31] The Charter aims not only to avoid future debt crises, but also to promote development effectiveness. The Charter consists of a comprehensive set of requirements for loans and investment contracts regarding the technical and legal terms and conditions, requirements for the protection of human rights and the environment, for the promotion of development effectiveness, for tax related measures, for procurement, public consent and transparency, and finally requirements for dispute settlement. The specificity of the Charter makes it easier to employ than the broader UNCTAD principles, and this report therefore employs the Charter in the analysis of selected case studies. Below is an abridged overview of the requirements of the Eurodad Charter (see annexure 1 for a more complete version).

29: Interviewed in Kvangraven, *Fra prinsipper til handling. Etter UNCTAD: Veien mot mer ansvarlig utlån og lånopptak*, 9.
30 Interviewed in ibid., 10.

31: For the full version see Eurodad, *Responsible Finance Charter.*

Eurodad Charter summary

A: Technical and legal terms and conditions	The first section of the Eurodad Charter consists of 15 specific requirements for the technical and legal terms and conditions for loan contracts and 14 such requirements for investment contracts.
B: Protection of human rights and the environment	This section of the Charter outlines requirements for loan and investment contracts in terms of **respect for human rights and internationally social, labour and environmental standards**, requirements for **needs assessments, ex ante impact assessments** and to uphold the precautionary principle.
C: Development effectiveness	This section requires that all loan and investment contracts are **aligned to national development goals** and that the **contracts are not tied to the purchase of goods or services from the lender or investor**. The section also requires that investment contracts promote the employment of local citizens, local community development, local business development, technology transfer, infrastructure development, and that products should be made available for domestic industry.
D: Tax related measures	Loans and investment contracts must **comply with national tax legislation**, tax information exchange, and to ensure financial transparency. Investment contracts must require that prices comply with an arms-length pricing requirements, amongst other requirements.
E: Procurement	**Public procurement must be rules-based, transparent and accountable**, creating a level playing field for all interested actors. Country systems should be used for procurement, and loan contracts must not be formally or de facto be tied to the purchase of goods or services from the lender. Investment contracts should also give preference to local procurement of goods and services.
F: Public consent and transparency	The contraction process for loans and investments must be **transparent and participatory**, i.e. parliaments, citizens and affected communities in the borrower or host country must be given adequate time and information to debate the loan or investment, including purpose, terms and conditions of the relevant contracts. All should **comply with national laws and regulations based on democratic principles**. There should be **public disclosure of information**, financial transparency, availability in local languages, and adherence to integrity and anti-corruption efforts. For project loans there must be **regular progress reports and independent and timely evaluation**.
G: Dispute settlement	The contract must stipulate what will happen in case of a change of circumstances leading to the borrower not being able to service the loan. The loan contract should have a provision for an **«independent and transparent debt workout procedure in case of repayment difficulties or dispute»**.

Part 2: Case studies of Indonesia, Egypt and Myanmar

The three selected case studies from Myanmar, Egypt and Indonesia illustrate the importance of instituting a strong rules-based framework for responsible finance. Recurring themes include lending to illegitimate regimes for projects that had little or no impact on development (while supporting the projects with concessional loans that were reported as official development assistance), and the consistent prioritisation of Norwegian commercial interests by Norwegian authorities at the expense of developmental outcomes. The case studies only represent a small selection (4 out of a total of 34 contracts) of the claims that are reviewed in the official claims audit. This section will employ the Eurodad Charter and SLUG´s interpretation of the UNCTAD principles to the selected case studies.

Although our analysis only concerns a small selection of all the claims, it is reasonable to assume that the problematic issues regarding the promotion of Norwegian commercial interests through mixed credits in developing countries can also be found in other parts of the claims. The following case studies concern two projects for the sale of environmental technology to Indonesia in 1995, the construction of a container terminal in Port Said in Egypt in 1984 and the purchase of Egyptian government bonds in 2007, and finally sales of gas turbines from Kongsberg Våpenfabrikk (KV)to Myanmar in 1980.

Indonesia

In 2009 SLUG and the International NGO Forum on Indonesian Development (INFID) published an in-depth report on the legitimacy of Indonesia´s debt to Norway.[1] As a part of the «Asia-plan», Norway promoted exports of environmental technology to Indonesia in the 1990s. The two case studies selected show that the debt is illegitimate, both because the loans were given to the illegitimate regime of Suharto, and because the project failed when the exporters did not deliver according to the terms of the contract.

Suharto´s illegitimate regime

General Suharto was Indonesia´s president from 1967 to 1998, and his regime was known for notorious corruption and human rights abuses, in particular, the Aceh mass murders and the invasion and occupation of East Timor. INFID argues that debt from the Suharto regime is per definition illegitimate.[2]

To extend loans to the Suharto regime violates principle 1 of the UNCTAD charter, as the state in question is not protecting the interests of its citizens. The regime itself was illegitimate, and the nature of the regime was well known to the international community at the time Norway granted the loans in question in the mid-1990s.

Failed projects

The two projects in question relate to the export of a wave power plant by the Norwegian company Indonor and a marine environmental monitoring system called Seawatch by the Norwegian company Oceanor. The following information is derived from GIEKs archives as referred to in the report by SLUG and INFID.

Indonor signed a contract with the Indonesian technology department in 1995 for a wave power plant to be constructed at Baron Beach in Java. The contract was worth NOK 53 million, and a loan was granted for NOK 37 million.[3] GIEK guaran-

1: See Flacké, *Is Indonesia´s Debt to Norway Illegitimate?* All the information about the two projects in Indonesia is taken from this report.
2: Ibid., 9-10.

3: In January 1995 the exchange rate was 1USD=6.7NOK. See **http://www.norges-bank.no/en/prisstabilitet/valutakurser/usd/mnd/**.

Wave crashing outside Indonesia.

teed the loan, while Norad contributed with a grant of NOK 10 million. The wave power technology had been developed and tested in a pilot project in Norway, but when the test plant was destroyed in a winter storm, the technology was deemed commercially uncompetitive. Instead, the company Indonor A/S was established to export the technology to Indonesia. Unfortunately, the project was never completed, and Indonesia is not permitted to use the technology to complete the plant themselves, as they do not own the property rights. Even though the project was never completed, and that no benefits accrued to the Indonesian population, Indonesia was still required to repay two thirds of the loan.[4]

In 1995, the agreement for the Seawatch project was also signed between Oceanor and Indonesian authorities. The Seawatch system was a marine environmental monitoring, forecasting and information system, and the project was priced at NOK105 million. The loan component of NOK 61.8 million was guaranteed by GIEK, and Norad contributed with a grant of NOK30 million for the project. According to Indonesian officials working on the project, Oceanor did not fulfil its obligations according to the contract in terms of training of Indonesian personnel, and parts of the hardware did not function from the start. The sea conditions are very different in tropical waters compared to in Norway, which led to higher maintenance costs. In 2000 the project came to a halt, without the second phase even being started.[5]

Ex ante assessments

Both the UNCTAD and the Eurodad Charter have clear requirements for substantial ex ante impact assessments, as well as monitoring of the projects after the money has been disbursed.[6]

For the Indonor wave power plant, there was no comprehensive ex ante assessment of the likely effects, in breach of both the UNCTAD principles and the Eurodad Charter. Moreover, the feasibility study for the wave power plant had already shown that the project carried high uncertainties regarding technical aspects and costs. The institution that carried out the feasibility study also stated that the data material that the feasibility study was based on was by no means sufficient. Norad based its approval and support for the project on this feasibility study, even though it was clear that the project would not be commercially viable for energy production in Indonesia, as the production would be too low and uncertain.[7] Given the experimental nature of the project and the high uncertainties involved, Norad recommended that the Indonesian authorities should receive a guarantee that the project would in fact be completed, but this did not form part of the final contract.[8] The feasibility study had already revealed that the costs were uncertain, and the costs rose significantly due to miscalculations by Indonor regarding the suitability of the site. This led to disagreements over who should cover the cost increases, which slowed down the project. When the 1997 Asian crisis hit Indonesia, the costs increased rapidly, and the project came to a complete halt.[9] In 2000, the Norwegian research institute FAFO reviewed the mixed credit scheme, and found that the Indonor project had «insufficient planning and ex ante evaluations,» and that the project was a «potential loss-making operation.»[10]

Oceanor´s Seawatch project in Indonesia was meant to be an environmental monitoring system. The system was supposed to use data collected by a number of observation buoys that would be placed in the sea. In the first phase of the project 12 buoys should have been deployed, yet by 1996, while 10 of the buoys were installed, they all had various defects in the sensors. In addition, the buoys had not been designed for use in tropical waters, and the amount of plankton covering the buoys required that they were cleaned frequently. This increased the maintenance costs substantially, while Oceanor had initially said that maintenance costs would be low. Furthermore, the lifetime of the buoys in tropical waters was much shorter than predicted. Today all the buoys are out of service, and the second phase that was meant to expand the area where buoys were placed, was never carried out.[11]

Many projects face unexpected and unpredictable problems along the way. However, given that the buoys were sold to Indonesia for use in tropical waters, one would expect that they had been adapted to function under such conditions, and that the problems that arose were problems that could have and should have been foreseen. This is a striking example of lack of proper planning and proper ex ante impact assessments.

Lack of development

To ensure development effectiveness, it is important that project loans form part of national development plans, as stipulated by section C(i)1 of the Eurodad Charter as well as the OECD guidelines.[12] None of the two projects reviewed here were initially part of Indonesia´s national development plan, known as the «Blue Book» of projects to be undertaken. Both of the projects were initiated by Norway, and there was high-level political involvement from the Norwegian government to ensure that these projects were carried out as a part of the Asia-plan.[13] This is in clear breach of the Eurodad Charter and the OECD guidelines. The loans were tied to the purchase of Norwegian goods and services, which constitutes a breach of section E(i) 3 of the Eurodad charter on procurement. Given that Norad provided funding through the aid budget for both of these projects it would be reasonable to demand concrete development benefits for the people of Indonesia from these projects.

The Indonesian representatives involved in the Indonor wave power plant project were clear in their evaluation of the project. The technology that was meant to be transferred cannot be used by the technology department in Indonesia, due to the restrictions of Norwegian intellectual property rights over the technology. No electricity has been generated by the project and there has been no employment creation or other developmental impacts resulting from the Indonor project.[14] In addition, a Norad source stated that it was clear that the Oceanor Seawatch project should never have been financed with aid money, and that the project was «totally without development effects in the country.»[15]

4: Flacké, *Is Indonesia´s Debt to Norway Illegitimate?* , 13.The 2/3s amount refers to what had been disbursed of the loan before the project came to a halt.

5: Ibid., 19-20.
6: See UNCTAD principles 5 and 12, and section B(i)4 and F(ii)6 of the Eurodad Charter

7: Flacké, *Is Indonesia´s Debt to Norway Illegitimate?* , 13.
8: Ibid., 14.
9: Ibid., 15.
10:Quoted in ibid., 17.
11: Ibid., 19-20.

12: Ibid., 22.
13: Ibid., 10-11, 19.
14: Ibid., 17.
15:Quoted in ibid., 21.

Picture of Seawatch buoy from oceanor.no (enlarged)

Breach of contract – but no independent resolution

UNCTAD principle 9 states that debt contracts should be honoured, but that there are «circumstances giving rise to legal defense» that can warrant that the debtor does not repay the loan. In both of these cases, Indonesia has been repaying the loans, despite not having received what the contracts with the Norwegian exporters stipulated. SLUG considers breach of contract to be a reasonable «circumstance giving rise to legal defense.»

The Eurodad Charter requires that disputes are settled through an independent procedure (section G(i)2) making use of an independent arbiter. In the case of Indonor, arbitration in Indonesia was attempted without success (see details below), and there was no arbitration in the case of Oceanor. Nonetheless, the Indonesian government continued to repay loans for projects that were not realised.

The projects illustrate both breaches of contract, which qualifies as a circumstance that gives rise to legal defense according to UNCTAD principle 9, and the need for an independent arbitration mechanism to deal with disputes between sovereign lenders and borrowers.

Indonor wave power plant

The contract stipulated that Indonor would deliver a turn-key project, meaning that it should be delivered ready to use by the buyer.[16] When the project came to a halt due to increased project costs (first due to Indonor´s cost miscalculations, and later due to the Asian crisis), many attempts were made to find a solution. The technology department in Indonesia sought to complete the project, but were then told that this would not be possible as the property rights belonged to a Norwegian company. The contract had stipulated that in the case of dispute, arbitration would take place in Jakarta. However, this route was blocked by the fact that only private companies were allowed to use this arbitration court. This means that the initial contract was flawed, by referring disputes to an arbitration court that was not allowed to process cases where one of the parties was an entity of the state. As taking Indonor to court would be too costly and take too long, the technology department instead drew up three options for Norad and Indonor: realise the project, cancel the debt, or allow the technology department to use the technology to realise the project. After representatives of the technology department discussed these and other options during a visit to Norway, a solution had still not been found. During the visit, Norad had given verbal confirmation that one of the three proposed solutions would be chosen. However, nothing was done, and Norad later claimed that it was no longer its responsibility. Norad instead pledged USD1 million in bilateral aid for a new energy park, which the Indonesian technology department perceived as an admission of guilt.[17]

16: Ibid., 15.

Oceanor´s Seawatch project

As with the Indonor project, the Seawatch project was also meant to be a turn-key project ready for use on delivery.[18] In addition to the problems with the faulty buoys, there were serious problems with the training that had been stipulated in the contract. The project demanded a high level of technological training, specifically in the advanced program that would be needed to process the data collected by the buoys. However, sufficient training was not given, even though the contract included significant resources earmarked for training. Without this training, it would be very challenging to use the technology. An «international team» of at least 21 people was meant to stay in Indonesia in time periods ranging from 4 to 24 months to take part in the project. However, Indonesians working on the project state that this was not carried out. Instead, the Norwegian instructors only stayed for very short time periods (in general around ten days) before going back to Norway, while some never even travelled to Indonesia. Yet, the costs allotted in the contract for paying for this team were over NOK16 million.[19] That the training stipulated in the contract was not carried out, despite its crucial role in ensuring the success of the project, is a clear breach of contract. Again, Indonesia did not receive what they paid for, but nonetheless continued to repay the debt incurred from the project.[20]

17: Ibid., 16.
18: Ibid., 21.
19: Ibid., 20.
20: Ibid., 21.

List of principles contravened

UNCTAD principles

- Principle 1: Agency: The loans were granted to the repressive and illegitimate regime of Suharto
- Principle 5 and 12: Project financing: Ex ante impact assessments and risk assessments were severely flawed.
- Principle 9: Binding agreements: For both projects there was a clear breach of contract, as the Norwegian exporters did not deliver the goods.

Eurodad Chapter

- B(i)4 Ex ante impact assessment: Ex ante impact assessments and risk assessments were severely flawed.
- C(i)1: Alignment to national development goals: None of the two projects were initially a part of the Indonesia´s development plan.
- G(i)2: Independent procedure for dispute settlement. No independent procedure was used to settle the disputes arising when the projects were not completed.
- E(i)3: Loan tying: The loans and grant components were tied to the purchase of Norwegian goods and services.

Egypt

The project evaluated from Egypt illustrates the problematic issues inherent in export credit schemes where Norwegian commercial interests are given priority over local economic development, even when the project has been approved as «developmental» by Norad.

The official debt audit reviews bilateral debt that originates from five guarantees granted between 1980-1984. Egypt´s total debt to Norway as of June 2013 stands at 25.2 million NOK.[21] The Egyptian debt has been rescheduled through the Paris Club, which means that the individual claims from the 1980s cannot be identified in today´s records. However, in respect of the relative size of the loans before the debt was restructured, the largest of these loans was given to Egypt to build a container terminal in Port Said in 1984, and it is this specific claim that this section deals with. This section also investigates the purchase of Egyptian government bonds by the Norwegian Government Pension Fund Global in 2007. The bonds are included here to illustrate the problematic issues related to investing in government bonds, although the official debt audit does not include these claims.

21: Information given on the 2/7/2013 by Nikolai Owe, Senior Advisor, GIEK. The size of the claims per 30.06.2012 was NOK 31 million, when the debt audit was launched.

Building a container terminal in Port Said – an overview of the project

The city of Port Said is located by the Mediterranean Sea, north of the Suez Canal, and is strategically placed for trade and international shipping. The project involved building and running a container terminal to handle incoming cargo. The Egyptian state entity, the Port Said Authority, was the official buyer, while the Norwegian company Selmer A/S was contracted to build the container terminal. Another Norwegian company, Wilh. Wilhelmsen, would be a shareholder in the company that would run the terminal, as well as oversee the construction process. The company that was going to run the terminal after its completion would be owned by a minimum of 51% Egyptian shareholders (including the Suez Canal Authority, Canal Shipping Agency and the Port Said Authority).[22] The project is dated 1984, but preparations had already taken place for several years. In 1982 GIEK issued a guarantee for NOK182 million, which was a 100% guarantee for the loan and represented 85% of the total contract value of NOK 214 million.[23] The remaining 15% of the contract value was to be paid directly to the Norwegian exporter. The National Bank of Egypt provided a counter-guarantee for the loan.[24] The guarantee from GIEK was given under the special arrangement for developing countries, and thus needed approval from Norad. Norad approved both the guarantee for export credit for Selmer A/S, which was to construct the container terminal, and the investment guarantee for Wilh. Wilhelmsen, provided for their investment in the joint-venture company to run the terminal.[25]

22: Board minutes 11/9/1980, GIEK archives, and «*Feasibility study on Port Said Container Terminal by Wilh. Wilhelmsen*», June 1982, GIEK archives. Also see Ingrid Stolpestad, *The Arab Spring and International Debt: Tunisia, Egypt and Bahrain's Debt to Norway* (Oslo: SLUG and Norwegian Church Aid, 2012).

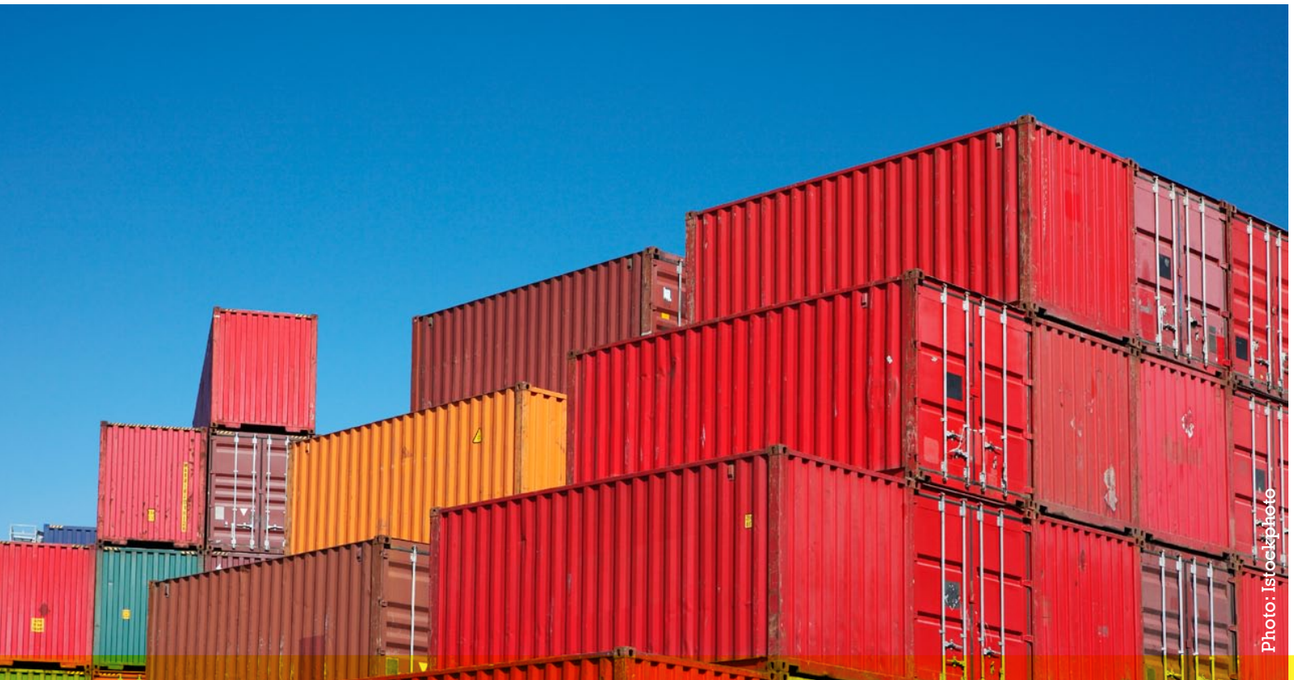


Photo: Istockphoto

Local economic development

The Eurodad charter requires that investment contracts contribute to development effectiveness (see C(ii) 2,3,4,5), and promote local employment, local community development, local business development and technology transfer.[26] When approving the guarantees, Norad emphasised that a container terminal would facilitate exports and imports and that the terminal was expected to create around 150 stable jobs. However, Norad also pointed out that traditional jobs in goods handling were expected to become obsolete as a result of the container terminal being built, and that it was hard to give an estimate of whether the new 150 jobs would exceed this.[27] The project was later expanded, and the feasibility study by Wilh. Wilhelmsen predicted that the first year of operations would require the employment of 184 persons, including 9 expatriates. Additional staff was to be recruited when the container volumes expanded, and a training program was to be implemented for Egyptian personnel.[28] In Norad´s assessment there is no reference to how many jobs could be expected in the building phase of the project, where one should expect quite a high number of construction workers.

One of the major problems with export credits in general when granted for projects in developing countries, is that the guarantee often contains a clause requiring a high percentage of Norwegian exports to be used in the project. This is particularly problematic when the guarantees are given under the special arrangement for developing countries, where one could expect a stronger emphasis on local economic development. In this case, although the guarantees were given under the arrangement for developing countries, the exporter ensured that at least 70% of the total costs would consist of Norwegian exports.[29] The guarantee from GIEK states that local components cannot exceed 15% of the total contract value (which equals the amount paid directly by Egypt, that is in any case not financed by the loan).[30]

A better way to stimulate local economic development would be to use local sourcing and buy as much as possible from Egypt. Instead, Norwegian companies were employed for most parts of the project, including the installation of cranes, generators and electrical installments, freight costs and container handling equipment. Non-Norwegian suppliers would contribute to some parts of the project, such as the construction of the quarry, drainage of the terminal area and the laying of the asphalt.[31] Clearly, with a maximum limit of 15% of the contract value to be from local components, local economic development in the construction phase was not a key priority. On a positive note, C(ii) 6 of the Eurodad Charter on promoting infrastructure development is fulfilled, and a joint-venture company was established. However, given the low level of expenditure in the project on local components, Norwegian business interests, and not local Egyptian ones, were the ones to benefit during the construction of the terminal.

23: GIEK memo 18.3.1982, GIEK archives.
24: Agreement between Eksportfinans and the National Bank of Egypt, 13/1/1983.
25: Norad memorandum, document 78/80, dated 1980, GIEK archives.
26: Norad gave approval for both a export credit guarantee for Selmer A/S (for the building of the container terminal) and an investment guarantee for Wilh. Wilhelmsen (for investing in the company that would run the terminal).
27: Norad memorandum, document 78/80, dated 1980, GIEK archives.
28:«*Feasibility study on Port Said Container Terminal by Wilh. Wilhelmsen*», June 1982, GIEK archives.

29: Letter from Wilh. Wilhelmsen to GIEK, dated the 8th of May 1980, GIEK archives.
30: GIEK memo 18.3.1982, GIEK archives.
31: Profitability study, «*Lønnsomhetsvurdering av container havneanlegg, Port Said, Egypt*». This document is in the GIEK archives, but is not dated.

Photo: B Wolff./UN Photo

Impact assessments and standards

The UNCTAD principles 5 and 12 require that both the lender and the borrower conduct an ex ante impact assessment of the likely effects of the project, «including its financial, operational, civil, social, cultural and environmental implications.» However, there is no indication that Norwegian authorities conducted any impact assessments beyond what was needed for Norad to approve the guarantees. In Norad´s approval, there is no thorough analysis of the likely effects of the project, notably not even when it comes to impacts on the local community or for local economic development. The Norad document assumes that the project will have positive spill-over effects for the Port Said area. However it acknowledged that the new container terminal might crowd out traditional jobs in goods handling, and that it was uncertain whether the expected 150 jobs would surpass the amount of jobs that might be lost. There is no reference in the Norad document to any other impacts, such as on local business, the environment, human rights or any reference to what kind of labour standards would be employed. The contract for Selmer A/S, states that «If found necessary the subcontractor may work on the project day and night and during official holidays».[32]Although it is possible that this could be done while employing decent labour standards, it is at least a cause for concern that a construction project of this size deemed «developmental» does not contain any references on the part of Norwegian authorities to ensure that the project would not be carried out with the use of exploitative labour conditions.

32: Subcontractor agreement between Canal Harbour Works and Selmer A/S, dated 11th of August 1982, GIEK archives.

In accordance with Egyptian law?

According to the Egyptian Centre for Economic and Social Rights, the Egyptian Constitution requires parliamentary approval of public loans.[33] There is no indication that such an approval was obtained. If the parliament did approve the loan this was not made available to the public. Further, the contract between the Port Said Authority, Canal Harbour Works and Selmer A/S specifies that «In compliance with article 58 of state council law No 47 of 1972, this contract will be subject to revision and ratification of the competent department in the state council. The three parties will abide by any modifications introduced by the state council.»[34] There is no indication of such ratification being obtained in GIEK´s records. If this is the case, this would be a breach of principle 3 of the UNCTAD charter regarding due authorization. The principle requires that lenders «…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.» Further, the Eurodad Charter requires parliamentary and citizen participation, as well as public disclosure of information (See F(i)1 and 2). Section A(i)3 also requires that there be compliance with national law, which in this case seems to be violated unless the loan was in fact given parliamentary approval, and the contract ratified by the relevant department in the state council.

33: Art.121 of 1973 Constitution of Egypt, which was in place at the time when the loan agreement was signed. Approval of public loans by parliament is a well-established constitutional principle in Egypt that was present in the constitutions of 1923, 1930, and the post-revolution constitution of December 2012. Information received from Mahinour El-Badrawi, Programs Officer in the research unit of the Egyptian Centre for Economic and Social Rights (ECESR) on the 18th of June and 13th of August, 2013.
34: Contract between Port Said Authority, Canal Harbour Works and Selmer A/S, dated 20th of July 1983, GIEK archives.

Egyptian law at the time also required that all public procurements had to be done through an open bid and tender system, except in cases where unique expertise was required.[35] There is no clear evidence that the project for constructing the container terminal was obtained through winning a tender. In some of the documents of the project there are some vague references to bids for the project and a tender, but it is not clear what kind of process preceded the contracts.[36] However, other documents point towards a less open type of process. In a letter from Wilh. Wilhelmsen to GIEK in 1980, reference is made to that the project would be presented during a visit to Egypt by the then Norwegian Minister of Trade, and would be discussed with Egyptian authorities.[37] This points in the direction that negotiations were held on a relatively high political level, and that the project did not necessarily come about as a result of an open bidding process where the best and cheapest supplier would get the tender. If this is the case, it would be in violation of Egyptian law at the time, and in breach of both UNCTAD principle 3

35: Law No 9 of 1983 governing public procurement, information from the Egyptian Centre for Social and Economic Rights, received on the 28th of June 2013.
36: Subcontractor agreement between Canal Harbour Works and Selmer A/S, dated 11th of August 1982, GIEK archives.
37: Letter from Wilh. Wilhelmsen to GIEK, dated the 8th of May 1980, GIEK archives.

List of principles contravened

UNCTAD principles

- 5 and 12: Project financing: No thorough ex ante impact assessment or post-disbursement monitoring
- Principle 3: Due authorization: Egyptian law requires parliamentary approval of the loan, and there are no records of this being obtained.

Eurodad Charter

- C(ii) 2,3,4,5): Development effectiveness: Local economic development from the construction of the container terminal was highly limited as a maximum of 15% of the contract value could be used on local costs during construction.
- Positive: C(ii) 6: Infrastructure was developed.
- B(i)1-2: Respect for human rights, and internationally recognised social, labour and environmental standards: There is no reference in the Norad document to any other impacts, such as on local business, environmental impacts, human rights impacts or what kind of labour standards would be employed.
- F(i)1: Parliamentary and citizen participation: Unknown whether the parliament gave its approval, and no evidence of open debate around the loans.
- F(i)2: Public disclosure of information: All relevant information was not disclosed.
- A(i)3 and A (ii)2 Compliance with national and international laws. Egyptian law requires parliamentary approval of the loan, unknown whether this was obtained.

Egyptian government bonds - 2007

The Norwegian government buys government bonds from other countries through the Norwegian Government Pension Fund Global (GPFG). Government bonds are issued by many countries, are interest bearing and are repaid at the maturity date. Thus, they are a form of debt. The GPFG´s investments in companies are regulated by a set of ethical guidelines that prohibit investments in companies that contribute to serious human rights violations or environmental damage. However, when GPFG purchases government bonds, the only restriction is that bonds cannot be purchased from countries where there are pervasive international sanctions against the country. Thus, the ethical framework for investments in government bonds is weak, and opens the door to the creation of illegitimate debt. Although the Norwegian government has made laudable efforts to promote responsible lending internationally, no guidelines for responsible lending are applied to lending through the GPFG.

In 2012 the Norwegian government´s investments through the GPFG in Egyptian bonds stood at NOK 156,5 million.[1] The largest increase in investments in Egyptian bonds took place in 2006/2007 as GPFG´s investments rose from NOK 14,6 million in 2006 to 203,4 million in 2007.[2] At this time, the Egyptian regime was becoming more authoritarian, limiting civil liberties and political rights through cracking down on journalists, limiting press freedom and repressing the Muslim Brotherhood. Further, military expenditure had increased significantly.[3] To buy government bonds from Egypt means to make resources available for the Egyptian government, and it is impossible to ensure that these resources did not contribute to repressive policies. In terms of both the UNCTAD principles and the Eurodad Charter, to buy government bonds from Egypt in 2007 does not constitute responsible lending. Principle 1 of the UNCTAD charter states that the lender must respect that the borrowing state is responsible for protecting the interest of its citizens, which was not the case in Egypt in 2007. The Eurodad Charter´s requirements of citizen participation (F(i)1) and respect for human rights B(i)1 are also applicable in this context.

Although it is important for the government to avoid a politicisation of the Fund, SLUG has proposed that the Fund limits its investments to states that are responsible borrowers, as defined by the UNCTAD principles.[4] This would further include requirements for transparency and public participation, such as requiring openness around the issuing of bonds, budgetary processes, and parliamentary participation and approval. Such process-based criteria would be an efficient way to prevent irresponsible lending by the GPFG.

1: http://www.nbim.no/Global/Documents/Holdings/FI_holdings_SPU_Sorted_12.pdf
2: See http://www.nbim.no/Global/Documents/Holdings/2007%20holdings%20fixedincome_spu%20(4).pdf and http://www.nbim.no/Global/Documents/Holdings/2006%20holdings.pdf.
3: Stolpestad, The Arab Spring and International Debt: Tunisia, Egypt and Bahrain's Debt to Norway, 16-17.
4: Leon Du Toit, «Ethical Deficit,» SLUG 2012, http://slettgjelda.no/no/english/Ethical+Deficit+-+Lending+by+the+Norwegian+Sovereign+Wealth+Fund.b7C_wlDQXf.ips. Accessed on 13.08.2013

Myanmar

All of Myanmar´s debt to Norway stems from the Ship Export Campaign of the 1970s. The campaign had been deemed a development failure, and in 2006 the Norwegian government assumed creditor responsibility and announced that it would cancel the debt. However, given the military regime in Myanmar, the debt would only be cancelled once Myanmar qualified for multilateral debt relief. In 2013 Norway cancelled 100% of the debt owed by Myanmar to Norway, as a part of a deal in the Paris Club to reduce Myanmar´s debt by 50% overall.[38] Myanmar´s debt is included in the official debt audit since the debt was cancelled only after the audit had been initiated.

This case study concerns the sale of gas turbines from Kongsberg Våpenfabrikk (KV) to the state companies Myanmar Oil Corporation and the Electric Power Corporation. This case is particularly instructive because it illustrates the problematic issues related to lending to a military dictatorship, using diplomatic means to promote Norwegian commercial interests through export credits and the complete lack of proper guidelines for project loans at the time.

Gas turbines for electricity production – an overview of the project

During 1979-80 two contracts were negotiated between the Norwegian exporter Kongsberg Våpenfabrikk (KV) and the state companies Myanmar Oil Corporation (MOC) and Electric Power Corporation (EPC). At the time, KV was a state-owned company that was best known for its export of weapons and defence material, but it also produced goods for non-military purposes. The state oil company MOC was interested in KG2 gas turbines, to enable it to utilize the natural gas that emerges in oil production, while the Electric Power Corporation would use the KG5 gas turbines for electricity production.

After discussions between KV, the Ministry of Foreign Affairs and the Ministry of Trade, Myanmar was offered a financing package for buying 8 KG2 turbines and 14 KG5 turbines. The contract value was USD 22 million, and a loan would be granted for USD 18.7 million, 85% of the contract value. For the remaining 15%, the two official buyers MOC and EPC would have to pay 6,6% of the contract value on delivery, while the Norwegian government would extend a grant for 8.4% of the contract value (also on delivery). In addition, the Norwegian Ministry of Foreign Affairs would give a grant of NOK 1,7 million to finance a training program for the project.[39] Norad approved the project on the grounds that electricity provision in general is important for infrastructure, works as a foundation for new industries and job creation, and that providing electricity to villages would improve living standards. The training program for local personnel was also considered to likely to produce a positive developmental impact.[40] The guarantee from GIEK was approved under the special arrangement for developing countries, and thus required approval from Norad.

Lending to a military dictatorship

In 1962 the General Ne Win imposed military rule after taking power by a coup.[41] The «Burmese path to socialism» was marred with economic decline and repression, in particular with violent crackdowns of numerous student uprisings starting in 1962 and continuing throughout the 1970s.[42]

Principle 1 of the UNCTAD principles requires that the creditor recognise that the state is responsible for protecting the interests of its citizens. SLUG´s interpretation of this principle is that odious debt is counter to the interest of the citizens of the borrowing state, and that the creditor has a responsibility not to lend to odious regimes. The case of lending to Myanmar in the 1970s should be examined in this regard. The three basic elements of the odious debt doctrine, as expounded by

38: The Norwegian Ministry of Foreign Affairs, «*Historisk gjeldsslette av Myanmars gjeld til Norge*,» ([Press release] 28.01.2013).
39: Memorandum of Understanding, dated 13th -14th of December 1979, GIEK archives.
40: Norad document 9/79, dated 15.11.1979, GIEK archives.
41: Christina Fink, *Living Silence: Burma under Military Rule* (London: Zed Books, 2001), 31.
42: Ibid., 32, 34, 42.

Alexander Sack, are that the loan must be given to an odious regime, be spent counter to the interests of the population, and the creditor must (or should) have known about the situation. That the loan for buying gas turbines was given to an odious military regime is clear, and it is reasonable to assume that the Norwegian government knew what kind of regime they were dealing with. The more controversial point is whether the money was spent against the interest of the population. When approving the guarantee, Norad argued that the sale of gas turbines for electricity production would have developmental effects. Unfortunately, it is unclear whether the installed gas turbines by the Electric Power Corporation produced electricity that was distributed to the population widely. However, as Joseph Hanlon argues, the fungibility of money means that all loans to an odious regime «can be classed as odious, even if the ostensible purpose was permissible». He argues this, because even if the loan was spent on improving electricity production, this frees up funds for the government to spend in other areas, such as arms.[43]

The Eurodad charter (section F(i)1) requires that the loan contraction process be transparent and participatory. Parliaments, citizens and affected communities must be given time and opportunity to debate the loan, a requirement that is clearly violated in repressive military regimes such as the regime in place in Myanmar in the late 1970s.

Loan pushing to promote Norwegian commercial interests

Two documents in this case clearly illustrate the prominence given to promote the interests of KV by the Norwegian government. One document from the Ministry of Trade clearly states that Myanmar was interested in buying the KG2 turbines for the Myanmar Oil Corporation, but that they were not particularly interested in the KG5 gas turbines for the Electric Power Corporation. The KG5 turbines were too small, and the document even states that the turbines of a Scottish producer (that Myanmar had purchased from at an earlier stage) would be more suitable. The KG5 turbines had recently been developed, and KV had only sold 3 units at the time. In order for the product to be competitive internationally, the turbine needed a certain number of «operating hours» to show for it.[44] Securing the sale of the KG5 turbines to Myanmar therefore took on strategic importance, and KV stressed that it was unlikely that Myanmar would sign a deal unless the Norwegian government made a good offer.[45]

In a letter from the Norwegian ambassador to the authorities in Myanmar, reference is made to a number of projects that the Norwegian government had already supported in Myanmar, detailing how much Norway had spent to support each project. After all these items have been listed, the ambassador goes on to state that «It is my hope that you will view our proposal in connection with the KV project on the background of the above-mentioned grants given to Burma by my government (…)».[46] Evidently, the Norwegian government used diplomatic means to put pressure on the authorities of Myanmar to buy the turbines. Norwegian commercial interest, not local development in Myanmar, was the main priority.

This project violates a number of the requirements of the Eurodad Charter. The Charter requires that a needs assessment is conducted (see B(i)3), but there is no evidence of one for this project. Even without a needs assessment the Norwegian government was already aware that the authorities in Myanmar did not need the KG5 turbines, as they were not of the right size.

The Eurodad Charter also demands that the loan is aligned to national development goals (see C(i)1). In their appraisal of the project, Norad stated that they assumed that because both buyers (Myanmar Oil Corporation and Electric Power Corporation) were state owned, this meant that the project was aligned to national development goals. However, it was clear that the Norwegian government knew that the largest part of the sale, the KG5 gas turbines, were not the ones most suitable. The same section of the charter (C(i)1, as well as E(i)3) states that the loan should not be tied to the purchase of goods or services from the lender. This is always violated in the case of export credits, as the loan and guarantee would not be given unless goods and services are procured from the lender. In the terms and conditions from the bank Eksportfinans that issued the actual loan (backed by a guarantee from GIEK), it is clearly stated that a minimum of 70% of each unit delivered to Myanmar must be produced in Norway. The Eurodad Charter further requires that public procurement processes must be «rules-based, transparent and accountable»(see E(i)1), in order to create a level playing field for all eligible and interested parties. This was not the case for the sale of gas turbines to Myanmar, where diplomatic pressure was exerted to reach a deal, and the Norwegian government pushed a concessional loan to ensure that KV obtained the contract.

Project loan with inadequate assessments

Both the Eurodad charter (see B(i)4) and the UNCTAD principles (5 and 12) require that an ex ante impact assessment is conducted in the case of project loans. There is no indication that the governments of Norway or Myanmar conducted any impact assessment before the project was approved or carried out. The Eurodad

43: Hanlon, *Defining Illegitimate Debt and Linking its Cancellation to Economic Justice*, 24.

44: Memorandum, Ministry of Trade, dated 18.12.1979, GIEK archives.

45: Letter from Kongsberg Våpenfabrikk to the Ministry of Trade, dated 30th of November 1979, GIEK archives.

46: Letter from the Norwegian ambassador to Burmese authorities, GIEK archives, undated.

charter requires that loans must not contribute towards activities that violate human rights (see B(i)1) or that contravene minimum standards on social, labour and environmental protection (see B(i)2). Impact assessments to evaluate possible impacts on human rights, labour and environmental standards were not well developed at the time, and there is no reference to any possible impacts on local communities, workers or the environment in this case.

Norad´s approval of the loan refers to the positive developmental impacts of the project in very general terms. Improved electricity supplies are seen as an important foundation for the development of new industries and increased job creation, while supplying electricity to surrounding villages is expected to improve the living standards of the inhabitants. However, there are no specific evaluations of expected results that indicate any proper impact assessment was conducted. On the other end of the project cycle, there is no indication of any post-disbursement follow-up to the project. The UNCTAD principle 5, requires, that where applicable the lender should perform post-disbursement monitoring of the project and its impacts. Similarly, the Eurodad Charter requires that progress reports and independent loan evaluations are conducted (see F(ii)6). In May 1991 the embassy in Singapore informed GIEK that they had obtained information about the outcomes of the projects where shipping related equipment was sold, but that they had not been able to obtain information about the equipment sold for electricity production.[47] That the government did not know what the status was for the project more than ten years later indicates that no progress reports or post-disbursement evaluations were conducted.

47: Telefax from the embassy in Singapore to GIEK, dated 22nd of May 1991, GIEK archives.

List of principles contravened

UNCTAD principles

- Principle 1 Agency: contravened by lending to a military regime.
- Principles 5 and 12 Project financing: contravened due to the lack of ex ante impact assessment and post disbursement monitoring.

Eurodad Charter

- F(i)1 Parliamentary and citizen participation: contravened by lending to a military regime, no indication of any public participation.
- B(i)3 Needs assessment: No indication of any needs assessment, the Norwegian government was aware that KG5 turbines were not suitable for Myanmar´s needs.
- C(i)1 Alignment to national development goals: The loan came about as a result of Norwegian pressure to ensure that the deal went through.
- C(i)1 and E(i)3 Loan Tying: Contravened as the loan was conditional on Myanmar buying gas turbines from Norway.
- E(i) 1 Public procurement: Contravened, as there is no indication of any transparent procurement process.
- E(i) 3 Loan tying: The loans were tied to the purchase of Norwegian goods.
- B(i)4: Ex ante impact assessments: Contravened, no ex ante impact assessment
- B(i)1 and 2 Respect for human rights and internationally recognised social, labour and environmental standards: No assessments of impacts on human rights or impacts on social, labour and environmental standards.
- F(ii)6: Progress reports and independent evaluation: Contravened, no indication of any progress reports or evaluations post-disbursement.

Conclusion

This report clearly shows that Norwegian lending practice has not been in line with neither the Principles for responsible lending developed by the UN Conference on Trade and Development (UNCTAD) nor the Responsible Finance Charter developed by the European Network for Debt and Development (Eurodad). The case studies presented do not constitute examples of responsible lending; the main motivation for the projects was to promote Norwegian commercial interests, there were few or no developmental impacts and the loans were all granted to illegitimate regimes.

Furthermore, the findings in this report show the value of both the UNCTAD principles and the Eurodad Charter when evaluating responsible lending practice. SLUG´s interpretation of the UNCTAD principles proved operational and was applied fruitfully to the case studies presented. The Eurodad Charter also proved fruitful to employ when evaluating lending practices, as it is more specific than the UNCTAD principles, and it highlights important areas such as development effectiveness, human rights, environmental protection, tax related measures, procurement and dispute resolution.

Norway has made laudable efforts to promote creditor responsibility in the past, both by cancelling the illegitimate debt from the Ship Export Campaign and by supporting and endorsing the UNCTAD Principles. If the government intends to continue to take its commitment to creditor co-responsibility seriously, it must assume creditor responsibility for its claims on Egypt and Indonesia, and cancel it unconditionally and unilaterally.

Notably, the case studies presented illustrate the need for regulations of lending and the need for stronger guidelines to ensure responsible lending through the Norwegian Export Credit Agency, GIEK, and the Norwegian Government Pension Fund Global. As the government formally endorsed the UNCTAD Principles last year, the time has come to implement them in practice. SLUG strongly recommends that the interpretation of the UNCTAD principles presented in this report be applied to Norwegian lending practice.

Finally, for the Norwegian debt audit to have relevance internationally, the Norwegian government must find ways to share its experience with other countries and promote debate on how the UNCTAD principles best can be interpreted and operationalized.

Box 4: Summary of recommendations to the Norwegian government

- Cancel the claims that originate from irresponsible lending. This includes the debts of Indonesia and Egypt.
- Implement the UNCTAD Principles, as interpreted in this report, to all forms of lending, including lending through the purchase of government bonds.
- Use Norway´s membership in multilateral development banks to promote their compliance with responsible finance principles.
- Promote the UNCTAD Principles internationally, and spur debate on how to best interpret them.
- Promote official debt audits internationally and share the Norwegian experience.

Annexure 1: List of selected Eurodad Charter requirements

A. Technical and legal terms and conditions

A (i) Loans

1: Purpose and amount of loan	2: Mutual obligations and predictable disbursement	3: Compliance with relevant national and international laws	4: Legal authorization to enter into the transaction	5: Repayment assumptions (made public)	6: Interest rates (stated and with upper limit)
7: Repayment profile (plan)	8: Penalties (not usurious, and no more than original interest rate)	9: Side-letters (not permitted)	10: Fees and charges (stated and not above international market prices)	11: Conflict of interest	12: Sale of loan on secondary market (only with the consent of the borrower)
13: Sovereign debt securitisation (prohibited)		14: Currency of the loan (possibility to borrow in local currency)		15. Agreements between borrower and lender (all details must be in the loan, incl. whether the provision of goods and services are involved)	

A. (ii) Investment contracts (Extract of the parts relevant for sovereign debt)

10. State financing and guarantees (the state is not obliged to provide any funds or credits, or issue guarantees)

B. Protection of Human Rights and the Environment

B. (i) Loans and investment contracts

1. Respect for human rights	2. Respect for internationally recognised social, labour and environmental standards	3. Needs assessment	4. Ex ante impact assessment (must be made public and available in local languages)	5. Precautionary principle

C. Development Effectiveness

C (i) Loans and investment contracts

1. Alignment to national development goals (should promote national development and not be tied to the purchase of goods or services from the lender or investor)

C. (ii) Investment contracts

2. Employment of local citizens	3. Local community development	4. Local business development	5. Technology transfer	6. Infrastructure development	7. Availability of products for domestic industry

D. Tax related measures

D. (i) Loans and investment contracts

1. Public revenues (loans and investment projects must comply with national tax legislation)	2. Tax information exchange (between all jurisdictions involved)	3. Financial transparency (ensure that companies do not avoid taxes or engage in abusive transfer pricing practices)

E. Procurement

E. (i) Loans

1. Public procurement (rules-based, public and accountable, details of the tendering process must be public)	2. Use of country systems	3. Loan tying – Loan contracts must not be formally or de facto tied to the purchase of goods and services from the lender	4. Immunity (no immunity clauses for any actors)

F. Public Consent and Transparency

F. (i) Loans and investment contracts

1. Parliamentary and citizen participation	2. Public disclosure of information	3. Financial transparency (keeping records)	4. Language (available in the main national languages, incl. affected communities)	5. Adherence to integrity and anti-corruption efforts

F. (ii) Project Loans

6. Progress reports and loan evaluation

G. Dispute settlement

G. (i) Loans

1. Change in circumstance	2. Independent procedure	3. Legal authorization to negotiate	4. Loan refinancing (details must be public).	5. Cross default (not allowed)	6. Collective action clauses	7. Termination of the contract

Annexure 2: Key implications and weaknesses of the UNCTAD principles

1. Agency	Implications	**Odious debt** • Debt that is incurred by an illegitimate regime, against the interests of the people and without its consent, and where the creditor was (or should have been) aware of this, is not the responsibility of a successor regime. • The lender has a responsibility to either avoid lending, or go to extra lengths to ensure that the loan does benefit the population in cases where the regime is odious. • The lender incurs an increased risk by lending to an illegitimate regime. • In the case of odious debt, a successor regime can repudiate the debt. **Rights and interests of the citizens** Any restructuring must take into account the responsibility of the sovereign to protect the fundamental rights of its citizens, and allow sufficient public funds for the debtor to fulfil this responsibility. The imposition of harmful policy conditionalities by lenders, either on the initial loan, or as a part of a restructuring, is in contradiction with the responsibility of the sovereign borrower to protect the interests of its citizens.
2. Informed decisions	Implications	The lender must present the borrower will all relevant information about the loan. This must include: • Specifications of the type and level of interest rates charged, and if the interest rate is variable, a fair upper limit should be set. • All details regarding grace and maturity periods and repayment profiles must be provided, as well as details of fees and charges. • Any penalty premiums must be clearly stated, and these should be at a maximum rate no higher than the original interest rate.
3. Due Authorization	Implications	The agreement should not be in breach of the laws of the borrowing country nor those of the lender. The national parliament must give authorization to take up loans. If due authorization was not granted, or the loan contravened national laws, the creditor in question will later have a weaker claim for repayment compared to other creditors that acted prudently. If the loan has been contracted in contradiction with national law, the debtor government can argue that the debt is illegitimate and repudiate it.
	Weaknesses	The principle should be more specific and should, as the Eurodad Charter, include a requirement that parliaments, citizens and affected communities «must be given adequate time to debate the loan or investment (…)» and that all loans must «comply with national laws».
4. Responsible Credit Decisions	Implications	• Lenders that extend loans to refinance the debt of a country that already has repayment difficulties must exert increased levels of due diligence. • If a lender knowingly extends a loan that puts the borrowing country at risk of default at a later stage, the lender can be said to act imprudently. • In a possible debt workout, the debtor country can argue that lenders that acted irresponsibly are not entitled to full repayment, and have to share a greater part of the costs of reducing the debt than prudent lenders that acted responsibly.
	Weaknesses	The IMF has faced on-going criticism of their debt sustainability analyses that are often unrealistic and too optimistic. Given that the IMF plays an important role as a creditor, it is necessary to have an independent body (such as UNCTAD) develop debt sustainability analyses. This would improve the basis upon which lenders can make responsible credit decisions.
5. Project Financing	Implications	«Likely effects» to be evaluated in both an ex ante assessment and post-disbursement monitoring must include impacts on human rights and labour standards.
	Weaknesses	The principle does not state that project finance must be in line with the national development priorities of the borrowing country, as both the OECD guidelines and the Eurodad charter do.
6. International Cooperation	Implications	If a lender does not comply with UN sanctions against a given regime, they take on the risk of debt repudiation by a future democratic regime.
	Weaknesses	The principle is too narrow, and is by no means sufficient to avoid the creation of illegitimate debt. However, the principle does implicitly recognise that the lender has a responsibility in terms of what kind of regime it finances through its lending.

7. Restructuring	Implications	• The term «manifestly unable to service its debt,» must be interpreted to include when a sovereign is unable to fulfil its basic duties towards its population through public services. • For a lender to «act in good faith», the debtor must be given the opportunity of independent arbitration in case of a debt dispute.
	Weaknesses	The impartiality of the IMF and World Bank is hampered by their status as creditors. For such an analysis to be just, an independent body should perform the evaluation of debt sustainability and how much resources need to be freed up for the sovereign to be able to fulfil its basic duties towards its population.
8. Agency		See implications under principle 1.
9. Informed Decisions	Implications	• When a sovereign is unable to cover the basic needs of its population and promote development due to its obligation to service its debt, this should be considered as part of the case to argue that the sovereign is in a «state of economic necessity.» • «Circumstances giving rise to legal defense» must include more than just corrupt practices by officials from the sovereign lender. For example, if the contraction of a certain debt was illegal under national jurisdiction this should qualify as giving rise to legal defence.
	Weaknesses	The definition of «circumstances giving rise to legal defense» is vague, and will not contribute to reducing reckless and irresponsible lending and borrowing that can create illegitimate debt, unless it is defined more widely.
10. Transparency	Implications	The parliament of the borrowing sovereign must give authorization to take up loans.
11. Disclosure	Weaknesses	Although increased transparency and improved information flows are positive in themselves, the UN principles do not introduce risk in a sufficient manner. For the information obtained through improved transparency and disclosure by the borrower to have substantive consequences, the creditor should face a risk if failing to behave responsibly.
12. Project Finance	Implications	As with principle 5 regarding lenders, SLUG interprets the ex ante assessment to include an assessment of impacts on human rights and labour standards.
	Weaknesses	The ex ante impact assessment should include public consultations with affected communities of civil society organisations. The sovereign borrower should have the right to refuse full payment of the debt if the creditor has acted imprudently or broken the contract. This is particularly relevant in relation to project funding through export credits. Principle 12 (and principle 5) should have included that the project loans must be in accordance with the development priorities of the sovereign borrower, as both the Eurodad Charter and the OECD guidelines do.

13. Adequate Management and Monitoring	Implications	Debt audits should assess whether • the loans were contracted in accordance with the principles • whether the debt was contracted legally with due authorization (in accordance with principle 3) • whether it was taken up and used in the interest of the population (principle 1 and 8) • whether the creditor provided sufficient information about the risks (principle 2) • whether in the case of project financing ex ante assessments were made by both the borrower and lender (principles 5 and 12) • whether the process was transparent with proper approval and oversight (principle 10 and 11). There should be citizen participation and parliamentary debate around how the findings of the audits should be used.
	Weaknesses	If a narrow interpretation of the principles is employed, these will not be sufficient to assess the legitimacy of the debt burden. A thorough debt audit should however assess the legitimacy of the debt, looking at how it was contracted, by what regime, for what purposes and whether it benefited the population and the development of the country. If a claim is deemed illegitimate in a debt audit, the sovereign borrower should be able to demand that this debt is cancelled. It would be in the best interest also of the creditors for such a dispute to be handled by an independent party through arbitration.
14. Avoiding Incidences of Over-Borrowing	Weaknesses	The principle states that the sovereign borrower has a responsibility to weigh costs and benefits, and should take up loans with a «prospective social return at least equal to the likely interest rate». However, in cash-strapped economies, it makes more sense to look at actual financial return. The implication of this is that work to achieve the Millennium Development Goals in the poorer countries should be financed mainly by grants and not loans.
15. Restructuring	Implications	In accordance with the responsibility of the state to protect the interests of its citizens, economic necessity should be interpreted not only as financial inability to service the debt, but also when the sovereign is unable to cover the basic needs of its population. The sovereign should be able to argue the need for restructuring on this basis, and also demand a debt reduction or cancellation that frees up sufficient funds for the state to be able to fulfil its fundamental obligations towards its citizens.
	Weaknesses	The system of international finance lacks a fair and independent mechanism to deal with sovereign debt. Ideally, there should be an international debt court to fulfil the function that bankruptcy courts have in national jurisdictions. However, this will take many years to establish. In the meantime, an ad-hoc arbitration procedure can provide the independent judgement that is lacking today. Such a procedure should also evaluate the legitimacy of the claims. If the principles had stated the responsibility to include arbitration clauses in the loan contracts, this would have been an important contribution towards more responsible financing.

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