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Renegotiating Third World Debt

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INTRODUCTION

The vicious cycle of debt is common in today's society. Consumers are routinely warned of the troubles of becoming mired in debt. Once they amass a certain level of debt, they cannot repay it in full and interest begins to mount. It is not uncommon to borrow from one lender in order to pay the interest accumulating on the debt owed to a second lender. Short of a miracle, completely ending this sort of debt becomes practically impossible.[2]

This is the debt crisis facing the Third World. The crisis is one so severe that it threatens to shatter the economy of countless nations and leaves the future of their lenders in doubt. The only viable solution is to come up with an "alternative" method of dispute resolution to deal with the debt crisis — one that is a cross between arbitration and mediation. A disinterested body should be created to recover some, or if possible, all of the outstanding loans owed to financial institutions, while alleviating the extreme hardships the debt and current debt repayment methods have inflicted. It should be noted, however, that the creators of such a solution cannot precede along the lines of traditional mediation methods. Traditional methods will be futile for the simple reason that both sides freely admit the loans are outstanding. This fact is undisputed. The dispute arises over how to repay the loans and by what methods.

The first part of this paper will explain what the Third World is; the nature of Third World debt; why the search for a solution for this economic quagmire is one of the most important tasks facing the world today; and how

1. Student, Pepperdine University School of Law. The author would like to thank Professor Roger Alford, Pepperdine School of Law, for his valuable insight on the topic and his willingness to share his vast knowledge of international law. The author would also like to thank Professors Asma Barlas and Naeem Inatuyalla, Ithaca College, for taking my interest in the Third World and turning it into a passion. The opinions expressed herein are solely those of the author.

2. It might seem off-base to compare credit card debt totaling in the thousands to Third World debt which is sometimes in the billions, but many may be surprised to know that the process that nations go through in procuring loans and repaying them are almost identical to that of the regular consumer applying for a credit card. The amount a nation receives depends on its credit history (this will become an important topic in this paper). The repayment plan is very similar to credit card repayment plans and the interest rate that a nation pays on the loan is, like a credit card, based on its credit history; however, the interest is more likely to increase and decrease than that of a consumer credit line.

mediation can help. The second part of this paper will focus on why some form of debt relief is needed and the importance of arriving at a better system of loan repayment and disbursement than the one currently being employed. The final part of this paper will pose possible alternative solutions that can help alleviate the problem of Third World debt without further straining an already volatile relationship that exists between the lenders and debtor nations, and most importantly, between the West and The Third World.

I. THE THIRD WORLD AND THIRD WORLD DEBT

A. What Is The Third World?

The Third World is a collection of dissimilar and unstructured groups of approximately 120 African, Asian, and Latin American nations.[3] These nations differ in race, language, religion and historical experience, but what they have in common, and what places them in the "Third World" category, are their goals of development.[4] Economic development has been, and still is, the main goal of these nations. However, social, political, and institutional development has also become a priority in the last fifty years.[5]

B. What Is Third World Debt?

Third World debt became a significant concern during the 1970s when U.S. banks began to lend extraordinary sums of money to Third World nations.[6] This is attributable to the massive influx of cash received when Middle Eastern countries began depositing oil revenues into U.S. banks.[7] Looking to

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3. *See* Jeremy J. Sanders, *The World Bank and the IMF: Fostering Growth in the Global Market*, CURRENTS: INT'L TRADE L.J., Vol. IX, No. 2, at 37, 40 (2000). *See also* Jeswald W. Salacuse, *From Developing Countries To Emerging Markets: A Changing Role for Law in the Third World*, 33 INT'L LAW, 875 (1999). Many Eastern European countries are called "The Second World" in that for most of the last century they were satellites of the Soviet Union and thus not considered a part of the Third World; nor were they considered part of the "West," but were communist nations still striving to develop.

4. Sanders, *supra* note 3, at 40. "Development" in the context that these nations strive to become self-sufficient, increase the standard of living for its citizenry, and increase trade by becoming an exporting rather than an importing nation. *Id.* The irony here is that not all nations can become solely exporting nations, because there would be no one left to export to. This suggests that some nations will forever have to be "developing" in order for capitalism to continue.

5. *See* Salacuse, *supra* note 3, at 875.

6. Alfred J. Puchala, Jr., *Securitizing Third World Debt*, 1989 COLUM. BUS. L. REV. 137 (1989).

7. Enrique R. Carrasco, *The 1980's: The Debt Crisis and the Lost Decade Of Development*, 9 TRANSNAT'L L. & CONTEMP. PROBS. 119, 120 (1999). In the 1970s the world's largest oil producing nations (with the exception of Norway) created the Organization of Petroleum Exporting

make a profit off the cash reserves they had available, U.S. financial institutions began loaning out money, in particular to eager Latin American countries, without properly assessing the risks involved and correctly calculating the amount of loans the nations could handle without defaulting.[8]

The bottom fell out in the 1980s with the coming of a global recession.[9] As exports of debtor countries dropped drastically while the dollar gained strength, and global interest rates soared, the ability of debtor countries to make timely payments stalled. It became increasingly more difficult to repay the loans as their interest rates increased.[10] The debtor nations never fully recovered from the events of the 1980s and the result has been "massive domestic and foreign borrowing, high and permanent inflation, and, consequently, huge deficit finance."[11]

Since the cycle began, no entity has succeeded in successfully coming up with a plan that allows debtor countries to break this cycle. Most of these debtor countries have been unable to achieve any significant period of economic growth. Consequently, Third World nations are in debt well over a trillion dollars. The possibility of default on even a very small portion of this debt has been enough to create an unprecedented financial crisis, which although very real, has not received the proper attention deserving of its magnitude.[12]

C. How Mediation Can Help

Historically, arbitration and mediation have been looked upon with dis-

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Countries (OPEC). Seeking to end competition amongst themselves, and to stabilize oil prices, OPEC ministers meet a few times a year and collectively set the quota for the number of barrels a day each member state will produce. The creation of OPEC caused oil prices to skyrocket and member states benefited greatly from its creation. Members are all from the Middle East with the exception of Venezuela. The two biggest and most influential are Iran and Saudi Arabia.

8. *See* Puchala, *supra* note 6, at 137.

9. *See* Carrasco, *supra* note 7, at 120. Ironically, one of the factors people cite as a cause for the recession was the Oil Crisis.

10. *Id.* In 1982 Mexico was the first country to declare that it could not pay its foreign debt. This was quickly followed by Brazil, Venezuela, Argentina, and Chile. *See also* Michael F. Hoellering, *World Trade: To Arbitrate or Mediate — That is the Question*, 49.1 DISP. RESOL. J., 67-69 (1994).

11. Tamara Lothian, *The Criticism of the Third-World Debt And Revision Of Legal Doctrine*, 13 WIS. INT'L L.J. 421, 444 (1995).

12. *See* Puchala, *supra* note 6, at 137.

trust in the Third World.[13] In disputes between the Third World and the West, Third World intellectuals, scholars and politicians argue that arbitration has tended to favor Western economic interests.[14] As this comment will suggest, there is much credence to this argument. Many, if not all of the attempts at alternative dispute resolution, undertaken to resolve the debt crises have been initiated and/or run by Western nations and financial institutions.[15] Sadly, the purpose of arbitration and mediation has been lost to the West.[16] Five factors allow mediation to be successful:[17] (1) an impartial third party facilitator;[18] (2) a third party who vigorously protects the integrity of the proceedings;[19] (3) a good faith participation from the participants;[20] (4) the presence of all parties involved; and (5) an appropriate site or venue. If a good faith effort was made to conduct mediation proceedings with all these five factors present, there should be no reason why a solution cannot be reached that is beneficial to both sides, and in particular, to the millions of impoverished people of the debtor nations.

II. THE IMPORTANCE OF FINDING A WORKABLE SOLUTION

A. Partial, But Not Complete, Debt Relief is the Answer.

Those in the West and in the Third World who object to repayment of any of the outstanding debt usually cite three reasons.[21] First, many of the

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13. Amr A. Shalakany, *Arbitration and the Third World: A Plea for Reassessing Bias Under the Specter of Neoliberalism*, 41 HARV. INT'L L.J. 419 (2000). Investigating disciplinary bias in international commercial arbitration.

14. *Id.* at 419. Although Mr. Shalakany argues in his article that this notion of bias towards the West is completely unfounded, he does not specifically touch upon the subject of mediation and arbitration in the Third World debt setting or the current forms of dispute resolution in place today which, I argue, are heavily pro-Western. Mr. Shalakany skillfully keeps his discussion centered squarely on Asia Minor and completely ignores Latin America and the arbitration injustices and manipulation that occur in that region of the world.

15. Organizations such as the World Bank, IMF, Clubs of Paris and London and plans such as The Brady Plan or The Baker Plan have all been the creations of the West or Western financial institutions.

16. *See What Is Mediation?*, *available at* http://adrr.com/adr1/essayi.htm (last visited Jan. 15, 2003).

17. *Id.*

18. All attempts up to this point have not truly been impartial in that all proceedings have been run and maintained by Western nations or financial institutions.

19. *See id.* The impartial Third Party does not exist making it difficult to protect the integrity of the proceedings.

20. The financial institution's only motive is the recovery of its investment, with little or no regard to the complaints held by the Third World nations.

21. *See* Lothian, *supra* note 11, at 439. Resistance to paying off the debt has existed in the Third World, and in particular in Latin America, since the 1970s. It has become a yearly ritual

loans paid out in the 1970s were made to military regimes, particularly in Latin America, who used the funds for purposes other than helping the citizenry and advancing development.[22] Although a valid concern, the banks were all too willing to make loans to military regimes who were eager for cash and utterly incapable of gauging the amount of debt the country could shoulder. This is a morality-based argument unsupported by any legal legitimacy.[23]

Two arguments that possess less moralistic undertones and incorporate some legal validity, are that the banks were responsible for the excessive borrowing of the period[24] and that full repayment of the loans would create massive hardships to the people of the debtor countries.[25]

The existence of the loans has already created instability and unrest in debtor nations. The obligation to pay back the loans has "undermined experiences of popular self-government and national self-determination . . . ."[26] The debtor nation's inability to create any substantive internal development strategies and invest in the well-being of its people and resources, has undermined the entire process of development. Although the loans were initially intended to help the process of development, they have, in fact, done more to stunt development than any other major development in the Third World.[27] As

for Argentina to threaten to default in order to garner more favorable repayment options. The campaign for complete debt relief has only recently become vogue in the West. Many entertainers have taken up the cause, not necessarily advocating that the debtor nations default on the loans, but for Western nations to grant debt forgiveness. *See* Editorial, *Africa's Debt Burden*, JOURNAL OF COMMERCE, Sept. 3, 1998, at 4A.

22. *Id.* For more on the role of the military in creating debt in Latin America, see JOHN SHEAHAN, PATTERNS OF DEVELOPMENT IN LATIN AMERICA, 188-94 (1987).

23. *Id.* It is highly unlikely that bankers would be willing to give debt relief based on moral guilt.

24. *See* KARIN LISSAKERS, BANKS, BORROWERS AND THE ESTABLISHMENT 218 (1991)(arguing that the banks had a duty to the debtor nations to calculate and figure out the ability of the debtor nation to pay back the loan, similar to the way consumer credit companies look at an applicant's income and outstanding debt to calculate whether the applicant will be able to shoulder the added debt).

25. *See* Lothian, *supra* note 11, at 439-41. The more resources debtor nations are forced to allocate to repayment of loans, the less resources they have available to provide for an already neglected society.

26. *Id.* at 423.

27. *See* STEPHAN HAGGARD & ROBERT R. KAUFMAN, ECONOMIC ADJUSTMENT AND THE PROSPECTS FOR DEMOCRACY, IN THE POLITICS OF ECONOMIC ADJUSTMENT 319 (Stephen Haggard & Robert R. Kaufman eds., 1992). *See also*, Lothian, *supra* note 11, at 423. It cannot be argued that the debt burden has severely hurt the ability of debtor nations to advance and provide for its

a result, numerous debtor nations have stagnant economies, indicated by unemployment rates as high as forty percent(40%).[28] Such conditions epitomize a breeding ground for dictatorships that promote national or ideological unity but do very little to increase the long-term chances of economic and social recovery.[29] In Ethiopia, for example, one hundred thousand children die annually from "easily preventable diseases while debt repayments are *four times more than public spending on health care* (emphasis added)."[30]

Although it has become clear that some form of debt relief is vital to the debtor nations, those who are concerned about the interests and the financial health of both debtor nations and the lender financial institutions realize that complete debt relief is not a realistic option. Financial institutions have loaned billions of dollars and if they do not see some return on their investment, the repercussions on the world financial markets would prove devastating to the global economy.[31]

Further, financial institutions are not obligated to extend unlimited credit to debtor countries.[32] By completely repudiating the debt, as opposed to formulating a viable solution to the problem, banks will simply cease extending credit, the potential ramifications of which would be as severe as having too much debt.[33] Financial institutions have made it very clear in the past that failure to honor the debt would "produce an immediate suspension of short-term credit lines which are essential to sustaining a country's foreign trade."[34]

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citizenry, as vital income is funneled away from needed social programs and into bank coffers. It seems also inevitable that to make debtor nations stable, better able to care for their own people, and better able to pay off financial obligations, some form of debt relief will be needed, either through debt forgiveness, additional time to pay off loans, or a reduction of interest rates.

28. *See* Lothian, *supra* note 11, at 444. For a further discussion on how the debt crisis has created a fiscal crisis in debtor nations, and in particular Brazil, *see* Geraldo Biasoto Jr., *Divida Externa e Desequilibrio Financeiro no Setor Publico*, 2 ANALISE E CONJUNCTURA 25 (1987)(translated from Portuguese).

29. *See* Lothian, *supra* note 11, at 433.

30. Antony Anghie, *Time Present And Time Past: Globalization, International Financial Institutions, And The Third World*, 32 N.Y.U. J. INT'L L & POL. 243, 257 (2000).

31. *See* Derek Asiedu-Akrofi, *Sustaining Lender Commitment To Sovereign Debtors*, 30 COLUM. J. TRANSNAT'L L. 1 (1992) (highlighting the importance of financial institutions remaining involved in the foreign debt market and providing new techniques that would enable them to see a return on their investment). *Id.* at 3.

32. *See* Carrasco, *supra* note 7, at 121.

33. *See* Lothian, *supra* note 11, at 425-26. Although self-sufficiency and decreasing the dependency of Third World nations on loans are the goals, it is necessary that the option for loans remains intact. Any nation could be hit by recession, inflation or an environmental catastrophe and borrowing money might be the only viable option of avoiding complete economic collapse. *See also*, Anghie, *supra* note 30, at 246-51 (concerning the enormous power international financial institutions wield over the Third World).

34. Lothian, *supra* note 11, at 426; *see also* JEFFREY D. SACHS, INTRODUCTION TO DEVELOP-

More importantly, the danger of a nation unilaterally repudiating its debt will lead to ostracization from the world economy that will not only cut off access to loan and risk capital, but direct capital investment in the country, such as factories and stores, will decrease as well, resulting in further economic destabilization.[35] The United States' interests would be severely affected if financial institutions refuse to extend credit to Third World nations. In order to protect its foreign interests, the U.S. would have to create numerous bail-out packages to sustain the Third World economies. This would effectively turn the U.S. government into a creditor and American taxpayers into reluctant investors, with very little to gain.[36]

B. Strategic Importance Of A Debt Free Third World

The importance of debtor nations being free of debt is of paramount concern to both the debtor nations and the West, specifically the United States, who plays a large and vital role in promoting stability in the Third World, and, in particular, Latin America.[37]

The resurgence of nationalism that often occurs when nations are unable to manage their foreign debts is a troubling phenomenon.[38] As American corporations enter these countries and begin to export the products of the people's labor with little in return and the nation struggling to meet the basic needs of its people due to the foreign debt, Anti-Western and Anti-American sentiment becomes common.[39] When these national sentiments are not properly addressed, actions directly endangering American interests abroad begin

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ING COUNTRY DEBT AND THE WORLD ECONOMY (Jeffrey D. Sachs ed., 1989).

35. *See* Carrasco, *supra* note 7, at 119.

36. *See generally,* Asiedu-Akrofi, *supra* note 31. Bail-out packages are usually created to prop up a nation's economy on the verge of collapse. *See* Sanders, *supra* note 3, at 33. The United States has an incentive to do this, especially in Latin America, because of the billions of dollars American citizens and corporations have invested in these nations and the need to maintain healthy countries to import American goods. Mexico, because of its close geographical proximity and trade with the United States, has been the recipient of numerous bail-outs in the past.

37. *See generally* Sanders, *supra* note 3, at 43. Most of the unpaid Third World debt is in Latin American countries that have historically been most susceptible to default. *Id.* The economic and social effects instability can have in Latin America is of great concern to the United States. *Id.* A faltering Latin American economy affects all aspects of the United States, not only the economy. *Id. See also* Puchala, *supra* note 6, at 148.

38. *See id. See also*, Irene A. Belot, Note, *The Role of the IMF and the World Bank in Rebuilding the CIS*, 9 TEMP. INT'L & COMP. L.J. 83, 85 (1995).

39. *See* Sanders, *supra* note 3, at 43.

to occur and the capital invested by U.S. corporations in the Third World is at risk.[40] Tamara Lothian, Director of First National Bank of Boston,[41] feels that that rising nationalism in debtor countries is a sign of discontent with the West and Capitalism as well: "the state that begins by repudiating its debt seems already to have set out on a course of upheaval."[42] Radical, left-wing elements have always existed in the Third World[43] but have usually been successfully offset by oppressive conservative classes.[44] Occasionally, however, when left unchecked, these radical elements win the support of the middle class and are successful in disrupting American interests abroad.[45]

C. Failed Attempts

1. The Brady Plan

Attempting to reach a viable solution for the debt crisis is nothing new; in the past twenty years both sides have attempted to formulate plans to resolve the crisis. Unfortunately, failure is the typical result as each side attempts to maintain its own interests rather than searching for a resolution beneficial to all parties.

Financial institutions have frowned upon politicians attempting to advance solutions for solving the debt crisis.[46] One such plan that received a

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40. *Id.* It is very common for the United States to bear the brunt of criticism in any country where Nationalism takes root, be it the Third World or Europe, due to American Corporations visibility throughout the world. This constant visibility is a clear reminder of the United States' political and financial dominance.

41. A respected bank that no doubt has outstanding loans, which it would like to have repaid.

42. Lothian, *supra* note 6, at 437. Anti-capitalism is more of a concern than general Anti-West or anti-U.S. sentiment, because although Anti-U.S. feelings might affect American tourists abroad, anti-capitalism sentiment affects American capital invested in the Third World. *See id.* at 437. This is not intended to mean that money could ever be considered more important than human lives, but for Lothian and other bankers, protecting their company's capital is of paramount concern.

43. It is fairly well known that Latin America has radical Marxist factions who have had success in their political struggles. These Marxist factions receive support and gain popularity from the negative attitude towards foreign debt and investment. For an unbiased look at socialism, see NANCY S. LOVE, DOGMAS AND DREAMS: POLITICAL IDEOLOGIES IN THE MODERN WORLD, 179-342 (1991).

44. Lothian, *supra* note 11, at 437.

45. *Id.* at 437.

46. *See* Puchala, *supra* note 6, at 138. One such plan that was vigorously resisted was The Baker Plan. In the late 1980s, The Baker Plan, proposed by former U.S. Secretary of the Treasury James Baker, was composed as a three party strategy, adoption by debtor countries of growth-oriented domestic reforms and a three-year $9 billion increase in World Bank lending. It never received the full support of the business community needed to ensure its survival. *See, Ec-*

warm response by many in the U.S. government, and some in the business community, was the "Brady Plan."[47] A commentator called it "the freshest and most realistic approach to the international debt crisis."[48] The Brady Plan called for banks to assist with voluntary debt reduction while offering Third World countries new money at lower interest rates and more manageable payment options.[49] In exchange, the Third World nations receiving Brady Plan assistance would be expected to undertake radical reform and restructure their economies along the lines of the Western market-oriented economies.[50]

The underlying basis of the Brady Plan seems to make sense: debt relief in exchange for a more market-friendly system that will hopefully allow the debtor nation to better handle its financial commitments in the future. In practice though, the Brady Plan posed problems for both sides, and in the end no one has appeared willing to allow it to succeed. For a plan such the Brady Plan to be successful, full cooperation from both sides is needed.[51]

The problems the Brady Plan posed for debtor nations will be discussed shortly, as they nearly parallel the problems posed by the suggestions of the World Bank and International Monetary Fund. Banks had no real incentive to forgive a significant amount of debt for promises of economic restructuring, because the policy changes called for by The Brady Plan benefited Western governments more than the financial institutions.[52]

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onomic Policy Council of UNA-USA Third World Debt: A Reexamination of Long-Term Management 15 (Sept. 7, 1988).

47. *See* Puchala, *supra* note 6, at 138. The Brady Plan was a polished version of The Baker Plan. *Id.*

48. *Id.* (Alfred J. Puchala, Jr.; B.A., 1983, Yale; J.D., 1988, Georgetown.)

49. *Id.*

50. *Id.* The country's progress towards reform would be closely scrutinized and all future debt relief and new money would be conditioned on the nation's aggressively continuing towards market reform.

51. *See* Lothian, *supra* note 11, at 426. The key distinction is whether "the confrontation . . . occurs under the aegis of a political project enjoying widespread support in the society" or one which causes discontent with the people and the financial institutions as well. *Id.*

52. *See* Puchala, *supra* note 6, at 139. Financial institutions now agree that some form of debt relief needs to be worked out for them to see any sort of return on their investments. The problem with the Brady Plan was that financial institutions felt they were making the sacrifice, but the eventual benefit of the sacrifice would flow more towards western governments than the banks. The Brady Plan was proposed during the end of the Cold War when the idea of having countries rapidly turning to capitalist free market societies was a major political victory for capitalist nations. Additionally, this would benefit western corporations who wished to invest in the Third World, although such reform didn't necessarily mean more money for the banks. *Id.*

2. The International Monetary Fund and World Bank

The International Monetary Fund (IMF) and the World Bank have received more criticism than praise for their handling of the international debt crisis.[53]

The World Bank was created in 1944 by the victors of World War II in Bretton Woods, New Hampshire.[54] After meeting its initial goal of reconstructing Europe's battered economic infrastructure, the World Bank began to focus most of its efforts in the Third World.[55] Today the World Bank sells shares to nation states and provides loans to developing countries with the proceeds.[56] The Vice-President of the World Bank states the organization's official purpose as being "the alleviation of poverty, the fulfillment of basic human needs for nutrition, safe drinking water, education, health and housing, the concern for the settlement of people affected by large development projects, the role of women in development, and preserving the environment."[57] Critics of the World Bank would say the organization has compounded these problems rather than alleviated them.[58]

The IMF was established at the same time as the World Bank, in Bretton Woods.[59] Unlike the World Bank, an organization that tries to deal with a host of issues such as human rights and potable water, the IMF is strictly concerned with international monetary markets, free trade, capital investment, foreign exchange stability, debt and debt repayment.[60] In exchange for its as-

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53. *See* Carrasco, *supra* note 7, at 124.

54. *See* Sanders, *supra* note 3, at 37. Members from forty-four nations attended the meeting. Their primary purpose was to rebuild the international economic system that was ravaged by a decade long depression and World War II. For a further discussion of the meeting see Michael P. Malloy, Note, *Shifting Paradigms: Institutional Roles in a Changing World*, 62 FORDHAM L. REV. 1911 (1994).

55. *See* Sanders, *supra* note 3, at 37. Although the reconstruction was done in speedy and magnificent fashion, The World Bank cannot take full responsibility for Europe's quick recovery. *See generally*, Jim Chen, *Pax Mercatoria: Globalization As A Second Chance At "Peace For Our Time"*, 24 FORDHAM INT'L L.J. 217, 228 (2000). Practically all of the credit goes to the implementation of The Marshall Plan in 1947. *Id.* The World Bank, overall, has very few accomplishments for which to be proud. *Id.*

56. *See* Sanders, *supra* note 3, at 37. The decision to give loans is based on a majority vote of the representatives holding shares in the World Bank vote. The United States has the most control in the World Bank because it has more than eighteen percent of the voting power "which equals nearly three times the amount of Japan, the next largest share holder." *Id.*

57. *Id., quoting* Malloy, *supra* note 54, at 179.

58. *See* PAUL CAMMACK, THIRD WORLD POLITICS: A COMPARATIVE INTRODUCTION 12 (John Hopkins, 2d ed. 1993).

59. *Id.* at 38.

60. *See* Sanders, *supra* note 3, at 38. The IMF's charter sets out six main objectives: 1) to promote "global cooperation by providing the institutionalized machinery for consultation and

sistance, the IMF asks for three things from Third World Nations: (1) reign in spending (as opposed to increasing taxes) by cutting back on public investment; (2) use earnings from exports to pay back debt, rather than finance the importation of needed goods; and (3) privatize almost all aspects of society.[61]

Although the idea of creating alternative "independent" organizations to attempt to solve global issues (such as Third World debt) is the main objective, the World Bank and IMF have not lived up to the expectations of many, particularly the Third World nations. First, the World Bank and IMF are not genuinely independent[62] — at least they do not share the same level of independence one would typically associate with an arbitrator or a mediator.[63] As noted, industrialized nations such as the United States, Japan, Germany and Great Britain play influential roles in both the World Bank and IMF.[64] In a dispute between a Western financial institution and a Third World country, the IMF and the World Bank does not appear to be the bias-free mechanism needed to mediate the conflicts and create substantive policies that will solve the debt crisis.[65]

Further, both organizations are accused of magnifying human misery in

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collaboration of members on global monetary issues"; 2) to promote a balanced growth in international trade, with the hope of creating higher employment and income and "the development of productive capacity of members"; 3) to promote stability in exchange arrangements and in exchange rates in order to counteract currency devaluation; 4)to create a "multilateral system of payments and transfers" for monetary transactions in hopes of not hindering the expansion of world trade; 5) to "make convertible financial resources available to member states, on a temporary basis with appropriate safeguards, in order to permit these states to correct international payment imbalances"; and 6) to reduce the amount and duration of these imbalances. *Id.*

61. Lothian, *supra* note 11, at 442. It is clear by these three requirements that the IMF is not the impartial mediator necessary to solve the problem of Third World debt, when it structures its requirements to benefit western financial institutions.

62. As already noted, neither the World Bank nor the IMF can implement a debt resolution program or disburse any form of financial assistance to a Third World nation without the approval of member states. *See* Sanders, *supra* note 3, at 37.

63. *Id.* at 38. The World Bank and the IMF cannot act without the approval of shareholder states (industrialized nations), unlike a mediator who would be independent.

64. *See* Anghie, *supra* note 30, at 244.

65. The fact that the United States alone can veto any World Bank policy decision, or an attempt to resolve financial disputes, makes it clear that the World Bank cannot be the impartial mediator needed to solve the Third World debt problem. Most of the financial institutions that have outstanding Third World loans are United States' institutions. *See* Christopher Gottscho, *DEBT-EQUITY SWAP FINANCING OF THIRD WORLD INVESTMENTS — WILL THE I.R.S. HINDER U.S. SWAPPERS?*, 8 Va. Tex Rev. 143, at 146, 147 (1988).

the Third World, something their respective charters claim they want to end.[66] The World Bank and IMF's system of requiring debtor nations to implement massive market-based reforms, for which most of the countries' internal structures are not ready, in exchange for financial assistance is credited with driving these Third World nations into deeper despair and exasperating the debt crisis rather than helping to resolve it.[67] These requirements came to be known as "globalization," i.e., duplicating the Western model of economy throughout the world, regardless of social and political consequences in the Third World.[68] Antony Anghie, an Associate Professor of Law at the University of Utah states, "Even scholars who assert that globalization is largely beneficial argue that globalization causes extensive social dislocation that needs to be remedied by increased state-sponsored social welfare programs."[69]

The shortsighted requirements by the IMF and World Bank and the failure to arbitrate the issue of foreign debt in an impartial and realistic way, have caused the poor, women, children, and indigenous peoples to suffer "disproportionately as a result of structural adjustment programs" since the 1980s.[70] Numerous studies have shown that the stabilization and structural adjustment programs the IMF and World Bank forced debtor nations to undertake have not resulted in the intended consequences.[71] In most Third World nations, these programs have led to a significant widening of the gap between rich and poor, shrinking salaries, high unemployment, malnutrition, and inadequate health care.[72]

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66. *See* Carrasco, *supra* note 7, at 120 (illustrating the complete collapse of the IMF and World Bank in their attempts to solve the debt crisis).

67. *Id.* at 119. The market-reform requirements of the IMF and World Bank are very similar to that of the aforementioned Brady Plan.

68. *See* Anghie, *supra* note 30, at 255.

69. *Id.* These countries are diverting huge amounts of money from social development programs to (a) pay back loans, (b) implement aggressive privatization campaigns, (c) undertake efforts that stabilize inflation, and (d) attract foreign investors in infrastructure. These programs routinely displace people, bring very low wages, and transform the economic structure from one that is self-sufficient based on agriculture to one that is dependent on exports as most farm workers migrate to the cities to work at these new factories. *See id.*

70. Carrasco, *supra* note 7, at 124.

71. *Id.*

72. *Id.* The studies do not show uniform despair in all of the countries. Some regions of the world, such as Latin American and Africa have been hit much harder then other places that have initiated reform programs such as Eastern Europe, Asia, and the Middle East. *Id.* It should be noted that these areas have not "benefited" from these programs as the IMF and World Bank would have hoped, but only that they have not been hit as hard as Latin American and Africa. *Id.* This cannot possibly be attributed not to the idea that globalization tends to work if given time, but rather that many of the Eastern European nations had additional assistance from West-

Whether the IMF and World Bank have achieved their true objectives is not clear; what is clear is that they have failed in reaching the goals set out in their respective charters. The reason the IMF and World Bank have not been able to solve the debt crisis is clear: they have never acted as a true mediation body seeking the fair resolution to the debt crisis dispute rather than gains for itself and its members.[73]

3. Securitization of Third World Debt

Securitization is the private sector securitizing Third World bank loans and then selling the securities to institutional investors or individual investors.[74] The benefit of this approach is the absence of despotic mandatory requirements on debtor nations.[75] Most often, an independent entity is created to hold the loans and the cash flow that is generated from the loans is disbursed to bondholders.[76] Many contend that securitization is the only way that questionable credit risks can be renegotiated.[77]

Supporters of securitizing Third World debt argue that such a process would "relieve the strain on financial institutions"[78] while benefiting the debtor countries by transferring the loans as a security to a more financially stable base of investors.[79] The presumption is that the security investors will

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ern European nations and the Middle East. (Resources from oil, for example, have helped greatly to prop up the governments).

73. The World Bank and IMF are controlled by industrialized nations, in particular the United States. Politicians set the agenda for the World Bank and IMF. Politicians are elected with the use of donations from corporations and financial institutions, mainly in the form of "soft" money. To get reelected the politicians need to appease their real constituents, the financial institutions. Which side does the World Bank and IMF favor? The answer is clear. *See generally* Sanders, *supra* note 3.

74. *See* Puchala, *supra* note 6, at 137. Securitization "involves the pooling and repackaging of loans into securities, which are then sold to investors" (*quoting* Pavel, *Securitization*, ECONOMIC PERSPECTIVES, FED. RES. BANK OF CHICAGO 16 (July/Aug. 1986).

75. Puchala, *supra* note 6, at 137-38. The carrot and stick approach is not used in securitization because the debtor nations are not involved in the transfer of the loan into a security. *Id.* The financial institutions are allowed to pass the risk on to other investors and Third World nations are allowed to continue feeding their citizens. *Id.*

76. *See* Puchala, *supra* note 6, at 137-38. This technique is nothing new, and is frequently used in residential and commercial mortgages, car loans, and credit card receivables. *Id.*

77. *Id.* at 143.

78. *Id.* at 139.

79. *Id.* Some experts believe that a contributing factor to the problem of Third World debt is that many of the financial institutions are financially troubled and unable to compromise or ne-

be better situated to allow the debtor nations to work through short-term problems.[80] The main reason is that securities, unlike loans, are insured and pass interest and principal.[81]

Although securitizing Third World debt is an intriguing response and one that can play a role in alleviating the crisis, it should not be seriously considered as a final solution. Even the staunchest supporters of securitizing the debt believe that it is not a complete solution, but one that could "serve as a component of a comprehensive plan" that a disinterested international organization might devise in dealing with the debt crisis.[82]

4. The Clubs of Paris and London — The First Step Towards Alternative Dispute Resolution

The Club of Paris and the Club of London are dispute resolution forums that resolve disputes between creditor and debtor countries (Club of Paris) and between commercial banks in creditor and debtor countries (Club of London).[83] A Professor of Economics calls the two Clubs "case studies in effective dispute resolution and a specialized form of mediation."[84] Their purpose is to (for the first time) resolve international disputes on an international stage while solving the enforcement difficulties that routinely plague alternative dispute resolution and mediation.[85]

The Club of Paris began in 1956 for the purpose of "settling controversies concerning debts that were guaranteed or owed by [Third World] governments to creditor governments."[86] The Club's membership includes "most of

gotiate effectively, needing to see immediate returns on their investment. *See id.* at 142.

80. *Id.*

81. *See id.* Long-term investors would be content receiving the interest from these instruments. *See also*, Michael Quint, *Marketplace: Expanding Roles in Selling Loans*, N.Y. TIMES, Dec. 12, 1988, at D6, Col. 1.

82. Quint, *supra* note 81, at D6. Securitization would best be used as a short-term fix while a more substantive plan is devised by a disinterested organization.

83. Mashaalah Rahnama-Moghadam,*The Clubs Of London & Paris: International Dispute Resolution in Financial Markets*, 53 DISP. RESOL. J. 71 (1998).

84. *Id.* Mashaalah Rahnama-Moghadam is an Associate Professor Of Economics at the Department of Economics & Geography, at Texas Tech University in Lubbock, Texas.

85. *See* Hoellering, *supra* note 10, at 67-69.

86. *See* Moghadam, *supra* note 83, at 71. The idea for the Club of Paris arose in 1956 when Argentina threatened to default on all of its international loans. *Id.* at 72. All of Argentina's creditors met in Paris to discuss strategy and the ramifications that a default by Argentina would have on the world financial markets. *Id.* In these meetings, which Argentina initially did not attend, the creditors decided that it would be in their "best interest" to renegotiate the loans with Argentina in exchange for certain concessions and assurances that would reduce the risk of future defaults. *Id.*

the world's larger industrialized nations."[87] Like the Club of Paris, the Club of London is an informal organization, which concerns itself not with debts owed to western governments, but Third World debt owed to private commercial banks.[88] Supporters of the Clubs claim that since their creation, the Clubs have resolved every case that has come to them and the debtor nations have either fully repaid their loans or are currently working to pay them off.[89]

Supporters credit this success to the Club's concept of "self-reliance, rather than third-party intervention and entanglements of third parties."[90] Although both Clubs are operated by creditors, the notion exists among their supporters that the Clubs' members recognize a "fundamental" interest in working out loan agreements that are mutually beneficial.[91] Supporters claim this mutually assured benefit enables the clubs to resolve all disputes they hear.[92] Simply put, the two sides will be forced to reach some sort of agreement if the costs of disagreement exceed the cost of agreement.[93]

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87. *Id.*

88. *Id.* at 72-73. The Club of London is much more informal than the Club of Paris, and does not have a permanent chair or secretariat; but, the negotiation of debt restructuring is much more structured than in the Club of Paris. To negotiate a particular debt restructuring, the creditor banks form a Bank Advisory Committee (BAC) which is represented by all the creditor banks. The nationality of each creditor bank is taken into consideration so as to draft all plans in compliance with local tax and regulatory schemes of the respective countries. The BAC negotiates as a single body with the debtor nation, but once a negotiated package is created, the signature of all creditor banks is needed for final approval.

89. *Id.* It should be noted however, that since both Clubs are "voluntary associations" not every case of international debt comes before them and they certainly have a choice in which disputes they hear. It is not at all unlikely that the two Clubs pick only the disputes with the highest possibility of success.

90. *Id.* at 73. The third-party intervention (referred to by Mashaalah Rahnama-Moghadam) is the intervention of western countries. *Id.* Rahnama — Moghadam proposes that any involvement by nation states would be to the detriment of debtor countries — citing European nations taking over the finances of Tunis in 1869, Egypt in 1880, Greece in 1898 and the case of Venezuela in 1902, in which British gunboats persuaded Venezuela to repay its debt or face invasion. *Id.*

91. *Id.*

92. *See id.* at 71. What the Clubs supporters fail to mention is why they believe the Clubs' creditor members have the best interests of the debtor nations in mind and what those interests are. Is it the long-term health of the nation and its citizenry, or merely the short-term interest of stabilizing the government enough so that it can repay its debts?

93. *Id.* at 73. In the case of creditors, if the debtor country defaults, this means a loss of future interest payments. Default by the debtor country means loss of future access to world financial markets. This theory was first put forward by Sir John Hicks in his 1963 work. SIR JOHN R. HICKS, THE THEORY OF WAGES (2nd ed., 1963).

What these supporters conveniently leave out is the fact that the potential costs of disagreement differ for financial institutions and countries. Where the cost of disagreement for a financial institution will be lost revenue, for a debtor country it can mean the loss of lives and the collapse of the social structure. What supporters of the Clubs of London & Paris fail to recognize is that most of the time a country is forced to come to the bargaining table because debt obligations are destroying any possibility of social stability and social welfare in the country.[94] In such a climate, financial institutions, under the guise of a mutually beneficial renegotiation package, might impose upon the country even higher interest rates in exchange for a renegotiated payment plan.

There should be no confusion that the Clubs' main purpose is to enable financial institutions the ability to continue doing business with Third World nations while not missing out on any interest payments.[95] Although the underlying premise of the Clubs appears noble, the fact is that they are self-described as being impartial.[96] They are willing to negotiate with debtor nations if it means they can see some form of return on their investment. Their main concern is clearly not the economic, political and social health of the debtor nation.

III. Possible Solutions

A. The Creation of Slow-Growth Economic Programs

A contributing factor to the current debt crisis has been the reluctance of Third World nations to implement long-term solutions, choosing instead "quick fix" methods that only bandage the problem while exasperating it in the long-term.[97] In trying to come up with quick fixes, Third World nations routinely turn to exploitation of their natural resources as a way to generate

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94. *See id.* Some of these supporters are: Mashallah Moghdam, David A. Dilts, and Hedayeh Samavati. David A. Dilts is Professor Of Economics And Labor Relations at Indiana University in Fort Wayne, Indiana. He is an arbitrator and a member of the National Academy of Arbitrators. Hedayeh Samavati is Associate Professor Of Economics at Indiana University, Fort Wayne.

95. *See id.* at 73. The author (who has nothing but praise for the Clubs) admits that, "the self-interest of the parties are more clearly observable than in most other processes." *Id.*

96. *Id.*

97. *See* Molly J. Moline, *Debt-For-Nature Exchanges: Attempting To Deal Simultaneously With Two Global Problems*, 22 LAW & POL'Y INT'L BUS. 133 (1991). Financial institutions are equally, if not more so, to blame for the lack of long-term solutions. Their insistence on timely interest payments forces Third World governments into such dilemmas. *See generally* Anghie, *supra* note 30, at 249-50.

income to pay for interest payments.[98] To counter the problem of environmental destruction and the exploitation of natural resources, the term "sustainable development" is gaining increasing popularity.[99] "Sustainable development" is a kind of economic development, which is "guided by an environmental understanding that strives to benefit from the natural resource base without destroying it."[100] In Latin America, the region of the world with the most foreign debt, 140,000 acres of tropical forest are cut every day for timber, cultivation, and cattle grazing.[101] Through the introduction of slow-growth economic programs, Third World countries are encouraged to handle their resources in such a way as to make viable the productivity of these resources for many years to come.[102]

In order to implement a slow-growth program, the countries heavy burden to quickly pay on interest needs to be relaxed and this is where "debt-for-nature swaps" comes in.[103] A debt-for-nature swap is an "agreement whereby a portion of a debtor nation's foreign debt is retired in exchange for that country's pledge to institute environmental protection programs."[104] Debt-for-nature swaps require the debtor nation, the financial institution and a third party (usually a private conservation organization), to work closely together.[105] The third-party purchases Third World debt, usually with a significant discount from the bank, and negotiates with the debtor nation to forgive the debt in exchange for the implementation and the authority to oversee environmental protection programs.[106]

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98. *See* Sullivan, *Building Economies and Saving Trees*, CHRISTIAN SCI. MONITOR, Jan. 4, 1988, at 3, col. 3 (asserting that environmental protection and economic development go hand in hand. Development of the economy should use up no more resources than can naturally be regenerated).

99. *See* Moline, *supra* note 97, at 134.

100. *Id.* The accelerated exploitation of natural resources will not allow the resources to regenerate naturally, causing their disappearance, which can have catastrophic consequences on the long-term health of the country and its people. *Id.* at 135.

101. *See* Nina M. Dillon, *The Feasibility of Debt-For-Nature Swaps*, 16 N.C.J. INT'L L. & COM. REG. 127 (1991).

102. *See* Moline, *supra* note 97, at 134; *see also*, Sullivan, *supra* note 98, at 4, col. 3.

103. *See id.*; *See also* Dillon, *supra* note 85; *see also* Work & Smith, *Using Red Ink to Keep Tropical Forests Green*, U.S. NEWS & WORLD REP., Mar. 6, 1980, at 49.

104. Dillon, *supra* note 85, at 128.

105. *See* Moline, *supra* note 97, at 138. Debt-for-nature swaps are "financially complex and politically delicate." *Id.* (quoting Work & Smith, *supra* note 95, at 48).

106. *Id.* Once the third party purchases the debt, the organization negotiates with the debtor nation's central bank, which will redeem the debt and "issue local-currency bonds

This is an innovative alternative solution to traditional debt negotiation programs in that it offers something of interest to all sides. Through this solution, the financial institutions free themselves not only of high-risk investments, on which they see little return, but major public relations issues as well. The Third World nation works off its debt for a fraction of what it would cost if it continued to make interest payments, while at the same time healing its environment and conserving vital natural resources for future generations. Finally, conservation groups get concessions from foreign governments for environmental protection programs that they would not normally have access to if not for debt-for-nature swaps. Innovations such as debt-for-nature swaps will allow the Third World to rid itself of foreign debt. It is currently the most practical solution of paying off debt while abstaining from damaging the nation's social, environmental, political, and financial infrastructure.

B. Mediation That Subjects Third World Debt To The Rules Of Law

The unequal bargaining power that Third World nations possess is undisputed.[107] Organizations established to solve the debt crisis, by so-called First World organizations, not only possess the autonomy that will allow for the beneficial resolve of the dilemma, but are also seen as legitimate in the eyes of impartial observers.[108] The only way impartial negotiations can become a reality is through the use of impartial mediation.[109] But, this is not the type of dispute resolution that has historically been practiced in the realm of Third World debt. Before mediation can be successful the debts must cease being treated as fixed obligations and must rather be viewed as public obligations subject to the same rules as domestic contract disputes.[110] Once the loans are

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equivalent to the total debt." *Id.* These bonds are issued in the name of the organization. *Id.* An example of this method at work is the debt-for-nature swap by Conservation International with Bolivia in 1987 when Conservation International purchased $650,000 of Bolivian debt. *Id.* at 139. In return Bolivia would establish an endowment fund of $250,000 to "cover the operating costs of managing the Beni Biosphere Reserve in the northeastern region of Bolivia." *Id.*

107. Lothian, *supra* note 11, at 460. Lothian suggests that debtor nations as borrowers in the "commercial real . . . enjoy few prerogatives in the matter of debt repayment." *Id.* For the most part the loans are considered "relatively fixed obligations." *Id.*

108. *See id.* Because the loans are considered fixed obligations, there is no ability to negotiate the heart of the dispute — the amount of the loan. Renegotiating the interest payments or the payment schedule is only a temporary fix, but does not go to the heart of resolving the crisis.

109. *See* Shalakany, *supra* note 13, at 421.

110. *See* Lothian, *supra* note 11, at 460. Treating the loans as binding contracts would open the door for debtor nations to dispute the amounts and the obligation to pay them back. *Id.* *See also*, IAN BROWLINE, PRINCIPLES OF INTERNATIONAL LAW (4th ed. 1990) (making the argument that government financial obligations should be treated differently than private obligations);

subject to regular contract law, debtor nations will be able to argue duress[111], adhesion contract[112], unfairness and unequal bargaining power[113] as a way to either reduce the loan amounts or have the contracts voided entirely.[114]

As previously mentioned, many of the debtor nations continuously borrow to merely pay back interest due on past loans. Even the staunchest supporters of the current system could not disagree that this creates an inherently unequal bargaining power that in turn creates poverty, oppression and legitimate anti-Western sentiment[115] in debtor nations.[116]

It is not my argument that all Third World debt should be voided. In fact contractual debts should be renegotiated, paid and enforced; but, the greatest emphasis should be placed on maintaining and promoting economic sovereignty, political democracy and autonomy and not in spite of it.[117] Impartial mediation can assure the viability and longevity of such goals in a way that no current "Western" implementation for solving this crisis can ever envision.

Gary W. Larson, Comment, *Default in Foreign Sovereign Debt: A Question for the Courts?*, 18 IND. L. REV. 959, 965 (1985) (arguing that the borrowing of money by sovereign nations is a commercial activity).

111. *See*, RESTATEMENT (SECOND) OF CONTRACTS § 177 (2001). "Undue influence is unfair persuasion of a party who is under the domination of the person exercising the persuasion or who by virtue of the relation between them is justified in assuming that that person will not act in a manner inconsistent with his welfare." *Id.* at § 177(1). "If a party's manifestation of assent is induced by undue influence by the other party, the contract is voidable by the victim." *Id.* at § 177(2).

112. An adhesion contract is a standardized contract prepared entirely by one party to the transaction for the acceptance of the other. *See*, Max True Plastering Co. v. United States fidelity & Guar. Co., 912 P.2d 861 (Okl. 1996). An Adhesion Contract is voidable if it is unconscionable. *Id.* If a court finds a contract to be unconscionable it may "refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result." RESTATEMENT (SECOND) OF CONTRACTS § 208 (2001).

113. Unfairness and inequality of bargaining power are factors for finding a contract to be unconscionable. *See*, Mullan v. Quickie Aircraft Corp., 797 F.2d 845, 850 (10th Cir. 1986).

114. *See* Lothian, *supra* note 11, at 460.

115. *See generally*, Balakrishnan Rajagopal, *From Resistance to Renewal: The Third World, Social Movements, and the Expansion of International Institutions*, 41 HARV. INT'L L.J. 529, 540 (discussing the radicalism and anti-Western sentiments that are created in Third World nations).

116. *See* Anghie, *supra* note 30, at 257.

117. *See* Lothian, *supra* note 11, at 462.

IV. CONCLUSION

The crisis engulfing the Third World is currently so severe that at times it appears no amount of alternative dispute resolution can fix the problem. To a great extent this is correct. Alternative dispute resolution and impartial mediation are not the final solution, but they are a start to recognizing the most basic premise that current financial attitudes and policies towards the Third World are causing massive destruction of basic principles valiantly defended in the West. Fundamental principles of self-determination, sovereign governance and the right to live depend on the resolution of this crisis.

Third World debt has crippled the development of countless countries and in its place has created numerous despotic governments that pay little or no attention to the basic human needs of its citizenry while destroying liberties at home and threatening them abroad. It is imperative of those in the West to help create solutions that will alleviate this great harm and help recognize the humanity of those that are suffering. Mediation and other forms of alternative dispute resolution is a start to solving the problem. Alternative dispute resolution though, by itself, is tantamount to trying to prop Africa up with Legos™ as the entire continent crumples before our eyes. The crisis engulfing the Third World will never be solved until the West recognizes its hand in it.