SSOAR

Open Access Repository
www.ssoar.info

Legitimacy in global governance of sovereign default: the role of international investment agreements

Brahms, Lisa

Veröffentlichungsversion / Published Version
Arbeitspapier / working paper

Empfohlene Zitierung / Suggested Citation:
Brahms, L. (2013). *Legitimacy in global governance of sovereign default: the role of international investment agreements.* (PIPE - Papers on International Political Economy, 16/2013). Berlin: Freie Universität Berlin, FB Politik- und Sozialwissenschaften, Otto-Suhr-Institut für Politikwissenschaft Arbeitsstelle Internationale Politische Ökonomie. https://nbn-resolving.org/urn:nbn:de:101:1-2013072310079

Nutzungsbedingungen:
Dieser Text wird unter einer Basic Digital Peer Publishing-Lizenz zur Verfügung gestellt. Nähere Auskünfte zu den DiPP-Lizenzen finden Sie hier:
http://www.dipp.nrw.de/lizenzen/dppl/service/dppl/

Terms of use:
This document is made available under a Basic Digital Peer Publishing Licence. For more Information see:
http://www.dipp.nrw.de/lizenzen/dppl/service/dppl/

gesis Leibniz-Institut für Sozialwissenschaften

Mitglied der Leibniz-Gemeinschaft

PIPE-

Papers on
International
Political Economy

Arbeitspapiere der Arbeitsstelle Internationale Politische Ökonomie
Working Papers by the Center for International Political Economy

Hrsg. von Prof. Dr. Susanne Lütz

Lisa Brahms

Legitimacy in Global Governance of Sovereign Default: The Role of International Investment Agreements

No. 16
2013

Freie Universität Berlin

Arbeitsstelle Internationale Politische Ökonomie
Center for International Political Economy

Lisa Brahms

Legitimacy in Global Governance of Sovereign Default: The Role of International Investment Agreements.

PIPE Working Paper No. 16 / 2013
Arbeitsstelle Internationale Politische Ökonomie, Berlin
Center for International Political Economy, Berlin
Hrsg. von Prof. Dr. Susanne Lütz

5. Februar 2013
Papers on International Political Economy
ISSN 1869-4985 (Print)
ISSN 1869-8468 (Internet)

© 2013 by the author(s)
Papers on International Political Economy are working papers from the current research of the Center for International Political Economy at the Free University of Berlin. They appear in irregular intervals and are available for download free of charge from the homepage of the Center.

Anna Lisa Brahms studies International Relations at Free University Berlin, Humboldt University Berlin and Potsdam University. She previously studied at University College Maastricht and University of California, San Diego and holds a Bachelor of Arts. She focuses on international investment agreements, international political economy and development studies. As a Carlo Schmid fellow she has worked at the International Investments Agreements section of the United Nations Conference on Trade and Development (UNCTAD) in Geneva and is currently working as a research assistant at the Collaborative Research Center Governance in Areas of Limited Statehood, in the project Rule of Law as Governance Resource.
lisabrahms@gmx.de

Downloads
http://www.polsoz.fu-berlin.de/polwiss/forschung/oekonomie/ipoe/index.html
PIPE Working Papers

Arbeitsstelle Internationale Politische Ökonomie
Center for International Political Economy
Freie Universität Berlin
Ihnestraße 22
14195 Berlin
Germany

Tel. (+49-30) 838-56470
Fax. (+49-30) 838-56474
http://www.polsoz.fu-berlin.de/polwiss/forschung/oekonomie/ipoe/index.html

Abstract

This paper analyzes the legitimacy of investor-state arbitration under international investment agreements in sovereign debt restructuring. The paper presents mechanisms governing sovereign default generally, namely collective action clauses and informal negotiation in the London and Paris clubs and then discusses how sovereign debt restructuring is governed by IIAs, looking at how the clauses affect restructuring. Taking the conception of legitimacy in global governance by Buchanan and Keohane as a theoretical framework, the legitimacy of IIAs as a mechanism of governing sovereign debt disputes is questioned, looking at the aspects transparency, accountability, minimal moral acceptability, institutional integrity and comparative benefit. It is concluded that investor-state dispute settlement on the basis of IIAs lacks legitimacy to decide on sovereign debt restructuring.

Table of Contents

Introduction 1

1. Conceptual Clarifications: Legitimacy 2

2. Governance of Sovereign Default: An Overview 2

3. IIAs as a Mechanism for Solving Sovereign Debt Issues 4
   a) IIAs and how they affect sovereign debt restructuring 4
   b) The Use of Investor-State Arbitration in Cases of Sovereign Debt: Argentina & Greece .. 5

4. Legitimacy of IIAs and Investor-State Dispute Settlement in Sovereign Debt 7
   c) Transparency and Accountability 7
   d) Institutional Integrity and Minimal Moral Acceptability 8
   e) Comparative Benefit: An Institutionalized Mechanism – Failed Proposals and New Approaches 9

Conclusion 11

Literature 12

»When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor.«

Adam Smith in 'The Wealth of Nations', 1776

Introduction

Sovereign debt crises are a prevalent feature of the global economy today. Nonetheless, there is no institutionalized mechanism to deal with sovereign debt restructuring, or sovereign defaults more generally. History has shown that the assumption that "states do not go bankrupt" is erroneous. In individual or corporate insolvency regimes, haircuts to creditors claims are a normal element. The last bigger effort to establish such a mechanism was lead by the IMF and has failed in 2003. There is thus, today, no mechanism on the global level which has the mandate to deal with this issue. However, international investment agreements (IIAs) contain obligations which can be used in international arbitration against states undertaking sovereign debt restructuring. Or as Kevin Gallagher (2011) puts it "there is thus increasing concern that international investment agreements may become a 'court' for sovereign workouts by default".

Several authors have addressed the issue of legitimacy of investor-state arbitration under IIAs generally (Afilalo, 2004; Brower, 2003; Franck, 2005; Van Harten, 2007). Some have even gone so far to proclaim a "legitimacy crisis" (Afilalo, 2004; Franck, 2005). Other authors have analyzed the effect of IIAs on sovereign debt restructuring (Waibel, 2011; Gallagher, 2011). There has been much written on sovereign debt restructuring and sovereign default more generally, especially on the issue of a missing international insolvency mechanism (Acosta, 2003; Kaiser, 2010b; Kargmann and Paulus, 2008; Raffer, 1993). This paper aims at contributing to this debate by applying the concept of legitimacy to investor-state arbitration in cases of sovereign debt restructuring while at the same time embedding the discussion in the more general question of how sovereign default is or should be governed. Holdout litigation has traditionally been taking place in national courts. With the case of Argentina, international arbitral tribunals have entered the field. This change leads to new questions about legitimacy of the institutions and mechanisms involved.

Taking the role of IIAs and investment arbitration in sovereign debt issues as a starting point, this paper will analyze the legitimacy of those institutions and the role they play in sovereign debt restructuring. The question will thus be: Are IIAs a legitimate mechanism to deal with sovereign debt crises? The analysis will be based on the conception of legitimacy by Buchanan and Keohane. First, the concept of legitimacy in global governance will be clarified and theoretical background will be given. Second, the paper will present the mechanisms governing sovereign default generally, namely collective action clauses and informal negotiation in the London and Paris clubs. Thirdly, it will be discussed how sovereign debt restructuring is governed by IIAs, looking at how the clauses affect restructuring and the consequences of sovereign debt restructuring in Argentina and how IIAs could affect the recent debt crisis in Greece. The fourth part analyzes the legitimacy of IIAs as a mechanism of governing sovereign debt, looking at the aspects transparency, accountability, minimal moral acceptability, institutional integrity and comparative benefit.

1. Conceptual Clarifications: Legitimacy

In their work on legitimacy of global governance institutions, Allen Buchanan and Robert O. Keohane (2006) establish a global public standard for the legitimacy of global governance institutions. They differentiate between a normative and a sociological meaning of legitimacy, the former meaning that an institution normatively posses the right to rule whereas the latter refers to the widespread belief by the population that a certain institution has the right to rule. Buchanan and Keohane focus on normative legitimacy. Refuting the commonly presumed candidates for the appropriate standard of legitimacy of state consent, consent by democratic states and global democracy, they create a new middle ground between a state centered view and the cosmopolitan ideal of a global democracy which they find unlikely to materialize in the close future. In the following, they establish three substantive criteria for institutional attributes which will be instrumental for the discussion of the institutions governing the sovereign debt restructuring in this paper: minimal moral acceptability, comparative benefit and institutional integrity. Additionally, they identify two "obvious" requirements for legitimacy, namely accountability and transparency. These criteria and requirements for legitimacy will be described more in detail in the discussion below.

2. Governance of Sovereign Default: An Overview

As already mentioned, there is no formal mechanism aimed at governing sovereign default and sovereign debt restructuring. This section will give an overview on the market based and informal mechanisms used, namely the use of collective action clauses, the so called Paris and London clubs and the Heavily Indebted Poor Countries Initiative (HIPC) initiative. The paper will only roughly describe these mechanisms and not go into detail on their legitimacy as those mechanisms have been analyzed by scholars and criticized by NGOs frequently while IIAs and sovereign debt remains less analyzed. It is still relevant to give an overview here in order to see the context and how IIAs affect the current mechanisms. A systematic analysis of these mechanisms from a legitimacy perspective would still be desirable although it would exceed the scope of this paper.

Policy makers, especially from the US, have supported the inclusion of collective action clauses (CACs) in international bond contracts - instead of creating a formalized mechanism. To analyze the purpose of these clauses we need to understand the basic problems in sovereign debt restructuring. Waibel (2011) defines sovereign debt restructuring as "any changes in the originally envisaged payments, either after a default or under the threat of default" (p.14). These changes of payments or terms can be related to a reduction in the amount of principal or changes in the rate of interest or maturity schedule. A collective action problem arises when single creditors hold out to wait for other participants "buying them out" by reducing their own claims and thereby restoring the debtors capacity to pay (Schwarcz, 2004).[1] CACs have been promoted to resolve these collective action problems. They set out that a restructuring is legally binding for all holders of

[1] In economics and political science, the term "collective action problem" generally describes a situation in which rationally acting self-interested individuals generate an outcome damaging their interests as a group (Olson, 1971).

the bond if a supermajority of bondholders agree to it. This prevents single participants from "free riding" on other participants concessions. The idea has been widely accepted. In the US, 90% of all newly issued bonds include a CAC (Helleiner, 2009). However, CACs also have fundamental drawbacks. Most importantly, the possibility that a single creditor of a particular bond purchases the needed 75% and is thus able to block the process cannot be ruled out and might be a real and easy option for some creditors (Gallagher, 2011). Furthermore, a country restructuring its debt often needs to deal with multiple bonds at the same time, CACs however only apply to a single bond (Gallagher, 2011). This latter problem has repeatedly been called "aggregation problem" (UNCTAD, 2011b). The most important drawback in view of IIAs is however that it cannot be excluded that even though there is a CAC, creditors would still have access to investor-state arbitration under IIAs (Gallagher, 2011; Simoes, 2011; UNCTAD, 2011; Waibel, 2007). In the words of Waibel (2007): "ICSID arbitration could blow a hole in the international community's collective action policy" (p. 715).

Next to this market based mechanism, there are also informal mechanisms. Since 1956, creditor countries, mostly from the OECD, get together informally to coordinate multilateral restructuring of the debt owed to them by, mostly developing, debtor countries (Helleiner, 2008). This informal group of official creditors has been termed the "Paris Club". In total, 426 agreements with 89 different debtor countries have been reached in the Paris club. Since its founding in 1956, it has treated debt in its agreements amounting to US$ 563 billion (clubdeparis.org).[2] As the Paris club is an informal group, there are no clearly defined procedures, it has no legal status, and it has been repeatedly criticized that its flexibility leads to inconsistencies as comparable cases are not always being comparably treated (Kaiser, 2010a). The outcome of the Paris club meetings, called "agreed minutes", are not legally binding per se. The countries agree informally to sign a bilateral agreement containing the settlement which is then legally binding (Rieffel, 2003). The Paris club only deals with debt owed to bilateral official creditors, which entails that the largest part is debt from concessional loans provided as part of Official Development Assistance (Kaiser, 2010a and Freytag and Pehnelt, 2009). In contrast to the Paris club, where it is governments negotiating with each other, the "London club" refers to ad-hoc fora organized by private international banks (Helleiner, 2008). Since 1975, those private creditors establish so called Bank Advisory Committees which aim at restructuring international debts on a country-by-country basis. There is thus no defined membership but the relevant creditor banks for a specific country come together to negotiate a restructuring of that country's debt. The London club is therefore even more informal than the Paris club. The HIPC initiative was a multilateral debt relief initiative directed towards the poorest, most heavily indebted countries. The initiative was guided by the assumption that such unsustainable indebtedness would be a "temporary exceptional problem" and was therefore designed as a one off exercise (Kaiser, 2010a). This also entails that it was never intended to serve as a permanent tool to resolve debt crisis.

[2] As Freytag and Pehnelt (2009) point out, the amount negotiated in the agreements was much higher than the amount of debt that has actually been forgiven.

Next to the negotiations at the Paris or London clubs and the HIPC initiative, states have the option to unilaterally reduce their debt, as happened for example in the case of Argentina (see below). Another prominent case of unilateral debt reduction is the case of Ecuador which declared part of its debt illegitimate under the doctrine of odious debt. This doctrine, based on Russian legal scholar Alexander Sack, stipulates that citizens should not be held liable for debts which can be classified as odious (Sack, 1927). The doctrine establishes three conditions under which debt is odious: when first, there was a lack of consent from the population, second, the loan was not used in the general interest of the population and third, the lender knew that there was a lack of benefit for the general interest (Dimitriu, 2011). Although some legal scholars assert that the doctrine has become part of customary international law, there is no widespread consensus on that issue. It has been suspected that one reason why Ecuador left the ICSID was because they feared claims similar to those faced by Argentina because of its debt restructuring. However, even if this was true and this consideration played a role in the decision by Ecuador to quit ICSID, it is certainly not the only reason as Ecuador is also entangled in other disputes at ICSID relating to its natural resources.

3. IIAs as a Mechanism for Solving Sovereign Debt Issues

It is often argued, that governance of sovereign debt restructuring takes place in those informal fora. This paper highlights the fact that IIAs play an important role as an institutional framework to govern claims against states restructuring their debts.

a) IIAs and how they affect sovereign debt restructuring

The term "international investment agreements" refers to agreements between states which commit states to adhere to specific standards on the treatment of foreign investments within their territory. IIAs also set out procedures for the resolution of disputes if those commitments are not met. As there is no multilateral treaty on investment, the IIA universe consists of bilateral investment agreements (BITs) and other investment agreements, for example regional trade agreements with an investment chapter. By the end of 2011, the total number of IIAs has raised to 3,164, which included 2,833 BITs and 331 "other IIAs" (UNCTAD, 2012a).

IIAs provide for two distinct forms of non discriminatory treatment. Under national treatment clauses, a foreign investor is entitled to treatment no less favorable than a national investor. The most-favored-nation treatment provides that a foreign investor cannot be treated less favorable than another foreign investor. Especially the national treatment clause is relevant in the context of sovereign debt restructuring as it might be economically reasonable in a crisis situation to treat national bond holders in a different way than foreign bond holders (Waibel, 2011).

Expropriation is not generally prohibited under IIAs. However, it usually needs to fulfill the criteria of having a public purpose, being non discriminatory, payment of full compensation and meeting due process requirements. A "haircut" can be interpreted as a form of expropriation, at least as "indirect expropriation", which falls under this clause in most IIAs, as by definition there is no full compensation paid. Provisions on "fair and equitable treatment" have been interpreted to

inter alia protect the legitimate expectations of investors, requiring transparency and requiring due process (UNCTAD, 2011a). Such a clause can be found in most IIAs although being extremely vague and leaving ample space for interpretation by arbitral tribunals. To fulfill these requirements in a sovereign debt restructuring is of course highly problematic as by definition the state is not fulfilling the bondholders expectations. Also the majority voting could be seen as a violation of the fair and equitable treatment clause as it is currently interpreted as a lack of due process for the creditors not participating (UNCTAD, 2011b). Also transparency is often not given in times of financial crisis when a potentially weak state needs to deal with large amounts of creditors and bonds at the same time (Simoes, 2011).

The most important feature of IIAs is however that they include investor-state dispute settlement clauses. These clauses give the investor, a private entity, the possibility to directly go to international arbitration without exhausting local remedies and suing a sovereign state. This is exceptional in international law as most dispute resolution mechanisms in international law are based on a state-to-state system or, as in human rights law, individuals or groups of individuals need to go through a national court system before being able to file a claim at an international institution. The number of known claims under IIAs has raised to 450 by the end of 2011 (UNCTAD, 2012b). The most important institution in which such claims are brought is the International Centre for Settlement of Investment Disputes (ICSID), which is a member of the World Bank group. Some treaties additionally provide for arbitration under UNCITRAL rules, at the International Chamber of Commerce or others. However, these remain marginal and due to stricter privacy regulations less open for academic scrutiny, this paper will be focusing on ICSID as a venue.

b) The Use of Investor-State Arbitration in Cases of Sovereign Debt: Argentina & Greece

The first, and to date only, instance IIAs have been used in a case of sovereign debt restructuring in arbitration are the cases following the financial crisis in Argentina (UNCTAD, 2011b). This part first discusses how sovereign debt restructuring led to claims under IIAs in Argentina and then goes on to consider possibilities of future use, especially in the case of Greece.

In the 1990s, Argentina enacted the "convertibility plan" in order to fight hyper inflation (Gallagher, 2011; Simoes, 2011). It guaranteed parity between the US dollar and the Argentinean Peso, which initially lead to high growth rates and high inflows of capital. However, it also lead to increased borrowing as the government could not apply monetary policy to "fill the gaps" (Gallagher, 2011, p. 13) and it made the country more vulnerable to external shocks. After the Asian Crisis and the depreciation of the Brazilian real, Argentina's situation deteriorated. The financial crisis in Argentina lead to the largest and most controversial sovereign default on debt in history (Gallagher, 2011; Hornbeck, 2010; Waibel, 2011). It was one of the most complex debt restructurings, as Argentina had to restructure a large number of instruments, totaling US$100 billion of debt. In 2001, Argentina defaulted on its debt and tried to solve the unsustainable debt burden by a voluntary "mega swap" (Waibel, 2011). However, the participation rate was not high enough to alleviate the problem. After having tried to restructure the debts under the supervision of the IMF with no success, in 2005 the new Kirchner government initiated a comprehensive debt re-

structuring based on a unilateral offer to creditors (Gallagher, 2011; Simoes, 2011). The government gave creditors six weeks to exchange old bonds for new bonds which had a much reduced face value, approximating a two-thirds haircut (Waibel, 2011). An unusually low part of creditors, 76%, accepted the offer. In 2010, the government thus started a new "take-it-or-leave-it" exchange. Taken together, the participation rate of creditors in the 2005 and 2010 restructurings was 92.5% (Waibel, 2011). Although this number is quite high, holdout creditors have filed claims in several fora; next to the ICSID claims discussed in this paper, there have been 140 individual and 18 class lawsuits under US law resulting in judgments of about US$6.4 billion (Waibel, 2011).

In February 2007, 180,000 Italian bond holders brought a group claim before ICSID, first the case was called "Giovanna A Beccara and others v. The Argentine Republic" and later renamed "Abaclat and others v. The Argentine Republic". Some of the claimants in the case accepted the second restructuring offer by the Argentinian government in 2010 which lead to a decrease of claimants in the case to about 60,000. The claim was based on the expropriation and fair and equitable treatment clauses under the Italy-Argentina BIT. In the Abaclat case, the tribunal has affirmed jurisdiction in a controversial decision in 2011. The highly renown arbitrator Abi-Saab has issued a dissenting opinion in which he has clearly stated that in his view an ICSIC tribunal would not have jurisdiction over sovereign debt instruments because they do not constitute a protected investment under the ICSID convention. More strongly, he considers the political context by writing that "the present case raises, in an acute manner, an international public policy issue about the workability of future sovereign debt restructuring, should ICSID tribunals intervene in sovereign debt disputes". The majority opinion however argues that "opening the door to ICSID arbitration would create a supplementary leverage against such rogue debtors and therefore be beneficial to the efficiency of foreign debt restructuring". Next to this case, there have been two further claims concerning debt restructuring in Argentina, "Giovanni Alemanni and others v. Argentine Republic" and "Giordano Alpi and others v. Argentine Republic", both still pending. Additionally, Argentina faces numerous other cases against measures taken to mitigate the financial crisis.

Taking up the concerns by Abi-Saab concerning the influence of the Abaclat decision on the future ability of governments to restructure its debt, it is critical that the recent debt crisis in Greece has already provoked certain actors to call for a claim at ICSID under the Germany-Greece BIT.[3] For example, it has been reported that the law firm Gröpper Köpke[4] intends to file a class action suit on behalf of German small investors who lost in the €206 billion debt swap.[5] They argue, similarly to the Argentinian cases, that their rights under the IIA have been violated as the bond swap amounts to expropriation. Also the law firm CLLB6 has proposed to start arbi-

[3] http://www.handelsblatt.com/finanzen/boerse-maerkte/anleihen/griechenbonds-argentinien-urteil-macht-mut/6614042-2.html

[4] http://www.bankrecht24.de/index.php?id=219&tx_ttnews[tt_news]=426&tx_ttnews[backPid]=306&cHash=55dd66568e661b48dbbe21fe7b6b6eb4

[5] "Germans seek lawsuits over Greek debt swap", James Wilson and Gerrit Wiesmann, Financial Times, March 12, 2012, http://www.ft.com/cms/s/0/79ed422c-6c67-11e1-bd0c-00144feab49a.html#axzz1owGOYBS3

[6] http://cllb.de/blog/2012/03/privatanleger-und-griechische-staatsanleihen-%E2%80%93-auswege-und-handlungsoptionen-%E2%80%93-cllb-rechtsanwalte-vertreten-anleihenglaubiger/

trations and put up articles on the website, advocating the option of filing a claim at ICSID. The actual probability that such a claim will be made remains uncertain. From a legal point of view the problem will be that the Germany-Greece BIT does not contain a clause on investor-state arbitration. However, the tribunal would have to decide whether it accepts the argument by the law firms mentioned above that the most favored nation clause in the agreement gives them the right to "import" the investor-state dispute settlement clause from another agreement. Apart from the probability of the creditors to file a claim and win the case, the general direction can be seen here. Abi Saabs concerns that the decision in Argentina would lead to further claims relating to debt under IIAs and an increased pressure on governments aiming to restructure their debts seem to be justified.

4. Legitimacy of IIAs and Investor-State Dispute Settlement in Sovereign Debt

As has been shown, the Argentina case might not long stay the only case in which "investors" use IIAs and investor-state dispute settlement for questioning sovereign debt restructuring by states. Thus, the legitimacy question has to be raised. Waibel (2011) concludes that ICSID tribunals "presently lack authority to adjudicate sovereign debt disputes" and "are unable to effectively deal with sovereign debt crises". He clearly sees the danger, that ICSID jurisdiction could "escalate sovereign debt disputes to a new level" and increase incentives for holdout behavior. In the following section, this paper will apply the criteria identified by Buchanan and Keohane to the use of IIAs and ISCID as an institution for dealing with sovereign debt restructuring claims. The main legitimacy problems, it will be argued, can be seen in the criteria transparency and accountability, institutional integrity and comparative benefit.

c) Transparency and Accountability

Buchanan and Keohane identify two "obvious" requirements for legitimacy: accountability and transparency. Clarifying the former, Grant and Keohane (2005) state that accountability "implies that some actors have the right to hold other actors to a set of standards, to judge whether they have fulfilled their responsibilities in light of these standards, and to impose sanctions if they determine that these responsibilities have not been met".

In investor-state arbitration, accountability is lacking as arbitrators can interpret public law without having a review mechanism which could ensure that another judge corrects errors of law (Van Harten, 2007). Especially in the case of sovereign debt restructuring, which can be seen as a public policy issue, the public should have the possibility to hold the arbitrator accountable. ICSID awards are binding on the parties and can not be appealed. There is an annulment committee, however, the conditions under which the award can be annulled are very limited, a reason would be for instance if one of the tribunal members was corrupted (ICSID Convention, Article 52).

Cremades and Cairns (2002) criticize the accountability of arbitrators, especially relating to their independence and impartiality. The argument here is that many arbitrators are partners in global

law firms and profit from an increase of arbitration cases. There is thus a systemic bias towards an interpretation favoring investors over states as only investors can bring claims under investment law. Brower (2003) states more generally that "by their very nature, ad hoc tribunals tend to be relatively less accountable, transparent, and accessible to democratic processes than permanent tribunals". Buchanan and Keohane furthermore claim that a narrow conception of accountability is insufficient for legitimacy of global governance institutions. Being a part of the World Bank, the criticism issued by Buchanan and Keohane fits well in the context of ICSID procedures: the ones holding the institution accountable are the "rich" states.

Regarding the second "obvious" requirement, Buchanan and Keohane argue that "transparency by itself is inadequate". According to them, availability of information needs to be complemented by a proper integration and needs to be accessible at "reasonable cost". Further, accountability holders need to use it properly. However, in international investment arbitration, even the availability of information is largely not a given. In the literature on transparency in investor-state dispute settlement it has been argued that the outcomes often affect public policy and the process thus needs to be open for public scrutiny (VanDuzer, 2007). However, the procedures come from commercial arbitration models which are based on confidentiality and thus operate largely without this scrutiny (Van Harten and Loughlin, 2006). Transparency in international arbitration involves the disclosure of arbitral documents and the openness of hearings to the pubic (Knahr and Reinisch, 2007). Article 48(5) of the ICSID Convention provides that the award may not be published "without the consent of the parties" which applies in similar manner to minutes and other records of proceedings. In Biwater Gauff v. Tanzania, the tribunal has dealt with the question of transparency and the publication of documents, concluding that especially minutes and other records of proceedings have an impact on procedural integrity and agreed with the tribunal in Metalclad that it would be of advantage if "during the proceedings they [the Parties] were both to limit public discussion of the case to a minimum". If the public is not even informed that a dispute exists, accountability to the public also becomes problematic. Although the Argentina cases were quite transparent, this does not mean future cases will. It can thus clearly be argued that the requirements within ICSID arbitrations lack legitimacy because of limited transparency and accountability.

d) Institutional Integrity and Minimal Moral Acceptability

The criterion *minimal moral acceptability* states that global governance institutions shall not commit serious injustices, which includes in the first place the violation of human rights but might be extended to the obligation to also promote human rights actively. As human rights are not *directly* affected here, this criterion is less important for the case at hand. However, the inability of a state to restructure its debts can certainly have *indirect affects* on the human rights of its citizens. The question is thus if it is morally acceptable that a state does not have the "policy space" to implement public policies which are clearly aimed at serving a public purpose. Furthermore, there is an obvious problem in that the holdout creditors who did not participate in the restructuring and

thus contribute to a situation in which the economy of a state is deteriorating would be the ones profiting from such a situation.

Institutional Integrity is the third criterion. An institution lacks legitimacy under this criterion if there is a substantial disparity between the major goals and self-proclaimed procedures of an institution and its actual performance. As described above, the dissenting opinion in *Abaclat* is stipulating that sovereign debt instruments are not covered under the ICSID convention. The primary purpose of ICSID is to "provide facilities for conciliation and arbitration of international *investment* disputes". More broadly, the idea behind ICSID was not to create some kind of "sovereign debt court". Another highly contested concern which has been raised by several authors is the problem of inconsistent decisions and interpretations of key provisions by different arbitral tribunals (Franck, 2005; UNCTAD, 2011c; Van Harten, 2008). The Secretary General of ICSID has conceded that in cases where multiple investors are affected by a certain policy measure, the "scope for inconsistent decisions in regard to essentially the same issues is obvious" (Parra, 1997).

e) Comparative Benefit: An Institutionalized Mechanism – Failed Proposals and New Approaches

The second criterion identified by Buchanan and Keohane is *comparative benefit*, by which they mean that the institution in question is providing benefits that could otherwise not be obtained. The comparative aspect in this criterion is that if there is an institutional alternative which could provide significant greater benefits without excessive transition costs, the previous institution looses legitimacy.

Regarding comparative benefit, an institutional alternative providing significantly greater benefits has been discussed several times in different international fora. The current system of bond holder protection under IIAs is beneficial for the bond holders but less so for the state. The general assumption when discussing this point is thus that "significantly greater benefits" is to be understood here as benefits for both the creditor and the debtor. Buchanan and Keohane state clearly that the institutional alternative to the one scrutinized needs to be feasible, accessible without excessive transition costs, and it needs to meet the minimal moral acceptability criterion.

The criterion of comparative advantage to determine legitimacy by Buchanan and Keohane go hand in hand with the search for alternatives. Waibel (2011) proposes that national courts and other institutions such as the IMF and the Paris club should be the ones dealing with the issue. However, several other authors have pointed out the shortcomings of these institutions as discussed above. Furthermore it is unlikely that creditors will choose those fora when they have the choice to use ICSID arbitration instead. As a consequence, the finding that ICSID arbitrations on sovereign debt might rise in future makes it even more compelling to establish a fair and transparent arbitration mechanism, an international debt court or some other kind of institutionalized mechanism to deal with questions regarding sovereign debt restructuring. In this section it will be discussed in how far the current form of governance can be changed to avoid problems such as those faced by Argentina. It will be argued that a more institutionalized mechanism might be able to prevent such problems and thus, if properly constructed, it can be a way to overcome the legitimacy crisis. First, we will look at failed proposals and then at new approaches.

In 2001, the creation of a more formal international bankruptcy mechanism was discussed. The IMF's deputy managing director Anne Krueger proposed a Sovereign Debt Restructuring Mechanism (SDRM) led by the IMF. This proposal was dropped in 2003, mainly because confidence in the stability of markets was restored and G7 officials consequently gave greater emphasis to market-based forms of governance (Helleiner, 2010; Helleiner, 2009). It was argued that a statutory approach was "too ambitious and bureaucratic". Although the IMF proposal is the most commonly known attempt to create such a mechanism, there have been further attempts in history. Helleiner (2008) analyzed the proposed mechanisms and why they failed in detail. The first attempt was at the Pan-American conference in Montevideo in 1933. Also in the US planning for the post 1945 international financial order there were strong advocates of a mechanism governing sovereign debt restructuring, most notably it was Harry Dexter White who advocated compulsory arbitration in debt settlements. In the 1970s, there has been a further proposal by the G-77. Being the debtors, the G-77 were largely dissatisfied with the London and Paris club approach and thus proposed a more formal process.

There are several books, papers and publications by NGOs which propose new approaches. A wide variety of agents is calling for an institutionalized mechanism. One proposal, one of the older and often cited ideas, is by Austrian scholar Kunibert Raffer (1990 and 1993) who suggests to establish an ad-hoc debt arbitration process based on Chapter 9 of the US Insolvency Code. Furthermore, he has been advocating a sharp cut as opposed to the piecemeal approach which he thinks is more hurtful in the end. His proposal has been taken up by the NGO network "Jubilee" which is lobbying for a "Fair and Transparent Arbitration Process (FTAP)" (Kaiser, 2010a). Some southern academics and NGOs on the other hand advocate an international insolvency court (Oscar Ugarteche and Albert Acosta, 2003). A third proposal by Christoph Paulus and Stephen Kargman envisages a sovereign debt tribunal under the auspices of the United Nations. There are thus ample possible alternatives.

Strictly looking at IIAs, a policy option can be to include specific clauses on sovereign debt restructuring claims. This approach was taken, for example, in the following two agreements. The Peru-Singapore Free Trade Agreement (2008) includes a definition of "negotiated restructuring" in article 10.1, namely that 75% of the bond holders have given their consent, and provide that investors can only put forward a claim when a restructuring was not negotiated, this again being subject to a "cooling off period". The Central America-Dominican Republic-United States Free Trade Agreement (DR- CAFTA) (2004) on the other hand clearly provides that sovereign debt restructuring shall not be dealt with under that agreement but exclusively under national law. However, this approach has its clear drawbacks. First of all, it has to be remembered that there are over 3,000 IIAs currently in force. Renegotiating all those which do not have a provision explicitly on sovereign debt, which is the majority, requires enormous capacities and is highly unlikely to take place within the closer future. Furthermore, tribunals have interpreted the most favored nation clause to include that granting a third party a right under a BIT which is not granted in the treaty applying between the two states in question would not be in conformity with the

IIA. Reforming IIAs in a way they explicitly exclude sovereign debt is thus unrealistic in the close future.

Conclusion

International investment agreements and investor-state arbitration are often overlooked when global governance of sovereign default is discussed. In a time where sovereign default becomes an issue even within the European Union and many states face an unsustainable debt burden in the long term, it is important to realize that the state's policy space to restructure its sovereign debt may be substantially limited by IIAs. In the light of general legitimacy concerns regarding accountability, transparency, institutional integrity and minimal moral acceptability, alternatives to the current governance mechanism become more important. Investor-state dispute settlement on the basis of IIAs lacks legitimacy to decide on sovereign debt restructuring.

Literature

Acosta, A. and O. Ugarteche, 2003: A favor de un tribunal internacional de arbitraje de deuda soberana (TIADS). Quito.

Afilalo, Ari, 2004: Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels should Solve Their Legitimacy Crisis, Georgetown International Environmental Law Review: 17, 51, 51-96.

Brower, Charles H., 2003: Structure, Legitimacy, and NAFTA's Investment Chapter, Vanderbilt Journal of Transnational Law: 36:37, 37-94.

Buchanan, Allen and Keohane, Robert O., 2006: The Legitimacy of Global Governance Institutions. Ethics & International Affairs, 20:4, 405-437.

Cremades, Bernardo M. and David J.A. Cairns, 2002, The Brave New World of Global Arbitration, 3 Journal of World Investment: 173, 180.

Dimitriu, Christian, 2011: Odious Debts and Global Justice.

Franck, Susan D., 2005: The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions, Fordham Law Review: 73, 1521.

Freytag, Andreas and Pehnelt, Gernot, 2009: Debt Relief and Governance Quality in Developing Countries, World Development: 37:1, 62–80.

Gallagher, Kevin P., 2011: The New Vulture Culture: Sovereign debt restructuring and trade and investment treaties. The IDEAs Working Paper Series.

Grant, Ruth W. and Keohane, Robert O., 2005: Accountability and Abuses of Power in World Politics. American Political Science Review: 99, 29-43.

Helleiner, Eric, 2008: The Mystery of the Missing Sovereign Debt Restructuring Mechanism, Contributions to Political Economy: 27, 91-113.

Helleiner, Eric, 2009: Filling a Hole in Global Financial Governance? The Politics of Regulating Sovereign Debt Restructuring, in The Politics of Global Regulation, Walter Mattli and Ngaire Woods (eds.), Princeton, Princeton University Press.

Helleiner, Eric and Stefano Pagliari, 2010: Between the storms: patterns in global financial governance, 2001-2007, in: Geoffrey R.D. Underhill et al (eds.), Global Financial Integration Thirty Years On, Cambridge: Cambridge University Press, 42-57.

Hornbeck, Jeff, 2010: *Argentina's Defaulted Sovereign Debt: Dealing with the 'Holdouts',* United States Congressional Research Service, July.

Kaiser, Jürgen, 2010a: Resolving Sovereign Debt Crises. Towards a Fair and Transparent International Insolvency Framework, Friedrich Ebert Stiftung Dialogue on Globalization.

Kaiser, Jürgen, 2010b: Talking Stock of Proposals for More Ordered Workouts. In Overcoming Developing Country Debt Crises, ed. B. Herman, J.A. Ocampo, and S. Spiegel. Oxford University Press.

Kargman, Stephen, and Paulus, Christoph, 2008: Reforming the Process of Sovereign Debt Restructuring: A Proposal for a Sovereign Debt Tribunal. UNDESA. April 8/9.

Knahr, Christina and Reinisch, August, 2007: Transparency versus Confidentiality in International Investment Arbitration – The Biwater Gauff Compromise, The Law and Practice of International Courts and Tribunals: 6, 97–118.

Olson, M. 1971: The Logic of Collective Action: Public Goods and the Theory of Groups. Cambridge, Mass., Harvard University Press.

Paris Club, http://www.clubdeparis.org/, last accessed 20.9.2012.

Parra, Antonio R., 1997: Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment, 12 ICSID Rev.-Foreign Investment L.J: 287, 291-92.

Raffer, Kunibert, 1990: Applying Chapter 9 Insolvency to International Debts: An Economically Efficient Solution with a Human Face, World Development: 18(2) (February), 301-313.

Raffer, Kunibert, 1993: What's Good for the United States Must Be Good for the World. Advocating International Chapter 9 Insolvency. In From Cancún to Vienna. International Development in a New World, ed. Bruno Kreisky Forum for International Dialogue. Vienna, 64-74.
Rieffel, Lex, 2003: Restructuring Sovereign Debt, Washington, DC, Brookings.
Sack, Alexander, 1927: Les Effets des Transformations des États sur leurs Dettes Publiques et Autres Obligations Financières Paris: Recueil Sirey.
Schwarcz, Steven L., 2004: "Idiot's guide " to sovereign debt restructuring. Emporay Law Journal: 53, 1189-1218.
Simoes, Joanna, 2011: Sovereign Bond Disputes Before ICSID Tribunals: Lessons from the Argentina Crisis. 7 Law & Bus. Rev. Am.: 683-719.
UNCTAD, 2011a: Fair and Equitable Treatment: A Sequel.
UNCTAD, 2011b: Sovereign Debt Restructuring and International Investment Agreements. IIA Issues Note.
UNCTAD, 2011c: Interpretation of IIAs: What States can do. IIA Issues Note.
UNCTAD, 2012a: World Investment Report.
UNCTAD, 2012b: Latest Developments in Investor-State Dispute Settlement. IIA Issues Note.
VanDuzer, J. Anthony, 2007: Enhancing the Procedural Legitimacy of Investor-State Arbitration Through Transparency and Amicus Curiae Participation, McGill Law Journal: 52, 782-732.
Van Harten, Gus and Loughlin, Martin, 2006: Investment Treaty Arbitration as a Species of Global Administrative Law, European Journal of International Law, 17(1): 121-150.
Van Harten, Gus, 2007: Investment Treaty Arbitration and Public Law, Oxford Monographs in International Law.
Van Harten, Gus, 2009: Reforming the NAFTA Investment Regime, Available at SSRN: http://ssrn.com/abstract=1687263
Waibel, Michael, 2007: Opening Pandora's Box: Sovereign Bonds in International Arbitration, The American Journal of International Law, 101 (711): 711-759.
Waibel, Michael, 2011: Sovereign Defaults before International Courts and Tribunals, Cambridge University Press.