

# Northwestern Journal of International Law & Business

---

Volume 13  
Issue 2 *Fall*

---

Fall 1992

## Impracticability, Mutual Mistake and Related Contractual Bases for Equitably Adjusting the External Debt of Sub-Saharan Africa

Jon H. Sylvester

Follow this and additional works at: <http://scholarlycommons.law.northwestern.edu/njilb>



Part of the [International Trade Commons](#), and the [Law and Economics Commons](#)

---

### Recommended Citation

Jon H. Sylvester, *Impracticability, Mutual Mistake and Related Contractual Bases for Equitably Adjusting the External Debt of Sub-Saharan Africa*, 13 *Nw. J. Int'l L. & Bus.* 258 (1992-1993)

This Article is brought to you for free and open access by Northwestern University School of Law Scholarly Commons. It has been accepted for inclusion in Northwestern Journal of International Law & Business by an authorized administrator of Northwestern University School of Law Scholarly Commons.

## ARTICLES

# Impracticability, Mutual Mistake and Related Contractual Bases for Equitably Adjusting the External Debt of Sub-Saharan Africa

*Jon H. Sylvester\**

### I. INTRODUCTION

At the end of 1988, the combined external indebtedness of the third world<sup>1</sup> (referred to below as less developed countries or "LDCs") was estimated at nearly \$1.3 trillion.<sup>2</sup> In the same year, the United Nations agency United Nations International Childrens' Emergency Fund ("UNICEF") attributed the deaths of 650,000 children in LDCs to re-

---

\* Jon H. Sylvester. J.D., Harvard Law School, 1981, Professor of Law, Loyola Law School, Los Angeles, and Fulbright Professor, University of Nairobi Faculty of Law. The author gratefully acknowledges the assistance of Ruth Busch, Mark Calahan and Michael Collins. Loyola Law School Professors Jennifer Friesen, Lary Lawrence, Chris May and Lawrence B. Solum were especially helpful in reading early drafts and providing specific and constructive criticism. Research for this work was made possible by a grant from Loyola Law School.

<sup>1</sup> The term "third world" has, to a significant extent, been replaced by "Less Developed Countries" ("LDCs"). The third world includes those sovereign states that resulted from the decolonization of the late 1950s and early 1960s. These nations were distinct from both the Western and Eastern bloc nations and, thus, were said to constitute a "third world." 21 *Britannica* 813 (15th ed. 1988).

<sup>2</sup> Jerome I. Levinson, *A Perspective on the Debt Crisis* 4 *AM. U. J. INT'L L. & POL'Y* 489, (1989).

duction in basic living standards caused by diversion of resources to servicing external debt.<sup>3</sup> Some experts say prospects for solving this huge and growing problem are actually growing worse due to "debt fatigue."<sup>4</sup>

There are three major categories of LDC debtor countries: Latin America, South-East Asia, and sub-Saharan Africa.<sup>5</sup> This article focuses on sub-Saharan Africa because sub-Saharan Africa is so clearly the "sick man" of the world economy, with many of that region's countries actually experiencing negative economic growth.<sup>6</sup> Sixteen of the world's 25 least developed countries are in sub-Saharan Africa.<sup>7</sup> In nearly all sub-Saharan African countries, most of the population subsists in abject poverty.<sup>8</sup>

It is arguable that only something in the nature of a Marshall Plan, perhaps at United Nations initiative and direction, has any chance of reversing sub-Saharan Africa's acceleration toward economic collapse.<sup>9</sup> It is clear that substantial debt relief is an indispensable step in the right

---

<sup>3</sup> In a report issued on December 20, 1991, UNICEF said massive debt relief for sub-Saharan Africa is indispensable to any meaningful effort to save significant numbers of that region's children.

<sup>4</sup> The term "debt fatigue" is used to describe the malaise, or generalized lack of energy and optimism, that sometimes seems to permeate the issue of third world debt. Ramesh C. Garg, *Exploring Solutions to the LDC Debt Crisis*, BANKERS MAGAZINE, Jan.- Feb. 1989, at 46.

<sup>5</sup> See Carsten T. Ebenroth, *The Changing Legal Framework for Resolving the Debt Crisis: A European's Perspective*, 23 INT'L LAW. 629, 630 (1989) [hereinafter Ebenroth] (explaining that, while these categories are essentially geographic, the same result can be reached "[b]y taking the distinctive features of the absolute extent of indebtedness, its relation to the GNP, the ratio between debt service and export revenues, the nature of the debt, the indebted country's concept of economic policy, its political system, its stage of development, and its resources. . . ." (footnotes omitted))

<sup>6</sup> Sub-Saharan Africa's real gross domestic product ("GDP") has grown by 2.3% per year during the past three years, but population has grown faster during the same period, so real GDP *per capita* has been falling by 0.7% per year. *Remembering Africa*, ECONOMIST, Aug. 31, 1991, at 33. See also, e.g., *Tanzania: Government Committed to Promote Foreign Investment*, FOREIGN TAX LAW BI-WEEKLY BULLETIN, FOREIGN TAX LAW PUBLISHERS, INC., Volumes 27 and 28, July 3 and 10, 1991, at 1.

<sup>7</sup> O. ABOYADE, ISSUES IN THE DEVELOPMENT OF TROPICAL AFRICA 8 (1976).

<sup>8</sup> A.W. Clausen, *Financing Development in the Third World*, BANKERS MAGAZINE, May-June 1985, at 12. The Los Angeles Times has reported that "Africa has a near-monopoly on the bottom rankings of countries in terms of social welfare. Six of the ten countries with the lowest life expectancies in the world are African. . . . Six of the countries with the lowest literacy rates and eight of the 10 countries with the lowest rate of access to safe water are also in sub-Saharan Africa." Michael A. Hiltzik, *Africa's Future: Riding the Train to Nowhere*, L.A. TIMES, July 17, 1990, at H-1. Sub-Saharan Africa includes 47 countries and approximately 7.4 million square miles of territory. ABOYADE, *Supra*, note 7, at 1.

<sup>9</sup> This suggestion is neither novel nor sufficiently precise. "In recent years the op-ed pages of the heavyweight newspapers have bulged with candidates for Marshallisation: Africa, the Arab world, Eastern Europe — and now the Soviet Union. . . . Like most familiar phrases, the 'Marshall plan' has gradually grown vaguer and vaguer. Today it tends to mean a bold initiative that involves spending lots of money. This scarcely reflects why the original Marshall plan worked, or in what circumstances a new one might work again." *The Marshall Plan: Doing Well by Doing Good*, ECONOMIST, June 15, 1991, at 30.

direction.<sup>10</sup> The United States government has announced its intention to cancel some of the debts it is owed by certain sub-Saharan governments, and it is expected that some other Western countries will follow suit.<sup>11</sup> The U.S. plan is conditional,<sup>12</sup> however, and would not, in any event, affect the huge debt owed to the International Monetary Fund, the World Bank or private lending institutions.

The imposition of conditions on debt relief makes it clear that debt relief is generally viewed as a concession, or perhaps merely a favor, to the debtor. The purpose of this article is to propose a fundamental reconceptualization of the sub-Saharan debt crisis based on the application of certain well established contractual principles to an international setting that has not generally been considered from a contract law perspective.<sup>13</sup> More important than their potential use in litigation which, for reasons discussed below, is unlikely, these legal doctrines can contribute to resolving the sub-Saharan debt crisis by helping to foster a new consensus (among government policy makers, lenders and the concerned public) about the origins and nature of the problem.

The inescapable, central fact of the sub-Saharan debt crisis is the

---

<sup>10</sup> In a recent speech to the United Nations General Assembly, Nigerian President Ibrahim Babangida, who is also Chairman of the Organization of African Unity, said “. . . Africa’s indebtedness is the single major obstacle to development in the continent[.] The debt problem is a central element of Africa’s critical economic situation. Africa’s debt is crippling.” Stanley Meisler, *Trying to Find Relief, Less-Developed Nations Ask Debt Forgiveness*, L.A. TIMES, Oct. 11, 1991, at A5. A conference of the Institute for African Alternatives, held in London in September, 1987, concluded that “Africa’s foreign debts . . . [have to] be cancelled by the creditors, or repudiated collectively by all African countries.” *Conference Closing Statement and Alternative Proposals on Debt and Reconstruction in Africa*, in THE IMF, THE WORLD BANK AND THE AFRICAN DEBT CRISIS, 191, 197 (Bade Onimode, ed., Zed Books Ltd. 1989).

<sup>11</sup> Annan Amegbe, *Debt Relief and Growth Prospects in sub-Saharan Africa*, 15 J. SOC. POL. & ECON. STUD. 225 (1990).

<sup>12</sup> The U.S. plan for sub-Saharan African debt forgiveness is conditioned largely upon economic reform in the debtor countries (see *infra* Part III, B-D). In some instances, however, debt forgiveness is more directly tied to short-term self-interest in traditional, geopolitical terms. The Cable News Network reported on September 10, 1991, that the U.S. government had forgiven \$42 million in debt owed by the government of Senegal in exchange for Senegal’s commitment of troops to help end the civil war in Liberia.

<sup>13</sup> Three particularly relevant recent works on third world debt have come to the attention of this author. Each views the problem from a different legal angle: (1) Yacob Haile-Mariam, *Legal and Other Justifications for Writing-off the Debts of the Poor Third World Countries: The Case of Africa South of the Sahara*, 20 J. WORLD TRADE L. 57, is a short piece focusing on exchange control acts, sovereign immunity, and the Articles of Agreement of the International Monetary fund. (2) John Baloro, *African Responses to the Debt Crisis: the relevance of public international law*, 23 COMP. INT’L L.J. S. AFR. 139 (1990), as its title makes clear, focuses on public international law — arguing, *inter alia* for application of the law of treaties. (3) Jacob Dollinger, *Solution of Latin-American External Debt by Internacional [sic] Arbitration*, XVII CURSO DE DERECHO INTERNACIONAL (Aug. 1990), focuses primarily on procedural means, rather than doctrinal bases, for resolving the Latin American debt crisis.

objective inability of the borrowers to repay the loans. Most LDC debtors facing this situation have adopted a policy under which "they announce their inability fully to meet their obligations, set out all the extenuating economic or other reasons for their difficulty and offer to pay what is possible in the circumstances."<sup>14</sup> This policy has come to be known as "conciliatory default."<sup>15</sup> As a practical matter, widespread adoption of such a policy was virtually inevitable. This article argues, however, that such a policy is also consistent with certain well established principles of United States contract law,<sup>16</sup> and that these principles excuse the debtor nations of sub-Saharan Africa from any obligation to repay the great majority of the external debt now ascribed to them.

The premise underlying this assertion involves an analogy to the central concept of bankruptcy: that, under certain circumstances, debt that cannot be repaid is conclusively discharged by operation of law.<sup>17</sup> This article does not discuss bankruptcy, however, because there is no such procedural device available to sovereign debtors.<sup>18</sup> In the international context, the contractual doctrines presented below serve, in effect, as a surrogate for such a device. These doctrines have not generally been applied in this way to transactions between private parties in the domestic context precisely because various forms of bankruptcy are available to such parties as a "last resort." In the context of international sovereign lending, the logical extension of these contractual doctrines into the void left by the absence of a bankruptcy regime leads inevitably to the conclusion that severely distressed sovereign borrowers owe no more of their external debt than they can reasonably repay.

---

<sup>14</sup> United Nations Center on Transnational Corporations, *International Debt Restructuring: Substantive Issues and Techniques*, at 55, U.N. Doc. ST/CTC/SER.B/4, U.N. Sales No. E. 89.II.A.10 (1989).

<sup>15</sup> *Id.*

<sup>16</sup> The civil law tradition is older and more widely distributed than the common law tradition and, *a fortiori*, United States contract law. The position advanced in this article, however, is not dependent on technical choice of law issues. Quite apart from its role in resolving disputes that are actually litigated, legal doctrine plays an at least equally important role in structuring parties' expectations. In this regard, it is the hegemony of Anglo-American common law principles, as a central part of the relatively homogeneous ideologies of the (western) lenders' cultures, that is key. Moreover, "most international loan agreements provide for the jurisdiction of either the United States or English courts [and] for the application of United States (New York) or English law. . . ." *International Debt Restructuring*, *supra* note 14, at 53.

<sup>17</sup> For an excellent discussion of the economic and psychological rationale for, and ramifications of, discharge, see, Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393 (1985). See also, Douglas G. Baird, *THE ELEMENTS OF BANKRUPTCY*, 24-57 (1992).

<sup>18</sup> See 11 U.S.C. § 109 (1992); for an interesting discussion of some ways in which United States bankruptcy law could be amended to accommodate sovereign debtors, see, Brett H. Miller, Note, *Sovereign Bankruptcy: Examining the United States Bankruptcy System as a Forum for Sovereign Debtors*, 22 L. & POL'Y INT'L BUS. 1, 107 (1991).

Before outlining the argument presented below, it is worth stating explicitly what is not argued. The sub-Saharan debt crisis results, in significant part, from the predatory practices of, and extraordinarily poor collective judgment exercised by, international lenders. The lenders' culpability is an important part of the background against which the fairness of any proposed solution should be considered. It is not argued here, however, that the lenders' sharp practices and bad judgment constitute a sufficiently strong independent basis for nullification of the debt, *ab initio*. Thus, it is not argued here that the debts never arose, but rather that they must be discharged in substantial measure.

The doctrines employed on behalf of this objective are highly discretionary and necessarily fact-reliant to an unusual degree. Therefore, the relevant facts are developed below in considerable detail. Part II provides background information on the third world debt crisis, generally. Part III describes and critiques some of the many contemporary proposals for solution of the crisis. The specific focus on sub-Saharan Africa begins in Part IV, which (in Section A) briefly sketches the region's history of exploitation and dependence. Section B of Part IV outlines the evolution of sub-Saharan Africa's external debt, including the role of the World Bank, the International Monetary Fund and the developed country governments, then describes the relevant practices of the commercial lenders.

The discussion of legal doctrine begins in Part V, which considers but rejects some arguably relevant but problematic legal bases for adjusting or discharging the debt, including foreign sovereign immunity, the Act of State Doctrine and lender liability theories.

Part VI begins with a brief, general discussion of contractual excuse doctrine. Unconscionability, perhaps the most basic of excuse doctrines, is considered in Section B, which also addresses the limits of the analogy to private parties under United States law. Sections C and D of Part VI focus, respectively, on the applicability of the doctrines of impracticability and mutual mistake to the sub-Saharan debt crisis. Section E proposes use of the doctrine of equitable adjustment as a specific device to discharge a substantial portion of sub-Saharan Africa's external debt. Part VII discusses implications of the approach proposed in Part VI.

Fundamentally, this article is divisible into two traditional hemispheres: the facts and the law.<sup>19</sup> Its detailed development of the facts

---

<sup>19</sup> The term "facts" is used here in its everyday — i.e., lay or non-legal — sense. Questions regarding admissibility of evidence are beyond the scope of this article and, in any event, quite premature vis-a-vis the process of reforming a policy consensus on the issue of sub-Saharan African debt and the modest contribution the author hopes to make to that process.

lays the essential foundation for application of the legal doctrines that follow. As these doctrines are equitable in nature, the facts are, to an even greater extent than is typical, the linchpin of the legal arguments. Extensive development of the facts is also intended to frame the crisis in its proper historical context, demonstrate the depth and origin of the crisis and highlight its urgency.

## II. DEVELOPMENT OF THE CURRENT THIRD WORLD DEBT CRISIS

Most analysts trace the current third world debt crisis<sup>20</sup> primarily to the oil crisis of the early 1970s. The steep rise in oil prices had the twin effects of further impoverishing oil poor LDCs and flooding the international financial system with excess oil profits in need of investment.

In the late 1960s, the economic expansion in major industrialized countries created a demand for oil beyond the supply then provided by the oil producing nations.<sup>21</sup> The supply-demand imbalance was exploited and exacerbated by the tightening of crude oil supplies on the part of the Organization of Petroleum Exporting Countries ("OPEC") and multinational oil companies.<sup>22</sup> The 1973 Yom Kippur War and the United States' inability to increase immediate production only worsened the supply-demand imbalance.<sup>23</sup> Between 1971 and 1974, oil prices increased five-fold.<sup>24</sup>

By 1974, OPEC's annual revenues were estimated at \$100 billion.<sup>25</sup> Its members could not spend all their profits on imports and, therefore, had to find investments.<sup>26</sup> In response, the United States developed a program by which foreign governments could purchase United States Government securities directly, by special procedures established outside the regular financial markets.<sup>27</sup> The plan did not eliminate the surplus, however, and petro dollars poured into a relatively unregulated London mar-

---

<sup>20</sup> The term "third world" is relatively new, but international debt crises are not. The first such crisis involving the U.S. and one or more LDCs began in September, 1873, after a dramatic crash of the New York stock market, when "a succession of [mostly Latin American] states declared themselves bankrupt and suspended payments on their external debts." CARLOS MARICHAL, *A CENTURY OF DEBT CRISES IN LATIN AMERICA* 99 (1989). See also, JOHN H. MAKIN, *THE GLOBAL DEBT CRISIS* 11-53 (1984).

<sup>21</sup> Levinson, *supra* note 2, at 490.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 491; See also Hans H. Angermuller, *Introduction*, *SOVEREIGN LENDING: MANAGING LEGAL RISK* vii-xii (Michael Gruson ed., 1984); and Marilyn Post, Comment, *The Debt-for-Nature Swap: A Long-Term Investment for the Economic Stability of Less Developed Countries*, 24 *INT'L LAW.* 1071, 1072 (1990).

<sup>25</sup> Levinson, *supra* note 2, at 491.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 492.

ket where United States, Japanese and Western European banks took deposits for investment. As world economic activity declined in 1973 and 1974, Western industrial countries adjusted their economies by adopting severe deflationary policies.<sup>28</sup> They did not borrow to expand capacity, in part, because their capital demand had been satisfied by OPEC investment.<sup>29</sup> In contrast, the oil importing LDCs<sup>30</sup> did not respond to increased oil prices by reducing economic activity, but borrowed from Western financial institutions to pay increasing oil prices, to expand economic growth and, in some cases, to offset capital flight.<sup>31</sup> The net effect was to make OPEC a major creditor of the United States and Western multinational banks, which in turn loaned the money to poor, often politically unstable LDCs.<sup>32</sup>

In 1979, a second oil crisis was precipitated in part by the fall of the Shah of Iran.<sup>33</sup> Multinational oil companies had let reserves fall; their rush to replace inventory caused oil prices to double in 1980.<sup>34</sup> LDCs borrowed again, this time not only to pay the increased price of oil and to fuel economic growth, but also to make payments on the loans taken during the first round of radical oil price increases.<sup>35</sup>

Meanwhile, government attempts to expand the United States economy after the retrenchment of 1973-74 had resulted in double-digit inflation and a rise in the prime rate.<sup>36</sup> Federal Reserve Board Chairman Paul Volker "slammed" monetary policy into reverse.<sup>37</sup> The effects of this slowdown were not limited to the domestic economy of the United States. Because the economy of United States was the largest and most influential in the world,<sup>38</sup> as money tightened and import demand dropped in the U.S., the same things happened throughout the world.<sup>39</sup>

---

<sup>28</sup> *Id.* at 493.

<sup>29</sup> *Id.*

<sup>30</sup> A few LDCs (e.g., Angola, Nigeria and Venezuela) are oil exporters. The great majority, however, buy oil on the international market.

<sup>31</sup> Levinson, *supra* note 2, at 491.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 495.

<sup>34</sup> *Id.* at 495-6.

<sup>35</sup> See Post, *supra* note 24, at 1072-73; and Levinson, *supra* note 2, at 496.

<sup>36</sup> Levinson, *supra* note 2, at 496.

<sup>37</sup> See *Id.* at 496, n. 34 (quoting W. Wriston in *Was I exacting? Sure. Was I Occasionally Sarcastic? of Course*, INST. INVESTOR, June 1987, 17, 20, as stating "[w]hat nobody knew was that Volcker was going to lock the wheels of the world. And when he threw the U.S. into the deepest recession since 1933, it spread to the whole world. And that's what started, the . . . international debt crisis: Export ratios that looked very good the month before he took office looked like a disaster a year later." *Id.* at 20).

<sup>38</sup> *Id.*

<sup>39</sup> Levinson, *supra* note 2, at 496-97.



Interest rates doubled when the major industrialized nations decided to deal with inflation through strict monetary policies. These developments affected third world debtors in two critical ways. First, a significant portion of the loans carried floating interest rates, and these rates skyrocketed.<sup>40</sup> Second, because of tight money and weakened demand, third world debtors had trouble selling their exports to raise revenue. In 1982, Mexico made its historic declaration of inability to meet even the interest payments on its external debts, and "third world debt crisis" was well on its way to becoming a household phrase.<sup>41</sup>

### III. CONTEMPORARY PROPOSALS FOR SOLUTION OF THE CRISIS

When Mexico defaulted on its loan payments in August 1982, the financial community was shocked into confronting a problem which had only been discussed previously in terms of conjecture.<sup>42</sup> Commercial banks abruptly reduced their lending to developing nations.<sup>43</sup> It became clear that the market system alone would not solve the debt crisis.<sup>44</sup> Proposals for resolving the crisis have been many, varied and, thus far, unsuccessful.<sup>45</sup> Some of these efforts are briefly described below.

#### A. Rescheduling

The severity and intractability of the debt crisis prompted debtors, creditors, and governments to look for solutions. One of the earliest and least innovative approaches is rescheduling — i.e., the extension of maturity and a temporary reduction in payment amount. Rescheduling is a fairly traditional means of giving a distressed debtor some "breathing room."<sup>46</sup> The rescheduling arrangement may also include a grace

---

<sup>40</sup> Garg, *supra* note 4, at 47.

<sup>41</sup> Levinson, *supra* note 2, at 497; *see also* Angermueller, *supra* note 31.

<sup>42</sup> *See generally*, GEORGE ANN POTTER, *DIALOGUE ON DEBT: ALTERNATIVE ANALYSES AND SOLUTIONS* (1988).

<sup>43</sup> *Id.*

<sup>44</sup> Levinson, *supra* note 2, at 503.

<sup>45</sup> *See generally*, RUDIGER DORNBUSCH, *DOLLARS, DEBTS AND DEFICITS*, 88-165 (1986).

<sup>46</sup> According to a former member of the Federal Reserve Board:

It has been said that lending to countries is less risky than lending to businesses or individuals because a country, unlike a business or an individual, will always be around. Country lending, it is sometimes said, is free of final bankruptcy and definitive loss. All that is needed is occasional rescheduling that gives the lender a breathing space and does not significantly affect the earnings or capital of the lending banks.

Dr. Henry Wallich, Remarks at the International Conference of Banking Supervisors (Sept. 24, 1981)(available at Federal Reserve Bank of New York), *quoted in* Ralph Reisner, *Default by Foreign Sovereign Debtors: An Introductory Perspective*, 1982 U. ILL. L. REV. 1, 5 (1982); *see generally*, Joseph J. Norton, ed., *Prospects for International Lending and Reschedulings*, (Southern Methodist University Institute on International Finance, 1988).

period.

In general, both debtors and creditors describe debt rescheduling as a temporary "remedial measure designed to reestablish more normal financial conditions."<sup>47</sup> Its long term utility is dependent, therefore, on the debtor countries' ability to establish such "normal financial conditions." A senior economist for the World Bank explains, however, that "[r]escheduling takes debt that is not being serviced and makes a new loan out of it at higher interest rates. Therefore, rescheduling has not eased the debt burden."<sup>48</sup>

Some commentators are decidedly pessimistic about the long term viability of rescheduling:

[S]ince 1982, no country involved in rescheduling its debts has significantly reduced its debt ratio. The experiences of the sub-Saharan African countries suggest that a cycle of rescheduling could persist indefinitely and that rescheduling alone may not be adequate to restore borrowing capacity to permit imports to levels consistent with modern growth.<sup>49</sup>

Two primary fora exist for the rescheduling of sovereign debt. The Paris Club (established in 1956 to address Argentina's difficulties in servicing its debts to several European countries)<sup>50</sup> is open to all official (i.e., government and multilateral) creditors who wish to participate. It meets at the request of individual debtor countries in response to specific requests for relief. Debtor countries must meet two conditions to qualify for Paris Club relief. "First, they must be in a situation of 'imminent default.' Second, they must have negotiated [an economic reform] program with the . . . [International Monetary Fund]. . . . Official creditors have always insisted that an IMF program be in place before commencing Paris Club negotiations."<sup>51</sup>

Because debtor countries have begun relying on commercial creditors as well as official lenders, it was perhaps inevitable that a parallel framework for restructuring commercial debts would also developed. It

---

<sup>47</sup> RIAD AJAMI & DARA KHAMBATA, *INTERNATIONAL DEBT AND LENDING: STRUCTURE AND POLICY RESPONSES* 46 (1986). Use of the word "reestablish" is problematic. It is argued below (Part VI, Section D) that it should have been clear from conditions existing at the time of many loans to LDCs that repayment would be extremely difficult, if not impossible. In other words, in many LDCs "normal financial conditions" (as lenders use the term) never existed and cannot, therefore, be "reestablished."

<sup>48</sup> Chandra Hardy, *The African Countries: Implications of the Debt Crisis*, 30 *How. L.J.* 469, 470 (1987).

<sup>49</sup> Annan Amegbe, *Debt Relief and Growth Prospects in Sub-Saharan Africa*, *Journal of Social, Political and Economic Studies*, 229; Ramesh C. Garg, *Exploring Solutions to the LDC Debt Crisis*, *BANKERS MAG.*, Jan.- Feb. 1989, at 46.

<sup>50</sup> BRIAN KETTEL & GEORGE MAGNUS, *THE INTERNATIONAL DEBT GAME*, 148 (1986).

<sup>51</sup> Karen Hudes, *Coordination of Paris and London Club Reschedulings*, 17 *N.Y.U.J. INT. L. & POL.* 553, 556 (1985).

is called the "London Club," reflecting the location of many of its meetings; although it lacks the formal structure of the Paris Club, it uses similar procedures and imposes similar conditions for relief.<sup>52</sup> London Club reschedulings have typically required a commitment that the debtor country will bring all past-due interest payments current by a specified date and remain current thereafter. New money may be advanced to pay interest on existing loans.<sup>53</sup>

Unfortunately, rescheduling — whether via the Paris Club or the London Club — does not offer a permanent solution to the crisis. There is a cost to the debtor under the traditional rescheduling arrangement because interest continues to accrue on any deferred amounts, and the debtor must pay interest on the entire balance until the loan is paid in full.<sup>54</sup> "All that . . . debt reschedulings are accomplishing are the postponements of the debt-service peaks accompanied by a steady increase in the burden of debt."<sup>55</sup>

While it has been argued that banks, too, may have reason to disfavor rescheduling arrangements,<sup>56</sup> Professor Andreas Lowenfeld suggests otherwise. He asserts that commercial banks have specific incentives to reschedule — regardless of the debtors' circumstances:

Assets of a bank basically consist of outstanding loans, and they remain on the [bank's financial s]tatement as assets so long as they are not in default. If a \$1,000 loan carries ten percent annual interest, payable quarterly, it brings in \$25 every three months; if the interest is not paid, say for two quarters it is considered a non performing loan and must be written down by 50% on the Statement of Condition; if non payment of interest continues further, the loan may have to be written off entirely. Thus, for \$25 or \$50 in additional funds used to keep interest payments current, a bank saves itself from a write-down of \$500 or a write off of \$1000, a reduction in the asset side of the balance sheet that must be matched (once loan reserves are exhausted) by a corresponding reduction in earnings and (if those are insufficient) in net worth.<sup>57</sup>

---

<sup>52</sup> *International Debt Restructuring*, *supra* note 21, at 18.

<sup>53</sup> Hudes, *supra* note 51, at 561.

<sup>54</sup> KETTELL & MAGNUS, *supra* note 50, at 146.

<sup>55</sup> *Id.* at 157.

<sup>56</sup> Economists Brian Kettell and George Magnus have noted:

Rescheduling disrupts the flow of funds into and out of the balance sheet and restricts the bank's ability to make loans on the basis of profitability and risk. The cost of management, . . . and the reserves held against bad loans or dubious loans disrupt the income statement. All these costs constitute direct and opportunity costs. Finally, adverse publicity regarding bad loans or exposure to major problem debtors affects the banks's share price, its funding capacity and its overall lending ability. Only time — and good fortune — will show whether the interest and fee earnings from rescheduling will compensate for the costs and repercussions associated with it. KETTELL & MAGNUS, *supra* note 50, at 158.

<sup>57</sup> Andreas Lowenfeld, forward to *The International Debt Crisis*, 17 N.Y.U. J. INT'L L. & POL., 485, 489 (1985).

Professor Cynthia Lichtenstein suggests that this need to reschedule to maintain the appearance — or perhaps merely the fiction — of stability went beyond the participating banks, and even beyond the banking industry, to the entire international financial system:

even the House of Representatives recognized the necessity for the moment, of rolling over the loans and allowing the rescheduling process to continue with the addition of new money to keep the interest payments on the old loans current, or at least current enough to prevent a mandatory recognition of default and a conceivable international financial breakdown.<sup>58</sup>

In summary, debt rescheduling is, at best, a “short-term solution to a long-run problem”<sup>59</sup> and will not suffice as a permanent approach. More importantly for purposes of considering the fairness of the contractual solution proposed in Part VI below, rescheduling has provided two specific benefits to the banks: (1) it commits the debtors to ever-increasing payment obligations with no end in sight and (2) it allows the lending banks to show an ever-improving (although likely false) picture through their financial statements.

## B. The Baker Plan

At the annual meeting of the World Bank and the IMF in Seoul, South Korea, on October 9, 1985, United States Secretary of the Treasury James A. Baker III announced a plan designed to solve the LDC debt problem.<sup>60</sup> Hailed as “a small step for one man . . . [but] a giant leap for mankind,”<sup>61</sup> the plan was welcomed, albeit tentatively, as a first step toward resolving a seemingly intractable problem.<sup>62</sup>

The Baker Plan, as it became known, recognized that the debt crisis was not a short term disruption of economic order but a permanent condition.<sup>63</sup> Secretary Baker called for increased lending by commercial banks located in the money centers of the developed countries and by the

---

<sup>58</sup> Cynthia Lichtenstein, *US Response to the International Debt Crisis: The International Lending Supervision Act of 1983 and the Regulations Issued Under the Act*, A DANCE ALONG THE PRECIPICE, 198 (William Eskridge Jr., ed., 1985).

<sup>59</sup> Garg, *supra* note 4, at 46-47.

<sup>60</sup> Statement by the Honorable James A. Baker, III, Secretary of the Treasury of the United States, before the Joint Annual Meeting of the IMF and World Bank, Oct. 8, 1985, Seoul, South Korea, reprinted in U.S. DEPARTMENT OF TREASURY, TREASURY NEWS, 4-5 (Oct. 8, 1985).

<sup>61</sup> *Welcome Plan on Debt*, FIN. TIMES (LONDON), Oct. 9, 1985, at I 16.

<sup>62</sup> Robert D. Hormats, *The World Economy Under Stress*, 64 FOREIGN AFF. 455, 474 (1986). The Baker Plan “urged debtor countries not only to implement sound fiscal and monetary policies, but also to strengthen their private sectors, mobilize more domestic savings, facilitate investment, liberalize trade and pursue market-oriented approaches to currencies, interest rates and prices.” *Id.*

<sup>63</sup> Christine A. Bogdanowicz-Bindert, *World Debt: the United States Reconsiders*, 64 FOREIGN AFF., 259, 268 (1985).

World Bank and various regional development banks.<sup>64</sup> Secretary Baker also asked the World Bank to seek greater efficiencies in its procedures in order to reduce the time required to process loans and speed funds to needy countries.

The second aspect of the Baker Plan made renewed lending by the commercial banks conditional on debtor nations' submission to IMF scrutiny of their economic policies.<sup>65</sup> The reforms required by the Baker Plan involved reduction of government involvement in the economy, tax reform to enhance entrepreneurial incentive, liberalization of trade barriers, market-oriented exchange rates, devaluation of currency and a move away from deficit financing.<sup>66</sup>

The financial community did not accept the Baker Plan enthusiastically. The first criticism was that the economic structure of the proposed lending package was unrealistic. The plan called for the renewed lending to grow 2.5 percent annually.<sup>67</sup> In order to ease the debt servicing crisis, however, the debtor countries' economies would also be required to grow at an annual rate of six to seven percent.<sup>68</sup> To meet this robust growth expectation, the debtor nations would first have to reverse their economic contraction and decline. Thus, in reality, these models were asking the developing nations to grow, initially, by *more* than seven percent.<sup>69</sup> If this was possible, the crisis would not exist in its current proportions.

At least one commentator has asserted that the Baker Plan was partly motivated by "the backlash building in the United States against the 1982-85 strategy and the fear that in the debtor countries, the moderates who wanted to work within the system were in danger of being overrun by more radical forces, who wanted a break with the existing international order."<sup>70</sup> Jerome I. Levinson, former General Counsel of the Inter-American Development Bank, describes the Baker Plan as "a rather eclectic attempt to synthesize the development experience of the

---

<sup>64</sup> The Inter-American Development Bank ("IDB"), the Asian Development Bank, and the African Development Bank. (Baker called for internal reorganization of the IDB in order to participate in the program.) Levinson, *supra* note 2, at 510.

<sup>65</sup> *Id.*

<sup>66</sup> Levinson, *supra* note 2, at 510 n. 96.

<sup>67</sup> Levinson, *supra* note 2, at 16.

<sup>68</sup> *Id.* at 5, citing H. Rowen, *Third World Debt has Nations Looking for Creative Answers*, WASH. POST, Mar. 20, 1988, at H41.

<sup>69</sup> See Levinson, *supra* note 2, at 511 ("During 1985-87, the seventeen most highly indebted countries that were to be the primary beneficiaries of the Baker Plan paid \$74 billion more than they received from private commercial banks and multinational lending institutions.")

<sup>70</sup> Levinson, *supra* note 2, at 511 (citing Robin Broad, *How About a Real Solution to Third World Debt?* N.Y. TIMES, Sept. 28, 1987, at A25).

past three decades.”<sup>71</sup> Citing the Baker plan’s focus on structural reform designed to elicit debtor countries’ commitment to substitute market forces and private enterprise for reliance on the public sector for economic and social development,<sup>72</sup> Levinson states:

Above all, by tying the debtor country’s access to capital for development purposes to fidelity to a single economic development model that enhanced the role of market forces and private enterprise, Secretary Baker created the impression that what he sought was a return to the conditions that had prevailed three decades earlier in the 1950s when access to capital for development purposes depended upon adherence to IMF and World Bank guidelines.<sup>73</sup>

### C. Congressional Proposals

By the middle of 1986, the Baker Plan began to draw heated criticism. Senator Bill Bradley recognized that the current debt burdens of developing nations were so onerous that sustained economic growth could not be expected without debt reduction.<sup>74</sup> According to Bradley, this reduction would require that Western bankers face up to their lending errors and recognize loan losses on their sovereign lending portfolios.<sup>75</sup> Although this aspect of Senator Bradley’s proposal sounded radical to the financial world, in fact the write-offs were to be contingent on economic reform, which had been central to the Baker Plan. Thus, in order to qualify for reduction in its outstanding obligations to Western bankers by ten percent over three years and three points off the interest rates,<sup>76</sup> each troubled developing nation seeking such assistance would have to agree to economic reform overseen by the IMF and World Bank.<sup>77</sup> Additionally, Bradley called for eased trade restrictions and flexibility conducive to case-by-case solutions.<sup>78</sup>

Other members of Congress have come forward with proposals of their own. The most comprehensive, innovative initiative called for the creation of an international debt adjustment facility.<sup>79</sup> The function of the institution would be to:

- (a) purchase sovereign loans at discount, passing along the benefits of such

---

<sup>71</sup> Levinson, *supra* note 2, at 515.

<sup>72</sup> *Id.* at 511.

<sup>73</sup> *Id.*, at 515.

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> Mark Sullivan, *Treasury’s David Mulford Blasts Bradley Third World Debt Plan*, AM. BANKER, July 31, 1986, at 2.

<sup>77</sup> Levinson, *supra* note 2, at 515.

<sup>78</sup> *Id.*

<sup>79</sup> Congressmen John J. LaFalce and Bruce A. Morrison made this proposal as part of the Omnibus Trade and Competitiveness Act of 1987. *Id.* at 518.

discount to the corresponding debt or country, (b) encourage developed countries with capital surpluses to invest these in debtor countries, and (c) assist creditor banks in voluntarily disposing of sovereign loans in the private sector.<sup>80</sup> Congress even went so far as to authorize research into the possibility of forming such an entity.<sup>81</sup>

However, Congress placed strict feasibility requirements on the establishment of proposed agency by the Treasury Department. If the creation of such an agency would result in a material increase in the discount at which sovereign debt would be sold, materially increase the probability of default of debtor nations or materially increase the likelihood of disruption of debt service by debtor nations,<sup>82</sup> then the Treasury could refuse to enter into negotiations with other developed countries to create the proposed agency.<sup>83</sup> Adding to the start-up difficulties imposed by the feasibility report, Congress prohibited any United States Government financial backing for the agency.<sup>84</sup> It was not clear, therefore, from where the debt relief would come.

#### D. The Brady Plan

It is generally conceded that the Baker Plan did little to solve the debt problem facing both the debtor nations and the creditor banks. On March 10, 1989, less than four years after the Baker Plan was first proposed, then United States Treasury Secretary Nicolas F. Brady endorsed a supposedly new strategy.<sup>85</sup> The central point of Brady's "plan" was simply that "the path toward greater credit worthiness and a return to the markets for many debtor countries needs to involve debt reduction."<sup>86</sup>

Brady proposed that the IMF and the Bank provide funding for these reductions by such efforts as debt buy backs and conversion to marketable securities. Debtor countries would be required, as a condition of receiving loans, to commit to measures that would encourage the flow of new commercial finance. In other words, more IMF or IMF-like conditions.

---

<sup>80</sup> *Id.* The key word is "encourage," because all the institution has to do is encourage countries with capital surpluses to invest in the developing countries. In order for investors to put money into developing countries, they must get higher returns than they could elsewhere in the world. Add to this the inherent economic risk of investing in developing countries, and one would expect that an investor would require substantially higher rates of return than from investments elsewhere.

<sup>81</sup> See 22 U.S.C. § 5331 (1990).

<sup>82</sup> Levinson, *supra* note 2, at 519 (quoting Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418 § 3111 (a)(2)(A)-(C), 102 Stat. 1107, 1376 (to be codified as 22 U.S.C. § 5331)).

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 535.

<sup>86</sup> *Id.*

However, like Baker's recognition in 1985 that developing countries needed new credits to keep their economies from severe depression, Brady's recognition that debt reduction is necessary does no more than state the obvious. Each so-called "plan" is alarmingly short on detail. The banks are unwilling to take severe "hits" to their bottom lines, when they are scrambling to meet the new capital ratios required through international agreement. Brady's so-called plan is no more than a Baker Plan rehash with a recognition that some LDC debt will have to be discharged, not just rescheduled. It has been suggested that the Brady Plan was actually intended only for Mexico.<sup>87</sup>

### E. Debt-for-Equity Plans

The magnitude of the debt crisis and its resistance to attack have fostered the growth of a secondary market for the debt of developing countries.<sup>88</sup> Creditors have realized that selling a debt, even at a deep discount, is preferable to reflecting a huge loss on the loan portfolio. One of the two dominant forms of debt conversion in the secondary market is the debt-for-equity swap. Under this scheme, some or all of a nation's debt is exchanged for a local currency equity investment in a local company.<sup>89</sup>

In a debt-for-equity swap, an investor approaches a large debtor nation and expresses an interest in investing in an industry or specific business. The investor proposes to buy outstanding debt from a specific creditor or on the open market for a fraction of the face amount of the outstanding loan. The investor then sells the outstanding loan to the debtor nation for the face amount or for a discounted amount of local currency. The terms of exchange are negotiable. The investor then uses the sale proceeds to buy an equity stake in the local business, and makes further capital investment. Ideally, this process reduces the debtor's outstanding debt, attracts new funds into the local economy and gives the investor control over his investment.

However, from the perspective of the debtor nation, debt-for-equity

---

<sup>87</sup> *Mexican President on Dealing with World Debt*, INT'L HERALD TRIB., Feb. 5, 1990, at 4.

<sup>88</sup> See generally, Eve Burton, *Debt for Development: A New Opportunity for Nonprofits, Commercial Banks, and Developing States*, 31 HARV. INT'L L.J. 233 (1990).

<sup>89</sup> Derek Asiedu-Akrofi, *A Comparative Analysis of Debt Equity Swap Programs in Five Major Debtor Countries*, 12 HASTINGS INT'L & COMP. L. REV., 537, 538 (1989). See generally, U.N. Centre on Transnat'l Corp. *Debt Equity Conversions: A Guide for Decision-Makers*, U.N. Doc. St/ctc/104, U.N. Sales No. E.90.II.A.22 (1990); Keith Stanton Richey, *Privatization and Debt-for-Equity Swaps from a U.S. Bank's Perspective*, 17 INT'L TAX J., no. 3, 70 (1991); Stuart M. Berkson & Bruce A. Cohen, *Tax Implications of Debt-for-Equity Swaps*, 12 HASTINGS INT'L & COMP. L. REV. 575 (1989).



swaps can have certain drawbacks that make them inadequate as a primary debt reduction device. In order to make the exchange between the hard-currency denominated value (usually dollars) of the debt and the local debt, the debtor government must print money or issue bonds. Both of these practices can be inflationary, and thus, if the debtor is under a strict austerity program, may violate the terms of its agreement that allowed external borrowing to resume. Additionally, as one Brazilian official observed of issuing bonds to raise local currency to make the exchange: "what we're doing is swapping long term foreign debt . . . for short-term domestic debt. . . ." <sup>90</sup> If there is further hardship, the government may even be forced to cut social spending in order to meet local bond payments. The debt-for-equity swap idea has been positively received, but it is simply unrealistic to expect that it will solve the debt crisis. <sup>91</sup>

Nationalism is a second fundamental impediment that wholesale debt-for-equity swapping would confront. Most sub-Saharan countries achieved their independence fairly recently. Memories of colonialism not only linger, but result in strong opposition to the idea of selling to the West anything that might be perceived as reducing autonomy. Furthermore, debt-for-equity swaps could have very limited applicability in countries where only one or two nationalized industries dominate the economy. There is also the problem of how swaps fit into the unbalanced developing economy. Because only relatively well developed industries would attract significant interest, the resultant investment is likely to exaggerate existing imbalance, rather than broadening the productive base of the economy. <sup>92</sup>

---

<sup>90</sup> Burton, *supra* note 88, at 237.

<sup>91</sup> Levinson, *supra* note 2, at 525.

<sup>92</sup> Debt-for-equity swaps are subject to regulation by the United States government. Regulation K (12 C.F.R. para. 211) was promulgated by the Federal Reserve Board to implement the exemptions in Section 4(c) of the Bank Holding Company Act (12 U.S.C. para. 1843(c)) which provide certain exemptions to the BHCA's prohibition against non-banking activities and investment in entities other than banks. The Board's 1987 amendments to Regulation K expanded the scope of authorized investments to permit a bank holding company to hold equity positions of up to 100% in non-financial (e.g., commercial or industrial) companies located in "eligible countries." However, the shares must be acquired from the government or a governmental agency; in other words, the acquired company "must be a public sector company in the process of being transferred from public to private ownership." Regulation K defines an eligible country as one that, since 1980, has restructured its national debt held by foreign creditor; the definition also includes any other country the Board determines is eligible. The 33 most heavily-indebted nations are considered eligible countries under Regulation K. Asiedu-Akrofi, *supra* note 89, at 566; Michael Gruson, *Investment in Foreign Equity Securities and Debt-for-Equity Conversion by U.S. Banks, Bank Holding Companies, and Foreign Bank Holding Companies*, 1988 COLUM. BUS. L. REV. 441, 443; *See also*, Scott A. Shane, *U.S. Policy Toward Debt Equity Swaps*, 16 J. SOC. POL. & ECON. STUD. 287 (1991).

## F. Debt-For-Nature/Debt-For-Development Plans

Two hybrid forms of the debt-for-equity device are debt-for-nature and debt-for-development plans. A debt-for-nature swap generally involves the permanent or temporary forgiveness of a nation's debt in exchange for the nation's agreement to certain environmental commitments. For example, in a typical debt-for-nature arrangement, a group—normally a conservationist organization—will buy outstanding debt either directly from the lender or on the secondary market and exchange it for control of some part of the debtor's environment.<sup>93</sup> The primary focus of the movement thus far has been on saving tropical rain forests. This approach reflects the essential ecological role of the rain-forests and the disproportionate representation of countries with significant remaining rain forests among the nations burdened with excessive debts.

The first such swap was completed in 1987 by Conservation International, which purchased roughly \$650,000 worth of outstanding Bolivian debt for \$100,000 and exchanged it for major environmental control of nearly four million acres of Bolivian rain forest.<sup>94</sup> More recently, a tri-party arrangement was established among the government of the Philippines, the World Wildlife Fund and the Haribon Foundation. Under this swap, the Wildlife Fund is to acquire up to \$2 million of debt owed to American banks; this debt is then exchanged for local currency at par. The local currency is in turn used by the Haribon Foundation to provide funding for the environmental activities of the Philippine Department of Environmental Natural Resources.

Debt-for-nature swaps have several benefits. The swap enables the debtor country to repay the debt in its own, readily-available currency, rather than less accessible foreign currency.<sup>95</sup> Also, "Debtor countries may be able to capture discounts on debts sold on the secondary market and convert such debts into conservation-related investments."<sup>96</sup> Creditors are able to rid their portfolios of loans with a high probability of default and non-performance; this elimination of the debt is vastly prefer-

---

<sup>93</sup> See Marilyn Post, *The Debt-for-Nature Swap: A Long-Term Investment for the Economic Stability of Less Developed Countries*, 24 INT'L LAW. 1071, (1990); J. Eugene Gibson and Randall K. Curtis, *A Debt-for-Nature Blueprint*, 28 COLUM. J. TRANSNAT'L L. 331 (1990); David Bigman, *A Plan to End LDC Debt and Save the Environment Too*, 33 CHALLENGE 33 (1990).

<sup>94</sup> Post, *supra* note 93, at 1081-1082.

<sup>95</sup> Gibson & Curtis, *supra* note 93, at 336.

<sup>96</sup> Asiedu-Akrofi, *supra* note 89, at 577. Also see generally, J. Eugene Gibson and William J. Schrenk, *The Enterprise for the Americas Initiative: A Second Generation of Debt for Nature Exchanges — With an Overview of Other Recent Exchange Initiatives*, 25 GEO. WASH. J. INT'L L. & ECON. 1 (1991).

able to continual adjustment and rescheduling of the debts, which are often accompanied by further advances to a debtor already in trouble. The conservation organization receives income from payments on the debt and is able to exert influence to further its environmental goals. Finally, the increased awareness of the need to protect and conserve environmental resources is beneficial to all.

However, debt-for-nature swaps raise serious concerns for debtor countries. Paramount among these is national sovereignty.<sup>97</sup> The prospect of foreign ownership and/or control of national resources and domination of the economy can be offensive and threatening to developing countries.<sup>98</sup> Criticism has been raised about the potential inflationary impact of swaps on the economy.<sup>99</sup> This concern is primarily because the country must print large amounts of new currency, issue unbacked bonds or divert circulating currency from other purposes in order to carry out the swap.<sup>100</sup> In addition, swaps necessarily can address only a small portion of the world's debt, and enforcement mechanisms may be inadequate or unavailable.

Debt-for-development is an idea posited by Eve Burton.<sup>101</sup> She argues that development agencies can use their allocated budgets for specific program countries to buy outstanding debt on the open market and then exchange it for its local currency equivalent. These funds are then invested in local development programs. Again, like debt-for-equity, this program is inflationary, but it does avoid nationalism problems.

## G. Some Smaller Experiments

### 1. *Securitization of Debt*

The development of a secondary market for third world debt in the financial and business communities and the creation of debt conversion schemes such as debt-for-nature and debt-for-equity swaps have paved the way for consideration of "securitization" as a possible solution to the problem of third world debt.<sup>102</sup>

Securitization of third world debt operates in much the same manner as the more familiar mortgage-backed and asset-backed securities

---

<sup>97</sup> See Priya Alagiri, *Give Us Sovereignty or Give Us Debt: Debtor Countries's Perspective on Debt for Nature Swaps*, 41 AM. U. L. REV. 485 (1992); Gibson & Curtis, *supra* note 93, at 343.

<sup>98</sup> *Id.*

<sup>99</sup> Alan Patterson, *Debt for Nature Swaps and the Need for Alternatives*, 10 ENVIRONMENT 4 (Dec. 1990).

<sup>100</sup> *Id.*

<sup>101</sup> Burton, *supra* note 88, at 243.

<sup>102</sup> Alfred J. Puchala, Jr., *Securitizing Third World Debt*, 1989 COLUM. BUS. L. REV., 137, 138 (1989).

transactions. Loans selected in accordance with rigorous underwriting criteria are pooled and sold to an independent entity, often a trust or a special purpose corporation established by the selling creditor. The income resulting from loan payments is used to make regular payments of interest to the security holders.<sup>103</sup>

Proponents of securitization as part of the solution to the debt crisis point to several benefits to all parties. Debtors could benefit from a structure permitting a hiatus in interest payments. Debtor nations could also gain by purchasing the securities and thereby realizing a portion of the market discount.<sup>104</sup> Creditor banks would relieve their portfolios of high risk loans, which could be replaced with better quality assets.

However, at least one commentator has questioned whether the securitization proposal truly addresses the needs of debtor countries.<sup>105</sup> In light of the impossibility of debt service for many developing countries, it is said that securitization addresses only the creditors' needs and is "a little like talking about what color to paint a house that has been condemned as structurally unsound."<sup>106</sup> The question is raised whether securitization renders the debts any less risky, and the point is made that the essential first step is to forgive or reduce part of the debt.<sup>107</sup> Unless steps are taken to resolve the "underlying problem of the crushing debt burdens,"<sup>108</sup> other efforts are almost certain to be ineffective.

## 2. *The Miyazawa Plan*

Japanese Finance Minister Miyazawa has proposed a plan that utilizes the securitization concept with a twist. Debtors would "guarantee" their debt service by granting liens on their exchange reserves and on the proceeds of sale of government-owned assets. The portion of the debt that is not contributed to the securitized pool is then adjusted; grace periods of up to five years are granted, during which interest payments may be reduced, suspended or canceled altogether. The last element of the plan is increased lending by multilateral and bilateral agencies to countries that have taken the first two steps.<sup>109</sup>

---

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* at 152-53.

<sup>105</sup> David W. Leebron, *First Things First: A Comment on Securitizing Third World Debt*, 1989 COLUM. BUS. L. REV. 173 (1989).

<sup>106</sup> *Id.* at 174.

<sup>107</sup> *Id.* at 175-6.

<sup>108</sup> *Id.* at 182.

<sup>109</sup> *Approaches to Debt Reduction*, FINANCE AND DEVELOPMENT, Sep., 1989, at 16.

### 3. *The Mitterand Proposal*

French President Francois Mitterand suggests creation of a fund in the IMF for middle-income debtor nations to guarantee interest payments on commercial loans converted to bonds. The guarantee would result in substantially lower finance charges to the debtors and would be financed by the developed countries' agreement to, in effect, donate their share of a new issue of Special Drawing Rights for the developing countries' use.<sup>110</sup>

### 4. *The Robinson Plan*

American Express Chairman James Robinson has proposed a plan that calls for creation of an International Institution for Debt and Development, which would purchase developing countries' debt at a significant discount in exchange for its own high quality obligations. The purchased debt would be subordinated to all new debt in an effort to encourage the flow of new capital to the debtor countries. The Institution is conceived as a joint venture between the IMF and the Bank and would condition its purchases on the debtor countries' agreement to satisfactory economic policies.<sup>111</sup>

---

None of the proposed solutions discussed above show any real promise as a means of resolving the LDC debt crisis — either alone or in combination with others<sup>112</sup> — because total LDC debt, now exceeding \$1 trillion, is simply too massive.<sup>113</sup> What is needed is a much heightened and comprehensive effort based on a new consensus about the nature and origins of the problem. The legal doctrines discussed below can provide the framework for such a consensus and, it is hoped, strengthen the resolve of policy makers by correcting the misperception that debt relief is essentially a favor to the debtors. The specific factual backdrop against which the legal principles must be considered is the history of sub-Saharan Africa.

---

<sup>110</sup> *Id.*

<sup>111</sup> Leebron, *supra* note 105, at 181 n.27 (“First things first. . .”).

<sup>112</sup> The Institute for African Alternatives concluded that conventional policy proposals “would give some temporary relief to African and other poor countries. But they cannot provide long-term solutions to the structural problems of these countries. This is because they fail to address the underlying causes of these problems — they deal mainly with their symptoms.” Onimode, *supra* note 17 at 195. “Much too often, bankers, economists and policymakers forget that the debt crisis has emerged over a long period of time and therefore that short-term or patchwork solutions will be largely unsuccessful in curing the underlying problem.” Garg, *supra* note 4, at 47. *See also*, Makin, *supra* note 27 at 224-245.

<sup>113</sup> Paul Krugman, *Debt Relief is Cheap*, 80 FOR. POL’Y 141, 143 (1990).

#### IV. SUB-SAHARAN AFRICA: THE FACTS

##### A. A Brief Historical Sketch

The pre-colonial economy of sub-Saharan Africa comprised relatively self-sufficient agricultural and pastoral communities that produced surplus food for inter-regional commerce.<sup>114</sup> Small peasant proprietorships formed the basic economic units, and property distribution was essentially egalitarian.<sup>115</sup> Political and social organizations were based on kinship and developed into fairly complex units that carried out bureaucratic functions, defense and extensive trade that crossed the Sahara, reaching as far as Cairo and the Mediterranean.<sup>116</sup> From the east coast, starting in about 1200 A.D., Indian Ocean trade routes carried African goods as far as Canton, China.<sup>117</sup> Pre-colonial African society produced sophisticated art, crafts and artifacts that evidenced a stable social order and reflected sophisticated cultural and religious values.<sup>118</sup>

Tropical diseases and natural environmental hazards such as flood, fire, pests and parasites kept an ecological balance between population and environment.<sup>119</sup> Because land was plentiful and the climate warm, there was little pressure toward innovative technological advances.<sup>120</sup> In addition, the terrain encouraged isolation. Apart from natural sources of transit such as rivers and lakes, "poor technology . . . made it difficult to construct the necessary transport and communication network through thick forest and swamp terrain to bring various communities together

---

<sup>114</sup> ABOYADE *supra* note 7, at 2; *see also* Davidson, *Africa in Historical Perspective*, AFRICA SOUTH OF SAHARA 4-10 (1989). "Sub-Saharan Africa" means Africa south of the Sahara desert, but excludes the Republic of South Africa.

<sup>115</sup> ABOYADE, *supra* note 7, at 2; *See* Davidson, *supra* note 114, at 10. Africa's pre-colonial societies were stateless. Stability was based on a complex balance of intra-group interests and power. The "ancestors" in a "more or less timeless past" created a tradition of a balance with nature in which outside influences were evils associated with witchcraft. "[A] given way of life, having brought a given community into existence and enabled it to survive and sufficiently to prosper, came to seem a way of life sanctioned by divine power. . ." *Id.*

<sup>116</sup> ABOYADE, *supra* note 7, at 2; *see also*, Davidson, *supra* note 114, at 6. African culture was characterized by self-rule such as village governments, chiefdoms, kingships and occasionally large powerful empires modified and influenced by ecology.

<sup>117</sup> Davidson, *supra* note 114, at 6-8. Carthaginians and later the Romans traded African products from coastal trade or overland routes. "A Greek-Egyptian mariner's guide to the Red Sea and the north-western Indian Ocean, written around 150 A.D., tells of a regular trade between Red Sea ports and the coasts of what are now Somalia, Kenya, and Tanzania."

<sup>118</sup> *Id.*

<sup>119</sup> ABOYADE *supra* note 7, at 3.

<sup>120</sup> *Id.* *See also* Davidson, *supra* note 114, at 6 (explaining the sub-Saharan Africans in their early development "had little incentive to invent new methods of production, transport or exchange" and felt little need to depart from their hoe-cultivation, pastoralism, and metal-working, "until they found themselves exposed to a world which had developed quite different systems and, with these, a far greater technological power.").

and foster still larger contiguous markets.”<sup>121</sup> Finally, with little outside competition, there was little economic incentive to exchange leisure for work.<sup>122</sup> European domination began in the 1440s with the Atlantic slave trade, which did not end until the 1880s.<sup>123</sup> The slave trade profoundly upset traditional African society.<sup>124</sup> Over 10 million Africans were taken to America alone, and at least ten times as many died en route.<sup>125</sup> Entire African societies were eliminated, and vital manpower essential to the demographic balance was upset. Meanwhile, America and Europe used African slaves to build and expand their infrastructure and economies.<sup>126</sup>

After the 1880s, colonialism emerged as the preferred system for exploiting Africa. Colonialism imposed territorial boundaries that were arbitrary at best, and often were designed to undermine the rights and interests of Africans.<sup>127</sup> African nations lost their capacity to develop independent, traditional African structures. During a period when European and American societies developed from a rural base to an urban, industrial base, African economies stagnated.<sup>128</sup>

Eventually, the colonial powers' desire to further expand exports from the colonies required basic changes in colonial socio-economic organization.<sup>129</sup> Because the transition, however, was unmanaged, movement of African labor from agricultural uses to urban and industrial uses resulted in serious socio-economic instability in the colonies.<sup>130</sup> The rural economy was substantially undermined, and the “modern” sector became responsible for providing for the social and capital cost of

---

<sup>121</sup> ABOYADE, *supra* note 7, at 3.

<sup>122</sup> *Id.* at 4 (explaining that “[c]onsistent with the assumptions of rational behavior, further growth of the communal economy must have to come from higher product prices, or sacrifice of leisure or improved technology.”)

<sup>123</sup> See Davidson, *supra* note 114, at 10-11 (explaining that although the African slave trade conducted from the East coast of Africa by Asian slavers began earlier and persisted longer, it was *de minimis* in comparison to the Atlantic trade.)

<sup>124</sup> Davidson, *supra* note 114, at 10.

<sup>125</sup> The number who died en route is unknown but estimated in the hundreds of millions. *Id.*

<sup>126</sup> *Id.*; see also ABOYADE, *supra* note 7, at 4-5.

<sup>127</sup> D.K. FIELDHOUSE, *BLACK AFRICA 1945-80: ECONOMIC DECOLONIZATION & ARRESTED DEVELOPMENT* 55 (1986).

<sup>128</sup> *Id.* Even the introduction into African colonies of advances such as excavated seaports, railroads, motor vehicles and deep mines, went unassimilated by Africans and their indigenous economies. Assimilation was precluded primarily by discriminatory colonial labor practices that excluded African workers, often by using short-term migrant workers instead. Access to modern education was limited to that provided by Christian missionaries. In general, Africans were kept on the periphery. *Id.* See generally, T.R. DeGregori, *Foreign Investment and Technological Diffusion: The Case of British Colonial Africa*, 2 J. ECON. ISSUES 403 (1968).

<sup>129</sup> See generally, ABOYADE, *supra* note 7.

<sup>130</sup> *Id.*

maintaining a large and relatively unskilled urban proletariat. This rapid urbanization destroyed a considerable part of sub-Saharan Africa's capacity for subsistence production and economic self-sufficiency.<sup>131</sup> As a result, sub-Saharan Africa became essentially a region of "enclave economies" under the control of the "metropolitan" countries.<sup>132</sup>

Most important in terms of current debt problems, colonial structures "imposed, both by indirect price incentives and by direct fiscal and physical coercion, a structure of production and specialization dictated by demand patterns and strategic requirements which were external to African economies and beyond their influence."<sup>133</sup> Thus, the colonial powers gradually replaced exportation of Africans with exportation of cocoa, coffee, groundnuts, timber and minerals. Introduction of technology into Africa was directed towards high returns, rather than economic and sociological development for Africans.<sup>134</sup> Although exports showed growth, the industrialization of peasant agriculture was very slow,<sup>135</sup> and Africa had to import substantial quantities of basic foods such as rice, wheat and maize.<sup>136</sup>

After World War II, the European colonial powers (sometimes hereinafter the "metropolitan states"), facing their own economic crises resulting from the war's devastation, saw intensified exploitation of their colonies as an essential part of their strategy for economic recovery and future development.<sup>137</sup> The metropolitan states used their superior bargaining power to make bulk purchases of commodities from the African colonies at below market prices. They exported manufactured goods only to colonies that could pay with hard currency. This allowed Britain alone to extract more than 140 million pounds from its colonies between 1945 and 1951 at a cost of less than 40 million pounds.<sup>138</sup>

By 1952, however, the post-war crisis had subsided, and capital liquidity and international trade increased.<sup>139</sup> The end of post-war

---

<sup>131</sup> *Id.*

<sup>132</sup> ABOYADE, *supra* note 7, at 5; *but see* Fieldhouse, *supra* note 139, at 5 (expressing suspicion of this assumption as arguing from "ex post situations"). The colonial powers extracted irreplaceable natural resources and distributed property and profits to a small, mainly European, elite. Aboyade, *supra* note 7, at 5. Colonialism also marginalized the role of Africans and imposed unfamiliar administrative bureaucracies upon indigenous societies. *Id.*; *see generally*, FIELDHOUSE, *supra* note 139, at 55.

<sup>133</sup> Aboyade, *supra* note 7, at 5. *See generally*, Fieldhouse, *supra* note 139, at 55-57.

<sup>134</sup> De Gregori, *supra* note 128, at 415.

<sup>135</sup> FIELDHOUSE, *supra* note 127, at 33.

<sup>136</sup> *Id.* at 36.

<sup>137</sup> *Id.* at 6, 12-13.

<sup>138</sup> *Id.* at 6.

<sup>139</sup> *Id.* at 7.



shortages and resultant drop in commodity prices caused most African colonies to run deficits due to drastic declines in their export income. Thus, "it was no longer necessary or useful to keep political control over African dependencies in order to harness them to the bogged-down imperial economies."<sup>140</sup> Colonial demand for capital was driving interest rates up.<sup>141</sup> Private industry in the metropolitan states was fearful that "imperial preference would enable newly industrializing colonies to compete unfairly with British manufacturers."<sup>142</sup> For the metropolises, the colonies had gone from providing economic windfalls to being economic burdens.

"The only way out of the self-created dilemma was to substitute rapid political advance for rapid economic advance; to give independence and then be free to restrict the flow of aid to manageable levels on the reasonable ground that independent states did not have the same claims as colonies."<sup>143</sup> In addition, the cold war gave Britain political and strategic reasons to seek the goodwill of those who would inherit political power in the colonies.<sup>144</sup> However, "it was beyond the economic capacity of either Britain or France, both seriously weakened by the war, to transfer sufficient resources to the colonies to enable them to modernize their economies quickly. . ."<sup>145</sup>

Between 1957 and 1965 virtually all African colonies, except those of Portugal, gained independence.<sup>146</sup> The pressing strategic and economic needs for African colonies during and immediately after World War II had eased. The cost of maintaining colonies had become too great, and metropolitan taxpayers viewed the colonies as a burden.<sup>147</sup> It was believed that:

if the colonies were liberated quickly and good relations established with the successor regimes, there would be little or no economic loss to the metropolises. African markets would remain open, colonial exports would continue to flow to their traditional European terminals [and] . . . foreign, particularly American, capital would flow into them and this would not only reduce the strain on metropolitan investment funds but would increase the consumer capacity of Black Africa.<sup>148</sup> Although there was fear that communism would take newly emerging African nations as client states,<sup>149</sup>

---

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at 23.

<sup>144</sup> *Id.* at 8.

<sup>145</sup> *Id.* at 23.

<sup>146</sup> *Id.* at 5.

<sup>147</sup> *Id.* at 231-34.

<sup>148</sup> *Id.* at 232.

<sup>149</sup> *Id.* at 22, 58.

it was believed that delegating political functions to colonial elites while continuing aid would relieve hostilities and encourage democracy.<sup>150</sup>

This rapid process of decolonization was unanticipated and unplanned. The metropolises, in creating their colonies, had suppressed the identity of tribal nations. The colonial "governments" were little more than administrative bureaucracies created within arbitrarily drawn territories and built upon concepts of economic specialization established by the metropolises.<sup>151</sup> Sub-Saharan Africans had no experience with the framework of European government within which they were expected to co-exist with one another.<sup>152</sup> Neither official government bureaucracies nor multinational corporations had integrated Africans into management of colonial economies in preparation for independence.<sup>153</sup> Thus, at the time of independence, the nations of sub-Saharan Africa lacked

the human skills essential in any Western-style economic system. . . . Their infrastructures could not carry the weight of large-scale modern industry or agriculture. Their welfare services were inadequate for an increasing urbanized society. . . . Manufacturing was a very small . . . part of the domestic product and agriculture, by far the largest sector measured by output or the numbers engaged in it, was still predominantly a peasant activity and was only partly integrated with the market economy.<sup>154</sup>

In sum, the former colonies had been politically underdeveloped and economically overexploited.<sup>155</sup> Uneven economic development and their relatively brief participation in the world economy put the emerging African nations in an untenable position.<sup>156</sup> The sudden and forced transition from colonial economies to independent, self-sustaining economies failed.<sup>157</sup> All these circumstances set the stage for sub-Saharan Africa's plunge into the current debt crisis.<sup>158</sup>

---

<sup>150</sup> *Id.* at 8, 22-23.

<sup>151</sup> *Id.* at 55.

<sup>152</sup> *Id.* at 56.

<sup>153</sup> *Id.* at 10.

<sup>154</sup> *Id.* at 233.

<sup>155</sup> See FIELDHOUSE, *supra* note 131, at 233; Aboyade, *supra* note 7, at 6-7.

<sup>156</sup> See ABOYADE, *supra* note 7, at 6-7.

<sup>157</sup> *Id.* Ironically, in many African countries, GDP per capita increased during the 1960s. See generally, African Economic Indicators (UN Economic Commission for Africa) for the years 1968, 1972, 1973. This apparent economic expansion during the 1960s, however, resulted from the new governments' imprudent efforts to gain short term advantage and was largely illusory. "What the new independent governments added was a readiness to borrow far beyond what colonial governments had regarded as prudent, to extract a greater proportion of the domestic product for public spending than had seemed politically safe before and to provide attractions to potential foreign and indigenous investors which derived from nationalist rather than economic calculations." FIELDHOUSE, *supra* note 127, at 42.

<sup>158</sup> "The fact that power was transferred when African societies were still quite unprepared for the difficulties ahead must be seen as a possible . . . link between decolonization and later 'arrested development.'" FIELDHOUSE, *supra* note 127, at 234.

The process by which the debt evolved is also important to the applicability of the legal doctrines developed below. The history of this evolution establishes that the loan transactions were anything but “arms length.”

## B. Evolution of the Debt

Sub-Saharan Africa’s external debt can be dissected in a number of ways. One useful approach is to distinguish, initially, between official debt and commercial debt, based on the type of lender. “Official” debts include those owed to sovereign states or international financial institutions such as the IMF and the World Bank.<sup>159</sup> “Commercial” debts, on the other hand, are those owed to commercial banks or other private lenders.<sup>160</sup>

Unlike the debtor countries of Latin America, most sub-Saharan African countries are indebted primarily to official creditors: Western governments, the World Bank and the International Monetary Fund (the “IMF”).<sup>161</sup> The World Bank and the IMF are the dominant players in the debt crisis,<sup>162</sup> and critics contend that these institutions are subject to extraordinary influence by the United States and that they cater to — or, at least, champion the interests of — the commercial banks, which rely heavily on World Bank/IMF “ratings” of LDCs as potential borrowers and often require compliance with IMF or “IMF-like” conditions.<sup>163</sup> The IMF, the World Bank and the commercial lenders have acted with

---

<sup>159</sup> John Baloro, *African Responses to the Debt Crisis: The Relevance of International Law*, 23 COMP. & INT’L L.J. S. AFR. 139, 146 (1990).

<sup>160</sup> *Id.* at 147. A third, less obvious category of debt includes loans from official or commercial lenders to companies within a debtor country. These loans do not represent sovereign debt — provided the company is not an agency or instrumentality of the state — but are relevant to the debt crisis because (1) in many instances, lenders require that these loans be guaranteed by the government of the debtor company’s country and (2) even where there is no guarantee, repayment of the loan will generally require drawing on the foreign currency reserves of the debtor country.

<sup>161</sup> Ebenroth, *supra* note 5, at 631; see also Yacob Haile-Mariam, *Legal and Other Justifications for Writing-off the Debts of the Poor Third World Countries: The Case of Africa South of the Sahara*, 24 J. WORLD TRADE 57, 58 (1990) (explaining that only 15% of African external debt is owed to private, commercial lenders because of the risks associated with lending to sub-Saharan countries).

<sup>162</sup> Other relevant institutions include the United Nations Development Program (UNDP), which provides 80% of its assistance to countries with annual per capita incomes less than \$500. In 1981, sub-Saharan Africa received 30% of the UNDP’s budget. The United Nations Industrial Development Organization (UNIDO) is an executive agency of UNDP that generates industrialization policies, plans, surveys, feasibility studies, management strategies and marketing and research studies for projects in LDCs. RONALD BENDRICK, 4 LEGAL ASPECTS OF DOING BUSINESS IN AFRICA 6, 9, 10 (Donald Campbell ed. 1986).

<sup>163</sup> “. . . the Fund and the Bank have been dominated by the United States and a commitment to multilateralism of free international flows of goods and capital that subordinate the interests of African and Third World countries.” Onimode, *supra* note 17, at 191.

the approval of the governments of the developed countries. Thus, the international lending system with which the LDCs deal is, as a practical matter, one entity. This lack of meaningful alternatives for the LDCs is a significant part of the background against which a solution of the crisis should be considered.

1. *The World Bank, the IMF and "Official" Lending*

The IMF and the World Bank were established at the Bretton Woods Conference<sup>164</sup> in July 1944. The United States, Britain and their World War II allies intended that the World Bank (the "Bank") and the IMF would be the central figures in the post-war economic order.<sup>165</sup> The role envisioned for the Bank was to promote development by financing investment in countries in need after the war; the assigned role of the IMF was "to maintain order in the international monetary system."<sup>166</sup>

The World Bank — whose real name is the International Bank for Reconstruction and Development — was to focus on rebuilding Europe's economies, but it was upstaged and rendered almost superfluous by the Marshall Plan.<sup>167</sup> The Bank then shifted its focus from reconstruction to development and, in the 1950s, turned its attention to the third world.<sup>168</sup> The IMF, on the other hand, performed its role as originally envisioned until the early 1970s, when changing circumstances forced it to assume responsibilities more akin to those of the Bank. The IMF became a lender after its original role:

was clouded by the breakdown of the system of fixed exchange rates that the Bretton Woods Conference had designed. Floating currencies and the expansion of private capital markets left the Bretton Woods code of economic conduct, and hence the IMF's role, in doubt. Later, during the 1980's, both the Bank and the IMF struggled to cope with the new problem of developing-country debt. Soon the demarcation of duties had become all the more blurred, almost beyond recognition . . . . In one developing country after another, the two institutions devised overlapping programs of economic reform and backed them with cash.<sup>169</sup>

---

<sup>164</sup> The conference took place at Bretton Woods, New Hampshire.

<sup>165</sup> MARGARET GARRITSEN DE VRIES, *THE IMF IN A CHANGING WORLD 1945-85* 5-9 (1986).

<sup>166</sup> *Id.* at 30.

<sup>167</sup> *Sisters in the Wood: Distant Relation*, *ECONOMIST*, Oct. 12, 1991, at 9.

<sup>168</sup> In the 1950s, the Bank's effort in the third world focused primarily upon development of infrastructure (e.g., roads, bridges, power stations). In the 1960s, it began to support urban development, farming, education and population control. *Id.* During his tenure as President of the Bank from 1968 to 1981, Robert McNamara reaffirmed the Bank's commitment to the third world and pledged to help the poorest of the LDCs. *Id.*

<sup>169</sup> *Sisters in the Wood: Two Pillars of Wisdom*, *ECONOMIST*, Oct. 12, 1991, at 5 [hereinafter *Two Pillars of Wisdom*]. "Before the current crisis, the Fund concentrated on short-run balance of payments adjustment, while the Bank engaged in longer-term project lending for agricultural develop-

Under the Articles of Agreement of the World Bank,<sup>170</sup> membership in the Fund is a prerequisite to participation in the Bank's programs.<sup>171</sup>

At present, the World Bank supplies capital for development projects that are open to international bidding,<sup>172</sup> and provides advice in conjunction with the IMF on economic and legal reforms directed towards stimulating economic growth by creating "a more attractive investment climate."<sup>173</sup>

## 2. "Conditionality" and the Collapse of the Distinction Between Official and Commercial Lending

"Conditionality" is the term used to describe the IMF's and the Bank's requirements that a member country follow certain economic policies in order to be able to use the Fund's general resources. The conditions generally include devaluations, budget cuts, subsidy withdrawals, privatization of public enterprise and demand suppression through devaluation of local currency.<sup>174</sup> The great majority of the IMF's lending is subject to conditions.<sup>175</sup> Not surprisingly, such comprehensive and strict austerity measures and forced reforms toward free market principles have been historically unpopular in the debtor countries.<sup>176</sup> In the con-

---

ment and growth. But since the 1980s, both agencies have increasingly synthesized their activities around a Structural Adjustment Programme (SAP) or Economic Recovery Programme (ERP)." ONIMODE, *supra* note 10, at 191.

<sup>170</sup> The World Bank consists of three institutions: (1) the International Bank for Reconstruction and Development ("IBRD") which makes loans to LDCs that are at an advanced developmental stage for government or government-guaranteed projects; (2) the International Development Association (IDA) which provides concessional credit primarily to poorer countries that allow for a ten year grace period with a 50 year maturity and no interest; and (3) the International Finance Corporation (IFC) which generates domestic and foreign capital for the private sector. The IFC has authority to make equity investments and loans to governments without government guarantees and to raise finance by syndicating its own loans or by parallel financing from capital markets. It also provides project sponsors with technical assistance. BENDRICK, *supra* note 162, at 7. The World Bank's co-finance partners are (1) governments and multilateral financial institutions, (2) export credit agencies that procure goods from specific countries and (3) commercial banks. *Id.* at 9.

<sup>171</sup> "This suggests that the founders [of the Bank and the IMF] believed that [debtor] countries should be prepared to accept the Fund's code of conduct as an assurance that the development financing made available through the Bank would be properly used." Stephan A. Silard, *Legal Aspects of Development Financing in the 1980's: The Role of the International Monetary Fund*, 32 AM. U. L. REV. 89 (1982).

<sup>172</sup> BENDRICK, *supra* note 162, at 6.

<sup>173</sup> *Id.*

<sup>174</sup> ONIMODE, *supra* note 10, at 191.

<sup>175</sup> Richard Gerster, *The IMF and Basic Needs Conditionality*, 16 J. WORLD TRADE L. 497 (1982).

<sup>176</sup> At one point, the Fund actually felt constrained to publish a defensive pamphlet entitled "Ten Common Misconceptions About the IMF." The "misconceptions": (1) that the Bank and the Fund apply identical remedies, irrespective of a country's circumstances; (2) the Fund supports programs that do not work; (3) the Fund is anti-growth; (4) the Fund's conditions harm the poor; (5) the Fund

text of the cold war, the IMF's conditions became a powerful instrument of influence, if not coercion.<sup>177</sup>

Meanwhile, an important change in borrowing patterns had already begun in the 1970s, when sub-Saharan countries were driven to borrow from more expensive private commercial sources to finance the deficit where the IMF or bilateral borrowing left off.<sup>178</sup> As sub-Saharan governments borrowed increasingly from private lenders, they subjected themselves to shorter maturities and higher (and/or floating) interest rates.<sup>179</sup> Yet they did not escape the IMF and its conditions. Increasingly, private lenders rely on the Fund's assessments of prospective debtors. The availability of a private loan might even be expressly conditioned on the borrower's status within the Fund.<sup>180</sup> University of Swaziland Professor

---

imposes austerity on member countries; (6) the Fund's priority is to bail out the commercial banks; (7) the Fund has a market-oriented, free enterprise philosophy, which it imposes in a doctrinaire way; (8) the Fund ignores the views of developing country governments; (9) the Fund has no influence over the governments of rich countries; and (10) the Bank and the Fund collude in dealing with developing countries. *Two Pillars of Wisdom*, *supra* note 169, at 6.

<sup>177</sup> One critical commentator ascribed six functions to these conditions:

1. As a key to IMF resources: From the members' point of view, conditionality is the key to access to the Fund's resources.
2. As a seal of approval for the economic policy of a country and facilitate[or of] . . . access to private and official loans.
3. As a vehicle to dependency: Through reintegration into the present world economy with unequal partners, conditionality tends to keep the developing countries in dependency instead of promoting their self reliant development.
4. To exclude alternative balance of payments policies: As conditionality of IMF credits is designed to promote the purposes of the Fund, the concept of IMF conditionality excludes — often undiscussed — alternative balance of payments policies.
5. As a rationing device: On its way to a more liberal system of international trade and payments, IMF conditionality facilitates rationing and allocation of scarce resources along the lines of market forces, thereby replacing other social and political priorities.
6. To favor foreign interests: The chosen IMF-conform adjustment policies favor the interests of foreign creditors and are therefore the key to the repayment of the Fund's own credits.

Gerster, *supra* note 175, at 499.

The economic failure and resultant world-wide political collapse of communism, however, have severely undercut debtor country arguments that the IMF's heavy-handed push toward free market principles meaningfully restricts the debtor countries' right to choose among credible alternative development paradigms.

<sup>178</sup> Although indebtedness to official creditors accounted for 70% of total external debt, there was an increasing tendency not only for borrowing to increase at a faster rate in many African countries, but also for private debt to accumulate at a higher rate than official debt. In the four-year period 1970-1974, private debt increased by 29.3% annually compared with 18.6% for bilateral official and multilateral debt. This tendency has a serious implication for the nature of indebtedness. [need full cite] *ECA* 1976 at 25-26; Garg, *supra* note 4, at 47. *ECA* 1976 at 8. Sub-Saharan African debtors were not alone in this. "Since 1971, there has been a marked shift in the debt structure of the LDCs, with private capital replacing official lending. . . . Lending from private sources historically has been more costly to the borrower and characterized by shorter maturities." Garg, *supra* note 4, at 47.

<sup>179</sup> Garg, *supra* note 4, at 47.

<sup>180</sup> Sir J. Gold, *Order in International Finance, the Promotion of IMF Standby Arrangements, and the Drafting of Private Loan Agreements*, INTERNATIONAL MONETARY FUND PAMPHLET NO. 39 2 (1982).

John Baloro states that, "In practice, the attitude of commercial banks toward a particular African state . . . depends very much on whether or not that country has agreed to implement an IMF adjustment programme."<sup>181</sup>

### 3. *The Role of the Developed Country Governments*

The collapse of the distinction between official and commercial lending, and the subsequent explosive growth of further lending (usually in the form of rescheduling, discussed above), occurred against the backdrop of supportive government policy in the developed countries. A British banker and former Cabinet Minister stated that:

We are not dealing with the isolated misjudgment of a few banks but with the worldwide overcommitment of an interlocking banking system. Moreover, the banks did not act in isolation. Their decisions were approved and encouraged by their governments . . . governments and banks shared the delusion that sovereign default was unthinkable and that the debtors would be able to service their debt indefinitely by borrowing.<sup>182</sup>

In 1983, the Banking Committee of the United States House of Representatives reached the same conclusion:

In the last decade the U.S. Government, along with other western govern-

---

<sup>181</sup> Baloro, *supra* note 159, at 146; *but see*, Andreas Lowenfeld, *Political Economy for the 1980's: Global Banks and National Governments*, 101 HARV. L. REV. 1061, 1070 (1988)(book review) (suggesting that — at least in Latin American lending — many commercial banks imposed no such "IMF-like" conditions). "All that was needed (to exaggerate slightly) was a commitment to 'market' interest rates, typically a floating rate. . . ." *Id.* On the other hand, it was reported that "as Brazil struggled under the burden of its external debt and as social unrest threatened to cause serious political trouble for the government of President Figueiredo, Brazil's bank creditors indicated that they might refuse to make new loans in an attempt to win further concessions (in addition to those exacted by the IMF) from the regime." Carl Peterson, *Brazil Takes the IMF Cure*, THE NATION, April 2, 1983, at 393.

In his article on Latin American debt, Professor Jacob Dollinger cites two sources describing, in almost the same terms, the combined pressure exercised historically by the banks and the IMF in that region:

- 1) the debtor state allowed its financial conditions to deteriorate until it was unable to meet interest payments;
- 2) the commercial bank lenders then refused to reschedule or refinance loans unless the debtor state agreed to IMF conditions. . . ;
- 3) debtors officially requested IMF assistance and accepted an IMF prescribed austerity program that lowered the domestic standard of living and facilitated social and political discourse (or . . . exacerbated social and political tensions);
- 4) the banks, after some delay and squabbling among themselves, gave new credit or rescheduled the debt; new loans carried relatively short terms, high interest rates and large negotiation fees.

Jacob Dollinger, *supra* note 13, *Solution of Latin American External Debt*, XVII CURSO DE DER-ECHO INTERNACIONAL, n.32, Aug., 1990, citing Barry C. Barnett, et al., *On Third World Debt*, 25 HARV. INT'L L.J. 83, 95-6 (1984), and Nancy A. Aliquo, *Treasury Secretary James Baker's "Program for Sustained Growth" or the International Debt Crisis: Three Steps Toward Global Financial Security*, 4 DICK. J. INT'L L. 281 (1985-86).

<sup>182</sup> Lord Lever of Manchester, *quoted in* THE INDEPENDENT, Mar. 3, 1987, at 15.

ments, encouraged bank overseas lending on the theory that the private flow of funds would aid U.S. export and job markets.<sup>183</sup>

Some writers have suggested that even commercial lenders dealing in sovereign finance are making essentially political decisions, and that the debt crisis is, first and foremost, a matter of foreign affairs.<sup>184</sup>

#### 4. *The Commercial Lenders' Behavior*

Shortly after Mexico's 1982 announcement of default, *The Economist* opined that "the banks have nobody but themselves to blame. For many years they lent on risks that were known to be bad, and did so merely because their competitors did so, because they did not want to be left out of the crowd."<sup>185</sup> Scholars have suggested that "the massive flow of commercial loans to LDCs in the past decade demonstrates the banks' inability to exercise self restraint."<sup>186</sup> Professor Andreas Lowenfeld, however, asserts a more specific motivation: ". . .this lending went on just because the lenders — i.e., the major commercial banks — had funds on which they needed to earn high returns to make up, in effect, for the bidding by which they had induced the oil producing countries to place their funds with them."<sup>187</sup> The private bank loans to LDCs earned higher interest than loans to industrialized countries because of the higher risk.<sup>188</sup>

---

<sup>183</sup> *International Bank Lending: Hearings Before the Sub-Committee on Financial Institutions Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs*, 98th Cong. 1st Sess. (1983) (statement of C.T. Conover, Comptroller of the Currency).

<sup>184</sup> See, e.g., W.H. Knight, Jr., *International Debt and the Act of State Doctrine: Judicial Abstention Reconsidered*, 13 N.C. J. INT'L L. & COM. REG. 64, 73 (1988).

<sup>185</sup> *Bottomless Debt* ECONOMIST, Dec. 11, 1982, at 12.

<sup>186</sup> Barry C. Barnett et al., *On Third World Debt*, 25 HARV. INT'L L. J. 83, 131 (1984).

<sup>187</sup> Lowenfeld, *supra* note 181, at 1069. At the IMF's 1979 annual meeting, Anthony Sampson reported that international bankers had begun to behave like aggressive salesmen. "As they pursue their prey down the escalators, up the elevators, along the upstairs corridors into the suites, they cannot conceal their anxiety to do business. For these men who look as if they might have been trained to say No from their childhood are actually trying to sell loans. 'I've got good news for you,' [Sampson] heard one eager contact man telling a group of American bankers; 'I think they'll be able to take your money.'" ANTHONY SAMPSON, *THE MONEY LENDERS: BANKERS IN A WORLD OF TURMOIL* 12 (2nd ed., 1981), *quoted in* MAKIN, *supra* note 20, at 45.

<sup>188</sup> The money loaned by the London market "often had a maximum eight-to-ten year maturity structure, some of it under innovative financing techniques due in a single "bullet" payment." Levinson, *supra* note 2, at 495. The interest rate on such loans was tied to the London Interbank Offered Rate (LIBOR) and was adjusted every six months. *Id.* The developing countries were charged floating interest rates based on spreads of 0.8% to 2.25% above the LIBOR, which fluctuates with the U.S. economy and has, in the last 20 years, ranged from six to 20%. Nera Seidman Makgetta, *External Influences on Third World Debt*, 12 HASTINGS INT'L & COM. L. REV. 59 (1988). See also Post, *supra* note 94, at 1072-1073. Andreas Lowenfeld, *forward to The International Debt Crisis, A Symposium held at New York University School of Law on Dec. 14-15, 1984*, 17 N.Y.U.J. INT'L L. & POL. 485, 486 (1985) (explaining that some believe the IMF might have been sleeping in 1982, and not surveilling the international banking transactions and "that petrodollar deposits were coming in



The need and resultant competition to recycle oil money significantly affected banking practices. Banks simply "lent too much money with too little thought. . . ."<sup>189</sup> This was perhaps inevitable, given that the prestige, compensation and career advancement opportunities of individual banking officials often depended on the numbers of large loans they made.<sup>190</sup> Conspicuously absent from the bargaining process was any incentive to exercise restraint. In its 1982 "International Banking Survey," *The Economist* observed that "the banker probably has a job life expectancy of about three years before he moves on to other tasks. The job life of the finance minister of the borrowing country is probably shorter still. It will not be they who have to pick up the pieces when the bicycle finally crashes."<sup>191</sup>

Additional incentive to make increasing numbers of loans with decreasing regard for their risk came from the questionable practice of charging a wide variety of loan "fees" and counting those fees as current bank income. Professor Lichtenstein writes that:

the multinational bank lending syndicates on sovereign loans were behaving very much like syndicates of investment bankers and were assessing a number of special fees. In addition to commitment fees generally charged in connection with loans, one or more of the banks in these syndicates were also sharing "front-end" fees, agency fees, advisory fees and expense reimbursements. The special fees would be of considerable importance to banks to the extent that, as an accounting matter, the banks take them into income at the moment the lending arrangements are put together, rather than treating the fees as additional interest, which under accounting rules must be accrued over the term of the loan. [Federal] regulators were concerned that some of these fees provide an added incentive to seek out international loans in order to boost earnings immediately and, once this has occurred, to sustain past earning levels.<sup>192</sup>

Thus, the "loans made in the early 1970s took their profits up front, but

---

so fast that ambitious bankers were aggressively fighting over acquiring and relending them . . . at least as of 1981 and 1982.")

<sup>189</sup> Krugman, *supra* note 113, at 141, 142.

<sup>190</sup> "Bankers competed to make these loans because their advancements and, apparently, in some cases, compensation, were directly awarded by the volume of dollar loans extended." Robert Lenzner, *Decline in Oil Prices Brings Help to Some Nations, Damage to Others*, BOSTON GLOBE, Mar. 6, 1983, at 9.

<sup>191</sup> *International Banking Survey: A Nightmare of Debt*, ECONOMIST, Mar. 20, 1982, at 55.

<sup>192</sup> Lichtenstein, *supra* note 58, at 187. The 1983 International Lending Supervision Act, passed in response to the crisis, provides in section 906 (a) that "No banking institution shall charge, in connection with the restructuring of an international loan, any fee exceeding the administrative cost of the restructuring unless it amortizes such fee over the effective life of each such loan."

There is also the somewhat suspicious circumstance that a significant portion of the money loaned to the LDCs ended up back in the developed countries — on deposit in commercial banks. No figures are available for sub-Saharan Africa, but a study of eight highly indebted Latin American countries showed that "for every \$1 lent to the group, \$0.30 left the country in the form of capital

the principal was not due until the end of the decade.”<sup>193</sup>

It is a common perception among the debtor countries that “they were the victims of aggressive salesmanship in the days when they were visited by hordes of foreign bankers with briefcases full of petrodollars. . . .”<sup>194</sup> Sovereign governments do not automatically have superior bargaining power over commercial entities. They too can be subject to tremendous pressure based on lack of expertise, urgent domestic need and the unavailability of meaningful alternatives.<sup>195</sup> The debt rescheduling process discussed above illustrates how easily sovereign borrowers can find themselves in a virtually powerless position. One writer likened the lending and rescheduling process to “offering crates of whisky to an alcoholic.”<sup>196</sup>

Professor Jacob Dollinger concludes, with specific respect to Latin America’s external debt, but no less applicable to that of sub-Saharan Africa, that:

we had in the seventies a feverish run by government officials of the developing countries and by executives of the large American banks to increase the debts of the former to the latter, in which the representatives of both sides may have had personal interests, whereas those loan reschedulings, according to later analysis, were in their larger part against the interests of lenders and borrowers.<sup>197</sup>

The Banking Committee of the U.S. House of Representatives concluded that “the lending banks had been imprudent and the regulators had been almost criminally lax and complacent.”<sup>198</sup>

Commercial institutions began significant lending to sub-Saharan countries only when those institutions found themselves awash in petrodollars in the early 1970s.<sup>199</sup> The commercial banks’ urgent need to lend coincided with increased sub-Saharan borrowing needs resulting from the oil crisis, world recession and a slowdown in IMF and World Bank lending. Neither the commercial lenders nor the borrowers had sufficient incentive to exercise restraint. It is clear from subsequent de-

---

flight. The beneficiaries of capital flight, of course, have almost always been the developed countries and their private banks.” Garg, *supra* note 4, at 48 (footnotes omitted).

<sup>193</sup> Jonathan D. Aronson, *Financial Institutions in the International Monetary System*, 12 CASE WEST. RES. J. INT’L L. 341, 352 (1980).

<sup>194</sup> Peider Kőnz, *The Third World Debt Crisis*, 12 HASTINGS INT’L & COM. L. REV. 527, 528 (1989).

<sup>195</sup> See Detlev F. Vagts, *Coercion and Foreign Investment Rearrangements*, 72 AM. J. INT’L L. 17, 21, 31 (1978).

<sup>196</sup> Anthony Sampson, *The Money Lenders* [new page #] (1983). Professor Dollinger argues that the rescheduling process is a clear example of coercion. Dollinger, *supra* note 13, at 149.

<sup>197</sup> Dollinger, *supra* note 13, at 151.

<sup>198</sup> Lichtenstein, *supra* note 58, at 188.

<sup>199</sup> See, Part II, *supra*.

velopments that far too much money was lent. Because the debt crisis and proposals for its solution have significant policy ramifications, they are often considered exclusively from a public policy perspective. The following Parts of this article suggest not that the policy perspective is unimportant, but that it can be better informed by legal analysis.

## V. CERTAIN LEGAL DOCTRINES REJECTED AS INEFFECTIVE

We now turn to legal analysis of the sub-Saharan debt crisis. This Part will briefly note but reject certain arguably relevant legal principles that are in fact not likely to be useful because they require the difficult showing of bad intent on the lenders' part or are otherwise technically unworkable.

The first category includes, for example, fraud. Unlike mere misrepresentation in contract formation, a successful showing of fraud may entitle the claimant to punitive damages. However, because a claim for punitive damages is unlikely in the circumstances that are the subject of this article, there is no utility in undertaking the relatively difficult task of demonstrating fraud.<sup>200</sup> The second category could include arguments disavowing contractual liability based on principles of agency and state succession.<sup>201</sup> Also included in this category are defenses such as the jurisdictional doctrine of sovereign immunity and the quasi-jurisdictional Act of State Doctrine, each of which warrants some discussion.

### A. Foreign Sovereign Immunity

Sovereign immunity is a principle of international law recognized in the United States by statute.<sup>202</sup> It acts as a jurisdictional bar to cases which involve disputes related to official or sanctioned acts of foreign countries. A United States court invoking the doctrine does not "validate" the foreign government's position; it simply refuses to hear the case because legal questions involving foreign sovereigns often involve politically sensitive decisions that might interfere with one or more policies of the Executive Branch of the United States government.<sup>203</sup>

The doctrine of sovereign immunity is codified in the Federal Sover-

---

<sup>200</sup> The tort of fraud requires scienter and is harder, therefore, to show than the type of innocent misrepresentation that can afford a basis for rescission in contract law.

<sup>201</sup> For an interesting discussion of the potential applicability of public international law principles regarding state succession to international lending, see, Baloro, *supra* note 13, at 151.

<sup>202</sup> 28 U.S.C. § 1604 (1988).

<sup>203</sup> See generally, Kevin M. McGinty, Note, *Opening the Courts to Protect Interests Abroad: The Effect of the Foreign Sovereign Immunities Act on Litigation With Developing Countries*, 10 B.C. THIRD WORLD L.J. 63, 74 (1990).

eign Immunities Act ("FSIA").<sup>204</sup> Under the FSIA, a court in the United States can exercise subject matter jurisdiction<sup>205</sup> over a foreign sovereign only if an exception applies.<sup>206</sup> The Act recognizes several exceptions.<sup>207</sup> One of these is a broad "commercial activities" exception.<sup>208</sup> foreign sovereigns are not immune from judicial process in any suit in which the cause of action is based upon commercial activity that has a jurisdictional nexus with the United States.<sup>209</sup>

The FSIA defines "commercial activity" as "either a regular course of commercial conduct or a particular commercial transaction or act

---

<sup>204</sup> *Id.*

<sup>205</sup> See *Morel de Letelier v. Republic of Chile*, 748 F.2d 790, 793 (2d Cir. 1984) *cert. denied*, 471 U.S. 1125 (1985). The FSIA confers original jurisdiction on district courts "without regard to amount in controversy of any nonjury civil action against a foreign state as defined in section 1603(a) of this title as to any claim for relief in personam with respect to which the foreign state is not entitled to immunity. . . ." 28 U.S.C. § 1330(a) (1988). In turn, 28 U.S.C. § 1604 (1988) establishes the general rule that "a foreign state shall be immune from the jurisdiction of the courts of the United States . . . except as provided in sections 1605 to 1607 of this chapter. . . ." *Id.*

<sup>206</sup> 28 U.S.C. § 1330(a) (1988).

<sup>207</sup> When an exception to immunity applies, "the foreign sovereign shall be liable in the same manner and to the same extent as a private individual under like circumstances. . . ." 28 U.S.C. § 1606 (1988).

<sup>208</sup> The FSIA was enacted in 1976 to codify the restrictive principle of sovereign immunity. H.R. Rep. No. 1487, 94th Cong., 2d Sess. at 7 (1976), *reprinted in* 1976 U.S.C.A.N. 6604, 6605-07. Under this principle, the immunity of a foreign state is "restricted" to suits involving a foreign state's public acts (*jure imperii*) and does not extend to suits based on its commercial or private acts (*jure gestionis*). See *id.* at 6605.

The principle of restrictive immunity for commercial activities is embodied in 28 U.S.C. § 1605(a)(2) of the FSIA, the so-called "commercial activity" exception. *Id.* at 1617.

<sup>209</sup> 28 U.S.C. § 1605(a)(2)(1988). The existence of subject matter jurisdiction under the FSIA is a question of law which the court reviews *de novo*. See *America West Airlines v. GPA Group, Ltd.*, 877 F.2d 793, 796 (9th Cir. 1989).

The FSIA identifies three types of acts that are sufficiently connected to the United States to satisfy the jurisdictional nexus requirement to the commercial activities exception: (1) a commercial activity carried on in the United States; (2) an act performed in the United States in connection with a commercial activity carried on outside the United States; and (3) a commercial activity carried on outside the United States that has a direct effect in the United States. 28 U.S.C. § 1605(a)(2). See *Callejo v. Bancomer, S.A.*, 764 F.2d 1101, 1110 (5th Cir. 1985).

A sovereign, however, does not abrogate its sovereign immunity simply because it conducts commercial operations that have a connection with the United States. Not only must there be a jurisdictional nexus between the United States and the commercial acts of the foreign sovereign, there must also be a connection between the plaintiff's cause of action and the commercial acts of the foreign sovereign, *Vencedora Oceanica Navigacion, S.A. v. Compagnie Nationale Algerienne De Navigation*, 730 F.2d 195, 199-204 (5th Cir. 1984), and the connection between the cause of action and the sovereign's commercial acts in the United States must be material. See *America West Airlines*, 877 F.2d at 797; *Compania Mexicana de Aviacion, S.A. v. United States District Court for the Cent. Dist. of Calif.*, 859 F.2d at 1360 (9th Cir. Date); *Alberti v. Empresa Nicaraguense de la Carne*, 705 F.2d 250, 254 (7th Cir. 1983). *Stena Rederi AB v. Comision de Contratos Del Comite Ejecutivo General del Sindicato Revolucionario de Trabajadores Petroleros de la Republica Mexicana, S.C.*, 923 F.2d 380, 386 (5th Cir. 1991).

. . .”<sup>210</sup> and instructs the court to contemplate the essential nature, not the purpose, of the activity in determining whether an activity is commercial or public. If the activity is a type that a private person would normally engage in for profit, it is generally “commercial” within the meaning of the commercial activity exception to the FSIA.<sup>211</sup> Issuing public debt has been held to be a commercial activity within the meaning of the FSIA.<sup>212</sup> Moreover, most international loan agreements require that sovereign borrowers expressly waive any claim to sovereign immunity in connection with the transaction.<sup>213</sup> Thus, what might first appear a simple and complete solution to the debtor governments’ problem is not, in fact, likely to afford relief.

### B. The Act of State Doctrine

Similarly promising on its face is the Act of State Doctrine, which “prohibits U.S. courts from reaching the merits of an issue — even though [they] otherwise have jurisdiction — in order to avoid embarrassment of foreign governments in politically sensitive matters and interference with the conduct of our own foreign policy.”<sup>214</sup> The doctrine applies where the acts called into question are clearly sovereign in nature and are performed within the foreign country’s own territory.<sup>215</sup>

The Act of State Doctrine is premised upon the notion that “[e]very sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory.”<sup>216</sup>

For the U.S., the doctrine is also an outgrowth of the constitutionally required separation of powers,<sup>217</sup> and the long-standing belief that

---

<sup>210</sup> 28 U.S.C. § 1603(d) (1988).

<sup>211</sup> *Id.*; *Callejo*, 764 F.2d at 1109.

<sup>212</sup> *The Republic of Argentina v. Weltover Inc.*, 112 S.Ct. 858 (1992); *Shapiro v. Republic of Bolivia*, 930 F.2d 1013, 1018 (2d Cir. 1991).

<sup>213</sup> *International Debt Restructuring*, *supra* note 14, at 53.

<sup>214</sup> *West v. Multibanco Comermex*, 807 F.2d 820, 827 (9th Cir. 1987).

<sup>215</sup> *Chudian v. Phillipine National Bank*, 734 F. Supp. 415, 420 (C.D. Cal. 1990)(*citing* *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964)).

<sup>216</sup> *Underhill v. Hernandez*, 168 U.S. 250, 252, (1897).

<sup>217</sup> The doctrine “arises out of the basic relationships between branches of government in a system of separation of powers. . . . The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its’ engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country’s pursuit of goals both for itself and for the community of nations as a whole in the international sphere.” *Sabbatino*, 376 U.S. at 423.

Originally linked with principles of sovereign immunity, the act of state doctrine has recently been described as “aris(ing) out of the basic relationships between branches of government in a system of separation of powers.” *Id.* “. . . The policy concerns underlying the doctrine focus on the preeminence of the political branches, and particularly the executive, in the conduct of foreign pol-

the United States should "speak with one voice" in its interactions with foreign nations. Therefore, the courts generally defer making judgments when a foreign governmental entity is involved, choosing instead to leave international dispute resolution to the executive branch.<sup>218</sup> Unlike the relatively rigid FSIA, the Act of State Doctrine is a "prudential doctrine" by which American courts implicitly validate acts done by or on behalf of foreign governments by declining to question the legality of such acts.<sup>219</sup> Thus, the Act of State Doctrine would appear to afford a basis upon which a United States court could refuse to rule on the issue of whether foreign debt is collectible by action in a U.S. court.

The appeal of this doctrine in connection with LDC's debt is that it is premised primarily upon policy considerations, rather than on legal rules and precedent. The doctrine demands a case-by-case analysis of the extent to which separation of powers concerns are implicated in the context of a particular dispute.<sup>220</sup>

In 1985, however, the United States Court of Appeals for the Second Circuit held in *Allied Bank International v. Banco Credito Agricola*

---

icy. (Citations) Therefore, the applicability of the doctrine depends on the likely impact on international relations that would result from judicial consideration of the foreign sovereign's act. If adjudication would embarrass or hinder the executive in the realm of foreign relations, the court should refrain from inquiring into the validity of the foreign state's act." *Id.*

<sup>218</sup> The Act of State Doctrine declares that a United States court will not adjudicate a politically sensitive dispute which would require the court to judge the legality of the sovereign act of a foreign state. . . . The doctrine recognizes the institutional limitations of the courts and the peculiar requirements of successful foreign relations. To participate adeptly in the global community, the United States must speak with one voice and pursue a careful and deliberate foreign policy. The political branches of our government are able to consider the competing economic and political considerations and respond to the public will in order to carry on foreign relations in accordance with the best interests of the country as a whole. The courts, in contrast, focus on single disputes and make decisions on the basis of legal principles. The timing of our decisions is largely a result of our caseload and of the random tactical considerations that motivate parties to bring lawsuits and to seek delay or expedition. When the courts engage in piecemeal adjudication of the legality of the sovereign acts of states, they risk disruption of our country's international diplomacy. The executive may utilize protocol, economic sanction, compromise, delay, and persuasion to achieve international objectives. Ill-timed judicial decisions challenging the acts of foreign states could nullify these tools and embarrass the United States in the eyes of the world. *Intern. Ass'n of Machinists, Etc. v. OPEC*, 649 F.2d 1354, 1358 (9th Cir. 1981).

<sup>219</sup> The Act of State Doctrine operates to confer presumptive validity on certain acts of foreign sovereigns by rendering non-justiciable claims that challenge such acts. *Allied Bank International v. Banco Credito Agricola de Cartago*, 757 F.2d 516, 520 (2d Cir. 1985), *cert. denied*, 473 U.S. 934 (1985). This is somewhat similar to the doctrine of sovereign immunity, but the Act of State Doctrine is applied to a case which has already been received by a court, whereas sovereign immunity works to deny a court's jurisdiction, thereby effectively preventing the court from hearing the case in any manner.

<sup>220</sup> *Texas Trading & Milling Corp. v. Federal Republic of Nigeria*, 647 F.2d 300, 316 n.38 (2d Cir. 1981). *Allied Bank*, 757 F.2d at 520-521.

*de Cartago*,<sup>221</sup> that neither the Act of State Doctrine nor the principle of comity required the court to let stand the Costa Rican government's unilateral declaration of a moratorium on payments in connection with its external debt.<sup>222</sup> If this precedent is followed, the Act of State Doctrine is probably unavailable for use as an effective defense for sovereign debtors facing collection suits by commercial lenders.<sup>223</sup>

### C. Public Policy

"Public policy," as the term is used in contract law, is a rubric too amorphous to be called a doctrine.<sup>224</sup> Professor Farnsworth refers to it as a "ground for unenforceability."<sup>225</sup> It describes an ever-changing collection of considerations that will occasionally outweigh the strong presumption in favor of freedom of contract.<sup>226</sup> Unlike the doctrines of mistake, misrepresentation, duress and undue influence, public policy as a ground for unenforceability is based "on reluctance to aid the promisee rather than on solicitude for the promisor."<sup>227</sup>

In the case of sub-Saharan Africa, it is arguable that the above de-

---

<sup>221</sup> *Allied Bank*, 757 F.2d at 516.

<sup>222</sup> *Id.* at 522. The *Allied Bank* case involved debts owed by three banks wholly owned by the government of Costa Rica to a syndicate of U.S. and foreign banks. See generally, Robert P. Coyne, Note, *Allied Bank III and United States Treatment of Foreign Exchange Controls: The Effects of the Act of State Doctrine, The Principle of Comity, and Article VIII, Section 2(b) of the International Monetary Fund Agreement*, 9 B.C. INT'L & COMP. L. REV. 409 (1986).

<sup>223</sup> For criticisms of the trilogy of *Allied Bank* cases, see Jonathan M. Clark, Jr., Note, *The Resolution of Act of State Doctrines Involving Indefinitely Situated Property*, 25 VA. J. INT. L. 901 (1985); Carsten T. Ebenroth & Louise E. Teitz, *Winning (or Losing) by Default: Act of State, Sovereign Immunity and Comity In International Business Transactions*, 19 INT'L LAW 225 (1985); Joseph E. Frumkin, *The Act of State Doctrine and Foreign Sovereign Defaults on United States Bank Loans: A New Focus for a Muddled Doctrine*, 133 U. PENN. L. REV. 469 (1985); Roger M. Zaitzeff & C. Thomas Kunz, *The Act of State Doctrine and The Allied Bank Case*, 40 BUS. LAW. 449 (1985).

<sup>224</sup> A nineteenth century English judge described public policy as "a very unruly horse, and when once you get astride it you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail." Burrough, J. in *Richardson v. Mellish*, 2 Bing. 229, 252, 130 Eng. Rep. 294, 303 (1824).

<sup>225</sup> E. ALLAN FARNSWORTH, *FARNSWORTH ON CONTRACTS* § 5.1, at 345 (2d ed. 1990).

<sup>226</sup> *Id.*, citing *Printing and Numerical Registering Co. v. Sampson*, L.R. 19 Eq. 462 (1875):

[Y]ou are not to extend arbitrarily these rules which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice.

<sup>227</sup> *Id.* p. 345, fn. 1. See also, *Sternaman v. Metropolitan Life Ins. Co.*, 170 N.Y. 13, 62 N.E. 763 (1902).

<sup>227</sup> FARNSWORTH, *supra* note 225, at 346. More specifically, Professor Farnsworth states that:

A court may be moved by two considerations in refusing to enforce an agreement on grounds of public policy. First, it may see its refusal as an appropriate sanction to discourage undesirable conduct, either by the parties or by others. Second, it may regard enforcement of the promise as an inappropriate use of the judicial process to uphold an unsavory agreement.

*Id.* at 346.

scribed lending practices of Western commercial institutions<sup>228</sup> do not merit legitimation through judicial enforcement of the resultant loan agreements. The courts, however, have not generally used the public policy approach to expand protection already available through statute or case law based on more conventional doctrine. In the case of the LDC debt crisis, such protection could include the law of usury and, more recently, lender liability theories, which are discussed below. Even when protection based on more conventional legal sources is unavailable, courts have been generally reluctant to refuse enforcement for reasons of public policy, unless the contract at issue is thought to offend a widely held moral value in some basic way. In this context, "moral value" has been narrowly construed along the lines of such issues as gambling, marriage and fiduciary relations.<sup>229</sup>

#### D. Lender Liability

Some commentators argue that various theories of lender liability, including fraud, misrepresentation and coercion, are readily applicable to the facts of the LDC debt crisis.<sup>230</sup> If the best defense is a good offense, it is difficult to imagine a more intuitively appealing position from the debtor countries' point of view than the assertion of lender liability. "Lender liability," which has been described as an emerging doctrine, actually refers to a collection of theories — some old, some relatively new as applied to lenders.<sup>231</sup> The more established theories include

---

<sup>228</sup> See *supra* Part IV, Section B, Subsection 4.

<sup>229</sup> See, e.g., *Cudahy Junior Chamber of Commerce v. Quirk*, 165 N.W.2d 116 (Wis. 1969) (gambling); *Hewitt v. Hewitt*, 394 N.E.2d 1204 (Ill. 1979) (enforcement of cohabitation contracts disfavored as undermining institution of marriage); *Corti v. Fleisher*, 417 N.E.2d 764 (Ill. App. 1981) (contract requiring breach of fiduciary duty).

<sup>230</sup> Professor Jacob Dollinger argues that various theories of lender liability should be applied. "In the U.S. courts the 'lender liability' theory has been raised as a basis to borrowers fighting back against their bank lenders' claims. 'Lender Liability' uses traditional legal theories such as fraud, bad faith, fiduciary responsibility and interference with a business to hold lender accountable for unfairness in calling a loan or mistake made in controlling the management decisions of a debtor in trouble. Dollinger, *supra* note 13, at 147 (citing Debra Cassens Moss, *Borrowers Fight Back With Lender Liability*, 73 Mar. A.B.A.J. 65 (1987)).

I propose that lender liability should be applied where debtor can prove that lender induced him to take the loan without having duly checked borrower's industrial and financial capacity to complete the project for which the loan was being taken and repay it in the agreed upon dates. Banks are usually much better prepared to analyze and evaluate potential debtor's industrial, economic and financial capabilities; this is, after all, their main field of action and income. If lenders of the [developed] countries were imprudent, unwise and reckless it is to be accepted that they are liable in some form and in some proportion for the disastrous consequences of debtor's defaults. Dollinger, *supra* note 13, at 147.

<sup>231</sup> See David T. Lowell, *Lender Liability Revisited*, BANKING L. REV. 38 (1991). See generally, JOSEPH J. NORTON & W. MIKE BAGGETT, *LENDER LIABILITY LAW AND LITIGATION* (1991); WILLIAM M. BURKE, *LENDER LIABILITY* (1992).



fraud, misrepresentation, duress and breach of contract. Most important among the newer theories of lender liability are those based on breach of a fiduciary or quasi-fiduciary relationship between the lender and the borrower.<sup>232</sup>

Successful assertion of such a fiduciary or quasi-fiduciary relationship imposes upon the lender a significantly higher duty than that of good faith — which is required in the performance of all contracts. Furthermore, a lender's breach of this higher duty entitles the borrower to the wider range of tort damages — including punitive damages. A trilogy of California cases marks the path of this development from contract to tort law.

The 1984 case *Seaman's Direct Buying Service, Inc. v. Standard Oil Company*<sup>233</sup> is best known for its recognition of the new tort of intentional and bad faith denial of the existence of a contract. Also in *Seaman's*, however, the California Supreme Court raised the question whether damages based on tort liability should be available in actions based on breaches of commercial contracts.<sup>234</sup> The next year, relying largely on the *Seaman's* dictum, a California Court of Appeal held that a bank's relationship with its depositors was "at least quasi-fiduciary" and, therefore, justified tort liability for breach of the implied covenant of good faith and fair dealing.<sup>235</sup> One year later, a California appellate court extended this quasi-fiduciary duty to include a bank's relationship with a loan customer, where the loan customer had relied heavily on the advice of a bank officer.<sup>236</sup> These three law-changing cases, coming in rapid succession, appeared to have established an important beachhead for debtors' litigation. Subsequent developments, however, appear to have stopped the emerging doctrine in its tracks.

In 1989, a California Court of Appeal held that there is no fiduciary or quasi-fiduciary duty in a regular commercial loan transaction.<sup>237</sup> The court stated that the 1985 and 1986 cases:

are inconsistent with both past authority and current trends in the law. It has long been regarded as "axiomatic that the relationship between a bank and its depositor . . . is that of a debtor and a creditor." . . . "A debt is not a trust and there is not a fiduciary relationship between debtor and creditor as

---

<sup>232</sup> See generally Alvin C. Harrell, *The Bank-Customer Relationship: Evolution of a Modern Form?* 11 OKLA. CITY U.L. REV. 641 (1986); Lawrence F. Flick, II and Dennis Replansky, *Liability of Banks to Their Borrowers: Pitfalls and Protections*, 103 BANKING L. J. 220 (1986).

<sup>233</sup> 36 Cal. 3d 752, 767 (1984).

<sup>234</sup> Tort damages were already available in some cases based on breaches of insurance or employment contracts, because of the special relationships those contracts are said to establish.

<sup>235</sup> *Commercial Cotton Co. v. United California Bank*, 163 Cal. App. 3d 511 (1985).

<sup>236</sup> *Barrett v. Bank of America*, 183 Cal. App. 3d 1362 (1986).

<sup>237</sup> *Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465 (1989).

such." The same principle should apply with even greater clarity to the relationship between a bank and its loan customers.<sup>238</sup>

Two years later, in *Copesky v. Superior Court*,<sup>239</sup> the California Court of Appeal repeated its conclusion that, as a general rule, banks are not fiduciaries for their depositors. The *Copesky* court also stated, in dictum, that it saw no relevant difference between bank-depositor and bank-borrower relationships.

Quite apart from the doctrine's uncertain status, lender liability would fit the facts of the sub-Saharan debt crisis awkwardly, at best. Lender liability has typically been asserted when banks refuse to make or restructure loans. Sub-Saharan Africa's problem, on the other hand, is not the refusal to make or restructure loans, but the making of too many loans that were too large and were imprudent, at best. Moreover, lender liability suits seek contract and even tort damages, whereas LDC debtors should seek excuse, at most, and perhaps mere judicial adjustment, of their contractual obligations. The doctrines discussed below are better suited to this relatively modest objective.

## VI. CONTRACTUAL BASES FOR ADJUSTING SUB-SAHARAN AFRICA'S EXTERNAL DEBT

This Part proposes a solution-oriented reconceptualization of the sub-Saharan debt crisis based on well-established principles of United States contract law. The position advanced below is as follows. First, the burden of repayment has become so onerous as to perhaps render enforcement of the loan agreements unconscionable. Second, the very existence of the many plans described above for dealing with the third world debt crisis (and, indeed, the uniform use of the word "crisis") reflects a general recognition that it is impossible for debtor countries, many of whom are experiencing negative economic growth, to repay their exponentially expanding external debt under the terms of the original or even rescheduled loan agreements. That which is impossible is, *a fortiori*, impracticable. Third, the parties' shared assumptions regarding the debtors' ability to repay based on certain economic "facts" reflect a profound mutual mistake and warrant equitable adjustment of the debt to an amount that reasonably can be repaid.

---

<sup>238</sup> *Id.* at 476 (1989) (citations omitted). See also *Mitsui Manufacturers Bank v. Superior Court of San Diego*, 212 Cal. App. 3d 726 (1989), specifically rejecting the argument that the quasi-fiduciary relationship asserted in *Commercial Cotton* should apply to commercial loan transactions.

<sup>239</sup> 229 Cal. App. 3d 678, 694 (1991).

### A. Excuse From Contractual Obligation, Generally

Though often stated as an absolute, the maxim *pacta sunt servanda* (“agreements are to be observed”) has always been subject to qualification.<sup>240</sup> The important qualifications of — or exceptions to — the rule (i.e., bases upon which a party to a contract can be excused from performing his or her obligations thereunder) are often divided into two categories: (1) those based on circumstances existing when the contract was made (e.g., unconscionability and mutual mistake), and (2) those based on subsequent developments (e.g., impracticability). This distinction seems useful — if only to compartmentalize an amorphous, discretionary and necessarily fact-reliant area of legal doctrine. The incentive to seek clear (if often unimportant) factual distinctions among cases in which parties seek excuse is also enhanced by the “all-or-nothing” nature of the remedy traditionally afforded in such cases: discharge of contractual duties. Often, however, this supposed distinction has no real importance or utility.

Consider the traditional example of a contract to sell a horse that, at the time set for transfer of ownership, is discovered to be dead with no fault attributable to either party. If the horse was dead when the contract was made, performance should be excused based on mutual mistake,<sup>241</sup> if the horse died after the contract was made, excuse should be based on the doctrine of impracticability or its predecessor, impossibility of performance. Because the result is the same, however, the distinction between existing and supervening bases for excuse generally makes little difference.<sup>242</sup>

The position advanced below is that the doctrines of unconscionability, impracticability and mutual mistake are distinguishable but substantially overlapping. The principal differences among the doctrines lie in certain technical requirements of their application, which make unconscionability problematic, impracticability readily arguable, and mutual mistake the most applicable of these doctrines to the facts of the sub-Saharan debt crisis. These three doctrines are discussed below in this descending order of difficulty of application.

The final section of this Part argues that the appropriate solution of the sub-Saharan debt crisis is not excuse but equitable adjustment. Be-

---

<sup>240</sup> Stees v. Leonard, 20 Minn. 448, 451 (1874).

<sup>241</sup> Dover Pool & Raquet Club v. Brookings, 322 N.E.2d 168 (Mass. 1975).

<sup>242</sup> The UCC has abandoned the pretense of such a distinction. U.C.C. § 2-613 governs casualty to identified goods. Comment 2 thereto states simply: “[t]he section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer.”

cause equitable adjustment is a flexible, discretionary and particularly fact-reliant doctrine, all of the facts are relevant. Thus, despite the artificial compartmentalization of these facts under the doctrinal headings below, the whole of the legal argument is in effect greater than the sum of its parts.

The doctrine of unconscionability is arguably the most basic of the excuse doctrines and provides a useful backdrop for consideration of the doctrines of impracticability and mutual mistake.

### B. Unconscionability and the Limits of the Analogy to Private Parties Under United States Law

The doctrine of unconscionability as a basis for relief from contractual obligations is at least three centuries old.<sup>243</sup> In a 1750 English case, an unconscionable agreement was defined as one that “no man in his senses and not under delusion could make on the one hand, and no honest and fair man would accept on the other; which are unequitable and unconscientious bargains; and of such even the Common Law has taken notice.”<sup>244</sup>

Today section 2-302 of the Uniform Commercial Code gives courts broad latitude to consider such fairness issues:

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may limit the application of any unconscionable clause as to avoid any unconscionable result.<sup>245</sup>

Section 2-302 represents a critical innovation because it is not limited to suits in equity. Comment 1 to Section 2-302 states:

This section is intended to make it possible for the courts to police explicitly

---

<sup>243</sup> HOWARD O. HUNTER, *MODERN LAW OF CONTRACTS*, 12-64 (1986).

<sup>244</sup> *Earl of Chesterfield v. Janssen*, 28 ER 82 (1750). The final portion of the quote is a direct reference to the fact that unconscionability arose as an equitable remedy in the context of a bifurcated judicial system and was most frequently advanced as a defense in actions for specific performance. HUNTER, *supra* note 243, at 12-65. Courts of equity were established for the express purpose of exercising greater discretion than did courts of law. Therefore, they were not hesitant to police bargains for substantive unfairness. It is generally acknowledged, however, that courts of law frequently accomplished the same objective by stretching — sometimes torturing — traditional legal defenses such as fraud and failure of consideration. See, e.g., WILLIAM D. HAWKLAND, 2 *HAWKLAND UNIFORM COMMERCIAL CODE SERIES* § 2-302, at 242-43 (1992). The significance of the distinction between legal and equitable remedies is, of course, now greatly diminished. Furthermore, as a practical matter, a suit to collect a debt is the functional equivalent of a suit for specific performance (perhaps with acceleration and/or consequential damages) — whatever the style of such a suit. In any event, developments described immediately below have freed the doctrine of unconscionability from its original theoretical limitation to actions in which an equitable remedy was sought.

<sup>245</sup> U.C.C. § 2-302.

against the contracts or clauses which they find to be unconscionable. In the past, such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract.<sup>246</sup>

Section 2-302 (by the terms of UCC Article Two, of which it is a part) applies only to contracts concerning transactions in goods. It has been widely applied, however, — either by analogy or as a statement of general principle — in actions involving other types of contracts.<sup>247</sup> The Restatement (Second) of Contracts includes a provision analogous to Section 2-302 but not limited to contracts for transactions in goods.<sup>248</sup>

The drafters of the UCC did not define “unconscionable” except, amazingly, by reference to the term itself.<sup>249</sup> The standard is entirely fact-dependent and, thus, inherently imprecise.<sup>250</sup> Professor E. Allan

---

<sup>246</sup> Under UCC section 2-302, a court finding unconscionability may refuse to enforce the entire contract or void or limit the application of the unconscionable provision(s). Thus, despite the doctrine’s significant development since its origins in equity, it is still based on withholding relief, rather than avoidance of obligation. FARNSWORTH, *supra* note 225, § 4.28, at 327. Therefore, unlike the doctrines of duress and misrepresentation, which are bases for avoidance, the doctrine of unconscionability carries no inherent requirement that the claimant make restitution. *Id.*

However, a court using the doctrine of unconscionability could easily accomplish the practical effect of restitution (i.e., repayment of principal) by refusing to enforce only the loan agreement provisions governing computation and payment of interest. Alternatively, a court could void the interest provisions, but then determine that restitution required compensation for the lender’s loss of use of the loaned funds and fill the “gap” in the agreement by establishing a reasonable interest rate. This last proposal is imminently defensible and, indeed, quite modest, considering that some scholars have argued that unconscionability should be actionable as a tort. See King, *The Tort of Unconscionability: A New Tort for New Times*, 23 ST. LOUIS U.L.J. 97, (1979); Note, *The Doctrine of Unconscionability: A Sword as Well as a Shield*, 29 BAYLOR L. REV. 309 (1977).

Of the UCC’s unconscionability provision, Professor Hunter says, “Section 2-302 also allows courts a wide range of discretion in deciding what to do when unconscionability is found. A court . . . may even reform the agreement.” HUNTER, *supra* note 243, § 12.06[2] at 12-71. Professor Hunter describes *Vasquez v. Glassboro Serv. Ass’n*, 415 A2d 1156 (1980) as involving judicial implication of “a condition allowing a ‘reasonable time’ to develop an alternative to performance that was unconscionable.” *Id.* at 12-71, n. 209.

<sup>247</sup> *Zapatha v. Dairy Mart, Inc.*, 408 N.E.2d 1370 (Mass. 1980); *Graham v. Scissor-Tail, Inc.*, 623 P.2d 165 (Cal. 1981); *Weaver v. American Oil Co.*, 276 N.E.2d 144 (Ind. 1971); *Ellsworth Dobbs, Inc. v. Johnson*, 236 A.2d 843 (N.J. 1967); *Bekins Bar V Ranch v. Huth*, 664 P.2d 455 (Utah 1983).

<sup>248</sup> Restatement (Second) of Contracts § 208. California omitted section 2-302 when it first adopted the UCC, but later enacted the substance of the provision without the limitation to contracts for transactions in goods. CAL. CIV. CODE § 1670.5.

<sup>249</sup> UCC § 2-302 Comment 1 provides that the “basic test is whether . . . the clauses involved are so one-sided as to be unconscionable under the circumstances. . . .”

<sup>250</sup> Unconscionable is a word that defies lawyer-like definition. It is a term borrowed from moral philosophy and ethics. As close to a definition as we are likely to get is “that which ‘affronts the sense of decency. . . .’” JOHN D. CALAMARI AND JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS § 9-40, at 406 (3rd ed. 1987)(quoting *Gimbel Bros., Inc. v. Swift*, 307 N.Y.S. 2d 952 (1970)).

Typically, the cases in which unconscionability is found involve gross overall one-sidedness or

Farnsworth asserts that "it is a source of both strength and weakness" that unconscionability "is incapable of precise definition."<sup>251</sup> The relative vagueness of the doctrine is generally compartmentalized, however, into its "procedural" and "substantive" aspects.<sup>252</sup>

The procedural aspect [can be] manifested by . . . "oppression," which refers to an inequality in bargaining power resulting in no meaningful choice for the weaker party. . . . "Substantive" unconscionability, on the other hand, refers to an overly harsh allocation of risks or costs which is not justified by the circumstances under which the contract was made . . . both procedural and substantive unconscionability must be present before a contract or clause will be held unenforceable. However, there is a sliding scale relationship between the two concepts; the greater the degree of substantive unconscionability, the less the degree of procedural unconscionability that is required to annul the contract or clause.<sup>253</sup>

Professor Farnsworth asserts a still more organic relationship between the two traditional aspects of unconscionability: "[u]sually . . . the bargain is infected with something more than substantive unfairness. It is typically mixed with an absence of bargaining ability that does not fall to the level of incapacity or with an abuse of the bargaining process that does not rise to the level of misrepresentation, duress, or undue influence."<sup>254</sup>

The above quotation seems to describe exactly the circumstances under which sub-Saharan Africa's external debt arose. It is easily arguable that the predatory behavior of the banks, coupled with the grossly inferior bargaining power and absence of meaningful choice for the debtor nations, constitutes procedural unconscionability.<sup>255</sup> Moreover, the impact of the massive and exponentially expanding burden of repayment on the already abominable living conditions in most sub-Saharan

---

gross one-sidedness of a term disclaiming a warranty, limiting damages or granting procedural advantages. *Id.*

In what may prove to be a leading case, the court indicated that if a clause places great hardship or risk upon the party in the weaker bargaining position it must be shown that "the provisions were explained to the other party and came to his knowledge and there was in fact a real and voluntary meeting of the minds and not merely an objective meeting." *Id.* at 407 (quoting *Weaver v. American Oil Co.*, 276 N.E.2d 144, 148 (Ind. 1971)).

<sup>251</sup> FARNSWORTH, *supra* note 225, at 327.

<sup>252</sup> See *Guthmann v. La Vida Llana*, 709 P. 2d 675 (N.M. 1985). HUNTER, *supra* note 243, § 12.06[3]; SAMUEL WILLISTON, 15 WILLISTON ON CONTRACTS § 1763A, at 213-215 (3d ed. revised by Walter H.E. Jaeger, 1972).

<sup>253</sup> *Carboni v. Arrospide*, 2 Cal. Rptr. 2d 845, 848 (Cal. App. 1st Dist. 1991). Comment 1 to UCC § 2-302 states "The principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power." The latter part of the quoted passage, however, is simply at odds with the cases. U.C.C. § 2-302 (1992). See, e.g., FARNSWORTH, *supra* note 231, § 4.28, at 332; § 12.06[3], at 73.

<sup>254</sup> FARNSWORTH, *supra* note 225, at 321.

<sup>255</sup> See *supra* Part IV, Section B.

debtor countries would seem to constitute substantive unconscionability. One problem with the application of this doctrine to the sub-Saharan debt crisis is that the sparse authority for the application of the unconscionability doctrine to loan agreements has narrowly defined substantive unconscionability to include only the exaction of excessive interest rates.<sup>256</sup> This is because of the requirement that unconscionability be found as of the time of contract formation.<sup>257</sup> However, this requirement does not preclude a judicial finding that a loan agreement is substantively unconscionable based on its allocation of risk regarding inflation, currency values and other economic variables including rates of growth and development.<sup>258</sup> Thus, although the doctrine of unconscionability has very rarely been applied to loan agreements, there is no logical reason that it should not.<sup>259</sup>

There is, however, a *practical* reason why the doctrine of unconscionability has rarely been applied to loan agreements — namely, the availability to private parties under United States law of the bankruptcy option. A court's consideration of a petition in bankruptcy is not limited to review of just one of the petitioner's credit agreements, or to consideration of the circumstances existing at the time that agreement was reached. A debtor seeking discharge of its obligations through bankruptcy need not prove sharp practice on the part of creditors, unfairness in the relevant agreements or that he or she did not assume the risk of inability to repay. The bankruptcy option may be available even to a debtor who expressly assumes the risk, knowingly borrows far too much and then squanders the loan proceeds in ways that shock the public con-

---

<sup>256</sup> *Carboni v. Arrospide*, *supra* note 253.

<sup>257</sup> See UCC § 2-302(1) and Comment 1. Professor Hunter states:

Courts have consistently rejected unconscionability defenses that were premised on inflation or dramatic shifts in currency values. This is not surprising, in view of the requirement that unconscionability be determined as of the time of contracting, not as of the time of performance. . . . To the extent that there is some dramatic and unexpected change in conditions, the frustration, impossibility, or commercial impracticability defenses may apply, but not unconscionability.

HUNTER, *supra* note 243, § 12.06[5][b], at 12-85. *Martin v. Joseph Harris Co. Inc.*, 767 F.2d 296 (6th Cir. 1985); *Kerr-McGee Corp. v. Northern Utilities, Inc.*, 673 F.2d 323 (10th Cir. 1982).

<sup>258</sup> See, e.g., *Fredonia Broadcasting Corp. v. RCA Corp.*, 481 F.2d 781 (5th Cir. 1973); *Office Supply Co. v. Basic/Four Corp.*, 538 F. Supp. 776 (E.D. Wis. 1982).

<sup>259</sup> In December, 1991, the California Court of Appeal found a loan agreement unconscionable and, in the course of its opinion, stated:

the parties have not cited, and we have not discovered, any case which applies the doctrine of unconscionability to specifically annul or reform a loan which bears a shockingly high rate of interest. Although one respected commentator has suggested that this would be a proper application of the unconscionability doctrine, it appears it has rarely, if ever, been applied in this context. Nevertheless, we believe we may look to cases finding unconscionability on the basis of gross price disparity as analogous authority. In essence, the interest rate is the "price" of the money lent; at some point the price becomes so extreme that it is unconscionable.

*Carboni v. Arrospide*, *supra* note 253, at 81-82.

science.<sup>260</sup> No wonder distressed debtors have not developed the case law in this area by legally challenging their loan obligations one by one using the doctrine of unconscionability.

Citicorp Chairman Walter Wriston once asserted that a sovereign nation "does not go bankrupt."<sup>261</sup> For all practical purposes, however, most debtor nations of sub-Saharan Africa have, indeed, gone bankrupt. The doctrine of unconscionability should not be written off completely in the context of the LDC debt crisis. But even if a debtor overcomes the problem of existing versus supervening conditions and the apparent rigidity of the definition of substantive unconscionability, excuse based on unconscionability still requires a greater showing of hardship than does excuse based on impracticability or mutual mistake.<sup>262</sup> The application of the latter two doctrines to sub-Saharan Africa's external debt is hampered by the same lack of direct case authority as the doctrine of unconscionability, and the reason is the same. However, the different technical requirements of the doctrines of impracticability and mutual mistake make their logical extension into the void left by the absence of the bankruptcy option for sovereign borrowers less problematic.

### C. Impracticability

The doctrine of impracticability is the modern and much liberalized incarnation of the traditional doctrine of excuse by reason of impossibility of performance.<sup>263</sup> When applicable, the doctrine excuses perform-

---

<sup>260</sup> *But see*, 11 U.S.C. 523(a)(2) (1988) (exempting from discharge, debt incurred by false pretenses, fraud, etc.).

<sup>261</sup> Krugman, *supra* note 113, at 142.

<sup>262</sup> *See infra* note 273 and accompanying text.

<sup>263</sup> The doctrine of excuse by frustration of purpose grows ever more closely related to that of impracticability. *See* RESTATEMENT (SECOND) OF CONTRACTS § 265 (1979); FARNSWORTH ON CONTRACTS, *supra* note 225, § 9.7. It sometimes allows a party to terminate or modify his contractual obligations if the underlying purpose or foundation for execution of the contract has changed due to an unforeseeable condition. (The doctrine arises from the Casebook standard, *Krell v. Henry*, 2 K.B. 740 (1903), where the Court excused a prospective tenant from his obligation to pay for a room overlooking the King's coronation route, when the King became ill, and the coronation parade was cancelled.) *Bank of America v. Envases Venezolanos, S.A.* 740 F. Supp. 260, 265-266 (S.D.N.Y. 1990).

"Frustration of purpose . . . focuses on events which materially affect the consideration received by one party for his performance. Both parties can perform but, as a result of unforeseeable events, performance by party X would no longer give party Y what induced him to make the bargain in the first place. Thus frustrated, Y may rescind the contract. Discharge under this doctrine has been limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party." FARNSWORTH, *supra* note 225, at 381; *see also* *Coker Int'l, Inc. v. Burlington Industries Inc.* 747 F. Supp. 1168, 1171 (D.S.C. 1990); *Matter of Fontana D'Oro Foods, Inc.*, 122 Misc.2d 1091, 1095, 472 N.Y.S.2d 528, 532 (Sup. Ct. 1983).



ance "due to intervening events."<sup>264</sup>

### 1. Scope of the Doctrine

Traditionally, excuse based on subsequent developments required that such developments render a party's performance impossible due to, for example, supervening incapacity or illegality.<sup>265</sup> Over the course of the twentieth century, however, courts have expanded the traditional doctrine of impossibility to include those situations where performance of contractual duties is burdened greatly — without necessarily being impossible.<sup>266</sup> In the 1916 case *Mineral Park Land Co. v. Howard*,<sup>267</sup> the court accomplished this important transformation with the following simple assertion: " 'A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at excessive and unreasonable cost.' "<sup>268</sup>

---

<sup>264</sup> United States v. General Douglas MacArthur Senior Village, Inc., 508 F.2d 377, 381 (2d Cir.1974).

<sup>265</sup> See, e.g., *Mulen v. Wareer*, 480 S.W.2d 332 (Ark. 1972); *Louisville & N.R.R. v. Mottley*, 219 U.S. 467 (1911).

<sup>266</sup> "The doctrine of impossibility of performance has gradually been freed from the earlier fictional and unrealistic strictures of such tests as the 'implied term' and the parties' 'contemplation.' " Page, *The Development of the Doctrine of Impossibility of Performance*, 18 MICH. L. REV. 589, 596 (1920)(citations omitted). "It is now recognized that 'A thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost.' " *Transatlantic Financing Corp. v. United States*, 363 F.2d 312, 315 (D.C. Cir. 1966)(quoting *Mineral Park Land Co. v. Howard*, 172 P. 458, 460 (1916)). "The doctrine ultimately represents the ever shifting line, drawn by courts hopefully responsive to commercial practices and mores, at which the community's interest in having contracts enforced according to their terms is outweighed by the commercial senselessness of requiring performance. When the issue is raised, the court is asked to construct a condition of performance based on the changed circumstances, a process which involves at least three reasonably definable steps." *Id.*

*Rebus sic stantibus* is the public international law version of the domestic impracticability doctrine. It is an implied condition of international agreements which excuses parties from performance of their obligations if assumptions or circumstances which were part of the original agreement change, substantially and in an unforeseeable manner, during the course of the contractual relationship. See generally, Ralph G. Steinhardt, *The Role of International Law As a Canon of Domestic Statutory Construction*, 43 VAND. L. REV. 1103 (1990).

Article 62 of the Vienna Convention on the Law of Treaties provides that an international agreement may be terminated due to a fundamental change of circumstances when:

- (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and
- (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

Vienna Convention on the Law of Treaties, May 23, 1969, 1155 U.N.T.S. 331, Article 62.

<sup>267</sup> *Mineral Park Land Co.*, 172 Cal. at 289.

<sup>268</sup> *Id.* at 293. The course indicated by *Mineral Park* has never been reversed. Sixty-five years later, in *Florida Power & Light Co. v. Westinghouse Electric Corp.*, 517 F. Supp. 440 (E.D. Va. 1981), the court stated that "[c]ommon law impossibility, formerly a very harsh doctrine which purported to require a showing of objective or scientific impossibility, has been moderated by case

Roughly a half century later the Uniform Commercial Code played an important role in both codifying and catalyzing the doctrine's liberalization.<sup>269</sup> Section 2-615 of the UCC, entitled "Excuse by Failure of Pre-supposed Conditions," provides:

Except so far as seller may have assumed a greater obligation . . . [d]elay in delivery or non-delivery in whole or in part . . . is not a breach of his duty under a contract of sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made. . . .

Section 261 of the Restatement (Second) of Contracts — not limited, even technically, to transactions in goods — adopts a virtually identical approach:

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

The basic elements of the doctrine require the occurrence or non-occurrence of an event (e.g., sustained economic development) subsequent to the execution of the contract which requires one or both parties to assume burdens and risks that were not contemplated when the contract was made.<sup>270</sup>

The crucial question in applying the doctrine of commercial impracticability to any given situation is whether, due to the "occurrence of an event, the non-occurrence of which was a basic assumption on which the

---

law to the point where it is equivalent to impracticability under the [Uniform Commercial] Code." Westinghouse, 517 F. Supp. at 451.

<sup>269</sup> See *Transatlantic Finance Corp. v. United States*, 363 F.2d 312 (D.C. Cir. 1966).

<sup>270</sup> Restatement § 263 defines the event the "non-occurrence of which (may be) a basic assumption on which the contract was made": If . . . the existence of a specific thing is necessary for the performance of a duty . . . its failure to come into existence or its destruction or deterioration makes performance impracticable, (is an event) . . . "the non-occurrence of which was a basic assumption on which the contract was made." RESTATEMENT (SECOND) OF CONTRACTS § 263.

Under the Uniform Commercial Code, three conditions must be met before a party is excused from performance. . . : "(1) a contingency must occur (2) performance must thereby be made 'impracticable' and (3) the non occurrence of the contingency must have been a basic assumption on which the contract was made." U.C.C. § 2-615. The relevant comments provide: "Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as . . . unforeseen shut-down of major sources of supply . . . which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance is within the contemplation of this action." (citations omitted) *Neal Cooper Grain Co. v. Texas Gulf Sulphur Co.* 508 F.2d 283 (7th Cir. 1974).

Non-delivery is excused under a contract "if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made. . ." U.C.C. § 2-615(a).

contract was made,"<sup>271</sup> the cost of performance has in fact become so excessive and unreasonable that failure to excuse performance would result in injustice. The party seeking excuse from performance must show not only that it can perform only at a loss but also that the loss will be especially severe and unreasonable.<sup>272</sup> This standard, while less than clear, is also something less than the standard of unconscionability.<sup>273</sup>

## 2. Quantification of Hardship

The central inquiry in the modern doctrine of impracticability is whether "the circumstances . . . have made performance so vitally different from what was anticipated that the contract cannot reasonably be thought to govern."<sup>274</sup> This, of course, only begs the question: "how bad must conditions be?"<sup>275</sup>

Although the indebtedness of the sub-Saharan group is low in comparison with the other country groups,<sup>276</sup> it is very high in relation to the affected countries' abilities to repay.

---

<sup>271</sup> Dowlatschahi v. Motorola, Inc. 970 F.2d 289, 294 (7th Cir. 1992).

<sup>272</sup> Gulf Oil Co. v. FPC, 563 F.2d 588, 599-600 (3rd Cir. 1977).

<sup>273</sup> To satisfy this requirement "The frustration must be so severe that it is not fairly to be regarded as within the risks (the obligor) assumed under the contract." RESTATEMENT (SECOND) OF CONTRACTS § 265 Cmt. a.

<sup>274</sup> Eastern Air Lines v. McDonnell Douglas Corp., 532 F.2d 957, 991 (5th Cir.1976).

<sup>275</sup> Professor Sheldon W. Halpern notes that:

[n]otwithstanding the logic and simplicity of *Mineral Park's* equation of impossibility with commercial impracticability, its application has been, at best, idiosyncratic. . . . If the straightforward *Mineral Park* extension of physical impossibility had become the basis for judicial thinking about impracticability, we would now have a body of case law establishing parameters of quantitative impracticability and a set of guidelines more useful than the simple statement that a doubling of cost is insufficient and a tenfold increase is sufficient.

Sheldon W. Halpern, *Application of the Doctrine of Commercial Impracticability: Searching for "The Wisdom of Solomon"*, 135 U. PENN. L. REV. 1123, 1134, n.45 (1987). "[T]he commercial impracticability doctrine is recognized, but rarely allowed as an excuse for nonperformance." McGinnis v. Cayton, 312 S.E.2d 765, 775 (W. Va. 1984) (Harshbarger, J., concurring). Professor Halpern further asserts:

[q]uantification predicated on the entire transactional context and all of the consequences of performance seems particularly consistent with fairness. . . . If, however, one abandons the bifurcation of impracticability into the elements of quantifiable loss and foreseeability, one can develop a qualitative analysis predicated upon 'how different' instead of 'how much' is performance that can serve as an integrating factor in resolving the excuse dispute.

Halpern, *supra* note 275, at 1137-8. Professor Halpern goes on to state "Such a qualitative approach is hinted at in *Asphalt Int'l, Inc. v. Enterprise Shipping Corp.*, 667 F.2d 261 (2d Cir. 1981). The court tried to determine whether, under the circumstances, performance would be 'essentially different from that for which [the parties] contracted . . . [or whether the event] . . . alter[ed] the essential nature of the contract.'" Halpern, *supra* note 275, (quoting *Asphalt Int'l*, 667 F.2d at 266 (2d Cir. 1981)).

<sup>276</sup> As of 1987, Brazil with \$114.5 billion, Mexico with \$105 billion and Argentina with \$49.4 billion had the highest levels of external indebtedness. The South-East Asian group had the second greatest indebtedness.

Africa's external debt in 1988 was approximately \$200 billion with annual debt-servicing requirements of about \$25 billion.<sup>277</sup> The massive burden of this debt and the conditions imposed by lenders have had a substantial negative impact on living conditions in the debtor countries.<sup>278</sup> Attempts by the borrower governments to repay the debt mean less money to spend on public health and development of basic infrastructure. Devaluation of currency means less buying power for citizens. For populations already living in abject poverty, the results can include increased malnutrition and infant mortality.

The hardship of debt and austerity programs generally falls on those least able to pay.<sup>279</sup> As Makgetla states: "In this context, the austerity programs endorsed by the Western banks and their governments worked to support those who sought to place a disproportionate share of the repayment burden on the poor."<sup>280</sup>

### 3. *Foreseeability*

The "basic assumption" rubric in the doctrine of impracticability has sometimes been interpreted as a tacit requirement that the circumstance on which excuse would be based must be supervening and unforeseen.<sup>281</sup> This requirement is surely met here, for neither the lenders nor the sub-Saharan government borrowers were aware that years of drought, civil wars and overwhelming international events such as the oil crises and the end of the cold war, would effectively destroy the debtors' ability to repay the loans.

The 1970s were bad times economically for nearly all sub-Saharan

---

<sup>277</sup> Jacob Haile-Mariam, *Legal and Other Justifications for Writing-off the Debts of the Poor Third World Countries: The Case of Africa South of the Sahara*, 24 J. WORLD TRADE 57, 59, n. 10; see Jane Perlez, *U.S. Forgives Portion of Kenya's Loan Debt*, N.Y. TIMES, Jan. 10, 1990, at D2.

<sup>278</sup> ". . . in virtually all cases, the impact of these programmes on African countries has been basically negative. They have resulted in massive unemployment, falling real incomes, pernicious inflation, increased imports with persistent trade deficits, net outflow of capital, mounting external debts, denial of basic needs, severe hardships and de-industrialization." Onimode, *supra* note 10, at 191.

<sup>279</sup> *Id.* at 599-611. "[T]he available information suggests that in most Third World countries the top ten percent of income earners enjoys between one-third and two-fifths of national income." *Id.* at 602. This disproportionate income distribution also unbalanced national production. "A disproportionate share of domestic output satisfies the demand of the small high-income group for relatively sophisticated consumer goods." Instead of broadening the manufacturing base for domestic consumption and export, this concentration of economic power fixes production on sophisticated consumer goods. *Id.* at 603.

<sup>280</sup> *Id.* at 599.

<sup>281</sup> If the . . . burden was a wholly unforeseeable one at the inception of the term or was so remote as to be of minimal importance, this would suggest that non-occurrence of such a burden was a 'basic assumption' within the meaning of the Restatement. See RESTATEMENT (SECOND) OF CONTRACTS, at 311 (1979).

African countries, principally because of oil price increases and world recession.<sup>282</sup> The 1974 world recession brought multiple economic problems to the non-oil producing countries in developing Africa.<sup>283</sup> The decline in world trade in 1975 had a severe impact on the balance of payments position of most non-oil producing developing countries.<sup>284</sup> The slow-down of growth from 1973 to 1975 seriously hurt the development plans of sub-Saharan African countries.<sup>285</sup> Developmental aid to Africa from all sources fell 20% between 1970 and 1974.<sup>286</sup> This is when the heavy borrowing began, but the "proportion of external capital resources directed to investment declined in favor of balance of payments financing."<sup>287</sup> This pattern of increased borrowing to repay debts remains the central feature of the debt crisis.

As developed countries began to recover from the economic crises of the early 1970s, the rate of inflation began to rise.<sup>288</sup> In 1976, the international financial community started to sense trouble. The IMF began to auction off gold reserves to establish a trust fund to help the neediest developing countries with their balance of payments problems.<sup>289</sup> Also in 1976, the Executive Committee of the Economic Commission for Africa began to move away from development policies aimed at increasing production of one or two major agricultural products for export, diversi-

---

<sup>282</sup> FIELDHOUSE, *supra* note 127, at 104. "Africa's imports of petroleum products in 1974 cost nearly three times as much as in 1973 and it has been estimated that 33 non-oil producing developing countries [had] to spend [\$1.3 billion] on their petroleum in 1974 compared with [\$500 million] in 1973." AEI 1973 at 30.

<sup>283</sup> Survey of Economic and Social Conditions in Africa 1976: Third Biennial Review and Appraisal of Social and Economic Performance in ECA Region in the Second United States Development Decade 5, United Nations (1976) [hereinafter "ECA 1976"].

<sup>284</sup> ECA 1976 at 5. In 1976, of the 47 countries most seriously affected by the external debt crisis, 25 were sub-Saharan African countries. *Id.* at 28.

<sup>285</sup> From 1974 to 1976, 18 non-oil exporting sub-Saharan countries with per capita GDP below \$100 had an average GDP growth rate of 2.5%, and 12 non-oil exporting sub-Saharan countries with per capita GDP between \$100 and \$200, had an average GDP growth rate of -1.1%. Six countries with per capita GDP of over \$300 in 1976, had an average GDP growth rate of 6.7%. Mineral exporting countries such as Zaire and Zambia who had relied on the copper market were hardest hit. Survey of Economic and Social Conditions in Africa 1976-1977 at 2, United Nations (N.Y. 1978) [hereinafter "ECA 1977"].

<sup>286</sup> ECA 1976 at 18-19.

<sup>287</sup> ECA 1976 at 22, quoting 1975 Report of the Development Assistance Committee.

<sup>288</sup> *Id.* at 6. Sub-Saharan African economies remained dependent on Western markets which took 82% of all exports in 1969 and 79% in 1979. FIELDHOUSE, *supra* note 139, at 105. In addition, African exporters faced protectionist tariffs in Western markets. *Id.* Africa's share of world trade dropped by one half, from 18 to 9.2%, between 1960 and 1978. *Id.* Between 1970 and 1974, developing Africa's external debt grew at an annual rate of 21.9%. ECA 1976 at 2.

<sup>289</sup> ECA 1976 at 12-12. In 1965, Zaire's balance of trade was \$14.6 million. AEI 1975, Table XI. By 1975, Zaire's balance of trade had fallen to -\$297.1 million. Mozambique's balance of trade for 1965 was -\$65.2 million and fell to -\$255.0 million by 1975. For the same periods, Zambia's balance of trade fell from \$191.1 million to -\$234.5 million. AEI 1975, Table XI.

fication of agricultural exports, and import substitution, to policies aimed at establishing self-sustaining socio-economic systems less dependent on external trade.<sup>290</sup>

Despite some minor growth in the mid-1980s, almost all sub-Saharan economies declined in virtually every measurable way during the 1970s and early 1980s.<sup>291</sup> From 1981 to 1986, sub-Saharan Africa again experienced widespread drought.<sup>292</sup> The economic decline of sub-Saharan economies was also exacerbated by external factors such as adverse movements in terms of trade, declines in foreign aid and investment, as well as internal factors such as poor soils, poor human<sup>293</sup> and physical infrastructure, rapid urbanization and population growth, and inappropriate public policies.<sup>294</sup>

Ironically, the apparent world wide collapse of communism will probably, at least in the short term, further exacerbate the crisis by eliminating sub-Saharan Africa's geopolitical role in the cold war. The East-West tension of the post WWII period gave both the United States and the Soviet Union reasons to provide substantial financial support to certain countries in sub-Saharan Africa. Some of this money was squandered or simply stolen by incompetent and/or corrupt officials and, in any event, it was not generally intended to benefit Africans.<sup>295</sup> Nevertheless, even if only inadvertently, U.S. and Soviet aid to Africa improved

---

<sup>290</sup> *Id.* at 15.

<sup>291</sup> DONALD L. SPARKS, *Economic Trends in Africa South of the Sahara, 1988*, in AFRICA SOUTH OF THE SAHARA 1989 25 (1989).

<sup>292</sup> *Id.*

<sup>293</sup> Among the relevant demographic issues is the extremely high dependency ratio in sub-Saharan Africa. AEI 1970 at 17. The economically productive age group in a given society is generally assumed to be 15 to 59. Developing Africa's 1970 population was about 340 million with a growth rate of about 2.5%. *Id.* In 1970 there were approximately 42 African countries in which at least 40% of the total population was under 14 years old. *Id.* "A young population is normally associated with a high population growth rate. . . ." Thus the number of older persons "still active enough to supply much accumulated experience is relatively small." *Id.*

In 1970, less than 50% of the primary school-aged children in 35 African countries were attending school. In 20 of these countries the figure was less than 25%, and in five of these countries, fewer than 5% of the children were attending school. *Id.* at 20. This was after developing Africa had made significant progress in education since independence.

In 1960, there were 19.2 million primary school students, 2.0 million at secondary schools and 219,000 in higher education in sub-Saharan Africa. *Id.* By 1970, the totals had increased to 29.0 million in primary, 4.6 million in secondary and 360,000 in higher education. *Id.*

<sup>294</sup> *Id.*

<sup>295</sup> "The allocation of U.S. support for economic development is now weighted heavily in favor of security assistance . . . much of the security assistance goes to developed nations, and even that given to lesser developed countries . . . is not intended to support self-sustaining growth." E. Boyd Wennergren, *U.S. Foreign Assistance and World Poverty: A Forgotten Commitment*, 25 J. DEVELOPING AREAS 169, 170 (1991); see also, generally, W. Raymond Duncan & Carolyn M. Ekedahl, *MOSCOW AND THE THIRD WORLD UNDER GORBECHAV* 167-190 (1990).

the lots of some Africans. With the end of the cold war, however, Soviet aid has abruptly ended, and U.S. aid has, no less abruptly, slowed to a trickle.<sup>296</sup>

These economic and political developments thus meet the rigid “supervening and unforeseeable” standard of the impracticability doctrine even at its most conservative.

This restrictive version of the impracticability doctrine, however, has been widely criticized.<sup>297</sup> Noted contracts scholar E. Allan Farnsworth asserts that “there is no reason why a party should not also be excused on the ground of impracticability or frustration existing at the time of the agreement . . .”<sup>298</sup> and, further, that “[e]xcuse on the ground of existing, as opposed to supervening, impracticability, is well recognized.”<sup>299</sup> Such an approach effectively eliminates the distinction between the doctrine of impracticability and the doctrine of mutual mistake. Unlike impracticability, however, excuse based on mutual mistake requires only that the mistake had a “material effect” on the agreed performances.<sup>300</sup>

#### D. Mutual Mistake

The doctrine of mutual mistake provides generally that when parties enter an agreement under one or more assumptions that are both shared and false, the agreement may be avoided, unless the risk is otherwise allocated by agreement, custom or law.<sup>301</sup> Perhaps because excuse based

---

<sup>296</sup> “On the day that U.S. President George Bush reiterated to Congress the urgency of approving some \$800 million in cash assistance to Panama and Nicaragua to consolidate ‘democratic’ gains, Secretary of State James Baker celebrated the birth of the world’s newest democracy by announcing plans to provide Namibia with \$500,000 this year . . . Washington’s meager contribution to Namibia’s future is emblematic of a clear trend in U.S. assistance to sub-Saharan Africa — it is falling.” Jim Lobe, *Africa: Lower Priority, Lower Aid Dollars for U.S.*, INTER PRESS SERVICE, Mar. 20, 1990. “Once Zaire was an anti-communist bulwark. Last year, as communism collapsed and the conflict in neighboring Angola lost its sting, America restricted aid. This year it froze aid.” *Zaire: The Descent to Darkness*, ECONOMIST, Oct. 19, 1991, at 47. See also, *Remembering Africa*, *supra* note 6, at 33.

<sup>297</sup> “The requirement of absolute non-foreseeability as a condition to the application of the doctrine would be so logically inconsistent that in effect it would nullify the doctrine. . .” 529 F. Supp. 826 (dist. date). [To require a complete absence of foreseeability would] “practically destroy the doctrine of supervening impossibility, notwithstanding its present wide and apparently growing popularity.” *L.N. Jackson & Co v. Royal Norwegian Gov’t*, 177 F.2d 694, 699 (2d Cir. 1949). “[B]oth the Code and the Restatement have specifically rejected the test of foreseeability as the only standard by which to measure impracticability. . . .” Paula Walter, *Commercial Impracticability in Contracts*, 61 ST. JOHN’S L. REV. 225, 237 (1987).

<sup>298</sup> FARNSWORTH, *supra* note 225, at 53.

<sup>299</sup> *Id.*

<sup>300</sup> *Guthrie v. Times Mirror Co.*, 51 Cal. App. 3d 879 (1975).

<sup>301</sup> RESTATEMENT (SECOND) CONTRACTS, §§ 152, 154; CALAMARI AND PERILLO ON CON-

on mutual mistake requires only a showing that the mistake had a material effect on the agreed performance, availability of the doctrine is limited in two important ways. First, the mistake must relate to a fact existing when the contract is made.<sup>302</sup> Second, as compared with impracticability, it is said to be more likely that one of the parties will be deemed to have borne the risk in a case involving a claim of mutual mistake.<sup>303</sup> These limitations have been seriously questioned, however, by at least one court. In the 1980 case *Aluminum Company of America v. Essex Group* ("ALCOA"),<sup>304</sup> a United States District court used the doctrine of mutual mistake to reform and equitably adjust a long term contract.

### 1. *The ALCOA Case*

*ALCOA* involved a long term service contract under which the aluminum company was to convert alumina into molten aluminum for Essex Group. The contract included a flexible price provision with an escalator clause tied, in part, to the federal government's Wholesale Price Index ("WPI"). The parties expected that fluctuations in the WPI would accurately reflect fluctuations in Alcoa's non-labor costs and, thus, provide an independent and objective standard by which contract price could be adjusted from time to time.

Less than half way into the contract's sixteen year term, it became clear that the WPI-based formula was not working as intended. ALCOA experienced cost increases not adequately reflected by corresponding proportional increases in the WPI. As a result, ALCOA stood to lose more than \$60 million out of pocket during the remaining term of the contract. ALCOA brought suit, based, in part, on mutual mistake and seeking reform or equitable adjustment of its agreement with Essex Group.

The United States District Court quickly dismissed an argument by Essex that because it had sought only to protect its own interests when the contract was negotiated, it could not be a party to any mistake con-

---

TRACTS, § 9-26, at 379. The doctrine of mutual mistake operates to excuse performance of obligations under contracts entered into by parties who shared a common misconception regarding a basic assumption upon which the contract was based. The same rule holds if the parties are operating under differing mistakes about the same vital fact. It is immaterial whether the mistake relates to factors traditionally stressed as most likely to be vital such as to the identity of the subject matter. The important thing is that it be a basic assumption upon which both parties acted. CALAMARI AND PERILLO ON CONTRACTS § 9-26; see also *United States v. Garland* 122 F.2d 118 (4th Cir. 1941), cert. denied, 314 U.S. 685 (1941). Compare *Allen v. Hammond*, 36 U.S. (1 Pet.) 63 (1837); *Hitt v. Cox*, 737 F.2d 421, 424 (4th Cir. 1984).

<sup>302</sup> *Dover Pool & Raquet Club v. Brooking*, 322 N.E.2d 168 (Mass. 1975).

<sup>303</sup> *Handicapped Children's Education Board v. Lukaszewski*, 332 N.W.2d 774 (Wis. 1983).

<sup>304</sup> 499 F. Supp. 53 (W.D. Pa. 1980).



cerning the extent to which the WPI-based formula would effectively protect Alcoa's interests.<sup>305</sup> The court stated that "[w]hile [Essex] did not share the motive to protect ALCOA, [Essex] understood the functional purposes of the agreement. [Essex] therefore shared this mistake of fact."<sup>306</sup> The court then distinguished cases in which one party "assumed or bore the risk,"<sup>307</sup> and went on to state:

where parties enter a contract in a state of conscious ignorance of the facts, they are deemed to risk the burden of having the facts turn out to be adverse, within very broad limits. . . . If, by contrast, the parties both mistakenly believe [a "fact" that later proves untrue], the case is said not to be one of conscious ignorance but one of mutual mistake.<sup>308</sup>

The loans made to sub-Saharan debtor nations, like all true loans, were made based on the shared assumption that repayment could and would occur. Subsequent developments have proved this assumption false. Under the doctrine of mutual mistake, however, the question is whether the assumption of future ability to repay was false *at the time it was made*. In other words, have these subsequent developments rendered the assumption invalid, or have they merely demonstrated that the assumption was invalid *ab initio*? The theory of structural dependency suggests that the latter is the case.

## 2. *Structural Dependency Theory*

Some commentators have explained the third world debt crisis in terms of a relational analysis that has come to be known as structural dependency theory. This view is not mutually exclusive — or even inconsistent — with the widely accepted "oil shock" attribution outlined in Part II above. Structural dependency theory, however, is much broader and decidedly more pessimistic, suggesting that the hierarchal relationship between the developed and developing worlds is permanent and that the economic gap between the two must inevitably grow. Professor John Baloro's view is representative:<sup>309</sup>

---

<sup>305</sup> *Alcoa*, 499 F.Supp. 53, 64 (W.D. Pa. 1980).

<sup>306</sup> *Id.*

<sup>307</sup> *Id.* at 66-67.

<sup>308</sup> *Id.* at 68. Additionally, although the contract included a detailed and specifically negotiated *force majeure* provision intended to protect ALCOA, the court declined the invitation to employ the principle of construction expressed in the maxim "*expressio unius est exclusio alterius*." *Id.*

<sup>309</sup> "Dependency theory" is the shorthand description of a large and well established body of economic/political literature addressing the relationship between the LDCs and the Western industrialized countries. *See, e.g.*, FERNANDO H. CARDOZO & ENZO FALETTA, *DEPENDENCY AND DEVELOPMENT IN LATIN AMERICA* (Majority M. Urquidi trans., 1979); J. Samuel Valenzuela and Arturo Valenzuela, *Modernization and Dependency: Alternative Perspectives in the Study of Latin American Development*, 10 COMP. POL. 535-57 (1978); and ANDRE GUNDER FRANK, *DEPENDENT ACCUMULATION AND UNDERDEVELOPMENT* (1979).

[T]he nature and background of the debt problem clearly antedates the "oil crisis." . . . The character of the economic relationship [between the LDC's and the Western industrialized countries] . . . has been defined by an international division of labor which has served to condemn the developing countries into the role of producers of industrial raw materials for the industries of Western Europe and North America. . . . In an ordinary situation of balanced trade and exchange, there would be nothing wrong with [this]. . . . However, from the time of colonial encounter to this day, the relationship has worked itself into an utterly lopsided one . . . the prices of the exports of the primary producers are not determined by them but are unilaterally fixed by the buyers.<sup>310</sup> . . . On the other hand, Third World consumers of [manufactured] products have virtually no influence over their pricing. . . . [T]he long-term payment deficits of these countries . . . have been caused by the unjust terms of trade existing between them and the industrialized world. . . . [T]he debt problem is merely the superstructural symptom of this unbalanced relationship.<sup>311</sup>

Simply put, structural dependency theory suggests that the factors rendering performance impossible were, though perhaps unknown to the parties, present from the outset. If export earnings lag behind import expenditures, and the gap inevitably grows, there is no realistic (or even theoretical) "way out" for the LDCs. To appreciate the debt-specific ramifications of this view, one must understand, *inter alia*, the concepts of "net transfer" and "debt service ratio." "Net transfer" is the difference between the gross amount of new loan money flowing into a debtor country and the cumulative foreign "debt service" obligation of that country (including principal and interest).<sup>312</sup> "Debt service ratio" is the ratio, expressed as a percentage, of debt service (as defined immediately above) to export earnings.<sup>313</sup> Each of these measures compares income from a different source (one borrowed, the other earned) to the accumulated cost of borrowing to date. A negative net transfer is good for a debtor country only if that country is successfully reducing its principal indebtedness and is able to fund the negative transfer from export earnings without undermining its development program or injuring the living standard of its people. No country in sub-Saharan Africa has been, or is now, able to do this.<sup>314</sup>

United Nations studies indicate that the net transfer into sub-

---

<sup>310</sup> "In 1985, 81% of [sub-Saharan] Africa's exports went to the Western industrialized countries (with the USA being the largest consumer). In the same period [sub-Saharan] Africa bought about the same proportion of its imports from these countries (with France the largest supplier)." Sparks, *supra* note 291, at 25.

<sup>311</sup> Baloro, *supra* note 159, at 141-2.

<sup>312</sup> Cheryl Payer, *Causes of the Debt Crisis, in THE IMF, THE WORLD BANK AND THE AFRICAN DEBT*, *supra* note 10, at 7, 8.

<sup>313</sup> *Id.* at 9.

<sup>314</sup> See *infra* Part IVB.

Saharan Africa in 1978 was about 20 billion dollars; by 1985 it had fallen to a rate of three billion dollars annually, and by the end of 1986 net transfer had turned negative.<sup>315</sup> Thus, although the trend had been ascertainable for many years, in 1986 it became graphically clear that sub-Saharan Africa's sovereign loan obligations exceeded — and were growing faster than — loan income.<sup>316</sup> At about the same time, the Organization of African Unity ("OAU") estimated that debt service was consuming about 40% of sub-Saharan Africa's export earnings.<sup>317</sup> For many individual African countries, the debt service ratio was already far higher than 40%.<sup>318</sup> The crisis is almost certainly beyond the control of the LDC debtors. One commentator explained:

Central to most dependency approaches to the political economy of development and underdevelopment is the notion that LDC's are inordinately vulnerable to events, processes, and forces that originate in the capitalist world economy . . . the economies of less-developed countries are structurally conditioned by the nature of their linkage to the international political economy. Typically, the international division of labor is one in which the LDC's export raw materials at relatively cheap prices to the countries of the industrial core, which convert these materials into finished goods and sell them to the LDC's at comparatively high cost. Such unequal terms of trade, in turn, produce serious balance of payments difficulties . . . [it has been] estimated that more than 80% of the increase in LDC external debt from 1973 to 1982 can be attributed entirely to the influence of external factors.<sup>319</sup>

As a general rule, the higher the level of development, the lower the ratio of primary activity, and the higher the ratio of manufacturing activity, to total production.<sup>320</sup> Agriculture is the largest single contributor to most African economies, accounting for an average of 39% of GDP.<sup>321</sup>

---

<sup>315</sup> Baloro, *supra* note 159, at 142.

<sup>316</sup> If dependency theory is right, and the reversal of net transfer is an inevitable tendency, one would expect the International Monetary Fund would (1) understand, and (2) — not being profit-motivated — resist this phenomenon. But "[e]ven the IMF . . . received approximately \$4.5 billion dollars more in interest charges and repayments than it extended in new credit in 1986." Garg, *supra* note 4, at 47.

<sup>317</sup> Baloro, *supra* note 159, at 142.

<sup>318</sup> The OAU's estimates of individual countries' debt service ratios for 1987 include the following: Sudan 204%; Zambia 100%; Madagascar 87%; Togo 54%; Ghana, Malawi and Uganda 50%. *Id.*

<sup>319</sup> William P. Avery, *The Origins of Debt Accumulation Among LDC's in the World Political Economy*, 24 J. DEV. AREAS 503, 506-507 (1990). Most countries of sub-Saharan Africa depend on one or two commodities for 70% or more of their export earnings. *Remembering Africa*, *supra* note 6, at 33.

<sup>320</sup> AEI 1968 at 21.

<sup>321</sup> Between 1960 and 1970, agriculture's real rate of growth was only 2.2%. In 1960, manufacturing contributed 11% to Africa's GDP. By 1970, manufacturing accounted for 17% of Africa's GDP. AEI 1970 at 14, 24.

In countries where agriculture is not dominant, mining is of special importance.<sup>322</sup> The disproportionate role of the two primary activities of agriculture and mining explains the low level of productivity in sub-Saharan Africa.<sup>323</sup> The Structural Adjustment and Economic Recovery Programs of the IMF and the World Bank have not effectively addressed, or even confronted, the problems inherent in this set of international economic relationships. Some analysts suggest that the IMF/World Bank programs and the often identical conditions required (i.e., effectively imposed) by commercial lenders have only exacerbated the problem.<sup>324</sup>

Some observers see the debt crisis as symptomatic of "a fundamental contradiction in U.S. economic policy toward the Third World."<sup>325</sup> Dr. Cheryl Payer contends that, contrary to basic capitalist economic theory, private investment capital has not generally flowed into the capital starved LDCs. This void was filled, in significant part, by United States foreign aid programs which were begun in the 1950s "as a means of supporting anti-communist governments in the Middle East and in Asia."<sup>326</sup>

---

<sup>322</sup> In 1960, mining contributed 4% to GDP. This proportion grew to 16.8% of GDP by 1970. AEI 1970 at 11.

Principal export product revenues as a percentage of overall export earnings (average for 1980-1982)

Uganda (coffee)	96	Madagascar (coffee)	47
Burundi (coffee)	90	Mali (cotton)	46
Zambia (copper)	89	Zaire (copper)	43
Rwanda (coffee)	68	Burkina Faso (cotton)	40
Ethiopia (coffee)	65	Sudan (cotton)	39
Ghana (cocoa)	59		

Source: Amex Bank (1983), quoted in *International Debt Restructuring, Substantive Issues and Techniques*, supra note 14, at 7.

<sup>323</sup> *Id.* In 1970, only five commodities accounted for 60.9% of all exports from developing Africa: crude petroleum, copper, coffee beans, raw cotton, and cocoa beans, with crude petroleum representing 30.9% of total exports. *Id.* at 21. Only a few sub-Saharan countries have oil exports; most rely on the latter four. In 1970, 95.3% of Zambia's export earnings and over 65% of Zaire's export earnings came from copper. *Id.* at 26. Coffee and cocoa represented over 50% of Cote D'Ivoire's exports in 1970. *Id.* at 23, tables. A falling international market for such commodities would be disastrous for the balance of payments of any "one crop" economy. *Id.* at 26.

<sup>324</sup> "On the global scale, the overall impact of Fund and Bank policies and programmes has been the strengthening of the international capitalist division of labour with a widening of the gap between rich and poor countries and the increasing external dependence of the Third World." Onimode, supra note 10, at 192.

<sup>325</sup> Payer, supra note 312, at 7.

<sup>326</sup> *Id.* at 8. In his 1949 inaugural address, President Truman declared that:

we must embark on a bold new program for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas. . . . I believe that we should make available to peace-loving peoples the benefits of our store of technical knowledge in order to help them realize their aspirations for a better life.

E. Boyd Wennergren, *U.S. Foreign assistance and World Poverty: A Forgotten Commitment*, 25 J. DEVELOPING AREAS 169 (1991).

Subsequent loans to the LDCs are an outgrowth of those aid programs but must, by definition, eventually reverse the flow of capital so that, in the end, the money is flowing out of the LDCs.<sup>327</sup>

The original loans were made based on the shared assumption that the economies of the debtor nations would grow at a relatively consistent rate, and that those nations, once endowed with financial support, would blossom into economic stability. This mutual assumption was profoundly mistaken. As structural dependency theory helps to demonstrate, repayment of the loans did not merely *become* impossible; it was impossible from the outset.

Sub-Saharan Africa's external, sovereign debt thus arose out of mutually mistaken assumptions, and if repayment is impracticable due to both existing circumstances and supervening developments, the question remains: what is to be done? Put differently, if objective impossibility of repayment is a fact of which judicial notice should be taken, how should fundamental adjustment — amounting to substantial discharge — of the debt be accomplished? The answer may lie in the discretionary judicial device of equitable adjustment.

### E. Equitable Adjustment

In contrast to the all-or-nothing nature of contractual excuse doctrines as traditionally applied,<sup>328</sup> an increasing number of commentators have taken the position that contracts found to be unconscionable or based on mutual mistake, or whose performance has become impracticable, should be judicially modified.<sup>329</sup> This approach is often called equitable adjustment and has been described thusly:

---

<sup>327</sup> Payer, *supra* note 312, at 7-8.

<sup>328</sup> See *supra* Part VI, Section A.

<sup>329</sup> Equitable adjustment is perhaps best understood in the context of the relational approach to contracts. Professor Sheldon W. Halpern summarizes the relational approach as follows:

The contract is a skeleton-like structure upon which the relationship is built, intended to do little more than describe the general policy governing the relationship. Under this view, when a supervening event renders a party's performance impracticable, fairness within the context of the relationship may require a sharing of the consequential losses between the parties. It is not unreasonable to posit an unarticulated 'duty to adjust' (footnotes omitted).

Halpern, *supra* note 275, at 1129.

Professor Ian R. Macneil describes the rationale for this approach:

Somewhere along the line of increasing duration and complexity, trying to force changes into a pattern of original consent becomes both too difficult and too unrewarding to justify the effort, and the contractual relation escapes the bounds of the neoclassical system. That system is replaced by very different adjustment processes of an on-going administrative kind. . . . This includes internal and external dispute resolution structures. At this point, the relation has become a mini-society with a vast array of norms beyond the norms centered on exchange and its immediate processes.

Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Law*, 72 Nw. U. L. REV. 854, 901 (1978).

Rather than simply allowing avoidance of performance, some have proposed a more flexible right to withhold performance pending modification of the original contract to reflect a sharing of the benefits and burdens generated by the disruptive event. Although the arguments for excuse and modification may differ, the thrust of each is the same: the law ought to require the advantaged party to adjust the original agreement.<sup>330</sup>

To date, only *ALCOA* has embraced this approach wholeheartedly,<sup>331</sup> but the *ALCOA* court made it clear that it did not consider its action to be of a sort that should be reserved for extraordinary circumstances. "The question of defining the risks *ALCOA* assumed is one of interpretation. It implicates no strong public policy."<sup>332</sup> If, as suggested below, the sub-Saharan debt crisis implicates strong considerations of public policy, the case for equitable adjustment is even stronger than it was in *ALCOA*.

*ALCOA* and the doctrine of equitable adjustment have been written about extensively and are not without contrary authority and commentary.<sup>333</sup> Professor Clayton P. Gillette's view is representative and well articulated. In an article opposing adjustment, written five years before the *ALCOA* decision, Professor Gillette states his position thusly:

If a commercial actor is able to bargain with uncertainty in mind, I suggest the law ought to consider a such [sic] bargain the product of a cognitive and analytical process for which the actor can be held accountable, notwithstanding the intervention of specific events that the actor did not predict. . . . I therefore reject recent commentary that views contract necessarily as a communitarian exercise and instead adopt a conception of contract as a mechanism for individual expression by commercial actors

---

<sup>330</sup> Clayton P. Gillette, *Commercial Rationality and the Duty to Adjust Long-Term Contracts*, 69 MINN. L. REV. 521, 522 (1985)(footnotes omitted).

<sup>331</sup> The court also helped to erode the somewhat artificial distinctions among the excuse doctrines. Even after acknowledging that the aluminum company had, to date, made a net profit of nine million dollars on the contract, the court stated that — based on the projected cost of complete performance by *ALCOA* — "if this case required a determination of the conscionability of enforcing this contract in the current circumstances, the Court would not hesitate to hold it unconscionable." *Aluminum Company of America v. Essex Group*, 499 F.Supp. 53, 66 (W.D. Pa. 1980). The quoted passage clearly implies both that equitable adjustment does not require a determination of unconscionability and that such a determination, if necessary, could be based on post-execution developments demonstrating a mutually mistaken assumption in contract formation.

The court was not deterred from equitably adjusting the contract by the possibility of continuing involvement in the relationship of the parties. "Since the effect of this decision is to modify the contract but to keep it in force, both parties may be adequately protected against severe and surprising economic developments. Each continues to have recourse to the courts." *Id.* at 66, n.7. The District Court's decision never took effect, however, because the case was settled. "The parties renegotiated their arrangement. . . . The decision plus the appellate process worked as a form of coercive mediation." Stewart MacCaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 476 (1985).

<sup>332</sup> *ALCOA*, 499 F.Supp. at 69.

<sup>333</sup> See, e.g., John P. Dawson, *Judicial Revision of Frustrated Contracts: the United States*, 64 B.U.L. REV. 1, 28 (1984); *Leasco v. Taussig*, 473 F.2d 777 (2d Cir. 1972).

capable of considering and bearing the consequences of reasoned choice.<sup>334</sup> This, of course, is no more than old fashioned *pacta sunt servanda* and *caveat emptor*. But Professor Gillette goes on to develop a “nonadjustment model” that he says rests on three assumptions.<sup>335</sup> The first is “that the contract does not impose significant costs on non parties, that is, that there are minimal externalities.”<sup>336</sup> The second assumption is that both parties to the contract are “self-interested actors.”<sup>337</sup> The third assumption is that, in negotiating the contract, each party will consider each term to be a matter of either certainty, risk or uncertainty.<sup>338</sup> But a critical fourth assumption is revealed later: “[t]he nonadjustment model assumes that each party to a contract has dickered about terms to the extent necessary to serve his self-interest.”<sup>339</sup>

The first, third and fourth of Professor Gillette’s assumptions are simply inaccurate as applied to the agreements underlying sub-Saharan Africa’s debt, and, because the second assumption has meaning only in connection with the fourth, it too is inapplicable.

Criticisms of equitable adjustment are most persuasive when applied to arm’s length market transactions in which the parties have meaningful alternatives. Professor Gillette’s “hard ball” approach is particularly inappropriate, however, when massive externalities and major issues of public policy are present, as with the third world debt crisis in general, and sub-Saharan Africa’s debt crisis in particular.

In theory, the governments of sub-Saharan Africa’s debtor countries are the representatives and agents of their respective populations, and sub-Saharan Africa’s massive external debt was incurred to advance the interests of the people of the debtor countries. In fact, for reasons including, but not limited to, government incompetence and corruption, it is simply absurd to conclude that the suffering masses in sub-Saharan Africa “assumed the risk.” These populations are innocent third-party victims of agreements between lenders and debtor country governments. Their suffering is an “externality” that should not be ignored.

---

<sup>334</sup> Gillette, *supra* note 330, at 524. Specifically criticizing equitable adjustment, Professor Gillette goes on to say that:

This invocation of law to require adjustment between the parties to relational contracts rests on two often unstated assumptions: first, that opportunism will cause an undesirable breakdown of the relationship in the absence of constraints and, second, that uncertainty prevents the parties from providing the necessary constraints at the negotiation stage.

*Id.* at 556. Professor Gillette’s implication is that either or both of these assumptions are often untrue. As regards sub-Saharan African debt, however, both are accurate.

<sup>335</sup> *Id.* at 527.

<sup>336</sup> *Id.*

<sup>337</sup> *Id.* at 528.

<sup>338</sup> *Id.* at 529, 530.

<sup>339</sup> *Id.* at 552.

It is also in the political and economic self-interest of the United States and other developed countries to seek solution of the LDC debt crisis. In a 1992 speech to the United Nations Conference on International Trade and Development, IMF Managing Director Michael Camdessus said:

The momentous changes in the political and economic framework are bringing new opportunities, but these are accompanied by many risks . . . the risks are immediate. They are with us now and they are pressing. Some of these risks are sufficiently serious that they could prevent us from reaping the potentially rich harvest of our efforts . . . the next few years, therefore, will be a time of great risks — risks that “adjustment fatigue” may be matched by “donor fatigue,” and risks of all possible kinds of vicious cycles, as failure in one area might contribute to failure in another.<sup>340</sup>

As briefly outlined in the Introduction to this article, the economic situation in most sub-Saharan African countries is bad, and in many it is rapidly deteriorating. In many cases, the result has been worsening living conditions for those already worst off, as the burden of economic hardship is shifted inevitably to those unable to resist its imposition.<sup>341</sup> A growing gap between the “haves” and the “have nots,” combined with an absence of any realistic prospect of upward mobility, is a tremendously destabilizing factor in any society.<sup>342</sup>

In many sub-Saharan African countries, therefore, there is considerable internal pressure for substantive political and economic change. A recent report in *The Economist* put it bluntly: “After 30 years of rule by thieves and autocrats, Africans are saying ‘enough.’”<sup>343</sup> Because command-style central planning has been abruptly discredited at the international level, and its African adaptations have uniformly failed to produce meaningful economic growth, the current socio-political firmament represents an historic opportunity to encourage broad scale democratic reforms.<sup>344</sup>

---

<sup>340</sup> Michel Camdessus, speaking to the United Nations Conference on Trade and Development VIII in Cartagena, Columbia, February 11, 1992, reported in *IMF Survey*, Feb. 17, 1992, at 60-61.

<sup>341</sup> In Zaire, for example, “Parliament, its members well supplied with houses, cars, lucrative contracts and outright bribes, is supine before the presidential whim. Frightful, and worsening, poverty has fuelled uncontrollable discontent. Corruption on a heroic scale has made economic disaster inevitable. . . .” *Descent to Darkness*, supra note 296, at 47.

<sup>342</sup> See, e.g., *Report of the National Advisory Commission on Civil Disorders*, 251-257 (1968).

<sup>343</sup> *Africa's New Drumbeat*, *ECONOMIST*, June 22, 1991, at 46.

<sup>344</sup> In Zambia, for example, the staple food, maize, is scarce. “Most Zambians buy it on the black market; in towns they pay double the official price, in rural areas (where they are poorer still) they pay at least four times that. Townspeople are tempted to riot, as they did when the government tried to raise the price in June 1990. Country people will just go short. The blame lies not with the usual African trioka of war, pestilence and drought, but with the command economics. . . .” *Zambia: Out of the Maize*, *ECONOMIST*, Oct. 5, 1991, at 44.



Zambia, for example, in 1991 scheduled the first multi-party elections to be held there since that country won independence in 1964. President Kenneth Kaunda's United National Independence Party ("UNIP") had been in power since then and had been the only authorized political party since 1972.<sup>345</sup> As the election approached, *The Economist* reported that, due primarily to deteriorating living conditions in Zambia, UNIP was expected to lose to a broad based coalition called the Movement for Multi-party Democracy ("MMD"):

The opposition's advantage is that the government has for a decade failed to stop people getting poorer. The roads have decayed. Most hospitals are understaffed and lack the most basic drugs. Schools have few textbooks, desks or chairs, so that most pupils must sit on the floor. The bloated civil service is aimless, underpaid and corrupt.<sup>346</sup>

The MMD did, indeed, win the Zambian election, and it was reported that "[t]he new president has a mandate for change, whatever change may be."<sup>347</sup>

Change does not always come smoothly. In Nigerian elections held at about the same time as those in Zambia, it was reported that "bribery was rife . . . supporters of at least one candidate openly handed out 20 naira (\$1) notes to anybody willing to stand in their man's voting line. . . . Violence continues to march alongside the military government's six year transition to democracy."<sup>348</sup>

Recent developments in Kenya demonstrate the potential effectiveness of external financial incentives where one-party government is already facing internal pressure for reform. In March, 1991, an opposition magazine in Kenya declared that:

The time is nigh when all foreign aid agencies should pause and reevaluate their continued economic support to this country. Earlier calls for conditioning economic aid by political reform should be put into practice now. . . . Foreign aid agencies should realize that without a democratic system and provisions for multi-parties; parties that would have a strong and effective opposition to the ruling party, the tendency is the development of a monolithic one-party state of laxity and inefficiency.<sup>349</sup>

---

<sup>345</sup> *Zambia: Revolution by Ballot*, *ECONOMIST*, Oct. 26, 1991, at 49.

<sup>346</sup> *Id.* at 49, 52.

<sup>347</sup> *Zambia: In the End, A Graceful Exit*, *ECONOMIST*, Nov. 9, 1991, at 44. "Mr. Kaunda has always blamed Zambia's economic collapse on external forces: the oil crisis of the mid 1970s, sanctions against Ian Smith's Rhodesia, poor prices for the copper on which Zambia depends for 90% of its foreign exchange earnings. President Chiluba points to ineptitude and corruption in Mr. Kaunda's government, and says that Zambians themselves must revive the economy by hard work, discipline, honesty and determination." *Id.*

<sup>348</sup> *Nigeria: Attention*, *ECONOMIST*, Oct. 26, 1991, at 52.

<sup>349</sup> Mburu Wa Kiago, *Of Debt Relief, Accountability and Political Reforms* 31, *NAIROBI L. MONTHLY* 39 (1991).

Eight months later, *The New York Times* reported that “[t]he United States and other aid-donor nations told Kenya today to introduce political and economic reforms and improvements in human rights or face major cuts in aid in six months.”<sup>350</sup> Within a week, Kenya’s only legal political party, the Kenya African National Union, followed President Daniel arap Moi’s direction and called for legalization of rival parties, which had been formally banned in 1982.<sup>351</sup>

The Kenyan example and others like it indicate that the current combination of (1) indigenous pressure for reform and (2) the disappearance of geopolitical competition between the cold war superpowers presents an important opportunity to encourage progressive political and economic reform. Progressive reform will help to improve living conditions,<sup>352</sup> which in turn will help to stabilize societies. Stability will better protect the interests of foreign lenders and investors and facilitate national economic development and international economic integration.<sup>353</sup> Thus, it is in the self-interest of the United States and other developed countries to aggressively pursue comprehensive solution of the LDC debt crisis. Among the LDC debtors, sub-Saharan Africa’s situation is by far the most urgent.

## VII. IMPLICATIONS OF THE CONTRACTUAL APPROACH

The contractual analysis described above suggests the following. First, the burden of repayment has become so onerous as to perhaps render enforcement of the loan agreements unconscionable. Second, it is

---

<sup>350</sup> Steven Greenhouse, *Aid Donors Insist on Kenya Reforms*, N.Y. TIMES, Nov. 27, 1991, at A1. The report went on to say that

Donor nations and international institutions like the World Bank have given Kenya about \$800 million in development aid over each of the past two years — a figure equal to perhaps a third of the Kenyan Government’s annual budget . . . Kenya has long been one of the largest recipients of aid in Africa south of the Sahara because in the past the former British colony was a bright spot for economic development and political freedom in Africa. But in recent months aid donors have reconsidered their aid to Kenya as repression has grown and economic policies have stumbled. . . . Over the past month, the . . . Government has arrested top opposition figures and used guns and batons to break up a pro-democracy march. [Kenyan President] . . . Moi and close associates of his in the Government are widely believed to have become wealthy men over the years.

*Id.*

<sup>351</sup> *Kenya: Cash Counts*, ECONOMIST, Dec 7, 1991, at 50.

<sup>352</sup> Among the findings and recommendations of a recent (U.S.) presidential mission regarding “Child Survival and Aids in Sub-Saharan Africa” is the following:

Healthy economies provide the resources for healthy children. United States policy should continue to emphasize broad-based economic growth that help create an environment in which health programs will be sustainable and effective.

Levinson, *supra* note 2, at 497-503.

<sup>353</sup> See generally, E. Wayne Nafziger, *African Capitalism, State Power and Economic Development*, 28 J. MOD. AFR. STUD. 1 (1990) 141; DAVID BEVAN, ARNE BIGSTEN, ET AL., *East African Lessons on Economic Liberalization* (1987).

impossible and, *a fortiori*, impracticable that sub-Saharan debtor countries, many of whom are experiencing negative economic growth, can repay their exponentially expanding external debt, even as rescheduled. Third, the parties' shared assumptions regarding debtors' ability to repay based on certain economic "facts" reflect a profound mutual mistake and warrant equitable adjustment of the debt to an amount that can reasonably be repaid.

Perhaps the most obvious potential use for the contractual approach described above is as a defense for debtors in a collection suit brought by lenders. This use is unlikely, however, because there is little chance of such a suit being brought. For official lenders, both bilateral and multilateral, the loans were never viewed as pure business transactions from which a monetary gain was expected. These lenders are guided primarily by policy considerations that, although self-interested, are not fundamentally profit-motivated. Recently, official lenders have shown increasing awareness of the severity of the poorest debtor countries' plight.<sup>354</sup> It is particularly telling that, in this context, some commentators have even begun to use the terms "lender" and "donor" interchangeably.<sup>355</sup>

Commercial lenders, on the other hand, are in the loan business to make money. Indeed, if a commercial lender voluntarily forgave large amounts of debt, its shareholders would probably have a basis for legal action against the institution's management. Refraining from legal action to collect the debt is quite distinct from voluntary forgiveness, however, and commercial lenders and their influential shareholders apparently realize that such suits would almost certainly be futile. Aggressive collection efforts by commercial lenders would not only be futile, they would probably be self-destructive for reasons detailed in Part III, Section A, above. Thus, a commercial lender would be unwise to "force the issue" when repayment is impossible.<sup>356</sup>

This does not mean, however, that the courts cannot become involved. Just as, under certain circumstances, a severely distressed pri-

---

<sup>354</sup> Despite the general history of resentment and resistance to conditionality, calls for *greater* pressure for reform toward free market principles have arisen in some debtor countries. Not surprisingly, some of these calls come from indigenous opponents of the status quo within debtor countries. Quite apart from internal politics, however, "increasingly, the Bank and the IMF find their borrowers running ahead of their advice in both the scope and pace of economic reform." *Two Pillars of Wisdom*, *supra* note 169, at 5. Indeed, each side seems to be more understanding of the other's concerns. The Economist recently reported that "past divisions over development policy are healing. Africa's old rulers are retiring, or being forced out. Governments these days accept the need for reform. Donors have realized that Africans cannot withstand as much austerity as aid conditions used to demand." *Remembering Africa*, *supra* note 6, at 33.

<sup>355</sup> See *Democracy in Africa: Lighter Continent*, *ECONOMIST*, Feb. 22, 1992, at 17.

<sup>356</sup> *Id.*

vate debtor can seek discharge in bankruptcy, debtor nations could seek declaratory judgments to the same effect based on the argument outlined above. The many technical and/or procedural issues that would arise in connection with such an action by a sovereign debtor are beyond the scope of this article. In this context, mere identification of a possible tactic by which debtors might take the initiative is sufficient to bring into focus the simplicity of the reconceptualization this article proposes. The approach described above would have debtors ask only to be treated like the commercial lenders themselves would be treated under similarly severe financial circumstances.

The contractual approach is not without drawbacks and bases for criticism. First, it is arguable that sovereign bankruptcy, or its functional equivalent, was not among the eventualities commercial lenders could reasonably have been expected to consider when the relevant loan agreements were entered into and that a solution analogous to bankruptcy is therefore unfair.<sup>357</sup> To the extent that this is true, however, the above argument regarding mutual mistake is strengthened. Moreover, while the lenders' abusive practices may not give rise to legal liability, their central role in creating the debt crisis certainly undermines lenders' arguments that their absorbing most of the resultant losses is somehow fundamentally unfair.

Second, it might be objected that the proposed solution subsidizes LDC debtors at the expense of commercial lenders and their shareholders. It does. But this is also the effect of discharging the debts of private parties through bankruptcy in the domestic context, which subsidizes debtors at the expense of creditors and their shareholders — without advancing any public policy objective broader than a desire to allow the bankrupt debtor to get on with his or her life.<sup>358</sup> In this regard, it is noteworthy that, according to one commentator's projections, significant debt relief for all LDCs (not just sub-Saharan Africa) would cost less than one-twentieth of the cost of the savings and loan bail out,<sup>359</sup> which some experts have estimated could cost United States taxpayers more

---

<sup>357</sup> See *supra* note 37 and accompanying text.

<sup>358</sup> Alternatively, because society's most important public policy objectives are usually pursued with public funds, perhaps commercial lenders should be entitled to partial reimbursement of their LDC loan losses from public funds. This, of course, does not happen with bankruptcy, but the resolution of this question is entirely independent of the point being made here. Perhaps more importantly, such partial reimbursement from public funds now appears inevitable because "the FDIC projects a deficit of as much as \$28.9 billion in two years. Battered by bad loans to real estate developers, takeover artists, and Third World countries, nearly 900 banks, with assets of \$162 billion, have failed since 1987." *How Deep is the Hole?*, BUSINESS WEEK, Dec. 9, 1991, at 30.

<sup>359</sup> Krugman, *supra* note 113, at 150.

than \$500 billion over the next 40 years.<sup>360</sup>

Third, it is arguable that the approach proposed here will cause banks to take punitive measures against debtor countries. Such measures might include termination of new lending, cancellation of existing trade credit lines, acceleration or "calling" of loans, or even attempts to attach debtors' assets. These responses seem improbable for the same reasons that commercial lenders are unlikely to sue. Their only practical hope of realizing even partial repayment lies in maintaining a non-adversarial relationship with the debtors. Also, because commercial lenders cannot be sure that private sanctions would be uniformly applied, unilateral imposition of such sanctions might only create opportunities for competitors.

Fourth, it could be claimed that the proposed approach would dangerously weaken the international banking system by requiring commercial lenders to write down or write off large loans now carried on their financial statements as assets. The answer to this criticism is that loans which cannot be repaid simply are not "assets" in any meaningful sense of that term, and their inclusion in banks' financial statements is therefore not a practice that should be protected. It is not a flaw of the proposed approach that it might serve to expose an existing financial crisis and need for realignment of the international banking system. Moreover, the proposed approach would provide a means by which the required realignment could be regulated, pursuant to principle, by parties with no pecuniary interest in the agreements to be modified.

Probably the most important implication of the contractual approach described above is that it affords debtor nations a principled basis for contesting, whether in legal or purely policy fora,<sup>361</sup> the extent of their indebtedness. Because it seeks only to achieve the result mandated by legal principles, equitable adjustment pursuant to contractual analysis is not a favor or concession to debtors. It is the law. This simple but fundamental reconceptualization of the problem could help to restore the self-esteem of sub-Saharan debtor nations and establish their dignity in the perception of the developed world.<sup>362</sup>

Finally, the proposed solution can be assessed only in comparison

---

<sup>360</sup> Stephen Labaton, *U.S. Bank Bailout Hurt by Weakness of Insurance Fund*, N.Y. TIMES, Nov. 25, 1991, at A1, col. B.

<sup>361</sup> Even in negotiations in "non-legal" fora, the law serves as an indispensable backdrop, informing the parties' expectations. See generally, Robert H. Mnookin and Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 Yale L.J. 950 (1979).

<sup>362</sup> The bankruptcy analogy is also illuminative on this point, however, for bankruptcy is not without stigma, and the "fresh start" policy that underpins bankruptcy law is, in significant measure, a paternalistic one. See Thomas H. Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 HARVARD L. REV. 1393, 1405 (1985).

with its alternatives. The alternative of unilateral, unprogrammed default poses a greater threat to the international banking system and is so unattractive to both lenders and borrowers that they have sought desperately to avoid it. Instead, they have endeavored to maintain their relationships and have developed, out of practical necessity, the policy of "conciliatory default."<sup>363</sup> This is, in effect, a policy of adjustment. It is too important a policy, however, to be administered on an *ad hoc* basis by interested parties.

### VIII. CONCLUSION

It is not the purpose of this article to blame all of sub-Saharan Africa's problems on "outsiders."<sup>364</sup> A recent report by the United Nations Development Program concluded that the LDCs could mobilize 50 billion dollars per year for development if they changed their spending priorities.<sup>365</sup> In addition, many LDC governments suffer from corruption and/or managerial ineptitude or, as Benin's Minister of Industry, Energy and Public Enterprises put it, "a quasi-absence of efficient management and control systems. . . ."<sup>366</sup> However, just as African governments must take primary responsibility for addressing their own internal political shortcomings, the developed world must, in fairness, consider the substantial evidence that the LDCs are not just "less developed" — they are structurally retarded as a direct result of their historical and present relationship to the developed countries.

The simplest reason to adjust the external debt of sub-Saharan Africa is that there is no realistic possibility of the debt ever being repaid. The choice, therefore, ultimately comes down to one between (1) systematic adjustment and discharge of the debt, and (2) unilateral, unprogrammed default. The long-term interests of the developed world, generally, and the United States, specifically, are best served by investing

---

<sup>363</sup> See *supra* note 14.

<sup>364</sup> Even the Institute for African Alternatives has acknowledged "[t]he partial responsibility of African governments for the current crisis . . . with respect to their neglect of rural areas, pervasive corruption, excessive bureaucratization, distorted national priorities and misplaced reliance on foreign capital." ONIMODE, *supra* note 10, at 192.

<sup>365</sup> Steve Mufson, *Study Faults Third World Priorities; U.N. Program Cites Military Spending*, WASH. POST, May 23, 1991, at A39. Specifically, the report blames high military spending and poor distribution of social services for much of the human suffering in the LDCs. *Id.* The countries of sub-Saharan Africa could also benefit significantly from increased trade among themselves. "[T]rade within the continent is a mere 5% of all black Africa's export trade, and is static, although some 200 organizations exist to promote it." *Africa's New Drumbeat*, *supra* note 350, at 46. See generally, Joanna Moss & John Ravenhill, *Trade Diversification in Black Africa*, 27 J. MOD. AFR. STUD. 3, 521 (1989).

<sup>366</sup> Klaus D. Stein, *Fiscal Affairs Department Conducts Seminar on Public Expenditure Management in Africa*, IMF SURVEY, Aug. 12, 1991, at 245.

in the economic health and political stability of the world's least developed countries.<sup>367</sup> The principal appeal of an approach resulting in substantial discharge of the debt through equitable adjustment based on contractual principles is that it is a real solution based on established principles, rather than a stop-gap measure based on expedience.

---

<sup>367</sup> See generally, F.V. GARCIA-AMADOR, *THE EMERGING INTERNATIONAL LAW OF DEVELOPMENT, A NEW DIMENSION OF INTERNATIONAL LAW* (1990); Charles F. Meissner, *Crisis as an Opportunity for Change*, 17 INT'L L. & POL. 613 (1985).