



## The battle to curb ‘vulture funds’

More countries are now facing a worsening debt situation and if they embark on debt restructuring, they may face a challenge from “vulture funds”, as Argentina recently did.

This issue of the South Bulletin focuses on the battle to curb the vulture funds, and the effects these funds have had on developing countries and on global financial stability.



A demonstration outside the office of vulture fund Elliott Associates, in London on April 2013.

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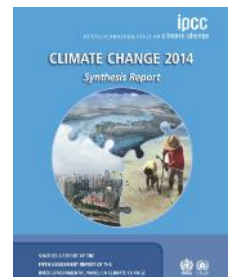
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# Battle hots up to curb 'vulture funds'

Many countries are facing a worsening debt situation, and thus feel urgency to curb 'vulture funds' and to set up a global debt restructuring mechanism. Recent resolutions adopted by the UN Human Rights Council and the UN General Assembly are moving this process forward but the battle will be an uphill one.

low prices (say, 10% of the original loan value) in the financial markets and then insist through the courts on being paid in full with interest thrown in.

Like vultures, they identify the bodies that are turning into or have become carcasses, then they circle overhead and swoop to make a meal of the dead or dying bodies. Only in this case the bodies are countries and they are asked to squeeze their shriveled economies further to pay the vulture funds, like drawing blood from a stone.

The US judiciary, after a long process that went all the way to the Supreme Court, decided this year that the holdout hedge funds that took up the case should indeed be paid in full, and with interest.

Worse, it decreed that the 93% of creditors who had already agreed to be paid at a big discount, are now not allowed to be paid, unless the vulture funds are paid in full at the same time. The New York judge used the principle of 'pari passu' (that all creditors should be treated the same) in reaching the decision.

Argentina had already arranged with a bank in New York to pay out interest to the 93% a few weeks ago, but the bank refused to do so, due to the court order.

The vulture funds want their pound of flesh. The main fund, NML Capital, would make an estimated 1,600% profit.

Argentina's President, Cristina Kirchner, refused to bow to these funds. If she did, the country might have to also repay all the creditors the full value, which is US\$120 billion, and that is impossible to do.

This incredible turn of events has caused outrage among many public interest groups and anger among developing countries' governments. The South Summit of the G77 in June 2014 in Bolivia criticized the vulture funds and called for a proper global debt restructuring mechanism.

Finance Ministries of developed countries have been concerned as well. After all, developed countries like Greece also went through debt restructuring.



A demonstration outside the office of vulture fund Elliott Associates, in London on April 2013.

## By Martin Khor

External debt is rearing its ugly head again. With the global economic slowdown, lower commodity prices and less tourism, many developing countries are facing reduced export earnings and foreign reserves.

No country would like to have to seek the help of the International Monetary Fund to avoid default. That could lead to years of austerity, high unemployment, cuts in social development and at the end of it, still no light at the end of the tunnel.

The debt stock might even get worse. Low growth, recession, social and political turmoil are probable. This has been experienced by many African and Latin American countries in the past, and by several European countries presently.

When it becomes clear that there is no solution within the present framework, some countries then restructure their debts. Since there is no international system for an orderly debt workout, the country would have to take its own initiative.

The results are usually messy, as it entails a loss of reputation with the markets, and having to face the anger

of creditors. But the country may feel it is a pill that has to be swallowed, rather than face years or decades of economic and political turmoil at home.

Such was the experience of Argentina, whose public debt reached 166% of GDP in 2002. After many years of economic decline and political instability, and when it was clear the debt was unrepayable, Argentina defaulted in 2001.

Then in 2003, President Nestor Kirchner began negotiating a debt restructuring with its creditors. Argentina undertook two debt swaps in 2005 and 2010, and restructured its debt with 93% of its creditors, who agreed to receive about a third of the debt value.

But 7% of the creditors, known as 'holdouts', did not agree to the restructuring. Worse, a few influential hedge funds (comprising only 1% of creditors) which bought some of the debt very cheaply on the secondary market, sought a court order in New York (where the original loans had been contracted) to be paid in full.

There are several such funds, now popularly termed 'vulture funds', that specialize in buying distressed debt at

turing, in which private creditors agreed to take a loss, a few years ago.

Accepting the court decision as the new template would make it quite impossible for any country to restructure their debts, since the now emboldened vulture funds would pounce, and of course even more investors would imitate the behavior of such funds, since there is big and easy money to be made.

Influential Financial Times commentator Martin Wolf has supported Argentina in its battle with the vulture funds, even saying that it is unfair to the real vultures to name the holdouts such since at least the real vultures perform a valuable task!

At the end of August 2014, the Swiss-based International Capital Market Association, a group of bankers and investors, issued new standards aimed at reducing the ability of holdout investors to undermine debt restructuring.

The Group of 77, representing de-

veloping countries, successfully promoted a resolution at the United Nations General Assembly which recognized that a state's efforts to restructure debt should not be impeded by hedge funds that seek to profit from distressed debt.

The General Assembly, by a vote of 124 in favour, 11 against and 41 abstentions, also decided to set up a multilateral legal framework for sovereign debt restructuring, to increase the stability of the international financial system.

A global system for debt restructuring will be a systemic solution, since countries with debt crises can have recourse to an international court or system and would not need to do debt restructuring on its own.

Although the developing countries as a whole championed the resolution, there will now be an uphill battle to get it implemented, since the United States, Germany and the United Kingdom (which are key countries in global

finance) were among those which objected.

Another resolution, initiated by Argentina and others, was adopted in September 2014 by the UN Human Rights Council, condemning the activities of vulture funds and mandated a report to be made on the human rights impact of vulture funds.

One good thing is that the UN, which is a universal body in which developing countries have a greater say in decision-making, is now at the center of the debt discussion.

The negotiations ahead to set up a global system will be tough but well worth it since preventing and managing a debt crisis is now a priority for a growing number of countries.

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# A long history of predatory practices by vulture funds against developing countries

**Vulture funds have a long history of predatory practices against many developing countries, including heavily indebted poor countries, mostly in Africa.**

**By Kinda Mohamadieh**

The world's attention had turned to the practices of 'vulture funds' after the United States' Supreme Court affirmed a lower court opinion in the case *NML Capital v. Argentina*, which forbids Argentina from making payments on its restructured debt.

Argentina had defaulted in 2001 and went through two rounds of negotiations to restructure its debt, both in 2005 and 2010. In June 2014, the US Court ordered Argentina to pay the 'vulture funds' that held-out and did not accept the terms of the debt swaps. The 'vulture funds' held out with the aim of achieving what amounts to 1600% of return on their original investment. The concerned funds had purchased the Argentinian bonds in 2008 at USD 48 million and the Court ruling ordered Argentina to pay them USD 832 million.

Nobel laureate Joseph Stiglitz notes that this was "the first time in history

that a country was willing and able to pay its creditors, but was blocked by a judge from doing so".

While this case brought the term 'vulture funds' into the public sphere, the predatory practices of these entities did not start with Argentina.

According to the former United Nations independent expert on the effects of foreign debt and other related financial obligations of States on the full enjoyment of all human rights, the term 'vulture funds' "is used to describe private commercial entities that acquire, either by purchase, assignments or some other form of transaction, defaulted or distressed debts, and sometimes actual court judgments, with the aim of achieving higher returns".

The African Development Bank considers 'vulture funds' as "entities that purchase distressed debt on the secondary market, where it trades significantly below its face value, and then seek to

recover the full amount, often through litigation".

Basically, vulture funds are hedge funds whose modus operandi focuses on three main steps including: (1) purchasing distressed debt on the secondary market at deep discounts far less than its face value, (2) refusing to participate in restructuring agreements with the indebted state, and (3) pursuing full value of the debt often at face value plus interest, arrears and penalties, including through litigation, seizure of assets, or penalties.

Many developing countries have been exposed to the predatory practices of vulture funds, especially African and Latin American countries.

The African Development Bank documents that at least twenty heavily indebted poor countries (HIPC)s have been threatened with or have been subjected to legal actions by commercial creditors and vulture funds since 1999. These countries include Sierra Leone, Cote d'Ivoire, Burkina Faso, as well as Angola, Cameroon, Congo, Democratic Republic of the Congo, Ethiopia, Liberia, Mada-





Vulture funds pick on countries that are attempting to restructure their debts and make predatory profits from these indebted countries.

gascar, Mozambique, Niger, Sao Tome and Principe, Tanzania, and Uganda.

In one case against Zambia, a vulture fund, having bought a debt for USD3 million, sued Zambia for USD55 million and was awarded USD15.5 million.

Other countries that have been targeted by 'vulture funds' include Nicaragua and Peru.

Peru was targeted by NML Capital in the year 2000, the same vulture fund that recently raised the case against Argentina in the United States' courts. The former United Nations independent expert on foreign debt and human rights documented that NML Capital won a case against Peru in the year 2000, recovering many times what the fund paid for the country's distressed debt. According to media reports, the fund spent almost four years in the courts to win a ruling that forced Peru to settle for almost USD56 million on distressed debt, which the fund had initially bought for USD11.8 million.

It is worth noting that European civil society groups documented that vulture funds threatened to sue the Greek government. According to a report released in 2014, creditors that decided to hold out and did not accept the debt restructuring deal proposed by the Greek government retained roughly 4.6 billion Euros of Greek bonds. They were ready to fight for their share. Afraid of legal battle and without an elected government, Greece paid off the vulture funds.

The African Development Bank documents that up till the year 2007, 25 judgments in favor of vulture funds had yielded nearly USD1 billion. Out of this amount 72% of the judgments have been against Members of the African Development Bank. The reported number of out-

standing cases against debtor countries has doubled since 2004.

According to the World Bank and the International Monetary Fund (IMF), 54 court cases were instituted against 12 HIPC countries between 1998 and 2008. The IMF estimates that in some cases claims by vulture funds constitute as much as 12 to 13% of a country's gross domestic product. The World Bank estimates that nearly one-third of countries that are eligible for debt-relief and other poverty alleviation programs are the targets of the nearly twenty-six vulture funds.

In 2013, a paper published by the United States Institute for Peace noted that "there are an estimated twenty-two vulture funds waiting for payouts amounting to \$1.3 billion, thereby draining crucial resources and undermining prospects for economic development".

Mr. Cephias Lumina, while serving as the UN independent expert on foreign debt and human rights between 2008 and 2014, documented the attempts of several national jurisdictions to adopt legislation that aim to prevent vulture funds from pursuing excessive claims against heavily indebted countries before their national courts. These cases include the Channel Island of Jersey and the United Kingdom, and Belgium.

It is worth noting that a similar bill entitled "Stop the Vulture Funds Act (H.R. 2932)" was introduced in the US Congress in the year 2009. The bill primarily aims at preventing vulture funds from making excessive profit at the expense of poor countries.

Concerned about the extent of the threat posed by such predatory practices of vulture funds and its systemic implications, several international authorities and multilateral institutions have pointed

out their concern about the matter.

The United Nations expert on foreign debt and human rights, Cephias Lumina, warned that vulture funds are able to "paralyze debt relief for heavily indebted countries".

The African Development Bank warned that "by precluding debt relief and costing millions in legal expenses, these vulture funds undermine the development of the most vulnerable RMCs [member countries of the Bank]".

In June 2014, the Heads of State and Government of the Group of 77 and China, in their statement issued on the occasion of the summit entitled "For a New World Order for Living Well", held in Santa Cruz de la Sierra, Plurinational State of Bolivia, reiterated the importance of not allowing vulture funds to paralyze the debt restructuring efforts of developing countries, and stressed that these funds should not supersede the State's right to protect its people under international law.

The IMF had cautioned that upholding the decision against Argentina would harm future sovereign debt restructuring attempts. In 2013, the IMF stated that the Court of Appeals decision "if upheld would likely give holdout creditors greater leverage and make the debt restructuring process more complicated".

In 2012, the United States presented an amicus curiae brief to the US Court of Appeals for the Second Circuit in support of Argentina's petition in the case against NML Capital. The United States argued that the interpretation by the panel of the 'Pari Passu' clause, upon which the decision to forbid Argentina from making payments on its restructured debt until it paid the 'vulture funds' is based, is incorrect and adverse to the United States' policy interest and may harm its foreign relations. The 'Pari Passu' clause is included in the contractual terms of most sovereign bonds. Traditionally, the clause has been understood to have a narrow meaning, addressing only the issue of legal priority, and preventing the debtor from legally subordinating the bonds in question to other debt. Within this approach, the settled understanding of this clause is that selective repayment of the debt does not violate the 'Pari Passu' clause, even if it is the result of sovereign policy. In the case *NML v. Argentina*, courts in the United States adopted a wider interpretation of this clause. In its amicus curiae brief, the United States stated that such interpretation "runs counter to the

longstanding U.S. efforts to promote orderly restructuring of sovereign debt”.

Back in 2007, the G-8 Finance Ministers had expressed concern about actions of some litigating creditors against HIPCs, and agreed to work together to identify measures to tackle this problem based on the work of the Paris Club. In the same year, the G-7 Debt Experts had invited the IMF and the World Bank to a meeting chaired by the Secretary General of the Paris Club to discuss the impact of vulture funds on debt relief and measures that could be employed to minimize the adverse effects on economic development of HIPCs.

A recent statement by more than 100 civil society organizations from around the world (June 2014) stressed that “the actions of vulture funds represent one of many expressions of the injustice inherent in the global financial system”. They called for “urgent collective action to: achieve by all States, and particularly the United States and other jurisdictions where similar claims have been filed, enact laws that restrict the predatory activities of creditor funds; ensure that debtor States implement procedural safeguards that limit foreign jurisdictions’ ability to impact the full enjoyment of human rights; and create an international mechanism that is neutral and independent, designed to resolve disputes concerning the restructuring of sovereign debt, based on the obligation of States to respect, protect, and enforce human rights, both in their territories and extraterritorially”.

In September 2014, a resolution on the activities of ‘vulture funds’ and the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights was presented by Argentina and adopted at the 27<sup>th</sup> session of the UN Human Rights Council, which took place in Geneva.

It is worth noting as well that the 26<sup>th</sup> session of the Human Rights Council in June 2014 had adopted, through a vote, a resolution entitled “Elaboration of an international legally binding instrument on Transnational Corporations and other Business Enterprises with respect to Human Rights” (A/HRC/26/L.22). This resolution sets in place a process of negotiations towards an international legally binding instrument on transnational corporations and their liability in the area of human rights.

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# Argentina’s vulture fund crisis—global implications

**In a special essay entitled "Argentina's 'vulture fund' crisis threatens profound consequences for international financial system" which we reproduce below, UNCTAD analyses the Argentinian debt-restructuring crisis and reiterates its long-standing call for a sovereign debt workout mechanism. UNCTAD is the United Nations Conference on Trade and Development based in Geneva.**



Argentines protest against the vulture funds.

## Global and systemic implications of United States Supreme Court rulings in favour of hedge funds over Argentina on 2001 defaulted bonds

The United States Supreme Court issued a ruling on 16 June 2014 declining to hear Argentina's appeal against a lower New York court decision that had ordered it to pay suing hedge funds \$1.33 billion, which is principal plus interest for holdout bonds. This was followed shortly by another decision by the Supreme Court to order the relevant financial institutions of the United States of America to turn over information to these hedge funds about assets that Argentina holds worldwide, including accounts held by entities of the Government of Argentina and by individual officials<sup>1</sup>.

These two rulings targeted at Argentina's 2005 and 2010 debt swaps, in the wake of its catastrophic 2001-2002

default on \$100 billion bonds governed by New York law, resonate well beyond the borders of Argentina and the United States. The rulings are a resounding victory for the specific hedge funds that have held out on Argentine debt swaps. They also open the door for other "vulture" funds and holdout investors to come forward to request full payment on Argentine bonds, estimated at around \$15 billion. If Argentina pays the holdout bond holders, it must extend full payment to the bond holders that accepted the 2005 or 2010 debt swaps, due to a "Rights upon Future Offers" clause in its law. This would amount to an estimated cost of over US\$120 billion<sup>2</sup>. In fact, the rulings could open floodgates to other similar cases depending on interpretations given by courts under New York law, British law or other laws. Copycats will abound.

But they also set legal precedents which could have profound consequences for the international financial





Artists and human rights defenders unite against so-called vulture funds in Argentina.

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system:

- First, by removing financial incentives for creditors to participate in orderly debt workouts, the rulings will make future debt restructuring even more difficult, in particular for outstanding bonds without a Collective Action Clause, the actual amount of which is unknown but is likely to be large.

- Second, obligating third-party financial institutions to provide information about assets of sovereign borrowers will have a significant impact on the international financial system as it forces financial service institutions to provide confidential information on the sovereign borrower's global financial transactions to facilitate the enforcement of debt contracts for the creditors.

- Third, the ruling will erode sovereign immunity.

### **A setback for debt restructuring**

After defaulting on its \$100 billion sovereign bonds in 2001, Argentina offered debt swaps in 2005 and in 2010. Investors holding about 93 per cent of the old bonds participated in these debt swaps. The Congress of Argentina passed a law in February 2005 that forbade the Government to make payments on any bonds not tendered, to later reopen the exchange or to settle with non-participating creditors one by one on the side. However, a handful of hedge funds purchased the bonds after the default when they were at deep discounts. Since then, they have repeatedly demanded to be paid at 100

per cent of their face value. This is considered by many as predatory. For example, NML Capital purchased the majority of their Argentine bonds from June-November 2008, paying an estimated \$48.7 million for over \$220 million in defaulted bonds, a price of just over 20 cents on the dollar<sup>3</sup>.

According to estimates by Morgan Stanley, bond holders who accepted the 2005 offer have received returns of about 90 per cent<sup>4</sup> thanks in particular to a coupon linked to gross domestic product growth, which significantly increased the amount actually received. In response, the holdout bond holders led by NML Capital changed tactics and took out law suits (based on the *pari passu*, or equal treatment, clause in bond contracts) in New York's lower court which would tie any future payments on restructured bonds to payment in full to holdout bond holders. This was an unheard of interpretation of the clause which shocked even veterans in the debt restructuring world. However, on 18 November 2013, the United States Second Circuit Court of Appeals ruled in favour of NML Capital. Argentina appealed the ruling to the United States Supreme Court. With the Supreme Court leaving the lower court rulings intact, it has created a precedent for awarding holdout creditors and penalizing creditors who participated in a debt restructuring.

Since the Argentine default, there has been a more prevalent introduction of the Collective Action Clause in bond contracts which has the potential of

restricting the likelihood of a small number of creditors holding out on debt restructuring. However, it is important to note that existing bonds without Collective Action Clause will take years to expire. This means that, with the Supreme Court rulings, the world has limited tools to initiate debt restructuring for bonds with a *pari passu* clause and without Collective Action Clause. The Supreme Court ruling has given bond holders a strong weapon to get full payments. As stated in the recently published International Monetary Fund (IMF) paper on debt restructuring, "in essence, the [United States] courts have interpreted a 'boiler plate provision' of these contracts (the *pari passu* clause) as requiring a sovereign debtor to make full payment on a defaulted claim (in this case, held by the secondary market purchaser) if it makes any payments on the restructured bonds"<sup>5</sup>.

Given such consequences, the Governments of France and Germany supported Argentina in its legal struggle. Economists such as Joseph Stiglitz and Anne Kruger petitioned against the hedge funds.

### **Obliging financial institutions to assist debt collectors**

The Second Circuit also rules that third parties (banks in this case) who make payments on behalf of the Government of Argentina to bond holders which participated in the two debt swaps will be punished and viewed and treated as being in contempt of law if they continue to make such payments. On top of this, the second ruling of the Supreme Court confirmed NML Capital's request that banks involved in handling the payment of Argentine bond holders must turn over information to holdout bond holders on assets that Argentina holds worldwide. Obliging financial institutions to provide information about sovereign borrowers' assets worldwide will have significant impact on the international financial system as it forces financial service providers to provide confidential information on the sovereign borrower's global financial transactions to facilitate enforcement of debt contracts on behalf of the creditors. Third parties have been dragged from the wings to centre stage. In addition, it also seems they are obliged to assist holdout bond holders in reclaiming their debt. Once

again, exchange holders are punished and holdouts are rewarded.

Justice Ruth Bader Ginsburg, a member in the Supreme Court's group of justices deciding the case, asked: "By what authorization does a court in the United States become a 'clearinghouse for information' about any and all property held by Argentina abroad?"<sup>6</sup> By setting this legal precedent, it would not be surprising to see changes in the financial market and ways to aid creditors in enforcing contracts and punishing borrowers.

### Erosion of sovereign immunity

The ruling does not only impact the financial service providers involved, it also severely erodes sovereign immunity and is not in compliance with the United States Foreign Sovereign Immunities Act. The Government of the United States filed a brief in favour of Argentina and stated that a ruling in favour of bond holders would harm international relations and could provoke "reciprocal adverse treatment of the United States in foreign courts"<sup>7</sup>. An official representing the Administration cautioned at the Court that "the United States would be gravely concerned about an order of a trial court in a foreign country, entered at the behest of a private person, seeking to establish a clearinghouse in that country of all the United States' assets"<sup>8</sup>. However, the Chief Justice of the United States Supreme Court did not seem to feel any apprehension. In response to concern of the Government of the United States on non-compliance with the Immunities Act, the Justice advised the Government to amend the Act.

With the Supreme Court ruling, the likelihood of aggressive holdout investors snatching assets of defaulted sovereigns might increase. In 2012, NML Capital detained an Argentine navy vessel in Ghana as part of its effort to gain repayment on the defaulted securities.

Following an Argentine proposal to pay exchange bond holders in Argentina under Argentine law on 17 June, one day after the Supreme Court rulings, the United States Second Circuit Court of Appeals ruled that this kind of act is in violation of the rulings and proceedings now in place in the Southern District of New York.

### Restating the case for a sovereign debt workout mechanism

The United States Supreme Court rulings have once again demonstrated what can happen in the absence of an international debt workout mechanism. This vacuum has led to fragmentation of legal forums, thereby creating inconsistency and unpredictability. Different courts have very different interpretations of the same contractual clause and can impose a wide array of rulings. Politics and interests groups can impact on the outcome of rulings and debt restructurings, compromising consistency and fairness.

The rulings have made future debt restructuring much more difficult as debtors are left with only moral suasion and foreign relations as weapons to encourage creditor coordination. They have also strengthened the hand of creditors even though their behaviour can be among the underlying causes of debt crises.

The June 2014 IMF Policy Paper entitled "The Fund's lending framework and sovereign debt - preliminary considerations" and its annexes (in a separate paper) reviewed the lessons of past debt restructurings. However, when it comes to possible directions for reform, the proposals are to maintain a market-based approach (based on debt contracts) and debt reprofiling - extending debt maturity - based on the IMF's judgement that an unsustainable debt situation exists. Debt reprofiling has the potential to trigger credit default swaps and is viewed by some as a debt restructuring. One wonders whether the IMF is best positioned to give timely and fair judgements on how unsustainable debt could eventually be restructured when the world does not possess sufficient tools to deal with the problems encountered so far. To rely on the market approach under which different courts are to interpret clauses of the debt contracts as the United States Supreme Court has done would lead to outcomes with "broad systemic implications", just as the IMF warned.

In this chaotic context, the formulation of global and harmonious rules and principles guiding sovereign debt restructurings has become of paramount importance. This is why UNCTAD has been a long-standing advocate of a sovereign debt workout mechanism and is currently working on a project finan-

ced by the Government of Norway to further clarify how it could work in practice. The list of general principles and issues identified thus far by a group of experts under the project includes:

- Standstill/stay of litigation
- Debt thresholds and indicators
- Transparency
- Comprehensiveness and seniority (equity among creditors, collective action issues)
- Legitimacy
- Impartiality (institutional)
- Institutional oversight and the relation between international and domestic levels.

### End notes:

<sup>1</sup> United States, Supreme Court of the United States, 2013, Syllabus, Republic of Argentina v. NML Capital.

<sup>2</sup> *Wall Street Journal*, 2014, Argentina wants to continue paying its debts: but they won't let it, 21 June.

<sup>3</sup> A Phillips and J Johnston, 2013, Argentina vs. the vultures: What you need to know, 2 April, Center for Economic and Policy Research.

<sup>4</sup> D Benson, 2012, Billionaire hedge funds snub 90% returns, *Bloomberg News*, 23 January.

<sup>5</sup> IMF, 2014, The Fund's lending framework and sovereign debt - preliminary considerations, IMF Policy Paper, June.

<sup>6</sup> United States, Supreme Court of the United States, 2013, Syllabus, Republic of Argentina v. NML Capital.

<sup>7</sup> United States, United States Court of Appeals for the Second Circuit, 2013, Brief for the United States of America as amicus curiae.

<sup>8</sup> *New York Times*, 2014, Argentina's debt appeal is rejected by Supreme Court, 16 June.

**This essay is available at:**  
[http://unctad.org/en/pages/newsdetail.s.aspx?OriginalVersionID=783&SiteMap\\_x0020\\_Taxonomy=UNCTAD%20Home](http://unctad.org/en/pages/newsdetail.s.aspx?OriginalVersionID=783&SiteMap_x0020_Taxonomy=UNCTAD%20Home).

# The Human Rights Council condemns vulture funds

The 27th session of the UN Human Rights Council (HRC), held in September 2014, saw the adoption of a resolution condemning the activities of vulture funds. This year, the follow-up work on the resolution will commence.

Within this context, the Human Rights Council Advisory Committee will start preparing a research-based report on the activities of vulture funds and the impact on human rights. In doing so, the Human Rights Council Advisory Committee will seek a variety of views and inputs, including from Member States, United Nations agencies, as well as non-governmental organizations.

This article reviews the content of the resolution and the positions taken by selected Member States in the process of the vote that took place on the resolution.

By Kinda Mohamadieh

The 27<sup>th</sup> session of the UN Human Rights Council (HRC) adopted, through a vote, a resolution condemning the activities of vulture funds. The resolution is motivated by the direct negative effect that the debt repayment to those funds, under predatory conditions, has on the capacity of governments to fulfill their human rights obligations, particularly economic, social and cultural rights and the right to development.

The resolution, officially entitled "Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds" (A/HRC/27/L.26) was presented by Argentina together with Algeria, Bolivia, Brazil, Cuba, Pakistan, Russia, Uruguay, and Venezuela. The resolution was supported by a broad group of more than 80 countries.

In the vote on the resolution, 33 Members of the HRC voted in support of the resolution, while 9 Members abstained, and 5 Members voted against it.

## The content of the resolution

The resolution focuses on the effects of vulture funds' practices, including through litigation and other means, that oblige indebted countries to divert financial resources saved from debt cancellation and undermine their capacity to guarantee the full enjoyment

of human rights for their populations.

Vulture funds have a long history of acquiring defaulted sovereign debt at vastly reduced prices and then seeking repayment of the full value of the debt through litigation, seizure of assets, or political pressure.

Such predatory action is enabled given the voluntary nature of international debt relief schemes and the absence of a multilateral legal framework for the orderly and predictable restructuring of sovereign debt.

The resolution reaffirms that the activities of vulture funds highlight problems in the global financial system and are indicative of the unjust nature of the current system. The resolution calls upon States to consider implementing legal frameworks to curtail predatory vulture fund activities within their jurisdictions.

The resolution also encourages all States to participate in the negotiations aimed at establishing a multilateral legal framework for sovereign debt restructuring processes, as referred to in General Assembly resolution 68/304.

[On the 9<sup>th</sup> of September 2014, the UN General Assembly had adopted resolution 68/304, which "decides to elaborate...a multilateral legal framework" to regulate the sovereign debt restructuring process (A/68/L.57/Rev.1). The resolution, which was presented by the Group of 77 and China, was adopted by a majority of 124 votes

(11 UN Member States objected while 41 abstained). Almost all developing countries voted in favor, including Brazil, China and India. The majority of European countries, including France, Greece, Spain and Italy abstained].

Furthermore, the resolution requests the Advisory Committee of the HRC to prepare a research-based report on the activities of vulture funds and the impact on human rights, and to present a progress report of that research to the thirty-first session of the HRC. In preparation of the report, the Advisory Committee will seek the views and inputs of Member States, United Nations agencies, relevant international and regional organizations, the Office of the United Nations High Commissioner for Human Rights and relevant special procedures, including the UN Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights (hereafter referred to as the UN Independent Expert), as well as national human rights institutions and non-governmental organizations.

In presenting the resolution, the **Minister of Foreign Affairs of Argentina, Mr. Hector Timerman**, noted that the issue of foreign debt and its effect on the enjoyment of human rights has been on the agenda of various human rights bodies of the United Nations for over two decades. Since the 1990s, the Human Rights Commission and subsequently the HRC, in various decisions and resolutions, highlighted the challenges that the burden of foreign debt represents for full enjoyment of human rights, in particular economic, social, and cultural rights. The Minister added that the former United Nations Independent Expert, Mr. Cephas Lumina, described the activities of vulture funds as those that manage to divert countries' financial resources saved from debt cancellation, thereby undermining the capacity of governments to guarantee human rights to their people.

In Africa, the Minister highlighted, activities of vulture funds have endangered or even removed the capacities of states to carry out development and



poverty reduction programs. Vulture funds allocate part of their vast amounts of profits to protect their despicable conduct, the Minister explained.

Mr. Timerman stressed that there are currently two defined groups, on one hand countries that are concerned with the defence of the human rights of their people, and on the other hand the vulture funds. This is the context in which the resolution should be considered, he added, noting that the resolution does not represent a clash between nations nor a criticism of an economic or political system. Pope Francis noted the need for financial reform along ethical lines that will produce an economic reform to benefit everyone, Mr. Timerman added. It is a resolution in favour of peace and peoples' economic, social, and cultural rights. He underlined that it is vital that countries commit to developing an international framework that is able to promote an investment market of high social impact, therefore combating the economy of exclusion and rejection.

Mr. Timerman reminded the HRC that it is not only developing countries that highlight the threat of vulture funds. As far back as 2002, he recalled, the then finance minister of the United Kingdom, and subsequent Prime Minister, Mr. Gordon Brown, referred to the severity of the problem in a special session of the UN General Assembly. Mr. Brown had highlighted then the immorality of vulture funds, noting that every time a country has to defend itself in front of courts, it diverts significant amount of time, attention, and resources that should be allocated to poverty reduction, health and education, and called for doing all that countries could to put an end to this practice.

Minister Timerman recalled the resolution entitled "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes" (A/68/L.57/Rev.1) that was presented by G77 and China to the UN General Assembly and adopted on the 9<sup>th</sup> of September 2014.

[The resolution was adopted by a majority of 124 votes, while 11 UN Member States objected and 41 abstained. Almost all developing countries voted in favor, including Brazil, China and India. The majority of Euro-



Argentina's Foreign Minister, Hector Timerman (right), speaking at the Human Rights Council. On the left is Argentina's Ambassador Alberto Pedro D'Alotto.

pean countries, including France, Greece, Spain and Italy abstained].

The Minister noted that the approval of the resolution on a multilateral legal framework for sovereign debt restructuring processes reflects the reaction of the developing world to the Argentinian case.

Not content with access to credit, vulture funds are now violating the possibility of successful debt restructuring, Minister Timerman explained. Their message is clear, he added: vulture funds want Argentina to pay the 1600% of profit that they are claiming or they will not allow the country to get back on its feet.

A legal vacuum exists in regard to debt restructuring and leaves sovereign states vulnerable to the abuses of speculators, Mr. Timerman warned. According to him, the resolution adopted by the UN General Assembly represents a fundamental change of discussions on debt restructuring as it decided to adopt a multilateral legal framework establishing effective and transparent rules to achieve sovereign debt restructuring processes that are orderly and predictable.

As regard the content of the resolution presented to the HRC, the Minister explained that it is based on language adopted in previous HRC resolutions, and merely updates those.

The Minister noted that Argentina knows that the countries that supported the resolution are not acting out of their friendship with Argentina but rather they are driven by the conviction that behind the speculation and

financial conspiracies and complicity in greed, lurk the inescapable burdens of debt.

Minister Timerman pointed out that the billions the vulture funds take from the impoverished South translate into closing schools, hospitals deprived of medicines, poverty, political instability, hate, violence, and fall of governments. He warned the members of the HRC that "vulture funds will not stop until we stop them".

The Minister reminded the HRC that during the years of military dictatorship in Argentina, the Council always supported the victims of that regime and gave them refuge and a voice so that they were able to denounce the atrocities of the dictatorship. According to him, what the Argentinian government does today is representing those victims of the dictatorship and supporting them in the face of vulture funds that carry the inheritance of the dictatorship.

In support of the resolution, **Algeria** stated that the resolution- in spirit and letter- reflects the recommendations of the former UN Independent Expert, in particular his recommendations on vulture funds. The reports of the Independent Expert revealed the negative effects that vulture funds have on debt relief measures adopted by the international community and its destabilizing effects on the economies of victims of vulture funds, Algeria noted. Algeria pointed out the fact that the international financial system today is inadequate and needs reform, and that debt has a major impact on developing countries and their devel-

opment. Algeria stressed the need to shed objective light on the activities of vulture funds and their impact on the right to development. Algeria called for adopting the resolution by consensus.

**Cuba** noted that the resolution brings to the HRC a subject of vital importance for developing countries. Cuba as a promoter of the resolution recognised the relevance of the HRC's activities on this issue, and the increasing importance to establish a multilateral legal framework for sovereign debt restructuring. Activities of vulture funds are a new form of aggression on countries of the South, Cuba added, which is fed by the economic conditions generated by foreign debts and the crisis of capitalism. More than twenty countries have been victims of vulture funds, Cuba warned. These activities are basically directed against progressive governments that are defending their sovereignty, as recently highlighted by the G77 summit held in Bolivia. Cuba reiterated the importance of upholding the right of countries of the South to sustainable development and to a just international economic order.

**Brazil** stressed their belief that reduced debt burden and enhanced fiscal capacities contribute to the necessary conditions for the realization of human rights, particularly economic, social, and cultural rights. Brazil reiterated its support for bilateral and international initiatives necessary to avoid having the debt burden of indebted countries become an impediment to economic growth, including social inclusion and poverty eradication. The international community needs to fully understand and better address the financial and legal uncertainties and negative social and economic implications that may result from the lack of a predictable mechanism for debt restructuring, Brazil stressed. The proposed resolution is a step forward as it can help shed light on the situation and its implications on the full enjoyment of human rights, according to Brazil.

**Russia** highlighted how the initiative draws attention to the predatory activities of vulture funds, including the related social problems that undermine national sovereignty, and which shatter the global financial stability paving way for financial and economic crisis. Russia noted that the resolution would be another building block in constructing a more just and fair world order based on

equal participation of all states in the global economy. Russia commended the constructive and transparent approach adopted by Argentina during the work on the draft resolution.

**Venezuela** highlighted that there has been talks for years in international fora and in the HRC about the negative effects of the excessive and unjust debt burdens on the enjoyment of human rights. This is exacerbated by the global crisis of capitalism, Venezuela noted. The harmful activities of vulture funds that carry excessive speculative activities oblige countries with sovereign debt to harness the resources they saved through debt relief, according to Venezuela, thereby undermining possibilities of governments to comply with their human rights commitments. The obligations shouldered by states in international financial agreements should not affect their capacity to guarantee the full enjoyment of human rights of their peoples, Venezuela stressed, in particular economic, social, and cultural rights including the right to development. Venezuela recalled the quote by the President of Argentina at the 69<sup>th</sup> session of the UN General Assembly, who stated that "it is not only terrorists that plant bombs but economic terrorists destabilize the economies of countries and cause hunger, poverty, and extreme poverty". Venezuela called for continuing progress towards a universally shared commitment to achieve international cooperation in addressing problems pertaining to economic and social rights and in promoting the respect of human rights and fundamental freedoms enshrined in the UN charter.

**Pakistan** noted that all countries have sovereign rights in regard to their debt restructuring, which should not be influenced through political and extremists pressure tactics that undermine the capacity of states, especially developing countries, to fulfil their human rights obligations and achieve sustainable development. Vulture funds reflect inherent flows in the current international financial system and could be used to challenge the sovereignty of indebted countries through economic pressures and huge financial implications, according to Pakistan. Although this issue is of special resonance for developing countries, it is also a threat to developed countries. The activities of vulture funds highlight some of the grave problems in the global financial system and are indicative of the unjust nature of the current system, Pakistan underlined. Pakistan added that measures to combat vulture funds and other debt restructuring issues should be part and parcel of reforms in the international financial system. Pakistan emphasized the importance of a timely, effective, comprehensive, and durable solution to the debt problems of developing countries, and reiterated its support to the negotiations aimed at establishing a multilateral legal framework on sovereign debt restructuring.

### **Countries took the floor to explain their vote**

**Mexico** explained that it will vote in favor of the resolution as a sign of solidarity with Argentina and the difficul-



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ties it faces in the process of restructuring its debt. Mexico noted that the negative effects of vulture funds are a concern given their effects on the institutional capacity of governments when taking measures to fulfill their obligations in regard to economic, social, and cultural rights. Mexico added that this type of speculative investments should not be invoked as a condition to prevent people from enjoying their full human rights or a justification by states that fail to comply with their international obligations. Mexico noted that it would have been desirable that the resolution would include reference to the essential obligation of states to comply with their human rights obligations as recognized in the Vienna declaration and program of action. Mexico had faced debt restructuring and has constantly been seeking to ensure that the framework applicable to debt restructuring processes allow solving problems that may arise in practice and grant certainty to the involved parties. In the past decade, significant steps forward have been noted and debt-restructuring processes are on the way to be perfected, Mexico added. These are processes being discussed at the competent international institutions, Mexico explained, and it is essential to continue to strengthen the framework applicable to debt restructuring. No debt restructuring process should impose unsustainable burdens on countries nor endanger the development of their people, Mexico noted, while stressing that the peoples' human rights should not be contingent on the economic conditions of states.

The **United States (US)** called for a vote on the resolution. The US noted that it remains committed to the stability of the international financial system and development of partners around the world, however in its opinion the resolution raises serious concerns. The US explained that discussions on mechanisms to advance orderly debt restructuring are technical in nature and risk creating uncertainties if not handled appropriately, which could drive up borrowing costs or even choke off financing for developing countries. The US was of the opinion that there are already active discussions underway in other more appropriate fora that take these complex technical issues into account. According to the US, the issues that the resolution addresses fall outside the scope and mandate of the

HRC, and may prompt states to use debt distress as an excuse for human rights violations. The US added that the states' obligations to promote and protect freedoms and human rights are not conditioned on its sovereign debt situation.

**Italy**, speaking on behalf of the European Union (EU), pointed to their solidarity towards countries that face economic and financial crises, but noted that the HRC is not the appropriate forum to discuss issues covered by the resolution.

The **United Kingdom (UK)** aligned itself with the statement by the EU. The UK recognized the importance of many of the issues raised in the resolution including the need for timely, predictable, and effective debt restructuring processes and the need for coordinated action to resolve the situation where a country cannot afford to repay its debts. The UK noted its active role as a member of the Paris club, where the UK delivered USD 7 billion in debt relief as part of the 'Highly Indebted Poor Countries' (HIPC) initiative. Domestically, the UK introduced targeted legislation to limit the ability of commercial creditors recovering through the UK courts an amount of debt in excess of that consistent with the HIPC initiative. The UK explained that they will vote against the resolution as there are discussions related to financial policies taking place in other international fora. The HRC is not the right forum to discuss these technical issues, according to the UK. The UK noted that they are already involved in the IMF's work to update the framework on sovereign debt restructuring. This work seeks to identify contractual solutions to reduce the power of hold-out creditors. The UK noted their support to previous calls to explore this issue in the UN, including a call by the Secretary General to assess options for enhanced approaches to debt restructuring and resolution mechanisms. The HRC should continue to focus on its core mandate to promote the implementation by States of their human rights obligations and avoid duplication of work undertaken by other bodies, according to the UK.

**France** abstained in the vote. In its explanation of its vote, France noted its concern regarding the effectiveness of international mechanisms for restructuring of sovereign debt. France re-

ferred to the submission it made as *amicus curiae* in the dispute that Argentina faced before the US Supreme Court. However, France reiterated the position of the EU and the US that considers that the issue does not fall within the mandate of the HRC, adding that it considers the obligations of a state in regard to its sovereign debt are independent of its obligations in the sphere of human rights. France added that issues of sovereign debt restructuring should be discussed within the competent international bodies, noting that the IMF has already started work in this area. France added that it is active in the context of the Paris Club and that the G20 Economic and Financial Forum has the vocation of dealing with this issue.

### **Previous resolutions and decisions on foreign debt and its effects**

The HRC and its preceding Commission on Human Rights had adopted several resolutions and decisions on the effects of structural adjustment and economic reform policies and foreign debt on the full enjoyment of all human rights, particularly economic, social and cultural rights.

The most recent was the resolution adopted by the HRC in April 2014, which extends the mandate of the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights for an additional three years (A/HRC/25/L.28 of 15 April 2014).

In July 2012, the HRC had also adopted the "Guiding Principles on Foreign Debt and Human Rights". In 2010, the UN's Independent Expert had issued a report with a thematic focus on vulture funds. The report addressed the negative impact of the activities of vulture funds on international debt relief efforts, and on the capacity of indebted poor countries that have benefited from debt relief to create the necessary conditions for the realization of human rights, including the right to development.

*Kinda Mohamadieh is a Researcher at the South Centre.*



# Why we need to counter the threat from vulture funds

Below is a speech by the Permanent Representative of Argentina at a meeting in the South Centre in September 2014, explaining why international actions are needed to counter the activities of vulture funds which prey on indebted developing countries.

By Alberto Pedro D'Alotto

I would like to thank the South Centre for organizing this discussion session. I also want to thank the presence of all of you today, since for Argentina the issue of the consequences of foreign debt, and in particular of vulture funds, on human rights is of high importance.

The main objective of this discussion is to share views on the issues pertaining to the effects of foreign debt and other related international financial obligations of States on the full enjoyment of human rights, particularly economic, social and cultural rights, with a focus on the activities of vulture funds.

The independent expert on the effects of foreign debt on human rights, Cephias Lumina, has defined the term "vulture funds" to describe private commercial entities that acquire, either by purchase, assignment or some other form of transaction, defaulted or distressed debts, and sometimes actual court judgments, with the aim of achieving a high return. In the sovereign debt context, vulture funds usually acquire the defaulted sovereign debt of developing countries on the secondary market at a price far less than its face value and then attempt, through litigation, seizure of assets or political pressure, to seek repayment of the full face value of the debt together with interest, penalties and legal fees.

To sum up, the vulture funds' *modus operandi* is simple: they purchase distressed debt at deep discounts, refuse to participate in restructuring, and pursue full value of the debt often at face value plus interest, arrears and penalties through litigation, if necessary.

It is interesting to mention that one of the first political leaders that used

this term was former Prime Minister of the United Kingdom Gordon Brown who stated before the General Assembly of the United Nations in 2002 that "We particularly condemn the perversity where Vulture Funds purchase debt at a reduced price and make a profit from suing the debtor country to recover the full amount owed - a morally outrageous outcome. The international community should consider giving technical assistance to any HIPC country being sued by a Vulture Fund and provide them with expert financial advice on debt restructuring to prevent future legal claims.

Whenever a country has to defend a legal case it has to divert considerable time, attention and resources away from focusing on poverty reduction, health and education and we must do everything we can to stop this shameful practice".

Martin Wolf from the Financial Times has said that the term "vultures" seem unfair to the birds: Vultures perform a valuable task while hold outs do not recycle carrion but insist the carcass can meet its obligations.

As is of public knowledge, in a recent decision, the U.S. Supreme Court denied cert. on a petition filed by Argentina in the case initiated by the vulture fund NML that had acquired Argentine sovereign debt bonds after the 2002 default and had not accepted the terms of the agreement reached with over 92% of the bondholders in 2005 and 2010. Thus, it interprets the standard *pari passu* clause (equality of rank and treatment) as forbidding Argentina from making payments on its restructured debt if at the same time it does not pay the bondholders who did not accept the terms of the agreement, and aim to achieve a 1600% return on their original investment.



Ambassador Alberto Pedro D'Alotto of Argentina

In 2010 there were already more than fifty claims of this sort against highly indebted countries, and many of them are still pending. According to the World Bank and IMF, 54 court cases were instituted against 12 Heavily Indebted Poor Countries (HIPC) between 1998 and 2008. The Report of the Independent Expert studies, in particular, the cases of Liberia, Democratic Republic of Congo and Zambia.

Commercial creditor litigation is not confined to Heavily Indebted Countries: according to a study by the Trade Association for the Emerging Markets (EMTA), at least nine non-Heavily Indebted Countries have been the subject of such litigation.

All this evidence clearly shows that the recent conflict between Argentina and vulture funds is not a new problem of the international financial system and that certainly, Argentina is not the first case. This is why we must not understand it as an isolated case, but rather as the expression of a global problem: **a broader case about the conflict between a few bondholders, the vulture funds, who rely on predatory practices furnished by the financial system, and the ability of States to reach agreements with the majority of their sovereign debt holders and guarantee the economic, social and cultural rights of their people.**

Because we believe that this is a global problem, with potential systemic consequences, that can affect any country, but specially developing countries, we promoted together with the G77 and China a resolution in the General Assembly of the United Nations in New York last 9<sup>th</sup> of September about a multilateral legal framework for sovereign debt restructuring processes.

**Resolution in the General Assembly**

On 9 September 2014, the General As-

sembly adopted Resolution 68/304 titled "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes", that was presented by the Group of 77 + China, and was adopted by 124 votes in favour, 11 negative and 41 abstentions.

This Resolution decided to elaborate and adopt, as a matter of priority during the General Assembly's sixty-ninth session, a multilateral legal framework for sovereign debt restructuring processes, that will allow to establish effective and transparent rules to achieve orderly and predictable restructuring of sovereign debt. Until now, the lack of a regulatory framework has evidenced that there is direct correlation between poverty, disease, illiteracy and insecurity faced and countries historically crushed by external debt.

The voting scheme on the adoption of this Resolution has also showed the far-reaching agreement of the countries in the developing world, as a true reflection of the importance and urgency that a clear majority of the world's nations assign to a reality that finds us unprotected against the use and abuse that speculators make of the existing regulatory gap in the current financial system, in matters pertaining to the restructuring of sovereign debt.

## Resolution in the HRC

As probably most of you know, we are promoting, together with a group of countries, a Resolution in the present Session of the HRC on the "Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds".

The issue of foreign debt and its effects on the enjoyment of human rights has been on the agenda of various United Nations human rights bodies for more than two decades. Since the 1990s, the Commission on Human Rights and, subsequently, the Human Rights Council, have, in a number of resolutions and decisions, adverted to the challenges that excessive foreign debt burdens and economic reform policies pose for the realization of human rights. Apart from several resolutions, the HRC endorsed the Guiding principles on foreign debt and human rights (A/HRC/20/23) by Resolution

20/10.

The debt burden complicates the numerous problems that developing countries face, reduces fiscal capacity, contributes to extreme poverty and is an obstacle to sustainable human development, and is thus a serious impediment to the realization of all human rights, particularly economic, social and cultural rights.

The concluding observations of the various treaty bodies on country reports submitted to them, also indicate that high external debt burdens and dependency on foreign assistance can constitute obstacles to efforts by States parties to comply with their human rights treaty obligations, particularly those relating to economic, social and cultural rights.



The Financial Times' Martin Wolf wrote that it is unfair to the vultures to name the holdouts after them. (Photo: AAP)

To illustrate the effects of such activities, the IMF, for example reports that in some cases the claims by vulture funds constitute as much as 12 to 13 percent of a country's gross domestic product (GDP). That means that vulture fund litigation oblige indebted countries from using resources freed up by debt relief for their own development programs, thereby undermining the capacity of governments to guarantee the full enjoyment of human rights of their populations.

In relation to the content of the Resolution titled the "Effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights: the activities of vulture funds", that as I said we are presenting for its adoption during this HRC session, it builds on adopted language by the Human Rights Council, updating it (mainly Resolution 25/16, 23/11 and 20/10, in Reports of the Independent Expert on Foreign Debt, on the Guid-

ing Principles on Foreign Debt and Human Rights and on the Guiding Principles of Human Rights and Business).

The Resolution condemns the activities of vulture funds for the direct negative effect that the debt repayment to the aforementioned funds, under abusive conditions, has on the capacity of governments to fulfill their human rights obligations, particularly economic, social and cultural rights and the right to development.

It also picks up language from the recent UNGA Resolution, in the sense that it urges States to participate in the negotiations aimed at establishing a legal regulatory framework for the sovereign debt restructuring processes, and calls upon States participating in the negotiations to ensure that such a legal regulatory framework will be compatible with existing international human rights obligations and standards.

Due to the recent and intensified pressure of vulture funds on developing countries, the Advisory Committee of the Human Rights Council, during its 13th session in August 2014, proposed the HRC to consider a research proposal on the activities of vulture funds and human rights. In that sense, the Resolution requests the Advisory Committee to prepare a research-based report on the activities of vulture funds and the impact on human rights, and to present a progress report to the Human Rights Council at its 31<sup>st</sup> Session.

## Conclusion

The main drive of these initiatives I have just explained has been not only to put in evidence of the global nature of the problem, but also the threat that the activities of vulture funds represent for all countries, particularly to developing countries.

These initiatives evidence, also, the will of the international community to breach the existing gap in a multilateral effort, where sovereign States decide not to be held hostage by the market nor their sovereign debt restructurings left to the discretionary will of speculators.

*Alberto Pedro D'Alotto is the Permanent Representative of Argentina to the United Nations and the WTO in Geneva.*

# Comment on IPCC's Final Climate Report

**The IPCC's final report, known as the Synthesis Report, indicates the world is doomed if present climate and emission trends continue, but the key solutions are as elusive as before.**

**By Martin Khor**

Imagine our world getting more and more polluted, and little space left for the Earth to absorb more pollutants before all kinds of disasters take place.

And imagine that we have not yet found the solutions to really slow down the emissions or to prevent the catastrophe that lies ahead.

This look into our scary future was evident at the meeting in October 2014 in Copenhagen to finalise the last climate change report of the IPCC (Intergovernmental Panel on Climate Change).

The IPCC produces the most comprehensive reports on the state of climate change. Over a thousand scientists came together to produce three huge reports on science, adaptation and mitigation.

And then a synthesis report was finalised at the Copenhagen meeting, with hundreds of government representatives going over, debating and finally approving a "summary for policymakers" (SPM) together with the authors.

The synthesis report and its SPM make very interesting reading. You can find information on the damage that climate change has already caused, and the many more harms that lie ahead.

But the most interesting scientific picture is found between the lines. The report reveals that between 1750 and 2011, cumulative anthropogenic (human-induced) carbon dioxide emissions to the atmosphere were 2,040 giga tonnes (one giga tonne, or Gton, equals a billion tonnes).

About 40% of these emissions, or 880 Gton of CO<sub>2</sub>, have remained in the atmosphere. The rest were stored on land (in plants and soils) and in the ocean. The ocean has absorbed about 30% of the CO<sub>2</sub>, causing acidification of the seas.

Emissions have continued to increase in recent decades, reaching a

2010 level of around 49 Gton of CO<sub>2</sub> equivalent.

Total CO<sub>2</sub> emissions since 1870 have to remain below about 2900 Gton, if global warming is to be kept at less than 2°C (relative to the period 1861-1880) with a probability of over 66%. However, about 1,900 Gton of CO<sub>2</sub> have already been emitted by 2011.

From the above figures in the IPCC synthesis report, you can do the simple maths, and it's frightening.

If total emissions since 1870 till now and the future have to be kept at 2,900 Gton, and 1,900 Gton have already been emitted, then there is "space" for only 1,000 Gton of CO<sub>2</sub> to be emitted from now to the future.

But the IPCC report also says that in 2011, the emission level was 49 Gton of CO<sub>2</sub> equivalent.

Thus, in 20 to 25 years, if the current rate of emissions continues, the ability of the Earth to absorb the gases (within the limit of keeping warming below 2°C) would have been exhausted.

Even at this scenario of 2°C warming there would be widespread and serious damage, with a rise of extreme weather events. With more warming, say 3°C, it would be catastrophic.

While the IPCC synthesis report is rich in scientific data and with scenarios drawn from computer models, it is unfortunately very thin on how to achieve the global solutions.

It does assess the technologies and physical changes needed to reduce emissions in various sectors. It also gives estimates of the economic costs needed to make mitigation work.

But it is shy about even hinting at the kind of global deal that is needed to get both developed and developing countries to seriously take actions.

At the negotiations in the United Nations climate convention, the developing countries have long made the point that they require funding and technology to support policies that shift

their economic growth towards environmentally sustainable pathways.

The climate-related actions they take should blend with their continued development, and not be at the expense of development.

The synthesis report hardly deals with the key issues of finance and technology for developing countries. Indeed, there were attempts by some developed countries to even strike out the term "technology transfer" from the report's summary. It took quite a battle by several developing countries to re-insert that term.

The North-South tangle was most evident in a working group to draw up a box in the report on the key relevant messages to be transmitted by the IPCC to the climate convention and its negotiators.

The draft by the IPCC authors was filled with data and required mitigation pathways, but developing countries' delegates complained that there was almost total absence of any mention on sustainable development, finance, technology and adaptation.

After days of discussion, the scientists finally agreed to include a paragraph on sustainable development and a few lines mentioning financing, technology transfer and adaptation.

However, when the new draft was brought to the plenary, whose closing had to be postponed for a full day, it was rejected by several developed countries.

Thus, the IPCC's final report is missing on what was to have been its most important message - the box on IPCC's relevant findings for the climate convention.

My conclusion is that the science of climate change has made progress in showing why we have to act, but that getting action agreed to as a community of nations and people is still a long way off.

*Martin Khor is the Executive Director of the South Centre.*



# The registration of biosimilar medicines: lessons from Colombia's experience

By German Velasquez

On 18 September 2014, the President of Colombia Juan Manuel Santos signed a decree defining the way and the standards that the country will require to register biosimilar medicines (products that replicate third parties' biological products). With the decree to open competition for biotech medicines, Colombia has won a battle but not the war.

The presidential decree that will allow the entry of new products and laboratories to the closed world of biotech drugs was celebrated in Colombia as a courageous decision against the power and pressure from the transnational pharmaceutical industry, owners of a big monopoly worldwide. The power of the transnational pharmaceutical lobby is so strong that they had succeeded to convince the Vice President of the United States, Joe Biden, to send a letter to prevent Colombia from taking this step. After the signature of the decree, it is foreseeable that bilateral and industry pressures will not cease and the battle will continue in other scenarios.

Ten or 15 years ago most of the drugs used worldwide were obtained through chemical synthesis. Today, biological drugs constitute a growing global market that may reach 6 billion USD in 2016. According to the Colombian Health Minister Alejandro Gaviria, last year biotech medicines accounted for 35 percent of the pharmaceutical market in Colombia, and the sector is growing rapidly. There are more and more new drugs for conditions such as arthritis, diabetes, cancer, hemophilia, multiple sclerosis, hepatitis and many rare diseases. These drugs account for a major portion of all reimbursed drugs under the Colombian Solidarity and Guarantee Fund (Fosyga). There has been a heated debate in Latin America and other countries about how to set regulatory standards to allow the reverse engineering of these drugs, known as 'biosimilars' or 'biogenerics' or 'biocomparables' in order to lower their costs for patients and health security systems.

As most of these biotech medicines may have patent exclusivity for 20 years, companies have been able to exercise a monopoly that enables them to set very high prices. This situation in some cases can put at risk the economic viability of the health system. For several years Colombia and other countries have discussed the way for national companies and laboratories to manufacture similar or equivalent drugs to achieve lower prices, and thereby facilitate access for people with low resources. The same battle has taken place for decades between the producers of 'original' and reverse engineered drugs known as 'generics'.

It is estimated that by 2020 half of biological patented medicines, which generate multimillion profits for the transnational pharmaceutical companies, will be out of patent protection. Some of these patents have already expired, but it is not clear whether they can be quickly reverse engineered.

The decree signed by the President of Colombia Juan Manuel Santos on 18 September is an important step forward to clarify this situation. The decree defines the way and the standards that the country will require to register biosimilar medicines. The Colombian government has chosen to favor health needs and refused to create the technical barriers that multinational companies wanted to generate through marketing approval regulations to extend their monopolies.

## The Decree

The original draft of the Decree introduced an 'abbreviated route' or 'fast track route' for the registration of biosimilars. Ultimately, the President decided to complement this mechanism with the concept of "comparability", a clarification that substantially improved the decree. In fact, the route established by the Decree for registration of biosimilars is not abbreviated as it requires the strict compliance with all health requirements, tests or clinical trials necessary to obtain the authorization for a new drug to enter in the market, as is required in most countries. However, the decree avoids to extend

the process, creating unnecessary delay through marketing approval regulations, as the transnational pharmaceutical companies wanted. As a result, the entry to market of biosimilars will not be delayed unnecessarily. As stated by President Santos, "the decree is not putting at risk the health of the Colombian citizens."

The core of the debate about the possibility and ways to reverse engineer biological products is: are biotech products completely different from the products obtained by chemical synthesis for marketing approval purposes? Is it possible to get a biotech 'similar' or 'generic' product? In the area of biological products it is evident that it is not possible to speak of "identical" products, because the use of biological materials do not permit to get perfect copies of a given product. What is needed, and was understood by the Colombian Ministry of Health, is to have an equivalent therapeutic effect with products that are safe, effective and of good quality.

This debate will increasingly occupy health agendas in the coming years. It is worth recalling that today the World Health Organization (WHO) has no regulations in this field. However, with the leadership of Colombia, Argentina and other countries in the World Health Assembly held in May 2014, a resolution was adopted requesting the WHO to withdraw the approved existing guidelines for biological products and to prepare new guidelines to be submitted for discussion by the governing bodies of WHO. We are therefore at the beginning of a complicated process that will take at least two or three years. The WHO will face external pressures on this issue. There is a great risk that the new global guidelines may be influenced by commercial and not strictly by health concerns.

The decree signed by President Santos is contrary to the views that the United States and other developed countries want to impose to protect their pharmaceutical industries.

*(Continued on page 17)*

# Did IMF policies weaken West Africa's capacity to tackle Ebola?

Health systems in Africa are ill-equipped to deal with Ebola. And that's partly the fault of IMF policies, says an expert on the social effects of policies of international financial institutions.



An Ebola patient being treated in West Africa.

By Rick Rowden

As the spreading Ebola emergency took center stage in Washington, the World Bank and International Monetary Fund (IMF) have pledged \$530 million to help Guinea, Liberia, and Sierra Leone. And in October 2014, at a special session with African leaders on Ebola during the IMF/World Bank annual meetings in Washington DC, IMF Managing Director Christine Lagarde said that in addition to the aid, the IMF would depart from its notorious budget austerity, and actually allow the hard-hit west African nations to increase their budget deficits: "We don't normally say this!" she emphasized. To which the Guinean president, Alpha Conde, responded, "I'm extremely pleased to hear the IMF Managing Director [say]... that we can increase our deficit, which is quite a change from the usual narrative."

He was right. Indeed, if you really want to understand why several West African countries have been so ill-equipped to tackle the latest outbreak of the Ebola virus, then you also need to look at the "usual narrative" of IMF fiscal and monetary policy restraint. That's because it is a major reason for the dilapidated public health systems that have proven to be such a vulnerability during the crisis.

Many experts note that the conspicuous unpreparedness of countries like

Guinea, Liberia, and Sierra Leone is a direct consequence of years of insufficient public investment in the underlying public health infrastructure. "We know how to prevent diseases like this, if we can get the basic level of the healthcare systems up to speed," said Columbia Business School Professor Amit Khandelwal. Critics point out that this lack of investment can be traced directly back to sparse spending on public goods dictated by IMF loan conditions and policy advice, which invariably entail adherence to its strict definition of "macroeconomic stability."

Since the 1980s, when the doctrines of Thatcher and Reagan reigned supreme, the IMF's monetarist approach has meant prioritizing price stability (low inflation) and fiscal restraint (low budget deficits) over other spending goals in developing countries. These policies had the effect of greatly limiting overall public spending each year. Because of this squeeze, most of the budget went to immediate needs and recurrent expenditures and little was left over for scaling up long-term public investment in infrastructure, including the underlying public health infrastructure. This led to a serious drop-off in public investment as a percentage of GDP seen across many developing countries that in many cases has been sustained until today.

So the harmful effects of IMF policies on health systems are not direct; it's

not as if the IMF comes in and directly tells a country to spend less on public health. Instead it's a two-step process: first the IMF policy targets constrain overall national spending levels, and this then limits the spending available for long-term public investment, including for the health infrastructure. Consequently, chronic and sustained underinvestment in public health infrastructure has become the norm in many countries, year after year, over the last few decades.

Some critics have long claimed that the IMF's policy targets are too tight, and other more expansionary policy options could allow for increased public investment. They charge that the IMF approach is unnecessarily restrictive, preventing developing countries from scaling up long-term public investment in public health systems. Such policies, they say, have led to dilapidated health infrastructure, inadequate numbers of health personnel, and demoralizing working conditions that have added to the "push factors" driving the migration of nurses from poor countries to rich ones. All this has undermined public health systems in developing countries, including the ones now trying to cope with Ebola.

Specifically at issue are two controversial IMF policies to keep inflation at or below 5-7 percent per year and budget deficits under 3 percent of GDP. Skeptics contend that such policies have unnecessarily undermined the ability of domestic industries to generate higher levels of productive capacity, employment, and GDP output -- and correspondingly reduced tax revenues as well. They call on the IMF to consider other more expansionary fiscal and monetary policy options that would enable governments to obtain higher levels of tax revenue for both recurrent expenditures, and crucially, for long-term public investment as a percentage of GDP. Most countries suppress inflation by raising interest rates, which makes credit less affordable and prevents the government from engaging in more affordable deficit financing or public investment. Higher interest rates also prevent the domestic private sector from expanding production and employment, which has negative long-term implications for revenues, national budgets and, consequently,

health financing.

More technically, the IMF squeezes fiscal space in countries by tightening two screws: it sets binding targets called “performance criteria” in IMF loan agreements that either raise the floor on required net international reserves (NIR) of foreign exchange at central banks or lower the ceiling on net domestic assets (NDA) (including foreign aid). Quite often the Fund does both in ways that greatly restrict public spending and longer-term public investment. To enforce compliance with budget restrictions, the IMF sometimes sets specific limits on the amount of the budget that can be spent on public sector employees -- including, according to Doctors Without Borders, desperately needed public health personnel.

So while the IMF says it is just being “cautious” because it is worried about how damaging macroeconomic instability can be, this concern about IMF policies being too tight was pointed out by a 2001 US Government Accountability Office report on IMF loans, which warned: “Policies that are overly concerned with macroeconomic stability may turn out to be too austere, lowering economic growth from its optimal level and impeding progress on poverty reduction.” Indeed, the consequences of such policies have led to years of insufficient public investment in the underlying health infrastructure of the countries today facing the Ebola outbreak.

For those interested in improving public investment in health infrastructure in developing countries, there’s no getting around the problems caused by the excessive restrictiveness of IMF policies. It would be one thing if the IMF had some hardcore base of academic research and evidence to justify its very tight fiscal and monetary targets, but, as critics point out, it doesn’t. As a result, the IMF’s ability to justify such budget restraint has long been challenged. This is important: if the IMF’s policies are unjustifiably restrictive and other viable options could better enable increased spending on long-term public investment, including on health systems, then that’s a real case for a policy change. And advocates for better health and education infrastructure in developing countries will have to mobilize to push for it.

On the inflation-reduction target, critics have claimed the IMF has little

evidence to justify pushing inflation down to the 5-7 per cent level. On the question of how low inflation must really be, critics note that the peer-reviewed economics literature on the subject offers no firm consensus for the appropriate level of inflation for developing countries. While everyone agrees that high inflation is bad and must be brought down, others make the case that there is a time when allowing moderate levels of inflation can be appropriate for developing countries during their key developmental phases, and that therefore IMF policy should permit more moderate inflation.

This point has been made by organizations ranging from the Washington-based Center for Global Development to the Financial Services Committee of the U.S. House of Representatives. This issue was raised again in the 2008 high-level report of the Spence Commission on Growth and Development, which noted that some countries have grown for long periods “with persistent inflation of 15-30 percent.” Commission member Montek Singh Ahluwalia criticized the IMF and other international financial institutions, which, he said “have tended to see public investment as a short-term stabilization issue, and failed to grasp its long-term growth consequences. If low-income countries are stuck in a low-level equilibrium, then putting constraints on their infrastructure spending may ensure they never take off.”

Indeed, the health infrastructure in Guinea, Sierra Leone and Liberia has never taken off.

In spite of this situation, the IMF has pursued the same basic set of policies for years -- starting long before the recent financial crisis and continuing during and after it. While the IMF has tried to present data that show relative increases in public health spending in its program countries in recent years in an effort to claim that its policies actually support public health, this belies the much more serious long-term drop in public investment as a percentage of GDP seen across many developing countries since the 1980s. We won’t be able to solve the underfunding of public health infrastructure without new fiscal and monetary policies that reverse this trend.

None of this is to say that the IMF is solely responsible for the Ebola out-

break. Of course, the wars in Sierra Leone and Liberia, corruption, ineptitude, and a host of other specific political, cultural, and socioeconomic factors have all contributed to the current state of the public health systems in West Africa. But if the international community is serious about addressing chronic under-investment in the public health systems in these countries, it will also have to revise the obvious shortcomings of IMF fiscal and monetary policies.

*Rick Rowden is the author of The Deadly Ideas of Neoliberalism: How the IMF has Undermined Public Health and the Fight against AIDS (Zed Books, 2009). He is currently a doctoral candidate in Economic Studies and Planning at Jawaharlal Nehru University, New Delhi.*

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## **biosimilar medicines...**

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Therefore, Colombia will have to play a prominent role in the international venues to protect its national approved regulation, which in a pioneering way has managed to place the interests of public health over commercial interests.

The process of the approval of the Colombian decree leaves several lessons that need to be taken into account to avoid compromising future regulations on this matter. The United States government’s letter not only violates Colombian sovereignty, but falsely states that the decree would be contrary to WHO regulations. It would be appropriate for the WHO to publicly say that Colombia is not violating any WHO rules or guidelines.

Colombia needs to seek international allies in the upcoming debates at the World Health Assembly in 2015. To ensure affordable access to biosimilar medicines, the governments of Colombia and other developing countries will have to maintain their position with the same clarity and determination that they have shown so far in addressing this important health issue in international fora.

*German Velasquez is the Special Advisor on Health and Development of the South Centre.*



# South Centre Statement on Coming into Force of the Nagoya Protocol

The following is a statement by the South Centre on the coming into force of the Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising from their Utilization.

This statement was presented by Viviana Munoz Tellez, Coordinator of the Innovation and Access to Knowledge Programme (IAKP) of the South Centre, at the first meeting of the Conference of the Parties serving as the meeting of the Parties to the Nagoya Protocol (COP-MOP 1) held on 13-17 October 2014 at Pyeongchang, South Korea.



The panel at the closing plenary of the first meeting of the Conference of the Parties serving as the meeting of the Parties to the Nagoya Protocol (COP-MOP 1) in October 2014.

The South Centre is very pleased to be participating as an observer at the first meeting of the Parties to the Nagoya Protocol of the Conference of the Parties to the CBD and to celebrate the entry into force of the Protocol.

The South Centre is an intergovernmental organization established in 1995 through an intergovernmental Agreement, with its headquarters in Geneva, Switzerland. Currently there are 51 developing countries that are member States of the South Centre. To date, 20 member States of the South Centre have ratified or acceded to the Protocol. Others are still considering the merits of doing so.

The South Centre is of the view that the Nagoya Protocol is an important framework for countries and indigenous and local communities to ensure the fair and equitable sharing of benefits arising from the utilization of genetic resources and associated traditional knowledge, thereby contributing to the conservation and sustainable use of biodiversity.

That said, the Protocol leaves a number of areas to be further strengthened in national legislation, including

the establishment of effective check points such as patent offices, and defining precise measures for compliance with prior informed consent and mutually agreed terms. Having followed closely the negotiations in the Nagoya Protocol, we are confident these uncertainties can be addressed in national ABS legislation and in the actual implementation of the Protocol.

The South Centre has a substantive program dedicated to research and capacity building for developing countries on the CBD Nagoya Protocol and related instruments and processes, including the FAO International Treaty on Plant Genetic Resources for Food and Agriculture (ITPGRFA), the relationship between the CBD and the WTO Agreement on Trade related Aspects of Intellectual Property Rights (TRIPS), and the work of the WIPO Intergovernmental Committee on Intellectual Property and Genetic Resources, Traditional Knowledge and Folklore (IGC).

The South Centre has been assisting developing countries in the processes of considering ratification or accession to the Protocol and in its national implementation. In August 2014, the South Centre co-organized together with the Ministry of Natural Resources and Environment of Malaysia a Workshop on the Nagoya Protocol for the Like Minded Asia Pacific Megadiverse countries.

The South Centre extends its invitation to provide capacity building to its Member States and other developing countries and least developing countries, upon request, and in the context of a strategic framework on capacity building to support the implementation of the Nagoya Protocol as may be adopted by the COP MOP, and looks forward to cooperating with the CBD, other IGOs and observers in this important endeavour.

## SOUTH BULLETIN

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