Chapter 14

Law and Neuroeconomics of Credit Default and Lender Protection: Uruguay vis-à-vis India

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ABSTRACT

Recently India and Uruguay signed agreements on investment activities in mining etc. In the context of foreign investments banks play essential roles of participating and facilitating through, inter alia, lending. Hence there is a need for comparison between these countries regarding protection of lenders by the legal systems and confidence of the lenders on the legal systems. This chapter devoted to modelling of the impact of credit-default events on the banking industries and the society. Between the countries this chapter compares the scopes for litigation, negotiation and bribery between lenders and borrowers in the events of loan-default and the comparative speeds of improvement or deterioration of perceived protection of lender out of changes in existing laws, court verdicts and recovery of bad loans in these countries.

Take up one idea. Make that one idea your life - think of it, dream of it, live on that idea. Let the brain, muscles, nerves, every part of your body, be full of that idea, and just leave every other idea alone. This is the way to success... — Vivekananda

BACKGROUND

The first interface between India and Uruguay was the Nehru-Cup football match on February 25, 1982 in India. The interface continued with General Agreement on Tariffs and Trade (GATT) in 1980s and 1990s and then further in the 2000s with the South American trade block MERCOSUR (Mercado
Común del Sur). This interface extended event further to an agreement between the two for exploring and encouraging investment in Uruguay’s mining sector on February 6, 2013. The latest date of single interface to strengthen bilateral relationships in trade, energy, and culture was April 11, 2014 in Montevideo, Uruguay involving an official from India’s Ministry of Foreign Affairs and the Uruguayan acting Foreign Minister.

In the middle of July, 2014 in Fortaleza, Brazil there was a joint interface between India and other members of the BRIC (Brazil, Russia, India, and China) nations, MERCOSUR members, and others. In the context of foreign investments, banks and financial institutions play essential roles of participating and facilitating through, *inter alia*, lending. Therefore, there exists the need for comparison between in these countries regarding protection of lenders by the legal systems and confidence of the lenders on the legal systems. In a comparative mode between the systems of common and civil law, this chapter explores the scopes for litigation, negotiation, and bribery between lenders and borrowers in the events of loan-default and the comparative speeds of improvement or deterioration of perceived protection of lender out of changes in existing laws, court verdicts, and recovery of bad loans in two emerging economies. India has the common law system and Uruguay has the civil law system.

**INTRODUCTION**

The credit rating of a country depends on a number of factors including protection of depositors in its banking system, internal capital adequacy of the banks, and strength of resilience of the banking system. Improvements reported by the International Monetary Fund (IMF, 2013) in the above aspects of the Uruguay banking system led to an upgrade of the sovereign rating of Uruguay as reported by the international credit rating agency Moody’s (2014). Uruguay’s past is characterized by sovereign debt default amidst a relatively underdeveloped banking system compared to India (Global Edge, 2013a, 2013b).

However, the international credit rating of a country depends on the number of defaults in commercial loans extended by the banking industry. The rating agency Standard & Poor’s has warned that India could become the first of the BRIC economies to lose its investment-grade status because of slowing down of growth prospect from bad loans (Pandey & Shah, 2012). Standard and Poor’s downgraded the ratings of 10 top banks of India including State Bank of India, ICICI Bank, and HDFC Bank (Dasgupta, 2012). CRISIL (2013) shows an increasing number of defaults in the sectors such as textiles, metals and mining, food products, distributors, and machinery.

Economy wide loan defaults slacken economic growth and at the same time rising non-performing assets (NPAs) of the banking industry may cause downgradation of a country’s global credit rating. For example, in March, 2013, Moody’s pronounced the probable end of recent increases in Latin American nations’ sovereign debt ratings. Since the 1970s, the Latin American economies have been suffering from loan defaults by the governments as well as the private commercial and industrial borrowers. In October, 2012, the British news agency BBC reported that Argentina had defaulted on more than US$100 billion (£62 billion) of debt in 2001 and 2002, the biggest default in history as per the BBC.

In May, 2012, Forbes magazine reported that Brazilian banks are suffering from their own sub-prime lending crisis. In June, 2012, the Wall Street Journal cautioned Brazil and Turkey about compilation of massive credit risk in view of much of the credits having been used for consumption rather than for building roads and bridges. A study in Banco Central del Uruguay in 2010 revealed that when the number of banks increased above the threshold level, their ability to screen the applicants for business loan
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