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Doing the Right Thing: Dealing with Developing Country Sovereign Debt

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Doing the Right Thing: Dealing with Developing Country Sovereign Debt

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DOING THE RIGHT THING: DEALING WITH DEVELOPING COUNTRY SOVEREIGN DEBT

Barry Herman†

ABSTRACT

This paper draws on recent discussions by lawyers, theologians, philosophers, and economists to reach some conclusions about the just international treatment of the government over-indebtedness and insolvencies that have occurred and recurred many times in many developing countries. It asks what should be considered “fair” expectations in the relationship between government borrowers and their lenders. It also considers some proposed reforms in the international treatment of sovereign borrowing and debt that are prompted by the ethical analyses.

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Introduction

As of December 2005, the governments of developing
countries owed or guaranteed almost $1.5 trillion in foreign debt
obligations, more than half of the $2.8 trillion owed abroad by
public and private sectors combined in developing countries.¹ This
amount of foreign government debt, let alone the untold
amount that governments owe in their own currencies to their own
residents and institutions, is not in itself a problem. Governments,
like enterprises and households, would pass up far too many
opportunities for economic growth and social advancement if they
did not borrow at all. It is a question of how much is borrowed
and on what terms that matters. The countries that account for
most of the huge amount of sovereign debt in the developing
world are well able to handle their debt, just as most households in
the world successfully manage their personal finances.² Usually,
the authorities in these countries act prudently and in an informed
way, and they are also lucky to not have had adverse
developments.³

¹ See 1 WORLD BANK, GLOBAL DEVELOPMENT FINANCE: THE DEVELOPMENT
   POTENTIAL OF SURGING CAPITAL FLOWS: REVIEW, ANALYSIS, AND OUTLOOK 196-97

² It may be taken as indicative that of the $2.2 trillion of total external debt of the
   "net debtor" developing countries at the end of 2005 (including private as well as
   sovereign debt), $575 billion was owed by countries with debt difficulties (defined as
countries that had arrears or rescheduled their debt servicing during 1999-2003). Moreover,
as another $844 billion was owed by developing and emerging economy
countries whose external assets exceeded their debts, the problem debts accounted for
under one fifth of total external obligations (based on country groupings, data definitions
and estimates of IMF, WORLD ECONOMIC OUTLOOK: FINANCIAL SYSTEMS AND
   pubs/f/woe200602/pdf/woe0906.pdf [hereinafter Data of IMF]).

³ As any politician having responsibilities for government spending and revenues
can affirm, budgeting is decision-making under uncertainty. The government plans its
Rather, the difficulty comes when governments, like many enterprises and households, find their debt has grown beyond what they can reasonably manage. They may or may not have acted prudently or have been well informed about the obligations they undertook, but they were also decidedly unlucky. When default becomes inescapable, the debts that governments cannot pay are almost always owed in foreign currency to foreign creditors and these are the debts on which the paper will focus.\textsuperscript{4} Like debt default for households, an inability to stay current on payments on external debt causes deep economic trauma.\textsuperscript{5}

The recent Argentine experience illustrates the dimensions a debt crisis can take in a middle-income country. In Argentina, where life expectancy at birth is 75 years and approximately 97\% of the population is literate, almost half the population was pushed below the poverty line by the trough of the economic crisis in 2002, the year following the debt default and collapse of its fixed exchange rate system.\textsuperscript{6} Poverty of that magnitude, unfortunately,
is the “normal” situation in the lowest income countries regardless of debt default. Indeed, almost half of the population of Sub-Saharan Africa lives on an income of less than one dollar per day (a shorthand for extreme poverty), and three quarters of the population live on less than two dollars per day. Poor countries that also suffer from debt problems in this region thus face obstacles added to these “normal” ones in overcoming poverty.

Moreover, there are too many sovereign debt crises in developing countries. The International Monetary Fund (IMF) counts 56 countries that had arrears in their foreign debt payments, or that rescheduled their debt-servicing obligations during 1999-2003. Together, these countries account for one fifth of world’s population, over one billion people, but less than six percent of world’s gross product. As can be inferred, the debt crisis countries are mostly low-income ones, although middle-income countries have also had to restructure those external debts that they could no longer service, including Argentina, the Dominican Republic, and Iraq in 2005. These persisting conditions have made sovereign debt crises in developing countries a major international policy concern. Indeed, if there is a consensus on any aspect of developing country debt, it is that new crises will erupt in the future, perhaps not next year, but perhaps during the next global economic downturn, perhaps before.

When sovereign debt crises burst open, there is considerable economic pain, but ultimately the crisis is resolved one way or another. There is a vast literature on why debt crises occur and on the processes for resolving them. There is a rapidly growing body of literature advising governments how to avoid debt crises, how to maintain debt “sustainability,” albeit without a consensus on what the indicators of sustainability should be. There have been


8 Data of IMF, supra note 2, at 182, 186 n.7.

9 Id.

10 See GDF 2006, supra note 1, at 73-74.

11 For a critical view of the approach of the Bretton Woods institutions and references to the main documents of the approach, see Matthew Martin, Debt Sustainability: Debt Relief Target, Rule for Lending or Policy Goal? (Jan. 2007) (paper prepared for the Task Force on Sovereign Debt of the Initiative for Policy Dialogue,
many proposals for reforming the sovereign debt workout process, going back at least to the debt arbitration mechanism adopted in the Hague Convention of 1907. There seems to be a smaller literature on the ethical issues embodied in sovereign debt and its crises, and what a “just” workout mechanism might look like. This paper investigates those questions.

After an introductory survey of the actors, their interests and modus operandi in sovereign debt, and how debt crises are resolved in practice, this paper asks what a theological focus brings to the discussion of sovereign debt problems. This is followed by discussion of some philosophical questions regarding where to place responsibility for debt problems and what consequences that responsibility should have on debt crisis resolution. The extreme case of “odious” debt is also considered, especially in the context of an international sanctions regime to change odious state behavior. Finally, this paper claims that justice demands that sovereign debt crises be treated in some yet-to-be-designed official international forum.

I. The Game of Sovereign Debt and its Players

Before entering directly into the ethical issues in debt, it seems useful to briefly recall who the parties are in a sovereign debt crisis. This begins, of course, with the developing country...
government as the borrower. Most governments have a diverse set of creditors, including commercial bankers, purchasers of government bonds, other governments that lend to them, and international financial institutions (IFIs), principally the IMF and the World Bank. When a debt default throws the debtor and its creditors together—and the usual event is a broad default, although almost always excluding a cessation of payments to the IFIs—the various creditors bring different views on the need for speed, let alone on the sharing of losses, in a negotiated workout agreement resulting from the default.

Repayment amounts and terms that are applied to the different types of creditors result from separate negotiations in different institutions or forums. Debts owed to governments are restructured by decisions of the main “bilateral” creditors meeting in the Paris Club; debts owed to commercial banks are renegotiated with ad hoc banker groups called London clubs (or Bank Advisory Committees); bondholder claims are usually settled through debtor government offers to exchange new bonds, often having lower value, for defaulted old bonds (if enough bondholders accept the swap, as stipulated in the bond contract, it becomes valid); finally, decisions to reduce obligations to IFIs—available only to the poorest countries—are made by the donor-dominated governing boards of the institutions. Will the total amount of relief add up to what the debtor country economy needs in order to have a fighting chance to grow, create jobs, service its remaining debt normally, and move toward eradicating poverty? Or, will the debt workout agreement give the debtor country just enough relief to return to full debt servicing with little budgetary room left for public investment and essential social services? Unfortunately, the experience over the past quarter century has


16 Id. at 10-29.
17 Id.
18 Id.
19 Id. at 19-22.
20 Id. at 12-14.
22 Id. at 22-29.
been more the latter than the former.\textsuperscript{23}

While IMF has usually assumed the role of international arbiter of how much relief, new financing, and policy reform a country needs to overcome its debt crisis, it has been widely accused of systematically underestimating the amount of relief needed.\textsuperscript{24} This could reflect an institutional optimistic bias, since its needs assessment for a country is based on the outcome promised when the country follows the IMF's policy advice. In addition, it is only fair to note that the IMF as an institution does not control any of the creditors that are expected to take losses from debt relief and its ability to influence them varies. Each creditor would prefer to collect the most it can of what is owed to it and leave it to the other creditors to take larger losses or leave the debtor to struggle as necessary to make remaining payments. Private creditors have never claimed to be in the business of poverty eradication and one can argue about the relative priority of that goal even among some of the official creditors; e.g., it is not the mandate of export credit agencies whose claims are treated in the Paris Club.\textsuperscript{25}

What thus seems to be missing in the financial architecture of sovereign debt is some effective coordinating mechanism, in essence a sovereign analogue to bankruptcy "protection" afforded to corporate debtors (such as Chapter 11 of the U.S. bankruptcy code), in which law and precedent guide a judge as she oversees

\textsuperscript{23} See Dealing Deftly, supra note 4, at 15-24. This experience reflects, in part, evolving views on what the outcome of a debt restructuring is intended to be. Id.


\textsuperscript{25} Export credit agencies are created by governments to promote national exports. Indeed, there have been explicit conflicts of interest between national export promotion and development assistance strategies, a notable example of which was the sale of an expensive air-traffic control system to Tanzania in 2001 that the British Government financed that "safeguards 250 jobs on the Isle of Wight." The U.K. Development Minister, Claire Short, bitterly opposed the sale as an inappropriate addition to Tanzanian debt, which was being relieved by the British and other donor governments at the time. For a debate on the controversy, see Postings to Discussion Board, Tanzania: Is the UK Radar Deal Justified?, BBC Talking Points, http://news.bbc.co.uk/1/hi/talking_point/1722213.stm (Dec. 21, 2001).
the efforts of the relevant parties to restructure a firm so it can survive, while honoring as many of the creditors' claims as feasible. Although several proposals have been made to create a coherent and development-oriented international mechanism for debt workouts, none has won broad support among governments. Creditors and even the largest debtor governments prefer to take their chances in the existing fragmented system. Perhaps they prefer the "evil they know" to an unknown arrangement, to play the existing game of sovereign debt rather than a new one whose rules they would have to master as they sought strategies to maximize their respective advantage.

If there were a global debt-workout mechanism (a point I return to at the end of this paper), one would want to know not only that it operated efficiently to bring all the relevant parties together and reach an agreement in a timely way, but also that the workout agreement was just. There is no reason to presume that different players competing to advance their own interest reach a social optimum under the existing debt game. We know that vast numbers of people sense the injustice in how sovereign debt has been treated internationally. One can see strong evidence of this in the Jubilee 2000 movement, an international coalition of national networks of civil society organizations in 69 developed and developing countries that successfully pressured the governments of the major creditor countries to cancel the debts that poor countries owed to them and the international financial institutions they controlled. An international coordination mechanism should aim to do better, but then, what does "better" mean?

27 See Dealing Deftly, supra note 4, at 24-37.
28 See THE WORLD WILL NEVER BE THE SAME AGAIN 17 (Marlene Barrett, ed., Jubilee 2000 Coalition, 2000), available at http://www.jubileeresearch.org/analysis/reports/J2REPORT.pdf. Illustrative of the pressure is that in September 2000, in the context of the Millennium Summit, Jubilee 2000 presented to the United Nations Secretary-General a petition calling on the leaders of the richest countries to cancel the debts of the poorest. It was signed by 24 million people from 166 countries. Id. (this reference also contains a history of the movement). For a more inclusive study of the efforts of civil society to influence international finance, see CIVIL SOCIETY AND GLOBAL FINANCE (Jan Aart Scholte & Albrecht Schnabel eds., 2002).
II. A Theological Focus on the Consequences of Over-Indebtedness

The fact that the terms of sovereign debt workouts have improved over time for many of the heavily indebted countries—albeit not fast enough or for enough countries—owes much to the steady and often heavy pressure of civil society campaigns that embarrass creditor governments before their voters and embolden debtor governments in facing their public and private creditors, as noted above. The civil society campaigns seem to have drawn much of their strength from arguments based on theological reflections on justice and from such global religious institutions as the Catholic Church and networks like the World Council of Churches. 29 Indeed, the rallying cry of the major anti-debt campaign over the past decade has been to call for debt relief in the “Jubilee Year,” itself a biblical concept. 30

As we will see, the central concern for writers in this tradition has been that sovereign debt obligations can become oppressive and keep or push people in heavily indebted countries into extreme poverty. This is regarded as morally unacceptable. Extreme poverty—especially with the technology available today—is a result of how societies are organized, how the social product is produced and shared among the population. Sovereign debt crises are seen to aggravate extreme poverty or impede efforts to eradicate it. Neither sovereign debt crises nor poverty are immutable facts of nature and one may conceive of ways to eliminate them (especially thinking globally). Since we are instructed by our religions to care about our fellow creatures (“solidarity”), we are obligated to work to overcome the debt crises and seek to eradicate poverty. An even stronger view can be found among some theologians, namely, that the bible warns us that a society with extreme poverty (especially when accompanied

29 See infra, notes 32-34.

30 While Christian churches have been centrally engaged in the debt advocacy movement, the movement itself draws strong support from people of other faiths and secular supporters. Without them, the movement would not have achieved even its limited, albeit important, successes. Nevertheless, much of the rhetoric of the anti-debt movement over the past several decades—and its moral appeal—has drawn importantly from the Judeo-Christian traditions that are the focus of the essays discussed in this section. See Semper Reformanda: World Alliance of Reformed Churches, Economy in the Service of Life, http://www.warc.ch/pc/eslife/index.html (last visited Apr. 27, 2007).
by extreme wealth) is unsustainable, let alone unjust. Not only can poverty be addressed, but also ultimately it must be addressed for the survival of the society. Under both arguments, excessive debt must be relieved and a "fresh start" afforded.

Seen from the world of practical politics, these are highly radical points of view. In fact, no debts are relieved except under very extreme circumstances, as under formal "bankruptcy protection," as noted above for the corporate case, when the alternative faced would be closing down the firm (and thus greater losses for the creditors), or socially intolerable pauperization in the case of a household. There is nothing comparable to bankruptcy for sovereign governments, where the alternatives are limited to redirecting more public expenditure to the creditors, raising more tax revenue for the creditors, or reducing the government's debt obligations. Moving international policy even partially towards the latter solution has required prolonged and intense advocacy by millions of people around the world. Something very powerful must have been motivating them; something very appealing like the core idea of the "fresh start."

A. An Interpretation of the Judeo-Christian Tradition on Debt

Ton Veerkamp, a founder of Kairos Europa, traces the origin of the "fresh start" case for debt relief back to biblical calls for periodic household debt forgiveness in "Jubilee Years." The most striking aspect of his view is that the Jubilee idea not only spoke to some innate sense of fairness, but also, and more importantly, would have served the crucial political function of maintaining social cohesion in the small-scale, and basically stateless, society of ancient rural Judea during the time of the exile of the Jewish elites to Babylon. Periodically forgiving all

31 Kairos Europa is an ecumenical network critical of neoliberal globalization that aims to stimulate the participation of churches in a "conciliar process of mutual commitment to justice, peace[,] and the integrity of creation." Semper Reformanda: World Alliance of Reformed Churches, God or Mammon?, http://www.warc.ch/pc/soester/07.html (last visited Apr. 27. 2007).


33 Id.
debts—and not only the debts of the poorest households—would reverse the increasingly unequal income and wealth distribution that the normal operation of the economy generated. Veerkamp notes that, whether or not the principle was actually applied (which we do not know), it was decidedly not applied during periods of strong states, whether in the earlier Davidic kingdoms or when the ancient Jewish people were under the Greeks or Romans. State power can and does sustain radically unequal wealth, at least for a time. In that reality, the biblical prescriptions for income and wealth redistribution survive only as ethical maxims, albeit, we might add, compelling ones for many, many people.

Veerkamp goes on to argue that it is possible even in modern times for the redistributive principles to be made into policy through politics. He warns, however, that this is not easy. He recounts how people with different economic interests tend to fruitlessly talk past each other, often invoking different moral principles and perhaps not even understanding—let alone appreciating—the views of the other side. Whether or not mutual learning is possible, political pressures can force policy change. Veerkamp thus for many years joined with the World Council of Churches and other networks and institutions in calling for organizing masses of people around the world to create precisely this political pressure to change policies on the treatment of debt crises.

He acknowledges, moreover, that politics is not for the faint-hearted. It is messy in a way that "a purely individualistic ethic must always find embarrassing," using the terminology of the
American theologian, Reinhold Niebuhr. Veerkamp describes as a case-in-point the debt policy of Nehemiah, governor of what was at the time the Judean province of the Persian Empire. Nehemiah faced a debtors’ political movement that he could either attempt to suppress or accommodate. He opportune chose the latter.

Veerkamp would apparently like to see the international movement for debt relief—Jubilee and its successors—become powerful enough to bring about sufficient debt cancellation for poor countries and give them the kind of “fresh start” that the biblical authors talked about giving to families in ancient Judea. He says we need it today for the same reason the Jewish people needed it then: a world of sovereign states as unequal as ours, tolerating extreme poverty, is ultimately unsustainable.

B. Catholic Church Activism on International Debt

Members of the Catholic Church have been strongly involved in the Jubilee Movement from its early years in the 1980s through the Millennium Year and beyond. Many in the Church leadership, including Pope John Paul II, spoke out for its principles, prepared formal statements in response to it, and pressed Catholic political and financial leaders to take it into account. Elizabeth Anne Donnelly, an American activist in Catholic social movements, has traced this development of Catholic involvement in the international policy response to developing country debt crises, starting from its origins in the concerns expressed to Church leaders by social service agencies and missionaries in heavily

44 Veerkamp, supra note 32 (citing REINHOLD NIEBUHR, MORAL MAN AND IMMORAL SOCIETY: A STUDY OF ETHICS AND POLITICS xi (1932)).
45 Id.
46 Id.
47 Id.
48 Id.
49 Id.
indebted developing countries in the 1980s.51

Through an analysis of two prominent 1980s statements on the debt crisis—one by the Pontifical Commission on Justice and Peace (1987) and the other by the United States Conference of Catholic Bishops (1989)—as well as reflecting on Catholic social teachings that underlay these statements, she emphasizes the social imperative that in Catholic religious tradition is called “exercising a preferential option for the poor.”52 That phrase, however, seems open to wide interpretation. Donnelly interprets it as meaning that when economic or political institutions exacerbate poverty, they should be recognized as “institutionalized violence and social sin” and should be “addressed.”53 Others might consider that holding private or even public financial institutions to such a standard is quite a radical idea.

The core implication of the “option for the poor” as regards external debt of developing countries is that it directly links debt relief and poverty alleviation. As Donnelly argued, to the extent that honoring debt obligations impeded the ability of countries to overcome extreme poverty, the debt was a problem that morally cried out to be addressed. One could add that the developed country governments and IFIs accepted the rhetoric of this approach in adopting their Heavily Indebted Poor Countries (HIPC) Initiative, in which the promise of “adequate” debt reduction was coupled with debtor country commitments to develop “poverty reduction strategies” in consultation with their civil society organizations.54 Unfortunately, when it came time to operationalize the Initiative, the developed countries did not reduce the total amount of debt by enough to put the poorest countries into a “sustainable” debt situation, as defined by the creditors themselves.55

52 Id. at 110.
53 Id.
55 Aside from evidence of inadequacy from the mere fact that the Initiative was repeatedly “enhanced” by IMF and the World Bank, the Bank’s own internal evaluators raised such concerns. See WORLD BANK, OPERATIONS EVALUATION DEP’T, DEBT RELIEF
While the goal of debt relief seemed broadly analogous to the "fresh start" of the biblical principle, the inadequate amount of debt cancellation was repeatedly associated with the still inadequate levels of education and health spending. Again and again, since the HIPC Initiative was first launched in 1996, civil society movements brought widespread public attention to the creditors' miserly approach to relief. Each time, some additional relief was forthcoming. Most recently, in 2005, this took the form of the Multilateral Debt Relief Initiative, which eliminates most remaining external debt obligations of a group of HIPCs, aimed explicitly to help them achieve the Millennium Development Goals (MDGs), the first and foremost being to halve extreme poverty by 2015.

Achieving the MDGs is not only for the poorest countries. Those countries that have managed to sustain a strong rate of economic growth, most notably China and India, are likely to succeed. Those that recently underwent financial crises face a
greater challenge.\textsuperscript{63} Argentina provides an example of that fact. Catholic bishops became more actively engaged in Argentina’s economic situation as the crisis deepened, as reported in a paper by Thomas Trebat, Executive Director of the Institute of Latin American Studies at Columbia University and a former managing director and head of Latin American economic research at Citigroup.\textsuperscript{64} In his view, the Catholic Church served as a credible institution in the midst of Argentina’s political and economic collapse and helped to facilitate—if “after some considerable hesitation and misgivings”—a broad national dialogue of government and civil society.\textsuperscript{65}

The Argentine story is particularly interesting because the Church there has a history of association with the business and political elite.\textsuperscript{66} Apparently, a number of Argentina’s bishops increasingly lost patience with them and the rigid policies they persisted in following at great economic and social cost.\textsuperscript{67} Trebat notes that at one point in 2000, the Argentine Church supported a protest march led by dissident union leaders against the IMF, which had endorsed and financially supported the policy rigidities.\textsuperscript{68} By the end of 2001, when the financial collapse finally came, Argentina had been in recession for 45 months.\textsuperscript{69} Church criticism focused on the damage done to Argentine society as a whole, as well as to the poor in particular.\textsuperscript{70}

This notwithstanding, the Argentine Church was not part of the Jubilee Movement. It sought to occupy a middle ground between the religious debt campaigners and the creditor interests.\textsuperscript{71} As Trebat reports, the Church called on the Administration of Nestor Kirchner to negotiate in good faith with Argentina’s creditors and also expressed concern for some of the holders of defaulted

\textsuperscript{63} See id.

\textsuperscript{64} See Thomas J. Trebat, Argentina, the Church and the Debt, 21 ETHICS & INT’L AFF. 135, 136 (2007).

\textsuperscript{65} Id. at 152.

\textsuperscript{66} See id. at 136.

\textsuperscript{67} Id. at 148-51.

\textsuperscript{68} Id. at 149.

\textsuperscript{69} Id. at 151.

\textsuperscript{70} Trebat, supra note 64, at 151-52.

\textsuperscript{71} See id. at 153.
Argentine bonds, including Italian households.\textsuperscript{72} It accepted the legitimacy of Argentina's debt and the presumption that it should be paid.\textsuperscript{73} But the Argentine Church also asserted a moral presumption that substantial relief was warranted in this case owing to the cost already paid by Argentine society from having tried to service its debt.\textsuperscript{74}

Trebat sees two lessons in the Argentine episode.\textsuperscript{75} First, creditors of emerging market governments should appreciate that "once a reasonable effort to repay has been made, demands for repayment according to strict contractual terms may be legal, but not morally defensible."\textsuperscript{76} That is to say that there is—and should be assumed to be—a risk in lending to sovereigns. Second, Argentina's elites "must be cognizant that theirs is a profoundly unjust society and that priority in matters of debt must be given to human development rather than blind adherence to what the bishops called 'the tyranny of the markets.'"\textsuperscript{77}

\textbf{C. Implications: The Post-Jubilee Advocacy Agenda}

In sum, in Argentina, as in the HIPC Initiative, the "ethical" became "political," as Veerkamp might say. However, the tension has remained palpable between the efforts of the debt campaigners to bring about major relief versus the efforts of many of the creditor authorities to simply coop the language of the Jubilee campaign without adopting its policy prescriptions. Debt activists contend that they have much still to accomplish.\textsuperscript{78} First, governments whose debts were cancelled must be monitored and pressed to redirect freed up resources to poverty alleviation. Second, the principle linking adequacy of debt reduction to achieving the MDGs needs to be extended to all countries needing it, not only to the selected HIPCs. Finally, as Donnelly concludes,

\textsuperscript{72} Id.
\textsuperscript{73} Id. at 156.
\textsuperscript{74} Id.
\textsuperscript{75} Id. at 157-58.
\textsuperscript{76} Trebat, \textit{supra} note 64, at 157
\textsuperscript{77} Id.
since the central issue is poverty, the focus on debt needs to be complemented with strong attention paid to trade and foreign aid policy under such broad banners as “Make Poverty History.”\footnote{Donnelly, supra note 51, at 129-30.}

In other words, the theologically oriented arguments presented in this section have asserted that because suffering from extreme poverty is unconscionable and unwise (as it is ultimately unsustainable politically), the economically powerful states of the world should accord developing countries a “fresh start” whenever it is observed that the external sovereign debt of those countries holds back their ability to overcome poverty. This call for debt relief applies firstly to defaulting governments, because default brings on a major financial trauma with severe social consequences.\footnote{See De Paoli et al., supra note 5.} It is not a step taken lightly. But by the logic of the argument, it should also apply to countries that meet their debt-servicing obligations at great social sacrifice. Admittedly, every government is responsible for how it raises and budgets its resources and so there may well be non-debt-related reasons for short-changing anti-poverty expenditure. Thus, decisions on which countries should get how much relief has to be open to interpretation. Nevertheless, the commitment of all the world’s governments to achieve the MDGs by 2015 adds a degree of concreteness to governmental and intergovernmental obligations: relief should be accorded to every country in danger of not achieving the MDGs owing to external debt servicing.\footnote{This point was acknowledged—if not acted on—by the 2005 World Summit of the United Nations, when the assembled heads of state and government underlined “the importance of debt sustainability to the efforts to achieve national development goals, including the Millennium Development Goals, recognizing the key role that debt relief can play in liberating resources that can be directed towards activities consistent with poverty eradication, sustained economic growth[,] and sustainable development.” G.A. Res. 60/1, ¶ 26(b), U.N. Doc. A/60/1 (Oct. 24, 2005).}

In short, the authors discussed here, drawing on the Judeo-Christian tradition, view debt instrumentally as a factor affecting their main concern: poverty and social cohesion. This implies that when debt cancellation is warranted, it should be delivered so as to effectively address the wider anti-poverty imperatives. The implications are systemic. First, the debt relief process described earlier should be restructured so as to take proper account of the
potential anti-poverty impact. Who, after all, speaks for the poor in the various sets of negotiations outlined earlier? Second, effective processes are needed for ensuring that the relief is in fact translated into appropriate public expenditure. Who, after all, insures government accountability to the poor? And third, debt relief must be seen as but one instrument among many that can be brought to bear in the struggle to bring about a more just world. After all, if developed countries fully opened their markets to the exports of developing countries, would so many countries even need to seek debt relief?

III. A Philosophical Focus on the Responsibilities of Parties to Loans

As we have seen, a strong case can be made for cancelling the foreign debts of the government in a poor country when they cause or contribute to significant hardship of the people. This entails, of course, imposing a loss on the creditors (or whoever insures them).\(^8^2\) We may not feel much sympathy with rich creditors, for whom the loss might be minor. However, do we feel differently if we realize that the ultimate creditors are not the owners of faceless institutions behind marble walls, but people like ourselves? After all, "we" believe that we lent that money in good faith.

The universal presumption in international legal affairs is that every loan agreement should be honored (\textit{pacta sunt servanda}); each loan should be repaid with interest on schedule.\(^8^3\) But debt contracts, like virtually all contracts, routinely have clauses dealing with how to handle the situation when one or another party fails to fulfill its obligations under the contract. The ability to fulfill such an obligation may be compromised by any number of eventualities and the contracting parties need to agree beforehand how to respond to such cases, or how to go about deciding how to


\(^8^3\) This is actually an application to international commercial contracts of a more general proposition about international agreements, which has been termed the "oldest principle of international law." MALCOLM SHAW, \textit{INTERNATIONAL LAW} 812 (2003).
handle such cases (e.g., to resolve the problem in a court of law or by arbitration).

The ethical question in this context can be framed in terms of what a just set of relationships would be between borrower and lender. What would a just loan contract look like, and what should parties to a loan do if they wanted to act justly? Writers who raise such questions, such as Christian Barry and Lydia Tomitova of the Carnegie Council for Ethics in International Affairs, ask what should be the legitimate expectations and responsibilities of the different parties agreeing to the loan and what should be done when the government’s debt—the result of a series of loan contracts with different creditors—cannot be serviced as contracted.  

Barry and Tomitova approached this problem by asking when does a sovereign have an “ethical obligation” to repay a debt and when should it honor that obligation? “Obligation” in this sense speaks to a relationship between the parties to a loan; “honoring the obligation” speaks to actions taken or not taken to make a payment at a particular time. The authors approach these separate questions by asking, under what circumstances ought a borrowing government repay, when might it permissibly repay, and when ought it not repay a debt. The answers are complicated, as sometimes a government ought not to repay a debt it is obliged to repay (e.g., if honoring a commitment to pay would impoverish the population, which is to say, when an obligation not to impoverish overrides the obligation to the creditor). Also, the authors see cases in which a borrower ought to repay even if it has no ethical obligation to pay (e.g., even if the loan was immoral in some sense, the government might pay to maintain its credit standing among potential lenders, a strategic objective so as to hold down future borrowing costs). By the same token, creditors sometimes ought to demand repayment, might permissibly

85 Id. at 654-60.
86 See id. at 656-57.
87 Id. at 653.
88 Id.
89 See id. at 657-58.
demand repayment, or ought to forgive repayment when the debtor has an ethical obligation to repay, and even when there is no such obligation.\textsuperscript{90}

The authors' strategy for sorting through these possibilities is to posit idealized conditions under which loan contracts in general between any two parties should be enforceable, and then asking how this informs a discussion of sovereign debt.\textsuperscript{91} Their idealized conditions are that (a) the contracting parties should be rational agents who are willing (and implicitly able) to bear the full risk of loss to get the potential gain from a loan; (b) both are "formally free" so that neither has the right to dictate the terms of agreement; (c) both are "substantively free" so that neither can effectively dictate the terms of agreement to the other; (d) both have the information they need and are competent to assess the prospective contract; and (e) the environment in which the contracting parties operate is "relatively stable" so few "unforeseeable changes" occur.\textsuperscript{92}

These criteria are held to be attractive because, when they are obtained, parties would make only mutually beneficial loans.\textsuperscript{93} Also, as these loan contracts would be legally enforceable, it would discourage parties from breaking the contract for which they would be held accountable.\textsuperscript{94} Moreover, under these criteria, rich people would have the confidence to lend in the first place, permitting the more efficient allocation of financial resources and more economic growth.\textsuperscript{95} In addition to such "consequentialist" considerations, Barry and Tomitova are attracted to these criteria for so-called "deontological" reasons, i.e., because they would give opportunities for people to develop their sense of duty and act ethically.\textsuperscript{96} The authors see the process of borrowing and repaying

\textsuperscript{90} Barry & Tomitova, \textit{supra} note 84, at 657-58.

\textsuperscript{91} Id. at 664-68.

\textsuperscript{92} The difference between (d) and (e) can be interpreted as taking account of the difference between evaluating known or knowable risks owing to the normal variability of economic activity versus uncertainty about economic "shocks" that are, by nature, surprises.

\textsuperscript{93} See Barry & Tomitova, \textit{supra} note 84, at 657-58.

\textsuperscript{94} Id.

\textsuperscript{95} See id.

\textsuperscript{96} Id.
as encouraging personal ethical development (becoming a "person of integrity").

Barry and Tomitova then ask how much of this applies at the level of sovereign borrowing in the world, as it exists. Their answer is, alas, not enough. To start, sovereign debtors are not individuals but complex collections of individuals, some of whom usually count much more than others. Also, the borrowing government may be formally free, but far from "substantively free." In addition, borrowers may not fully appreciate the risks they enter into when borrowing (and one could add that sovereign borrowers and their creditors have at times taken on excessive risks on the assumption—true in some years and false in others—that they would be bailed out by the official international community). Finally, the global economic environment has been more volatile than expected in recent decades and subject to major uncertainties.

This seems a sensible framework, but does it help us figure out where justice lies in resolving a sovereign debt crisis?

A. Responsibility of Debtors

One may ask if, in practice, there are circumstances in which creditors have a moral claim to be paid in a sovereign debt crisis, acknowledging that the burden might be born by the residents of a low-income country experiencing political and economic difficulty. When should the debtors be held responsible?

A first presumption might be that those responsible for undertaking the debt are obliged to repay it. In other words, one could argue that citizens of a democracy should pay because they are responsible for acts of their government, including the signing of loan contracts. But this is not as straightforward as it seems. Sanjay Reddy, an economist at Barnard College, notes in this

97 Id. at 667.
98 Id. at 668-74.
99 See Barry & Tomitova, supra note 84, at 668.
100 Id.
101 Id. at 670.
102 Id.
103 Id. at 672.
context that at any moment in time, including the day a loan contract is signed, the state represents a collection of individuals who are at different points in their life cycle, including, of course, some yet to be born, who will be affected by the terms of the loan. Thus, democracy per se cannot be an effective criterion for sovereign debtor responsibility to repay any long-term loan, as the unborn cannot vote.

Reddy argues that the state can nevertheless morally bind its ongoing collective of people in the country to repay its debt. He posits that the collective would be morally bound to repay if the people in the country "equitably" share the benefits and costs of the debt (satisfying some agreed distributional criteria, such as fairly sharing the tax burden for repaying and deciding how or where in the country the proceeds of the loan would be spent and the benefits of the loan captured), assuming also that the overall outcome is "beneficial" for the country (again, satisfying some agreed meaning, as in terms of economic growth). In other words, creditors could fairly demand repayment from the state when it contained net beneficiaries of the loans and the distribution of the net benefits had been arrived at fairly. Reddy thus takes us to a point of intersection with the theological arguments discussed earlier. The call of the latter for debt cancellation posited the negation of the conditions warranting repayment, i.e., when debt servicing impedes achieving the MDGs.

This conclusion hinges, in Reddy’s terms, on the

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105 Id. at 38-40.
106 Id.
107 Id. Axel Gosseries, *Should They Honor the Promises of their Parents’ Leaders?* in DEALING FAIRLY WITH DEVELOPING COUNTRY DEBT (Christian Barry et al., eds., forthcoming 2007), takes a similar approach, but asks us to pay attention in making the assessment to the consequences of the loan as well in the lending country (e.g., less domestic investment and economic growth compared to having retained the funds in the creditor country). More broadly, he examines ethical principles that might apply to sovereign foreign debt that span generations and finds several reasons why actions of one generation cannot, per se, ethically obligate the following one to repay. This is taken to invalidate “odious debt” claims for canceling sovereign debt (see Section C below), as well as arguments to repay in “normal” circumstances. He finds distributive approaches to be more firmly grounded in ethical principles for discussions of such cases.
108 Id.
negative impact of debt servicing on the poor and the lack of fairness when the prospective benefits of the loans were allocated in the first place.\footnote{See id. at 33.}

Implicit in Reddy’s argument is not only that the state should be willing to pay when there are net benefits of the debt, but that it has the ability to repay. But should the debtor state have to repay even if there were no net benefits of the loans? The nature of a debt contract is to put all the risk on the borrower: even if the project for which the funds were borrowed fails, the borrower is still expected to repay the loan.\footnote{Reddy, supra note 104, at 41.}\footnote{Id.}


Unfortunately, creditors have generally shown little interest in any such “modified debt contracts,” outside of Islamic finance.\footnote{Emerging Markets Traders Association, Primer on Mexican Value Recovery Rights, Apr. 18, 2000, available at http://www.emta.org/ndevelop/primer.pdf. This is underlined by the name commonly assigned to such payments—“value recovery rights.” Id.}

The major instances in which the market has accepted sovereign loans with built-in contingent payments have been as part of debt restructuring negotiations, which were not unconstrained choices.\footnote{See Ken Miyajima, How to Evaluate GDP-Linked Warrants: Price and Repayment Capacity (IMF, Working Paper 06/85, Mar. 2006), available at http://www.imf.org/external/pubs/ft/wp/2006/wp0685.pdf. Mexico, Nigeria, and Venezuela attached warrants to the “Brady bonds” that restructured their 1980s international bank debt, wherein additional payments would be made to the bondholders if oil prices rose sufficiently. Although Bulgaria, Bosnia-Herzegovina, and Costa Rica issued GDP-linked “Brady bonds” as part of their debt restructurings, most financial market attention has focused on the GDP link in Argentina’s 2005 bond swap. Id. at 5-7.}

By the same token, sovereign borrowers with normal market
access have not shown interest in issuing modified debt contracts, even though it appears to be in their interest to do so.\textsuperscript{115} This is not to deny that the debt management offices of some developing countries have explicitly sought to manage their sovereign liabilities by altering their portfolios of obligations so as to reduce risk and cost. For example, in some instances debt management officials have prepaid riskier debt and issued more local currency debt.\textsuperscript{116} However, as noted, they have not sought to build risk mitigation features into new bonds themselves.\textsuperscript{117} Public sector and academic efforts to promote development of such instruments have so far been mainly treated as interesting curiosities.\textsuperscript{118}

We are thus unable to escape the question of assessing the ethics in servicing or not servicing standard sovereign loan contracts. Alexander W. Cappelen, Rune J. Hagen, and Bertil Tungodden, three Norwegian scholars, have suggested that it is important to inquire who caused the debt crisis before giving debt relief.\textsuperscript{119} How much should the creditors have to forgo if the losses—and poverty—of the borrower was its own fault? Is there not a proper notion of "national responsibility" of sovereign debtors and their people?

Cappelen and his colleagues invoke a "liberal egalitarian" framework in their discussion, which seeks to distinguish when persons or institutions should be held responsible for their situation.\textsuperscript{120} Under this framework, inequalities that result from

\begin{footnotes}
\item[115] That is, one is hard pressed to find cases of countries that issue such bonds when they can issue standard bonds instead.
\item[120] \textit{Id.} at 71-75.
\end{footnotes}
“responsibility factors” are considered justified and thus should be socially accepted (a principle of national responsibility).\textsuperscript{121} In such a case, the citizens of a poor country—albeit not necessarily the poorest among them—should pay the government’s debt.\textsuperscript{122} However, inequalities for which agents are not responsible are considered unjustified and should be eliminated (a principle of international equalization).\textsuperscript{123} In such cases, debt cancellation is warranted.\textsuperscript{124} Responsibility presupposes that national policies are freely formulated and democratically adopted (as it can be argued was the case in Argentina, but may not have been the case in many other developing countries).\textsuperscript{125} Further, as there is much uncertainty and volatility regarding how policies turn out, they argue that agents should only be held responsible for the “fair consequences of borrowing.”\textsuperscript{126}

The authors then ask if there is evidence that such a framework has been used in according relief to the HIPCs, the group of heavily indebted poor countries singled out for special debt relief treatment.\textsuperscript{127} Their answer is no.\textsuperscript{128} They find that the amount of relief given to these countries is statistically related to the amount of debt accumulated, but not to the degree of poverty in the country.\textsuperscript{129} If poverty was a non-responsibility factor, creditors should have forgiven relatively more debt in poorer countries. Instead, the results seem to conform more to the theologians’ argument for a “fresh start” discussed earlier, wherein one would seek to bring each crisis country to a point where it had a fair chance to succeed economically.\textsuperscript{130} More indebted countries would require more relief to get to this fair starting point, regardless of who was at fault or whether there was a large or small amount of poverty. In this perspective, the amount of relief

\begin{itemize}
  \item \textsuperscript{121} Id. at 72.
  \item \textsuperscript{122} Id. at 74-75.
  \item \textsuperscript{123} Id. at 72.
  \item \textsuperscript{124} Id. at 74-75.
  \item \textsuperscript{125} See Cappelen et al., supra note 119, at 73.
  \item \textsuperscript{126} Id. at 75.
  \item \textsuperscript{127} Id. at 75-81.
  \item \textsuperscript{128} Id. at 79.
  \item \textsuperscript{129} Id.
  \item \textsuperscript{130} Veerkamp, supra note 32.
\end{itemize}
should be a function of the amount of indebtedness, as was found, and not the extent of poverty.\textsuperscript{131}

It appears from this discussion that the theologians’ approach to debt is the opposite of the liberal egalitarian one. The biblical call for periodic cancellation of debts, as discussed earlier, made no reference to who was at fault in the accumulation of the unpayable debt. Indeed, all debts were to be cancelled, even payable ones. In Veerkamp’s view, this was to prevent society from becoming too unequal, to prevent the rich from getting too rich or the poor from getting too poor. In the discussion by Donnelly, the focus was more on the impulse of solidarity to alleviate the suffering of the poor. To Trebat, the limit had been reached on how much punishment the Argentine people should be allowed to sustain in trying to service the debt. And in all variants of the theological approach, individual or national blame for the debt is beside the point. The perspective of the “fresh start” is forward looking.

\textbf{B. Responsibility of Creditors}

If the argument that debtor governments should be held responsible for their debt crises has not been reflected in international debt relief policy, neither has the argument that creditors should be liable for damages caused by their loans or the policies they required of governments to get the loans. Kunibert Raffer, a lawyer and economist at the University of Vienna, makes the case for lender liability.\textsuperscript{132} In fact, he charges that southern governments that entered into debt crises after 1970 have born a higher and disproportionate share of the cost of default than have their creditors compared to the experience of debtor governments over the previous century.\textsuperscript{133} He also believes that sovereign debtors have been treated worse than corporate debtors, owing in part to the absence of a legal bankruptcy regime for governments, as there are protections for the debtors (as well as the creditors) in

\begin{itemize}
\item \textsuperscript{131} This does not imply donors were necessarily insensitive to poverty, as foreign aid, unlike debt relief, could be allocated according to the extent of poverty.
\item \textsuperscript{132} See generally Kunibert Raffer, \textit{Risks of Lending and Liability of Lenders}, 21 ETHICS \& INT’L AFF. 85 (2007).
\item \textsuperscript{133} \textit{Id.} at 86-93.
\end{itemize}
bankruptcy laws.\textsuperscript{134} He blames these results on the great disparity in economic power between the developing country debtors and their different international creditors, which is illustrative of what Barry and Tomitova, in the paper discussed above, referred to as the problem of "substantive freedom" in borrowing, or rather the lack thereof.\textsuperscript{135}

Raffer emphasizes that lenders should be held liable for sovereign default when their actions impede the debtor from honoring its obligations.\textsuperscript{136} An example of such a case would be where debtors cannot raise sufficient tax revenue to service their debt because of artificial restraints on their country's exports (and thus income) owing to tough import tariff and quota restrictions on the goods in which the debtor economy has a comparative advantage.\textsuperscript{137} In the same vein, the major international commercial banks are accused of having abetted the difficulties that developing countries had in servicing their debts to those banks in the 1980s, as their private banking arms helped rich nationals remove their financial resources (capital flight), while their sovereign lending arms kept extending loans that were ultimately unpayable.\textsuperscript{138}

Raffer is particularly concerned about the behavior of the IFIs, which insist on being the first in line to be repaid while pushing debtor countries to adopt policies that he alleges have contributed to the debt crises.\textsuperscript{139} He cites cases in private law in which debtors did not have to repay creditors that misled them.\textsuperscript{140} Nothing of the sort is available to sovereign debtors under international law.\textsuperscript{141} No one but the debtor pays for mistakes at this level.\textsuperscript{142} He argues not only that this is wrong, but also that each of the IFIs has the legal and financial ability to grant relief through its normal

\textsuperscript{134} Id. at 93-95.
\textsuperscript{135} Id. at 95.
\textsuperscript{136} Id. at 95-103.
\textsuperscript{137} Id. at 96.
\textsuperscript{138} Raffer, supra note 132, at 101.
\textsuperscript{139} Id.
\textsuperscript{140} Id. at 102.
\textsuperscript{141} Id.
\textsuperscript{142} Id.
decision-making processes and so could take financial responsibility when its advice proved misguided.\footnote{Id. at 101.}

Raffer further argues that better recognizing lender responsibility is not only important for making international financial relations fairer, but they would also lead to better decisions.\footnote{Raffer, supra note 132, at 105.} Giving debtor governments the opportunity to claim that responsibility for a crisis should be shared with the IMF or World Bank should make the institutions more cautious in pushing on governments whatever the current policy fad happens to be.\footnote{Id.}

By the same token, the possibility that any of the creditors could be held liable should make the "due diligence" expected of all creditors individually into a better mechanism for crisis prevention.\footnote{Id.}

This line of argument also leads one to think about how other types of creditors might be encouraged to lend "better" by shouldering more responsibility for their loans. For example, export credit agencies have been accused of promoting sales of goods that developing countries do not need.\footnote{Id.} Indeed, in October 2006, the Norwegian Government agreed to "share responsibility" for loans originally extended to cover the purchase of Norwegian ships between 1976 and 1980 by twenty-one developing countries in an export promotion campaign that was subsequently discredited in an official evaluation by the Brundtland government in 1988-89 as having been based on "inadequate needs analyses and risk assessments" in which "a great many" of the funded projects "proved to be unsustainable."\footnote{Id.} The current government came to the conclusion that the operation had been a "development policy failure" and it thus cancelled the $80 million remaining due

\footnote{This point was developed in a workshop discussion of an earlier draft of this paper at Central European University, Budapest, Oct. 26, 2006.}

This principle could be internationalized. The Organization for Economic Cooperation and Development (OECD) in Paris hosts an intergovernmental Working Party on Export Credits and Credit Guarantees that has already inscribed "debt sustainability and responsible lending" on its agenda. This forum could develop an agreed definition of "irresponsible" lending and members could then promise to eschew making such loans and not hold borrowing governments responsible for repaying such loans if they are made. While borrowing governments might nevertheless choose to service such loans (an instance of deciding to pay when not having an obligation to pay), in the event of default, one may be confident that these loans would be accorded lower repayment priority than other debts of the government.

**C. Implications: Broader Responsibilities in Loan Agreements?**

Several policy questions are raised by the preceding discussion, including how to help governments of developing countries become better borrowers, how better to handle international volatility and uncertainty, and how to hold creditors (and debtors) accountable when they contribute to sovereign insolvency. International technical assistance programs in debt management and public finance contribute to the first goal. Volatility and uncertainty have mainly been addressed outside the debt contract per se, as in programs of compensatory official financing to ease the impact of international commodity price volatility. The last point, defining more clearly what should be

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149 Id.


151 See IMF Pol’y Dev. & Rev. Dep’t, Guidance Note on the Exogenous Shocks Facility 4 (2006), available at http://www.imf.org/external/np/pp/eng/2006/012706.pdf (covering the new IMF facility including comparison to other arrangements). Significant contingent financing programs were introduced decades ago by the IMF and the European Union (the latter including grants for the poorest countries when commodity export prices declined significantly), but were subsequently weakened or retracted in the 1980s and 1990s, although they have seen a partial rethink in the current decade, if only for the poorest countries. Id. See generally STEPHANY GRIFFITH-
the responsibilities of different agents in debt contracts, has not seen very much international policy follow through thus far, although the recent attention paid to "odious" debt and the Equator Principles may be interesting straws in the wind.

Unlike government regulation of the consumer market for loans and national bankruptcy laws, there is no binding international agreement on "truth in sovereign lending," nor are there enforceable international rules or guidelines for treating sovereign debt when crises arise. 152 There are only specific contractual obligations in individual loans and the treatment of those contracts in different national courts of law. 153 There is, however, one example of supra-contractual international policy embodied in a small set of cases in which the political authorities of a state have, in essence, repudiated or forced the cancellation or restructuring of their own or another country's debt obligations based on the assertion that the government that incurred the debt had carried out "odious" actions against its own people with funds that the creditors helped to provide. 154

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152 See generally IMF, Standards and Codes, http://www.imf.org/external/standards/index.htm (last visited Apr. 27, 2007) (demonstrating that the guidelines that do exist pertain to standards of public finance and debt reporting for IMF member countries and codes on statistical and fiscal transparency, all of which are addressed to issuers of sovereign debt). The primary effort to specify joint rules for sovereigns and their lenders (meant only to apply to private sector creditors) entails purely voluntary "commitments" by governments and major investment and commercial banks to cooperate in good faith in good and bad times. See INST. OF INT'L FINANCE, PRINCIPLES FOR STABLE CAPITAL FLOWS AND FAIR DEBT RESTRUCTURING IN EMERGING MARKETS (2005), available at http://www.iif.com/download.php?id=c/48cJgSDtk.


Under this doctrine, a sovereign government’s debt may be defined as “odious” if the funds were borrowed by a government that lacks “legitimacy” in some sense, if they were not borrowed for a public purpose (i.e., not to benefit the people in some sense), and if the lenders were aware of both conditions when they made the loans. The doctrine then says that a legitimate successor state need not repay such odious debts. The doctrine was most famously applied by the United States after the Spanish-American War of 1898 to explain why the new government of Cuba should not be held responsible for the debts incurred when it was under Spanish control. The doctrine has also been cited recently in arguments claiming the current Iraqi government should not have to repay the creditors of the former Iraqi regime. It has to be noted that U.S. authorities made the case for both Cuba and Iraq at times of strong U.S. interest (and military involvement) in each place. It is an argument meant in these cases to punish creditors (or their government patrons) for abetting the odiousness of a government that has fallen, as much as to help the new government.

Several civil society advocacy groups have also used the doctrine to call for cancellation of the debts that governments in some developing countries inherited from past governments. However, these governments—especially those in fragile, new democracies—seem most intent on knitting their society back together and re-establishing normal international relations,

155 Id. at 13-19.
156 Id.
159 Id.; see also Pérez & Weissman, supra note 157.
including those with prospective creditors. A case prominently discussed among civil society networks was that of South Africa.\textsuperscript{161} Just as its post-apartheid government wanted “Truth and Reconciliation,” not new Nuremburg Trials, so too it wanted investors—domestic as well as foreign—to be fully confident that the South African government would honor its debt obligations without interruption.\textsuperscript{162} The South African authorities rejected calls to nullify the debt on the basis of its odiousness. Efforts by international advisors and civil society advocates to convince new regimes in other countries to make the case for odious debt cancellation have similarly been rejected by debtor country finance ministries.

Debtor governments clearly appreciate that all the risk falls to them if they initiate a claim that the debts inherited from a previous regime are odious and should not be honored. Should they unilaterally repudiate the debts, they may be frozen out of future funds. If they plead their case to the international community, they may receive a sympathetic hearing, when what they need is some form of concrete statement that would be acceptable to the government agencies, multilateral institutions, and courts of the creditor countries, saying that payment of those debts was not required.

This risk could be reduced if an anti-odiousness pledge were written into the loan contracts.\textsuperscript{163} It would then be a matter of determining whether an odious situation had occurred, not whether odiousness would be an acceptable condition for non-payment.\textsuperscript{164} This presupposes an internationally agreed definition of odiousness and an international mechanism to judge individual instances of externally financed odious behavior (not to mention including enforceable legal covenants in the loan contract protecting the claims of the non-odious creditors of an odious debtor).\textsuperscript{165} Such a project would require a very ambitious international negotiation agenda. Yet it suggests that a contractual


\textsuperscript{162} Id.

\textsuperscript{163} See Feibelman, supra note 117.

\textsuperscript{164} Id.

\textsuperscript{165} Id.
approach might be devised, in conjunction with international political action, to move creditors and debtors towards accepting broader responsibilities for their loan agreements.

In this regard, a potentially important precedent is being established by the revised "Equator Principles" for preventing negative environmental and social impacts of large-scale projects financed by commercial banks.\(^{166}\) Although banks voluntarily adopt the principles, they do so under pressure from within the industry and from civil society organizations, the net result of which is that adoption of the revised principles has spread as of February 2007 to forty-five institutions responsible for over eighty-five percent of private cross-border "project finance" (although the degree of implementation by participating banks is apparently less than clear).\(^{167}\) Of particular relevance to the present discussion, institutions subscribing to the revised principles are now required to include compliance covenants in their loan agreements, including borrower promises to implement "Action Plans" that are prepared according to specified procedures in order to mitigate the potential adverse impacts of a project, and to periodically report on implementation.\(^{168}\) If the borrower fails to comply, the lending banks "reserve the right to exercise remedies, as they consider appropriate."\(^{169}\) It remains to be seen what such "remedies" might be and how transparent the whole process will become.

This initiative understandably has its critics as well as supporters,\(^{170}\) but is nonetheless notable for directly acknowledging that there is an issue of creditor and debtor responsibilities for what is done with borrowed monies. Also, while the Principles were designed with an eye towards complementing the Sustainability Policy of the International

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\(^{167}\) See id.

\(^{168}\) See id., Princ. 8: Covenants.

\(^{169}\) Id.

Finance Corporation, the private lending arm of the World Bank,\(^{171}\) the internationally agreed processes for monitoring implementation of the IFC commitment are not paralleled in the case of the Principles.\(^{172}\) Thus they are a test of how far a purely voluntary contractual approach can go in development of what we may call ethical standards in lending. Finally, one may surmise that the banks, which are, after all, agents of their depositors and shareholders, developed the Equator Principles as a response to pressures demanding they exercise more responsibility in their lending rather than just assuming that the borrower will repay.

IV. An Extension of "Responsibility": Odiousness as a Sanctions Regime

Some authors have taken the responsibility concerns elaborated in the previous section and proposed that they be made operational in a different way, namely as a sanctions regime designed to change the behavior of rogue governments. Internationally agreed-upon trade sanctions were viewed for a time as a promising way nations could collectively isolate a country that threatened its neighbors or seriously violated principles of human rights, democracy, and development.\(^{173}\) In practice, trade sanctions have been a "blunt instrument."\(^{174}\) To the extent they are effective, trade sanctions cause economic disruption, close factories, and impoverish people.\(^{175}\) Moreover, trade sanctions

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\(^{172}\) Id. ¶ 12-23 (noting that the IFC requires social and environmental reviews of potential projects before funding them). The IFC also monitors the projects. Id. ¶ 26-29. Finally, civil society complaints to a compliance advisor/ombudsman independent of IFC management is provided for. Id. ¶ 31-35.

\(^{173}\) U.N. Charter art. 41 (providing that the Security Council could call upon Member States to apply measures short of armed force "to give effect to its decisions" which could include "complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication"); see also ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 697-764 (2002) (for a review of legal aspects of collective and unilateral sanctions).

\(^{174}\) BOUTROS BOUTROS-GHALI, AN AGENDA FOR PEACE 26 (2d ed. 1995).

\(^{175}\) Id. at 25-28; see also Lori Fisler Damrosch, The Civilian Impact of Economic Sanctions, in ENFORCING RESTRAINT: COLLECTIVE INTERVENTION IN INTERNAL CONFLICTS 274-315 (Lori Fisler Damrosch ed., 1993).
create strong incentives for evasion, as the rich will pay high prices for prohibited imports. This means that the sanctions disproportionately harm poor people.\textsuperscript{176} To try to mitigate these unintended consequences, policy makers began to consider more precisely targeted sanctions. This brought some attention to targeted financial sanctions, especially where they could be aimed directly at the offending government without collateral consequences.\textsuperscript{177}

In this context, Thomas Pogge, a philosopher at Columbia University, has asked if there are times when a government's ability to borrow abroad should be curtailed by other countries.\textsuperscript{178} Interestingly, he turned the sanctions question around and asked first what a fledgling democracy could do to protect itself from potential \textit{coup d'état}. His answer was that it could try to make it harder for an undemocratic successor regime to operate by discouraging new foreign lending to that regime.\textsuperscript{179} To be effective, however, his proposal would also require broad international cooperation, as in more conventional sanctions regimes.\textsuperscript{180}

Pogge suggested that fledgling democracies amend their constitutions so as to provide that debts incurred by any undemocratic successor regime not be serviced out of the nation's public funds.\textsuperscript{181} As the phrase "undemocratic regime" could be open to interpretation, he proposed that the amendment specify that an external entity determine when the regime had crossed from democratic to non-democratic.\textsuperscript{182} This "Democracy Panel" would be an independent entity formed from reputable and


\textsuperscript{179} Id. at 10-12.

\textsuperscript{180} Id. at 12-18.

\textsuperscript{181} Id. at 10-12.

\textsuperscript{182} Id. at 12.
knowledgeable jurists, possibly under the auspices of the United Nations.\textsuperscript{183} Pogge's intention was that there would be an expert, rather than a political, assessment that the country is no longer democratic.\textsuperscript{184}

Pogge expected the leaders of a coup to suspend or annul the constitution, thus permitting continued debt servicing during the new regime, a practical \textit{quid pro quo} for obtaining (and servicing) new credit.\textsuperscript{185} Creditors would have to be concerned, however, that democracy and the constitution might be restored and the servicing of loans made during the non-democratic period discontinued, for which risk they would compensate themselves by adding a premium to the interest rate on any such loan.\textsuperscript{186} Thus, foreign credit—at least foreign private credit—would be more expensive and of uncertain availability to an odious regime.\textsuperscript{187} Indeed, one could take the argument further and call on creditor governments to cease providing their usual guarantees for export financing and not approve any IFI loans to any regime that was declared non-democratic by the Democracy Panel.\textsuperscript{188}

Pogge was quite concerned, however, that his proposal was too radical and that the major democratic regimes would be less anxious to promote fledgling democracies than to maintain international financial rules.\textsuperscript{189} One could add that foreign policies \textit{vis-à-vis} individual governments seem generally driven more by concerns for national advantage than the international spread of desirable principles. As he notes in a different context, in some circumstances, the major powers might prefer a less democratic but friendlier regime to a more democratic but more independent

\textsuperscript{183} \textit{Id.} at 12-14.
\textsuperscript{184} See Pogge, \textit{supra} note 178, at 12.
\textsuperscript{185} \textit{Id.} at 11.
\textsuperscript{186} \textit{Id.} at 10.
\textsuperscript{187} \textit{Id.}
\textsuperscript{188} Moreover, if new loans were denied to such a non-democratic regime, it may be expected that the regime would discontinue servicing the legitimate debts that were still outstanding. Thus, so as not to punish those earlier creditors unfairly, Pogge also proposed establishing a multilateral fund with resources provided by democratic countries to cover the payments to the creditors that the "odious" regime ceased making. \textit{Id.} at 14-17.
\textsuperscript{189} \textit{Id.} at 18.
one. However, he believes the proposal could be put into effect even without the support of the major powers, and should certainly be put into effect with their active participation.

Jonathan Shafter, lawyer, manager of private investment partnerships, and Principal of Boston Provident, an investment firm, further developed the idea of discouraging international access to credit by rogue states as a way to strengthen democratic regimes. While Pogge formulates his proposal as a declaration by an individual legitimate government not to honor financial obligations entered into by an illegitimate successor regime and calls for international support of that declaration, Shafter proposes establishing an international sanctions regime to use against governments that the international community deems odious. Had such a system existed, we might add, the United Nations sanctions imposed on South Africa’s apartheid regime in 1985 could have included a declaration that any loans extended to the regime would not have to be paid by a proper successor regime. This would have created strong pressure on banks not to lend, as their home governments would have in essence declared that they would oppose attempts to collect on those loans through the courts. This would have greatly strengthened international pressure on the regime.

Shafter admits, however, that a blanket discouragement of lending to a regime subject to sanctions would be too extreme, and could prevent government projects that would benefit the people forced to live under that regime. Creditors might wish to lend for such projects, but they would need some way to determine that the loan actually had a public purpose, and be able to prove in the future that it had reason to believe that to be the case so as to avoid

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190 Pogge, supra note 178, at 21.
191 Id. at 17.
193 Id.
194 One could add that banks that did lend would have explicitly worked against their governments’ foreign policy, which is terrible public relations, especially for publicly regulated institutions like banks.
195 Shafter, supra note 192, at 58.
the loan being declared "odious" and non-payable.\textsuperscript{196} For this reason, Shafter introduces what he calls the "due diligence" model.\textsuperscript{197}

The proposal is that first an international organization be charged to declare countries "odious prone," based on the principles of international law given to it.\textsuperscript{198} The member states of the organization would make the determination, and so the finding would be political, albeit justified by international law.\textsuperscript{199} This is not only a matter of pragmatism, but also recognition that there is much room for interpretation in whether a government rules with the "consent" of the governed.\textsuperscript{200} Potential creditors would then need to assure themselves through "reasonable due diligence" that the loan they are considering is for a public purpose and they would need to monitor the loan to ensure that it is actually used in the way envisaged.\textsuperscript{201} The international organization would presumably issue guidelines on this. In any event, the organization should certify that the creditors' due diligence on the proposed project was adequate for the loan to go forward. This certification would be based on the "no action" letters model followed by the Securities and Exchange Commission in the United States when there is concern that proposed transactions might run afoul of regulations.\textsuperscript{202} In essence, this puts responsibility for properly assessing the project on the creditors, in exchange for which they can be confident their loan will not be declared odious.\textsuperscript{203}

The proposal has many attractive features, but much still needs to be fleshed out, as the author himself concludes.\textsuperscript{204} First, should the organization be placed in the United Nations, which is universal, but as such often has difficulty in reaching consensus, or

\textsuperscript{196} Id. at 54-56.
\textsuperscript{197} Id. at 58-65.
\textsuperscript{198} Id. at 59-60.
\textsuperscript{199} Id.
\textsuperscript{200} Id. at 56-58.
\textsuperscript{201} Shafter, supra note 192, at 60-63.
\textsuperscript{202} Id. at 61.
\textsuperscript{203} Id. at 61.
\textsuperscript{204} Id. at 65-66.
should it be in a more homogeneous organization, such as the OECD, which brings together the developed country democracies and certain large emerging democracies, such as Mexico.\textsuperscript{205} One could also envisage a freestanding organization of "like-minded" countries. In addition, decisions would have to be reached on the range of application of the sanctions regime; e.g., should it cover government and IFI lending or only the private sector?\textsuperscript{206} Finally, much detailed work is still needed to be able to move from the general prescription of "due diligence" to the legal requirements for deal structuring and auditing.\textsuperscript{207} It appears to be, however, a very interesting proposal.

Nevertheless, odiousness is far from ready to enter the toolkit of preventive diplomacy. To start, there is no consensus on the concept of odiousness, or of democracy. Moreover, international intervention on a domestic issue like the form of government in a country has little basis in international law.\textsuperscript{208} On the other hand, the world needs a stronger international human rights policy. There is a formal global agreement defining human rights, which was the result of decades of deliberations, negotiations, and legal inquiries on human rights.\textsuperscript{209} Might odiousness better be defined by international agreement in terms of major and sustained violation of human rights? Might the world agree to international interventions to stop such human rights abuses? Might not the models of Pogge and Shafter help shape a tool of diplomacy that is more than a non-binding resolution expressing outrage, better targeted than trade sanctions, and less destructive than military invasion?

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\textsuperscript{205} Id. at 63-65.

\textsuperscript{206} Id. at 66. Note that, if IFIs were included, it would mean accepting that there were conditions under which IFI loans should not be repaid.

\textsuperscript{207} Shafter, supra note 192, at 60-63.

\textsuperscript{208} See generally SHAW, supra note 83, at 1039-48 (discussing the principle of non-intervention as understood today).

V. We Still Need an International Forum for the Fair Treatment of Sovereign Debt

Arguments for relieving developing countries of excessive debt and for distinguishing responsibilities of different parties in a loan are one thing. Turning them into international policy is quite another. Developing this international policy requires having an international forum in which to address these concerns transparently, in a coherent way, and with the participation of all the relevant stakeholders. It does not necessarily mean the creation of a new forum, but it does require the existence of a place with a roof, enough seats, and booths for interpreters. One should want, first, a forum that is appropriate for agreeing to a set of principles, such as have been discussed here, and for designing mechanisms for their application. Second, one would want an effective and independent operational arm to apply the principles when and as necessary. This has been, and remains, a missing piece of the global financial architecture.

Indeed, since the 1970s, different policy writers have suggested introducing into the official international system some mechanism for sovereign debtors that would parallel the bankruptcy laws and their judicial instrumentalities that exist at the national level in most countries.210 International civil society organizations began to advocate for such a reform of the international financial architecture, especially in the 1990s, but to little avail.211

Suddenly, in late 2001 the idea entered the agenda of the IMF and became a serious matter for consideration by policy makers. The staff of the IMF had already been internally considering an institutional model for addressing sovereign bankruptcy when the Secretary of the U.S. Treasury, Paul O'Neill, voiced support for studying such a proposal.212 The First Deputy Managing Director


211 Several of the civil society proposals have been collected in THE DEBT PROBLEM FOR POOR COUNTRIES: WHERE ARE WE? (Rogate R. Mshana ed., 2004).

212 Brad Setser, The Political Economy of Bankruptcy 2 (Columbia Univ. Initiative for Pol'y Dialogue, paper for the Task Force on Sovereign Debt, draft of July 12, 2006) (citing The U.S. Financial System in the Wake of the Attack on the World Trade Center:
of the IMF at the time, Anne Krueger, then launched the proposal as the Sovereign Debt Restructuring Mechanism (SDRM) in a speech in November 2001.\textsuperscript{213} This was followed in March 2002 when the United Nations Conference on Financing for Development encouraged work to go forward on “an international debt workout mechanism” like the SDRM.\textsuperscript{214} The ministerial oversight committee of the IMF in September 2002 then requested that a “concrete proposal” for a statutory SDRM be elaborated for its consideration the following April.\textsuperscript{215} The private financial markets mobilized in opposition, joined later by some of the major developing country borrowers, and the United States, which had rethought its position under a new Treasury Secretary, John Snow.\textsuperscript{216} By the end of April 2003, the proposal was dead.\textsuperscript{217}

Up to the moment of its demise, SDRM was hotly debated in multiple conferences in Europe and North America.\textsuperscript{218} In one such discussion at the Carnegie Council on Ethics and International Affairs, Ann Pettifor, former coordinator of the Jubilee Campaign, argued forcefully for an alternative proposal to SDRM.\textsuperscript{219}

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\textsuperscript{216} As he said in his statement to the IMFC, “it is neither necessary nor feasible to continue working on SDRM.” John Snow, Treasury Sec’y, Statement at the Int’l Monetary and Fin. Comm. Meeting in Wash., D.C. (Apr. 12, 2003), http://www.ustreas.gov/press/releases/js185.htm.


\textsuperscript{218} Two important meetings that might be mentioned in this regard were the “Conference on the Sovereign Debt Restructuring Mechanism” at IMF Headquarters, Wash., D.C., January 22, 2003 and the International Policy Dialogue on “New Sovereign Debt Restructuring Mechanisms: Challenges and Opportunities,” organized by Internationale Weiterbildung und Entwicklung gGmbH (inWEnt) and the German Federal Ministry for Economic Cooperation and Development, Berlin, Feb. 21-22, 2003.

\textsuperscript{219} Ann Pettifor, \textit{Resolving International Debt Crises Fairly}, 17 ETHICS & INT’L
proposal for an international institution dealing with debt was based on three principles that seem fully consistent with the analyses discussed in earlier sections of this paper. First, as both debtors and creditors could be held responsible for a sovereign debt crisis, they should share the burden of relief to the extent that each side was “reckless, irresponsible[,] and delinquent.” 220 Second, “no one should be judge in their own court,” which is to say that the judge should not be one of the creditors. 221 And third, the mechanism should be “open, transparent, and accountable to citizens and taxpayers.” 222

The Jubilee framework had been inspired by Chapter 9 of the U.S. bankruptcy code (applying to municipalities and other non-sovereign public entities) and the ad hoc arbitration panels that are formed under the International Chamber of Commerce or other bodies to resolve disputes between direct investors and their host governments. 223 The framework thus called for an ad hoc, independent body, operating under transparent procedures, representing the interests of both the creditors and the citizens of the debtor country. 224 The restructuring plan would be developed by a panel formed for each case, with equal numbers of representatives from the debtor and creditor sides, who would jointly appoint an additional person to act as chair. 225 Pettifor also proposed that the United Nations, rather than IMF, should oversee the debt sustainability analysis that would provide the analytical background for the discussion of how much reduction of debt was needed. 226

Many experts and some governments, especially in Europe, while considering the SDRM a flawed proposal, advocated further development of the ideas it was meant to address. 227 In fact, not


220 Id. at 2.
221 Id.
222 Id.
223 Id. at 3.
224 Id. at 8.
225 Pettifor, supra note 219, at 8.
226 Id.
much has happened in this regard since the death of SDRM. Moreover, Argentina showed there could be an advantage to a debtor government in not settling with its creditors all at once in a comprehensive approach. Argentina settled first with the creditors it needed most and let arrears to the others accumulate in an acrimonious atmosphere. Foreign bondholders waited four years for a resolution and then settled for about 27 cents on the dollar. This may not have been a fair apportionment of the relief among the creditors, but that was not Argentina’s problem. Market-based solutions are not ipso facto fair. Argentina was also not the typical debtor developing country. Its default was “by far the largest and potentially most complex default the world has ever known.”

Nevertheless, the case for a statutory approach to debt workouts—even an “ad hoc” and informal mechanism that nevertheless pushes all creditors to work with the debtor for a comprehensive solution—remains as robust as ever. The question was never that a sovereign bankruptcy regime was needed, because the current system would fail to produce a solution. No one should doubt that existing mechanisms will resolve sovereign


debt crises, or that the crisis countries that had borrowed from the private markets previously will come again to enjoy market access. The concern here is not whether debt crises would be resolved, but whether they would be resolved justly. This involves first that there be appropriate international processes for reaching a just restructuring of the debt, but it also involves, complementing it, as discussed earlier, that there be appropriate allocation and effective monitoring of the cash flow consequences of the relief, which should in any case be part and parcel of the overall integrity of a democratic regime.

How does the international community go from here to there? One lesson to be drawn from the SDRM experience is that the time has passed in which a proposed major innovation in international financial architecture that could seriously impact developing countries can be developed behind closed doors in the institutions of the North and presented almost full cloth to governments for adoption on short notice. Governments that do not participate in developing the forum will feel no ownership or, at best, support it weakly. Powerful non-governmental stakeholders that see their interests threatened—whether they are right or wrong—will fight it. It requires a strong sense that the global public purpose will be served by the innovation to counter such opposition.

In this context, it seems that the end point of the SDRM debate can be turned into the starting point for a new debate, especially now that some years have passed and tempers have cooled. The SDRM and counter proposals made by the financial community at the time could all have been stamped “Made in the North.” Governments of the debt-issuing countries of the South came to be among the most vocal opponents of them. No finance minister in the South has the personal constitution to talk about what she ought to do if she cannot meet the next debt payment, especially if she does not actually face a looming crisis. However, other parties in the South ought to raise that question. Indeed, as we are currently not in a period of debt crisis, there is a space in which to think about the issue, develop a new proposal, starting from an idea and not a full-blown prospective piece of legislation, building consensus and momentum as it is further developed, and then, when the political opportunity arises, move it to adoption.

Sovereign default is never attractive politically, economically,
or socially, but sometimes it is necessary, even for well-managed governments. That is the reality of the global economy today as much as it was in the 18th century. Sean Hagan, in his reflections on the SDRM episode, began with a quote from Adam Smith that bears citing as the conclusion of this paper:

When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonorable to the debtor and least hurtful to the creditor. \(^{231}\)

All of history tells us sovereign bankruptcy will again become necessary. We should be better prepared next time.

\(^{231}\) Hagan, supra note 217, at 300 (quoting ADAM SMITH, WEALTH OF NATIONS 416 (1776)).