



## **Recent Developments on Odious & Illegitimate Debt**

There has been growing legal and political interest in the concepts of odious and illegitimate debt in recent years. Notably, the U.S. government-led push for cancellation of Iraq's debt highlighted the odiousness of the previous Iraqi government. Although the decision to provide cancellation was ultimately made on the basis of debt sustainability, the ensuing debate surely raised the profile of the odious debt issue.

In October 2006, Norway became the first government to unilaterally cancel specific debt claims on the grounds that the loans in question represented "failed development policy". Meanwhile, calls for comprehensive audits of debts suspected to be odious or illegitimate have been raised throughout the global South, with civil society in numerous countries initiating citizens' debt audits. In 2007, Ecuador became the first government to convene an official debt audit commission, to assess the legitimacy of historical lending to Ecuador.

At the multilateral level the issue of odious debt has been the subject of recent papers on the topic by UNCTAD<sup>1</sup> and the World Bank<sup>2</sup>. This briefing note will explore these developments in greater detail.

### WHAT ARE ODIIOUS & ILLEGITIMATE DEBTS?

Odious debt is a legal term for money lent to an oppressive regime and used for purposes other than the "needs and interest" of the country. Alexander Sack, a Russian jurist, was the first to define odious debt in 1927. Under his definition (one that is widely used today), an odious debt is one that was contracted against the interests of the population of a State, without their consent, and with full awareness of the creditor.

The term 'illegitimate debt' is a more expansive concept. It can refer to a broad range of debt encompassing odious and illegal debt, as well as debt resulting from losing a war, debts to creditors who lent irresponsibly, and debt resulting from loans made for ideological or political reasons. The definition of illegitimate debt also often includes: debt incurred by undemocratic means, without transparency or participation by civil society or representative branches of government; debt that cannot be serviced without violating basic human rights; and debt incurred under predatory repayment terms, including situations where original interest rates skyrocketed and compound interest made repayment impossible.<sup>3</sup> Many Global South based debt campaigning organizations have a broad view of illegitimacy of global South debt. As the International People's Tribunal on Debt concludes, "The External Debt of the countries of the South, for having been accumulated outside of national and international legal frameworks and without consultation with society, for having favored elites almost exclusively to the detriment of the majority of the people, and for having hurt national sovereignty, is illegitimate, unjust and ethically, legally, and politically unsustainable."<sup>4</sup>

### RECENT DEVELOPMENTS

#### Norway Unilaterally Cancels Debt

In October 2006, the Norwegian Government cancelled \$80 million of official debt owed by Ecuador, Egypt, Jamaica, Peru, and Sierra Leone as a result of the Norwegian Ship Export Campaign. The main function of this campaign, which ran from 1976 to 1980, was to secure employment for a domestic ship-building industry in crisis, not to serve the development needs of the countries concerned. When announcing the cancellation of these debts, Norway's current minister of International Development, Erik Solheim declared, "This campaign represented a development policy failure. As a creditor country Norway has a shared responsibility for the debts that followed. In cancelling these claims Norway takes the responsibility for allowing these five countries to terminate their remaining repayments on these debts."<sup>5</sup>

While the Norwegian government avoided labeling this debt as "odious" or "illegitimate," the cancellation of debt on the grounds of failed development policy is unprecedented. No creditor country has ever appealed to a doctrine of creditor-debtor co-responsibility when declaring the cancellation of debt. In recognizing its own failed development policy, which lacked proper needs assessment and risk analysis, Norway broke new ground in the movement for recognition and cancellation of odious debts.

### DEBT AUDITS

In recent years, there has also been a proliferation of debt audits. Debt audits are a valuable analytical tool used by civil society and/

<sup>1</sup> Robert Howse. "The Concept of Odious Debt in Public International Law." UNCTAD, July 2007.

<sup>2</sup> "The concept of Odious Debts: some considerations," The World Bank, September 2007.

<sup>3</sup> Definitions above can be found in: Joseph Hanlon. "Defining Illegitimate Debt and Linking Its Cancellation to Economic Justice." Commissioned by Norwegian Church Aid, 2002, p. 7-19. Latin America & Caribbean Jubilee 2000, "Tegucigalpa Declaration: Yes to Life, No to Debt," Available: <http://www.wcc-coe.org/wcc/what/jpc/tegu-e.html>. AFRODAD (African Forum and Network on Debt and Development), "Fair and Transparent Arbitration Mechanism on Debt", Policy Brief No 1/2002, Harare. Available: [http://www.una.dk/ffd/south\\_ngo/AFRODAD\\_Debt\\_arbitration.htm](http://www.una.dk/ffd/south_ngo/AFRODAD_Debt_arbitration.htm).

<sup>4</sup> "Verdict of the International People's Tribunal on Debt," II World Social Forum, Porto Alegre, Brazil, 1-2 February, 2002.

Available: <http://jubileesouth.org/tribunal/index.htm>.

<sup>5</sup> "Cancellation of debts resulting from the Norwegian Ship Export Campaign (1976-80)." Official Press Release of the Norwegian Government, No.: 118/06, October 2006. Available: <http://www.regjeringen.no/nb/dep/ud/Pressesenter/pressemeldinger/2006/Cancellation-of-debts-resulting-from-the-Norwegian-Ship-Export-Campaign-1976-80.html?id=272158>.

or governments to determine the nature of a country's debt.<sup>6</sup> The objective of a debt audit is to determine:

- the original terms of the loan;
- how much interest has been paid;
- what the money was used for, including any percentage that was misappropriated;
- who borrowed the money, and in whose name; and
- the role and identity of the lender.

This information can be used to determine the legitimacy of debts. Once the distinction between legitimate and illegitimate debts is made, the illegitimate debts can be cancelled or repudiated and the legitimate debt can be renegotiated.

But the utility of debt audits goes beyond separating legitimate from illegitimate debt. Because they require a participatory process, including citizens and civil society groups, debt audits are also a way to hold governments accountable for the borrowing decisions they make.

In several countries, citizens and governments have already launched inquiries into the legitimacy of their country's debt. In Brazil, for example, Unafisco, a union of tax auditors, recently launched an audit of Brazil's debt in close collaboration with Jubilee Brazil and other social movements. This recent effort follows in the footsteps of a Brazilian government commission, formed in the 1930's under President Getulio Vargas and charged to review all debt contracts and shed light on any irregularities. From 2001 to 2002, the Peruvian Congress set up a commission to audit that country's external debt, particularly the debt accumulated in the 1990s under the regime of Alberto Fujimori. In August 2005, a group of Uruguayan organizations set up a citizen's commission charged with auditing that country's external debt and publicizing the results.

The Filipino organization, Freedom from Debt Coalition, in partnership with other civil society organizations, recently led a call for an official debt audit and lobbied members of the Filipino Congress to establish a debt audit. The Philippine Parliament drew up a joint resolution in September 2004 calling for an audit and the creation of a parliamentary commission, but the resolution stalled in the Senate.<sup>7</sup> In January 2008, Filipino debt organizations launched a People's Petition calling for the creation of an Independent Citizen's Debt Audit.<sup>8</sup>

#### **Ecuadorian Debt Audit Commission**

Civil society has long worked to establish audits. But in July of 2007, Ecuador became the first government to launch a Debt Audit Commission in cooperation with civil society, and with the authority to undertake a complete audit of all the country's debts. The "Comision para la Auditoria Integral de la Deuda Publica" (CAIC), brought together national and international experts in the fields of debt, economics, law and local social and environmental struggles as well as Ecuadorean government officials to conduct an audit of all of Ecuador's debts. President Rafael Correa Delgado's presidential decree establishing the commission called for the determination of each debt's "legitimacy, legality, transparency, quality, efficacy and efficiency, considering the legal and financial aspects, and the economic, social, regional, and environmental impacts, as well as the impact on all genders, nations, and peoples."<sup>9</sup> This year-long project represents the first time a government has willingly and actively opened its financial archives for critical public

**ILLEGITIMATE DEBT: DEBT INCURRED  
BY UNDEMOCRATIC MEANS, WITHOUT  
TRANSPARENCY OR PARTICIPATION  
BY CIVIL SOCIETY  
OR REPRESENTATIVE BRANCHES  
OF GOVERNMENT; DEBT  
THAT CANNOT BE SERVICED  
WITHOUT VIOLATING BASIC HUMAN  
RIGHTS; AND DEBT INCURRED  
UNDER PREDATORY  
REPAYMENT TERMS,  
INCLUDING SITUATIONS WHERE  
ORIGINAL INTEREST RATES  
SKYROCKETED AND COMPOUND  
INTEREST MADE REPAYMENT  
IMPOSSIBLE.**

<sup>6</sup>"Let's Launch an Enquiry Into the Debt: a manual on how to organise audits on third world debts," CETIM & CADTM, October 2006. p. 62

<sup>7</sup>Ibid.

<sup>8</sup>"RP debt campaigners to launch petition for the creation of Citizen's Debt Audit Commission." Available: <http://freedomfromdebt.wordpress.com/2008/01/09/rp-debt-campaigners-to-launch-petition-for-the-creation-of-citizens-debt-audit-commission>.

<sup>9</sup>Presidential Decree Number 472, Rafael Correa Delgado, President of Ecuador. July 9, 2007.

scrutiny. Civil society advocates are hopeful that Ecuador's commission will inspire similar actions by governments in other developing countries.

### UNCTAD & WORLD BANK PAPERS

In 2006, the Government of Norway made funds available to both UNCTAD and the World Bank to research the concept of odious debt in international law. The resulting papers were released in July and September 2007, respectively.

#### UNCTAD: "The Concept of Odious Debt in Public International Law"

UNCTAD's paper, written by University of Michigan Law professor Robert Howse, finds that "the international law obligation to repay debt has never been accepted as absolute, and has been frequently limited or qualified by a range of equitable considerations, some of which may be regrouped under the concept of 'odiousness.'"<sup>10</sup>

Howse finds solid legal grounds for the concept of odious debt in scholarly literature and treaties, as well as in general principles drawn from the world's legal systems, all sources of international law recognized in Article 38 of the Statute of the International Court of Justice.

Howse identifies twelve instances in which the concept of odious debt has been used in international case law. In all of these cases, the legal issue involved proving that the debt in question was odious or ensuring that the claimant was not assuming an overly broad definition of odiousness. In none of the cases was a claim rejected on the grounds that no such concept as odious debt exists under international law. Some of the most compelling and cited cases include:

- **1898: When Spain ceded Cuba to the United States, the U.S. refused to assume Cuba's debt to Spain.** The American Commissioners argued that because Cuba had not consented to the debt and because some of the money was used to suppress popular uprisings with the knowledge of the creditors, the debt was odious and should not have to be repaid. This was the first application of the term 'odious debt' in international law.
- **1923: Costa Rica refused to honor debt to the Royal Bank of Canada resulting from money that was lent to the dictator Federico Tinoco.** U.S. Chief Justice William Howard Taft was the arbiter in the dispute. He determined that because the debt was not incurred in the public interest and because the Royal Bank of Canada could not show that the money had been used for legitimate purposes, Costa Rican legislation invalidating the transactions should be upheld.
- **1985-2002: South African debt incurred under the Apartheid regime is a classic example of odious debt.** When UN sanctions were imposed in 1985, the South African government continued to borrow from private creditors, often using the money to repress the anti-apartheid movement. In 2002, a suit was filed in New York for apartheid reparations from private creditors in 6 Western countries on behalf of 32,000 who suffered under the regime. However, because of fears that South Africa's access to credit and foreign investment would be limited as a result of legal action or debt repudiation, the South African government has distanced itself from the case and from the debt repudiation movement in general.
- **2003: The U.S. Congress introduced an initiative to cancel Iraq's odious debt after the overthrow of the Hussein regime.** U.S. Treasury Secretary John Snow and Undersecretary of Defense Paul Wolfowitz both commented that Iraq should not be saddled with the debts of a past dictator. Debt relief was granted, though in the end it was justified on the grounds of debt sustainability rather than odiousness.

In the last segment of the UNCTAD paper, Howse concludes that while there is no obvious legal forum for the adjudication or settlement of claims of odiousness, such claims might appropriately be raised in bilateral or multilateral negotiations on debt relief, or adjudicated in the context of arbitration or domestic litigation. Howse recognizes the utility of special transitional tribunals to handle claims related to a particular political transition and rule on the validity of claims of odiousness.

#### The World Bank: "The Concept of Odious Debts: Some Considerations"

In contrast to the UNCTAD analysis, the World Bank paper claims that international law does not generally provide for the repudiation of debts on the grounds of their being odious, while calling on lenders and borrowers to ensure that loans are used for the benefit of borrowing states and not to subjugate their populations or enrich the corrupt.

The authors dismiss an applicable odious debt doctrine in international law for two reasons. First, they claim that a broad range of contradictory definitions have been proposed, making the official legal definition of odious debt unclear. Second, they claim that none of the common sources of international law — treaties, state practice and international custom — has produced a coherent odious debt 'doctrine' in the proper sense of the word.

Jürgen Kaiser of *erlassjahr.de* (Jubilee Germany) accuses the World Bank authors of failing to fully examine the existing modern literature on odious debt, while focusing in too much on Alexander Sack's definition and discussion from 1927. Kaiser also notes that

<sup>10</sup> Robert Howse. "The Concept of Odious Debt in Public International Law." UNCTAD, July 2007.

<sup>11</sup> Jürgen Kaiser. "Commentary on the draft World Bank paper 'The concept of Odious Debts: some considerations', published Sept. 7th 2007." *Erlasjahr.de*, Germany, December, 2007.

the bank dismisses existing odious debt cases as inadequate evidence for “general practice” of the doctrine, without defining how many more or what kinds of cases would be necessary to fulfill that requirement. “General practice” refers to customary international law, one of four kinds of international law recognized in Chapter 2, Article 38 of the Statute of the International Court of Justice. According to Amnesty International, customary international law “results from a general and consistent practice of states followed out of a sense of legal obligation, so much so that it becomes custom.” Kaiser would argue that the concept of odious debt has already been generally and consistently applied by states, while the World Bank disagrees without providing an adequate explanation.

International civil society organizations note that the World Bank paper was not produced through a transparent process, finding the paper “incomplete, selective and misleading in its treatment of existing literature.”<sup>11</sup> In response to their call for a roundtable with World Bank officials to further discuss this matter, a discussion has been scheduled for the day following the 2008 IMF/World Bank spring meetings in April.

### Debt Audits in the United States

The Jubilee Act for Responsible Lending and Expanded Debt Cancellation (HR.2634/S.2166), introduced into the United States House and Senate in 2007, instructs the Government Accounting Office to undertake audits of debt portfolios of countries holding loans that could be considered odious, onerous or illegal. The Jubilee Act requires that the audits include loans from international financial institutions, as well as export credit debts and debts owed to commercial creditors. The audits would be conducted in a transparent and inclusive manner, and would determine if any domestic or international laws were violated in the contraction of the loans. The GAO would be required to provide a report to Congress within two years of enactment of the legislation.

## ADDITIONAL RESOURCES

**Jürgen Kaiser.** “Commentary on the draft World Bank paper ‘The concept of Odious Debts: some considerations’, published Sept. 7th 2007.” Erlassjahr.de, Germany, December 2007.

Available: [http://www.eurodad.org/uploadedFiles/Whats\\_New/News/erlassjahr\\_on\\_WB\\_Illeg\\_Paper\(1\).pdf](http://www.eurodad.org/uploadedFiles/Whats_New/News/erlassjahr_on_WB_Illeg_Paper(1).pdf)

**Robert Howse.** “The Concept of Odious Debt in Public International Law.” UNCTAD, July 2007.

“**The concept of Odious Debts: some considerations,**” The World Bank, September 2007.

“**Let’s Launch an Enquiry Into the Debt: a manual on how to organise audits on third world debts,**” CETIM & CADTM, October 2006.

“**Norway makes ground-breaking decision to cancel illegitimate debt.**” EURODAD, October 2006.

Available: <http://eurodad.nvisage.uk.com/whatsnew/articles.aspx?id=302>