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"ODIOUS DEBTS" VS. DEBT TRAP: A REALISTIC HELP?

Christoph G. Paulus[*]

I. INTRODUCTION

It seems there are not too many lawyers who have an understanding of or about the technical meaning of "odious debts." Nevertheless, this highly dubious doctrine—if it is one, but for reasons of simplification it will be called a doctrine in what follows—has the potential of almost explosive power for many lender states in this world. Just a glance at the internet under this catchword makes clear where this power comes from. Literally dozens of NGOs claim that states like Iraq are debt-free—not because the lender states should display grace after liberation from Saddam Hussein, but because of legal consequence! "Odious debts" are understood as a legal institution which, by force of law, make certain debts automatically null and void.[1]

The doctrine of "odious debts" dates back little more than one hundred years. Because it has been topical only sporadically over this period, it is unclear whether or not it already has the precision or "marginal sharpness" that would be necessary if it were to be used as a legal instrument. This uncertainty, in turn, makes the term "odious debts" appear very versatile in the ways it can be used and instrumentalised. In particular, the value statement already inherent in the terminology tends to mislead one into exploiting this doctrine to attempt to render morally repugnant facts legally null and void. In view of these facts, it is the (thankless) task of the legal scholar to call for an exercise of caution in drawing conclusions of this sort (however understandable they may be in human terms), and to point out the distinction between law and morality,[2] which is a hard-

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1. Thus, debt forgiveness is seen as an improper act of voluntary grace. If there is instead a legal automatism, there is no room for grace and reciprocal gratitude. For the "traditional" treatment of state debts and the possibility of their restructuring, see, for example, FABIO MARCELLI, IL DEBITO ESTERO DEI PAESI IN VIA DI SVILUPPO NEL DIRITTO INTERNAZIONALE (2004); *see also* AUGUST REINISCH & GERHARD HAFNER, STAATENSUKZESSION UND SCHULDENÜBERNAHME BEIM "ZERFALL" DER SOWJETUNION (1995).

2. *See* IMMANUEL KANT, METAPHYSISCHE ANFANGSGRÜNDE DER RECHTSLEHRE § E, at 47 (William Hastie trans., A.M. Kelley 1974) (1887).

won victory in legal history and which requires recognition by the legal community.

This exhortation naturally does not negate the option of developing legally practicable contours with the help of which certain debts can be termed "odious" and can accordingly be dealt with on a legal level. It is only an attempt to clarify the fact that moral indignation, however justified, cannot automatically produce the desired legal consequences by using a purportedly legal concept. For this, the term must be defined more precisely in legal terms. This paper will look at the extent to which this appears feasible at the present time.

II. HISTORY OF THE "ODIOUS DEBTS" CONCEPT

The phenomenon of efforts being made to seek a way of ending debt repayment at the state level looks back on a long history.[3] The first recorded use of the concept of "odious debt" in this respect dates back to 1898 where it was cited by the United States of America.[4] In the wake of the Spanish-American War, from which the United States emerged victorious, "odious debt" was taken as a justification for not repaying Cuba's debts to Spain, which the United States, as the *de facto* ruling power over Cuba, should normally have honoured.[5] The United States claimed that these debts were "odious" because the money lent to Cuba by Spain, which then had to be repaid, would have served to consolidate and perpetuate the oppression of the Cuban people.[6]

The term resurfaced about a quarter century later in Costa Rica, triggered by an act of Parliament and the subsequent arbitration proceedings.[7] In 1919, Costa Rica managed to end the dictatorship of Frederico Tinoco and passed a law (the Law of Nullities) repudiating the debts granted by the Royal Bank of Canada to the dictator in the name of Costa

3. *See, e.g.*, MAX HUBER, DIE STAATENSUCCESSION 84 (1898); M.H. Hoeflich, *Through a Glass Darkly: Reflections Upon the History of the International Law of Public Debt in Connection with State Succession*, 1982 U. ILL. L. REV. 39 (1982). For other precedents (although not expressly based on the principle of odious debts) see Theo Kneifel, Kirchliche Arbeitsstelle Südliches Afrika (KASA), *"Odious Debts"—Ein Sonderfall von Illegitimen Schulden am Beispeil der Apartheidschulden Südafrikas* (Feb. 2002), www.odiousdebts.org/odiousdebts/publications/odiousdebts_KASA.pdf; Andreas Fischer-Lescano, *Odious Debts und das Weltrecht*, 36 KRITISCHE JUSTIZ 223 (2003), *available at* http://www.odiousdebts.org/odiousdebts/publications/Fischer-Lescano.pdf.

4. Hoeflich, *supra* note 3, at 53–54.

5. *See generally* Sovereignty: Its Acquisition and Loss, The Cuban Debt, 1 MOORE DIGEST § 97, at 351–85 (summarizing the peace negotiations between the United States and Spain); ERNST H. FEILCHENFELD, PUBLIC DEBTS AND STATE SUCCESSION 329 (1931).

6. MOORE, *supra* note 5, at 367.

7. Great Britain v. Costa Rica, 1 R. Int'l Arb. Awards 375 (1923).

Rica, on the ground that they were "odious."[8] The subsequent arbitration proceedings ended in 1923 when the arbitrator, Chief Justice Taft of the United States Supreme Court, upheld the right of Costa Rica to act in this way.[9]

A few years later, the legal scholar Alexander Nahum Sack produced an in-depth study in which he examined attempts to define the doctrine of "odious debts" precisely in legal terms, such that it could be operationalised.[10] According to Sack, a successor state is only bound to repay the debts of its predecessor if the funds thus obtained were used to meet the needs of the state and were obtained in the best interests of the state.[11] If, however, (1) the funds were not used to meet the needs of the state and were not obtained in the best interests of the state, and (2) the creditors were aware of this fact, then the granting of the loan represents a hostile act against the people of the debtor state, which renders the debt "odious" and thus invalid.[12]

Sack is often held to be the academic who has dealt most in-depth with the issue of what happens to national debts after a regime change.[13] He is still in some respects considered the "crowned prince" of advocates of this legal principle. Recently, however, his proposal has been taken one step further in a Canadian study.[14] The authors of the Canadian study propose that the "odiousness" of a national debt should be determined not only on the basis of the two criteria advanced by Sack (i.e., use of the funds to the benefit of and in the best interests of the state, and the knowledge on the part of the lender that this is not the case).[15] They argue that a third, objective criterion should be added—that the debts must have been taken out with the consent of the population.[16]

In the early 1980's, the International Law Commission had already tried to find a definition in the context of developing the Vienna Conven-

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8. *Id.* at 376.

9. *Id.* at 399.

10. *See generally* ALEXANDER NAHUM SACK, LES EFFETS DES TRANSFORMATIONS DES ETATS SUR LEURS DETTES PUBLIQUES ET AUTRES OBLIGATIONS FINANCIÉRES: TRAITÉ JURIDIQUE ET FINANCIER (1927) [hereinafter SACK, LES EFFETS DES TRANSFORMATIONS]; ALEXANDER NAHUM SACK, LA SUCCESSION AUX DETTES PUBLIQUES D'ÉTAT 70 (1929).

11. SACK, LES EFFETS DES TRANSFORMATIONS, *supra* note 10, at 157.

12. *Id.*

13. FEILCHENFELD, *supra* note 5, at 16.

14. Ashfaq Khalfan, Jeff King & Bryan Thomas, Advancing the Odious Debt Doctrine (Mar. 11, 2003) (unpublished working paper), *available at* http://www.odiousdebts.org/odiousdebts/publications/Advancing_the_Odious_Debt_Doctrine.pdf.

15. *Id.* at 42.

16. *Id.*

tion on Succession of States in Respect of State Property, Archives and Debts from April 4, 1983.[17] The proposal was as follows:

> Article C. Definition of odious debts
>
> For the purposes of the present articles, "odious debts" means:
> (a) all debts contracted by the predecessor State with a view to attaining objectives contrary to the major interests of the successor State or of the transferred territory;
> (b) all debts contracted by the predecessor State with an aim and for a purpose not in conformity with international law and, in particular, the principles of international law embodied in the Charter of the United Nations.[18]

However, not only was this article not inserted into the Convention, the Convention itself has not yet come into force at all.[19]

To conclude this brief historical outline, it can be said that these lines of thought and argumentation leave too great a vacuum in theory and in practice for us to accept the principle of "odious debts" as a legal institution recognised under customary law.[20] For this to happen, the principle would have to have been applied over a longer period and would have to be recognised as a legal obligation.[21]

III. PURPOSE OF "ODIOUS DEBTS"

Before we go on to look at the question of whether and how the doctrine of "odious debts" can or could be used legally in the future, at least in the proposed manner, it would be helpful to clarify the purpose of this new legal principle.

A. The Original Purpose

The two historical examples given above in Part II were retrospective. Therefore, the outcome could not have been foreseen by the two parties to the loan agreement when the loan was originally granted. Thus, (from

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17. *Id.* at 33.

18. *Documents of the Thirty-Third Session*, [1981] II Y.B. INT'L L. COMM'N 79, U.N. DOC. A/CN.4/SER.A/1981/Add.1 (82.V.4).

19. *See* KNUT IPSEN, VÖLKERRECHT, *in* JURISTISCHE KURZ-LEHRBÜCHER NO. 5, at 347 (2004).

20. *See also* Fischer-Lescano *supra* note 3. On customary law from the stance of international law as a whole, see CHRISTIAN TOMUSCHAT, INTERNATIONAL LAW: ENSURING THE SURVIVAL OF MANKIND IN THE EVE OF A NEW CENTURY, *in* ACADÉMIE DE DROIT INTERNATIONAL, RECUEIL DES COURS: COLLECTED COURSES OF THE HAGUE ACADEMY OF INTERNATIONAL LAW 1999 NO. 281, at 324 (2001).

21. *See* IGNAZ SEIDL-HOHENVELDERN & TORTSTEN STEIN, VÖLKERRECHT § 28 para. 467, at 99 (10th ed. 2000).

a European legal stance) an essential prerequisite of law is not met—the tenet that the law should act as an instrument to steer the behaviour of actors.[22]

It is true that this deficiency alone is not enough to call into question the legal validity of the measures, particularly for customary law. Thus, a generally accepted source of law is characterised precisely by the fact that somewhere, at some point in time, a new legal understanding emerges which, in the course of time, becomes so convincing that it eventually becomes an integral part of the general notion of justice.[23] We have not yet reached this point with respect to the doctrine of "odious debts." Even if one hundred percent agreement is not needed to achieve this level of acceptance, neither is it enough for a few small groups to be convinced of the legal validity of a concept for it to become accepted as customary law.

B. Today's Purpose

The direct *purpose* of the doctrine of "odious debts," as laid out in the terms of reference for this study, is to create the sort of impact which would steer the behaviour of relevant actors. Like a signal, it should remind the parties involved in future loan agreements to respect the limits of private autonomy (*Privatautonomie*) set by the new legal principle.

This doctrine would thus take its place among a number of existing legal regulations—in particular those under private and constitutional law—which act as protective mechanisms against any overly-hasty and thus irresponsible commitment on the part of a state.[24] Usually, both constitutional and civil law clearly state what formalities a country must comply with before entering into a commitment of this sort. If these formalities are ignored, which according to reports appears to be the case more often than not, the commitments regularly have no legally binding impact, even under private law.[25] A doctrine of "odious debts" could not

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22. *See* RENÉ DAVID, FRENCH LAW: ITS STRUCTURE, SOURCES, AND METHODOLOGY 108–10 (Michael Kindred trans., La. State Univ. Press 1972) (1960).

23. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 102 (1987) (formation of customary law).

24. The question as to whether or not a legal regulation of this sort is an instrument of international, public or civil law is of more technical interest, and the issue will not be analyzed in any more depth here. *See generally* AUGUST REINISCH, STATE RESPONSIBILITY FOR DEBTS: INTERNATIONAL LAW ASPECTS OF EXTERNAL DEBT AND DEBT RESTRUCTURING (1995).

25. There are of course *de facto* problems in obtaining legally binding confirmation that contracts of this sort are null and void, and even greater difficulties involved in stipulating the legal consequences of a decision of this sort.

add any additional, more serious, or further-reaching form of invalidity—with the exception perhaps of a demonstratively expressed stronger moralistic condemnation.

Any legally recognised doctrine of "odious debts" would thus only come into play over and above the (long-standing) legal instruments already in use. Since the doctrine would be used to enforce certain moral values, an attempt would have to be made to reach a global agreement on these moral values because the simple fact of the matter is that here, as in many other instances, the values praised by one appear to be unacceptable to another. Considerations pertaining to a clarification (or even discussion) of this sort have no place in a legal study. However, we will simply state that the *goals* of having the "odious debts" doctrine accepted as a legal principle must surely be to leave a dictatorial regime high and dry in material terms, and thus to foster democratic forms of government. For, in line with the variations of the doctrine of "odious debts" proposed thus far, the potential lender can only be sure at the planning stage that the sum borrowed will be repaid in the latter case.

IV. PROS AND CONS OF "ODIOUS DEBTS"

Whatever the finer details of these objectives, we must examine in legal terms the pros and cons of introducing (or establishing) the doctrine of "odious debts."

A. Cons

The most crucial and obvious argument against establishing the doctrine of "odious debts" is the basic legal principle of *pacta sunt servanda* (pacts must be respected).[26] This ancient principle is not based on inflexible and stubborn legal thinking, but on the recognition of the value of having a firm basis for planning, not only for the economy but also for interpersonal dealings in general. Even if the "invention" of the contract *per se* is not necessarily the result of a need for future security of this sort or in some other form, the binding nature of a contract, once entered into, is a matter of personal and economic interest. We should not lose sight of the fact that any incursions into this security will trigger a response on the part of the affected party, which ought to be taken into account before any pertinent new legal principle is introduced.

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26. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 321 cmt. a (1987) (noting that *pacta sunt servanda* "lies at the core of the law of international agreements and is perhaps the most important principle of international law."); s*ee also* Vienna Convention on the Law of Treaties art. 26, Jan. 27, 1980, 1155 U.N.T.S. 331.

In the case at hand, the response might well be that the willingness of potential lenders to grant loans decreases dramatically. We can, of course, counter that this is precisely the desired effect (see Part III.B) of the doctrine—that certain states or certain governments are unable to borrow money. However plausible this argument might appear at first sight, if we disregard for the moment the fate of the population (i.e., each individual citizen) affected, the consequences are far-reaching. However, as morally repugnant as it might seem to lend money to a generally abhorred dictator, what about the loans accorded to his in-no-way-disreputable predecessor[27] which are due for repayment under the regime of the current dictator? Who is to set the yardstick for what is to be deemed "generally abhorred?" What will happen if a head of government with a hitherto unblemished reputation suddenly turns bad during his period in office? Should a sort of blacklist be drawn up of endangered countries?[28]

The list of questions of this nature could easily continue. However, the examples already given indicate the trend that a doctrine of "odious debts" would imply a politicisation and moralisation of legal considerations,[29] which would undoubtedly make it more difficult to borrow money in many cases and would entirely preclude it in others. This cannot be the overall desired effect because the populations of the countries affected would then bear the brunt of the changes. If the aim is not to introduce any across-the-board bans on lending, but to deem legally untenable those loans or parts of loans that fall into the category of "odious" on an individual basis, this will at the very least involve considerably higher costs on the part of lenders since they will have to monitor the actions of their borrowers more closely. Lenders will not be able to cir-

27. It is more than just a historical footnote that the term "dictator" stems from the ancient Roman republic where this office was seen as a salvation in a desperate situation. *See* WOLFGANG KUNKEL & MARTIN SCHERMAIER, RÖMISCHE RECHTSGESCHICHTE 22 (13th ed. 2001).

28. A proposal of this sort is made by Seema Jayachandran & Michael Kremer, Odious Debt (Apr. 2005) (unpublished manuscript, on file with author), *available at* http://post.economics.harvard.edu/faculty/kremer/webpapers/Odious_Debt05.pdf (proposing to impose loan sanctions in lieu of trade sanctions against dictatorial regimes). An (unofficial) list of this sort already exists in the United States in conjunction with the infamous Alien Tort Claims Act, 28 U.S.C. § 1350 (1994). *See* AmnestyUSA.org, Annual Report: The State of Human Rights, http://www.amnestyusa.org/annualreport/annualreport.html. Anyone transacting with the governments of these countries (currently about 150) runs the risk of being taken to court in the United States today by the populations of these countries.

29. *See* Anupam Chander, *Odious Securitization*, 53 EMORY L.J. 923 (2004).

cumvent their responsibility to refuse to be part of "odious debts" by incorporating simple provisions in their lending agreements to the effect that the funds lent are to be used for generally accepted purposes. Consequently, if the costs of monitoring borrowers rise, the costs of borrowing will increase, in turn making borrowing prohibitively expensive for some countries, while severely restricting the borrowing capacities of others.

B. Pros

On the other hand, we must realise that there is a current worldwide trend to erode the principle of *pacta sunt servanda* which has been held in such esteem for thousands of years. In the field of civil law, we can point to consumer protection law, which has been developing over the last forty or so years.[30] One of its main achievements has been to make it significantly easier to rescind a contract, thus making serious inroads into the binding nature of contracts.[31]

While it is true that this comparison is not entirely apt—given that consumers play no part in the borrowing sector involved here and that consumer protection law regularly excludes "non-consumers" from its field of application—it should still be mentioned since calls for the recognition of the doctrine of "odious debts" practically all appear to be based on a *de facto* power gap between the lender and the borrower (or at least the population of the borrowing state). Given the fact that globalisation is shrinking our world to the "global village" in which international law is increasingly moving into areas that were hitherto the prerogative of civil law,[32] the parallel drawn between consumer protection under civil law and international law no longer appears quite so unthinkable.

Equally, the "erosion" of the basic principle of *pacta sunt servanda* is slowly being seen in international law. It is no coincidence that here too (although still in very few isolated cases) the principle of democracy, which is enshrined in international public law, is being taken as a ground to justify the cancellation of long-standing contracts, although no reason

30. *See, e.g.*, Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, art. 3, para. 5, 1999 O.J. (L 171) 12, 15.

31. *Id.*

32. It is enough to mention the discussion on the introduction of a state insolvency law. *See* Christoph G. Paulus, *A Statutory Procedure for Restructuring Debts of Sovereign States*, *in* RECHT DER INTERNATIONALEN WIRTSCHAFT No. 49, at 401–06 (Thomas Wegerich et al. eds., 2003); *see also* Detlev F. Vagts, *Sovereign Bankruptcy: In re Germany (1953), In re Iraq (2004)*, 98 AM. J. INT'L. L. 302 (2004).

exists to terminate the contract under either its agreed upon terms or other valid legal provisions.[33]

In view of these findings, we must conclude that the introduction of a legally binding doctrine of "odious debts" is not automatically condemned to failure on the ground that contracts, once concluded, must be honoured. Another qualification of this basic principle by no means implies a fundamental rejection of the traditional principle—particularly in view of the erosion of the binding nature of this principle that can be observed in many areas of law worldwide. On the other hand, it must be said that the introduction of any doctrine of this sort will make it more difficult to borrow money in the future, thus potentially worsening the living conditions of entire populations.

V. Approaches to Resolving the Problem

If we sum up the findings so far, we can state the following: the doctrine of "odious debts" has not yet achieved the status of customary law. The desired introduction serves the goal (*inter alia*) of undermining the material basis of dictatorships and fostering democratisation worldwide. The introduction of the doctrine would doubtless make it more difficult to borrow money but would not entail any fundamental break with existing law.

If these are the starting conditions for any doctrine of "odious debts" in whatever form, we must then look at the finer points. What form should the doctrine take or how should it be formulated in legal terms in order to achieve the intended objectives? The answer to this entails two steps. First, we must look at the approaches proposed to date, and second, we must devise our own proposal.

A. Response (ad hoc)

The cases to date in which the doctrine of "odious debts" has been invoked (Cuba and Costa Rica) are, from a legal point of view, particularly unfortunate cases of the application of "law."[34] By deciding retrospectively on the legal nullity of the debts, they preclude the steering impact of law already discussed in Part III.A. If it is uncertain *ex ante* whether or not the sword of Damocles of legal unenforceability is merely hanging

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33. *See* Christian B. Fulda, Demokratie und *pacta sunt servanda* (Oct. 10, 2002) (unpublished dissertation), http://edoc.hu-berlin.de/ (follow "dissertationen" hyperlink; then follow "F" hyperlink; then follow "Fulda, Christian B." hyperlink); *see also* Chander, *supra* note 29.

34. *See supra* Part II.

over the sum lent, or whether it might actually fall, the foundation for determining the cost of loans begins to wobble. If the sword falls, the lender must bear the risk that the borrower might not conform to the norms of acceptable and accepted behaviour. At best, this appears to be perhaps a morally justified preferential treatment for the population thus freed from the yoke of debts, but in legal terms it is difficult to reconcile with a basic sense of justice.

At this juncture we should, however, add a qualification. The idea of the law as a steering instrument can be put into practice in various ways. In Germany, for instance, it takes a different form from that adopted in the United States. In Germany, the legislator is held to be responsible for ensuring security in planning, which means that the feasible path to be taken must be laid down *ex ante* in great detail,[35] whereas in the United States, the prevalent philosophy is that individuals are free to wheel and deal as they please, but that in so doing they accept the risk that some court might at some point in time brand this past wheeling and dealing illegal.[36] So what would appear untenable in Germany is the expression of a fundamental understanding of liberty in the United States.

B. Prevention (ex ante)

Having looked at these premises, it would thus appear preferable, from a German point of view, to develop preventive criteria for a doctrine of "odious debts" that is to be applied in the future.

1. The New Proposal

a) This approach is in line with the Canadian proposal mentioned above.[37] It extends Sack's criteria, stating three conditions—lack of consent on the part of the people, the loan not being in the interests of the people, and the lender's knowledge of the other two facts. If all three conditions are met, this would render the debt null and void, thus effectively freeing the borrower from the obligation to repay the debt.

b) Two positive aspects of this proposal should be mentioned. First, by pinpointing "creditor awareness," it stands out from many other propos-

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35. *See* Eckart Klein & Thomas Giegerich, *The Parliamentary Democracy*, *in* THE CONSTITUTION OF THE FEDERAL REPUBLIC OF GERMANY 150–51 (Ulrich Karpen ed., 1988).

36. *See, e.g.*, Paul Carrington, *The American Tradition of Private Law Enforcement*, 5 GERMAN L.J. 1413 (2004), *available at* http://www.germanlawjournal.com/pdf/.Vol05No12/PDF_Vol_05_No_12_1413-1429_SI_Carrington.pdf (arguing that business conduct in the United States is regulated *ex post* by private plaintiffs "in the form of civil money judgments rather than *ex ante* in the form of official approval or disapproval.").

37. *See supra* Part II.

als and ideas advanced by various NGOs, which simply ignore (intentionally or unintentionally) this condition.[38] It is quite clear that this cannot be, and one would assume that there is no need to belabor the point. However, in order to make things as clear as possible, we should stress the fact that it would be extremely unjust, in line with all precepts of justice that exist in the civilised world, to foist on a lender, merely because he is a lender, the risk that the funds lent by him might be used for some improper purpose. This risk can only be attributed to the lender if he can subjectively be held responsible for the "odious" use to which the borrowed sum is put.

The second positive aspect is that the proposal does not concentrate on a change of government or regime, which was the case in both Cuba and Costa Rica, and which was more or less explicitly taken as a major contributory ground or appeared to play a major role in Sack's proposals. A result of this sort might *de facto* play an important part in honouring existing commitments. For instance, what dictator, however rough, would plead that his debts were null and void on the basis of the doctrine of "odious debts," when in the future he would be dependent on borrowing more funds at regular intervals. However, in legal terms, we must always see the "odiousness," however we choose to define it, independent of and separate from any such government or regime change. The fact that such regime change takes place does not make the funds previously lent and used in any way more odious. The change *per se* is nothing that could increase the burden of guilt of an odious dictator. We can thus conclude that a legally binding doctrine of "odious debts" is independent of any such change in government or regime. The debt *per se* is odious; it does not merely become odious because of any change in the actors involved.

c) At the same time, however, the criteria contained in the Canadian proposal must be criticised because they are too vague and therefore incalculable.

If the consent of the population is needed, the application of the doctrine must (surely) be excluded where a democratically elected government is in power. Whether this or the opposite case genuinely limits the desired target group sufficiently, appears questionable. Firstly, we must ask how we should proceed in the case of a mock democracy, in which the government claims to be legitimated by the votes of the people, as is the case in "true" democracies. Secondly, monocracies automatically fail to meet this requirement. Monarchs or spiritual heads of a religious state

38. Surprisingly, the same is true for the abovementioned definition of the International Law Commission. *See supra* note 18.

are thus, by virtue of the structure of the state, branded "odious," which will automatically make it more difficult for them to borrow money and will thus make borrowing more expensive for them.

This leads us to the underlying and truly fundamental question—namely, who should define who is a dictator under the terms of the doctrine of "odious debts?" This is an extremely delicate question which cannot be answered using the yardstick of existing law, or indeed, existing philosophy. The answer that "any government that is not legitimated by the people" is a dictatorship can in no way be accepted as being sufficiently precise.

The other objective criterion of the Canadian proposal—absence of benefit—suffers from the same shortcomings. Who is to provide the yardstick against which "benefit" is to be measured? This is an important inquiry in both factual and temporal terms: in factual terms because it must be possible to define *ex ante* what serves the interests of the population and what does not. However, there are no blanket answers to this question. Weapons purchases, for instance (to take a particularly controversial example), are only discreditable because of the individual circumstances that accompany them—i.e., if they are to be used for an unjustified war of aggression or for other criminal purposes, but not if they are to be used for the country's own defence. Or, to take another example, funds might be used to install a system of repression in the form of prisons, but what number of prisons can be said to be in the interests of the population and what number can be considered excessive and hence no longer in their interests? Nobody would seriously suggest that a country should not be allowed to build prisons at all.

Still, doubts are justified in the other direction as well. The construction of schools and hospitals is generally considered to be in the interests of the population. However, what is to happen if these schools and hospitals remain the sole prerogative of the rich or of the family of the ruler? The question is, to put it succinctly, who are the "people" and who should represent them?

This brings us to the temporal aspect. At which point should we ask about the "benefit"—at the time of lending or the time at which a decision is made as to whether or not the debt is odious? From a legal stance, it can only make sense to look to the time of lending. Otherwise, lenders would be expected to perform monitoring functions, which they would either be unable to perform, or which would make the loan prohibitively expensive.

Finally, we must also criticise the subjective criterion of "creditor awareness." While creditor awareness, as already mentioned, is essential, the focus cannot exclusively be on the positive knowledge on the part of

the lender. This would make it all too easy to circumvent the doctrine. If it is to be applicable in practice to any real degree, the subjective yardstick must be worded more precisely, for instance, such that positive knowledge is considered equal to ignorance resulting from gross negligence.

2. *Lex Mercatoria*

While we must concede that the criticism above appears to imply that it is possible to achieve greater precision, it must be said that at least at present this will be difficult since we have not advanced beyond considering the structure of a statutory definition. Having said this, though, we can attempt to come closer to an appropriate solution—and do so without departing too far from what we have dealt with so far. It is particularly helpful to base our work on existing models the legal character of which is unquestionable.

This stance allows us to look at a complex set of regulations which can best claim to be accepted worldwide, or at least to be the *lex mercatoria*[39] complied with—the UNIDROIT Principles of International Commercial Contracts.[40] Courts in many countries increasingly rely on these principles when they are called on to judge international contracts where it is not entirely clear which legal system should apply.[41] Since the lending agreements we are dealing with here are generally of a commercial nature, it is natural that we should take the UNIDROIT Principles as our guidelines. Article 3.1(b) restricts the field of application of the UNIDROIT Principles in that they do not deal with invalidity arising from immorality.[42] Thus, the *lex mercatoria* makes no express statement on this generally accepted legal principle, which comes closest to the doctrine of "odious debts." This is a reflection firstly of the unwillingness to incorporate moral aspects into the legal sphere, and secondly of

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39. On the *lex mercatoria* in general, see JAN DALHUISEN, DALHUISEN ON INTERNATIONAL COMMERCIAL, FINANCIAL AND TRADE LAW 191–98 (2d ed. 2004).

40. Int'l Institute for the Unification of Private Law, *UNIDROIT Principles of International Commercial Contracts* (2004), *available at* http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf [hereinafter UNIDROIT Principles].

41. *See* Michael Joachim Bonell, *UNIDROIT Principles and the Lex Mercatoria*, *in* LEX MERCATORIA AND ARBITRATION 249, 249 (Thomas E. Carbonneau ed., 2004); Michael Joachim Bonell, *UNIDROIT Principles as a Means of Interpreting and Supplementing International Uniform Law*, 13 INT'L CT. ARB. BULL. 29–31 (Special Supp. 2002).

42. UNIDROIT Principles, *supra* note 40, ch. 3, art. 3.1(b).

the realization that standards of morality vary so widely the world over that it would be impossible to find a common denominator.

Nevertheless, Article 3.10 does provide for basic rules when there is an "excessive advantage" between the duties of the parties, as a result of which the pertinent contract can be contested.[43] This right exists "if, at the time of the conclusion of the contract, the contract or term unjustifiably gave the other party an excessive advantage."[44] The text goes on to list the factors that should be taken into consideration: "the fact that the other party has taken unfair advantage of the first party's dependence, economic distress or urgent needs, or of its improvidence, ignorance, inexperience or lack of bargaining skill,"[45] as well as "the nature and purpose of the contract."[46]

It is not entirely certain, however, whether or not this approach can be developed to produce an operational doctrine of "odious debts." Even if there is indeed a gross disparity between the lender's duty and the duty of the people of the borrowing state, in the kinds of cases of interest here, it is unlikely that there is a great disparity between the lender and the representative of the borrowing state (which is, in legal terms, the only relevant party here).

3. Case Groups

Nevertheless, the above *lex mercatoria* approach can be used in other ways. We can apply the methods of combining various elements prescribed in Article 3.10 to the question of "odious debts." This is not unusual in terms of legislation and is often encountered in the national standardisation of open offences such as the immorality of legal transactions. At first glance, this procedure might seem even less precise than the three conditions laid down in the Canadian proposal, but the advantage of the method proposed here compared with the criticised lack of precision in the attempts hitherto to concretise the doctrine of "odious debts" is as follows.

The odiousness of a debt is not automatic, provided the said factual elements are met. Instead, a number of diverse facts must be seen in context before a decision is made in each individual case. This procedure, which will initially have to commence by force of circumstances, can be defined with increased precision as more experience is gained by establishing so-called case groups. Once established, these case groups will

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43. *Id.* ch. 3, art. 3.10(1).
44. *Id.*
45. *Id.* ch. 3, art. 3.10(1)(a).
46. *Id.* ch. 3, art. 3.10(1)(b).

represent the experience gained in several cases such that when this level of experience is gained, an individual case can be accorded to an already recognised case group of "odious debts" and the legal consequences will then become axiomatic. Thus, while the rulings in the beginning will have the flair of some kind of decisionism—since they are made without any pre-existing experience and without directly comparable material—they will gain predictability and certainty in the long term and will eventually line up to create a coherent chain of decisions.

The advantage of this procedure is that the large number of possible case constellations is not forced from the outset into a straight-jacket of predefined characteristics. Instead, it ensures the necessary openness that allows us to take into account the wide range of possible options. With every case dealt with, however, the acquired experience will grow with the result that the initial openness can gradually be replaced with increasingly precise formulations, culminating in the establishment of case groups.

In terms of the foreseeability and calculability for potential lenders, which we have considered at several junctures to be extremely important, national experience with standards of this sort (in Germany we need only quote section 138 of the German Civil Code or BGB (Immorality of Legal Transactions))[47] indicates that this form of standard-setting is acceptable. Also, if the criteria for the assessment of each individual case are sufficiently clear, lenders can more easily anticipate the outcome than would be the case with the definitions of factual elements, which in many ways are too narrow and/or too broad.

Apart from the above mentioned considerations, we always need to be able to impute "odiousness" to both sides with no exceptions. In addition to subjective prerequisites, such as knowledge of the purpose for which the funds would be used or the fact that the lender should have had such knowledge, the following paragraphs outline the main criteria.

Borrower's Representative

For reasons of legal precision, the term "borrower's representative" must first be explained. While we often speak of the "borrower," in the cases relevant here, this term is inappropriate. The "borrower" is always

47. Bürgerliches Gesetzbuch [BGB] [Civil Code] 1896, § 138(1) (F.R.G.). For the approach taken in the United States, see 15 GRACE MCLANE GIESEL, CORBIN ON CONTRACTS: CONTRACTS CONTRARY TO PUBLIC POLICY (Joseph M. Perillo ed., 2003). For an international law perspective, see Alfred von Verdross, *Der Grundsaz "pacta sunt servanda" und die Grenze der "guten Sitten" im Völkerrecht*, 16 ZEITSCHRIFT FÜR ÖFFENTLICHES RECHT 79 (1936).

the country in question and not the natural person who is to be targeted by the doctrine of "odious debts," i.e., the dictator or despotic ruler. Thus, the focus should not be on the borrower, but on the person who uses the borrower in order to take out a loan. In somewhat simplified terms, we shall use the term "borrower's representative" to designate this person hereinafter.

It is generally accepted in the analysis of the case of Costa Rica discussed above or of Iraq at present that the odiousness of a debt can arise as a result of the person or the behaviour of this borrower's representative. However, the question as to how a necessary degree of censure can be identified is extremely difficult to answer and can only be touched on here. It is by no means sufficient to define the circle of individuals affected in terms of their lack of democratic legitimation (see Part V.B.1), unless we wish to consider it odious *per se* that there is no "genuine" democracy in that country. We can define more usable criteria if we measure the legitimation of the borrower's representative by taking generally accepted requirements as a yardstick. International law can help us here[48]—for instance, fundamental principles such as *jus cogens*.[49] We could, perhaps, also use the conventions on human rights to which the state in question is a signatory.

It is true, all the same, that the consequence of gearing action to these yardsticks of values is that one category of "odiousness," which has often been advanced and which was specifically mentioned in the arbitration in the Costa Rica case, cannot be identified—namely the use of the loan for the personal purposes of the borrower's representative. The borrowing state, rather than the lender, must demand repayment from the ruler who has thus benefited personally.

Creditors

Another advantage of the concrete definitions of a doctrine of "odious debts" proposed here is that it opens our eyes to the fact that the odiousness need not be caused by the state representative alone. It is only rarely noted that the very first instance where the doctrine of "odious debts" was applied, in Cuba, is a case in which the creditor (in this case Spain)

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48. The present proposal coincides with the idea expressed by the International Law Commission in their abovementioned definition. *See supra* note 18.

49. Under the terms of the Vienna Convention on the Law of Treaties, a treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. Vienna Convention on the Law of Treaties art. 64, May 23, 1969, 1155 U.N.T.S. 347.

was responsible for giving the debt its negative character.[50] Again, the aim here is not to make moral issues or values the sole criteria for assessment, and so in this context too, the fundamental principles of international law already cited in the above section, perhaps accompanied by human rights conventions to which the lender's state is a signatory, will have to be used. If, for instance, debts arise as a result of an unjustified war of aggression, at least one criterion of odiousness would be met.[51]

Purpose of the Loan

Another criterion used to identify "odious debts" is the purpose of the loan. However, great caution is called for here because the truism that there are two sides to every story applies here as well. We have already pointed out above that weapons purchases or the construction of prisons are not odious *per se*, just as the construction of schools and hospitals need not necessarily be an automatic blessing for the population.[52] The purpose of a given loan will have to be assessed against the provisions of international law in order to produce generally binding value-based yardsticks.

General Circumstances

Another criterion that will have to be defined more precisely, and will surely be defined more precisely in the future, is the general circumstances under which the loan is granted. The high standards of international law norms need not necessarily be applied exclusively here. To fine-tune the identification of "odiousness," other circumstances could also play a part, such as money laundering, cooperation with internationally wanted criminals (i.e., drug dealers, etc.) or comparable factors.

4. Result

In conclusion, a doctrine of "odious debts" appears to be legally practicable if it is based on more precisely defined standards than has been the

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50. This peculiarity is noted by Jürgen Kaiser & Antje Queck, *Odious Debts—Odious Creditors? International Claims on Iraq*, at 7 (Friedrich Ebert Stiftung, Dialogue on Globalization, Occasional Papers Nov. 12, 2004), http://www.fes-geneva.org/publications/OccasionalPapers/FES%20OccPapers%2012.pdf.

51. *See* U.N. GAOR, Int'l L. Comm'n, *Fourth Report on State Responsibility*, at 17, U.N. Doc. A/CN.4/517 (Apr. 2, 2001) (*prepared by* James Crawford) (arguing that violations of international law, such as genocide and wars of aggression "are such an affront to the international community as a whole that they need to be distinguished from other violations, [as in] the laws of war . . .").

52. *See supra* Part V.B.1.c.

case to date. This can be achieved by taking a step back from the factual elements which are not detailed enough and by replacing them with an open factual element of "odious debts," which would then be limited by an assessment of factors that are as concrete as possible, so as to establish case groups. If these are to gain general acceptance, the value-based yardsticks used must be stringent—they cannot be allowed to reflect only the ethical beliefs of one small group. If these factors are considered in relation to one another, and if a certain debt is judged "odious" on this basis, we must still demonstrate that both parties involved are accountable with the help of subjective criteria (knowledge on the part of the lender or the fact that the lender should have had this knowledge). If this is the case, the legal consequences will follow.

VI. LEGAL CONSEQUENCES

This final, apparently banal statement conceals a problem. What should the legal consequences be? If the goal of the doctrine of "odious debts" is to legally exonerate a state from its obligation to honour its debts, provided it meets the terms of this doctrine, it is not really appropriate to declare the automatic nullity of the loan agreement or to bestow upon it the right to repudiate the contract. For, if only the legal basis (i.e., the loan agreement) were declared null and void, the lender could demand the repayment of at least the sum granted as a loan on the ground of unjust enrichment. Whether or not this would apply to the agreed interest is uncertain. We should also point out once again that a large number of loan agreements are likely to be null and void anyway because they contravene inter-state formalities.

If we are to achieve the declared goal of the doctrine of "odious debts," then we must not only have the loan agreement declared null and void, but also preclude demands for repayment on the ground of unjust enrichment. There is a parallel to this in the civil law of almost all legal systems based on Roman law (i.e., from late nineteenth century Europe) in the form of a provision corresponding to the German Civil Code (BGB) section 817.[53] According to these provisions, the lender is not entitled to demand repayment on the ground of unjust enrichment if both the borrower and the lender can be accused of unethical behaviour under certain circumstances.[54]

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53. In the United States, this legal consequence is applied in cases when a contract is illegal. *See* PETER HAY, U.S.-AMERIKANISCHES RECHT 56 (2000).

54. *See, e.g.*, CODE CIVIL [C. CIV.] art. 1370 (Fr.); Código Civil Federal [C.C.F.] [FEDERAL CIVIL CODE] art. 1882 (Mex.).

VII. INSTITUTIONAL ASPECTS

One final, extremely important question pertains to the institution that is to be responsible for enforcing this new legal principle. Because of well-known reservations, this responsibility should not be accorded to the IMF/World Bank[55] or to the International Court in The Hague.[56] Ad hoc arbitration, like the Iran-U.S. tribunal, is unlikely to be acceptable because the specific power relations in that case are unlikely to be replicated. However, using a different arbitration court in each instance would prejudice the establishment of case groups proposed in this study. A fairly consistent court or panel would be needed for this.

Under these circumstances, we find ourselves faced with only two options: either we use existing court institutions or we create a new adjudicative body. One option would be the Dispute Settlement Body of the WTO pursuant to Article III(3) of the Convention of 15 April 1994.[57] This would be the preferred solution because this body has already gathered a wealth of expertise in global legal disputes.

A second option, creating a new body, could be the responsibility of the United Nations[58]—perhaps to be transferred to UNCTAD because of the subject matter involved. Procedures could be based on those proposed by the IMF for a Sovereign Debt Restructuring Mechanism (SDRM) and the pertinent Dispute Resolution Forum (DRF).[59]

Such a panel of judges would have the exclusive power to decide the relevant cases. The rules containing the details of the procedure could be established by that very panel itself (thereby following the U.S. model). However, it should be clear from the outset that any suit brought before the panel can be initiated only by a petition. A general duty to initiate

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55. *See, e.g.*, Joseph Stiglitz, *Odious Rulers, Odious Debts*, ATLANTIC MONTHLY, Nov. 2003, at 42, *available at* http://www.globalpolicy.org/socecon/develop/debt/2003/11odiousdebts.htm (arguing that the IMF playing a central role in the bankrupcy process would be problematic because it is one of the international community's major creditors).

56. This Court, of course, could be involved under the present conditions only if both parties to the loan agreement are States.

57. For a description of this panel and how it works, see MATTHIAS HERDEGEN, INTERNATIONALES WIRTSCHAFTSRECHT, *in* JURISTISCHE KURZ-LEHRBÜCHER NO. 4, § 7, at 151 (2003); IGNAZ SEIDL-HOHENVELDERN & GERHARD LOIBL, DAS RECHT DER INTERNATIONALEN ORGANISATIONEN EINSCHLIEßLICH DER SUPERANATIONALEN GEMEINSCHAFTEN 182, para. 1312 (7th ed. 2000); JOHN JACKSON, THE JURISPRUDENCE OF GATT AND THE WTO 133 (2000).

58. *See* Stiglitz, *supra* note 55, at 42.

59. *See* Christoph G. Paulus, *Die Rolle des Richters in einem Künftigen SDRM*, *in* HANS-PETER KIRCHHOF, INSOLVENZRECHT IM WANDEL DER ZEIT: FESTSCHRIFT FÜR HANS-PETER KIRCHHOF ZUM 65 GEBURTSTAG 421 (2003).

suit would instead require a worldwide control system which is bound (according to national experiences) to be selective and thereby inefficient. The consequential question—namely who should be given the right to file a petition—is, as a matter of course, a political one.

The answer depends on what one tries to achieve with the new legal principle. If only the parties to the loan contract in question were permitted to file a petition, it would seem more likely than not that a procedure would be initiated only after a change of government or political system, since it might be assumed that hardly any party would have an interest in learning that a debt is "odious" unless it goes through such a political change. In contrast, if the circle of potential candidates for initiating such lawsuits is drawn too broadly (including, e.g., NGOs), this would foster a certain control mentality which, in turn, would result in a whole set of further problems. Thus, it is necessary to find an appropriate process which guarantees access to the panel in cases of "odious debts" without imposing an unbearable control mechanism on the parties involved.

VIII. RESULTS

The above deliberations can be summed up in the following results:

- The doctrine of "odious debts" has not yet acquired the status of a legal rule. The only conceivable source of law would be customary law, but the necessary prerequisites have not yet been met.
- The existing proposals for defining an "odious debts" doctrine make very clear the direction in which the doctrine is headed. However, the proposed definitions are still not precise enough to be acceptable as a general rule. What is needed is a higher degree of flexibility.
- A heightened degree of flexibility could be achieved by establishing open factual elements with sufficiently precise assessment factors in order to establish case groups over the course of time.
- The legal consequences of this "odious debts" doctrine would not only be the nullification of the underlying loan agreement, but also the denial of the right of the lender to demand repayment on the ground of unjust enrichment.
- The court responsible for judging whether or not a debt is "odious" could either be the Dispute Settlement Body of the WTO/GATT or a new court set up by the United Nations along the lines of the DRF.