

## Do “Odious Debts” Free Over-indebted States from the Debt Trap ?

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There are not, it would seem, too many lawyers who have an understanding of the technical meaning of the term “odious debts”. Nevertheless, this doctrine – if doctrine it can be called, which is highly dubious (but to keep matters simple it will be called a doctrine in what follows) – has almost explosive potential for many lender States in this world. A mere glance at the Internet under this catchword makes it clear why: literally dozens of NGOs go on record there claiming that States like Iraq are debt-free – not because the lender States should show mercy after the ousting of Saddam Hussein, but for purely legal reasons. “Odious debts” are understood as a legal institution which, by force of law, renders certain debts automatically null and void.<sup>1</sup>

The “odious debts” doctrine is little more than 100 years old. Since it has been topical only sporadically over this period, it is unclear whether or not it already has the precision or “marginal sharpness” needed for it to be used as a legal instrument. This uncertainty, in turn, makes it appear very versatile in the way in which it can be used. In particular, the value judgement inherent in the terminology tends to mislead one into exploiting the doctrine to attempt to render morally repugnant facts legally null and void. In view of this, it is the (thankless) task of the legal scholar to call for caution in drawing conclusions of this sort (however understandable in human terms), and to highlight the distinction between law and morals,<sup>2</sup> a distinction that represents a hard-won victory in legal history and one for which we should be grateful.

Naturally, this exhortation does not negate the option of developing legally practicable contours, with the help of which certain debts can be

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<sup>1</sup> Forgiving debts is thus seen as an improper act of voluntary grace. If there were a legal mechanism instead, there would be no room for grace and reciprocal gratitude. For the “traditional” treatment of State debts and the possibility of restructuring them, cf., e.g., MARCELLI, *Il Debito Estero di Paesi in via di Sviluppo nel Diritto Internazionale* (2004); REINISCH, *Staatsukzession und Schuldenübernahme – beim “Zerfall” der Sowjetunion* (1995).

<sup>2</sup> Cf. in particular KANT, *Metaphysik der Sitten, Einleitung in die Rechtslehre*, § E.

termed “odious” and can accordingly be dealt with at a legal level; the reminder only serves to clarify that moral indignation, however justified, cannot automatically produce the desired legal effect by using a purportedly legal concept. For this, *inter alia*, the term must be given a more precisely legal definition. This paper will look at the extent to which this appears feasible at the present time.

#### A. – HISTORY OF THE “ODIOUS DEBTS” CONCEPT

The phenomenon of seeking ways of cancelling debts at State level or in State affairs goes back a long way.<sup>3</sup> The first recorded use of the concept of “odious debt” for our purposes, however, dates back to 1898 – when the United States of America, in the wake of the Spanish-American War from which it had emerged victorious, used it to justify not repaying Cuba’s debts to Spain, which the USA, as the *de facto* ruling power over Cuba at that time, should normally have honoured. The USA 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.

The term resurfaced about a quarter of a century later, triggered by an act of Parliament and subsequent arbitration proceedings. In 1919, Costa Rica managed to end the dictatorship of Federico Tinoco, and passed a law (Law of Nullities) repudiating the debts granted by the Royal Bank of Canada to the dictator on behalf of Costa Rica, on the grounds that they were “odious”. The ensuing arbitration proceedings ended in 1923 when the arbitrator, Chief Justice Taft of the U.S. Supreme Court, ruled to uphold Costa Rica’s right to act in this way.

Not long after, legal scholar, Alexander Nahum SACK, produced an in-depth study of attempts to give a precise legal definition of the “odious debts” doctrine, such that it could be used in a rational manner.<sup>4</sup> Sack argued that a successor State is bound only to repay its predecessor’s debts if the funds were used to meet the needs of the State and in the best interests of that State. If, however, (1) this is not the case and (2) the

<sup>3</sup> Cf., e.g., M. HUBER, *Die Staatensuccession* (1898), 84 ff.; HOEFELICH, “Through a Glass Darkly: Reflections upon the History of the International Law of Public Debt in Connection With State Succession”, *University of Illinois Law Review* (1982), 39 ff. For other precedents (albeit not expressly based on the principle of odious debts), see KASA, <[www.odiousdebts.org/odiousdebts/publications/OdiousDebts\\_KASA.pdf](http://www.odiousdebts.org/odiousdebts/publications/OdiousDebts_KASA.pdf)>; FISCHER-LESCANO, “Odious Debts und das Weltrecht”, *Kritische Justiz* 36 (2003), 223 ff.

<sup>4</sup> SACK, “Les effets des transformations des Etats sur leurs dettes publiques et autres obligations financières”, *Recueil Sirey*, Paris (1927). *IDEM*, *La succession aux dettes publiques d’Etat*, 70 (1929).

creditors were aware of this, the granting of the loan represents a hostile act against the people of the debtor State, which renders the debt "odious" and thus invalid.

Sack is widely regarded as the academic who has made the most in-depth study of the issue of what happens to national debts after a change of regime.<sup>5</sup> He is still in some ways the "crown prince" of advocates of this legal principle. Recently, however, a Canadian study has taken his arguments one step further.<sup>6</sup> Its authors suggest 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 detriment of and against** the best interests of the State, and the lender's awareness **that this is the case**), but that a third, objective, criterion should be added – to wit, that the debts must have been taken out **without** the consent of the population.

Before that, in the early 1980s, the International Law Commission had attempted to craft a definition in the process of developing the *Vienna Convention on Succession of States in respect of State Property, Archives and Debts* (4 April 1983):

Article 31: 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."<sup>7</sup>

However, not only was the article not inserted into the text of the Convention, but the Convention itself never entered into force.<sup>8</sup>

To wind up this brief historical outline, it may be asserted that these lines of thought and reasoning 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.<sup>9</sup> For this, the principle would need to have been applied over a longer period, and it would need to be recognised as a legal obligation.<sup>10</sup>

<sup>5</sup> See, e.g., FEILCHENFELD, *Public Debts and State Succession* (1931).

<sup>6</sup> KING / KHALFAN / THOMAS, *Advancing the Odious Debts Doctrine*, Montreal (2003).

<sup>7</sup> Cf. *Yearbook of the International Law Commission* 1981 II/2, 79.

<sup>8</sup> See IPSEN, *Völkerrecht*, 5<sup>th</sup> ed. (2004), 347 f.

<sup>9</sup> See also FISCHER-LESCANO (*supra* note 3). On customary law from the point of view of international law as a whole, see TOMUSCHAT, "International Law: Ensuring the Survival of Mankind on the Eve of a New Century", Hague Academy of International Law, *Collected Courses* 281 (1999), 324 ff.

<sup>10</sup> See SEIDL-HOHENVELDERN / STEIN, *Völkerrecht*, 10<sup>th</sup> ed. (2000), Rz. 467.

## **B. – 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, it would be helpful to clarify the purpose of this new legal principle.

### **1. Original purpose**

The two practical examples given above in Section (A) were retrospective. The outcome could not have been foreseen by the two parties to the loan agreement when the loan was originally granted. This means that (from a European legal standpoint) an essential prerequisite of law is not met – *i.e.* the tenet that the law should act as an instrument to steer the behaviour of actors.

It is true that this is not enough by itself to call into question the legal validity of these measures, since customary law, in particular – that is to say, 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 over time becomes so convincing that it becomes an integral part of the general sense of justice. We have not yet reached this point, however, with respect to the doctrine of “odious debts”. Even if no 100% agreement is needed to achieve this level of acceptance, neither is it enough for a few small groups to be persuaded of the legal validity of a concept for it to become accepted as customary law.

### **2. The purpose today**

The direct *purpose* of the “doctrine of odious debts” as set out in the terms of reference for this study is to create the sort of impact that would steer the behaviour of the 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 other, existing legal **mechanisms** – in particular under private and constitutional law – that serve as protection against over-hasty and therefore irresponsible commitment on the part of a State.<sup>11</sup> Both constitutional and civil law as a rule clearly state the formalities with which a country must comply before entering into a **financial** commitment of this kind. If these are flouted, which it would appear is the case more often than not, such commitments generally have

<sup>11</sup> The question as to whether or not a legal principle of this sort is an instrument of international, public or civil law is of more technical interest, and we will not go into the issue in any more depth here. See REINISCH, *State Responsibility for Debts: International Law Aspects of External Debt and Debt Restructuring* (1995).

no legally binding impact, even in private law.<sup>12</sup> An "odious debts" doctrine would not add any more serious or incisive form of invalidity – except perhaps for stronger moral condemnation openly expressed.

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 global agreement on these. The simple fact of the matter is that here, as elsewhere, the values praised by one appear unacceptable to another. Considerations pertaining to such clarification (or even discussion) have no place in a legal study, however, so we will simply assert 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 so foster more democratic forms of government, the only guarantee for potential lenders at the planning stage that their outlay will be repaid, as the variations of the "odious debts" doctrine proposed thus far make abundantly clear.

#### C. – "ODIOUS DEBTS": PRO AND CONTRA

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

##### 1. *Contra*

The crucial and most obvious argument against establishing the doctrine of "odious debts" is the basic legal principle of "*pacta sunt servanda*" (pacts must be respected). This ancient principle is not based on inflexible and stubborn legal thinking, but on the recognition of the value of a firm basis for planning, not only for the economy as a whole but in interpersonal dealings in general, as well. Even if the "invention" of the contract *per se* is not necessarily the result of such a need for future security or security in some form, the binding nature of a contract once entered into is a matter of top (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 party affected which ought to be taken into account before any pertinent new legal principle is introduced.

In the case at hand, the response might well be a dramatic drop in the willingness of potential lenders to grant loans. We could, of course, counter that this is precisely what we are after (see Section B.II) – to make it

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<sup>12</sup> 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 nature.

impossible for certain States or governments to borrow money. However plausible this argument might appear at first sight, and disregarding for the moment the fate of the population (*i.e.* of each individual citizen) affected, its consequences reach far and wide. It may be morally repugnant to lend money to a generally abhorred dictator, but what about the loans granted to that dictator's perfectly honourable predecessor<sup>13</sup> that fall due under the dictatorship? And who is to set the yardstick for what is to be deemed "generally abhorred"? And what happens if a Head of government with a hitherto unblemished reputation suddenly turns bad during his period in office? Should a sort of black list be drawn up of endangered countries? <sup>14</sup>

The list of questions of this nature could easily be continued. However, the examples given are sufficient indication that a doctrine of "odious debts" would imply the politicisation and moralisation of legal considerations, which would beyond doubt make it more difficult to borrow money in many cases and preclude it entirely in others. Clearly, this cannot be the overall desired effect, since 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 condemn, on a one-off basis, as legally untenable those loans or parts of loans that fall into the category of "odious", then at the very least lenders' costs will become considerably higher since they will be required to monitor the actions of their borrowers much more closely. Lenders would not be able to waive their responsibility for eschewing "odious debts" simply by incorporating a provision in their lending agreements to the effect that the funds are to be used for a generally accepted purpose. Consequently, if the cost of monitoring borrowers rises, so will the cost of borrowing. This in turn will make borrowing prohibitively expensive for some countries and severely restrict the borrowing capacities of others, thus potentially at least worsening the living conditions of the entire population.

## 2. Pro

At the other end of the spectrum, we must remember that the principle of "*pacta sunt servanda*", held in such high esteem for thousands of years, is

<sup>13</sup> It is more than just a historical footnote that the term "dictator" has its origins in the ancient Roman Republic where this office was regarded as salvation in a desperate situation: see, e.g., KUNKEL / SCHERMAIER, *Römische Rechtsgeschichte*, 13<sup>th</sup> ed. (2001), 22.

<sup>14</sup> Such a proposal is made by KREMER / JAYACHANDRAN, "Odious Debt", <[http://post.economics.harvard.edu/faculty/kremer/webpapers/Odious\\_Debt.pdf](http://post.economics.harvard.edu/faculty/kremer/webpapers/Odious_Debt.pdf)>. An (unofficial) list of this nature already exists in conjunction with the infamous *Alien Tort Claims Act* in the USA. Anyone transacting with the Governments of these countries (currently roughly 150) runs the risk of being taken to court in the USA by the populations concerned.

currently prone to erosion all of the world. In civil law terms, we need but point to the consumer protection law that has been developing over the last 40 years or so. 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.

While it is true that this comparison is not entirely apt, given that consumers play no part in the borrowing sector under scrutiny here, and that consumer protection law usually excludes "non-consumers" from its scope of application, it still must be mentioned since calls for the recognition of the "odious debts" doctrine seem almost entirely to be based on a *de facto* power gap between lender and borrower (or at least between lender and the population of the borrowing State). Given that globalisation is turning our world into a "global village" where international law is increasingly moving into areas hitherto the prerogative of civil law,<sup>15</sup> the parallel between consumer protection under civil and international law no longer appears quite so unthinkable.

Equally, the "erosion" of the basic principle of "*pacta sunt servanda*" is beginning to tell in international law. It is no coincidence that here too (although so far in very few isolated cases only) the principle of democracy, which is enshrined in international public law, is being taken as grounds to justify the cancelling of long-standing contracts although no reason exists to terminate them under either the agreed contract terms or other valid legal provisions.<sup>16</sup>

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. In view of the erosion of the binding nature of this principle that may be observed in many areas of the law worldwide, another exception to this basic principle would not however imply a fundamental rejection of the traditional principle.

#### D. – APPROACHES TO RESOLVING THE PROBLEM

Summing up the findings so far, we may state the following. The doctrine of "odious debts" has not yet achieved the status of customary law. Its

<sup>15</sup> Suffice it to mention the discussion on the introduction of a State insolvency law; see PAULUS, "A Statutory Proceeding for Restructuring Debts of Sovereign States", *Recht der Internationalen Wirtschaft (RIW)* (2003), 401 ff.; cf. also VAGTS, "Sovereign Bankruptcy: In re Germany" (1953), "In re Iraq" (2004), 98 *American Journal of International Law* (2004) 302 ff.

<sup>16</sup> Cf. FULDA, *Demokratie und pacta sunt servanda*, Diss. Berlin (2002), <<http://dochost.rz.hu-berlin.de/dissertationen/fulda-christian-b-2002-10-10>>.

introduction would serve the goal (*inter alia*) of undermining the material basis of dictatorships and fostering democratisation worldwide; it would doubtlessly make it more difficult to borrow money, but it would not entail any fundamental break with existing law.

If we take these as 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 involves two steps. First, we must look at the approaches proposed to date and second, we must devise our own proposal.

### 1. Response (*ad hoc*)

The cases in which the doctrine of “odious debts” has been invoked to date (Cuba, Costa Rica) are, from a legal point of view, particularly unfortunate cases of the application of “law”. By deciding retrospectively on the legal nullity of the debts, they preclude the steering impact of law discussed in Section B.I. If it is uncertain *ex ante* whether or not the sword of Damocles of legal unenforceability is merely hanging over the sum lent, or whether it might actually fall, the foundation for the costing 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 situation may perhaps appear as morally justified preferential treatment for the population thus freed from the yoke of its debts, but it is difficult in legal terms to reconcile it with a basic sense of justice.

At this juncture we must, 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 of America. Whereas in Germany, the legislator is held responsible for ensuring security in planning, which means that the feasible path to be taken must be laid down *ex ante* and in great detail, the prevalent philosophy in the United States 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 as illegal.<sup>17</sup> So what would appear untenable in Germany is the expression of a fundamental understanding of liberty in the USA.

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<sup>17</sup> See, e.g., CARRINGTON, “Punitive Damages – The American Tradition of Private Law”, in: *Humboldt Forum Recht*, <[www.humboldt-forum-recht.de/7-2004](http://www.humboldt-forum-recht.de/7-2004)>.



## 2. Prevention (ex ante)

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

### 1. The new proposal

(a) The approach adopted in the new proposal is in line with the Canadian study mentioned *supra* (Section A, footnote 6). It extends Sack's criteria, positing three conditions which, if met, would render a debt null and void and effectively free the borrower from its obligation to repay the loan. The three conditions are: lack of consent on the part of the people, loan not in the interests of the people, and the lender's fore-knowledge of these two facts.

(b) Two positive aspects of this proposal jump to the fore. In pinpointing "creditor awareness", it stands out from quite a few of the schemes and ideas advanced by some NGOs, which tend simply to ignore this stipulation (intentionally or unintentionally).<sup>18</sup> Clearly, this is a mistake, and although we might feel that there is no need not labour the point, we should stress for clarity's sake that it would be extremely unjust, from the point of view of all precepts of justice in the civilised world, to foist on a lender, merely because it is a lender, the risk that the loans it makes might be put to some inappropriate use. That risk can only be attributed to a lender if it can be subjectively held responsible for the odious use to which the money is put.

The other positive facet of the proposal is that it does not focus on the criterion of a change of regime, as was the case in both Cuba and Costa Rica and was more or less explicitly taken as a major contributory ground or appeared to play a major role in Sack's proposals. While this might play an important *de facto* role in ensuring that existing commitments are honoured – for what dictator, however ruthless, would invoke the doctrine of "odious debts" to plead that his debts were null and void, knowing that he will himself need to borrow at regular intervals in the future? – in legal terms, we must always view the "odiousness", whichever way we choose to define it, independently of and separate from any such changes of regime or government. The mere fact of a change taking place does not make the funds previously borrowed and used more odious. Change *per se* does not increase the burden of guilt of an odious dictator.

<sup>18</sup> The same, surprisingly, holds true of the aforementioned definition of the International Law Commission.

It is accordingly safe to conclude that a legally binding doctrine of "odious debts" must be independent of any such change in government or regime. It is the debt *per se* that is odious; it does not become odious because of a mere change in the actors involved.

(c) At the same time, however, the criteria set out in the Canadian proposal must be censured for being too vague and hence difficult to quantify.

(1) If the people need to give their consent, application of the doctrine must surely be excluded wherever a democratically elected government is in power. Whether this circumstance, or its opposite, genuinely and sufficiently limits the target group would seem questionable. First, we must ask ourselves how we should proceed in the case of a mock democracy, where the government **falsely** claims legitimacy through a popular vote, as in "true" democracies. Second, monarchies automatically fail to pass this test: monarchs or the spiritual leaders of a religious State would thus, by virtue of the way in which their nation was structured, be branded odious, thereby making it more difficult and hence, more expensive, for them to borrow money.

This brings 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 that cannot be answered using the yardstick of existing law, or indeed existing philosophy. The reply: "any government that is not legitimated by the people" is in no way sufficiently precise to be acceptable.

(2) The other objective criterion used in the Canadian proposal – absence of benefit – suffers the same shortcomings. Who is to provide the yardstick against which "benefit" is to be measured? This is important in both factual and temporal terms: in factual terms, because it must be possible to give an *ex ante* definition of what serves the interests of the population and what does not. There are no blanket answers to this question, however. 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 in an unjustified war of aggression or for other criminal purposes, but not if they are needed for the country's own defence. Or, to take another example, funds might be used to install a repressive grid of prisons, but who is to say how many prisons serve the people's interest and how many are excessive and hence no longer to their advantage? Nobody would seriously suggest that a country should not be allowed to build any prisons at all.

Doubts are justified in the other direction too, however. The construction of schools and hospitals is generally considered to be in the

people's best interests. But what happens if these schools and hospitals remain the sole prerogative of the rich, or of the ruler's own family? The question, to put it succinctly, is: who are the "people", and who should represent them?

This brings us to the temporal aspect. At which point in time should the "benefit" be assessed – at the time of lending or when the decision is made as to whether or not the debt is odious? From a legal standpoint, it only makes sense to look at the time of lending – otherwise lenders would be expected to shoulder a monitoring function, which clearly they would either be unable to do or which would make the loan prohibitively expensive.

(3) Finally, the subjective criterion of "creditor awareness" must also bear its share of criticism. While essential, the lender's positive knowledge cannot be made the **fulcrum** or the doctrine would be all too easy to circumvent. If it is to be to any real degree applicable in practice, the subjective yardstick must be worded more precisely, for instance, by stipulating that positive knowledge is to be regarded on a par with ignorance resulting from gross negligence.

## 2. *Lex mercatoria*

While we must concede that the above criticism appears to imply that it is possible to achieve greater precision, it is also true that, for the time being at least, this will be no easy task, considering that we have got little further than to consider 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 much 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 allows us to contemplate a set of regulations which can lay claim to worldwide acceptance, or which can at least be regarded as the *lex mercatoria* <sup>19</sup> complied with – the *UNIDROIT Principles of International Commercial Contracts*.<sup>20</sup> Courts in many countries are increasingly relying on these Principles in judging international contracts when it is not entirely clear which legal system should be applied.<sup>21</sup> Since the lending

<sup>19</sup> On the *lex mercatoria* in general, cf. DALHUISEN on *International, Commercial, Financial and Trade Law*, 2<sup>nd</sup> ed. (2004), 191 ff.

<sup>20</sup> Cf. <[www.unidroit.org/english/principles/contracts/main.htm](http://www.unidroit.org/english/principles/contracts/main.htm)>.

<sup>21</sup> See BONELL, "UNIDROIT Principles and the Lex Mercatoria", in: Carbonneau (ed.), *Lex Mercatoria and Arbitration* (1998); IDEM, "The UNIDROIT Principles of International Commercial Contracts: Towards a New Lex Mercatoria?", *Revue de droit des affaires internationales* (1997), 145 ff.; IDEM, "The UNIDROIT Principles as a Means of Interpreting and Supplementing International Uniform Law", in: *ICC International Court of Arbitration Bulletin* (2002), Special Supplement, 29 ff.

agreements we are dealing with here are generally of a commercial character, it is natural that we should take as our guidelines the UNIDROIT Principles.

Article 3.1(b) of the UNIDROIT Principles restricts their scope of application insofar as they do not deal with invalidity arising from immorality. In other words, this particular *lex mercatoria* is expressly silent on this generally accepted legal principle that comes closest to the doctrine of “odious debts”. This is a reflection, first, of widespread unwillingness to incorporate moral aspects in the legal sphere and, second, of the realisation 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 a “gross disparity” between the duties of the parties, as a result of which the contract can be contested. This right exists “if, at the time of the conclusion of the contract, the contract term unjustifiably gave the other party an excessive advantage.” 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”, and “the nature and purpose of the contract”.

It is not entirely certain, however, whether this approach can be developed to produce an operational doctrine of “odious debts”. Gross disparity though there may indeed be between the lender’s duty and that of the people of the borrowing State in many of the cases of interest here, there is unlikely to be much disparity between the lender and the representative of the borrowing State (in legal terms, the only ones relevant here).

### 3. Case groups

Nevertheless, the above “*lex mercatoria* approach” can be used in other ways. We can apply the methods described in Article 3.10 of the UNIDROIT Principles (involving the combination of various elements) 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 that make up the Canadian proposal, yet it has one advantage over the lack of precision displayed by the attempts made hitherto to give concrete shape to the doctrine of “odious debts”:

The “odiousness” of a debt is not automatic, even where the said factual elements are present. Several facts must be seen in context before a decision is made in each individual case. In time, as more experience is

gained, this procedure, which will initially have to be open by force of circumstance, can be more finely honed by establishing so-called case groups each of which will represent the outcome of the experience gained in specific cases so that individual cases can thereafter be identified as belonging to an already recognised case group of "odious debts" and the legal consequences become axiomatic. Thus, while early rulings will still be redolent of a degree of decisionism – since they will have to be handed down before any experience is gained and without the benefit of comparative material – they will gain in predictability and certainty in the longer run and lead to a coherent chain of decisions.

The merit of this procedure is that it does not force the (large) number of possible case constellations into a straight-jacket of predefined characteristics from the outset but rather ensures the necessary openness that allows account to be taken of the wide range of possible options. As each case is dealt with, however, experience will accumulate and the initial openness will then gradually be replaced by increasingly precise formulations, culminating in the establishment of case groups.

In terms of foreseeability and calculability for potential lenders, which we have emphasised at several junctures are extremely important, national experience with standards of this sort (in Germany we need only quote § 138 of the German Civil Code – BGB – (*Immorality of Legal Transactions*))<sup>22</sup> indicates that this form of standards-setting is acceptable. And if the criteria for the assessment of each individual case are sufficiently clear, it is easier for lenders to anticipate the outcome than would be the case with definitions of factual elements, which in many ways are either too narrow or too broad, or indeed both.

Apart from the need (see D II(1)(c)(3)) to be able always to impute the "odiousness" to both sides, with no exceptions – with the help of subjective prerequisites such as knowledge of the purpose to which the funds are to be put, or the fact that the lender should have had such knowledge – the following are the main criteria:

(a) Borrower's representative

For reasons of legal precision, this term must first be explained. For, while we often speak of the "borrower", this is inappropriate in the cases of relevance here. The borrower is always the country in question, not the

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<sup>22</sup> For the USA (contravening public policy) see REIMANN, *Einführung in das US-amerikanische Privatrecht*, 2<sup>nd</sup> ed. (2004), 45 ff. From a international law perspective see VERDROSS, "Der Grundsatz *pacta sunt servanda* und die Grenze der guten Sitten im Völkerrecht", *Zeitschrift für öffentliches Recht* 16 (1936), 79 ff.

natural person to be targeted by the doctrine of "odious debts", i.e. the dictator or despotic ruler. Hence the focus should not be on the borrower, but on the person who uses the borrower 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 discussion of the Costa Rica case or, more recently, of that of Iraq that a debt may become odious as a result of the person or the conduct of the borrower's representative. The question of how to identify the necessary degree of censure is, however, extremely difficult to answer, and can only be touched upon here. It is by no means sufficient to define the group of individuals that is affected in terms of lack of democratic legitimation (see above) unless we wish to consider it odious *per se* that there is no (genuine?) democracy in the country concerned. We can define more workable criteria by measuring the legitimation of the borrower's representative, taking generally accepted requirements as the yardstick. International law can help us here<sup>23</sup> – for instance fundamental principles such as the "*ius cogens*" (peremptory norm of general international law).<sup>24</sup> We could, perhaps, also take the human rights Conventions to which the State in question is a signatory.

It is true, all the same, that in using such yardsticks, one category of odiousness, often advanced and specifically mentioned in the arbitration in the Costa Rica case, cannot be identified: namely the case in which the borrower's representative uses the loan for personal purposes. The borrowing State rather than the lender must demand repayment from the ruler who has thus benefited personally.

(b) Creditors

Another advantage of the concrete definition of an "odious debts" doctrine 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 case in which the doctrine of "odious debts" was applied, in Cuba, was one in which the creditor (in this case Spain) was to be made responsible for giving the debt its negative character.<sup>25</sup> Again,

<sup>23</sup> To this extent, the current proposal coincides with the idea expressed in its aforementioned definition by the International Law Commission.

<sup>24</sup> 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"; see also Art. 64 of this Convention.

<sup>25</sup> This peculiarity is underlined by KAISER / QUECK, "Odious Debts – Odious Creditors? International Claims on Iraq", Friedrich Ebert Foundation, *Dialogue on Globalization*, Occasional Papers, Nr. 12, Berlin, March 2004.

what we are aiming at here is to avoid turning moral issues or values into the sole criteria for assessment, so that in this context, too, the fundamental principles of international law already cited in the preceding Section will have to be taken on board, perhaps accompanied by any human rights Conventions to which the State from which the lender hails is a signatory. If, for instance, debts arise as a result of an unjustified war of aggression, at least one criterion of odiousness would be met.<sup>26</sup>

(c) Purpose of the loan

Another criterion used to identify "odious debts" is the purpose of the loan. Here, too, however, great caution is called for. The truism that there are two sides to every story applies here as well. We have already pointed out that arms purchases or the construction of prisons are not odious *per se*, just as the construction of schools and hospitals is not necessarily automatically a blessing for the people. However, the purpose of the loan will have to be assessed against provisions of international law in order to produce generally binding values-based yardsticks.

(d) General circumstances

Another criterion that requires more precise definition 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, co-operation with internationally wanted criminals (drugs dealers, etc.) or comparable factors.

4. Result

In conclusion, then, a doctrine of "odious debts" appears to be legally practicable if based on more precisely defined standard conditions than has been the case to date. This can be achieved by taking a step back from factual elements which lack detail and replacing them with an open factual element of "odious debts" which is then limited with the help of assessment factors that are as concrete as possible so as to establish case groups. If these are to gain general acceptance, the values-based yardsticks used must be stringent – they cannot be allowed to reflect only the ethical beliefs of one small group. If these factors are set in relation to one another, and if a debt is judged odious on this basis, we have yet to demonstrate that both parties involved are accountable, with the help of

<sup>26</sup> Cf. Report of the International Law Commission, Fifty-third session, on State Responsibility, United Nations (2001), 29 ff.

subjective criteria (knowledge on the part of the lender or the fact that the lender should have had this knowledge). If this proves to be the case, the legal consequences will follow of themselves.

#### **E. – LEGAL CONSEQUENCES**

This final, apparently banal statement conceals a problem. What should the legal consequences be? If the goal of the “odious debts” doctrine is to liberate a State by law from its obligation to honour its debts provided they meet the terms of the doctrine, it is not really appropriate to declare the automatic nullity of the loan agreement or to bestow the right to repudiate the contract. For, if only the legal basis, *i.e.* the loan agreement itself, were declared null and void, the lender could then demand repayment at least of the amount granted as a loan on the grounds 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 since they contravene inter-State formalities.

If we are to achieve the declared goal of the doctrine of “odious debts”, we must not only have the loan agreement itself declared null and void, but also preclude demands for repayment on the grounds of unjust enrichment. There is a parallel for this in civil law in almost all legal systems based on Roman law (*i.e.* stemming from late 19<sup>th</sup> century Europe) in the form of a provision corresponding to the German Civil Code (BGB) § 817<sup>27</sup> according to which the lender is not entitled to repayment on the grounds of unjust enrichment if both borrower and lender can be accused of unethical behaviour, under certain circumstances.

#### **F. – INSTITUTIONAL ASPECTS**

One final but extremely important question pertains to the institution that is to be responsible for enforcing this new legal principle. With well-documented reservations in mind, this responsibility should not devolve on either the International Monetary Fund (IMF) / World Bank or the International Court of Justice in The Hague.<sup>28</sup> *Ad hoc* arbitration, such as the Iran-US Claims Tribunal, is unlikely to be acceptable because the specific power balance in that case is unlikely to be replicated. On the other hand, to use a different arbitration court in each case would

<sup>27</sup> In the United States, this legal consequence is applied in cases when a contract is illegal, *cf.* HAY, *US-amerikanisches Recht*, 2<sup>nd</sup> ed. (2003), par. 120.

<sup>28</sup> This Court, of course, could be involved under the present conditions only if both parties to the loan agreement are States.



prejudice the establishment of case groups as proposed in this article. What is needed is a fairly **permanent** court or panel.

Under these circumstances, we are faced with only two options: either we use existing court institutions or we create a new body. As to the first of these options, we might look to the Dispute Settlement Body of the World Trade Organization (WTO) pursuant to Article III(3) of the Convention of 15 April 1994.<sup>29</sup> This body has already gathered a wealth of expertise in global legal disputes. This would be the preferred solution.

As to the second option, that of creating a new body, this would have to be done under the aegis of the United Nations<sup>30</sup> – perhaps UNCTAD (United Nations Conference on Trade and Development) given the subject matter involved. Procedures could be based on those proposed by the IMF for a Sovereign Debt Restructuring Mechanism (SDRM) **to be implemented by a** Dispute Resolution Forum (DRF).<sup>31</sup>

Such a panel of judges would have exclusive power to decide on the relevant cases. The rules detailing the procedure could be established by the panel itself (thereby following the **Iran-US Claims Tribunal** model). However, it should be made perfectly clear from the outset that cases brought before the panel can only be initiated by a petition. A general duty to initiate would instead require a worldwide control system which (if national experience is anything to go by) is bound to be selective and thus inefficient. The resulting question – *i.e.*, who should be given the right to file a petition, is a political one **by definition**.

The answer depends on what we are trying to achieve with this new legal principle: if only the parties to the loan contract were permitted to file a petition, more likely than not no proceeding will be initiated until after a change of government or political system intervenes, since it is hardly to be expected that either of the parties will have an interest in learning that the debt is odious unless such a political change occurs. By contrast, drawing the group of potential candidates for initiating proceedings too broadly (*e.g.*, by also including NGOs), will foster a certain control mentality which would, in turn, result in a whole new set of problems.

<sup>29</sup> About this panel and how it works, *cf.* PICONE / LIGUSTRO, *Diritto dell'Organizzazione Mondiale del Commercio* (2002), 575 ff. See also HERDEGEN, *Internationales Wirtschaftsrecht*, 4<sup>th</sup> ed. (2003), § 7 par. 52 ff.; SEIDL-HOHENVELDERN / LOIBL, *Das Recht der internationalen Organisationen einschließlich der Supranationalen Gemeinschaften*, 7<sup>th</sup> ed. (2000), par. 1312; JACKSON, *The Jurisprudence of GATT and the WTO* (2000), 133 ff.

<sup>30</sup> See also STIGLITZ, "Odious Rulers, Odious Debts", <[www.globalpolicy.org/socecon/bwi-wto/wbank/stigindx.htm](http://www.globalpolicy.org/socecon/bwi-wto/wbank/stigindx.htm)>.

<sup>31</sup> *Cf.* PAULUS, "Die Rolle des Richters in einem künftigen SDRM", in: *Festschrift Kirchhof* (2003), 421 ff.

In other words, what is needed is an appropriate way of guaranteeing access to the panel in cases of odious debts without imposing an unbearable control mechanism on the parties involved.

**G. – RESULTS**

The above deliberations can be summed up in the form of 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.
- Proposals to date for defining an "odious debts" doctrine make it very clear where they are heading; however, they are still not sufficiently precise for the doctrine to be acceptable as a general rule. What is needed is a higher degree of flexibility.
- Such flexibility could be achieved by establishing open factual elements with sufficiently precise assessment factors, in order to establish case groups in the fullness of time.
- The legal consequences of such an "odious debts" doctrine would be not only the nullity of the underlying loan agreement, but also denial of lender's right to demand repayment on the grounds 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 or a new court set up by the UN along the lines of the Dispute Resolution Forum (DRF).

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**LES "DETTES ODIEUSES" LIBERENT-ELLES LES ETATS SURENDETTES DU PIEGE DE LA DETTE ? (Résumé)**

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*Le concept de "dette odieuse" a un peu plus de cent ans d'âge et est aujourd'hui invoqué par certains milieux pour soutenir l'annulation de certains types de dettes contractées par des Etats. Au-delà des arguments d'ordre moral, quels contours juridiques peuvent être donnés à ce concept ? L'auteur rappelle les critères avancés par Alexander Nahum SACK à la fin des années 1920 pour une définition, à savoir que les fonds empruntés ont été employés à l'encontre des intérêts de la Nation, et que le prêteur savait que les fonds recevraient une telle utilisation, auquel s'ajouterait – ainsi que le soutient une étude canadienne récente (KING/KHALFAN/THOMAS, Advancing the Odious Debts Doctrine, Montreal 2003) – le fait que l'emprunt a été contracté sans le consentement de la population.*

La reconnaissance d'un concept de "dette odieuse" – actuellement dépourvu de statut juridique – permettrait de promouvoir la règle démocratique et d'isoler les régimes dictatoriaux en soumettant les prêteurs peu regardants au risque de perdre les sommes avancées. Elle pourrait globalement rendre plus difficile l'accès à l'emprunt, mais n'impliquerait aucune contrariété fondamentale avec le droit positif actuel.

L'auteur souligne la difficulté pratique et politique à préciser davantage, en vue de sa mise en œuvre, le concept de "dette odieuse" et écarte l'hypothèse de l'élaboration de dispositions réglementaires. Pour ce qui est de la *lex mercatoria*, il se réfère aux Principes d'UNIDROIT relatifs aux contrats du commerce international dont il est certes prévu qu'ils ne traitent pas de l'invalidité découlant de l'immoralité ou de l'illicéité du contrat (article 3.1(b)) mais dont l'article 3.10 sur l'avantage excessif pourrait peut-être servir de fondement pour donner effet au concept de "dette odieuse".

Cependant c'est une méthode fondée sur les précédents qui, selon l'auteur, aurait les meilleures chances de succès, l'expérience constituée sur la base de cas permettant de dégager des lignes directrices concernant des éléments de fait essentiels (qui représente l'emprunteur, l'attitude du créancier, le but du prêt, les circonstances ...). Mais il est entendu que la conséquence juridique de la qualification d' "odieuse" est l'annulation pure et simple de la dette, et non pas la résiliation du contrat qui pourrait ouvrir la possibilité d'une action en enrichissement injuste et d'une restitution des sommes. Enfin l'auteur s'interroge brièvement sur l'organe qui pourrait être habilité à connaître des actions intentées et sur les conditions de mise en œuvre d'une procédure, se prononçant pour la compétence de l'organe de règlement des différends de l'Organisation mondiale du commerce (OMC) ou bien pour la constitution d'un nouveau tribunal à constituer sous l'égide des Nations Unies.

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